

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 Moree Services Club  
Albert Street, Moree

On Wednesday, 2 December 2009, at 10am  
.2/12/09 1

Transcript produced by Merrill Legal Solutions

---

1 THE ACTING CHAIRMAN: Good morning, ladies and  
2 gentlemen. I would like to welcome you to this public hearing.  
3  
4 We are inquiring into the maximum prices that  
5 State Water Corporation will be permitted to charge for  
6 bulk water services in New South Wales for the period  
7 commencing on 1 July 2010.  
8  
9 I would like, first of all, to introduce ourselves.  
10 I am Mr Jim Cox and I am the Acting Chairman and Chief  
11 Executive Officer of the tribunal. I am joined on this  
12 review by my fellow tribunal member, Ms Sibylle Krieger,  
13 to my left.  
14  
15 IPART last determined prices for State Water's bulk  
16 water services in 2006. That pricing determination covered  
17 a four-year period and is due to expire on 30 June 2010.  
18  
19 As part of this investigation, the tribunal released  
20 an Issues Paper in July 2009 which set out key aspects of  
21 the review process.  
22  
23 That Issues Paper outlined some of the matters which  
24 the tribunal considers are important to this review, the  
25 matters that its Act says it must take into account in  
26 conducting an investigation and also a draft timetable for  
27 the review.  
28  
29 In the Issues Paper the tribunal called for  
30 submissions from State Water, its customers and other  
31 interested stakeholders.  
32  
33 The tribunal is grateful to those who have taken the  
34 time and trouble to make a submission. A number of the  
35 organisations that made submissions to the review will be  
36 presenting their views to this hearing today, and we are  
37 grateful for those who have travelled, in some cases  
38 considerable distances, to be with us today. All  
39 submissions received will be carefully considered by the  
40 tribunal in developing its findings and recommendations.  
41  
42 The tribunal considers this to be a very important  
43 investigation.  
44  
45 At the last determination, IPART determined a revenue  
46 requirement for State Water of \$335m for the term of the  
47 price path. Of this total, some \$230m was expected to be

.2/12/09 2

Transcript produced by Merrill Legal Solutions

1 recovered from tariffs paid by extractive users. The  
2 balance was to be effectively paid for by the state  
3 government on behalf of the community.  
4  
5 In its submission, State Water Corporation has argued  
6 that drought conditions have meant that it has not been  
7 able to generate the revenue that was forecast at the time  
8 of the 2006 determination and that a continuation of low  
9 revenue will threaten its longer term financial liability.  
10 State Water has suggested a range of measures that it would  
11 like to see put in place to address the matter of climate  
12 induced revenue volatility. These include changing the  
13 manner in which future water supply availability is  
14 estimated, changing the charging structure and adjusting  
15 the allowed rate of return to reflect the increased risk.  
16  
17 We will be exploring these issues more fully over the  
18 course of this review and I have no doubt that they will be  
19 a key feature of presentations and discussions today.  
20  
21 State Water is forecasting an increase in operating  
22 expenditure of almost 9% in real terms over the next four  
23 years. Much of this is due to what it terms thematic  
24 expenditure items. We will be seeking to explore the  
25 reasons for these additional costs today.  
26  
27 State water is also forecasting a significant increase  
28 in capital expenditure from some \$117m over the four years  
29 to 2009/2010, to \$342m over the four years to 2013/14.  
30 Compliance with pre-1997 dam safety requirements makes up  
31 a significant proportion of this expenditure. This  
32 expenditure will be met by the government if existing cost  
33 shares are maintained.  
34  
35 Significant capital expenditure is planned on the  
36 renewal and replacement of assets and upgrading and  
37 modernising water delivery and operational aspects of  
38 State Water's business.  
39  
40 State Water is also proposing that a premium should be  
41 introduced on high security entitlements to incorporate a  
42 scarcity premium to reflect the value of water under  
43 changing seasonal conditions. The scarcity premium would  
44 change through time, depending on the relative availability  
45 of general security water.  
46  
47 State Water has proposed considerable price increases

.2/12/09 3

Transcript produced by Merrill Legal Solutions

1 for high security entitlement holders as well as usage  
2 charges in the Border, Gwydir, Namoi and Peel Valleys.  
3 Lower increases are proposed for general security  
4 entitlement holders.  
5  
6 For high security entitlement holders, we estimate  
7 that for the Border Rivers, State Water is proposing to  
8 increase the entitlement charges by 137 per cent over four  
9 years. For the Gwydir the increase will be 116%. Namoi  
10 entitlement holders would face a 58 per cent increase and  
11 those in the Peel a 103 per cent increase under  
12 State Water's proposal. This is largely driven by  
13 State Water's proposed scarcity premium.  
14  
15 General security entitlement charges are projected to  
16 decrease by 7 per cent in the Border, and increase by  
17 19 per cent in the Gwydir. Namoi general security  
18 entitlement holders will face an 18 per cent increase and  
19 those in the Peel a 17 per cent increase.  
20  
21 Water usage charges are projected to increase by 33,  
22 41, 67 and 139 per cent in the Border, Gwydir, Namoi and  
23 Peel valleys respectively.  
24  
25 This hearing is a very important part of a broader  
26 price review process. It provides an opportunity for the  
27 tribunal to hear, in a public forum, from the State Water  
28 and other stakeholders and to question the propositions put  
29 forward.  
30  
31 The submissions made by State Water and stakeholders  
32 are available to the public through the Tribunal's website.  
33  
34 Before we commence proceedings today, I would like to  
35 say a few words about the process for this hearing.  
36  
37 You have available to you an agenda which indicates the order  
38 in which organisations will be presenting before the  
39 tribunal.  
40  
41 For each organisation appearing, a presentation time  
42 has been allowed and this is to be followed by a period for  
43 questions by the tribunal.  
44  
45 Assisting the tribunal today are tribunal secretariat  
46 members Mr Colin Reid, Director Water, and, on my right,  
47 Mr Richard Warner, Program Manager, Water Pricing.

.2/12/09 4

Transcript produced by Merrill Legal Solutions

1  
2 At the conclusion of the scheduled presentations,  
3 I will make time available for members of the public to  
4 express their views and opinions on the proposals that have  
5 been put before us by State Water and other stakeholders.  
6 State Water will then be given a short opportunity to  
7 respond to matters raised during the day if they so wish.  
8  
9 The tribunal will consider all the submissions  
10 received and all that is said today when it makes its  
11 decisions on bulk water prices for the State Water. The  
12 tribunal plans to release a draft report and draft  
13 determination for public comment in March 2010. Interested  
14 parties will have a four to five-week period to make  
15 submissions for consideration by the tribunal before it  
16 makes its final decisions. A final report and  
17 determination will be released in June 2010.  
18  
19 I should add that the proceedings are being  
20 transcribed to assist the tribunal in its work. When it  
21 comes time to speak, can you please introduce yourselves  
22 and, if you can, speak slowly and clearly.  
23  
24 We commence proceedings today with State Water.  
25 I would ask representatives from State Water to identify  
26 themselves. Can you please state your names and positions  
27 for the record and then, when you are ready, commence your  
28 presentation.  
29  
30 STATE WATER CORPORATION  
31  
32 MR WARNE: Good morning and welcome. I am George  
33 Warne, the CEO of the State Water Corporation. This  
34 morning, fortunately, I have Lisa Welsh with me, who has  
35 been largely the author of our IPART submission.  
36  
37 Looking around the room, I am reasonably confident  
38 that most of you have either read our submission or had the  
39 benefit of paying a current State Water bill, so that you  
40 know exactly what we are and what we do, but I hope to  
41 elaborate just a little on our submission this morning.  
42  
43 We are going to talk about the achievements during the  
44 2006 determination period, particularly in terms of water  
45 delivery and our delivery of the opex and capex program.  
46 We are going to talk about the impact of drought and our  
47 failure, even in our most pessimistic outlook, to predict

.2/12/09 5

Transcript produced by Merrill Legal Solutions

1 what we have just been living through. We will talk about  
2 the financial viability of State Water. We will talk about  
3 changes proposed to prices, particularly with the local  
4 focus here, and about how we look to managing the impact on  
5 our customers.

6  
7 I will deliberately try to speak a little bit more  
8 slowly today. Someone once said to me, just because you  
9 speak quickly, it doesn't mean you are right. I wonder  
10 about that.

11  
12 In terms of our forecasts, we came to IPART four or  
13 five years ago and, interestingly, I was on the other side,  
14 at that time of my career. IPART determined that State  
15 Water would enjoy 5.5 million megalitres of statewide sales  
16 per year; State Water projected something a little bit less  
17 than that, but the truth is that even if you project for  
18 the rest of this year what we might be likely to sell,  
19 actual sales by State Water have been of the order of a  
20 quarter of what was expected to be sold on average. So it  
21 has been a very torrid time for State Water, and, before  
22 you jump up, I also am acutely aware that it has been a  
23 very tough time for a number of our irrigating customers.

24  
25 In terms of our own business, IPART determined that  
26 State Water should be able to run a better business and,  
27 fortunately, State Water's management and board took  
28 exactly the same view, as did a number of the people who  
29 work with us. IPART should not be the sole driver in  
30 trying to run a more efficient business; it should be an  
31 objective of any business.

32  
33 State Water took to that with some gusto, and we are  
34 reasonably proud to report that in this year, in the fourth  
35 year of the determination, State Water will hit or even  
36 undershoot slightly the IPART suggested target for opex.  
37 IPART determined that we should be down to \$36.1m and we  
38 will be. So, having taken a little while to get started,  
39 you can see the organisation has achieved that target.

40  
41 The key drivers were that we wanted to satisfy IPART's  
42 targets; we wanted to become a better business so that we  
43 had some respect with our stakeholders and our customers;  
44 and we wanted to actually provide a platform for future  
45 growth. With a footprint in 35 rural offices, we would be  
46 hopeful that there are other activities that we can  
47 logically take on to return a dividend to our shareholders.

.2/12/09 6

Transcript produced by Merrill Legal Solutions

1  
2 We replaced the geographical structure with a  
3 functional structure, not because a functional structure  
4 based largely in Dubbo is better, but because the  
5 organisation really needed change. Over a period of  
6 100 years, they had developed quite distinct silos,  
7 particularly in Tamworth and more particularly in Leeton,  
8 where there was very much a local focus and a failure to  
9 exchange ideas, IT systems, business methodologies and  
10 staff training. So we replaced that with a functional  
11 structure, and we believe that has resulted in substantial  
12 savings and we believe there are more to be had.

13  
14 In terms of the organisational restructure, we are now sharing  
15 information more broadly across the organisation. We are  
16 starting to see some very good signs of that. We have  
17 literally the situation now where our operator in Goondiwindi,  
18 who is actually here today, can look at the screen  
19 and provide valuable input and effectively operate river  
20 valleys right through the state; and the training and the  
21 systems that he is using aren't so different to the ones being  
22 used on the Murrumbidgee or the Murray that he wouldn't  
23 understand the principles and operations of those rivers  
24 and valleys.

25  
26 We have separated our groups for better  
27 accountability, and we have obviously delivered a corporate  
28 restructure in terms of how we deliver the business.

29  
30 We are investing in technologies. That investment is  
31 not complete, but it is getting better. For example, we  
32 are now able to send our customers customer statements,  
33 which is something we never used to do; we are now sending  
34 customers more frequent accounts, which might not be that  
35 popular, but it certainly indicates that the business is  
36 more in control of its billing; and we have also provided a  
37 service to customers through iWAS, which we have rolled out  
38 across the state and which has been growing in popularity  
39 at a very rapid rate based on the number of people who are  
40 seeking their water account information online and being  
41 able to input their orders electronically. It has been  
42 quite an advance for a lot of our isolated customers.

43  
44 Obviously, the organisation realises that it can do  
45 better. We are targeting a further 6 per cent efficiency  
46 saving in the new determination period. So, despite the  
47 fact that we have these thematic expenditures coming at us

.2/12/09 7

Transcript produced by Merrill Legal Solutions

1 that will increase the cost of doing business in this  
2 regulatory framework, we are targeting further savings in  
3 the business.  
4  
5 In terms of the capex program, it has been patchy.  
6 We have had a couple of very good years, a couple of very  
7 bad years. We have just completed a complete review of the  
8 year to date, which I received on my desk last night.  
9 We are very confident that we are going to hit at least a  
10 \$117m targeted figure of capex for the four-year period. A  
11 lot of that work is really, principally, a legacy issue of  
12 the pre-1997 dam safety issues that State Water is  
13 delivering on behalf of the state government.  
14  
15 In terms of the revenue collected and the disastrous  
16 figures there, IPART thought we would collect \$195.8m,  
17 based on a series of average seasons. We have collected  
18 \$112m. That sums up as an \$83m shortfall. The figure is  
19 not quite that dramatic, because some of that is  
20 effectively a government contribution, but really we are  
21 about \$56m short on the budget we were expecting to get.  
22 During that period, the biggest loser in all of that has in  
23 fact been the state government, or the shareholder, who  
24 has, if you like, hundreds of millions of dollars invested  
25 in dam infrastructure and has received absolutely no  
26 dividend.  
27  
28 There is the impact of the drought. Even the most  
29 pessimistic view would not have predicted the drought that  
30 we have just been going through. As I said, for those of  
31 you who are tied up in agriculture in western New South  
32 Wales, we know that you probably know as well as we do  
33 what we have been through, but you can see from that graphic  
34 about State Water's diversions for sale just how it has  
35 fallen off the graph.  
36  
37 When the organisation was formed, they said, "It's  
38 very, very unlikely that you will ever get a season where  
39 you will sell less than 2900 megalitres. I think each of  
40 the four years in the determination period has been below  
41 that. We have been down as low as 1.2 million megalitres.  
42  
43 Just to get the drought in context - and I know that  
44 there are a number of climate-change sceptics in this  
45 world; I am no longer one of them - if you don't believe in  
46 climate change, maybe you have to think about changes in  
47 catchments, changes in hydrology, overuse of groundwater.

.2/12/09 8

Transcript produced by Merrill Legal Solutions

1 Something has happened to our systems.  
2  
3 The most graphic example that I have, admittedly, is  
4 the Lachlan. The graph you can see in front of you shows  
5 the blue line at the bottom, which is the last 10 years of  
6 inflows into the Lachlan catchment storage. The other  
7 lines are, in fact, the other worst nine-year periods. You  
8 can see that the drought we are living through now is twice  
9 as bad as the worst drought ever recorded in 113 years of  
10 data collection. It just signals the severity of the  
11 drought we are going through and how something has  
12 categorically shifted in the world of water supply.  
13  
14 In terms of financial viability, obviously the drought  
15 has exposed us to some financial stress. We have seen our  
16 nominal credit rating deteriorate during that period. We  
17 are not meeting our obligations under the national water  
18 initiative pricing principles of full cost recovery and an  
19 appropriate rate of return for the massive amount of assets  
20 employed; and obviously with the knowledge of the future  
21 capital program which we have committed to and we have to  
22 meet, anyone looking forward for this organisation will  
23 recognise that growing debt will create a vulnerability for  
24 the business.  
25  
26 In terms of our capex, it's pretty lumpy and you can  
27 see that during the four-year period there is quite a spike  
28 in our capex. They are just a couple of landmark projects  
29 that have to be completed. They put off the works at  
30 Keepit and Blowering in 1996; they put them off again in  
31 2000; they were put off again in 2004. If we are going to  
32 be a first-world dam operator, we need to get ourselves off  
33 Australia's table of most wanted dam operators, and to do  
34 that we have to invest in two or three of our key storages:  
35 namely, Keepit, Blowering, and particularly the works  
36 through the MDBA at Hume Dam, must be completed to  
37 bring these up to first-world standards. That gives you an  
38 idea of the sort of expenditure that we have.  
39  
40 Fortunately, the dark blue indicates the asset  
41 contribution that is going to be consequently funded by  
42 government through an increased regulatory asset base. The  
43 smaller light purple or light blue section is going to be  
44 funded by irrigators. It might not seem proportionately  
45 much, but it is actually a significant increase in the  
46 amount of capital that is engaged to meet the  
47 responsibilities for irrigators to pay, as determined in

.2/12/09 9

Transcript produced by Merrill Legal Solutions

1 the cost sharing outlined by IPART.  
2  
3 The prices are driven by an increase in the weighted  
4 average of cost of capital which State Water feels reflects  
5 exactly our increased financial vulnerability. We are  
6 suggesting a lower gearing to reflect our revenue  
7 volatility. So we are saying two things: based on the  
8 pricing model that we are putting forward, State Water  
9 expects there is going to be less water for sale during the  
10 determination period; and incomes are going to be more  
11 volatile, more likely to be up and down than they have been  
12 in the past.

13  
14 That is not to say that there will never be floods  
15 again, that is not to say that we won't ever see water  
16 raging through the rivers here; we will. But we are just  
17 saying that our inflows will be more volatile and the trend  
18 will be that there will be less water available.

19  
20 So we are simply saying that although we can run the  
21 core business operation for the same or less, there will be  
22 less water, and to distribute that cost there are less  
23 megalitres to distribute it over in terms of usage.

24  
25 Reduced asset lives - there is obviously increased  
26 depreciation, and some work has been done on our asset  
27 lives.

28  
29 The other thing we have to recognise is that there is  
30 increased environmental compliance expenditure. If we are  
31 going to be an operator in the first world, we are going to  
32 recognise that there are environmental responsibilities  
33 that we have to undertake collectively. They have to be  
34 funded. I think to say that you can completely refurbish a  
35 weir without addressing the issue of fish passage in the  
36 current world is a bit naive. We have a responsibility to  
37 maintain these assets, not only in terms of their  
38 functionality for you, the water users, but also in terms  
39 of the environmental outcomes.

40  
41 In terms of the water prices, you can see here a heavy  
42 weighting towards increases in high security pricing and an  
43 attempt to maintain or even, in one case, decrease the  
44 price of general security fixed charges, because I know  
45 that that causes a fair bit of angst.

46  
47 We had a long discussion as an organisation about

1 whether we should maintain the 60 per cent  
2 usage/40 per cent fixed charging, because it would appear  
3 that some organisations, maybe even the ACCC, are saying  
4 that costings should be more cost reflective of what the  
5 actual costs are, and our costs are very largely fixed; we  
6 have some farming groups saying that it should be usage  
7 based, because usage is much better to encourage  
8 conservation of water and more efficient use of water;  
9 other people say that it doesn't really matter, because the  
10 market is so red hot in water, any efficiency saving is  
11 recognised through a market mechanism.

12  
13 We have attempted here to find something that  
14 represents a reasonable compromise. State Water are saying  
15 that we would like to move, for general security, to a  
16 scenario where 40 per cent of your charges are raised on  
17 average through an entitlement charge and 60 per cent  
18 through a usage charge. Those prices that you can see  
19 there reflect that.

20  
21 The prices in the Peel are higher, but I guess it's  
22 worth noting that in the case of the Peel, the northern  
23 rivers, and our southern rivers down at Brogo, in the past  
24 they have been subject to an explicit subsidy from  
25 government recognising the difficulty to get to a full cost  
26 recovery path there.

27  
28 In terms of managing the impact on customers, I said  
29 earlier that we think that the 60:40 fixed:variable ratio  
30 is important to our customers, and they would like to see  
31 it maintained. If you think, however, you would like to  
32 reduce the overall cost of running State Water, reduce the  
33 average cost of capital to those who are paying for the  
34 fish ladders and weirs and what-have-you, maybe you could  
35 go to something like 90 per cent fixed and 10 per cent  
36 variable, and we would be more in line with more stable  
37 organisations like Sydney Water, and the pricing would  
38 reflect that.

39  
40 In terms of conversion factors, most of the plans in  
41 most of the valleys have been suspended. Everyone is  
42 taking a very deep breath about conversion factors. In  
43 fact, a recent paper has suggested that we abandon  
44 conversion factors, just leave the entitlements as they are  
45 and let the market work out who gets what high security; if  
46 they want to buy some they can go and buy some, and we  
47 stop conversion.

1  
2 I guess the point I am making is that the drought that  
3 we have been through, the projections that CSIRO are doing  
4 and the work we did with CIE would indicate that conversion  
5 factors are not a methodology for determining water prices,  
6 unless someone wants to rewrite the conversion factors  
7 based on the climate as we understand it today.  
8  
9 We obviously have also recognised - and I guess this  
10 is about a fairness factor - that during this terrible  
11 drought there has been a massive free kick to some of the  
12 high security users, particularly those who are allocated  
13 14 or 15 megalitres a hectare and their record use has been  
14 6 or 7 megalitres a hectare, because the market has been  
15 running rampant with governments entering annual markets,  
16 and we have seen a very significant benefit to the owners  
17 of high security water and a disproportionate amount of the  
18 cost of running the valley being paid by the general  
19 security user.  
20  
21 So in an attempt to rectify that, we have run that  
22 through our 15-year model, which shows that there will be a  
23 little less water available, and of course that kicks up,  
24 once again; it increases the premium for value of  
25 high-security water.  
26  
27 That's about all I wanted to say. You will get the  
28 chance to question me later, if not physically abuse me,  
29 but I would like to hand over to Lisa now, who will provide  
30 some of the detail on our submission.  
31  
32 MS WELSH: My name is Lisa Welsh, for those of you who  
33 I haven't already met. I am State Water's strategic and  
34 regulatory manager and I was also the project manager for  
35 our submission to IPART.  
36  
37 Today I want to run through with you a little bit more  
38 of the detail and the thinking behind our submission, and  
39 I guess some of the ideas that went into some of the  
40 proposed changes that we have put forward to IPART.  
41  
42 I would like to go through with you the following:  
43 the objective of our pricing submission; the extent of the  
44 consultation that we undertook; an overview of what our  
45 forward opex and capex programs look like - particularly  
46 for the four valleys that I guess we are most interested in  
47 today; a little bit more detail on some of the financial

.2/12/09 12

Transcript produced by Merrill Legal Solutions

1 viability concerns of State Water; some more detail on the  
2 tariff design issues; and to just touch on a few of the  
3 other charges that we have incorporated into our  
4 submission.  
5  
6 Our objective going into this pricing submission was  
7 very clear. We believe that the current tariff design does  
8 not allow for State Water's financial viability. The  
9 numbers that George took you through a moment ago which  
10 showed that we have a \$56m shortfall in our revenue  
11 requirement from users says that there is something  
12 seriously wrong with pricing.  
13  
14 We are not financially viable with the current tariff  
15 design and so, as a regulated business with a one in every  
16 four or five years opportunity to secure our regulated  
17 revenues, we believe that it is essential that IPART  
18 considers our financial viability going forward, so that is  
19 what we are hoping to achieve with our pricing submission.  
20  
21 Having said that, though, we are obviously not immune  
22 to the fact that the drought has affected State Water, but  
23 it has also affected our customers, so, wherever possible,  
24 we have tried to take on board the very strong customer  
25 feedback from users about what tariff design means to them  
26 and the security of their business as well, because  
27 obviously we want to be financially viable but we also want  
28 our customers to be financially viable as well.  
29  
30 Just briefly, a lot of you in this room were part of  
31 this consultation. State Water undertook quite a  
32 significant amount of consultation in developing its  
33 pricing submission. The means of that consultation was  
34 largely through their customer based CSCs, and we also  
35 talked directly to Irrigators Council on a number of  
36 occasions.  
37  
38 There were three stages to the CSC consultation. The  
39 first was to outline broadly the IPART process, so that our  
40 customers could understand how and when they could  
41 engage with that process. We also talked about the types of  
42 discretionary services that perhaps they would be  
43 interested in purchasing from State Water, understanding,  
44 as they did, the base level of service that State Water  
45 provides and whether there are additional services that  
46 effectively are discretionary and not things that State  
47 Water would ordinarily be obliged to do under its

