INDEPENDENT PRICING AND REGULATORY TRIBUNAL

REVIEW OF RURAL WATER CHARGING SYSTEM
WORKSHOP - GRIFFITH

Tribunal Member

Mr James Cox, CEO, Workshop Chairman

Members of the Secretariat

Ms Amanda Chadwick, Ms Chen Chou and Ms Joyce Tapper

Held at Gemini Hotel, 201 Banna Avenue, Griffith

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OPENING REMARKS

THE CHAIRMAN: Good morning, perhaps we can start now. Just to introduce myself, for those whom I may not have met before, I am Jim Cox. I am chief executive officer and full-time member of IPART. I would like to welcome everyone who has come to this session today. I would particularly like to welcome those people who travelled to join us and made an effort to do so.

What we are looking for today is to have a fairly informal interactive session. As you know, we have been asked to undertake a review of rural water pricing in a very short time frame, and what we would like to do is just get some ideas and some early input for us to consider as we undertake the review, so that is probably the objective of today. It is really to get some ideas and to have some discussions so we can have a better understanding of the issues and the possibilities which are in your minds so that we can take them into account. We will try to make sure we can get as many people as possible to share their information with us.

I should point out that the session is being transcribed by Bairbre. To help her and us, it would assist if you were to introduce yourselves and please speak clearly into the microphone when you want to speak. I might ask you now to introduce yourselves around the table. Obviously, while you may know a lot of the people here, you may not know everyone. I invite you also to say a bit about your interests in rural water pricing and then we will resume with the first session.

MS AMANDA CHADWICK: My name is Amanda Chadwick. I am the director of water at IPART. My interest is in fulfilling the government's objectives and listening to your views today.

MS CHEN CHOU: My name is Chen Chou. I am a program manager at IPART and I am leading this review. It is good to see you.

MR JOHN MADDEN: I am John Madden from Arche Consulting. I have been asked by IPART to assist with the review. I am an agricultural economist - that is my background.

MS GILLIAN ECKERSLEY: Gillian Eckersley, from State

Water. I am interested in hearing the views of IPART and of our customers in preparation for the submission that we will be making to the ACCC next year.

MS LISA WELSH: Lisa Welsh from State Water. We have started some preliminary consultation with customers on pricing, which I think has been deferred in recognition of IPART's current review. We are quite keen to hear people's views today and how they might fit in with our own consultation.

MR JOSEPH CARUANA: I am Joseph Caruana. I work at State Water. I am the manager for our submission to the ACCC. As part of that, as Lisa said, I would be interested too in hearing customers' views and getting a better understanding of who our customers are and what you wish for.

MS VIRGINIA TROPEANO: I am Virginia Tropeano and I am representing Murrumbidgee Valley Food and Fibre Association.

MR BRIAN HALSE: Brian Halse, High Security Irrigators Murrumbidgee, the chief executive officer.

MS ELIZABETH STOTT: I am Elizabeth Stott, policy and public relations officer at Murrumbidgee Irrigation.

MS SALLY JONES: Sally Jones, irrigator, and here for Murrumbidgee Valley Food and Fibre as well. I am also an agricultural economist apart from being an irrigator.

MR JOHN HOWE: I am John Howe from Murrumbidgee Irrigation. That is probably sufficient.

MR JAMES ASHTON: My name is James Ashton and I am from Carrathool Shire Council.

MS ANTHEA McQUEEN: My name is Anthea McQueen from DSEWPAC in Canberra, which is the department portfolio looking after water. I am here because we look after the rules under the Water Act, which includes the infrastructure charges and I am interested to hear about how everyone is going with the transition and in hearing people's views.

MR RAVEEN JADURAM: I am Raveen Jaduram. I am the chief executive at Murrumbidgee Irrigation. I am here because bulk water is a major part of our cost and I am trying to see how we can keep it low.

MR DAVID STAR: David Star. I am a farmer at Wee Waa and plus a farmer down in a family farm down at Colleambally. I am here representing the Rice Growers Association.

MS KATE ARTHUR: Kate Arthur, Rice Growers Association, and also a farmer at Colleambally Irrigation.

MR HAYDEN CUDMORE: Hayden Cudmore, local irrigator and delegate to the Rice Growers Association, and an irrigator who is concerned about all our spiralling costs in agriculture. Our farm businesses are suffering from price increases right across the board.

MS RUTH WADE: Ruth Wade, secretary and director of the Rice Growers Association.

MS JENNY McLEOD: Jenny McLeod, manager of corporate affairs for Murrumbidgee Irrigation. I am obviously interested in the ACCC process, bulk water charges and cost control.

MR JOHN CULLETON: John Culleton, chief executive officer Colleambally Irrigation. I have similar interests to Raveen, but I suppose I have a larger interest and that is trying to comprehend where so many different reforms, both at the state and federal level occurring at the same point in time, are actually going to do to my business and its members.

MS ANN RZESZKOWSKI: Ann Rzeszkowski, Colleambally Irrigation company secretary.

MS JOYCE TAPPER: Joyce Tapper from IPART. I am just assisting on this review.

THE CHAIRMAN: Thank you for that. The next session is on the terms of reference of the review and Chen will lead off.

SESSION 1: TERMS OF REFERENCE FOR THE REVIEW

MS CHOU: To give you an idea of what to expect for the workshop this morning, I will give you a brief overview of the terms of reference of the review, some of the key dates and what we want to get out of the workshop today. Then I will pass you over to John Madden and Joyce Tapper to

give you a bit of instruction for each of the key topics that we want to discuss today to ask some questions and lead the discussion that way. As Jim said, we want to have a very interactive session with you, so by all means feel free to ask questions as matters come up and interrupt us any time.

I will start the presentation now. The idea for today is to introduce the terms of reference for the review so that everyone has an idea of what IPART is being asked to do and to outline the key milestones. We have up to 15 August to deliver a final report to the government and we need to fill in stakeholder consultation during that time. We therefore want to point out the key dates for you so you can be prepared for them. We also want to outline the key issues that we want to discuss with you today and, most importantly, we want to seek your input pretty early on into our analysis for the issues paper.

What is the review about? There are, I guess, two key areas that we have been asked to look at. The first one is price structure options that better match farm cash flows. In the terms of reference that we have, there are some examples of what that might be. Those options could also include billing or payment options. The second area relates to options to determine the New South Wales government's share of State Water costs. So once State Water moves under the ACCC's price determination, the ACCC is looking for guidance from the New South Wales government on what is the cost share component for New South Wales. We need to make recommendations to government taking into account the ACCC pricing rules, State Water's and the NSW Office of Water's financial viability and the state budget.

Any questions so far?

The key dates for us are: we are planning to release the issues paper on 26 June. Submissions for that are due on 10 July, so I think that is about two weeks. We will have the public hearing in Sydney on 3 July. We are planning to release an executive summary - if you like, a draft outline of our final decision - by 23 July, and then we are seeking submissions on that. Also that is a very short time frame, a week for submissions on that, and the final report, as I said, is due to be given to the government on 15 August.

SESSION TWO: FARM CASH FLOWS AND IMPACT OF WATER VARIABILITY

MS CHOU: The first topic we want to cover is relating to the first point on the terms of reference on matching farm cash flows and water availability. I will hand over to John Madden for that presentation.

MR MADDEN: Thank you. I guess we are not here to go through a whole lot of theory, but we do have to, in this review, think about the issues that we have to deal with in terms of farm cash flow, et cetera.

The number one thing up there on the screen is water availability. This review, in a sense, is a part reaction obviously to the drought which has just passed, particularly where there were zero allocations for a number of years in the Lachlan, and the government actually had as one of its policies, when it came to the election, to do this review. There was also then a policy that waived charges when there were two years of zero allocations.

One of the first issues up there on the screen is water availability. This is not meant to be a comprehensive list for treatment of farm cash flow, but those are some of the key issues that we have to deal with first up, one of which is: what is the link between water availability and then farm cash flows?

That sounds quite obvious, but when you actually start looking across the whole state in terms of how you look at water availability, whether people have off-farm storages, whether they have carry-over, it becomes a little bit more difficult than you first think, because it is quite easy to say, "Okay, low water, low cash flow." When we are trying to design a policy, what we are trying to look at is how you would actually, in some cases, trigger a policy to occur.

The example we just had of two years of zero allocations is basically one of those possible triggers that actually then was the policy to waive fixed charges for that year.

So really that is one of the key things today. We want to get some feedback about that issue, about how do

you actually link a potential farm cash flow problem to water availability. We realise that there are other issues that affect farm cash flows, but I guess generally, when you have given the time frame that we have, it will probably be a little bit different from a drought policy, for example, which actually has triggers or it had triggers. Obviously there is a new drought policy that has come out. The exceptional circumstances was an example where a climatic trigger enabled a policy to be potentially turned off, and the board in Orange made that determination. You could then have a number of policies that you could access, whether they be payments, cheap loans, et cetera, depending on their individual circumstances.

The first question I think for IPART when we are looking at this review is how do you actually make that link? There is one option at the moment that is on the table. People will have views. The Irrigators Council, a couple of years ago, put up a policy which was, I think, the lowest 5 per cent of historical diversions. So if it went below that trigger, that was their trigger that they put forward at the time.

Given that this varies by water source or area for some of the groundwater policies, even though that is probably not a particular issue here, we are really trying to investigate that link between cash flows and water availability. I guess the questions we have are: is there any work being done that we should be aware of in those last couple of years? I assume that was a hot topic in the last few years. Another question then is what other factors may come in. Like most of these reviews, one of the big questions is how significant is that fixed component of the water charge as a component of farm costs? So there is a different issue here in terms of the ongoing price of water in terms of the costs versus that period of low availability and just paying the fixed cost.

THE CHAIRMAN: We would be interested in hearing comments or reactions on what has been said or any general comments about the issue of water availability and how it affects farm costs and profitabilities - so over to you.

MR STAR: The zero allocation should be raised to at least 20 per cent because an average farm with 1640 megs would only have, say, 300 megs to grow the summer crop in these tight years. So my push would be, if the allocation does not get to 20 per cent, to allow us to waive our fixed charges.

MS McLEOD: Could I clarify something? When you are talking about waiving them, are you saying that they are not paid at all?

MR MADDEN: This was the policy at the time and these are some of the questions that we have to go through with the ACCC rules when we go through them potential policies that we can examine. A waiving there is different from a deferral.

MS McLEOD: Correct.

MR MADDEN: So that policy was a waiver - State Water might comment here - but then that cost was then covered by treasury, which I think is different from a deferral --

MS McLEOD: Correct.

MR MADDEN: -- where you actually defer it and put it on to a different period; so you actually end up all paying the costs into another period.

MS WADE: It is fundamentally different in terms of impact on farm cash flows and in terms of ability to recover, so it is absolutely crucial that we have worked out whether at this stage we are talking about waive or defer.

MR MADDEN: As this is the start of a process and there is not much data out there, I think we might go through the policy options because that will then help us. It is a very basic framework that we are starting with here to then actually talk about what some of these issues are.