.2/12/09 13

Transcript produced by Merrill Legal Solutions

1 regulatory and legislative framework.  
2  
3 The second stage, several months later, was to discuss  
4 some of the key issues that we were developing as part of  
5 our submission. Obviously, consumption forecasts were a  
6 huge issue, in that it was quite important for us that we  
7 discussed with our customers what we were thinking about  
8 that. The other big issue to talk about was, obviously,  
9 the high security premium which generated quite a lot of  
10 discussion.  
11  
12 We also provided a little bit more feedback on some of  
13 the discretionary services, so things that customers had  
14 shown some interest in. Particularly, up here, it was the  
15 gauging stations: how much are they going to cost; what is  
16 the benefit; what do State Water river operators really  
17 think about the improvements that could be made to service  
18 delivery as a result of some of that expenditure?  
19  
20 Finally, we were able to present some draft prices and  
21 also some draft opex and capex budgets for our customers to  
22 go through and reality-test some of our proposed  
23 expenditure. We also finalised the discretionary services.  
24  
25 Just going forward, as George said, we are confident  
26 that we will achieve our efficient level of operating  
27 expenditure for '09/'10, and that's our baseline of  
28 expenditure; that's how much we know as a result of  
29 restructuring our business how much it costs to provide  
30 services to customers in State Water.  
31  
32 We built in some efficiencies going forward and that's  
33 largely based on further investment in systems. So, making  
34 the most of iWAS and also some more improvements to river  
35 operations, better use of telemetry, that sort of thing.  
36 Also included in those efficiencies is a partial management  
37 restructure which says that, once we bedded down our  
38 systems and the new structure, we need to have another look  
39 at the sorts of management that we need, but certainly  
40 nothing in terms of the fundamental restructure that we've  
41 already gone through. That's the basis of our 6 per cent  
42 cumulative efficiency saving.  
43  
44 However, we've also highlighted some additional costs,  
45 which are, if you like, as a result of external influences  
46 and pressures on State Water. The end result of that is  
47 that by '13/'14, what we are saying is that it is going to

.2/12/09 14

Transcript produced by Merrill Legal Solutions

1 cost about two and a half million dollars more to run  
2 State Water than it does today.  
3  
4 The additional what's been termed "thematic  
5 expenditure" I note is something which has generated quite  
6 a lot of interest from IPART, via the Opex/Capex review,  
7 but also via our customers. Our view is that this  
8 expenditure is exogenous to State Water. It is pressure  
9 that is coming on us; it is not something we would be  
10 ordinarily doing unless we have a regulatory or legislative  
11 obligation to meet. Some of those, without going into the  
12 detail - obviously the full details are in our submission -  
13 but some of the examples are the works approvals fees that  
14 state that the Office of Water will be levying on us now  
15 that our works approvals are in place. They are charging  
16 us a fee so that they can monitor our compliance and that  
17 we can undertake reporting against our requirements in  
18 those approvals.  
19  
20 There are some quite substantial environmental and  
21 heritage requirements, in particular, associated with the  
22 new fish passages that we are required to implement. So,  
23 monitoring those fish passages so that we can report to the  
24 Department of Investment Industries about the success of  
25 those. So, not only then do we report to our regulator,  
26 but that information also allows us to refine the designs  
27 for fish passage to ensure that they do continue to  
28 represent value for money in terms of actually achieving  
29 the improvements in fish passage.  
30  
31 Another example is some of the water quality  
32 monitoring, which arises partly as a result of our works  
33 approvals, but also because we've only just now been able  
34 to clarify what our obligations are with the Office of  
35 Water.  
36  
37 Also included in that thematic expenditure are the  
38 discretionary services that were endorsed by the CSCs as a  
39 result of the negotiations.  
40  
41 They are modest amounts, but I think that,  
42 particularly up in the north, our customers engaged quite  
43 actively in that process. That has resulted in those  
44 customers choosing to install a number of additional  
45 gauging stations, particularly in the Namoi and the Gwydir,  
46 so that is something that we will be undertaking in the new  
47 regulatory period, and certainly something that customers

.2/12/09 15

Transcript produced by Merrill Legal Solutions



1 will continue to be interested in, how that gauging station  
2 has improved our service delivery. So, that's where we can  
3 maintain that relationship by the CSCs and report on that  
4 expenditure.  
5  
6 This is just a table format of the graph that George  
7 presented earlier. We have quite a significant increase in  
8 our capital expenditure programme going forward, compared  
9 to the current regulatory period. That is almost entirely  
10 driven by our dam safety upgrade programme. Several of our  
11 big dams do not meet the dam safety committee's  
12 requirements for dam safety, obviously. Actually, they  
13 will affect a couple of the valleys here, in particular  
14 Gwydir, so there are some works scheduled at Copeton Dam,  
15 and also in the Namoi at Keepit Dam and also Split Rock.  
16  
17 So, those programmes really need to be viewed in the  
18 context of an increasing amount of expenditure on  
19 environmental, because a lot of those dams are triggering  
20 both fish passage as well as the cold water pollution - the  
21 Government's policy on cold water pollution mitigation.  
22  
23 We also can see down the bottom quite a bit of  
24 expenditure on water delivery, which refers to the systems  
25 we are going to put in place to again improve the  
26 efficiency of our water delivery.  
27  
28 Valley by valley, what does that mean? For the  
29 Border, quite a modest capital expenditure programme and  
30 largely on renewal of assets.  
31  
32 The Gwydir, as I said, dominated by a government share  
33 for the upgrade of Copeton Dam, but also a 50 per cent  
34 share for users of the cold water pollution and the fish  
35 passage program.  
36  
37 Namoi: This a bit of a hotly contested one. What  
38 you can see there is the combined impact of a substantial  
39 upgrade to Keepit, which is by far the most expensive of  
40 our dam safety upgrades to date, and has also triggered  
41 some offset fish passage requirements downstream of the  
42 dam, as well as the upgrade of Split Rock, so there is  
43 quite a big chunk of Capex in the Namoi, and no doubt we'll  
44 hear from the Namoi users - in particular, their views on  
45 how the costs of that environmental compliance should be  
46 shared with users.  
47

.2/12/09 16

Transcript produced by Merrill Legal Solutions

1 What you can see there in the Peel is actually the  
2 upgrade of Chaffey Dam, which is 100 per cent  
3 government-funded.  
4  
5 The cost shares are something that I noticed in my  
6 consultation with users, that there are many and varied  
7 views on cost shares, usually wanting to shift costs to one  
8 team or the other, so to speak. Our view is that this is  
9 an area that does have significant price implications for  
10 customers, but also there's a lot of grey area. There's no  
11 exact right and wrong.  
12  
13 Something that I noticed when we were putting together  
14 our submission is that under the current cost shares the  
15 government share of our revenue going forward has increased  
16 substantially more than our user share. Coming on the back  
17 of our users having many views as to how those costs should  
18 be allocated, our view is that this is such a big issue and  
19 is something that really ought to be reviewed by IPART or,  
20 dare I say it, the ACCC in the future to make sure that the  
21 current cost shares are appropriate and are still achieving  
22 the sorts of outcomes in terms of cost recovery and  
23 compliance with the national water initiative as they were  
24 intended.  
25  
26 So, just in terms of financial viability, as I said  
27 before, we don't believe that the current tariff design is  
28 sufficient to allow for our ongoing financial liability.  
29 In particular, the consumption over the last four years has  
30 been only 29 per cent of the average volumes assumed in the  
31 2006 determination.  
32  
33 This is compounded by the fact that we have a 60/40  
34 fixed to variable ratio. This is something that was  
35 mandated at the time of the last determination by our  
36 operating licence. It is no longer mandated by the current  
37 operating licence, so it is an area which is something that  
38 we could consider changing in this determination.  
39  
40 The impact of those two combined was that we  
41 under-recovered user share revenues by \$56m. What that  
42 says to us is that we have a big hole in our balance sheet,  
43 firstly. We've been able to provide virtually no dividends  
44 to our users. Look, I'm not asking for any sympathy here  
45 at all, I'm simply outlining the facts. We have had  
46 several downgrades of our investment grade rating, and if  
47 that was to continue we would lose our investment grade

.2/12/09 17

Transcript produced by Merrill Legal Solutions

1 rating and that is seriously going to impact our ability to  
2 maintain our assets and to continue to provide services.  
3  
4 So, in terms of what we wanted to do going to this  
5 determination, the very first thing was obviously to get  
6 the right consumption forecast. The current consumption  
7 forecasts are based on a 100-year modelled average from the  
8 Office of Waters IQQM model. Based on what we'd seen, we  
9 didn't think that that was a robust option to go forward  
10 with, so we commissioned the Centre For International  
11 Economics to provide us with an alternative to the IQQM.  
12 We did that consultancy in association with the Office of  
13 Water as well.  
14  
15 What they came up with was a suggestion that there had  
16 been a structural break in the historical patterns of water  
17 availability to the extent that we could no longer be  
18 confident that what had occurred in the past was going to  
19 be repeated in the future. That said to us that, in terms  
20 of using those numbers for cost recovery, there was a  
21 serious problem, because certainly no business wants to  
22 recover its costs over a 100-year period.  
23  
24 Instead, we are proposing that consumption forecasts  
25 be based on a rolling 15-year average of actual use. So,  
26 what this means is that over the 15 years, at every pricing  
27 determination we'd be updating their average. It is  
28 definitely a bit of a call.  
29  
30 This is one of the more hotly contested issues in our  
31 pricing determination. Our view is that actually probably  
32 a shorter period of time would give us a much more robust  
33 projection of water availability, but given the drought  
34 that has occurred in the last seven years, that's going to  
35 have unrealistic price shocks for usage charges in  
36 particular. So, our view is that 15 years incorporates  
37 some of the wetter years that occurred before this  
38 structural break in water availability, as well as some of  
39 the dry years. What it would mean is that, yes, we would  
40 continue to recover our costs, but over a 15-year period  
41 and not 100 years.  
42  
43 It also avoids us having to make any definitive  
44 statements on climate change. State Water is not a climate  
45 change expert. We don't know what's going to happen in the  
46 future, and one thing we're confident about is that we will  
47 get it wrong, going forward. No-one can predict exactly

.2/12/09 18

Transcript produced by Merrill Legal Solutions

1 what the next four years of water availability are going to  
2 be, but we think that the proposal that we put forward is  
3 self-correcting. So, if we do go into a wetter period,  
4 then that average will continue to adjust as we go forward.  
5  
6 What does that mean on a valley basis? Overall, it  
7 means around about a 20 per cent reduction in consumption  
8 forecasting going forward. As you can see, the top four  
9 valleys there are our northern valleys, and the reductions,  
10 I would say, are probably, surprisingly in a way, actually  
11 quite a lot worse for the Border and the Namoi. They are  
12 actually among some of the biggest reductions across  
13 State Water regulated valleys, whereas there is only  
14 11 per cent in the Gwydir.  
15  
16 This slide actually shows the difference between cost  
17 recovery under the current 100-year IQQM, which said that  
18 with this drought you can see the top blue is the level of  
19 cost recovery that we achieved, so 29 per cent of our  
20 average volumes. With our 15-year rolling average, we  
21 would have improved things slightly but we still would have  
22 under recovered. We would still have only achieved  
23 36 per cent of the average volume. So, what we are  
24 saying is that we don't think this drought is going to  
25 continue going forward to the same extent, so we don't  
26 think that the 15 years is unreasonable. What we're saying  
27 is that even with an unforeseen drought to the same extent,  
28 State Water is still wearing some of the pain, I guess, of  
29 revenue volatility.  
30  
31 I guess, in terms of stage 1 being, "Let's get an  
32 alternative consumption forecast", the next step that we  
33 undertook was to look at the remaining level of revenue  
34 volatility and consider how that's addressed in terms of  
35 our weighted average cost of capital. At the moment, our  
36 weighted average cost of capital is 6.5 per cent, which is  
37 consistent with the IPART determination for the  
38 metropolitan water businesses. What we observed is that  
39 over this current drought, Sydney Water achieved  
40 95 per cent cost recovery, while State Water had a  
41 \$56m hole in its balance sheet.  
42  
43 What we are saying is that because we have a higher  
44 level of volatility compared to the metropolitan water  
45 businesses, we can't sustain the same level of debt as a  
46 metropolitan water business. So, we're saying that rather  
47 than the efficient benchmarking for debt within the WACC

.2/12/09 19

Transcript produced by Merrill Legal Solutions

1 calculation being 60 per cent, we are saying that  
2 30 per cent is more achievable because that's the amount of  
3 debt that we can sustain and still maintain our credit  
4 rating.  
5  
6 So, that results, without going into too much of the  
7 technical details, in our proposed WACC of 7.9 per cent.  
8 This is the WACC that would allow us to both maintain water  
9 charges at a 60/40 ratio and also maintain our credit  
10 rating.  
11  
12 I guess that's a few of the points I have already  
13 covered. This is something we are saying to our  
14 customers: If you want to maintain this current ratio,  
15 there is a charge associated with that. If the 60/40 price  
16 ratio is not something which you value, then certainly we  
17 can sustain a lower WACC, which in an average year will  
18 mean lower prices, and we will do that by proposing an  
19 alternative tariff design of a 90/10 fixed to variable.  
20 Certainly we've received strong customer feedback to date  
21 that suggests that our customers really do value it at a  
22 60/40 split.  
23  
24 The other thing that we considered in looking at  
25 tariff design is the conversion factor. This is not  
26 something which increases the overall return to  
27 State Water. However, it is something that we noticed  
28 during the current regulatory period, which was that  
29 obviously during the drought high security users have  
30 continued to get near to full allocations, as the level of  
31 security of those licences would imply. General security  
32 users in some valleys have had zero or just slightly above  
33 zero allocations and, yet, by virtue of the fixed charges,  
34 they are actually wearing the costs of running most of the  
35 system.  
36  
37 We think that that's an inherent inequity in the  
38 current tariff design. Having observed this, we thought it  
39 was at least partly our responsibility to try and propose  
40 an alternative to IPART. We acknowledge that there are any  
41 number of ways that you could achieve this. Certainly,  
42 what we found is that the current process of high security  
43 variables, which is based on the conversion factors in the  
44 water sharing plan, we think is inaccurate and I guess the  
45 best argument for that is the fact that the Office of Water  
46 has actually suspended conversions using those factors at  
47 the moment.

.2/12/09 20

Transcript produced by Merrill Legal Solutions

1  
2 So, ideally, we would like to see the Office of Water  
3 review the conversion factors, to something that does more  
4 accurately reflect the value of a higher security  
5 entitlement over general security entitlement, but we  
6 acknowledge that that's something out of our control.  
7  
8 Instead, what we are proposing is that the current  
9 water sharing plan factors be amended by what is  
10 effectively the inverse of an average of the general  
11 security allocations. What that means is that in times  
12 when water is scarce, the high security premium should  
13 increase, and in times of greater water availability, with  
14 the relative benefit of having a high security licence over  
15 a general security licence, that that high security premium  
16 should reduce.  
17  
18 So, what does all that mean to water prices? These  
19 are the same slides that George showed you, so I won't  
20 linger on that for the purposes of time, but it does mean  
21 some quite substantial changes to high security users  
22 relative to general security users overall. Usage,  
23 obviously, is affected by the consumption forecast quite  
24 significantly.  
25  
26 Just a couple of other issues. We're not proposing  
27 any change to the current maximum fee for temporary water  
28 transfers of \$150. By fixing this as the level, this  
29 equates to around about a 9 to 10 per cent efficiency  
30 saving. We've found through our restructure and through  
31 being able to centralise the processes of those trades down  
32 at the Deniliquin office, that we have been able to achieve  
33 significant efficiency savings and we still think that  
34 there are some more savings that we can achieve. So, no  
35 change proposed for that fee.  
36  
37 We are, however, proposing a new information charge.  
38 State Water is increasingly requested to put together  
39 various and often quite time-consuming information  
40 requests, often from people who are very interested in what  
41 we do and the information we hold, but they are not our  
42 customer, so they are not contributing towards the cost of  
43 running State Water. What we're saying is that if a third  
44 party wants some information from State Water and they are  
45 not our customer, then we'd like to charge them for the  
46 time it takes us to put together that information so that  
47 their information request is not basically being subsidised

.2/12/09 21

Transcript produced by Merrill Legal Solutions

1 by our customers.

2  
3 In addition, we do think that that charge should apply  
4 to our customers. So, for their account requests, for  
5 anything that is over two years old, we think that that  
6 charge should also be incurred. So, there is a  
7 responsibility on our customers to maintain their own  
8 records, to keep some of the statements that we send them  
9 and to understand their own allocations. But, if it is a  
10 reasonable request, then we'll be quite happy to fulfil  
11 that.

12  
13 Finally, we also did include a metering service  
14 charge. As we are all aware, State Water and the Office of  
15 Water have received, in principle, approval from the  
16 federal government to install State Water-owned meters on  
17 regulated rivers. The federal government intends to meet  
18 the capital costs in the installation of those meters.  
19 However, going forward, there will be some minor  
20 maintenance costs and also some data transfer costs  
21 associated with the information coming from those meters.  
22 That's what this metering service charge is intended to  
23 capture.

24  
25 Having said that, there is still a little bit of  
26 uncertainty in terms of whether there will be final  
27 approval for that project, and also when the project will  
28 roll out. So, what we're saying is that that charge will  
29 only be incurred once the meter has been installed.

30  
31 That is where I want to finish today. Thank you.

32  
33 THE ACTING CHAIRMAN: Thank you very much for the  
34 presentation. We will now have some time for questions.  
35 This will be led off by Colin Reid and Richard Warner, but  
36 Sibylle and I may also ask some questions. We will hand  
37 over to you, Richard.

38  
39 MR WARNER: Thank you very much. Gwydir Valley  
40 Irrigators have argued that the CSIRO estimates for the  
41 Gwydir, as a result of climate change, is likely to result in a  
42 10 per cent deduction in water availability by 2030,  
43 I think it is, and they contend that the period 2007 to  
44 2014 is a long way short of 2030. So, their argument is  
45 that we are only seeing the early beginnings of climate  
46 change, if you like. How would you respond to that?

47  
.2/12/09 22

Transcript produced by Merrill Legal Solutions

1 MR WARNE: When we started doing the work, the CSIRO  
2 work had not been published, so we used the available data.  
3 We asked CIE to give us a view on the most valid data set. I  
4 think climate change is a very important factor. I don't  
5 think it's the only factor. I think farmer's behaviour in  
6 more recent times in regard to their own carryover  
7 indicates an inherent very real conservatism, which has  
8 lead to much low water sales, and much higher unit costs in  
9 delivering water.

10  
11 So, I think there are a number of factors involved.

12 What we are trying to do is deal with the most valid set,  
13 our own reasonably accurate figures of how much water has  
14 been used in our valley, weighted towards the last  
15 15 years, which is what we've chosen to do.

16  
17 As Lisa pointed out, it has the ability of  
18 self-correcting. I think they are right, but if you look  
19 at the CSIRO data, you take the worst one and you take the  
20 best one out, and you look at the year 2030, the years that  
21 we've been living through are amongst the very worst at  
22 projecting 30 years and 50 years hence. So, we are really  
23 are living through an extraordinary period, but we can't  
24 ignore it. Even before that four-year period there was  
25 significant reduction in the amount of water being used,  
26 when you compare it with the golden days of 1970 to 1994.

27  
28 MR WARNER: Gwydir Valley has also developed its own  
29 approach to assessing high security and general security  
30 charges, or the conversion of those. Have you had the  
31 opportunity to consider their approach, and do you have a  
32 view on it?

33  
34 MS WELSH: Obviously, I have seen the submission and  
35 I understand that they had proposed what is essentially a  
36 cost-based approach, and no doubt Michael will outline that  
37 in a little bit more detail later today. Our view is that  
38 that's something that IPART has previously already  
39 explicitly considered and chosen not to endorse. In terms  
40 of us coming up with some solutions to what we see are the  
41 inequities, we decided to go with something that was a  
42 little bit new and innovative and also that would be based  
43 on the principles that IPART endorsed in its 2006  
44 determination, so, thereby perhaps having a greater chance  
45 of success.

46  
47 MR WARNE: On this specific issue, there are some farmers,

.2/12/09 23

Transcript produced by Merrill Legal Solutions

1 but very few, that have got a large component of both high  
2 security and general security. When we went through the  
3 consultation phase, and Lisa covered this, we're not  
4 actually after more money; it's how we share the costs of  
5 delivering water in a valley.

6  
7 In terms of fairness, we recognise that it's been a  
8 pretty easy run for a lot of guys with high security water  
9 in the last four years, when you compare it with their  
10 neighbour with general security water. When we sat down  
11 with the irrigators council and said, "Guys, have you got  
12 some suggestions ", the room divided almost exactly along  
13 the lines of who has got the high security and who hasn't.

14  
15 I just think that we are looking for the wisdom of  
16 IPART. State Water actually don't mind which way we go,  
17 provided we get the same amount of revenue, but we would  
18 really like to think we have a consistent principle that  
19 applies from the north of the State to the south, rather  
20 than trying to cherry-pick on a valley-by-valley basis. It  
21 is one area that we are open to suggestion. As Lisa said,  
22 we tried an innovative approach and I think it's a mixture  
23 of cost-based, scarcity and, if you like, a fairness  
24 factor.

25  
26 MR WARNER: Gwydir Valley has also questioned the  
27 capacity of State Water to undertake its planned  
28 environmental planning protection Capex over the likely term  
29 of the price path. It asserts that no significant planning or  
30 design work has been undertaken to date. How do you  
31 respond to that, or are you able to reassure Gwydir Valley  
32 Irrigators on that point?

33  
34 MR WARNE: I think their observation has some merit.  
35 I think their suggestion is wrong, though, because I think  
36 as an organisation now in the 21st century, if we can't  
37 come to grips with delivering our environmental  
38 responsibilities as outlined in that plan, we are going to  
39 have some serious issues with regard to our relevance and  
40 viability.

41  
42 I think we, as an operator in rural New South Wales,  
43 and farmers as beneficiaries of that water, have got to  
44 recognise that part and parcel of taking water from our  
45 rivers today through a licensed regime is meeting your  
46 environmental responsibilities, and collectively  
47 State Water are charged with that responsibility now.

1 That's not to say we can't do it cheaper or smarter or  
2 better. We've got a responsibility to do that, but I think  
3 now that we've restructured the organisation and now that  
4 we've got a distinct and operational environmental group,  
5 we have got responsibility to deliver those programmes and  
6 we are going to do it.

7  
8 MS WELSH: I would just add to that that the environmental  
9 expenditure in the Gwydir is actually weighted towards the  
10 second half of our proposed four-year regulatory period.  
11 That is quite deliberate, in the first instance to align  
12 with our dam safety upgrade programme, but also, secondly,  
13 so that we can pick up on some of the learnings from the  
14 other environmental compliance expenditures that we are  
15 undertaking in the first half of the period - Keepit, for  
16 example, at Burrendong in particular for cold water  
17 pollution. I think that you will find for expenditure  
18 that's not programmed for 12/13, it's not surprising that  
19 we have not reached the detailed design stage yet.

20  
21 MR WARNER: It has also been suggested that consideration  
22 be given to establish a fixed charge on supplementary water  
23 licences. Has State Water considered such a proposal? If  
24 so, what are your views and what issues are you likely to  
25 encounter in actioning such a proposal?

26  
27 MR WARNE: In a non-IPART area, Murrumbidgee, we  
28 charge in the order of \$450,000 a year for an area-based licence  
29 which is effectively for access to supplementary water;  
30 that is, overland flows that occur in the Murrumbidgee  
31 floodplains.

32  
33 We have some experience in this. We just thought the  
34 progressive modern water management was about measuring  
35 what you are using, understanding the volume and having a  
36 price per unit applied to it. We are not totally opposed  
37 to the thing; I just don't think the measuring costs are  
38 going to be premium because it's the same pump you are  
39 using for your regulated water supply. While we understand  
40 the principle, we just think that the overriding principle  
41 of good water management through measuring what you are  
42 using ought to be reinforced and reinforced through the  
43 pricing principles.

44  
45 We're very happy to talk to them about that. It  
46 obviously stabilises our income stream. For them, I guess,  
47 it consolidates their right to access those supplementary

1 flows and it may be something worthy of consideration.

2  
3 But, once again, I'd encourage IPART to recommend a  
4 principle that would apply from the Border rivers down to  
5 the Murray.

6  
7 MR WARNER: It's been suggested that the land management  
8 thematic expenditures will give rise to new unregulated  
9 business activities, and, as such, these expenditures  
10 should be set aside and recovered from unregulated revenues  
11 when those business opportunities mature. Would you like  
12 to comment on that proposition?

13  
14 MR WARNE: I think if we got unregulated business  
15 opportunities that make State Water money, that will go  
16 towards a very welcome dividend to our shareholders who  
17 actually fund the business. I think to the extent that  
18 there are riparian works or other works that incur a cost  
19 that directly relate to the delivery of regulated water, it  
20 is a cost that's got to be legitimately borne by the water  
21 users. We obviously are not actually requesting  
22 cross-subsidy here, or some artificial gauging, and we need  
23 to be very confident that the charges we are applying to  
24 regulated water users applying to the provision of their  
25 services, but, I point out again, in the context of an  
26 organisation that has quite considerable and growing  
27 environmental responsibilities.

28  
29 MR WARNER: Namoi Waters suggested that the Peel  
30 regulated system will never be able to pay its way due to the  
31 small size of Chaffey Dam. Do you have a view on that? If  
32 costs recovery is unlikely to be a viable outcome, do you have  
33 a view on how IPART might deal with that?

34  
35 MR WARNE: You might be right. The Peel and the rivers in  
36 the north coast of our state and the south coast, some may  
37 argue, will never been viable. You want to be very careful  
38 saying "never", I think, because no-one would have thought  
39 that water entitlement value, since 1996, would have  
40 increased by 38 per cent compound.

41  
42 No-one would have thought that dairy farmers in the  
43 Murray Valley would be happy to pay \$200 a mega litre for  
44 the annual access to a mega litre for water for pastures.  
45 There have been a lot of things that have happened which  
46 have surprised us all in the past 10 or 12 years, but  
47 I think it's very unlikely that during the determination

1 period - it is probably unreasonable to expect the  
2 irrigators in the Peel Valley to pay those charges, and it  
3 is very likely that the treasury will step in with a modest  
4 support for State Water, keeping in mind that those  
5 unviable valleys represent a tiny proportion of our water  
6 sales.

7  
8 MR WARNER: One of the propositions that has been put to  
9 us, and I think you raised it at one of our previous  
10 hearings, was the idea of having a uniform statewide price.  
11 I don't think you accepted that idea at the time, and you  
12 can comment on that again, but also, on that issue,  
13 Tamworth Regional Council has asked whether, if a uniform  
14 statewide price is not able to be introduced, would State  
15 Water consider merging the Peel and Namoi Valley  
16 systems. Do you have a view on merging those two systems  
17 instead of keeping them separate?

18  
19 MR WARNE: A lot of our valleys, obviously, as you are  
20 aware, have been effectively merged. We don't have a  
21 separate pricing path for the Walcha River as opposed to  
22 Murray, or for the Edward River as opposed to the Murray;  
23 they are considered part of one system.

24  
25 We would actually seek direction from IPART. The  
26 merging of those two systems in a physical or in an  
27 allocation or in a water pricing sense is more a  
28 responsibility of the regulatory environment, rather than  
29 State Water's call. We understood that in the past there  
30 was a reluctance, particularly given that the Peel is yet  
31 to enjoy the benefits of a water sharing plan. So there  
32 are some obstacles there. Our view is pretty much benign  
33 on that.

34  
35 In terms of postage-stamp pricing across the entire  
36 state, I think you would find we would probably be in  
37 contravention of the pricing principles of the national  
38 water initiative and others, and that we have a  
39 responsibility to recognise the costs where they fall as  
40 far as is practically possible, and our pricing attempts to  
41 do that.

42  
43 MR REID: At the public hearings in Griffith and Dubbo we  
44 spoke about the management of revenue volatility. At  
45 Griffith we discussed who is best placed to bear that risk,  
46 and at Dubbo we discussed the availability of market  
47 instruments including insurance.

1  
2 Presenters from the irrigation corporations at those  
3 hearings indicated that they place a greater reliance on  
4 fixed charges than State Water nominally does, and in fact  
5 they indicated that they derive 70 per cent of their  
6 revenue from fixed charges and 30 per cent from usage  
7 charges; and in one case, namely, the Murrumbidgee, they  
8 used a relative dry period in recorded history as their  
9 sales base.  
10  
11 Since preparing your submission and having heard those  
12 presentations at those hearings, have you reconsidered the  
13 extent of your exposure to the variation in sales volumes  
14 and the management of the associated volatility?  
15  
16 MR WARNE: This is one area where the consultation with  
17 our irrigators has been quite important. They were adamant  
18 that, as we moved away from a legislative requirement to  
19 have 60 per cent usage-based charging, we didn't flee back  
20 to the safety of, say, a 30 per cent usage-based charging,  
21 and they saw that as one of the cornerstones of maintaining  
22 a healthy relationship with our customers - that is, they  
23 would pay a lot less money in years when there was less  
24 water available, despite the fact that our costs were  
25 largely fixed.  
26  
27 Now, as you have pointed out, Murray Irrigation and  
28 Murrumbidgee Irrigation, who are both quite large - two of  
29 our biggest customers - have moved increasingly towards  
30 fixed and away from usage-based pricing. That probably  
31 reflects the financial vulnerability and how they are  
32 feeling about their finances.  
33  
34 I think irrigators would argue that state government  
35 should be more robust than that, and that we have a  
36 responsibility to wear some of the ups and downs, and some  
37 would argue that the fact that you have basically broken  
38 even but failed to pay a dividend is about right, given the  
39 sorts of terrible seasons that they have been through as  
40 irrigators.  
41  
42 So we understand the political reality and the howling  
43 that comes out of valleys where there is absolutely no  
44 water, and the impact that that has on our shareholding  
45 minister and on our portfolio minister, and the sort of  
46 cries we get and the anxiety it causes at a very real level  
47 for farming families, and we think the proposal that we

.2/12/09 28

Transcript produced by Merrill Legal Solutions

1 have put forward of 60 per cent usage-based and 40 per cent  
2 fixed largely meets that compromise.  
3  
4 MR REID: Could you clarify for us the charges that you  
5 propose for the commonwealth and state environmental water  
6 holders?  
7  
8 MR WARNE: State Water is proposing that the commonwealth  
9 environmental water holder, who will probably use, it would  
10 appear, the Department of Environment and Climate Change  
11 and Water as their agent to deliver the outcomes with the  
12 water that they buy in the valleys in the north, will pay  
13 normal charges for water. We are not proposing any  
14 discounts, because it would appear that, unlike some of the  
15 big users or big corporations, they are in fact quite  
16 disparate users: they will use it all over the place; they  
17 will have some seasons when they don't want it in certain  
18 wetlands and other seasons when they do; it may be they are  
19 asking our staff for gauging at sites where they are not  
20 able to install proper metering equipment in time to  
21 achieve an environmental outcome that they may only be  
22 seeking one year in five. So they are going to be a new  
23 customer and, as an organisation, we have to be ready for  
24 that new customer, we have to be prepared to embrace them,  
25 but there is no thought whatsoever about discounting the  
26 pricing of their water.  
27  
28 A letter from them to you that I see in their  
29 submission indicated that they are expecting to be paying  
30 water charges. At this stage, we are not proposing any  
31 discounts.  
32  
33 MR REID: A number of valleys - for example, the Peel -  
34 have not achieved full cost recovery. In making decisions  
35 on how much you will spend in those valleys, do you have  
36 consideration for the level of cost recovery and the  
37 financial viability of the proposed expenditure?  
38  
39 MR WARNE: Well, you will want to be pretty careful.  
40 I understand where you are going, but if you follow the  
41 extent of that logic you would actually work out how much  
42 it is going to cost you to pull the dam down and dismantle  
43 it and walk away.  
44  
45 I think that governments have said, "We have  
46 constructed these dams; we are committed to their ongoing  
47 safety and their efficient operation," and they recognise

.2/12/09 29

Transcript produced by Merrill Legal Solutions

1 that, despite strenuous efforts after eight or nine years  
2 to work towards full cost recovery, in a couple of cases  
3 that's extremely difficult, and the Peel is one of those.

4  
5 I don't think the government is proposing to say to  
6 State Water, "It is your problem". I think it is very  
7 likely that as a result of this hearing and your  
8 recommendations there will be some small level of  
9 cross-subsidy.

10  
11 Do we treat them as a lesser customer or a less-worthy  
12 customer? The answer is no. They are State Water  
13 customers and we are committed to providing them with the  
14 same service as everyone else, despite the anomaly with  
15 regard to the cost of the infrastructure relative to the  
16 value of the water sold.

17  
18 MS WELSH: I would also add that the majority of costs in  
19 our valleys are actually as a direct result of our  
20 legislative and regulatory obligations, and they don't take  
21 into account non-compliance as a result of the failure of  
22 our customers to pay for the costs of us servicing those  
23 obligations, and our view is that the attainability of full  
24 cost recovery is a social policy issue for government and  
25 not for State Water.

26  
27 MR REID: From your operating costs forecasts, it would  
28 appear that in your own, if you like, internal costs you  
29 are achieving efficiency gains, but there are exogenous, as  
30 you say, impositions which are causing your overall  
31 operating costs to increase.

32  
33 For example, the works approval charges imposed by  
34 NOW; and also possibly an issue or an item of expenditure  
35 that has always been subject to comment is the costs of  
36 hydrometric services; and obviously the construction of  
37 fish ladders to coincide with dam safety upgrades. What  
38 discretion do you have in regards to these, and to what  
39 extent do you explore the possibility of reduction in some  
40 of these charges imposed upon you and/or the deferral of  
41 some of that expenditure?

42  
43 MR WARNE: The first couple are actually services that are  
44 provided to us from New South Wales Office of Water, and  
45 I would encourage irrigators and State Water alike, when we  
46 read their submission, to make sure they are not double  
47 dipping: that is, they are not taking from our irrigators

1 in the valley and then saying, "And we have 1.5 full-time  
2 equivalents managing State Water's compliance with their  
3 licence." I think that is an important point.

4  
5 I think hydrometrics is a service we buy from them.  
6 It is a very important service for State Water, because  
7 State Water requires real-time accurate data on what river  
8 flows are doing to manage our business properly and to give  
9 outcomes for our customers, whereas, more likely, Office of  
10 Water are after long-term trends and monthly or annual  
11 figures with regards to flows of water, so it does seem  
12 anomalous that we are buying the service from them and not  
13 the other way around, but that is the way the organisations  
14 were separated, and we would trust IPART to make strenuous  
15 efforts to make sure that the costs of those services,  
16 which are monopoly services provided to us - some of it  
17 back-charged to irrigators - be entirely the most efficient  
18 possible.

19  
20 In the case of the fish ladders, that is more  
21 difficult. The fish ladders are an impost by government  
22 required as we trigger some of these environmental  
23 requirements for the major works we are carrying out. We  
24 are making every effort to try to get cost-effective  
25 results rather than ludicrous projects with regard to fish  
26 passage, and we have had quite a good working relationship  
27 with the senior officers at Fisheries in establishing the  
28 most cost effective way to get the best result for fish  
29 movement in a given river.

30  
31 In addition, you will see a small budget there for  
32 research. I think we have a responsibility to arrest the  
33 almost exponentially increasing cost of fish ladder  
34 construction which has occurred during the last 10 or 12  
35 years. It is one area of construction that has gone up  
36 very dramatically as scientists wrestle with what is the  
37 most effective way to design, construct and operate a fish  
38 passage.

39  
40 THE ACTING CHAIRMAN: I would be grateful if I could  
41 have a couple of clarifications.

42  
43 Firstly, Lisa, I think, showed a chart which showed  
44 the effect of moving from the IQQM to the 15-year  
45 consumption forecast. Actually, it is quite significantly  
46 different for the various valleys in this part of the  
47 state. Do you want to comment a bit more on the reasons



1 for that and any issues you think might arise from it?  
2  
3 MS WELSH: I guess not being a hydrologist or a scientist,  
4 I don't want to comment in too much detail, other than that  
5 it does show the differences that can be incurred across  
6 the state.

8 I personally was quite surprised that the extent of  
9 the reduction in the Gwydir was much less than the other  
10 valleys.

11  
12 As to the reason for that, probably Craig, who is our  
13 water delivery manager up north, is far more able to  
14 respond to that question, but what I think it does say is  
15 that our proposed approach is highly transparent and easily  
16 understood. The IQQM model, and particularly CSIRO  
17 sustainable yields, are not. We are not trying to make a  
18 broader comment on climate change. We are not trying to  
19 predict the future. We are just trying to come up with  
20 something that is simple and allows for cost recovery over  
21 a relatively modest period of time.

22  
23 THE ACTING CHAIRMAN: Secondly, capital expenditure.  
24 You have left me with the impression that the vast bulk of  
25 capital expenditure is dam safety work, largely paid for by  
26 government. Nonetheless, there is quite a lot of capital  
27 expenditure that is paid for by users. Am I right in  
28 thinking that it is largely environmental works that are  
29 triggered by dam safety upgrades, or is there more to it  
30 than that?

31  
32 MR WARNE: There is quite a bit more to it than that.  
33 I think that we have to recognise that we now have ageing  
34 infrastructure supplying the water. The capital needs of  
35 that infrastructure haven't been set aside in some sinking  
36 fund, or what-have-you, and the government has made a very  
37 important decision about the pre-1996 works, but  
38 increasingly we are finding other works that are  
39 significant in nature which require refurbishment, repair  
40 and replacement, and obviously that is scrutinised.  
41 Obviously the efficient delivery mechanism is very  
42 carefully considered, but we are going to find increasingly  
43 that the cost of running a regulated river system with  
44 man-made infrastructure, apart from very significant  
45 environmental costs, is going to be borne, in part, by the  
46 users.

.2/12/09 32

Transcript produced by Merrill Legal Solutions

1 THE ACTING CHAIRMAN: I would appreciate now or later  
2 some understanding of what the major renewal projects are,  
3 particularly perhaps within this part of the state.

4  
5 MS WELSH: Yes, not a problem. We have that information  
6 and we can perhaps come back to you with that later this  
7 afternoon.

8  
9 MS KRIEGER: I have just a couple of questions. Did  
10 I understand you correctly when you said that re-weighting  
11 the fixed charges between general security and high  
12 security was revenue neutral for State Water even if  
13 implemented across the state?

14  
15 MR WARNE: Yes. There is no attempt by State Water to  
16 increase our revenue. It does, obviously, improve the  
17 stability of our income, because the high security guys are  
18 much, much more likely to get their income and, therefore,  
19 we are charging them more, so you can see a small benefit  
20 there, but it doesn't increase the total revenue to State  
21 Water in a run of the 15-year model seasons.

22  
23 MS KRIEGER: Of the other measures that you have proposed  
24 that do have revenue consequences - the improvement, as you  
25 see it, in the forecasting by using the 15-year rolling average  
26 and the change in the WACC by reducing your gearing  
27 levels - how do you rank those? I assume you have looked  
28 at the sensitivities of the results that those steps  
29 produce. How do you rank them?

30  
31 MS WELSH: Perhaps some of our customers could actually  
32 give you a fairly informed view on this as well. There is  
33 no doubt that the biggest impact on our customers comes  
34 from the change in consumption forecasting, because that  
35 has a direct impact on usage-based charges.

36  
37 The WACC, on the other hand, has a much less direct  
38 impact on our customers because it is levied on our  
39 regulatory asset base, which is shared at the moment  
40 between government and users. In fact, at the moment,  
41 about one-third, on average, across the State is allocated  
42 to customers, and this is something that I pointed out in  
43 my price modelling as part of the customer consultation,  
44 which is that in increasing the WACC, the government bears  
45 by far a greater proportion of those costs compared to  
46 users.

.2/12/09 33

Transcript produced by Merrill Legal Solutions

1 So if that is a service that users desire or  
2 appreciate, if you like, it is actually a pretty good deal  
3 that they are getting, because they are paying for some of  
4 it and the government is paying for most of it.

5  
6 MS KRIEGER: One final question about your operating  
7 expenses. I noticed in going through them that in recent  
8 years you have fairly substantial sums for what you call  
9 corrective maintenance; whereas previously that was  
10 allocated zero. Is that just a reclassification of opex,  
11 or is that a sign of rundown capital assets?

12  
13 MR WARNE: This is a subject of a lot of our work and a  
14 lot of customer concern in the past, that state government  
15 authorities are inclined to over-service maintenance in  
16 areas that are close to home or where they are gold-plating  
17 products, or whatever, and we have actually, throughout the  
18 organisational structure, tried to create an internal  
19 friction for the better of an asset owner and asset  
20 maintainer to try to really focus on what is the  
21 maintenance that is needed and what is the maintenance that  
22 is absolutely required, as opposed to a wish list of  
23 projects that our engineers might like to undertake.

24  
25 You are right, there has been a bit of catch-up footy  
26 played in the past few years, but we feel that we are now  
27 very much in charge of our asset base and that what we are  
28 reflecting here is really the come-and-go that irrigators  
29 could reasonably expect in coming determinations at IPART;  
30 not some lumpy, massive expenditure that they are being  
31 hurdled with, given particularly the government's  
32 willingness to take on the dam safety program.

33  
34 THE ACTING CHAIRMAN: Thank you very much for your  
35 presentation and for answering questions. We will hear  
36 from you a bit later in the day in response.

37  
38 We will now move on to a presentation from the  
39 Gwydir Valley Irrigators. Would their representatives  
40 please come forward and introduce themselves?

41  
42 GWYDIR VALLEY IRRIGATORS

43  
44 MR MURRAY: My name is Michael Murray. I am the CEO  
45 of Gwydir Valley Irrigators Association. Obviously as an  
46 organisation we represent the interests of irrigators  
47 within the valley, and we can claim a membership in excess

1 of 93 per cent of the available entitlement, excluding the  
2 20 per cent that is now owned by the state and federal  
3 governments, who have obviously been massive purchasers of  
4 water entitlement in this valley over the past 18 months or  
5 so. Many thanks for the opportunity to present here today.  
6 It is certainly a great chance to put our case forward.

7  
8 I have to say at the outset that it is a very  
9 different State Water that we are dealing with today than  
10 that which we dealt with around about four years ago in the  
11 room next door when they came forth with their submission  
12 at that time. They have undergone a lot of change, and  
13 certainly State Water needs to be congratulated for the  
14 efforts that they have had made to become a more efficient  
15 organisation.

16  
17 That hasn't been without pain to us as irrigators,  
18 particularly in the Gwydir Valley. We have certainly lost  
19 local staff; it was significantly downsized there, and  
20 there was a perceived risk about what impact that may have,  
21 and we are still watching that very closely, but we are  
22 taking the view that we have come here to IPART in the past  
23 and said, "State Water must become more efficient." They  
24 have got to come up with the ways of doing that. They  
25 still have to make sure that they deliver what they are  
26 meant to deliver to us, but we have to wear what their  
27 management comes up with. So far, it appears to be working  
28 pretty well.

29  
30 Last time around, I extolled State Water to jump out  
31 of bed in the morning and work out ways of delivering more  
32 water within the rules. I think State Water today is doing  
33 that a lot better than they did in the past. Certainly  
34 they have improved their performance in a key area for us,  
35 the delivery of supplementary water.

36  
37 I also have to say that this year the submission  
38 prepared by State Water is far better than what has been  
39 done in the past. There is a lot more information. A lot  
40 of effort has gone in, as State Water has indicated, in  
41 terms of consulting with members. They have come out and  
42 spoken to customers, they have engaged with us, they have  
43 engaged consultants, and they are obviously here today.

44  
45 When you look at that submission, you would say,  
46 "Well, that's not a bad submission", and certainly if I was  
47 one of their team, I would be trying to prepare something

1 very similar, because when you have an opportunity to put  
2 forward a case to basically maximise your charges and  
3 minimise your business risk, you grab that opportunity, and  
4 State Water has done that.

5  
6 But this has to be a lot more than just State Water  
7 coming here, Oliver Twist style, and saying, "Please, sir,  
8 can I have some more?" to the tribunal. There must be a  
9 recognition that in a monopoly-type environment there has  
10 to be some form of artificial competitive pressure applied,  
11 and this is, I guess, the role of the tribunal, to look at  
12 what comes forward and to work on that basis.

13  
14 Really, State Water's submissions are about income,  
15 regardless of sales and prices without competitive  
16 pressure. State Water is a monopoly, and State Water's  
17 submission makes it very clear that it understands its  
18 monopoly position.

19  
20 Quite interestingly, listening to the figures earlier  
21 on, effectively they are saying that they delivered about  
22 70 per cent less water than their revenue projections had  
23 suggested, and yet they actually maintained 70 per cent of  
24 their user revenue. That's not a bad performance. It's a  
25 performance that, given the drought that we have been  
26 through, many of their customers, many of my members,  
27 would love to have been able to emulate. Certainly later on  
28 we will look at a slide which shows what has happened to  
29 profitability in this part of the world over the past four  
30 or five years.

31  
32 GVIA has tendered a lengthy submission to IPART, and  
33 it is not my intention to go through every one of those  
34 points today. I certainly urge you to go through it, and  
35 I am sure you have done, and based on the questions today  
36 it is clear that it has been clearly looked at, but I do  
37 want to go over some of the key points.

38  
39 Let's look at the overall headlines. There is no doubt that  
40 over the past four years or so of the determination  
41 period we have gone through the worst drought  
42 in the history of the irrigation industry of New South  
43 Wales. Within the Gwydir Valley, we haven't received any  
44 new general security increments since March 2008, and our  
45 average annual increment since 2003 has been 10 per cent.  
46 From what we have heard from State Water, the situation is  
47 not any better across the state.

.2/12/09 36

Transcript produced by Merrill Legal Solutions

1  
2 Yet State Water has managed to make a regulated profit  
3 every year since this determination started. Granted, it  
4 may not have been as big a profit as they would have liked,  
5 but when your core business is the capture, storage and  
6 delivery of water, any profit at all during the worst  
7 drought in irrigation history has to be a testament to two  
8 things: good management - and we have certainly  
9 acknowledged the way in which State Water has performed;  
10 and a clear indication that the bulk water delivery process  
11 is not as risky as State Water would like to make out.

12  
13 Not only were there regulated profits made but,  
14 despite some statements from George today, in 2007 a  
15 dividend of 5.7 million was declared, with 7.9 million  
16 declared in the previous year. So there has been some  
17 return back to their shareholders. Again, this is in a  
18 situation where, no doubt, the water has not been there to  
19 deliver, and yet the business model and the parameters that  
20 have been put forward in terms of the pricing have allowed  
21 them to deliver a profit, at least in those two years.

22  
23 So here at the Gwydir Valley, at the end of the 2006  
24 determination, basically this year, IPART has determined  
25 that we have reached full cost recovery, and yet State  
26 Water is calling for a real increase in prices over the  
27 next four years of approximately 33 per cent. In terms of  
28 impact on a general security irrigator's total bill, they  
29 are looking at around about a 33 per cent increase.

30  
31 While we consider that, let's just think about the  
32 fact that we have gone through a drought; it is a business  
33 of delivering water; State Water has managed to make an  
34 EBIT profit every year and declare a dividend; they have  
35 managed to get 70 per cent revenue in a period in which  
36 they tell us that they have only delivered 30 per cent of  
37 their expected water; we have declared full cost recovery;  
38 and yet the argument is for 33 per cent increases.

39  
40 I would have to say, when Tom Cruise starred in his  
41 movie "Risky Business", he didn't actually have State Water  
42 in mind.