MS McLEOD: I presume you are talking about both State Water and the NSW Office of Water charges when we are having this discussion?

MR MADDEN: Yes.

MS JONES: Could I make a comment before you proceed so perhaps you can then refer to it. One thing that has come up constantly in our conversations in Murrumbidgee Valley Food and Fibre is that there are several aspects to water,

and I think this speaks to something that John Culleton said about the implications of reform, and that is that it is not just quantity; it is also quality and timing of delivery.

Those factors are very significant to the cash flow that you can make from the water. There are issues like huge environmental waterholes and storage in the dams being released in a way that we don't know how that will be managed could affect the timing of access to water for us as well as quantity of water available.

So in a sort of post water-reform environment, it is not just a matter of water availability in terms of volume; it is also a quality issue and a timing issue. The quality of the water both in the river and in the Murrumbidgee Irrigation area varies dramatically. I would like you, if you can, to refer to those things as you talk about this issue.

MR CULLETON: The timing issue is really critical. I think, John, you would appreciate this. If a lot of water comes your way in a rush at the wrong time of the year, then the cash flow problem is already present and it will not change the cash flow circumstance, unless you can trade it basically. So this becomes a risk management issue which is essentially NOW's problem now.

I am not being critical of NOW at all when I make this comment. I am just saying that this timing issue is critical. The farmers are looking at trying to plan in advance what they are going to do. If water allocations do not present at an appropriate time, then plan A goes out the door and he or she is then looking at plan B, which might have a totally different cash flow outcome.

MS WADE: Can I reconfirm that from an industry perspective. If our industry does not have an allocation by probably the middle of September, but definitely 1 October, we would probably have no production.

You can look across the season and there could be an allocation of 40 per cent as there was a couple of times in the last few years, that came far too late from an industry perspective to produce anything. You then rely entirely on the water market in terms of what is happening.

The issue of timing is not about just looking and saying zero allocation or 40 per cent allocation. If 40 per cent allocation comes in February, it is absolutely unusable in much of both the Murrumbidgee and the New South Wales Murray Valley.

MS McLEOD: The other issue is that farmers, particularly in the Murray Valley, have significant access to manage their allocations between years by using the carry-off facility of 50 per cent, and our farmers are actually doing that. So you have the announced allocations confounded by carry-over which may be quite disproportionately held between farmers. Some might have none because they used it all the year before and others may have 50 per cent because they either used it or chose to enter the market at the end of the season to manage their own risk profile.

MS CHADWICK: So that I fully understand what you just said, when you used the expression "confounded by carry-over", can you explain that implication?

MS McLEOD: Say, for example, the announced allocation might be 20 per cent but the actual volume available to be used might be equivalent to 60 per cent - so the Murray Valley has 50 per cent carry-over and the Murrumbidgee only has 30 per cent carry-over - by using a trigger of the general security announcement, you are getting different - well, the actual water available might be quite different.

MR CULLETON: At the surface you might say why not simply let everyone have the same carry-over rule? But the carry-over is largely dependent on what storage capacity exists. If you have limited storage capacity to service a particular catchment, then that impacts on how the carry-over policy is set and where it is set.

The message here probably is that these things are determined on a catchment-by-catchment basis for logical reasons and therefore some of the determinations might have to take into account catchment-by-catchment circumstances. The principle that one solution will necessarily fit neatly across the board needs to be challenged because of the catchments.

MR MADDEN: I guess, as a background to this, some of the things like water sharing plan rules and even ACCC rules have to come in, and we can note that obviously they are

different in different places, but they were a given in a sense.

MR CULLETON: But the water sharing plans take into account catchment.

MR MADDEN: No, I understand that.

MR CULLETON: So to the extent that that is a reality, it needs to be a reality in the context of IPART's considerations.

MR MADDEN: One of the things that might be good for our understanding is just to think about recent history and get some comment now as a kind of a lead-in to these policies about water availability, and not just the water availability but the link then to cash flow and what happened in the different regions.

I assume Murray and Murrumbidgee had different experiences, as I assume with people within the schemes versus those on the river. We might not have everyone here to cover off a whole lot of different areas, but is there anyone who wants to comment on what were the key years where there were actually issues and just some of the history and background?

We have heard a lot of statements and anecdotes, and the Lachlan seemed to come through a fair bit in terms of background. I wonder whether anyone wants to reflect on the period when there was low water availability and how people responded.

MR CUDMORE: There was a time through the drought when water allocations were non-existent. In 2007 we actually ended up with a negative allocation because of an accounting anomaly or oversight. In that year, people had access to certain water in their water accounts, but our irrigation companies could not actually deliver that water. They did not have what they called a loss allowance to transmit that water to the farm gate.

In those certain circumstances, there could have been an opportunity to capitalise on good commodity prices because with the drought, commodity prices obviously increase and, in certain circumstances, people - other than the water market of course - were not able to capitalise on those opportunities in that drought.

THE CHAIRMAN: How did people respond to that?

MR CUDMORE: I guess they made a business decision based around what the returns are from the trade versus growing a commodity. There are also other things to consider other than the price. The rice industry had a continuity of supply issue where it needed a set volume of rice to supply its markets and that probably took precedence over the water market in those years. But it just depends, from an industry perspective, on maintaining a critical mass in the industry.

MS WADE: From a rice industry perspective, we closed mills. We wound back our operations. We provided incentives for those people who had access to groundwater to actually pump to plant crops on the basis that there was potential for a very small allocation of surface water.

I think we need to be very careful in this whole discussion that we don't just focus on the impact on the water users. The social and economic impacts across our region were devastating. Through the years we are talking about, the flow-on effects across the region were horrific and we are still recovering now. After two years of full water allocations, there is still a very big lag time to rebuild the infrastructure and employees in order to get everything back into production again.

MR CULLETON: From a company perspective, the minister has very far-reaching prerogatives when the water sharing plan is suspended. One of the prerogatives that was exercised then was to withhold some Colleambally Irrigation conveyance and socialise it across the valley to deal with the drought.

That was done with absolutely no warning to Colleambally Irrigation and with no recompense. I don't know of any business that actually could cope with that situation, but that was our reality. But it was dire straits and we had towns which had run out of supply, so I am not suggesting that some drastic action was not taken and ought not be taken, but my view is that there ought to be some sort of credit arrangement --

MR CUDMORE: A recognition.

MR CULLETON: -- so that, at a point in time when the circumstances were better, Colleambally should have been re-credited that water. It could have then taken the water back into the marketplace and either made it available to its farmers as extra water or traded that extra water to offset what was a loss.

I am not questioning the decision. I am questioning the fact that it came pretty much without warning and it was unilateral. There needs to be a better arrangement when that happens so that, as a company, we just don't have money disappear off our balance sheet.

MS CHADWICK: Could I break in the proceedings for a moment? David Harriss, I am sure, would have wished to have been here to respond to that. He sent his apologies this morning. He has been called to a meeting of Murray Basin officials in Melbourne; otherwise, he would have been here.

MS JONES: I would like to reiterate that the economic problem was massive uncertainty. People were really playing Russian roulette because we were in a new set of circumstances and a unprecedented set of circumstances. The information that may have mitigated the uncertainty was not available. As John has pointed out, there were a whole lot of decisions taken, like the reduction in the allocations, which I don't think had ever happened before. So it was just massive uncertainty.

In a sense the discourse that we have not had about water is how we can set in place a pricing structure that encourages the best use of the water for society. We are sort of into the detail in an incremental kind of a way. But we have this water resource. What is the pricing structure that will enable it to, for example, flow to farmers, to their farms, in the appropriate quality at the appropriate time, if the opportunity is there to make something out of that?

I think we are going into, if anything, a more uncertain future and not a less uncertain future because of the Commonwealth Government owning a lot of water and potentially climate change and so on.

MS McLEOD: When you asked the question as to what happened, were you wanting a response in terms of what did people do with their water and how did they manage their finance? Is that what you were looking for?

MR MADDEN: Actually I was just going to ask the three large schemes to provide or give a bit of an outline. What was done in terms of pricing then? If you had the delivery zones where you could deliver, was the fixed price obviously passed on from State Water? What did you do internally in terms of fixed price versus variable in those different zones? Did they do anything different with pricing in that year or was it actually just --

MR CUDMORE: There was some state government relief in the way of a grant, but it was not necessarily specifically for fixed charges. I think it could have been used for a number of things, but the people in that year chose to use it for their fixed charges in some cases.

MR MADDEN: But did the corporation have any pricing policy that was different and switched on during the drought in terms of their charges?

MR CULLETON: We were already on fixed charges and what we ended up doing was deferring - well, first of all, we didn't move our charges. Our charges remained. They were pegged, so effectively as a company we were absorbing inflation.

On top of that, there were a series of fees which were initially deferred and then subsequently waived. Therefore, we took a hit as a company in recognition of the fact that our farmers' capacity to pay was dramatically affected.

The whole question of water trading is often brought up as sort of instant solution. It is an instant solution if there are no restrictions on water trading. Of course there are restrictions because there are physical constraints and because if you don't have some sort of control over water trading, your dams and carry-over and so on can become a complete mess.

As much as the ACCC might want to see water trading completely deregulated, there are some physical issues which impact on that, and then there is the question of dam capacity which has to come into play, so there will always

be some restraints on the trade of water.

MR MADDEN: Did Colleambally have the same issue as MI in terms of that conveyance loss and only servicing some or part of their customers or everyone got it?

MR CULLETON: No, we had the loss because we had actually invested in modernisation which had produced some water savings for us.

MR MADDEN: No, I am just wondering whether it affected deliveries to any of our customers - unequally, I guess.

MR CULLETON: No, it did not affect deliveries unequally.

MR MADDEN: I don't like using that term; let's say, differentiating because of the system --

MR CULLETON: We didn't sort of say "Supply is guaranteed to this zone but not that zone", no.

MS RZESZKOWSKI: I think this might have happened before you came, John. We only provided water initially for stock and domestic for people to fill up dams and that. I think it was December before we actually delivered any water for irrigation in that sense. So that is past the season of --

MS WADE: Can I make sure, for the record, that we are understanding the three schemes we are talking about. The hit is magnified because the same people that are impacted at an industry level own the company. I think we really need to understand that are our farmers are the owners of these companies. So when the company takes a hit, it is pushed back to the same people that have been unable to produce.

MR MADDEN: Yes, it is just socialising and the costs of --

MS WADE: Exactly. I think it is really important that that is one of the fundamental differences, John, when we are talking about the three big companies. They are owned by the people who are going to be using the water in the end.

MR MADDEN: Jenny, do you want to talk about --

MS McLEOD: Would you like me to run down what we did and what happened?

MR MADDEN: Yes, thank you.

MS McLEOD: 2006/2007 was the year the water was suspended. Whilst we had a zero allocation, we had a lot of carry-over. We were also in the midst of an irrigation delivery program when the water was suspended, so that year is quite different from the subsequent years when we had virtually no irrigation.

So in 2006-2007, we delivered a reasonable amount of water. We had the suspension happen. After discussion with our landholders, and it was probably the most difficult decision we had to make, we instituted delivery zones. We endeavoured to supply our dairy industry. We have a very small permanent plantings and we supplied those, and we supplied some rice crops. There were some people at the periphery of our scheme that actually turned off their rice crops.

As a consequence of introducing the delivery zones - and we based that on some assumptions about the water available - we then started to get water being traded from outside of the delivery zone into the delivery zone, which put us up at delivering more water than we anticipated which meant we had a problem. We then had to introduce restrictions on trade or otherwise our decision making would have collapsed and we would not have been able to supply the people who had water. So we introduced a restriction on trade --

MR MADDEN: Was that a ration for individual or a total?

MS McLEOD: I think if it was going from outside in, it was 50 per cent. So if you had 2 megs outside, the person buying it only got one. That had a huge impact on the market but the market continued to operate.

The other thing we did, to the consternation of DSEWPAC, was that we actually stopped external trade. We stopped external trade because, at that time, the water market was really valuable and some people still had some water. We had to do that or otherwise our system would have collapsed. We would not have been able to supply the people who had dairies and crops. People had crops halfway

through their production system. People had bought water on the annual market to supply those crops to produce, so it was just a disaster and we put in place these management tools to manage it.

We did not provide fee relief. We have a fixed and a variable fee. Our fee recovery is made up of fixed and variable charges. We did not provide any fee relief, but we introduced restrictions on trade and restrictions on delivery.

In the next two years, we virtually delivered no irrigation water, but that was known about from the start of the season because the irrigation water that was available was so low. As the suspended water was returned our farmers responded by trading it out, and it largely went into South Australia, where the South Australia government was buying water. They traded it out at quite high prices and that helped them with their cash flow situation.

The other two things that are important is that both the New South Wales government and the Commonwealth had funding programs, grants, available. The Commonwealth grant could be used to offset the fixed fees. That was enormously beneficial to the farmers' cash flows.

MR CUDMORE: It is DHAS.

MS McLEOD: DHAS, yes.

MS WADE: $20,000 I think.

MS McLEOD: The New South Wales government also had a grant. At the same time, we had the EC provisions.

In terms of our farmers and our payments, we have had reasonable recovery of our fees, but if we had not had that sort of external support, I am absolutely sure it would have been different because our farm businesses would nearly all have needed those cash flows.

MR MADDEN: Were those two grants rolled in under the EC banner --

MS McLEOD: No, they were administered separately.

MR MADDEN: -- or were they tied to anything else like the South Australian ones or any kind of structural change or not?

MS McLEOD: The New South Wales one was effectively recompensed for the suspended water and it was limited to what a farm business could get. I am really testing my memory. The DHAS one was an irrigation deficiency provision. It had some certain criteria that needed to be met.

MS WADE: Their criteria were different from the criteria for EC, which meant that farm businesses that were not eligible for EC assistance could often still access those two grants, and that was of fundamental importance as well.

MS McLEOD: Subsequently, and I think it was in 2008-2009, we provided effectively fixed - we billed quarterly and we provided for both the company and the government charges fixed fee relief from the company's resources to one quarter.

MR MADDEN: So you covered the state as well as your own?

MS McLEOD: Yes.

MR CULLETON: That effectively is a fee offset.

MS McLEOD: Yes, it is. I think that would have been about 4 or 5 million offsets that covered our fees as well. But under the new water charge rules, if we were to do that, we would be classified as providing a dividend, which would bring in the ACCC as determining our charges. So going forward, we will not be doing anything like that.

MR HOWE: We had the same experience. Any deferrals or waivers that we tried to consider triggered the essential dividend rule as well as reductions in XP calculations. It was quite a difficult regulatory framework to guide your way through in order to deliver the fundamental objective, which was price and charge relief to our customers.

MR MADDEN: John, given that you were there through the period, in terms of your actual charges then, you did not do anything with the zones, did you? I am just wondering how you dealt with the zones within Murrumbidgee in the policy sense just like Jenny described.

MR HOWE: Probably the most fundamental change related to the inability to supply, that is insufficient loss water allowance to have even or, as I think John termed it, equal supply. What we did was put it to customers that if they were willing to meet the losses involved as well as the delivery - so you basically imposed the water cost as well as a delivery cost - and if they were willing to meet the cost of the loss water allowance, we would negotiate a delivery on a case-by-case basis within deliverable zones. That is how bad the drought was in terms of delivery.

Our customers, I think, as in any such situation, would report quite a varied experience with that system. Some would say the system was responsive and helped them get through the worst of the drought. Others would complain that the system was a major deviation from past practice and it did not really help them much at all.

Going back to on-farm, I think that is the trick. When you are talking about the irrigation businesses, we sort of tried to deliver the best we could for our owners, as Ruth pointed out, but we are not always perfect in that.

MR JADURAM: I am sorry; I don't think that is true. Because of the ACCC rules, we do not differentiate between shareholders and customers as much. So when you say, "owners", you are meaning our customers.

MR HOWE: Yes, I'm sorry.

MR JADURAM: You have to be careful in what you are saying.

MR HOWE: As Ruth pointed out, in this context what we are talking about is how the whole system dealt with the drought. To some extent, irrespective of what we do, the farmers do meet the cost of a drought. In many instances, the regulatory framework pushes us towards inflexibility and an inability to actually meet the needs of customers.

MR JADURAM: If I may add to that my observation coming in is, in a simple way, that an irrigation company is a transport entity. We transport the water. Our costs are mostly fixed. I would say that in MI, over the last six or seven years, there has been a tendency to move towards a higher fixed cost. So our tariffs are collecting the bulk of our charges through fixed costs.

From an economic signal point of view, one would say that if the resource is scarce, which is water, you would want to have volumetric charges to say, "If you use more, you pay more." However, as a transport company it is almost like it is an excess charge. If I have a train that comes to Griffith every day, or whatever, and there are so many containers on it, whether you put anything in the containers or not, you still have to pay for the containers. That is basically what we have now ended up doing.

I believe the issue really is that if we are not supplying the service from the customer service point of view, customers are not seeing the ability for them to use our infrastructure, because there is no water, and yet they still have to pay us.

We are not a dividend-paying organisation. It is not as if we forgo dividends in those tough years and say "Well, we will make up for the fact that you didn't get it." The reality is that if we do not charge our customers then and if we do not get external funding, we just have to recoup that. It is just a deferral.

In my view, that is the sum total of the equation. Unless there is funding from another source to make up for the times when the money is not coming from within the farms, because they are the ones who pay for all this, it is just a deferral.

MR CULLETON: I suppose the nature of the challenge becomes more acute as you modernise your system. The more Dethridge wheels you pull out, which are low cost, low maintenance, and the more you replace them with technologies which are designed to produce greater water efficiencies, the greater your sunk costs are whether there is water running through those meters or not.

THE CHAIRMAN: I guess you have this fixed cost base and, on the other hand, you have a group of customers, owners, whatever, that are going through cash flow difficulty. How do you see those things being rectified?

MR CULLETON: It is complex. Our company's approach was to invest in the technologies to reduce our water losses and then use the water losses in a way that our customers,

who are also owners of the business, would benefit. That means you either realise a return on your water savings as a company that allows you to build reserves which means that further on down the tracks, you don't have to pass on a cost to customers that you otherwise would have to do, or you make that saving available to the customers so that they can realise a return on it. So that is one side of the equation and that was our aim. Our aim was to try and minimise our losses and have the savings commercialised.

As a cooperative, it does not matter really whether - this is from a business perspective and the customers might see it slightly differently - we commercialise that benefit, and therefore can hold our costs when otherwise we might not be able to, or whether we pass the entire saving across to our customers and allow them to realise the benefit so that we can in fact continue to increase our charges.

MR MADDEN: It seems to me that you are trying to maximise the usage charges basically, however you did it.

MS McLEOD: Colleambally isn't.

MR MADDEN: No, I am just saying, in this circumstance when you actually have a fixed versus usage structure, you want as much going through meters so you can actually maximise that amount, depending on your structure, whether that be through rice growers giving out remits that we want to grow rice and getting people to trade and basically putting the conveyance losses through a meter so they are paid for. With that kind of fixed usage structure, you are trying to maximise the usage income as much as possible in terms of --

MR CULLETON: I think it is slightly simpler. When you invest in technology, your overhead increases but you realise operational savings. You have to commercialise those operational savings somewhere within your organisation, be it at the company level or be it your customers. However, the net effect is the more you modernise, the more your costs base becomes fixed.

MR MADDEN: But even at the moment it is pretty fixed. You are just talking about higher fixed, because with the Dethridge wheels it is still --

MR CULLETON: Well, in our case it is fixed, but I am saying that is just --

MR MADDEN: It is still a fixed cost, so --

MS RZESZKOWSKI: It is totally fixed, so there is no --

THE CHAIRMAN: Sorry, I would like to bring Jenny McLeod into the discussion.

MR HOWE: Isn't there a bit of problem, though, when you compare the experience of water companies likes us with the regulator providers like State Water and NOW in the sense that if we invest our way to a better future, which is part of the strategy, of course, we do not have to charge a regulated weighted average cost of capital on the investments we make. In a sense, that is one area where we do have much more flexibility than does the more regulated price-determined part of the industry, if you like.

If there are lessons to be learned there, maybe it really just resorts back to structure and fixed and variable charges. In other words, once you have your total costs under the determined structure, really the only flexibility that you have is the structure of the charges.

MR MADDEN: What has to be paid.

MR HOWE: Yes.

MR MADDEN: So if you have a high usage charge and only half your customers get water that year, they are paying and basically they are paying more than everyone else. So it is in-built in that system.

MR HOWE: Exactly.

MR MADDEN: Those people with cash flow, because they are putting water through, and we presume they are producing, are paying. If you have almost 100 per cent fixed charges, you have to have another mechanism in a sense to spread that cost. You would have to make a determination that people that year who did not get water delivered would pay less of the fixed charge and someone else would pay more. It does not happen automatically.

MR JADURAM: I think the key point is, though, that if you

let the market determine the consumption charge, it would work out, but you can't. We have to specify what your consumption charges are and that is the charge for the year. We can't sort of say, "Oh, if only half our customers can get water and therefore our volumetric revenue will drop to half, let's increase the price to double and therefore from our revenue point of view we are the same" - you can't do that.

MR CULLETON: The other thing you need to bear in mind is that we focused --

MR MADDEN: You don't do that.

MR JADURAM: Well, you can't.

MS WADE: You can't now; you can't,

MR CULLETON: We focused on this question of differential pricing based on zones. Differential pricing based on water product is one thing, but we are always talking about the supply system. You have a drainage system as well and the people at the bottom end of your supply system are the people who are at the top of your drainage system.