43  
44 So what is driving State Water's grab for higher  
45 prices? Clearly, as discussed, consumption forecasts have  
46 a huge impact on what they are trying to do. Times have  
47 been tough, and they have been tough for both irrigators

.2/12/09 37

Transcript produced by Merrill Legal Solutions

1 and for State Water, but that is the industry that we  
2 happen to be in.  
3  
4 However, in the quest to become the ultimate zero-risk  
5 business, State Water, with the assistance of the New South  
6 Wales Office of Water, has bought from the Centre for  
7 International Economics a study that argues that a 15-year  
8 rolling average consumption forecast is the way to go. If  
9 that consumption forecast is applied in the here and now to  
10 the Gwydir Valley, it will be the equivalent of applying  
11 the doomsday climate change scenarios to right now.  
12  
13 The report, statewide, suggests a new consumption  
14 forecast of 20 per cent below what is currently used by  
15 State Water, the tried and true IQQM long-run model.  
16  
17 It is interesting that CIE's predictions are so  
18 dramatic that I don't even think State Water believes them.  
19 I had a look at their brand new website the other day.  
20 There, proudly covered on the website in one of the early  
21 pages, it is said that State Water makes average deliveries  
22 of 5,500 gegalitres every year, not the 4,400 gegalitres  
23 claimed in the CIE report.  
24  
25 State Water and CIE argue that New South Wales has  
26 undergone a climate change induced step change in water  
27 availability and that they appear to be the only ones who  
28 believe that what we have gone through lately is the new  
29 normal. However, this is not an argument about whether  
30 climate change is reality or not; this is an argument about  
31 how best to account for whatever occurs.  
32  
33 Accepting the CIE report for the Gwydir would mean  
34 accepting a climate change scenario today worse than what  
35 the CSIRO, after spending \$50m - which I suspect is a  
36 little bit more than what State Water paid CIE - considers  
37 the most likely scenario for the Gwydir in 2030. No  
38 credible scientist will argue that climate change is as  
39 rapid as the outcome of the CIE report suggests.  
40  
41 The long term IQQM model will take into account  
42 climate change. It averages it out as it goes along, if  
43 and when it occurs.  
44  
45 We need to remember that the CSIRO report, while it  
46 suggests that we may see a best guess reduction of  
47 8 per cent in surface water availability in 2030, also

.2/12/09 38

Transcript produced by Merrill Legal Solutions

1 suggests that run-off may increase by 31 per cent or it may  
2 decrease by 28 per cent. The long-run IQQM will pick that  
3 up as it occurs. What we are seeing from State Water is a  
4 10.9 per cent decrease to be applied straightaway.  
5  
6 Acceptance of this consumption forecasting model has  
7 an immediate double-whammy effect on Gwydir irrigators: a  
8 massive and immediate increase in usage costs; and a very  
9 real and significant risk of over-recovery during this  
10 determination period.  
11  
12 If we look at this slide, you can see our water usage  
13 over the period from 1994 to 2009, and there are certainly  
14 some ups and downs there. The pink line is basically the  
15 IQQM long-run average forecast; it has been used up to now.  
16 The yellow line is the suggested one through the State  
17 Water submission. We can see that the blue one is the  
18 average that occurred in the period from around about 1996,  
19 I think, to 2002 - or 1997 to 2002. So if this area here  
20 from 2003 represents a step change in climate, it is  
21 equally true that this area through here should equal a  
22 step change in climate (indicates).  
23  
24 We can and we will get to a stage where we have  
25 above-forecast deliveries, and there will be times when we  
26 do not. It is a variation, and a variation that will  
27 continue to occur. But what we do have there, just looking  
28 easily at that graph, is that there is basically the same  
29 amount of area above that pinkish line as below. So the  
30 long-term IQQM model has actually done a very good job  
31 over time, and there is nothing out there to really suggest that  
32 things are going to change that dramatically in the short  
33 term that you would want to apply a worse-than-2030  
34 prediction here today.  
35  
36 The other major issue that we have is the weighted  
37 average cost of capital. I have to tell you that I would  
38 be kidding you as the tribunal if I suggested that I could  
39 tell one end of a beta from a gamma, it is certainly not  
40 the case, but what I do know is that in the real world one  
41 can judge desired return against risk and compare it  
42 against other alternatives.  
43  
44 With the Reserve Bank rate going up 0.25 per cent  
45 yesterday, it now sits at 3.75 per cent, a return of  
46 6.5 per cent for a WACC would appear very attractive.  
47

.2/12/09 39

Transcript produced by Merrill Legal Solutions

1 It should be noted that when this tribunal last  
2 considered State Water's WACC, the Reserve Bank cash rate  
3 was at 5.5 per cent and the WACC was set at 6.5, a  
4 1 per cent premium.  
5  
6 Maintaining the WACC today at 6.5 per cent would  
7 effectively deliver State Water premiums of 2.75 per cent.  
8 A WACC of 7.9 per cent would be a massive premium of  
9 4.15 per cent, and would certainly whack every irrigator  
10 right out of business.  
11  
12 State Water has argued that it is an inherently  
13 risky business. It is worth considering the argument State  
14 Water puts forward to support its claim of a high-risk  
15 business. It argues that its revenue is highly volatile,  
16 but consider the following: its 40 per cent fixed and  
17 60 per cent usage pricing strategy plays a very effective  
18 role in minimising revenue volatility while putting its  
19 business in sync with the businesses of its customers.  
20 That was clearly demonstrated by the fact that a  
21 70 per cent decrease in actual delivery of water only  
22 resulted in approximately a 30 per cent decrease in the  
23 revenue that they expected.  
24  
25 It argues that it faces supply-side risk, and that is  
26 true to the extent that the amount of water available for  
27 sale in any one year is very hard to forecast, but there is  
28 as much upside risk of supply as there is downside risk,  
29 and when there are those good years, there is no cap on  
30 the income that State Water can earn in those particular  
31 years.  
32  
33 Interestingly, in the answers that George gave to some  
34 of the questions earlier on, he talked about the change in  
35 irrigator behaviour and the effect that that would have,  
36 and he raised the issue of carry-over rules.  
37  
38 In the Gwydir Valley we have continuous accounting:  
39 that is, once an increment is made into your account it  
40 remains your water to use when and if you please. So, yes,  
41 it is possible that an irrigator, as they have through this  
42 drought, may decide not to use the water in the year that  
43 it was credited to their account; may use it the following  
44 year or the year after; but that revenue stream is never  
45 lost to State Water, it just moves it out. So I think that  
46 is a very important issue when you consider George's  
47 answer.

.2/12/09 40

Transcript produced by Merrill Legal Solutions

1  
2 Even in the event that the tribunal considers  
3 State Water to have a significantly higher risk profile  
4 than other comparable businesses, the tribunal needs to  
5 consider that State Water is just one asset among a very  
6 wide and diversified portfolio held by the New South Wales  
7 Government, and, as such, the overall risk of that  
8 portfolio is very low, and that could mean that you can  
9 accept an average risk and therefore build your WACC around  
10 that.  
11  
12 GVIA calls on the tribunal to carefully consider  
13 the real nature of State Water's risk when assessing  
14 State Water's WACC, and to completely dismiss State Water's  
15 threat to move to a 90 per cent fixed water charge regime  
16 if not awarded a WACC of 7.9 per cent. I'm afraid that  
17 really just smacks of bully-boy tactics.  
18  
19 GVIA supports the retention of a 6.5 per cent WACC and  
20 the 60 per cent usage and 40 per cent fixed pricing regime.  
21  
22 In terms of operating costs, the last time around  
23 IPART applied close scrutiny to State Water's operating  
24 costs and deemed them to be efficient and set new efficient  
25 targets for State Water.  
26  
27  
28 We've acknowledged that basically State Water has got  
29 there, they have just got to deliver on their budget for  
30 this year and they'll be over the line.  
31  
32 What have we seen? We've seen the creation of a new  
33 term - or a new term to me - of "thematic expenditure".  
34 I always get a little bit suspicious when someone comes up  
35 with a new name for something. I think, really, the  
36 Tribunal needs to look very closely at what has been  
37 included in thematic expenditure. We have gone through in  
38 detail in our submission, and we support some that might be  
39 genuine. We support some of the expenditure. We believe  
40 some of the other expenditure is genuine, but is, indeed,  
41 someone else's responsibility to pay. Some of them are  
42 dubious in the extreme.  
43  
44 I would just like to take a quick look at the one  
45 listed under "thematic expenditures", the environmental and  
46 heritage thematic plan and the need to include the cost of  
47 State Water's environmental management plan. Basically,

.2/12/09 41

Transcript produced by Merrill Legal Solutions

1 the argument from State Water was that this is a new  
2 expenditure requirement for them, and it wasn't included in  
3 the 2006 range. Taking a look at State Water's interim  
4 operating licence dated July 2004, it actually required a  
5 State Water environment management plan to be completed by  
6 the end of June 2005. So, the requirement's been there.  
7 It was followed up. Similar requirements were in the  
8 operating licence that followed this one. So, it has  
9 certainly been around and to be double-counting it throws a  
10 lot of suspicion on the rest of the claim State Water makes  
11 in this area.

12  
13 In a similar vein, State Water's calling for  
14 additional operational expenditure for its fish passage  
15 programme which, by its own admission, integrates two  
16 existing fish-related programmes. You would think merging  
17 two programmes would actually generate savings, not  
18 additional expenditure.

19  
20 GVIA urges the Tribunal to examine very closely  
21 State Waters' thematic expenditure claim. Apart from those  
22 specific concerns about thematic expenditure, GVIA believes  
23 that IPART should drive a commitment by State Water to  
24 consistently deliver efficiency savings, which will result  
25 in ongoing real reductions in operating costs.

26  
27 I note that George talks about 6 per cent efficiency  
28 savings coming through, but, from my memory of submission,  
29 that's not until the later part of the determination  
30 period.

31  
32 In terms of capital costs, GVIA well understands the  
33 argument that much of State Water's capital's expenditure  
34 is driven by factors outside the control of customers and,  
35 indeed, outside the control of State Water. The dam safety  
36 committee has extensive powers and demands standards way  
37 outside any commercial parameters. GVIA also understands  
38 that the vast majority of dam upgrade costs are borne by  
39 government. And, therefore, it is argued by some that  
40 irrigators should not be too concerned.

41  
42 However, GVIA has concerns regarding capital  
43 expenditure and they include, as far as price  
44 determinations go, plant Capex forms part of the RAB  
45 whether the work is done in the timeframe nominated or not.  
46 So, there is a real concern than in some years we've been  
47 paying for capital works that haven't been completed within

.2/12/09 42

Transcript produced by Merrill Legal Solutions

1 the proposed timetable.

2  
3 That's particularly true, as George alluded to in one  
4 of his answers, and we're concerned about the \$15m that's  
5 been earmarked for cold water pollution work in Copeton  
6 Dam. There isn't any evidence of any detailed planning  
7 that's occurred on that and, from history, we know that  
8 these things take an awful long time to get through all the  
9 planning process. So, I'd be quite amazed if they can  
10 actually deliver that within the timetable. It's not  
11 saying that we oppose the work occurring; it's just saying  
12 that, you know, we're going to be paying for it under this  
13 process whether it happens or not, and that's obviously a  
14 major concern.

15  
16 The way State Water funds these works through state  
17 government borrowings is also a concern for us. Because,  
18 as I understand it, they effectively borrow the money  
19 through the State Government's finance corporation, and  
20 then are charged a rate of interest on that. The very fact  
21 that they are borrowing this money to carry out works that  
22 have been required by the Dam Safety Committee and are  
23 outside any commercial parameters, is actually putting up  
24 the pressure on their interest rate, puts downward pressure  
25 on their credit rating and, therefore, puts further  
26 pressure on trying to have a higher WACC.

27  
28 It's got to be careful. This is being driven by  
29 things that are outside our control and, admittedly,  
30 outside largely State Water's control. The dam safety  
31 committee is saying these works must be done. However,  
32 that shouldn't mean that we need to have to pay for it in  
33 the long term through a higher WACC, driven by increased  
34 pressure on the interest rates and downward pressure on the  
35 credit rating.

36  
37 In terms of cost shares, the Tribunal's well aware,  
38 they have been debated very vigorously over the years. For  
39 this determination, GVIA is content to maintain the  
40 existing cost share, although if IPART is of a mind to  
41 actively review them, we will be reserving our right to  
42 vigorously re-enter the debate. Our only request in terms  
43 of cost share is not to change the cost shares, but have a  
44 ruling that where fish passage works are required solely  
45 because of the fact that pre-1997 dam safety works are  
46 required, that fish passage work be covered as dam  
47 safety upgrade costs, linking it directly to the fact that

.2/12/09 43

Transcript produced by Merrill Legal Solutions

1 they are only being required because the dam safety works.  
2 Therefore, they should be 100 per cent a government cost.  
3  
4 Quite simply, if the dam safety requirements weren't  
5 being required for Copeton Dam, weren't being called on, we  
6 wouldn't have to be doing the particular fish passage works  
7 that are associated with that upgrade.  
8  
9 In terms of the high security/general security water  
10 premium, we agree with State Water that there is an  
11 argument that high security irrigators have not been paying  
12 their fair share of costs. However, we are totally  
13 rejecting and oppose the concept of applying a scarcity tax  
14 on high security water delivery charges. It's not the role  
15 of State Water to bring in any form of scarcity tax. What  
16 we believe is that the costs paid by high security users  
17 should reflect the cost of actually delivering their water.  
18 And, on the work that we've done, effectively the cost of  
19 delivering high security water is about seven and a  
20 half per cent of the cost of total water delivery in the  
21 Gwydir Valley and, at the moment, they are paying basically  
22 5 per cent in terms of charges. So, we have proposed a  
23 model that would actually bring their charges in line with  
24 the costs that are actually incurred in delivering that  
25 water.  
26  
27 Now, a scarcity premium is all about trying to value  
28 something and basically modify its use through its value.  
29 That's definitely not the role of State Water, whose job is  
30 to capture, store and deliver bulk water. There is already  
31 a scarcity tax built into the premium. People pay for high  
32 security water. That's already covered. Usage is already  
33 controlled by the entitlement system and by a resource  
34 assessment system. So, any move to apply a scarcity tax  
35 would be very strongly opposed by Gwydir Valley Irrigators.  
36  
37 One of the major concerns of State, Water as they put  
38 forward in their submission is their long-term business  
39 viability. As I hope I have demonstrated, given the  
40 circumstances that they've gone through, State Water as a  
41 business has performed very well. They have managed to pay  
42 dividends; they have managed to make EBIT profits over the  
43 period of this determination. But if we look at what's  
44 actually happening to their customers - and I think, while  
45 I congratulated State Water on their overall submission,  
46 I thought their work that they had subcontracted out on  
47 capacity to pay was actually an appalling piece of

.2/12/09 44

Transcript produced by Merrill Legal Solutions

1 documentation and did no justice at all to the overall  
2 State Water submission. But this is what's happening to  
3 our customers here in the Gwydir Valley. Effectively from  
4 2003 on you can see that only in one year did cotton  
5 growers make an actual profit.  
6  
7 Certainly, in the last couple of years, you can see  
8 very significant decreases. This is largely due to the  
9 fact that there has not been enough water made  
10 available - there hasn't been the water to be made  
11 available - for people to actually grow enough crop to  
12 cover their overheads. It's not that cotton growing or any  
13 other crop that they may choose is inherently unprofitable;  
14 it's the fact that they simply haven't had the water to  
15 actually grow enough crop to cover their cost. So, in  
16 terms of making your decisions, as I understand it, you  
17 need to look at the efficient costs of State Water and then  
18 consider the capacity to pay.  
19  
20 I think that graph really clearly demonstrates that  
21 irrigators in this valley have been hurting very much  
22 financially and they have been hurting proportionally far  
23 greater than State Water. Anyone would argue that our  
24 irrigators are as good as business managers at State Water.  
25 So, the difference is the risk profiles of their business  
26 and, clearly, you know, the risks are a lot higher if you  
27 are growing irrigated crops rather than delivering the  
28 water.  
29  
30 In summary, GVIA is supportive of the retention of the  
31 long-run IQQM model for consumption forecasting. We are  
32 supportive of the 40 per cent fix and  
33 60 per cent usage charging regime. We are supportive of  
34 the maintenance of the 6 and a half per cent WACC, but  
35 suspicious of the validity of the number of the thematic  
36 expenditure claims. We seek a ruling that fish passage  
37 works triggered solely by pre-1997 dam safety upgrade works  
38 be treated as safety upgrade costs. We are supportive of a  
39 high security premium that accurately reflects the cost of  
40 high security water, and acutely aware of the diminished  
41 capacity of Gwydir Valley irrigators to pay higher charges.  
42  
43 Just if I may, I would like to pick up on a couple of  
44 the questions and answers that were raised to State Water  
45 earlier on. Some of them I've touched on already. In our  
46 submission, we raised the issue of a fixed charge for  
47 supplementary water for something not to be considered by

.2/12/09 45

Transcript produced by Merrill Legal Solutions

1 this determination period, but by future determination  
2 periods.  
3  
4 The theory is in the Gwydir and other valleys,  
5 although it was done differently, when the water management  
6 Act 2000 came into being in 2004, irrigators were issued  
7 supplementary licences, which used to be the equivalent of  
8 their old high flow or off allocation, but, in the past,  
9 they never actually had a licence for it and they were  
10 given a licence. In the Gwydir Valley for every one  
11 megalitre of general security licensing you had, you  
12 received 0.35 of a megalitre of supplementary licensing.  
13 But that's where the connection between the two stops.  
14  
15 You can now hold your general security licence, sell  
16 off your supplementary licences; change the balance left  
17 right and centre. What we are seeing at the moment, it is  
18 theoretically possible where someone can irrigate in this  
19 valley holding only supplementary licences, and they make  
20 no contribution at all to the fixed costs of the valley.  
21  
22 Certainly, there are fixed costs. The way  
23 supplementary water is distributed, it requires the weir  
24 system, it requires river operators, it requires a whole  
25 range of metering and other costs and charges that go on  
26 regardless of whether the supplementary water is delivered  
27 or not. So, we feel, as a matter of equity, it's an issue  
28 that needs to be looked at in future determinations.  
29  
30 I have touched on the fact that as far as the  
31 environmental Capex programmes go, we're not opposed per  
32 se to the actual programme; we are just concerned about  
33 State Water's patchy performance in terms of delivering  
34 significant Capex programmes in the timeframes that they  
35 claim to do it. Given that the RAB is based on what's  
36 proposed rather than on what actually happens, that is an  
37 issue for us.  
38  
39 I would like to thank you for the opportunity for  
40 presenting here today.  
41  
42 THE ACTING CHAIRMAN: Thank you very much. We will  
43 now have some questions, starting with Richard and Colin.  
44  
45 MR REID: Thanks very much, Michael. I just wanted to  
46 clarify a couple of matters in your submission, if I can.  
47

.2/12/09 46

Transcript produced by Merrill Legal Solutions

1 Firstly, as far as the high security/general security  
2 charges that you propose, instead of those put forward by  
3 State Water, you have indicated that in one of your  
4 calculations that State Water incurs, on behalf of high  
5 security users, 7.5 per cent of the costs and are only  
6 paying 5 per cent of the revenue. Could you just clarify  
7 for me how you have made that calculation and the basis for  
8 that, please?  
9  
10 MR MURRAY: That was based on effectively long-run  
11 deliveries of water to both categories and looking at the  
12 total user share costs on the charges.  
13  
14 MR REID: So it's really the effective price, if you like,  
15 that they've paid per megalitre based on their actual  
16 consumption?  
17  
18 MR MURRAY: Yes. It's going back and looking at how much  
19 they've actually paid to State Water for what percentage of  
20 the water that they received.  
21  
22 MR REID: Over what period was that calculated?  
23  
24 MR MURRAY: That was based on a number of potential  
25 models. Under the 15-year forecast of State Water, it was at  
26 7.8 per cent. If you looked at the long-run IQQM model, it  
27 was 7 per cent.  
28  
29 MR REID: To clarify another point in your submission,  
30 when you are looking at the impact of State Water's  
31 proposed prices on its customers, in table 12 you come up  
32 with the average annual cost of a megalitre of general  
33 security in Gwydir and a profit from the annual assignment  
34 market.  
35  
36 Say, for example, we took the 10 per cent allocation  
37 line there. I understand the opportunity cost are at  
38 7 per cent, but the next column where you have the  
39 opportunity costs per megalitre of allocation of \$1,680,  
40 I'm just wondering if you can explain to me how that's been  
41 calculated?  
42  
43 MR MURRAY: That was simply saying if you wanted to get  
44 one megalitre of actual real water in the dam, at a  
45 10 per cent allocation, you were actually required to hold  
46 10 megalitres of entitlement. So, it's just simply  
47 multiplying the opportunity costs for that one megalitre by

.2/12/09 47

Transcript produced by Merrill Legal Solutions



1 10.  
2  
3 MR REID: I understand that now.  
4  
5 You raise in your submission the issue of the  
6 government as the adaptive environmental water manager.  
7 You have indicated that the federal government has been  
8 very active in the Gwydir. What have been the implications  
9 of that action on the costs left to be borne by the  
10 irrigators?  
11  
12 MR MURRAY: If, as we suspect, and from the assurances  
13 that we've been given, the government continues to pay both  
14 fixed and usage charges, obviously there is actually no  
15 overall effect at all. I was disturbed. We thought that  
16 deal was absolutely done and dusted. However, in  
17 State Water's submission they did indicate that, as far as  
18 the state government is concerned, they still haven't  
19 finalised their position and that, you know, is certainly  
20 of concern for us.  
21  
22 We strongly believe that any water that they purchase  
23 should maintain its characteristics of what's been  
24 purchased, and should be subject to the same charging  
25 regime as other users.  
26  
27 MR WARNER: State Water has put forward a number of  
28 proposals for addressing revenue volatility: one is to  
29 increase the WACC and another one is to move to a 15-year  
30 moving average for forecasting water sales.  
31  
32 I note that you're not in favour of either of those  
33 propositions. Do you have any views on how State Water  
34 might best manage revenue volatility if those proposals  
35 that it's put forward are not accepted?  
36  
37 MR MURRAY: I think there needs to be an acceptance by  
38 State Water and by their shareholders that they are  
39 actually in a volatile business. There will be years when  
40 they deliver less water and there will be years when they  
41 deliver significantly more water than the long-run average.  
42 But that's a fact of life.  
43  
44 You know, their performance during what admittedly has  
45 been an horrendous drought, horrendous for State Water and  
46 horrendous for irrigators, has been an admirable one where  
47 they have actually managed to continued to make a profit,

.2/12/09 48

Transcript produced by Merrill Legal Solutions

1 which is more than what can be said for the vast majority  
2 of their customers who rely solely on irrigation for their  
3 businesses.  
4  
5 Anyone who wants to set up a business really would  
6 like to have the zero risk business. That's not the real  
7 world out here and it's not the real world for Qantas and  
8 it's not the real world for Elders and not the real world  
9 for De Bortoli wines or Australian Vintage or anyone else.  
10 Volatility is a fact of life. That's part of the business.  
11  
12 MR WARNER: Just on the IQQM model, which I note you  
13 support, that, I think, ranges or covers a 115-year period  
14 and more readings get added to it. That means that an  
15 average is going to take an awfully long time before  
16 adverse events are actually affecting the average. I do  
17 have a little bit of sympathy for State Water in that  
18 regard. It's very difficult for them to manage cash flows,  
19 waiting for good times to return.  
20  
21 Is there some intermediate period that we should be  
22 looking at that's longer than 15 years, but shorter than  
23 100 years?  
24  
25 MR MURRAY: When you think, there are entitlement systems  
26 based on the long-run IQQM, our water sharing plans are  
27 based on the long-run IQQM model; the whole system is  
28 based on that. I'd be very reluctant to move away from it.  
29  
30 Sure, there's volatility, but just as that previous  
31 graph showed, that volatility sometimes works in favour of  
32 State Water, sometimes works against State Water. It's  
33 part of their business.  
34  
35 MR WARNER: But under their proposal, when it works in  
36 favour, the price would presumably fall and you would get  
37 cheaper water in those good years, if you like?  
38  
39 MR MURRAY: Not during any particular determination  
40 period. I mean, my understanding is whatever they lock in for  
41 this year, this determination period will be the number used  
42 for the entire four years.  
43  
44 We are looking at a full dam scenario next year, which  
45 is one of the reasons why I'm concerned about them getting  
46 their environmental works done up in Copeton Dam because  
47 it's going to be very difficult with a full dam.