If you focus on one group because of where they sit in terms of the supply system, the reverse applies on the drainage. Supply distance is measured from the point where your take the water from the river, our main off-takes. Your drain from the bottom of your system. So it is not as simple as simply saying that this group of people here will pay more for their supply.

MR MADDEN: All I am doing is making the point - and I think John Howe said this - that if you have a fixed cost that you have to cover, in the end, it is actually about how you share and who pays.

MR CULLETON: Absolutely.

MR MADDEN: And what are the mechanisms around that. Now, for a fixed cost, you --

THE CHAIRMAN: John, I would like to ask Jenny to speak now. She has been waiting for a while.

MS McLEOD: From our perspective, we have put a lot of effort into our tariff reforms and we have significantly changed our tariff structure. That is driven by two things: one is the impact of our fixed fees on farmers' ability to pay when we have no water.

Under our new fee structure, instead of your fixed fees just being based on the number of, in our case, delivery entitlements - on the river it would be water entitlements and in individual owns - we have introduced two other fixed fees: one is a landholding access fee, which is sort of like a connection point; and the other is an outlet fee.

We have properties where some might have five outlets and some might have one. We have introduced an outlet fee which we have endeavoured to set at a level that will send a pricing rule to that customer to ask whether they actually need all of them or whether they could perhaps reduce the number down. So when we do what John Culleton has done and we try to replace these Dethridge wheels with a more expensive outlet, we can try and reduce our capital investment.

The rationale for having a landholding fee was to recognise what was happening during the years of low water availability. A person who might have been using just 2 megs for their house and garden and was only on a very small block was paying maybe $200 a year total cost. The neighbour next door with 300 or 500 acres would be paying more like $8,000 or $10,000.

We have endeavoured to say there is a cost associated with being connected to our infrastructure irrespective of how much water you use. So we have altered our tariff structure for our fixed fees and we have also altered our usage fees to make the first few megalitres significantly more expensive recognising the cost of conveyance.

The same applies on the river. For the person who is only using 5 megs a year or 10 megs a year, you still have this huge loss factor to deliver that small volume. We have changed our tariff structure so that it does increase some people's fixed costs, but for larger scale commercial irrigators, it allows them opportunities to reduce their fixed costs and it is more equitable between large and small users in the system from their perspective.

MR HOWE: Can I expand on what I was also trying to get at in my earlier observation. It seems to me that if we are going to learn a lesson for the regulator-determined part of the market, we first have to acknowledge the differences between the regulatory and environmental constraints on businesses such as the three businesses that we have been talking about today compared with, say, State Water and NOW.

It seems to me with regard to opportunities that State Water and NOW are relatively unconstrained compared with businesses such as ours in terms of that fixed charge/variable charge structure. In other words, it will not put State Water into a financially unsound position by lifting the variable charges or it will not risk that as much as, say, Murrumbidgee Irrigation if we went down that path. As Raveen said, this is why we have been slowly pushed to more fixed charges compared with past history.

I think the way to go is really to ask the question: "What would you do if you could?", and I think you would get a different set of answers.

You will get things like deferred revenue. You will get things like capped prices, which was another thing that Murrumbidgee Irrigation has tried to the past and it has become ever more difficult to do. You will get, I think, a taking advantage - which we try to do to an extent - of the different needs of different customers. There would be greater flexibility in your aggregate pricing framework, such that, for some customers, a higher proportion of fixed charges is quite doable; whereas for other customers, it really erodes their business.

At the moment one of the problems that we have in terms of cross-valley decision making is that the determined pricing area actually stops that flexibility within valley. I think to get to a better position, we really have to focus on within valley and systems within customers within that valley.

I would say that the environment and the regulatory price drivers, for example, would be almost 100 per cent fixed - likely.

MS WELSH: If I could respond, John, to some of your statements in relation to NOW and State Water being able to be more flexible than some of our customers, I would disagree. In fact, that was my thought in listening to some of the people around the room; that is, that some of the more innovative suggestions that you have had on the ways you have had to deal with water availability, volatility and the impact on your business, are not actually available to us.

Our current determination is a four-year period. Within that determination, we have no flexibility to adjust our prices. With losses, rather than us choosing to defer or waive, in fact we have no ability to recover losses after that determination period is finished - once it has gone, it has gone. We saw that during the last drought certainly where $63 million of legitimate revenues disappeared from our business.

We wore that loss. We understood that our customers wore losses that were to that same extent or perhaps even greater. As to the suggestion that somehow, because we are government owned, we then have an ability to continually take on board those sorts of losses, I guess I would disagree with that and our shareholders would disagree - in the absence, I guess, of a decision by government to direct State Water to act in a non-commercial manner. That is certainly not within our charter and nor would it be in your member and business interests.

MR HOWE: I am sorry; I was not implying that you have flexibility on the pricing framework. It is very, very rigid. I was implying that with things like the trade rules coming in and impacting on irrigation companies to say, "Look, if you do that, then you will pay this price", that limits our flexibility. If you have exit fee considerations, it limits our flexibility.

What I was referring to is if we are looking towards introducing greater customer focus in the determination part of the supply network, then you probably do have a lot of scope for increasing the very flexibility that is currently not there. I acknowledge it is not there, but I think if we can think about it in terms of the things that we would do if we could, maybe we actually could help you out a lot more, and help IPART out a lot more, rather than looking at what we actually did. I think when we talk about what we actually did, we are constrained so much by the costs associated with delivery and regulatory costs,

not revenue necessarily.

MS WELSH: Can I ask, John, if I may, what the scope for flexibility is that you are talking about with our business? Certainly our discussions with the ACCC and our interpretation of the rules would imply that there is increasingly less flexibility to offer usage based prices unless there is an arrangement that we can reach with our customers which might be an explicit agreement in relation to, for example, a pricing of risk associated with usage based charges. I am not sure that I understand exactly what you are saying.

MR HOWE: If you had, say, a price cap based on available water, it certainly would not trigger the dividend payment question and therefore reclassification of the company into division 7 rather than division 6 under the ACCC. So you would have flexibility to do certain things that we do not have flexibility to do.

I guess what I am saying, with all of the suggestions that we have been talking about today that actually failed, is that is the area that might prove most beneficial in terms of improving the customer linkages with State Water and NOW. I am not talking about the past but the potential future.

MR CARUANA: It sounds like, and please correct me if I am wrong, you are talking about regulatory flexibility from State Water's perspective as opposed to commercial flexibility. So there is regulatory scope for State Water different from what we did in the past.

MR HOWE: Yes, there is regulatory scope for State Water to be commercially more flexible at less regulatory risk than, say, Murrumbidgee Irrigation than --

MS WELSH: I am not sure. I think we are drawing different conclusions from both the current IPART framework and also the future ACCC framework. I would say that, in one sense, the ACCC framework does potentially allow for greater flexibility in terms of usage prices. So with things like a revenue cap as opposed to a price cap which we currently operate under and an ability to change usage-based forecasts annually, it actually says to me it gives State Water potentially a greater ability to fully recover our revenue requirement in any one year.

But I actually think that what we are gathered here today for is, in fact, to achieve the opposite outcome.

MS McLEOD: Correct.

THE CHAIRMAN: I think you're getting there.

MS WELSH: Yes, that's right and, look, that is why we are here. We want to discuss what are the other alternatives to what, I guess, a narrow interpretation of the ACCC rules would imply for us.

MS CHADWICK: Before we turn to various price structures and what flexibility we have in mind, one aspect of the terms of reference on cash flows that we have really not touched on is things around dealing and arrangements that you might have had for individuals to defer payment and also how much debt you are still holding. Can you give us a dimension as to what were the kinds of things that members were asking for and what you did?

MR CULLETON: I think members were asking for their debts to be wiped. We have a company policy which says that we deal with every customer's financial circumstance and debt to the company on a case-by-case basis, but we have some parameters.

First of all, there will be interest accrued on the debt for as long as the debt exists. We try to get the customers to enter into an agreement whereby they make progressive payments. That is pretty normal, but with regard to a customer's capacity to make progressive payments, the point in time when they can make progressive payments is normally linked to a cropping outcome. At the time that they have to make that payment, then everybody else is in the payment queue as well. ACCC and our rules allow us to seek forms of security where there is debt.

So you have some flexibility, but at the end of the day, you can find yourself in a situation where the farmer is paying the debt to you, but this is what happens by the time it is paid, and this is case in point. Say a farmer owes us $90,000, and he has owed us $90,000 for a couple of years, that $90,000 is actually principal plus interest. He gets his latest rice crop in and he will be able to make a payment of $30,000 again, so he has brought it down by

$60,000. But his water charges will go out again for the next season very shortly and he will be back in the situation where he has not actually been able to draw his debt down at all.

I think most companies would have a policy relating to how much bad debt do you carry? Well, you carry some, and we classify it by times; that is, how long has this debt been owing - less than 60 days, more than 90 days? At the end of the day, you can withhold supply. That is in our rules. We can withhold supply. We can simply not deliver any more water to the farmer, but what, in essence we then do is put him out of business or force him to sale an asset. In the process of forcing him to sell the asset, he will probably realise less on his asset than what it would ordinarily be worth.

It is pretty simple in the commercial world, but when we are talking about customers being owners of the business, it is a much more complex circumstances.

MS McLEOD: I can comment about what we do and I would also like to hear Lisa's view.

We do a number of things. The first thing we do is if you have 12 months outstanding - say, for example, if someone has not paid the 2011/2012 water bill by the middle of August, which I think would be about the due date - you cannot have your outlet turned on. You will not get any water.

We offer a 10 per cent discount for our quarterly account, so we get quite high levels of payment of our quarterly account. Like John, we charge interest. For example, this year with our 2011/2012 account, if they don't pay it in full, interest starts to accrue.

Then for what we call our bad debtors, people who are effectively on stopped supply because they have 12 months or more outstanding, if they want to take water, we will enter into a payment arrangement with them, which is like a contractual arrangement where they pay a certain amount over a period of time. We have a number of those in place and have quite high compliance with that.

The other thing we do is we allow people to trade their available water on our water exchange so long as we get the funds from it. If they enter into an arrangement with it, they might get some of the funds and we get some. If they are just on stopped supply, we encourage them, "Well you can't use your water but you can sell it and we will get the money to offset your debt." So we are endeavouring to minimise our bad debtors and keep that under control, with reasonable success.

MR JADURAM: From MI's point of view, we bill almost 12 months after the customers have had the service, which does create its challenges, and we do similar things. We get into arrangements. At the end of the day, I guess those who pay are subsidising those who do not pay because we are a not for profit and we do not pay dividends.

Shutting down businesses does not actually get us the revenue and that is not what we are here for. In short, I think customers inability to pay has huge consequences for us.

The issue for me as a newcomer is the whole sequence of farming, and the way that this aspect works is it is beyond a 12-month horizon. It is supposed to be a resilient long-term venture and it is great that we are celebrating 100 years here.

I struggle with some of the economic principles that have been applied. In my view, tongue in cheek, I would say it seems like failed electricity economists are trying to write water policies. That is just my feeling. I think the earlier comments about water quality and timing and some of the principles that apply to water, which makes it very different from electricity, for example, have just not been discussed. This is being said as an observer, just observing.

When we are talking about Commonwealth buy-backs, it is just a one-dimensional approach to getting water from the environment at whatever cost. The reality is that this industry has multi dimensions to it, and it is far more complex to understand all those dimensions and how they interrelate.

For me, I think there is a pie. State Water would say this is my pie and this is how much it would cost me. All we can talk about is how I divide the pie as to what MI should pay and Coleambally should pay and Murray should

pay. We would probably do the same. We would say "MI, this is the pie", and I have to say: high security, low security, general security, fixed, variable.

The real issue is what do we do when the consumer is unable to pay for all those pies? That is the issue, I think.

THE CHAIRMAN: I am getting a sense that we should move on to the next session unless someone has something really important to add.

MS JONES: I am towards the end of the system and I would like to share my experience. Firstly, I understand they might put rebates onto people's accounts during the drought. I am not sure whether John would be able to tell you where they came from.

I think a consideration in the MIA - I don't think it is relevant to Colleambally; it could be in the Murray Valley - is that we have a horticultural industry here that relies on timed drainage. That water that comes out, due to management issues mainly, is contaminated, pretty seriously contaminated.

During the drought, unbeknownst to me, there was still a considerable amount of timed drainage water that was released into system. I am relying on the environmental reports of MI. That water became more contaminated probably because there was less volume going through, in some cases up to twice as contaminated. But it is also in the environmental reports that the opportunities for dilution were reduced, which is obviously because they were running the system more tightly. What are the implications for that downstream? I am still working through the science of that.

I was in a zone which was deemed not to be a continuous supply zone and also where, at the beginning of the season, we were not told whether we would be able to trade our water out or not. So we were sort of faced with a vast increase in uncertainty which sort of evolved over time.

May I refer to a very good study that a woman called Katrina Proust at the Fenner School at ANU has done. She wrote brilliant thesis on the resilience of the systems behind the MIA from the time of its establishment. She documents how, when you get a vast increase in complexity which happens from time to time when the policy scene changes, you get spectacular failure in farming. She has documented that beautifully. I think it is a very good observation that there are these crises where farmers cannot pay and you see tragedy basically.

Her point is that this is a very complex industry, the water industry and the irrigation industry, but if you don't have good, clear policies, that spells disaster. The policymakers have to think through the complexities and come up with a decent set of policies or else farmers bear the brunt of it.

I think what is happening within a system at the moment is quite complex, and not even when you get a reduction in supply that effects people's bottom lines in very different ways, or at least that is how it was during this last period.

THE CHAIRMAN: Thank you.

Do you want to add something?

MR CUDMORE: Yes, thank you. As an irrigator, I am supportive of how the three irrigation companies go about their debt recovery. I generally pay my bills, don't I, Raveen?

MR JADURAM: Yes, I know.

MR CUDMORE: We have heard from the three irrigation companies. As someone who does pay their bill, I would not like to think that I would be cross-subsidising someone else who doesn't. From that perspective, I am supportive of how the irrigation companies go about recovering bad debts.

We also need to recognise where those bad debts come from. The bad debts are almost entirely due to the drought and those conditions of the last 10 years are unprecedented. Normally in our part of the world, our general security licence has a long-term yield of 64 per cent. Through the drought we were down to 17 and even at minus 5 per cent.

With regard to pricing in the future, we should be looking to a situation where we don't go back to those drought years. We need to keep it in the back of our minds. If we do end up back there, really we should be looking at our long-term yields on our entitlements in our pricing set. In those bad years when conditions are extreme, we obviously should be looking for relief from the government.

Ultimately, the only way we can pay our bills and pay for our water is to be productive and we need a critical mass of volume of water through our meters and on our farms to be productive.

MS McLEOD: I wanted to make the comment that we must not lose sight of the fact that we are here because we have a monopoly industry that is being regulated and I get concerned with constant comments: "Well, it's a fixed cost business, so therefore we have to recover our fixed costs."

I think part of the challenge through the pricing determinations is to somehow provide some signal to these businesses to think a little bit more creatively about the extent to which their costs fixed and what other options might there be for them to have costs that increase when their sales are higher. Otherwise we will just be facing enormous increases in our bulk water charges which will exacerbate the problems that our farmers face.

MR CULLETON: I would say that bad debt in the past might have equalled bad farming, but there are fewer and fewer bad farmers. The last 20 years have sorted out bad farmers and what we are talking about nowadays are pretty good farmers and bad circumstances.

While we talked about, and I have talked about, fixed cost, the one thing that is at the end of this supply chain is the farmer for whom nothing is fixed other than a lot of his or her costs. Unless they are locking in on their crop every year in advance and knowing that they will be able to produce that amount of crop, there are no assurances for farmers in terms of revenues. So whilst the question of how we deal with debt is a significant issue, I think the current circumstance needs to be put in context.

We deal with the debt. State Water gets its money from us and if there is a debt, we wear it. I would not want IPART to fixate on that side for too long. State Water gets its debt from the irrigation corporations. If the farmers cannot pay us, we bear that risk, not State Water.

MR STAR: Just to elaborate on what Hayden Cudmore said on the experience we had in 2007. On 11/11/2007 at 11 o'clock, we had to shut our supply off because of a mix-up with our allocation. We had approximately 250 hectares of rice. If you know a rice crop, it was about that high (indicating) in November. This rice crop had been sprayed with all the up-front chemicals. After you get it out of the water, it does not require any more weed control and insecticides. We had a loss, a total loss. They just shut the doors and that was it.

I think this is a case where State Water could come in and help us out because it is beyond your control if someone comes and shuts your door down. We have had big losses. In that situation, State Water should at least have a yarn with us about trying to get the debt over. Anyway, what we did, there were our fixed charges for the following year. MI had a water trading account and we sold water to pay our fixed charges.

THE CHAIRMAN: Can we perhaps now move on to the next section, which is on price structures. I think we have heard a lot about the importance of what State Water does in terms of cash flow to farms, not just availability and also timeliness. We have heard a lot about the generally fixed cost nature of this business. I think what we are looking for are ways of trying to reconcile those two things better and perhaps in terms of price structures we might find an answer or two, so we will move on to price structures.

SESSION THREE: OPTIONS FOR PRICE STRUCTURES

MR MADDEN: This is just a quick overview. I guess all we want out of this little section is to make sure we have covered things off as a couple of ideas have come up as we have been talking.

As a very quick overview, and I think we have already mentioned this a couple of times, the majority of valleys across New South Wales are 40:60 at the moment under the current price determination. There are two that are, being

the Hunter and North Coast.

MS CHADWICK: And for the NSW Office of Water the ratio is different and it is only available with a metre.

MR MADDEN: Generally it is about 40:60 fixed to variable. That is a generic list there on the screen in terms of the key elements of the pricing structure we are talking about. So fixed versus the variable is the one that people go to.

There are two-part or multi-part tariffs. We should probably ask if they are relevant, but we do want to cover off what is a price structure in this review.

Just jumping to the peak or seasonal pricing, whether something such as low water availability going to a different price level could occur, what we are talking about here is a canvas. It is not even the options yet.

Obviously differential pricing we actually have in terms of locations because we do not subsidise across valleys water sources at the moment. There is also differential pricing with the high security, low security and supplementary and things like that. It is again another element of the pricing structure as it is that we can look at. Finally, and this is not quite pricing, payment terms, hardship, et cetera, is another element for us to look at.

The other issue there is the price setting approach. We have alluded to the discussion of annual price setting versus a price path. State Water might comment here. ACCC is looking at a process to have annual price setting. Obviously if you have better information, as opposed to what will be used and diverted next year, that can vary and be more volatile, I guess, within a policy of having no price shocks under the ACCC rules.

So it is a more variable - or a more volatile, I guess - system potentially than what is currently in place with the IPART process over the four-year period.

MR CARUANA: Could I jump in there and say that there is probably one thing that does not explicitly come out that we had a chat with our customers earlier in the year and did a bit of thinking on, and that was a tariff choice model.

MR MADDEN: Yes, we are coming to the policies. These are the actual building blocks in a sense. That is probably not the right word with IPART, but these are the elements that you can examine - so fixed versus variable, and so on - that you can actually change. That is what I mean by the canvas in a sense: what we do mean by price structure?

Just looking at the options, you have variations of the two-part tariff which we have at the moment. Really, there are structural changes to a tariff, which basically means leaving it at 40:60 or if it was going to move to 80:20. So looking across the board or across the valley that is the ratio of fixed versus variable. That is what I mean by structural changes to that tariff.

As Joseph mentioned, there is the choice of tariff structure, and John might have alluded to it before. You can actually choose a higher portion of fixed as an individual customer, fixed versus variable. There are obviously a range of options there, 100 to 0; 0 to 1000 flipping the other way.

These things are not to a point of knowing where they actually lie, but given that we have a 40:60 at the moment, an obvious thing to look at would be the flip-side of that being an 80:20. There are issues around that policy in terms of how long you actually lock in for the choice and if you are happy to wear that risk. It is really about that risk assignment between customers and State Water, about your certainty of knowing what you will be paying versus a more volatile price over time.

I have labelled the next slide "Conditional pricing policy." By that I mean they actually would be turned on by a condition. These are like the EC payments or even in a sense the Lachlan one we talked about. Really, a circumstance occurs and then that price comes in. It could actually be that you defer for everyone, as we heard today where you waive the third payment for a quarter; or it could be that people opt in that they are happy to defer that payment. There are a number of different variations around each of these policies.

Conditional pricing could again be a different fixed charge in periods of low availability - I think Hayden Cudmore mentioned that before - namely, having different levels of payment depending on how much water you get. Then payment in terms again could be conditional. A different set of payment terms could be put in place in a period of low water availability.

Again for the sake of completeness and probably here with the high security versus the general security issue, we don't want to get into that too much. But this is a wide-ranging review and one of the issues would be the fixed cost allocation between customers groups. You could actually say between valleys as well. I am sure some of the little valleys want actually to be tied to bigger valleys potentially depending on their cost structures. That is just a part of the review that we should look at.

Again that is just to note there that could actually be a different approach to how the current determination works with the conversion rate and premium for high versus the general because it will have an effect on cash flow issues for general security if you have different policies in that area.

MR HOWE: In speaking to that, I was also including the whole customer base such as the environmental customers so that you get the variable circumstances. So when I was talking to that, I was actually talking about the entire customer base not just general security and high security, which are from the consumptive pool, but rather that regulatory cost drivers and environmental customers be included in that particular option.

MR MADDEN: That will be interesting. State Water might have a comment. I assume the water they hold as general security, for example, will be a consumptive issue.

MS WADE: With held entitlements, it would be.

MR MADDEN: That's right. I am talking about the held entitlements, not the rules based. I am not sure how you would start charging on the rules based.