.2/12/09 49

Transcript produced by Merrill Legal Solutions

1  
2 MR WARNER: State Water is also proposing some other  
3 charges. Do you have a view on their new information  
4 charge that they are proposing?  
5  
6 MR MURRAY: A sensible application of that is a good idea.  
7 You are talking about the \$80 an hour charge. Yes.  
8  
9 We would expect that customers should be given good  
10 and reasonable access to their information and we'd  
11 encourage them to be able to provide, you know, long-term  
12 customer records on the web so they can be accessed, but if  
13 there are outsiders seeking information from State Water  
14 that is of dubious direct benefit to either customers or  
15 State Water, yes, sure, charge a reasonable rate.  
16  
17 THE ACTING CHAIRMAN: Thank you. Just a couple of  
18 questions from me.  
19  
20 Looking at the chart you've got up on the screen now,  
21 as I understand it, what State Water are proposing is the  
22 yellow line and the IQQM is the red/purple line. My first  
23 observation, from my point of view, they don't look that  
24 different. Secondly, I think, for our purposes, what we  
25 are trying to do is to get the best possible forecast of  
26 water sales over the four-year period of the determination.  
27 So, we are looking for a fairly short-term reporting.  
28 Which one of those two lines is the preferred for that  
29 purpose, and why?  
30  
31 MR MURRAY: I don't know. If you look at the Elders  
32 weather forecast site, we're in for a flood. It's been  
33 green all December, it was green all November. It didn't  
34 deliver. I don't know what's going to happen and  
35 I challenge anyone in this room to tell me what's going to  
36 happen. What I do know is that the long term IQQM model  
37 was the one that's tried and tested and it is the one that's  
38 based on our entitlement system, it's based on our  
39 allocation system, the resource assessments; it would be  
40 very foolish to move away from it. While those two lines  
41 don't look too far apart, basically that movement is the  
42 prime driver of a 33 per cent increase in water charges for  
43 the Gwydir Valley over the next four years. So, thank God  
44 it's only a narrow one, because I'd hate to see a wide one.  
45  
46 THE ACTING CHAIRMAN: Thank you for that. The other  
47 thing I wanted to raise with you is the issue of fish passage,

.2/12/09 50

Transcript produced by Merrill Legal Solutions

1 which you have asked us to rule on. You have argued that  
2 fish passage works triggered by dam safety work should be  
3 funded entirely by the government. I guess the contrary  
4 view would be that those are works required on an  
5 impactor-pays basis because the dam is there, and,  
6 therefore, should be charged to irrigators. It would help  
7 if you explain why you disagree with this view.  
8  
9 MR MURRAY: I don't disagree with the view in principle.  
10 I disagree with the fact that these works are only being  
11 triggered now because of the pre-1997 dam safety upgrade  
12 work.  
13  
14 If these fish passage works are triggered through  
15 other means outside the pre-1997 rule, we'll have to wear  
16 the green percentage. But these works are triggered solely  
17 because of the fact that the dam safety committee has  
18 determined to act on upgrades, which I have explained are  
19 well outside any commercial level of risk, and we are now  
20 being forced to undertake these works and pay the  
21 50 per cent charge, which we strongly believe wouldn't be  
22 occurring if it wasn't for the fact that those upgrade  
23 works were required.  
24  
25 THE ACTING CHAIRMAN: Thank you very much for the  
26 presentation and for answering the questions.  
27  
28 THE ACTING CHAIRMAN: The next presentation is from  
29 Namoi Waters. Could their representation please come forward.  
30  
31  
32 NAMOI WATER  
33  
34 MR CLEMENTS: Thank you for the opportunity of presenting,  
35 and we appreciate the fact that IPART makes the effort to  
36 come out to regional communities.  
37  
38 THE ACTING CHAIRMAN: Could you please introduce  
39 yourself for the record?  
40  
41 MR CLEMENTS: John Clements, Executive Officer,  
42 Namoi Water.  
43  
44 I don't propose to make a long presentation. I would  
45 like to have a little bit of a discussion. I think our  
46 position is, and was in the last determination, and is more  
47 strongly this time, that we feel as if often in these

.2/12/09 51

Transcript produced by Merrill Legal Solutions

1 processes the ball gets thrown on the grass and we are  
2 meant to run after the ball in the grass. I don't  
3 particularly want to do that.

4  
5 We are quite concerned that the process really is  
6 about protection from monopoly abuse. I'm afraid, I have  
7 to say that we don't think that the process is delivering  
8 that. So, we are actually, I'm afraid, critical of IPART's  
9 determination previously and are very concerned about this  
10 current determination. That the role of IPART under its  
11 legislation, and the reason IPART was set up originally,  
12 and still is its substantive reason for being, is to  
13 protect consumers in New South Wales from the monopoly  
14 abuse of government authorities.

15  
16 In this instance today, we are dealing with a  
17 state-owned corporation, State Water, their submission for  
18 pricing. We would maintain that we are also actually  
19 dealing directly with the government. The government has a  
20 strong role in State Water's determination. The government  
21 is a regulator. The shareholders are actually the  
22 regulator of state-owned corporations. In the previous  
23 determination, the government quite happily got in and  
24 varied opinions by State Water on cost shares, and we have  
25 the draft documents and the variations.

26  
27 In a very direct way, they have influenced  
28 State Water's request for weighted average cost on capital  
29 for dividends and we think that that's inappropriate. We  
30 are actually saying that there are two rules we are seeking  
31 today: one is on the submission by the state-owned  
32 corporation; the other is on the involvement directly of  
33 the New South Wales government in the state-owned  
34 corporation's submission to IPART. Both need to be looked  
35 at and ruled on.

36  
37 In general terms, if we are being protected from  
38 monopoly abuse, we need also to see the comparative model  
39 that IPART is using to check the business. So, there are  
40 all sorts of issues, rolling the ball into the grass  
41 issues, which are fun, we can run after the ball and all  
42 get captivated by that, but, as I said, we don't want to do  
43 that. We really want to look at the comparative model that  
44 IPART is using to check out this business. We want to know  
45 that this is an efficient business.

46  
47 The things we can see, the things we are competent

1 in - our members are competent in operational issues. They  
2 are competent in logistical issues. We tend to get  
3 over-focused on that because they are things we understand,  
4 but State Water as a business has a huge management  
5 structure. We want to know that that's an efficient  
6 management structure. We want to know that you are using a  
7 model somewhere, a comparative model from the real world  
8 that looks at those structures and looks at those costs.

9  
10 We are particularly interested in this notion that, in  
11 the last determination, State Water turned up and there was  
12 a rewrite in their submission - there was a re-write. They  
13 turned up all concerned about upper-bound pricing and the  
14 state government's obligations under two  
15 intergovernmental agreements - the 1995 COAG on water  
16 reform, and the 2004 national water initiative.

17  
18 There were two intergovernmental agreements. The  
19 State Water was suddenly very worried about the need to  
20 move to upper-bound pricing. In this submission here, we  
21 don't see anything about upper-bound pricing. There is no  
22 mention of the intergovernmental agreement. Suddenly this  
23 time it is just a dividend to the state. That's a  
24 state-owned corporation policy of New South Wales. That is  
25 not its obligations, as previously submitted to you under  
26 the two intergovernmental agreements.

27  
28 We need to go back and look at what those  
29 intergovernmental agreements say. The reason for  
30 upper-bound pricing, clearly in 1995, and the 1994 paper,  
31 the water reform paper, which was signed off in 1995, April  
32 I think, in Launceston, talked about upper-bound pricing  
33 being progressed to, where possible, with two caveats: the  
34 first is there was an indication for future investment; the  
35 second was that there are legacy costs that need to be  
36 negotiated. In some instances, upper-bound pricing could  
37 never be achieved because of legacy issues.

38  
39 The second caveat, that's always forgotten, is that  
40 upper-bound pricing dividends, even appreciation schedules,  
41 upper-bound pricing, is an indication of future investment.  
42 So, we are back there. We are not on this current  
43 submission that we are adhering to now, these days; we are  
44 now adhering to the policy of New South Wales, a  
45 state-owned corporation. Sorry, we are not there, and the  
46 government was not there last time. The government, with  
47 its dead hand in the State Water submission was all about

1 its obligations to two intergovernmental agreements to  
2 proceed to upper-bound pricing. We are staying there. We  
3 want to know that IPART are looking at those obligations  
4 under those intergovernmental agreements.

5  
6 Where is the dividend being held, as a guide for  
7 future investment? It is not. Where are the legacy costs  
8 being dealt with? They are not.

9  
10 CIE in 2001 put forward a preliminary paper to talk  
11 about legacy costs. It has now become the overall  
12 simplistic - I am sorry - policy of IPART. "The  
13 beneficiary pays" is somehow or other something that was  
14 written by CIE and endorsed, and is now the policy that is  
15 laid out all around the place. Well, it wasn't the  
16 intention of CIE that that was the case.

17  
18 The "beneficiary pays" policy of CIE was specifically  
19 about trying to work out how you model the efficient costs  
20 of a regulator. Not even State Water. State Water is not  
21 the regulator. The CIE paper was particularly about DNR.  
22 It was how you model, how you provide, how you work on a  
23 framework to work out how you deal with the legacy costs  
24 and how you actually work out the efficient operation of a  
25 regulator.

26  
27 Regulators aren't the market. Peculiarly, you are  
28 being asked to rule on something that doesn't have any  
29 comparative model. State Water presumably has a  
30 comparative model somewhere around the world. Regulators  
31 don't. There is no marketplace for regulators. CIE were  
32 talking about how you work out how the efficient costs of a  
33 regulator; water sharing costs; how you work out the legacy  
34 issues.

35  
36 The concept of beneficiary pays is all about legacy  
37 issues. "Impactor pays", I am sorry. Impactor pays is all  
38 about legacy issues. It has now become - I am sorry, and I  
39 will use the word - perverted to the point where it is a  
40 policy that applies to anything to do with bulk water. It  
41 shouldn't be. You need to look at beneficiary pays. You  
42 need to look at impactor pays, purely in the context of  
43 working out legacy costs. That's why it is there. It is a  
44 legacy costs model.

45  
46 There is not enough attention, there is not enough  
47 work from 2001, and there is not enough modelling, not

1 enough good hard work on working out what the legacy costs  
2 are. State Water is just a great example of a business  
3 that is inherently ridden with legacy costs, and struggling  
4 with it.

5  
6 A lot of the submission that we have seen this time is  
7 about State Water trying to deal with legacy costs. You  
8 have to love the term, "Oh, it is an uncertain business".  
9 It is an uncertain business because it is a business that  
10 is not a business. It is a business that has all sorts of  
11 compromises due to legacy issues.

12  
13 We have this now where, "We try to bump the WACC up;  
14 we change the depreciation model and we have some backing  
15 for that, so that's okay; and we get out there and we work  
16 out that if we do a 15-year run on a really bad climatic  
17 model we can get some business certainty." That's just  
18 inappropriate. It is what you have to do if you are in  
19 that position.

20  
21 But if you go back to the intergovernmental agreement,  
22 the need to deal with legacy costs is inherent with New  
23 South Wales signing to this process, and IPART were  
24 commissioned to this work based on that intergovernmental  
25 agreement, that we would move to recovery of costs,  
26 lower-bound pricing, where possible to upper-bound pricing,  
27 and when we talk about upper-bound pricing, as a signal to  
28 future investment and with recognition that legacy costs  
29 might mean that upper-bound pricing is impossible. That's  
30 the context in which New South Wales referred these  
31 processes to IPART.

32  
33 The national water initiative states very clearly that  
34 it is built on the 1995 agreement. It again talks about  
35 "upper-bound pricing where practical".

36  
37 The current submission of State Water talks about  
38 state owned corporations policies. We reject that. It is  
39 not appropriate that that language is now sitting in the  
40 vernacular of pricing determinations of State Water. It is  
41 upper-bound pricing courtesy of intergovernmental  
42 agreements.

43  
44 One of the points that we have put forward is that we  
45 agree with the dividend, as long as it is captured inside  
46 State Water. That fund will overcome a lot of legacy  
47 issues. I think we'd get out to over \$60m in the next

1 four-year determination.  
2  
3 If State Water need to buffer their business, if they  
4 need to get their credit rating up, they can capture the  
5 dividend and hold it there, hold it there with legislative  
6 intent expressed that the money is held there as a signal  
7 for future investment, and it is there also for the benefit  
8 of the business. Let the business buffer itself using that  
9 fund.  
10  
11 In 150 years we will need \$2.5bn or \$3bn in today's  
12 value, if we are serious about this as upper-bound pricing  
13 as a guide to future investment.  
14  
15 It would be not a bad looking business if it had a  
16 couple of billion dollars sitting in it. I think the  
17 credit rating would be good, and I think State Water could  
18 cut a bit of slack in a difficult time for its clients if  
19 it had that capacity in the business.  
20  
21 I'm not talking about that fund being diminished to  
22 subsidise hard times for growers, but to be used as a  
23 business buffer, as an improvement in its credit rating.  
24 That is appropriate in terms of the intergovernmental  
25 agreement, and this is about us being protected from  
26 monopoly abuse.  
27  
28 So IPART needs to either go and look at the  
29 intergovernmental agreement and take a decision or it needs  
30 to specifically request external advice on that. I don't  
31 believe that you can sit there sort of halfway.  
32  
33 I am increasingly concerned, in meeting with the  
34 former Minister for Water, now the Premier, the Premier,  
35 then the Minister, had no idea that the referral to IPART  
36 was anything other than a 12A referral. He was used to, at  
37 that time, writing referrals to you for water utilities  
38 processes and others. He assumed it was the same referral.  
39 The concept of the New South Wales Government is that this  
40 is a 12A process; it is disconnected from section 15 and  
41 the need to protect us for monopoly abuse. There is no  
42 idea in New South Wales at a government level that this is  
43 actually a section 15 process.  
44  
45 The intergovernmental agreement dealing with the ACCC  
46 has no concept that actually we are protected from monopoly  
47 abuse under this process. The referral to ACCC is like a

.2/12/09 56

Transcript produced by Merrill Legal Solutions

1 12A referral. The concept is that the ACCC will be making  
2 a 12A referral process.  
3  
4 We object very strongly to that. We are provided with  
5 protection from monopoly abuse, and we are asking IPART to  
6 take that process seriously. We need to get away from  
7 impactor pays, unless we are seriously going to deal with  
8 impactor pays in the context of legacy issues, and the  
9 legacy issues are huge. They are not just fish passage or  
10 safety upgrades. There are more inherent legacy issues in  
11 this business than that.  
12  
13 Moving to the fish passage issue, we object very  
14 strongly to the fact that negotiations have been held in  
15 our valley on fish passage really without our involvement.  
16 We do not believe that the triggering of 218 by a safety  
17 upgrade is a cost that should be attributed to us  
18 50 per cent or any percentage. Section 218 is very clear:  
19 if you modify a works, the minister will write to you and  
20 ask you to pay some costs for fish passage. Well, the  
21 reason for the modification to the works is safety upgrade,  
22 a legacy issue. Very much a legacy issue. The legacy  
23 issue locked to that, in this case, courtesy of 218, is  
24 that there will be fish passage issues. That's fine. The  
25 government can negotiate any offset they want as long as it  
26 is 100 per cent their responsibility.  
27  
28 To negotiate an offset that involved us without our  
29 knowledge is reprehensible. That is in a way an issue for  
30 IPART, and in another way an issue for State Water and DPI.  
31 But our submission to you today very specifically on that  
32 legacy issue is that it is a legacy issue. The fish  
33 passage legislation was passed in 1994. New South Wales  
34 well and truly understood that fish passage was an issue in  
35 1994. They passed legislation. Section 218 is all about  
36 that. Knew well enough to legislate in 1994. They can't  
37 claim today that they were unaware of legacy issues. They  
38 signed an intergovernmental agreement that said that legacy  
39 issues are a significant part of the agreement.  
40  
41 We do not want to pay for legacy issues, particularly  
42 one as well understood as fish passage, which was  
43 legislated in 1994.  
44  
45 Some of the specifics of our valley. The Peel, as per  
46 our last submission to IPART in 2006, is a political dam.  
47 It was never built with the intention of cost recovery. It

.2/12/09 57

Transcript produced by Merrill Legal Solutions

1 was never built with any other intention than getting  
2 someone elected and getting a city on side. It is not an  
3 efficient structure. It is a legacy issue. It is a legacy  
4 issue, as I have said, that was signed to in two  
5 intergovernmental agreements. It may be impossible to move  
6 to cost recovery because of legacy issues, not just  
7 upper-bound but lower-bound.  
8

9 There is a huge legacy issue in the simple fact that the Peel is  
10 an inefficient storage. It was not built to provide business  
11 opportunities to irrigators. It was not built with an  
12 efficient structure in mind in terms of the pricing and the  
13 efficiency to business of delivering water. It was built  
14 for political services. An industry was encouraged around  
15 it. The industry has investment. People have debt,  
16 they have effectively mortgaged their superannuation. The  
17 government encouraged people into that before cost recovery  
18 and these agreements were signed to. The Peel industry  
19 existed before 1995. The legacy issue is simply that you  
20 cannot request of those people cost recovery, when the  
21 intergovernmental agreement clearly acknowledges that there  
22 are significant legacy issues to be dealt with.  
23

24 Our recommendation is not as per Tamworth Regional  
25 Council's wonderful view that perhaps the Namoi could  
26 subsidise out of the goodness of our hearts their peers in  
27 the Peel; our submission is, quite simply, that the pricing  
28 for the Peel should be set at the Keepit value, and that  
29 the state government should deal with the legacy issues  
30 that they were well aware of when they signed the  
31 intergovernmental agreement in 1995 and took some \$2.5bn  
32 worth of commonwealth money for. The competition  
33 payments, the competition process - and that's what the 1995  
34 water agreement is, it is inherent in the competition principles  
35 signed to in 1995, it is part of the package - there are  
36 two billions of dollars coming to this state, and the state  
37 government signed to that agreement knowing there were  
38 legacy costs.  
39

40 They have had a truckload of money come from the  
41 commonwealth, and they need to just take a little bit of  
42 the percentage, a bit of the sweat off that money and apply  
43 it to some transfer and subsidy. It is inappropriate for  
44 the Peel to be charged at cost recovery. The government  
45 knew that when it signed. There was a significant amount of  
46 money provided by the commonwealth to New South Wales  
47 knowing that these issues had to be dealt with. It is an

.2/12/09 58

Transcript produced by Merrill Legal Solutions

1 issue for the state government to deal with.  
2

3 Again, if we are just going to be chasing the ball in  
4 the grass, we can do all sorts of things; if we are going  
5 to get more serious and look at this in terms of the  
6 responsibility under legislation and the intent in the  
7 agreements, and get a bit strategic about it and talk the  
8 policy language of the day, and the appropriate policy  
9 language of today, then I submit to you that you need to  
10 tie the Peel costs to Keepit and tell the state government  
11 to dip into some of its huge funds that it received from  
12 the commonwealth from signing those agreements.  
13

14 The MDBC costs. It is very good of State Water to put  
15 up its hand and put the MDBC costs forward, but I note that  
16 it is not an asset of State Water; it is not under their  
17 operating licence; it is not part of their business. It is  
18 also not part of the referral in the Water Management Act  
19 2000 and it is not part of your schedule, so I don't think  
20 that you can look at MDBC costs. It doesn't matter whether  
21 State Water put them up or DWE put them up. They are not  
22 on their asset registers, they are not part of the Water  
23 Management Act 2000, and they are not part of your  
24 schedule. So we would ask that they not be ruled on,  
25 particularly not State Water.  
26

27 If DWE, or whoever they are, would like to put them up  
28 in their submission, we will have a look at them in that  
29 context. That's probably more appropriate than State  
30 Water, who have a very clear asset register, a very clear  
31 operating licence, and the scheduling to you is also very  
32 clear. It simply doesn't exist there.  
33

34 Split Rock. We would endorse the view of State Water,  
35 and we have the documentation that shows that, again, the  
36 legacy issues of Split Rock in terms of safety were well  
37 understood prior to 1997. It is appropriate that the  
38 safety upgrade is 100 per cent the cost of the New South  
39 Wales Government and, again, we would submit that the fish  
40 passage trigger caused by that work, when that work  
41 commences, again is a legacy issue and 100 per cent the  
42 cost of the New South Wales Government.  
43

44 Capacity to pay. I think this document is better than  
45 the previous work, but I will point out that using  
46 statistical data that is generated for marketing purposes  
47 and for other purposes at a very broad scale can never

.2/12/09 59

Transcript produced by Merrill Legal Solutions

1 deliver precise quantification of impacts at a business  
2 level. I think Michael Murray put up the Boyce & Co  
3 report. We, in our submission, point to that. It is a  
4 great comparative analysis of business and it gets down  
5 into good detail.

6  
7 In the Namoi, our offer is that CMA is independent to  
8 us; we are happy to put forward a business model to you of  
9 impacts, so you can work out what is appropriate, but  
10 actually get specific impacts.

11  
12 Bernie George is here today from the Namoi, from  
13 Auscott. Bernie manages the Auscott' operation in the  
14 Namoi Valley. He will detail some of the costs in that  
15 business to show you that the impacts are probably far  
16 greater than the broad statistical data would indicate.  
17 I will leave that to Bernie.

18  
19 But the offer is there that we would be happy to give  
20 some comparative analysis of specific businesses, talk to  
21 you about what is appropriate so that we actually get  
22 something that is representative, that is not targeted in a  
23 way which prejudices the outcome, and try to show you  
24 specifically, in terms of our valley and real businesses,  
25 what the impacts are.

26  
27 There are plenty of other things we can talk about,  
28 but I think that sets the field and I can take some  
29 questions, thank you.

30  
31 THE ACTING CHAIRMAN: Okay. Thank you very much.  
32 We will now have some questions for you, but I think you  
33 probably asked some questions of us, so perhaps I should just  
34 try and briefly respond.

35  
36 On efficiency issues, I think it is perhaps worth  
37 pointing out we have recently published a draft report from  
38 our consultants which does go into some depth of State  
39 Water's efficiency including such benchmarks as are  
40 available. So that has been considered.

41  
42 Second, intergovernmental agreements. We are well  
43 aware of our obligations under intergovernmental agreements  
44 and we will apply them. In particular, I think, on the  
45 cost sharing and legacy issues, what is probably most  
46 important there I think is the cost sharing ratios that  
47 have now been reviewed in the successive determinations, so

1 I think it is perhaps not so much the work done by CIE but  
2 the decisions of the tribunal in successive determinations  
3 that really sets our approach. Obviously, there are some  
4 issues of judgment in deciding the cost sharing ratio, but  
5 certainly when we did them, we looked at legacy issues in  
6 considerable detail. I will now pass to Colin for  
7 questions.

8  
9 MR REID: Thank you very much. You mentioned the work  
10 that you are doing. That's the work with NATSEM that you  
11 referred to?

12  
13 MR CLEMENTS: Yes.

14  
15 MR REID: So that work is continuing?

16  
17 MR CLEMENTS: It is. We have actually just won funds out  
18 of the commonwealth to progress that work. On 11 December  
19 I am meeting with the Macquarie to look at combining other  
20 valleys' funds under the "Strengthening of Basin  
21 Communities" program to get that NATSEM modelling up.

22  
23 The comparative modelling I referred to earlier on is  
24 very much the accountants' business modelling, but also we  
25 are working on a valley scale on business impacts, so  
26 external shock impacts, modelling the business impacts,  
27 putting that into an input-output model, an economic model,  
28 and linking that for the first time, as we understand,  
29 certainly in this country, to a micro-simulation model to  
30 predict social and economic changes, and we are working  
31 with the National Centre for Social and Economic Modelling  
32 in Canberra for that.

33  
34 MR REID: What is the likely timing?

35  
36 MR CLEMENTS: Actually, in the middle of next year we aim  
37 to have output for the Murray Darling Basin Authority.  
38 Certainly that would be available in the middle of next  
39 year, is the plan. It is a little bit of a new field,  
40 Colin, in terms of hooking an input-output model to a  
41 micro-simulation model, and NATSEM are telling us that  
42 they are very pressured for the June time, but October  
43 definitely; June possibly.

44  
45 MR REID: Thank you. Getting back to the legacy issue for  
46 a moment, the depreciated optimised replacement costs of  
47 State Water's assets are something over 3 billion, or

1 whatever, and the amount that is shown for their assets is  
2 approximately 300 million, which is shared between  
3 government and users.  
4  
5 The intention of that was to try to capture those  
6 legacy issues which combined with the cost sharing ratios  
7 to perpetuate the capture of those legacy issues, and at  
8 the same time, as new expenditure was made, as new  
9 investments were made, to add that new investment to the  
10 regulatory asset base and for State Water to earn a rate of  
11 return on that new investment. To what extent, given your  
12 comments, do you believe that write-down of investments and  
13 the cost sharing ratios failed to capture those legacy  
14 issues?  
15  
16 MR CLEMENTS: Colin, certainly the regulatory asset base  
17 is that it is a significant recognition of legacy issues  
18 and of previous returns made by the industry that simply  
19 couldn't be captured in the transfer.  
20  
21 In terms of the new assets being put in at full value,  
22 I have a few concerns that some of the new assets are  
23 actually legacy issues in themselves, but I don't think you  
24 can just keep repeating that process forever, so maybe we  
25 just accept that the new world is that new assets go in at  
26 full value.  
27  
28 That's good for the State Water business in terms of  
29 them having something to show the taxation department,  
30 et cetera, but it doesn't capture the need to rebuild the  
31 asset at a certain time in the future. The depreciation  
32 schedule is running books, it is doing your tax returns.  
33 It is not a guide to future investment.  
34  
35 The dividend is the guide to future investment. It  
36 has simply been transported to someone who has no intention  
37 of investing in the future. So that would be the concern,  
38 I think, more than the depreciation schedule.  
39  
40 The depreciation schedule - we have a legacy  
41 recognition in terms of the reduced regulatory asset base  
42 from the \$3bn book value. Happy with that. Happy that,  
43 obviously, the business needs to run a depreciation  
44 schedule. I think we can live with the fact that the new  
45 assets, even though I think some of them are actually  
46 legacy issues themselves - all right, they go into the  
47 depreciation schedule at full value. I think we can live

1 with all of that.  
2  
3 The point that I think we get very sticky on is that  
4 70 per cent of profit - and this is a monopoly business, so  
5 they are dialling in the profit, and they have all sorts of  
6 mechanisms they are using to do it, and, let's face it,  
7 no-one else has this discussion about, "Oh, we're going to  
8 model the climate" or "We're going to do this, that or the  
9 other, and, by the way, the prices will then be set" - any  
10 other business that has had the last five years would be  
11 making a loss; a significant loss.  
12  
13 I'm afraid that there are a few growers in the room  
14 today, and I can predict, I'm sorry, that they are probably  
15 all making a loss. The fact that State Water doesn't make  
16 a loss and can put all these contrivances up is proof of  
17 the fact that it is a monopoly business, and that's why we've  
18 here. You guys are charged with making sure that they are  
19 kept under control.  
20  
21 So I don't think the depreciation schedule - I agree  
22 and accept that the RAB is written down. That's a legacy  
23 recognition. Happy for the depreciation schedules to run.  
24 I think it is a bit odd that we have moved from 170-odd  
25 years back to 80 for everything, and I am sure there are  
26 reasons for that, but I think the reason is that if you are  
27 a monopoly you can do these things. And there will be  
28 disagreement to that.  
29  
30 The legacy issues put in at 100 per cent  
31 depreciation - fine, but the point I come to straightaway,  
32 though, is the dividend. It is there as a proof that there  
33 is a monopoly capacity being exerted here. It is  
34 inappropriate that it is transported elsewhere. It should  
35 be held in the business as a guide to future investment,  
36 and it could then regulate a lot of the legacy problems in  
37 this business. It could be there to help with the credit  
38 ratings; it could be there to help with the fixed charge or  
39 variable charge issue. If you had a significant fund  
40 sitting in State Water, they could bump out those climate  
41 models with their own internal fund. They are a business  
42 that has been pushed into the real world, stripped of any  
43 history and regulated heavily. There are all sorts of  
44 intergovernmental agreements actually run into their  
45 business, and other compliance issues that are very  
46 peculiar to their business. They are not a normal  
47 business. And then to transport their profit out to



1 somebody who really doesn't give a tinker's cuss about  
2 their future or our future, is inappropriate. It should be  
3 held in the business and it could then be used to deal with  
4 the inherent problems that the business faces.

5  
6 MR REID: Obviously, as we have spoken about, under the  
7 cost share ratios a significant amount of money is being put  
8 into the business by government for the dam safety upgrades.  
9 I suppose a private firm, obviously, would go through  
10 fluctuations in profit, depending upon their situations.  
11 Some of that money would be retained in the business for  
12 future investment. Some would be paid out in dividends to  
13 shareholders, so it would go external to the business. Are  
14 you suggesting that the pay-out ratio of State Water is  
15 inappropriate, or the concept of paying a dividend at all?

16  
17 MR CLEMENTS: Both. The concept of paying a dividend is a  
18 state owned corporations policy of New South Wales. This  
19 business came into being out of two intergovernmental  
20 agreements. It has caveats on its capacity to pay  
21 dividends in those intergovernmental agreements. They have  
22 been ignored. They were given lip service in the last  
23 determination to get in there. They near as don't exist.  
24 Well, they do exist. It is the reason that the State can  
25 contemplate the dividend. But it can't refer back to the  
26 state owned corporations policy of New South Wales. It has  
27 to refer back to the reason that this came into existence,  
28 which is two intergovernmental agreements, both of which  
29 agreed that you move into that upper-bound pricing for  
30 dividend recovery for one purpose only, and that is for  
31 future investment. That's the context of this business.

32  
33 This business is not a run-of-the-mill state owned  
34 corporation. It was set up courtesy of an  
35 intergovernmental agreement in 1995, it has caveats on its  
36 construction and on how you progress to upper-bound  
37 pricing. They were given lip service by the government who  
38 inserted them into State Water's submission. That's  
39 inappropriate itself, that a state owned corporation  
40 regulator intervened in its own business that it is a  
41 shareholder of. That is a problem anyway. That was  
42 completely inappropriate in the last determination. They  
43 got all sorts of words in there to make sure they get a  
44 return. That is monopoly abuse and, as I said, I think you  
45 should be ruling on the actions of the government as well  
46 as the actions of the state owned corporation.

47  
.2/12/09 64

Transcript produced by Merrill Legal Solutions

1 THE ACTING CHAIRMAN: Thank you very much for your  
2 presentation and for answering questions.

3  
4 The next presentation is from the Peel Valley Water  
5 Users Association. I would invite the presenters to come  
6 forward.

7  
8 PEEL VALLEY WATER USERS ASSOCIATION

9  
10  
11 MR PENGELLY: My name is Laurie Pengelly. I represent the  
12 Peel Valley Water Users Association, and I would like to  
13 thank the pricing tribunal for giving me the opportunity to  
14 put the Peel's case.

15  
16 I, unlike the previous two speakers, am not an  
17 executive officer. I am a broken-down old irrigator from  
18 the Peel Valley. I suggest you take a good, hard look at  
19 me, because the younger generation of Peel Valley water  
20 users are highly unlikely to reach my stage of decrepitness  
21 and age and still be irrigators in the Peel Valley. The  
22 irrigators in the Peel Valley are an endangered species and  
23 they are highly likely to fade off the planet in the not  
24 too distant future.

25  
26 Our scientific name is "Erroneous Ipartus", and I will  
27 explain those terms for you. The "erroneous" bit comes  
28 from the fact that we have a draft water sharing plan out  
29 in the public arena at the moment. It restricts our usage  
30 to very small limits in terms of our average long-term  
31 usage. In the groundwater it will equate to 15 per cent of  
32 entitlement, and in the regulated system it will be  
33 20 per cent of entitlement. It is not because the water's  
34 not there; it is not because of environmental issues; it is  
35 because that's what we use. We have been responsible  
36 irrigators, responsible water users, and we are going to  
37 pay a severe penalty for being that. We should have built  
38 on-farm storage, filled it up and let it evaporate or seep  
39 or whatever else. Whatever we have done, we have done it  
40 wrong and we are going to pay the penalty for it.

41  
42 A small increase in the active use, 3.5 per cent in  
43 the groundwater and 5 per cent in the regulated system,  
44 will wind back active use to the extraction limit. It will  
45 cause the per megalitre per unit share to drop from 1 to  
46 around about 0.5. That has implications for the IPART  
47 process; it means that a \$4 entitlement charge equates to

.2/12/09 65

Transcript produced by Merrill Legal Solutions

1 \$16 if we breach our extraction limit. It also has impacts  
2 on the IPART process, because our long term average  
3 extraction limit will be around about the 20 to 25 per cent  
4 of our entitlement. We haven't given up, we are hoping to  
5 get these numbers up a little bit.  
6  
7 The figures generated are well below our average use.  
8 One lot was generated by the IQQM, which I don't have a lot  
9 of faith in, unfortunately. It cannot handle the low water  
10 usage in our valley relative to the total surface water  
11 availability. Small errors in the IQQM finish up being  
12 large errors in our extraction limits.  
13  
14 In terms of the groundwater, well, that was based on  
15 the last 10 years' average use, that's the only metered use  
16 that is available. In the first couple of years there was  
17 not much in the way of metering, and of course there have  
18 been administrative restraints put on the groundwater users  
19 for the rest of that period of time.  
20  
21 So in both cases, our extraction limits are well below  
22 average use. So that's the "erroneous" part about it.  
23  
24 Getting on to the IPART process, in the last two  
25 rounds of the IPART process, the north coast, south coast  
26 and Peel Valley have been pegged out on a meat-ant's nest.  
27 We've been left out in the noonday sun, waiting for IPART  
28 to come to the rescue of us, and they have done. We  
29 haven't had the prices imposed on us that have been  
30 proposed by State Water and DNR in the past, and now, if  
31 they get around to doing this. We have been rescued.  
32  
33 We shouldn't be in this position. Our current  
34 entitlement charges are around about \$27 a megalitre -  
35 four, five, six, seven, eight times what other valleys  
36 have. In the current round of the State Water proposition,  
37 this - and you don't need your glasses to read it, and  
38 I don't have a flash computer business that you can put it  
39 up on - the one on this side is south coast; the next one  
40 is the Peel. I didn't put north coast on here, because it  
41 would have been up here somewhere (indicating).  
42  
43 The situation is ridiculous. The Murrumbidgee and the  
44 Murray are the next two. These are all on the same scale,  
45 a 1,000 megalitre licence. You don't even need your  
46 glasses to see where the Peel and the south coast is,  
47 compared to those other valleys. What is fair and

.2/12/09 66

Transcript produced by Merrill Legal Solutions

1 equitable about that? There is certainly an equity issue  
2 that is in train here.  
3  
4 The Peel Valley water users and dairy farmers and hay  
5 makers probably get more hay and milk per megalitre of  
6 water in our valley than they do in the Murray and  
7 Murrumbidgee, but we don't get 8 and 10 times more.  
8  
9 These issues need to be addressed, and we think  
10 the whole process needs to be looked at. The proposal that  
11 we would put is that there should be uniform statewide bulk  
12 water pricing across all of the valleys. It is a quite  
13 straightforward and simple process, and the reasoning for  
14 it is going to be exacerbated by climate change, the Murray  
15 Darling Basin Authority's impact on extractive use, and, of  
16 course, water sharing plans.  
17  
18 Very basically, what does that really mean? What is  
19 uniform bulk water pricing? Well, I did some calculations  
20 for it. It is fairly straightforward. It is based on the  
21 40:60 fixed:variable ratio. Based on a likely usage of  
22 3,500gl, not the 4,300 put up by State Water - I consider  
23 that is an overestimation of where their sales are likely  
24 to be, although I hope I am wrong; I am hoping it is going  
25 to rain and our dams will become full and there is plenty  
26 of water - but, nevertheless, based on that sort of figure  
27 you have a high security entitlement charge of \$9.50 - this  
28 is to get back the 55 million that State Water want - a  
29 general security charge of \$1.90, and a usage charge of  
30 \$9.50 gets you the 55 million.  
31  
32 Straight across the board it maintains the fixed ratio  
33 of 40 per cent fixed assets and 60 per cent variable.  
34 Nobody, no water user in this State, can complain about  
35 that. A high security entitlement charge of \$9.50 is five  
36 times that of general security. It gives a reasonable  
37 approximation of the improved reliability of supply, and  
38 this is particularly the case for towns. The general  
39 security charge of \$1.90 is reasonably low - it's lower  
40 than quite a few of the valleys at the moment - but that  
41 means that irrigators can support State Water in years when  
42 we have very little water to use. You have got that  
43 situation currently in the Lachlan where those charges had  
44 to be waived because they are too high. \$1.90 is likely to  
45 be met in years with low income or even negative income.  
46  
47 Of course, our usage charge of \$9.50 cannot be

.2/12/09 67

Transcript produced by Merrill Legal Solutions

1 considered high because six of the 12 states' regulated  
2 rivers already pay more than that. Peel has been paying it  
3 since before the last round was in place, so nobody can say  
4 that a \$9.50 usage charge is excessive.

5  
6 In the case that State Water actually sells more water  
7 than the 3,500 gigs that I talked about, well, I can put  
8 the money away and save it for a rainy day, or a not so  
9 rainy day, as the case may be. It's time that the State  
10 looked at this as a reasonable measure of making the  
11 irrigation industry fair and reasonable, getting full cost  
12 recovery across the State, stabilising State Water's funds  
13 and keeping the irrigation industry viable right throughout  
14 the State. There's a perception out there that you can  
15 just keep jacking up the price of irrigation water and keep  
16 people in business. That's not going to be the case.

17  
18 Most of the water that's used in New South Wales is  
19 used on relatively low-priced products which can be grown  
20 in other countries under natural rainfall. We've got a dry  
21 climate. We grow wheat, cotton, rice; we grow those  
22 industries. They are relatively low-priced. There's not  
23 enough high-valued use for the water that we've got for all  
24 of it to be channelled to so-called high-valued users such  
25 as towns, industry and some niche agricultural industries.

26  
27 Part of the reason why I think we should go to a  
28 uniform state-wide pricing is the fact that water use in  
29 the basin is going to decrease over time. You can argue  
30 why. First of all, we've got climate change. We can argue  
31 about the degree of climate change and its impact and where  
32 the climate is going to occur, but there is little doubt  
33 that in the future our extraction of active use will  
34 decrease as a direct result of climate change.

35  
36 We've also got the Murray Darling basin authority.  
37 They put out their concept statement not so long ago.  
38 If you read through it, they are going to have sustainable  
39 diversion limits, scientifically calculated or assessed,  
40 and there is no doubt that once the Murray Darling basin  
41 authority gets into position, we are going to use less  
42 water than we currently are.

43  
44 The authority itself is going to find itself in a fork  
45 stick. It has to make environmental gains, otherwise it  
46 won't satisfy the environmental issues that are in the  
47 basin today, but it's also got to try and maintain some

1 socioeconomic fabric in the valley. So, they are going to  
2 get themselves in a fork stick but, nevertheless, we are  
3 going to be losing less active water in the future than we  
4 currently are. The degree of that cut is where we'll sit  
5 around and see. But, either way, State Water's revenue is  
6 not going to be there from just that fact alone.

7  
8 We've also got the situation where water sharing plans  
9 come into place, which I talked about before. In the Peel,  
10 we will have a long-term average extraction limit of around  
11 about 20 to 25 per cent entitlement. That limit is  
12 State Water's usage, for starters.

13  
14 IPART in the past have also proposed that bulk water  
15 pricing should show some environmental incentives for  
16 people not to use water, and it certainly works in the  
17 Peel. I'll read out a few figures. In the Peel, and this  
18 is State Water's usage charges, \$25.72. We use 5 per cent  
19 of the surface water availability. In the Namoi, it's \$12  
20 .56. They use 34 per cent of the Namoi surface water  
21 availability. In the Murrumbidgee it's \$3.54. They use  
22 53 per cent. The Murray is \$4 and they use 81 per cent of  
23 the surface water availability that's generated in the  
24 Murray. So, it's quite likely that a \$9.50 usage charge  
25 would make some environmental gains in the two southern  
26 valleys. I would like to think so, anyway.

27  
28 The other issue that probably needs to be addressed is  
29 inter-valley bulk water sales. Everybody is promoting it,  
30 including IPART, but nobody has addressed the issue of what  
31 happens when water is sold from one valley to the next.  
32 Does it take charges from one valley, the valley that it  
33 comes from, into the next valley? Does it leave the  
34 remaining valley with less water to defray the costs of  
35 State Water over of running the dam? None of these issues  
36 have been addressed, but uniform state-wide bulk water  
37 pricing does that.

38  
39 I think that's about all I need to say, except that  
40 I probably should quote from Barack Obama, because I think  
41 the quote is applicable:

42  
43 I am reminded that the actions of those in  
44 power have enormous consequences; a price  
45 that they themselves almost never have to  
46 pay.

47

1 That applies to the IPART process, and it also applies to  
2 the water sharing plan process. The people that pay are  
3 the people on the ground struggling to make a living, and  
4 the people that don't pay are the people who make all the  
5 decisions.

6  
7 Thank you very much.

8  
9 THE ACTING CHAIRMAN: We now have some questions.

10  
11 MR REID: We have raised your proposition of a common  
12 charge across all users in a number of hearings we've held,  
13 and I'm sorry to say that there's not a great deal of  
14 support for it.

15  
16 My question is what do we do in the face of all that  
17 opposition?

18  
19 MR PENGELLY: I'm hoping that the face of that opposition  
20 will change in the fullness of time. I recognise that this  
21 wasn't going to happen this round; it didn't happen last  
22 round. I've tried this I think for the last three rounds,  
23 but you can see that the northern valleys thought they were  
24 at full-cost recovery the round before last, or near enough  
25 to it, and they could handle the price. They might think  
26 they are getting close to full-cost recovery this time but  
27 the goalposts keep shifting, as was pointed out earlier.

28  
29 The prices in the northern rivers that are proposed  
30 for this round would have been shrieked at four years ago,  
31 and now they are saying, "Well, we are starting to get  
32 impact", and the northern rivers are starting to get prices  
33 that they never, ever conceived that they would get.  
34 You've got the situation where farming viability is coming  
35 into play, but none of the prices in the northern valleys  
36 compare anything like what the Peel is getting, and the two  
37 coastal rivers.

38  
39 MR WARNER: One of the things I think you did mention  
40 was that under your proposition there was a conversion factor  
41 between high security and general security of 4 or 5, or  
42 something like that. State Water has also put forward an  
43 alternative conversion proposal. What do you think of  
44 their proposal?

45  
46 MR PENGELLY: I haven't really looked at it too closely,  
47 to be quite frank. The Peel is in such a severe situation

1 that to go through the State Water's submission and argue  
2 about various points of issue when we're not even in the  
3 same ballpark, is something that I didn't want to do.

4  
5 I decided that we would push forward with the  
6 uniformed state-wide one. I think the ratio that we've set  
7 there is reasonable. Five to one is a close proposition.  
8 In some situations, you could argue for different  
9 relationships, but I think that's that reasonable in the  
10 prices that we've put forward to be worn by everyone in the  
11 industry.

12  
13 MR WARNER: One last question from me. This deals with  
14 Tamworth City, I suppose. It seems to me, and I think you  
15 have raised this before, that, as Tamworth grows, they are  
16 taking more of the available water, I guess is the best way  
17 to describe it. How do we address that as an issue?

18  
19 MR PENGELLY: Pull Chaffey Dam down! It's not an issue  
20 that can be reasonably addressed. I mean, basically you  
21 can't have a town run out of water. We're not happy with  
22 the situation with Chaffey Dam being as it is. We get zero  
23 allocation when it is half full. If that happened in any  
24 other major dam in the state there would be hell to pay.  
25 But that's the situation we are in and we have to live with  
26 it. Maybe the dam will get enlarged one day, but I don't  
27 think we'll hold our breath for that.

28  
29 MR REID: You indicated the small percentage of surface  
30 water in the Peel that's being taken by irrigators, in  
31 particular relative to the other valleys. This is  
32 presumably an issue that's common with some of the coastal  
33 valleys as well.

34  
35 MR PENGELLY: I think so.

36  
37 MR REID: This issue of significant costs being spread  
38 across the smaller number of users, if you like, is  
39 obviously a major issue. You have suggested, I suppose,  
40 State postage-stamp pricing as a way of equalising out the  
41 burden of some of those costs. Do you have any alternative  
42 in the absence of that occurring?

43  
44 MS PENGELLY: In the absence of that occurring, we just  
45 have to put our hand out and hope that the government will  
46 come to the rescue. But if that's going to be the case  
47 into the future, it needs to be put out there upfront.

1 We can't go through this process each time there's an IPART  
2 round. Remember, this drags on for quite some time.  
3  
4 Currently the people in the Peel are hoping they won't  
5 get a \$6 usage charge. They are not going to be too  
6 pleased if they get any increase from where we are at.  
7 We are already at \$27-odd, which is well above most  
8 people's usage charge throughout the rest of the state.  
9 We are supposed to feel happy we only got a \$45 one. We  
10 are not going to be happy. Basically, we are starting to  
11 run out of room to move. There's only so much money you  
12 can make out of hay and dairying, which are the two  
13 principal industries in the Peel.  
14  
15 THE ACTING CHAIRMAN: Thank you very much for your  
16 presentation and for answering the questions.  
17  
18 We'll now take a break for lunch for 45 minutes. That  
19 means we will come back here at 1.30.  
20  
21 LUNCHEON ADJOURNMENT  
22  
23 UPON RESUMPTION  
24  
25 THE ACTING CHAIRMAN: Ladies and gentlemen, if we can  
26 have your attention, we will resume now. The next  
27 presentation is from Auscott Limited. If their representative  
28 could please introduce themselves for the record.  
29  
30 AUSCOTT LIMITED  
31  
32 MR GEORGE: My name is Bernie George. I'm the General  
33 Manager of Auscott Limited's Namoi valley operations, and  
34 also the person responsible for their water matters. Thank  
35 you for the opportunity to present to the tribunal today.  
36  
37 Auscott operates mostly an irrigation farming  
38 business. It is also an agricultural commodity processor  
39 in ways of cotton gins. We conduct commodity marketing for  
40 both wheat and grains and we also have warehouses and  
41 logistics operations which export directly to world  
42 markets. As I said, the business is basically cotton and  
43 grains, and, when water provides the opportunity, those are  
44 irrigated. That is our main business.  
45  
46 We have operations here in Gwydir, Moree, in the Namoi  
47 between Wee Waa and Narrabri, and in the Macquarie at both

.2/12/09 72

Transcript produced by Merrill Legal Solutions

1 Warren and Trangie. The lifeblood of our business is  
2 general security water entitlement. We also have other  
3 water access, but most of our water, when it's around,  
4 comes from general security.  
5  
6 What I'd like to try and do today, if I can, is give  
7 you an irrigation farmer's perspective of this process - a  
8 customer's view, if you like. The things I'd like to cover  
9 are the business environment for northern basin irrigators  
10 as we are finding it right now; what we consider to be  
11 unreasonable price increases, those for the last  
12 determination and for the one ahead of us; the concept of  
13 this customer ability to pay idea; I'd like to comment on  
14 the business risks as we see them to State Water  
15 Corporation, and a couple of other issues that I've covered  
16 in my submission.  
17  
18 The sort of water availability we have been facing in  
19 our business is pretty much summed up on this table, and  
20 these are my calculations. There may be others around.  
21 They are in the ballpark; they are around about the right  
22 place. We are looking at much lower access to water than  
23 we can reasonably expect to run a profitable business, and  
24 that's been mentioned already today.  
25  
26 In order to survive in a business sense, we've had to  
27 adjust in major ways our businesses in terms of operating  
28 costs, postponement of capital improvements, the normal  
29 sorts of things that businesses do in tough times.  
30  
31 In short, we are in survival mode. I think it was  
32 mentioned earlier that there is little profit around.  
33 I can confirm that. It's been pretty hard to make a profit  
34 in the last five years if you are an irrigator farmer in  
35 this part of the world.  
36  
37 What I'd like to turn to are the price increases that  
38 we faced after the 2006 determination. Here's my take on  
39 those in this table, for general security water in the  
40 Gwydir, the Namoi and the Macquarie. The line I'd like to  
41 focus on is the bottom one where we've got an average  
42 annual increase over those years.  
43  
44 In my submission I used the term "price gauging".  
45 Some may think that's a bit tough or a bit unreasonable.  
46 Wikipedia tells me that price gauging is: "Seller pricing  
47 much higher than considered reasonable or fair" or,

.2/12/09 73

Transcript produced by Merrill Legal Solutions

1 alternatively, "seller of essential goods or services  
2 raising prices in anticipation of or during a civil  
3 emergency". Now, I don't think we are in one of those.  
4 Why do I think it's unfair? RMCG on page 42 of their  
5 report in the State Water's submission said that the  
6 average inflation rate over the last 20 years was  
7 3.2 per cent. On this basis, we consider that reasonable  
8 pricing would be somewhere in that vicinity - reasonable  
9 price rises - yet, this is what we see, significant price  
10 rises.  
11  
12 Let's have a look at the determination in front of us.  
13 Some improvement, yes, but, again, significant price rises,  
14 well above that 20-year inflation rate. So, what impact do  
15 these prices really have on irrigators? Again, RMCG  
16 concluded in their study that the price changes will have a  
17 relatively small impact on income and profitability.  
18 I took it to mean they were meaning us, the customer, the  
19 farmer.  
20  
21 Firstly, from our view, the price changes will have no  
22 impact on our income. We are irrigators; water is a key  
23 input. So, if it's available, we'll use it. The only  
24 place we'll get any income effects are from commodity  
25 prices or, in fact, the volume that we produce.  
26  
27 Secondly, the real cost of State Water charges per  
28 megalitre for water actually delivered to our farms, water  
29 that we can actually grow something with, in these sort of  
30 years is much greater than the sum of the fixed charge and  
31 the usage charge.  
32  
33 Here are some numbers that I've done for the Namoi  
34 over the past determination. We have to pay fixed charges  
35 regardless, but then we may get no water, we only get the  
36 water that's available and for that we pay a usage charge.  
37 So, if you divided our total charges by the water we  
38 actually get to use, here are the sorts of numbers that you  
39 get. I can tell you that they have a significant effect on  
40 our profitability. They are not insignificant numbers.  
41 For 2009/2010, I have estimated a figure there simply based  
42 on that we'll use the water that we at this moment have  
43 available. That number may be different; let's hope so.  
44  
45 The consultants also concluded that the impact from an  
46 enterprise perspective will be generally small. I don't  
47 think so. Here's the ranking for the top six cotton

.2/12/09 74

Transcript produced by Merrill Legal Solutions

1 growing costs in 2008 on our operation at Narrabri. I will  
2 be the first to admit, these are affected, warped, if you  
3 like, by low area production compared to what we normally  
4 grow. But, the fact remains that water charges,  
5 State Water Corporation and now, are our fourth largest  
6 cost in a per hectare basis in that year.  
7  
8 I haven't included whole farm costs for labour or R&M  
9 because, like most producers, we are trying to tough this  
10 drought out, so we are trying to keep our skilled labour.  
11 What do you do when you don't have a lot of crop area to  
12 grow? You do more R&M than you may normally do. So,  
13 those numbers, in this sense, won't include the whole farm  
14 costs, in my view. So, the point I am trying to make is that in  
15 these years, these charges are significant in-costs to our  
16 operating costs and our profitability.  
17  
18 State Water business risks. State water rightly cites  
19 that the business risks, in their submission, they see  
20 were: water supply dependent on rainfall; consumption  
21 impact by weather and economic conditions; and the global  
22 financial crisis. Let me tell you that all businesses  
23 concerning water and agriculture face these same risks.  
24 Our view would be why should State Water Corporation have  
25 any special remedies available? We all have to face these  
26 as well. Everyone has to cut their cloth to suit and  
27 accept lower levels of business performance until better  
28 times return.  
29  
30 Rightly or wrongly, we believe we are in a drought  
31 which will pass. Already today we've seen some graphs  
32 showing water availability over time with extended periods  
33 above trend and the period we are in now, which is below  
34 trend. But, we all have to wear that. We can't plan our  
35 businesses on four-year cycles and expect to be in  
36 agriculture in the long-term.  
37  
38 In response to these business risks, State Water  
39 Corporation propose the following: to change the  
40 consumption model from the IQQM to a 15-year rolling  
41 average. Our view of that is that, to abandon the IQQM  
42 model is inappropriate. If the IQQM model is good enough  
43 to set New South Wales water sharing plans, allocations,  
44 entitlements for the valleys in which we operate - in other  
45 words, the amount of water that we're entitled to - then  
46 it's good enough to set the pricing. We don't believe you  
47 can change the rule to suit this particular point in time.