MS WELSH: The Commonwealth environmental water holders are not here to defend themselves, but they are a customer of ours like any others. We understand, however, they may have some different preferences in respect to charges and that issues such as water availability and volatility perhaps do not affect them as much as perhaps our traditional extractive users. That is what we are hoping to capture.

Actually, one of the things that we do like with the price choice model is if they do want a stable base of water charging, then they can opt into that and that actually would balance out the rest of our revenue base. However, I don't think that it is necessarily appropriate for that to be imposed upon them in order to, if you like, allow some of our more traditional customers to have more flexibility. I think we have to be very careful as to how we treat them because they are legitimate customers. If we were to do the reverse, I am sure you guys would not be happy about it either, so I just think we need to tread carefully on that one.

MR CULLETON: What you are saying, Lisa, is you don't want to offend your biggest customer. We understand.

MS WELSH: No, no. Look, the rest of --

MR CULLETON: We are not happy about that, but we understand.

MR MADDEN: It is not just that, but the ACCC would have something to say.

MS WELSH: Discriminatory pricing is something we all have to avoid these days.

MR STAR: Charge them double.

MR HOWE: I think they should be included. I am assuming that you would not make non-consultative decisions between general security and high security. I am just simply asking, if this is sort of a tabling of issues, that the environment as a customer be included in that option.

I am not suggesting that we kick the environment in the head or anything of that nature. I am just simply saying they have become a very important customer. There is general security, high security. In my way of thinking if you look at the environment, general security and high security, there is more potential there, maybe, for getting greater gains from customer flexibility.

MR MADDEN: I think Lisa's point is right. It is an

opt-in thing and government actually might like fixed costs because they can budget for it because they don't like variable budgets, but it is driven by their needs not a differentiation of options. In a sense they are not a different customer group in the way defined here because they are part of the general security customer group.

MS WADE: Or high security.

MS WELLS: Or high security, that's right.

MR MADDEN: Or high security, yes.

MR CULLETON: Could I canvass amongst the irrigator representatives here how bearable would it be from our perspective to have a water charge, a state government water charge, which was basically varying year by year versus the kind of price determination period that we have now? In terms of budgeting, what does that do to you?

MS TROPEANO: I think it would make it quite difficult.

MR JADURAM: It depends on whether the bulk supplier, State Water, has a plan where they have their best estimate of what the charges would be for the next five years, say, because we are doing our NSBs. And if it was totally dependent on being told sort of months before the start of the financial year, "This is what the charge will be", then that would be totally unacceptable.

I would expect that an organisation such as State Water, with its asset management plans and funding plans and everything else that it does for budgeting, would have a cost path, that this is the cost of operating the business and therefore this is the implication on the revenue.

MS WELSH: Raveen, I think that that is completely possible if you are talking about a high fixed charge and a low variable charge because the major driver of volatility in water charges from year to year will only be usage charge. In my mind, a water usage charge that varies annually with water availability looks a lot like a fixed charge to me because it is all about State Water fully recovering its revenue requirement every year.

I don't want people to be confused by what we are talking about here. If the price is changing every year, you are talking about a fixed charge even though it might have a usage component and a fixed component. Based on everything we are saying here, I guess that is not something that our customers would like to consider, or even State Water would necessarily like to consider, without a broader discussion of what are the other options, but those other options then will involve some degree of uncertainty.

MR JADURAM: True, and again --

THE CHAIRMAN: But it seems to me the underlying premise in the timing of this inquiry is that somehow the recovery of costs by State Water ought to be more variable depending on the times when farmers have the income.

MS WELLS: Yes.

THE CHAIRMAN: That is the underlying proposition we are here to examine. I would be interested to have some discussion on that idea.

MS McLEOD: We support that methodology.

MS WELSH: I can't speak without - we have not made any decisions in terms of what we would like to see going to forward, although we have discussed the options internally and also externally with our customers. We are supportive of an alternative to fixed charges.

Even in the medium term, so beyond an initial price path - we are an asset driven business; we are here for the long term - logically there should be some scope for some variability in our revenues which could be matched to water availability and therefore farm cash flows.

But if you are a fixed cost business and you have a variable charge, that means that you are risky and there needs to be some compensation for the risk. If there is explicit compensation for the risk such that we can be able to prove to the credit agencies and our shareholders that we are a viable business over the long term, even though if you look at us within a five-year drought we look pretty shaky, that is certainly something that we would consider. But in the absence of that explicit compensation, a business that is fixed cost with no ability to recover any

of the under-recovery from previous years is just not a viable proposition

MR HOWE: As I understand it, though, the ACCC has limited the extent to which you can get that compensation; is that correct?

MR CARUANA: I suppose it might be worthwhile giving a bit of context as to our understanding of the regulatory framework. The ACCC are following two sets of rules. One is the water charge infrastructure rules that DSEWPAC - basically the minister - released and under those we have the ACCC guidelines. The rules sort of dictate how and when we must interact with the ACCC and basically the broad framework. Underneath that, you have the ACCC pricing principles which set out the financial parameters that they are working with.

In this particular case, we are actually talking about the weighted average cost of capital from our particular perspective.

In the last determination when we went to IPART, we said, "We know we are in a drought and we understand the customers and the capacity to pay issue." We went with two strategies. We said that we could either have a higher weighted cost of capital - basically our revenue requirement, that conversation Lisa was talking about with that variable price structure - or, if we don't get that particular approach, a higher fixed charge but an overall lower revenue requirement.

Basically those were the two options we went with last time. IPART determined that it preferred the 40:60 for various reasons, and historically that has been the case. What State Water's view is going forward --

MS WELSH: I would say that there were compensations in place through both the weighted average cost of capital and the revenue volatility allowance that are associated with that volatility, so that is the current state.

MR CARUANA: I suppose what we are thinking about going forward is that the framework is no longer the status quo any more. With the new regulator in place our interpretation of their guidelines suggests that they think we are not as risky as we say we are. We have always argued that our biggest risk is volatility. The ACCC suggestion is: "No, you can actually diversify away for that risk and you should not be compensated for that risk particularly in a weighted average cost to capital or even potentially in a revenue volatility allowance. The best way to overcome that risk is potentially higher fixed charges."

That was their initial argument. We have always said, "Look, that's great in theory, high fixed charges and so on and so forth, but as customers rightly point out it is about risk sharing."

When we originally set up and we talked to customers, we were saying, "Given the framework we are in, what we understand the ACCC is moving towards is lower revenue requirements based on a less risky business. How can we work together to come up with an objective and outcome?" That is what we focused on.

I think after that, the minister made a decision to do a price review and asked IPART to come in with a particular outcome. If you look at the wording in her press release, it talks about "better"; it suggests that the current framework under IPART did not quite do what she wanted it to do. It is like we need to move into a particular regime in order to --

MS WELSH: We don't believe that, though, by the way. Obviously we thought it was good.

MR MADDEN: This is a baseline issue, but it could be better than what the ACCC are going to give you.

MS WELSH: Correct.

MR MADDEN: So it could be an offset because if you move --

THE CHAIRMAN: I would be interested to hear you views on how it might be done in the future because I think that's interesting to hear.

MR CARUANA: We have been talking about particular options we can work with. One of the lines we talked about with customers was, "Okay, we know that there is this risk that must be managed by someone, whether it be State Water or

whether it be customers."

What we understood was, and we didn't really get to numbers, that there are different risks parameters out there and there are different appetites. As mentioned before, perhaps the Commonwealth environmental water holders as one group may have a high-risk appetite to maintain their cost base, ie, their bulk water charges. In that instance, obviously there will be less risk for State Water; therefore there will be less need for compensation because they would prefer that particular risk approach.

Another option would be a lower fixed cost, ie, more variability, more risk, but that comes at a cost. There is a risk that someone needs to bear. If that risk is to be borne by State Water, then there is a need to sort of compensate for that particular risk. What the ACCC has said is that it is open to risk compensation, but just not in that weighted average cost of capital and not on the rate of return we make on our assets. For example --

THE CHAIRMAN: So what it says is that a volatility allowance would be okay?

MR CARUANA: That's correct, yes. So a volatility allowance --

THE CHAIRMAN: But just not in that way?

MR CARUANA: That's correct. They have said to us that with anything that is not in that weighted cost of capital, that volatility allowance, they are open to that suggestion. Obviously they have rules that they need to follow.

The pricing principles and the water charge infrastructure rules outline what they are going to follow. I don't want to speak on their behalf. I don't know what they are going to think, but our interpretation of those rules is basically what they are saying to us is, "You are not as risky as you said in the past. You can diversify away from that risk. How you diversify away from that is your business. It is between you and your customers, State Water. You figure it out." It is just not the weighted cost of capital is our understanding. So that is kind of the context that we understand the framework to be.

MR MADDEN: So for customers that choice is a higher cost for one over the other?

MR CARUANA: Yes.

MR MADDEN: It is not just the choice and "Yes, I'll go with higher fixed, that's great for me"; that will cost you over the term to give that risk over to State Water.

MR JADURAM: It all comes down to what the risk is. As John Howe said earlier, the risk of debt, State Water doesn't have that. You are only talking about the risk of the consumptive revenue. That is basically what it is.

MR MADDEN: But there is still a cost of debt tor State Water.

MR CARUANA: I suppose in this particular valley, we have the large irrigation corporation as an intermediary, but as a statewide corporation we have direct customers to deal with and we have over 500 customers.

MR JADURAM: I am a firm believer that tariff structures should give the right signals for behaviour changes that will reduce your cost - simply.

MR CARUANA: Yes.

MR JADURAM: Because otherwise it is just government thinking. I know you are government, but I think the only reason we are sitting here is because we want some lateral thinking. So if your cost drivers are from those customers, I would say to you "Put that burden on those customers. Don't put that burden on my customers because I am a good payer", and that is a conversation we had earlier here with Hayden Cudmore.

Perhaps we can come up with tariff structures where your cost drivers and your concerns can be put to the right customers. I would like to think that I am a loyal customer. I would like to think that I am happy to pay a higher fixed charge if I know what that fixed charge payment gives me; in other words, in terms of the liability or capacity or loyalty or something. I am struggling with --

MR MADDEN: But you are just talking about your decision

of which one to take, if there is a choice there, unless you want some kind --

MR JADURAM: No - some good customer discount?

MR CULLETON: No, I think what Raveen is saying is that he is asking for the flexible approach where you look at your customer base. In this case your customer base is the Murrumbidgee and our history of repayment to you would suggest that you don't bear a lot of risk. If your pricing is around risk, we are saying that the pricing --

MR MADDEN: No, but the risk is not --

MS WELSH: Yes, but there are two different risks here

MR MADDEN: The risk here is not --

THE CHAIRMAN: I'd like to bring State Water in here, John.

MR MADDEN: It is actually the usage part, not the --

THE CHAIRMAN: John --

MS WELSH: Can I suggest we are talking about two different types of risk here. One is payment default and we agree in fact most of our customers are pretty good payers. That is not the problem we talking about here.