.2/12/09 75

Transcript produced by Merrill Legal Solutions

1  
2 Furthermore, as I have already said, we believe we are  
3 in a drought and that this will pass - I don't know when,  
4 but it will - and we will return to a more long-term trend.  
5 So, our view is that State Water Corporation needs to do  
6 what we need to do, and adjust our businesses to get  
7 through a tough time.  
8  
9 The second proposal is to increase the WACC to  
10 7.9 per cent. Again, that's been talked about in some  
11 detail earlier today. The WACC is stated to represent a  
12 return to debt and equity holders for committing capital to  
13 State Water and bearing the risks associated with the  
14 business. We, as customers of State Water, have to live  
15 with the commercial realities of returns at the moment.  
16  
17 I would agree with the Gwydir Valley Irrigators'  
18 assessment that 6.5 is quite attractive under those current  
19 conditions, let alone a move to 7.9 per cent. We know that  
20 large business interest loan rates are currently around  
21 6 per cent. So, any assessment of a WACC of 7.9 to us  
22 would appear to be out of line with the market and an  
23 expectation that is not warranted.  
24  
25 Lastly, if the higher WACC was not done, then the  
26 proposal is to change the fixed to variable ratio from  
27 40/60 to 90/10. Our view of that is that at least the  
28 current ratio provides some offset to risk for customers in  
29 years of low supply. A move to 90/10 would exacerbate the  
30 figures I had up a couple of slides ago to a level where it  
31 wouldn't work for us.  
32  
33 What happens if State Water does not meet its business  
34 hurdles? Do its bankers send the business into  
35 receivership? Do the shareholders dump the stock? Do the  
36 creditors sell up the assets at discounted prices? Our  
37 view would be that none of these things will happen. What  
38 would happen is that State Water Corporation wouldn't meet  
39 its government-imposed hurdles for that period of time -  
40 not forever, just for that period of time in which business  
41 is tough. Do they really need to make a profit every year?  
42 Is that real? Is that reasonable in this current  
43 environment?  
44  
45 These things are certainly real for irrigation  
46 businesses at the moment. If you read the newspapers, you  
47 will see that some of that is going on; irrigators are

.2/12/09 76

Transcript produced by Merrill Legal Solutions

1 going out of business.  
2  
3 Other key issues I'd like to touch on: level of  
4 customer service. From an irrigator's perspective,  
5 State Water's function is to store and deliver water.  
6 Water is one of our input costs. We have many others,  
7 like fertiliser, fuel and oil, equipment. So, our simple  
8 view is that water is another one of those inputs. A few  
9 of those inputs are time-critical in our business. Let me  
10 explain that a little.  
11  
12 When we have got a crop in the ground, water is  
13 time-critical. When we have got a crop in the ground,  
14 insect management is time-critical. We can't put up, in a  
15 business sense, with delays or non-performance. So, there  
16 are certain businesses which we expect a very high level of  
17 performance. State Water is one of them.  
18  
19 Furthermore, during the drought there are businesses  
20 we've dealt with that have taken a little bit of a  
21 different view of the tough times. We do have supply  
22 businesses that have said to us, "Things are pretty tough,  
23 but we both want to survive in this environment so we won't  
24 put our prices up but, in return, our service might be a  
25 little bit off until we get through this rough period". As  
26 farmers, our view is, "Well, fair enough". If they're a  
27 few days late with the fuel, we can probably get over it,  
28 but at least they didn't put their prices up.  
29  
30 All I'm trying to point out is that when you have been  
31 paying around a 20 per cent price increase for the last  
32 four years, and the input supplier says to you, "Guys, over  
33 the next four years we are going to do about the same",  
34 then, as a farmer, as a customer, my level of expectations  
35 of performance from that business are much, much higher  
36 than one who said to me, "We're in a tough time, let's hold  
37 them where they are until we tough this out and then relook  
38 at it".  
39  
40 Upper-bound cost structures and capital expenditure.  
41 Investment in working infrastructure is key to irrigators  
42 in this part of the basin. Our view is that if we are  
43 paying charges that reflect upper-bound pricing, then we  
44 expect appropriate investment in infrastructure which  
45 maintains those assets and keeps them at a level, which  
46 means they perform well for us.  
47

.2/12/09 77

Transcript produced by Merrill Legal Solutions

1 There's been quite a bit of detail this morning about  
2 capital costs, about dam upgrades, about safety upgrades.  
3 Our simple view is that we are paying a charge for capital  
4 improvements, and we expect that to be spent in fair  
5 proportion to the infrastructure needs of our businesses,  
6 if we are paying that charge.  
7  
8 Looking through the State Water Corporation's  
9 submission, we found a small amount, in our view, of that  
10 capital is being directed to those sorts of things.  
11 Admittedly, a lot of the other capital is being paid for by  
12 the state government, but the point is, if we are paying a  
13 level of fees or fixed charges to reflect upper-bound  
14 pricing, then we expect investment in infrastructure.  
15  
16 Other users. There are many other users of water out  
17 of State Water Corporation dams and irrigators, and, in  
18 part, the government rightly pays for the benefits of water  
19 infrastructure that accrues to the environment and to some  
20 other users, but I think we have reached a point in time  
21 where those other users need to be responsible in terms of  
22 paying for their water use.  
23  
24 These other users include the environment, other  
25 downstream states, recreational users, communities, stock  
26 and domestic, and others.  
27  
28 What really brought this home to me was in October, on  
29 ABC Radio, the president of the Keepit Sailing Club came on  
30 and had a few words to say about how things were at Keepit  
31 and that sailing was good, but that he had a clear  
32 expectation - he left listeners in no doubt - that Keepit  
33 dam shouldn't be permitted to drop below 17 per cent,  
34 I figured because that was the level at which good sailing  
35 might be interfered with. That's fine. I have no  
36 objection to that whatsoever. The Keepit's lake is a great  
37 recreational facility, but our point is that other users  
38 need to start bearing their relative costs.  
39  
40 How much in fixed charges is the sailing club paying,  
41 for example? And I don't want to pick on them; there are  
42 many other users.  
43  
44 That's pretty much the end of my presentation, so I am  
45 happy to take some questions.  
46  
47 THE ACTING CHAIRMAN: Thank you. We will now proceed to

.2/12/09 78

Transcript produced by Merrill Legal Solutions

1 questions from Richard and Colin.  
2  
3 MR WARNER: State Water, as you know, as has been referred  
4 to today, hasn't met its revenue forecast over the last  
5 four years because water sales were affected by drought,  
6 and in many ways I suggest that your company faces similar  
7 risks due to drought. How do you handle those drought  
8 risks?  
9  
10 MR GEORGE: First and foremost we take a long-term view.  
11  
12 MR WARNER: How long a term is your long-term view?  
13  
14 MR GEORGE: If you are in agriculture, I think if you  
15 don't have a view of 20 years or more, then you are  
16 probably in another game.  
17  
18 MR REID: Obviously, you have indicated that you rely upon  
19 general security?  
20  
21 MR GEORGE: Yes.  
22  
23 MR REID: Presumably, given the lack of water, the  
24 effective price that you pay may have been much greater  
25 than high security users. Do you have any thoughts on the  
26 proposed differential between high and low security  
27 prices - high and general security, I should say.  
28  
29 MR GEORGE: I don't have a strong view on that and nor  
30 does the company. I guess our view would be that they need  
31 to pay their fair share of the costs. In other words, if  
32 it costs 10 per cent to deliver their services, then they  
33 should pay 10 per cent of the costs; other than that, no.  
34  
35 MR REID: Presumably, you don't have the option at this  
36 point in time to change your entitlement to high security?  
37  
38 MR GEORGE: Not on any significant scale, no.  
39  
40 MR REID: What opportunities are there for you to purchase  
41 water out on the open market?  
42  
43 MR GEORGE: Temporary transfer water? Temporary  
44 transfer water opportunities are very dependent on the valley  
45 that you are in. So is the pricing. For example, at the  
46 moment, the Macquarie Valley has had quite some water  
47 available at what northerners might consider a fairly cheap

.2/12/09 79

Transcript produced by Merrill Legal Solutions



1 price. Water in the Gwydir and Namoi is particularly  
2 difficult to find. So the answer to your question is we do  
3 what we can where we can. We also obviously maximise the  
4 use of our other water sources and we try to maximise the  
5 use of our dry land operations.

6  
7 MR REID: And the quantity that those temporary transfers  
8 would make up of the total water that you acquire?

9  
10 MR GEORGE: In terms of temporary transfer, I would say in  
11 general we would be fortunate if we found 10 per cent of  
12 our requirements, in these sorts of years, from the market.  
13 There may be exceptions to that, but that would be my  
14 general observation.

15  
16 MR REID: Presumably, you would make those decisions on  
17 an economic basis?

18  
19 MR GEORGE: We do, but as the season progresses your  
20 parameters for an economic decision change. If you get a  
21 little bit of rain along the way, that changes things; if  
22 you have a crop that is three-quarters done, that changes  
23 things, and you only need a small amount of water to finish  
24 it off. So it is an ongoing assessment of both value,  
25 I guess, and what you are prepared to pay, if it is  
26 available.

27  
28 MR REID: As opposed to temporary transfers - permanent  
29 transfers?

30  
31 MR GEORGE: In terms of our company's view of permanent  
32 transfers at the moment, that market seems to be dominated  
33 and particularly focused on the buy-back at the moment. We  
34 are still trying to figure out what that means for our  
35 economics in terms of farming. We aren't generally buying  
36 any permanent transfer at the moment.

37  
38 MR REID: You mentioned State Water's service levels in  
39 terms of ongoing maintenance of assets. On a day-to-day  
40 basis, are you satisfied generally with their level of  
41 service?

42  
43 MR GEORGE: I'd say generally, yes. I referred to a  
44 recent occasion when we weren't, and what I was trying to  
45 explain is why we have a very low tolerance of  
46 non-performance for these sorts of inputs. But I would  
47 have to say that State Water has addressed the issue that

1 we had earlier on in the year and I have full confidence  
2 that it won't come again. I don't know yet. We haven't  
3 got to the next irrigation period.

4  
5 MR REID: Sure. You talk in terms of the other users of  
6 the water, and you mentioned, obviously, the sailing club,  
7 et cetera. Of what significance do you see them, in the  
8 context of the total demand for water? IPART has adopted  
9 these cost sharing ratios to try to assign some broader  
10 community cost; do you see a ready opportunity for these  
11 people to be identified and charged.

12  
13 MR GEORGE: I think my view would be that they ought to  
14 be identified and their water use recognised. It would seem  
15 impractical to charge, for example, the sailing club some  
16 fee for their water use, but I think it needs to be borne  
17 in mind that there are users other than irrigators, and if  
18 the government isn't prepared, or it is impractical to,  
19 charge them some fee for their water use, then they should  
20 foot the bill.

21  
22 In that regard, we would be opposed to any sort of  
23 lessening of government charges. They need to pay their  
24 way and they need to pay the way of other water users who  
25 aren't charged.

26  
27 THE ACTING CHAIRMAN: Thank you. There are a couple  
28 of questions from me, if I may. First, I think the  
29 requirement of IPART is to set prices that achieve full  
30 recovery of State Water's costs over a four-year  
31 determination period, which may be different from the  
32 period that you work with in agriculture. In that context,  
33 what is the most accurate forecasting basis that we can  
34 choose? Should we take the very-long-term forecast in the  
35 IQQM or some shorter-term period?

36  
37 MR GEORGE: My view is that you take a long-term view and  
38 that the business should adjust itself, tough it out, if  
39 you like, for that period that we are going through right  
40 now.

41  
42 I have trouble reconciling a four-year pricing period  
43 based on what is happening right now in the context that  
44 the customers of the business have an horizon which is  
45 much, much longer than that. It appears to me to be  
46 incompatible. Whether the legislation is right or whether  
47 that is how it should be is a whole other question.

1  
2 THE ACTING CHAIRMAN: You can see the sort of  
3 disconnect that we are having to work with, I guess.  
4  
5 MR GEORGE: I do, but I think, on the other hand, you  
6 probably have to be brave enough to recognise it and  
7 hopefully provide some allowance or remedy to it.  
8  
9 THE ACTING CHAIRMAN: The other issue I want to raise is  
10 the issue of how important is cost structure. You showed a  
11 graph or table, I think, that showed water prices as a  
12 component of your cost structure, but I think in going  
13 through that you mentioned that it excluded labour costs  
14 and some other costs as well, if I remember correctly. If  
15 you were to include labour costs in the total, what  
16 proportion of your total costs would your labour costs be?  
17  
18 MR GEORGE: Let me go back to that one, if I can. There  
19 is no doubt at the moment, with low levels of water supply  
20 and therefore low levels of production, that our labour and  
21 our repairs and maintenance costs are the largest costs we  
22 have, but we consider them, at the moment, not to be a  
23 variable cost. We have made a decision that we want to  
24 retain our skilled labour. So in terms of dollars, they  
25 are much higher than the number 1 ranked there.  
26  
27 THE ACTING CHAIRMAN: Thank you very much.  
28  
29 The next presentation is from the Tamworth Regional  
30 Council, if their representative could come forward, then  
31 we will proceed.  
32  
33 TAMWORTH REGIONAL COUNCIL  
34  
35 MR TRELOAR: Thank you very much, Mr Chairman. I am  
36 James Treloar. I am Mayor of the Tamworth Regional Council  
37 area. I come to represent the council's submission, of  
38 which I hope you have received a written copy. I haven't  
39 got a presentation to present but I would like to speak to  
40 that written submission.  
41  
42 Firstly, can I give you a brief background as to the  
43 history of the Tamworth Regional Council licence,  
44 particularly that out of the Chaffey Dam. Many years back  
45 the city realised that the water supply out of Dungowan Dam  
46 was not going to be sufficient to allow a city of  
47 Tamworth's size to grow and develop, and they put forward a

1 proposal to place a dam on the Peel River. That proposal  
2 was taken on board with the state government, who came on  
3 board to increase the size of the proposed water storage so  
4 there would also be some irrigation licence out of that  
5 dam.  
6  
7 Council contributed approximately 25 per cent of the  
8 then cost of that dam so that we would secure a significant  
9 licence in the longer term to allow the city to develop  
10 and, as such, we now have a contractual licence with State  
11 Water to the tune of 16,400 megalitres of water per annum.  
12  
13 Currently we use approximately 5,400 per annum. We  
14 support that with the licence out of the Dungowan Dam as  
15 well.  
16  
17 However, in using such a small portion, we have given  
18 an undertaking to State Water that we will not trade in  
19 bulk water - in other words, we will not use the excess of  
20 our licence to offset the significant charges we pay in  
21 terms of entitlement by a temporary transfer of any of that  
22 water at all.  
23  
24 However, State Water has chosen to increase our fees  
25 from \$180,000 as an entitlement charge to a proposal in the  
26 next year of \$389,000. The submission makes it quite  
27 clear: it is something like a 140 per cent increase in the  
28 costs in one single year of our entitlement charge alone.  
29  
30 It is put there purely because it is perceived that  
31 the community of Tamworth can afford to pay that  
32 excessively high cost for an entitlement fee alone.  
33  
34 I would like to draw your attention to the fact that  
35 our five major water users in Tamworth are all business  
36 users for that water. We have Country Fresh, who trade as  
37 a lamb abattoir; we have Cargill, who trade as a beef  
38 abattoir; we have Baiada, who are a chicken processor; and  
39 Penfords who are a starch manufacturer. Our fifth-largest  
40 user of water is actually our Tamworth Base Hospital.  
41  
42 We actually have to compete in the marketplace to attract  
43 business to regional centres in New South Wales, and I cannot  
44 in my mind justify why Tamworth has to compete  
45 to attract business opportunities to our region when we pay  
46 seven times the price for bulk water that Dubbo would and  
47 17 times the price for bulk water that Albury will.

1  
2 Talk about something called the Murray Darling Basin -  
3 and we are in that basin - but for some reason we have to  
4 wear a horrendously high cost in comparison.  
5  
6 The state uses a mythical equation that says we try to  
7 achieve cost recovery on a dam by dam basis. I say it is a  
8 mythical equation, because if you even look at the Namoi  
9 Valley, as a good example in our area, the people who are  
10 downstream of the Split Rock Dam pay exactly the same price  
11 for their water as the people downstream of Keepit Dam.  
12 The people low of Keepit Dam have the capacity for two dam  
13 storages, and they pay for the right to upkeep two dams.  
14 The people in that area between Split Rock and Keepit pay  
15 exactly the same price, but they can only possibly get the  
16 use of the water out of one dam.  
17  
18 State Water uses this mythical equation that we  
19 actually charge for water on a cost recovery basis on the  
20 dams that are involved.  
21  
22 To further give you an example, last year at this  
23 exact time Tamworth was declared a natural disaster. We  
24 had horrendous flooding in the city. That water was not  
25 captured in any way, shape or form once it left Chaffey  
26 Dam; water flows in to the Namoi Valley just below  
27 Keepit Dam.  
28  
29 If there was an irrigator in Tamworth who chose to  
30 pump water during that particular time, under the formula  
31 that is proposed by State Water, that irrigator, next year,  
32 will pay \$62.36 per megalitre of water. That very same  
33 water will reach the Namoi Valley at the Carroll area, and  
34 those same people downstream will then pay \$17.32 a  
35 megalitre. I don't know how, in anybody's mind, they can  
36 say in fairness that that is a process that the state  
37 should be following.  
38  
39 The water causes flooding in one area; there is no  
40 farmer who has the capacity to capture and pump into  
41 off-stream storage. Even if they did, it is going to cost  
42 them \$62 a megalitre. Then somebody downstream can get  
43 access to that exact same water and be charged a third of  
44 the price. There has to be something that says that there  
45 is an equity imbalance in terms of that water being cheaper  
46 as it goes further downstream.  
47

.2/12/09 84

Transcript produced by Merrill Legal Solutions

1 On top of that, the people in the Peel Valley, who  
2 rely on that water, have a storage dam that has a  
3 62 gigalitre capacity. That is a minuscule capacity and  
4 they very rarely get the opportunity to get their  
5 entitlement out of that storage. I am certain that there  
6 would be a far greater reliability in a far larger storage  
7 capacity further downstream, but they get their water  
8 cheaper.  
9  
10 The other thing that I don't believe has been taken  
11 in, in fairness, is the fact that many of these dams were  
12 built for the purpose of flood mitigation as well. The  
13 state government has a requirement, once an area exceeds  
14 \$250,000 worth of damage in terms of a single flooding  
15 event, that they then get declared a natural disaster area  
16 and the state significantly funds the repairs to that local  
17 government area once that has happened.  
18  
19 Now, if a dam has been constructed to avoid the state  
20 having to pay a significant flood damage bill through  
21 natural disaster, there should be a significant  
22 consideration given to the cost of maintaining that dam to  
23 offset the cost of having to honour any natural disaster  
24 funding.  
25  
26 So I would like to just say that, in summary, it is  
27 not fair: there is an enormous inequity in the way water  
28 is charged across the state. You don't see people in the  
29 city paying more money for electricity because they live  
30 further from the service provider their power comes from,  
31 yet there is a significant transmission system that has to  
32 be maintained to get their electricity to that source.  
33  
34 Nor should there be a difference, when we are talking  
35 about an area called the Murray Darling Basin, that there  
36 should be such a differential in the pricing of water in  
37 that one basin area. The Peel Valley probably provides  
38 more, in terms of environmental flows to the Murray Darling  
39 Basin, than any other river area, any other valley area,  
40 because there is no off-stream storage in that valley;  
41 nobody can pump when there is an additional flow in the  
42 river. Most of them are irrigators that require water at  
43 that time; once their lucerne flat has been completely  
44 saturated, they don't further pump.  
45  
46 The other equity issue, I would have to say, is that  
47 driving out here I drive through Gunnedah and I see lucerne

.2/12/09 85

Transcript produced by Merrill Legal Solutions

1 farmers in the Gunnedah area able to be charged water at a  
2 third of the price a lucerne farmer is charged for water in  
3 the Peel Valley. I don't know how somebody can say, in all  
4 honesty, when they would be competing in exactly the same  
5 marketplace to sell that product, there is an equity or  
6 fairness issue that hasn't been addressed in that area.  
7 So, sir, I thank you for the opportunity to present our  
8 submission. You have the fully written submission there  
9 from the council. I am very happy to take any questions,  
10 if there are any.

11  
12 THE ACTING CHAIRMAN: Thank you. We will now  
13 proceed to questions.

14  
15 MR WARNER: I note that Tamworth Council has opposed  
16 State Water using 15-year moving average to forecast sales  
17 and favours a longer-term approach. Given the considerable  
18 issues with the long-run average approach greatly  
19 overestimating sales in previous periods, how would  
20 Tamworth Council suggest that State Water address its  
21 under-recovery of revenue for future periods?

22  
23 MR TRELOAR: The submission talks about the State Water  
24 supply suggesting that there's a 14,875 megalitre sales  
25 opportunity each year, I suppose would be a nice way of  
26 putting it. In actual fact, they are now re-forecasting  
27 that down to 11,422, I think.

28  
29 Yes, we are opposed to them shortening that period of  
30 forecasting. We believe the longer the forecasting period  
31 the more accurate it will be, and on the basis that it is  
32 not a given science, there is nothing pure about it, it is  
33 an estimating science, and the longer we can use an average  
34 period the more accurate that estimation will be, at least.

35  
36 MR WARNER: Tamworth Council is also proposing to  
37 increase the ratio of entitlement to usage charges for general  
38 security users in order to reduce the number of inactive or  
39 sleeper licences. Can you tell us further about the  
40 rationale for that submission?