MR CULLETON: It is your revenue risk.

MS WELSH: It is a revenue risk associated with the revenue of having 60 per cent of our costs associated with a usage charge. If there is no usage, there is no recovery of that 60 per cent cost. I think there are two separate sorts of risks here. I would argue that we already have a high security/general security premium, so our high security users who do get that reliability of supply are paying in some valleys substantially more than general security users. I believe that is correct because, in the drought, they are benefiting from use of that system, whereas general security users in any one year may not get anything and yet they are still paying the 40 per cent charge on their fixed costs.

MR JADURAM: Exactly, and that is the point that I am trying to make. As high security customers, we are paying for high security and if it is all fixed, we know that that means this is what we are getting.

MS WELSH: Yes. And with high security users for State Water, except in the most exceptional conditions, that usage, that customer base and the charges they pay, can be considered virtually 100 per cent per cent fixed anyway.

MR CULLETON: Guaranteed.

MS WELLS: Yes.

THE CHAIRMAN: John, do you want to add anything?

MS WELLS: I think we agree.

MR MADDEN: I was just trying to say that we are talking non-payment versus water availability.

MR STAR: Just elaborating, you are saying with the environmental water, that pool of water, they could afford to pay more?

MS WELSH: No, no.

MR CARUANA: No, no that is not what we are saying. What we are saying is that there is potential to have different customers groups. I used the environmental water holders as an example of a potential customer group that may have a different risk profile to traditional irrigation customers.

MS CHADWICK: Another example of someone who may have a different risk profile would be, say, some of our energy generators, who again are large customers of State Water.

MR CARUANA: Yes, that's right.

MS CHADWICK: So if we have certain views about the environmental water, maybe we should also talk about these lower risk, more able to pay, fixed cost businesses like the energy generators.

MS WELSH: I would say that the drivers of their farm cash flows, if you like, are not linked to water availability and therefore they may want to choose a different type of tariff design that suits them.

MR MADDEN: There is an issue there in terms of how you deal with the irrigation corporations and how do they bundle that risk and chose with you. You are talking customer choice, but actually you have three big customers. So do they have a bundle of choices or do they just make the choice on behalf of their customers?

MS WELSH: With the price choice tariff design, I do not want to oversimplify what a potentially complex solution it could be. Even though as much as I think we love the idea in theory, there are some pitfalls as to what term is, what do you do about trading from one to the other and --

MS McLEOD: I was just going to ask that.

MS WELSH: It is a solution that would need a lot of discussion with a large range of customers in order for us to come up with the best design solution, I think.

MR CARUANA: This is not conclusive. It is just that creative thinking that was mentioned before about "Let's get away from fixed charges." We are going down that particular creative thinking path but there are some administrative issues to be dealt with.

It is like the tax system. You can have the most complex tax system in the world, but obviously there are always incentives for people try and beat that system. What we are trying to do is make sure that the system we have in place meets the particular objective and covers all those potential issues for trade or whatever complex issue you want to include in there, but this is kind of the thinking. We are still going down a particular path.

As Lisa said, it is by no means saying this is an easy option, but it is an option. From our understanding, it sounds like maybe it merits more thinking moving forward. I don't know; that is kind of the understanding that we got. It is just sort of an example of the creative thinking we have started to think about going forward.

MS JONES: I would like to make the comment, having looked at what has happened in water reform and hearing this conversation about choices, that if you are going to have choice, you have to have information. You have to have transparency. You have to have very strong regulation to make sure that people with conflicts of interest are not taking advantage of a position.

There are administrative costs in this industry. I do wonder looking at water reform, including water trading whether anyone has done a cost benefit analysis. I am an economist. I believe in the market. I think it has an important role to play. MI has considerable administrative costs, I am sure Colleambally would have as well, because all these complexities require a huge amount of work.

Who is doing the cost benefit analysis to look at whether all of these niceties are actually going to add to society and to customers? I think the administrative costs of water reform in this country are pretty shocking and I don't think they would stand up to any kind of cost benefit analysis.

MS CHOU: We have talked a lot about price structure in relation to choice and what about the role of payment terms in terms of options to match farmers' cash flows? Does that have a --

MR JADURAM: We would like to pay once a year.

MR CUDMORE: For the irrigation companies or for the irrigators?

MS CHOU: Both.

MR CUDMORE: From my perspective, general security, annual cropping to match the cropping programs would suit, generally summer cropping and winter cropping. We have both programs, summer and winter cropping programs, so it could work if the payment terms were based around cash flow of cropping. Bringing payments forward, you would need incentives and discounts, as Murray does.

MR HOLSE: The difficulty you raise on payment terms is that once you go to a structure where payment terms are either on a quarterly or different basis than what is previously standard now, which is effectively over 12 months, you are almost trying to second-guess what commodity prices will be doing and what payment terms in the commodity prices the farmers will be getting. That is extremely difficult.

The rice industry is obviously a bit more regulated in the Murrumbidgee Valley and New South Wales Murray so it could be constrained a bit. But effectively repayments and payments from packing sheds and things like that are extremely variable and I think most people would find it rather difficult. While being in business, it would be very nice to have it on quarterly terms or something that more beneficial, I think you would find it would be quite difficult to implement.

MR MADDEN: But at least in the corporations, because I guess that is the focus of the people here, do the discounts and that apply to the bulk water State Water charges as well or not?

MS McLEOD: I think we are the only ones who apply discounts.

MR JADURAM: We don't apply discounts.

MS McLEOD: We apply discounts to the entire account, the quarterly bill.

MR MADDEN: So, in a sense, the flexibility is there at the moment?

MS McLEOD: That is in ours, but we do not have the same flexibility with our payments to the State Water and the NSW Office of Water. They get a quarterly bill from us.

MS WELSH: We have considered this in discussing initial options. With the deferral and optional deferral, I think it would make sense that you would examine something like it to give incentives for people who choose not to defer because of their own different cash flow situation, for an up-front discount. That is really just the flip-side for paying a penalty if you chose to defer. I think that is effectively the same thing. In terms of how you model that, you could get conflicts, but I guess an incentive for up-front payments is a good idea.

MS McLEOD: If you have options it gives people choices and they could change between years presumably. We would have some customers who, in some quarters, might choose for cash flow reasons to not pay their quarterly account and benefit from the discount. People quite consciously weigh off the cost of their moneys: Is the 10 per cent really better than the money they will have to pay on their overdraft if they don't pay the bill?

In terms of how we would react, we would evaluate what would be our cheapest option and pay it that way because we have reasonable cash reserves. I think that is probably a good thing.

In terms of our introduction of quarterly accounts, we heard, "Oh, I can't possibly do that", but the response, especially now that we have the discount, in the feedback we are getting is that it is much better getting a smaller quarterly bill than to have a very large bill in July. Some of our customers have bills over $100,000, so being able to spread that has actually had benefits in their financial planning.

MS ARTHUR: As a Collie irrigator, I love discounts. Note that down, John.

MR CULLETON: I've got that, Kate.

MS ARTHUR: But as an irrigator we do do things called budgets. We actually budget for an end of financial year water bill payment. If we come into trouble with paying it, we ring our bank and negotiate an increase in our overdraft. Going to quarterly payments might suit some because they cannot cope with such a large bill.

I don't mind the quarterly - if we get a 10 per cent discount, it makes it more worthwhile for us to pay it quarterly as opposed to annually - but if it means that those who will pay it quarterly, because they can't cope with the thought of paying such a large bill at the end of the financial year, will add a cost to those who want to pay it annually, that would be unfair.

MS RZESZKOWSKI: Just introducing an option like this where you get a discount, does that introduce another variability into the amount of income that you have to recover? You have another portion. You say you have a risk associated with a variable usage and a variable charge. Is this introducing another one or are you going to price it so that you take it into consideration?

MS WELSH: You would still have to model as to what proportion of revenues you think will come in when.

I think we considered it in the context of a bigger deferral. I am not talking about annual billing but saying if certain triggers are reached, for example, you can choose to defer your charges for up to two years, so that is about a risk. That is us saying that we will take on the risk in the short term for you of revenue volatility. But then, in that situation - and we have not modelled any of this at this stage - it would logically make sense that those people who choose to defer would be paying for that risk, which would effectively mean that those who choose to pay up-front should not be paying for that risk and therefore should be entitled to a discount relative to those other charges. That is actually effectively I think what happens anyway. If you elect to go on a payment plan, you actually pay the costs associated with that. One of the other businesses around the table said that is what they do, so --

MR CULLETON: You wouldn't be talking about paying an incentive. You would be talking about people varying paying a premium surely.

MS WELSH: Yes, and they are two sides of the same coin as far as I am concerned. If there is a cost associated and if there is an interest charge on the deferral, that is the same thing as people paying up-front getting a discount.

MS RZESZKOWSKI: No, I don't get that.

MR MADDEN: I think we had better move on because we are running out of time.

MS WELSH: But effectively if you pay now, it is cheaper; if you pay later, it costs you more. Whichever the way you slice and dice it, the outcome is the same. It's just semantics.

MR MADDEN: There are a number of variables there. That is one we will be looking at in depth in terms of --

MS WADE: If it was adopted, there would need to be a transition process, so that --

MR MADDEN: And it is different in different valleys in different circumstances depending on what historically happened. The Murray would have no problems because they understand it, which might be different elsewhere.

I think we need to move on because --

THE CHAIRMAN: I want to ask another question just to fix in my own mind the various interests in this group and pursuing this idea of offering people choices. It is something that may be complex but it is worth pursuing.

MR CULLETON: I think it is consistent with what the water reform agenda is supposed to be about. The water reform agenda is supposed to be about irrigators having more choice. The whole creation of separation, delivery entitlement, land, water entitlement, putting a value on delivery entitlement, being able to transfer, sell delivery entitlements was all about giving customers a greater array of options as to what they do with their set.

There is a lot of pain associated with that and we have borne a lot of that pain already, but people now have the mindset that they look at the asset differently. They look at how they utilise their asset differently. I think the notion of being able to look at how we have to pay our bill and having choices is a good one. How State Water can actually manage that against the revenue targets, I don't know, but I am inherently attracted to that notion of choice.

MS McLEOD: The comment I would make, though, is that it is about choices in the face of having to shift away from the 40:60. If 40:60 was to be maintained, depending on what you did with your consumption forecasts, maybe it would be worth all the effort. But if we are now looking at potentially a significant increase in the fixed fee, providing some options for people who might have difficulty with that concept or meeting that higher cost, maybe it applies. Do you understand what I mean?

THE CHAIRMAN: Yes, I do, thank you.

MR JADURAM: I would say if there are choices, it sounds good but the devil is always in the detail. The choices need to be available in a consistent manner to every type of customer rather than having a certain bias towards a big customer or a small customer.

The second issue is your model will show whether it can be abused - so whether the choices are 12 month,

12 month or whether it is a long-term choice. I agree with John; the option of having choices is a good move forward, I would just say urge caution as to what is actually in them?