41  
42 MR TRELOAR: Yes. About 50 per cent of the licences in  
43 that valley currently are not used for the purpose of  
44 irrigation. In terms of trying to get a water management  
45 plan together for that valley, they have to take into  
46 consideration the entire number of licences that are out  
47 there for potential usage in any one year. We believe that

1 if you leave an extremely low entitlement - and I think the  
2 highest the entitlement gets is just over \$2 for inactive  
3 licences - people will do exactly that; they will sleep on  
4 them, waiting for something to happen in the distant  
5 future.

6  
7 If we actually increase the entitlement charges to a  
8 higher level and lower the cost recovery required through  
9 the usage of that water, it will encourage people to do  
10 something with their licence, either transfer, sell it or  
11 whatever, so that it can then be assessed in a better  
12 frame.

13  
14 MR WARNER: We have heard today, though, from a number  
15 of irrigators, that they favour the 60:40 split that State  
16 Water currently has. It seems like your proposition would  
17 go contrary to that.

18  
19 MR TRELOAR: I would suggest that an entitlement charge  
20 for general security water of \$2.03 and a usage charge of  
21 \$62 is nowhere near a 60:40 ratio.

22  
23 MR WARNER: Is there a level of cost recovery that  
24 Tamworth Council believes the Peel Valley can and should  
25 attain, and how should that be determined?

26  
27 MR TRELOAR: I think if you are going to look at full cost  
28 recovery there should be greater access to the costs that  
29 are being borne by State Water in terms of trying to  
30 achieve that cost recovery. Their figures seem to be  
31 rubbery, at best, in terms of the costs that are levied  
32 that have to be recovered, in terms of infrastructure  
33 costs, particularly when you have an area where we believe  
34 we paid for our infrastructure costs to get cost recovery.  
35 So I question that enormously.

36  
37 But I also believe it is totally inequitable to think  
38 that cost recovery can be done on a valley-by-valley basis.  
39 When you talk about the Murray Darling Basin, surely it  
40 must be more equitable to have the charging done across the  
41 Murray Darling Basin, not out of a single valley area.

42  
43 MR REID: One of the issues that you have raised is the  
44 uniqueness of the Peel in a number of respects, but also  
45 one of the key ones is its relationship between high  
46 security and general security licences and the position of  
47 the council. I wonder if you would like to expand on that

1 a little bit further?  
2  
3 MR TRELOAR: The council's high security licence is  
4 purely there for the opportunity for the city to grow.  
5 Some 25 per cent of our total water usage is done through  
6 industrial usage now, and I would like to see that continue  
7 and grow, because that will actually offer the job  
8 opportunities for our community.  
9  
10 In the past 10 years we have actually seen the average  
11 household water usage of our tenements in Tamworth drop  
12 from 470 kilolitres per annum to about 352 kilolitres per  
13 annum. So actually through enormous campaigns in water  
14 saving, encouragement of the council actually providing  
15 cash-back offers for water tanks, for water-efficient  
16 washing machines, swimming pool covers - for various other  
17 areas - we have been able to reduce the amount of water  
18 usage by our community. So it is not as though the council  
19 is sitting there with an abnormally high licence saying,  
20 "Well, let's see how much money we can make out of this by  
21 selling as much water as we can." We have taken a very,  
22 very responsible attitude in trying to lessen the amount of  
23 water our community uses, and I think we have been very  
24 successful in that area. But what we are not prepared to  
25 do is be reliant on the state for future opportunities of  
26 developing the city, because they have an amazing habit of  
27 not being able to understand what regional development  
28 really is and not being very supportive of regional  
29 development.  
30  
31 So, we believe that the opportunity to hold a licence  
32 that will allow us to encourage business and opportunity to  
33 our region is vitally important and that is why we are not  
34 prepared to trade-off that abnormally high licence that  
35 currently sits there. But we have also given an  
36 undertaking that we won't go into trading that bulk  
37 licence. It gives them the opportunity to on-sell the  
38 water that we're not using, even though we have paid the  
39 entitlement charge for it, to other user groups, which they  
40 currently do do.  
41  
42 THE ACTING CHAIRMAN: Thank you very much for your  
43 presentation and for answering questions.  
44  
45 MR TRELOAR: Thank you.  
46  
47 THE ACTING CHAIRMAN: We now have the opportunity for

1 people sitting in the room to ask us questions or to make a  
2 statement. We will follow this up by a session in which  
3 State Water can respond.  
4  
5 If you have a question or wish to make a comment,  
6 please indicate. We will get a microphone to you.  
7  
8 STATEMENTS AND QUESTIONS FROM PUBLIC  
9  
10 MR GAYNOR: Harvey Gaynor, from Auscott Limited. Look,  
11 I hadn't intended to say anything today, knowing the  
12 presentations that were going to be made, but some of the  
13 stuff I have heard today just compels me to comment, and  
14 I hope that these comments are in support of and in  
15 addition to what some of the others have said during the  
16 day.  
17  
18 Something that particularly concerned me was the  
19 statement from the tribunal that there is some sympathy  
20 with State Water for the fact that it is difficult to  
21 maintain cash flow when you don't know when good years  
22 will return.  
23  
24 Well, hello, welcome to the world of agriculture and  
25 business in regional areas. It is exactly the same issue  
26 for the customers, as you have heard from a number of  
27 speakers today.  
28  
29 I think if all of our suppliers took that sort of  
30 approach to business, when the good times returned there  
31 would be no customers left.  
32  
33 State Water only has one group of customers: it is  
34 the irrigators, who have probably got an investment in this  
35 valley two or three times the size of that which State  
36 Water has in there. So we are trying to make a return on  
37 that. We are the only customer that State Water has.  
38 There is no-one else that is going to use, in the Gwydir  
39 Valley, 300,000 megalitres of water in a year, so we must  
40 remain viable if State Water is to remain viable and  
41 produce a return to their shareholder.  
42  
43 When I think through our suppliers, all the suppliers  
44 that we have, I can only come up with a handful that  
45 actually impose a fixed charge for their suppliers. Just  
46 about everything we buy, we pay a fully variable price for.  
47

1 Those suppliers that do charge a fixed charge on their  
2 services - Moree Plains Shire Council, a government  
3 monopoly, the Livestock Health and Pesticides, the pests  
4 authority, the old rural lands protection boards - again  
5 they have a statutory monopoly. Telstra, in effect, when  
6 you live where we do, is a monopoly; there is no other  
7 choice for your phone services. And the power distribution  
8 network. Again, everyone else has to survive in tough  
9 times and in good times with fully variable charges,  
10 otherwise we won't do business with them and we'll make a  
11 choice to go elsewhere.

12  
13 We want to see State Water stay in business. We  
14 certainly support the work that they do and the product  
15 they deliver, but, again, the issue here seems to be some  
16 unrealistic expectations from the shareholder in this  
17 business. I think if anyone in all of this has the  
18 capacity to absorb the volatility over 120 years rather  
19 than five years or 10 years or 15 years, it's the  
20 government that's backed by all of us, so, really, I think  
21 they should be prepared to take that risk.

22  
23 I know that may not be within IPART's brief, to change  
24 the government's policy on their expected returns, but  
25 I think your decisions, especially with respect to the  
26 averaging period that you accept in this determination, and  
27 the fixed and variable share of the charging, can at least  
28 have some influence on the way the government, as the  
29 shareholder, behaves and thinks in the future.

30  
31 I just wanted to add to a couple of points or a couple  
32 of questions that were raised about Bernie's presentation.  
33 You asked a bit about what sort of averages we would use in  
34 terms of five years, 10 years or 15 years. What we have  
35 done in our business is set up around the 120-year IPART  
36 modelling. We have made some significant changes over the  
37 past five to seven years, cutting our fixed costs heavily,  
38 all based around 120-year averages. When we don't meet the  
39 120-year average inflows that we based our business around,  
40 then we have to cut the cloth to suit, as Bernie described.  
41 So, you know, I'd suggest that if that's what the customers  
42 are doing, for the reasons I stated earlier, the state  
43 government should surely be able to take the same approach.

44  
45 In the same way, the question was asked, "Well, how do  
46 we tough it out?" We, as Auscott, are owned by a larger  
47 shareholder who has got a diverse business - not as diverse

1 as the New South Wales state government, but it is diverse  
2 enough that they accept the ups and the downs. They have  
3 been in the agricultural business for 80 years; they are  
4 prepared to accept poor returns from time to time, and from  
5 business unit to business unit, knowing that the good times  
6 will return and, you know, the income will be good in those  
7 times.

8  
9 I hope that you can take that into your deliberations.

10 Thank you.

11  
12 THE ACTING CHAIRMAN: Thank you very much for that.  
13 Are there other questions and comments? No. We will then  
14 invite State Water to respond.

15  
16 MR WARNE: Thank you for the opportunity. I would just  
17 like to say, at the outset, how constructive most of the  
18 comments were and how it demonstrates, I guess, the very  
19 important need for State Water to have a place in this  
20 community, in these businesses and, I guess, in the future,  
21 not only their organisation, but of the state government  
22 business.

23  
24 I'm reminded of a comment of a mate of mine, David,  
25 made down in The Riverina at the news that Twineham sold  
26 the huge majority of their water. He said, "The trouble  
27 with people like that is they think like businessmen".  
28 I guess, to a large extent, he, as a farmer, has got more  
29 than just his family's capital invested in the business;  
30 he's really got the family's future invested in the  
31 business. That is something that State Water are more  
32 cognisant of than most.

33  
34 Being quite specific about some of the comments that  
35 were made and some of our initial responses, we have heard  
36 a pretty solid defence of IQQM. In case you heard  
37 incorrectly, or didn't understand our submission, we come  
38 to bury IQQM, not to praise it. IQQM, in our view, has  
39 failed. In our principal valleys, our big valleys in the  
40 western fall of New South Wales, in the four years of the  
41 determination, it has not even got to the bottom confidence  
42 band of the lower level of IQQM. We've slipped off the  
43 scale. We've got to find something that makes more sense  
44 as we go forward, and State Water's strong submission is  
45 that we need a better model.

46  
47 I think you might have detected some reticence when we

1 put forward the 15-year model. We think it's a much better  
2 model. We are not actually convinced it's the perfect  
3 model. Politically, we realise if we had have used the  
4 model that showed a clear step about six years ago, the  
5 price changes would have been catastrophic and that  
6 wouldn't have been very fair either.  
7  
8 Some comments were made about carry-over in revenue,  
9 and, it's true, with large storages in the northern valleys  
10 and rather sophisticated accounting models, it is very  
11 unlikely we'll lose the under-use as a result of a farmer  
12 carrying water from one season to the other. That's  
13 actually not true in the Murrumbidgee in the Murray Valley,  
14 and even more recently in the Macquarie where,  
15 interestingly, significant amounts of high security water  
16 were lost by farmers, even this year, as the allocation  
17 went to 100 per cent.  
18  
19 We've heard some criticism of the thematic expenditure  
20 that we're proposing. All I would ask is that the tribunal  
21 look very carefully at that. I think the point you have  
22 raised is that it's an appalling term to use. I would be  
23 more likely to say this is the compulsory regulatory  
24 framework we are living in and these are some of the things  
25 we have to do.  
26  
27 So, before you throw out all the thematic expenditure  
28 as being unnecessary, or think that you would be easily  
29 able to cover it by other efficiencies in the business,  
30 just have a look at it line by line and I think you'll see  
31 the chunky items of it are not very discretionary at all.  
32  
33 I think there was some legitimate criticism of our  
34 performance with regard to our environmental plan, and we  
35 know we've got to do better.  
36  
37 I think there was some comment about the 6 per cent  
38 saving and could we do better. I think the comment was  
39 made twice in submissions that we need to cut our cloth to  
40 match the times. Well, I would say to you that maybe a  
41 stitch in time saves nine, and, as an organisation, we have  
42 got to have a commitment to timely and commercial approach  
43 to infrastructure, maintenance and repair, because we  
44 certainly don't want the disaster that is something like  
45 the New South Wales rural rail network where now, even if  
46 you wanted it, in most places you haven't got a viable  
47 alternative to road transport because the investment simply

.2/12/09 92

Transcript produced by Merrill Legal Solutions

1 has not occurred.  
2  
3 You spoke about your organisations and the troubles  
4 you are going through and the difficulties you are having  
5 and how your business capital model is also struggling.  
6 The truth is that State Water's assets are almost  
7 exclusively depreciating. We don't have a large item  
8 sitting in the corner that is our water entitlement that,  
9 in the case of the Murray, have enjoyed 38 per cent  
10 compound growth in the 13 years since 1996 up until today.  
11 For the cynics that say that's just because of the  
12 commonwealth buy-back, someone else says, "No, it was  
13 when Timbercorp came into the market", and somebody else  
14 says, "Oh, no it was when people actually freed up the water  
15 from the land and we got this entitlement value separated" -  
16 there are a whole myriad of reasons - if you look at the  
17 graph, it is steady and consistent growth four or five  
18 times the growth in other assets. That's part of your  
19 businesses that you enjoy, and I know it's enabling a lot  
20 of you to survive during this very difficult time. It's  
21 something that State Water simply doesn't have access to.  
22  
23 A comment was made about the environmental water  
24 costs. We're getting increasing reassurance that the  
25 environment will pay their share of water charges. We have  
26 certainly got it specifically from the commonwealth  
27 environmental water holder, and Lisa Corban, the boss of  
28 GWWA, is under no illusions that they are going to pay  
29 their water charge. There is a group in the Murray Darling  
30 basin authority that feel there is something wrong with it  
31 and that it is immoral to charge the environment for water,  
32 that it is an impactor-pay issue, so I think it is not  
33 quite dead, but it very nearly is.  
34  
35 I guess in terms of Namoi Water and John's comments,  
36 I don't think we should apologise for being a state-owned  
37 corporation. I don't think we should apologise for being  
38 an organisation set up under a corporate structure that is  
39 trying to achieve commercial outcomes, albeit in a shadow  
40 environment; that is, where IPART determine how should a  
41 commercial business behave in that environment. The  
42 independent rating agency says, "What is the  
43 creditworthiness of this organisation if it stood alone".  
44 I think some of those things are the shadow that have been  
45 set up to try and hone the performance of a rather large  
46 monopoly.  
47

.2/12/09 93

Transcript produced by Merrill Legal Solutions

1 There was quite a discussion about legacy costs from  
2 John and what they mean. I guess you might argue that  
3 State Water is not a perfect model. We heard from Tamworth  
4 why they absolutely feel it's not a perfect model in terms  
5 of the water supply for that urban, but I guess it's an  
6 improving model and certainly better than a lot of others  
7 we've looked at.  
8  
9 The concept of the Murray prices the MDBC costs,  
10 I didn't quite get. Somehow you've got to work out a way  
11 the Murray guys pay for their water, and trying to follow  
12 the financing of the MDBA and back to State Water is a  
13 myriad, and I really applaud IPART for the methodology they  
14 use in finding those prices.  
15  
16 I guess in the Peel, the simple argument is that it's  
17 not the fault of the farmers that they live there, but we  
18 are stuck in this regime where people are looking for  
19 actual real costs for applying a service. Somewhere  
20 between lies the answer. In the past, the government has  
21 seen fit to assist those people really as an adjustment  
22 process, I guess.  
23  
24 Earlier there was the comment made about how we are  
25 going to grow these low value crops when we are competing  
26 against people who use less water, and the simple answer  
27 might be to move. I think the comments made by the mayor  
28 of Tamworth, while very valid, mirror the comments we are  
29 getting from towns like Broken Hill, or from Cobar, or  
30 others who live a long way away from a cheap or reliable  
31 water source, and that is what is the community's response  
32 to a town that has got a natural disadvantage in terms of  
33 the cost of or the availability of a particular natural  
34 resource.  
35  
36 I think Bernie George's comments from Auscott were  
37 ones that may be copied across the state. I think farm  
38 profitability is important. State Water is twigging to the  
39 fact that, if we are not careful, around Toonambar, where  
40 we have got a storage that's usually full and we've only  
41 got three dairy farmers left, we've got very real issues  
42 with regard to a collapse in demand as an organisation. We  
43 would not like to see that across the state and we  
44 recognise that successful farm businesses are very much a  
45 part of our future too. That's part of the reason we are  
46 opting for the 60 percent usage/40 per cent fixed, because  
47 we recognise we need to try and move along bit more in

.2/12/09 94

Transcript produced by Merrill Legal Solutions

1 synch with your businesses.  
2  
3 I think as to the comments made earlier about the  
4 consumption model, as I said, the IQQM, we think it's  
5 broken. The people who wrote the water sharing plans can  
6 no longer depend on it, and in a number of valleys for four  
7 years of the last five, the plans have been operating as a  
8 suspended water sharing plan, recognising that we are  
9 actually off the dial in terms of the IQQM model, and a  
10 very important part of our submission is the need for a  
11 rethink of what the right consumption model is.  
12  
13 We have spoken about the drought and people have said  
14 it will pass. Well, by golly, I hope you're right. Our  
15 future and yours certainly depends on it improving quite  
16 dramatically. 6.5 per cent is an attractive interest rate.  
17 To give you a bit of an idea - and I don't think I'm giving  
18 away commercial secrets - one of my senior staff leased  
19 some computer equipment contrary to treasury policy, and it  
20 was costing her 9.35 per cent in lease payments. After  
21 I whipped her a few times, she said, "Have you looked at  
22 what your finance is costing you?" When we borrowed  
23 money from the treasury corp and we applied the new  
24 government guarantee fee, we were paying about exactly the  
25 same for finance in State Water. So, that gives you an idea of  
26 the cost of finance for an organisation like ours with our  
27 BBB credit rating as applied through the treasury corp  
28 model.  
29  
30 What do they do if they go broke? State Water won't  
31 go broke, but they might start to do some crazy things.  
32 For example, there is an argument going on at the Hume Dam  
33 now with the dam safety programme, and they have suggested  
34 that Hume Dam, for example, contrary to repairing the joint  
35 in the wall between the urban embankment and the spillway,  
36 maybe we just run the dam two metres lower with 421,000  
37 megalitres less capacity and that would have the same  
38 effect in terms of the dam safety requirement. I just  
39 think it is appalling solutions like that one, and the  
40 under-investment line, that that would actually lead to  
41 really bad decisions about the long-term future of key  
42 infrastructure in our state.  
43  
44 On the example of cutting our cloth, I know when I was  
45 at Murray Irrigation we chose to go to a three-day a week  
46 service rather than a seven-day a week service, and we gave  
47 our staff half the year off. It was a very difficult

.2/12/09 95

Transcript produced by Merrill Legal Solutions



1 measure. The tragedy, of course, is, and most of you  
2 people would realise this, it is in years like this when  
3 you get occasional events, when you've got so little water,  
4 that every bit of care and attention has to be taken to the  
5 distribution of water, sharing of water, the monitoring of  
6 use and in fact perversely a lot of your actual operational  
7 costs are inclined to go up.  
8  
9 State Water in response, by the way, is currently  
10 running 10 or 15 vacancies in our river operations area.  
11 They are areas that we would fill within our budget, be it  
12 a normal season, but we are just trying to hold off and  
13 make people do the extra bit while we've got such low  
14 allocations.  
15  
16 In terms of the concept of other users should pay  
17 their way, I couldn't agree more, except that I think it's  
18 an extremely challenging area for governments. Inland  
19 angling is extremely popular, but none of the licence fees  
20 go towards the running of regulated rivers, even though  
21 that is the very reason a lot of the fish species are  
22 there. Our water schemes are a phenomenally popular sport  
23 in the south of the State. The Murray river is the  
24 second-most popular destination after the coast in Victoria  
25 for the summer holidays. Trying to tap into some of that  
26 resource at relatively modest levels is extremely  
27 difficult. It's a bit like the local councils who lament  
28 places like Bondi that have parking charges of \$5 an hour  
29 down by the beach. It's just an enormous source of revenue  
30 from outsiders that they do not appreciate.  
31  
32 At the extreme end, I have seen Canadian models where  
33 the Canadian railways actually funded irrigation areas  
34 because they knew it would create very heavy freight. They  
35 were hoping they would get melons and things being carted  
36 hundreds of miles to help cross-subsidise the irrigation.  
37  
38 As I said about Tamworth, I do feel for your  
39 predicament, given your high dependancy on the Peel and  
40 your extremely high cost of water from that dam. It would  
41 appear, superficially, there's a flaw in the model and  
42 there's just got to be some way of addressing that model,  
43 but I point out that other towns like Broken Hill or Cobar,  
44 and others, have also got water supply problems and costs  
45 of water supply emerging.  
46  
47 It was interesting to hear the comments about the

.2/12/09 96

Transcript produced by Merrill Legal Solutions

1 fixed charges and what the right solution is. Yes, your  
2 council rates, the Telstra charges, and your electricity  
3 supply company have very high fixed components of their  
4 charges. Can I say, they charge a lot more in rural  
5 instances than they do in the urban environments where  
6 they've got a lot more customers per square kilometre.  
7 Certainly the electricity supply companies do.  
8  
9 I just think this issue of fixed charges is a very  
10 difficult one, and we've tried to find that balance with  
11 the 40 fixed/60 usage and we hope that's appreciated by the  
12 people who are our customers.  
13  
14 Lisa, did you want to add at all to that?  
15  
16 MS WELSH: I have only a few points to add in addition to  
17 the points that George has already made. First of all,  
18 just to clarify, I think the concern that came, in  
19 particular from Michael, about the environmental water  
20 charging and the apparent uncertainty that continues, that  
21 specific situation is only with regards to the creation of  
22 new adaptive environmental water licences under the  
23 Water Management Act. These licenses are gradually being  
24 created as a result of water savings projects. And, yes,  
25 the government is still deciding its policy position on  
26 that, although I believe they are close.  
27  
28 However, water that is purchased by the commonwealth  
29 and then converted, if you like, to environmental water by  
30 the placement of a caveat, or what have you, that is fully  
31 chargeable and we are not aware of any problem at all with  
32 that continuing to be the case.  
33  
34 I would just like to address this issue of  
35 State Water's financial performance over the last four  
36 years, and this perception that, somehow, the fact that we  
37 have somehow broken even is a sign that nothing's wrong  
38 because that's just the way it should be during a drought.  
39 Partly I agree with that, except for one key difference,  
40 which is that, as a regulated monopoly, it is, as it should  
41 be, extraordinarily difficult to make super normal profits  
42 because we have a regulated rate of return so we are capped  
43 at that end, if you like.  
44  
45 At the same time, because by virtue of the fact of the  
46 regulation, we are usually considered to be a little bit  
47 immune from the downside as well. So, if you like, all

.2/12/09 97

Transcript produced by Merrill Legal Solutions

1 things balance out. I would argue that to make virtually  
2 no rate of return at all is an actually extraordinarily  
3 difficult task for a regulated monopoly, yet somehow we  
4 achieved it quite admirably. That says to me that there is  
5 something fundamentally wrong with how our financials are  
6 arranged.

7  
8 I believe the only final comment I wanted to make was  
9 that there was a view that somehow IQQM, because it  
10 constantly picks up a new year every year, eventually it  
11 will get climate change right. Well, given that the IQQM  
12 only picks up one year at a time, if we are really going to  
13 have to take another 100 years to finally pick up what is  
14 currently happening with the economy, or only half of it,  
15 then I guess we are all supporters of the Liberal Party.

16  
17 THE ACTING CHAIRMAN: Thank you very much for that.  
18 This brings us to the end of the public hearing process.  
19 I think it has been a very useful day for us. I think the  
20 meeting has been successful in identifying the major  
21 issues, particularly in this part of the state, and, having  
22 had some focused discussions on it, I think it's been  
23 extremely helpful to the tribunal. Thank you very much for  
24 that and for your assistance.

25  
26 The next stage is that we resume in Sydney tomorrow  
27 afternoon for the final public hearing. Then we will  
28 obviously need to consider everything that has been said  
29 and produce a draft report in March.

30  
31 Once again, I think you have been of great help to the  
32 tribunal. Thank you for the effort that you have made and  
33 to the constructive participation during the day.

34  
35 AT 2.30PM THE TRIBUNAL WAS ADJOURNED  
ACCORDINGLY

36  
37  
38  
39  
40  
41  
42  
43  
44  
45  
46  
47

.2/12/09 98

Transcript produced by Merrill Legal Solutions

---