MR CULLETON: Yes, what the range is.

MR JADURAM: Yes.

MS McLEOD: Yes.

MR CULLITON: If we are choosing from a range which is worse than we are now, that is not a desirable outcome.

MS WADE: I would like to make the comment that I think there are tens of thousands of dollars of resources sitting around this table now, in another review. There is an expectation from the people who pay the bills that when we do this review, we come out with clear options and clear reasons why particular outcomes have been adopted.

I think most of the people that I represent are tired of reviews being called that take enormous resources and then we end up in the same place. My plea would be that we look at all the options and then be very clear about what certain recommendations or certain outcomes are settled on at the end of the review process.

MR CUDMORE: With regard to those choices that you talk about, it is a great theory, but if those choices do not ultimately drive efficiency, we are back at square one.

Just to pick up on Sally Jones's point before, through the drought, I am not sure what the break-up is, the costs of compliance of irrigation companies and the layers of complexity from government, the various levels of government, added substantially to the costs of doing business and utilising water.

Ultimately, and I have said this before about three times, I want to put water through my doppler and be productive with it and grow crops. Trading my water is an ancillary product as far as I am concerned. I get the most benefit out of being productive with the water. Unless those choice can drive more efficiencies to be more productive, we could be just going round in circles.

MS McLEOD: To add to that sort of theme, we need to look at the implementation costs associated with it and whether it is actually worth it. We can't have this wonderful model that nobody understands or that costs a fortune to implement.

MR CUDMORE: That's right, and as the compliance costs have put more regulation, it does become prohibitive.

MS WELSH: We would agree with that wholeheartedly. Any tariff design that might be recommended from this review needs to be able to be administratively simple and transparent so that we can explain it to our customers as well.

MR CULLETON: The final plea I would make is that so much of the cost benefit analysis that has been done from Canberra in particular is done in what I would call very dry economic terms.

As irrigation corporations, we do not exist in isolation. We exist in the context of communities that are highly dependent on what we do and our customers are highly dependent on those communities existing. There is a notion that if you do a cost benefit analysis and if State Water wins and we are okay, that then is a good outcome. But without consideration of what the impact is on the pattern of economic activity more generally in our region that is pretty limited. It is a pretty limited analysis.

This is one of the problems that we have with the MDBA's thinking. With the modelling that has been done for them, it looks at things in silos. If, for instance, we landed pricing somewhere where it was okay for us but it threatened the criticality of value-added activities in our region because it drove agricultural activity in one direction and in a direction where those value-adding activities locally did not occur any longer, then that would be a bad outcome. The net effect would be that the businesses on which we depend, the ag suppliers and the like, will now be further afield than they would have been yesterday. Our cost of accessing those ag services is further afield so our costs go up. So you have a new cost pressure on your business. You have an unintended consequence.

So much of what is happening in terms of economic

modelling is limited to the immediate problem. It does not take into account the wider perspective. You have well-established industries in this area that could disappear very quickly if we were not to take that wider view.

THE CHAIRMAN: Are there any more final comments on price structure before we move on?

We will move on to cost shares.

SESSION FOUR: OPTIONS FOR COST SHARES

MS TAPPER: I will talk quickly about the cost shares because I don't think it is as big an issue as the price structures.

You probably all have an understanding of how IPART in the past has dealt with cost shares. For the people who may not know, what we have done is we have applied an impactor pays principle to determine how much the user should pay of the efficient costs of State Water versus the government and we have done that at an activity based level.

We developed that back in 2001 and that was subject to an extensive review again in 2006. In the most recent determination in 2010 on cost shares, we did not adjust any of the cost shares for each of those activities because we came to a decision that they did reflect, based on the impactor pays, what the government should pay and what the users should pay.

With the ACCC taking over, we will no longer be setting the prices for State Water, so we would not have the ability to set the cost shares. Basically the New South Wales government has asked us to come up with a method for determining the cost shares as we would no longer do it through our price determination process.

Under the ACCC rules, basically what they are saying is that that is an independent variable. They will not set how much the New South Wales government will contribute to the efficient costs. So we are looking to kind of use the methods that we have done our established framework to cost shares and a way of going forward to continue that process for something else to do with cost shares.

We have some preliminary options based on how we have done it in the past and we are looking to find out whether or not people consider these options are appropriate.

The first one is maintaining our existing approach. That would mean applying the cost shares as they have been developed and implemented in the 2010 determination. Then we could recommend to the New South Wales government an ongoing role to determine or review those cost shares at each determination that the ACCC would make every five years going forward. I guess that is basically applying the approach that we took in 2010 but through a different framework.

The second option that we have is to freeze the current cost shares. The ratios that we developed in 2010 are saying that we do not think that the activities will change that much and that they do reflect the impactor pays principle that we have developed and used to develop those ratios. Therefore we fixed that as it currently is and then we are not going to review them any more so that State Water could then just apply the shares as they are currently developed - so basically, ongoing.

They would do that, so when the ACCC comes to make its determination, State Water, in its submission, would just apply the cost shares as they currently are and then the New South Wales government would agree to do whatever comes out of that process.

The third option is, I guess, similar in that process, but still leaves the option to review those cost share ratios over a period of time. It might not be every single ACCC review, which is five years. It might be every second or third determination, just to make sure that the cost sharing ratios and the activities and the way it is being implemented still match the impactor pays principle that we have used.

The last option that we are considering is basically leaving it up to the New South Wales government and they could determine how much they are willing to contribute to the efficient costs of State Water.

Those are the initial options that we have considered. We are looking to hear whether there are any other options

that people have in terms of the user shares that we should look at. That is basically what we are trying to get out of this discussion. Does anyone have anything to add?

THE CHAIRMAN: So the basic message is that cost sharing lives on; it is just achieved by a different route.

MS McLEOD: That is good.

MS TAPPER: Possibly, but it is the government's final decision as to whether or not it takes up the recommendation. We are basically doing the recommendation on it and the government does not have to accept anything we say. I guess our initial view is to come up with a way to bring forward that methodology into the ACCC price determination process

MR HOWE: So ultimately we are left with dot point 4 insofar as there is no obligation for the government; in effect, the government is independently setting its own contribution even if it is based on IPART advice? The earlier options are in relation to IPART advice, but it is just that and, therefore, ultimately we are left with the New South Wales government decision about this?

MS TAPPER: Yes, they potentially could come up with a view, which is similar to where the ACCC is at, that the government should not be subsidising the services and they could essentially say that they --

MS CHADWICK: John, before we go too far down that path, I think it should be acknowledged that, under the current approach, in the 2010, 2006, and 2001 IPART decisions, we made assumptions and we made recommendations about what New South Wales treasury should pay to State Water and the Office of Water, but our role does not extend to enforcing that and our role does not extend to double-checking that treasury gave that money. If you are thinking of something that you are losing from this process, remember it was not there.

MS WELSH: I support those comments, Amanda. Treasury has historically really stood by 100 per cent the terms of the IPART determination, even though, it is not, strictly speaking, required to.

MR CARUANA: I suppose, to give a bit more context too, the difference here is that the ACCC thinks cost sharing is a matter of government policy decision and it is not in the business of making policy decisions. All they want to know is how much does State Water need to recover its efficient costs and they determine what the prices should be based on efficient costs. They are asking the question, "State Water, in your submission, tell us what you think your efficient costs are minus any contributions you get from external sources, ie, government." What they are saying is, "We only want to determine prices on costs that will not be covered by someone else."

So this question is about how much should be covered by someone else, ie, the government. All we are doing is changing the order in which it was last time and we are getting it done up-front first. That is sort of my thinking that basically --

MS CHADWICK: Does that mean you like option one best?

MR CARUANA: We are indifferent. It is not a State Water decision it is pure government policy.

THE CHAIRMAN: So long as you get your money.

MS WELSH: Correct.

MS CHADWICK: Are there any other comments?

MS JONES: I would like to ask what is the structure that drives efficiency? That is a point that has been made here today many times. Is there one structure above another that drives efficiency? I note that, as another agricultural economist in the room, we moved away from cost production pricing about 30 years ago with good reason, so what are the assumptions about all the costs of implementing water reforms? Where are the pressures to force the hard thinking on a whole range of issues?

I don't have any detail, but sitting where I sit in an irrigation system, that is an answer I would like to have. What is the structure that is forcing people to make hard decisions and be as efficient as possible so that they will take the water where it needs to go for the benefit of society?

THE CHAIRMAN: That is a good question. It is worth

pointing out that what we are talking about here is incentive regulation and the idea that State Water is required, as they will be required by the ACCC in the future, to make efficiently. It recovers only the efficient costs of producing its services. I am sure State Water will comment on this and I am sure they will have something to say about efficiencies in the past and will continue to do so in the future.

What we are talking about here in the cost sharing debate is who should pay for State Water's efficient costs. I suppose the argument is the producers' benefits go both to water users and to broader society, that the water users should pay the share that is a benefit to them, and that the wider society pays the share of those activities of State Water which benefits the wider society. That is the thinking behind the cost sharing approach. We are trying, I think, to find a way to maintain that into the future under the ACCC's rules.

MS JONES: All I am saying is how do you structure it and what questions do you ask to drive efficiencies in both of those areas? Again coming back to our conversations in Murrumbidgee Valley Food and Fibre, we are trying to seek efficiency in the whole policy, water reform and environmental productivity, as well as in the production side, and that obviously requires certain questions to be asked and scrutiny in perhaps a different way than occurred in the past.

MR JADURAM: From your options, it seems to me that the only body that would remotely come close to doing what Sally is saying is IPART. From my point of view, with the last bullet point, the government can do that anyway, but at the moment, it gets advice from IPART. That one from the elimination, gets eliminated.

The third bullet point, that is too long. Anything beyond five years is just too long, so that gets eliminated, and the second one is actually not an option because it is just status quo. It is the same as number one; it is not going anywhere. I would have to say with those four, I would go for the first one.

MR MADDEN: Just note that the ACCC will then be taking over the process to look at what are efficient costs.

MR JADURAM: Yes.

MR MADDEN: So IPART will vacate that part of it. ACCC will come in and have a process that does exactly the same monopoly regulation that looks at all their costs and what is efficient, et cetera. The cost shares here are actually the share that the community plays for things like flood mitigation and environmental works. There are only about three or four activities that actually have a cost share that is not 100 per cent user.

MR JADURAM: Yes.

MR MADDEN: So it is really a bit of a philosophy, you know, a judgment call, on those activities that actually relate to those things like flood mitigation, et cetera, which is other beneficiaries.

The efficiency drive, you could argue will be exactly the same depending on what the ACCC does: it could be more or less, but it is around that process of going through the books and activities and assumptions really.

MR HOWE: John, does it have to be prior? You know in the current system the cost shares get put forward by the service provider in a submission. They are looked at by IPART in a draft submission and subsequently finalised. So they are looked at on probably at least three different occasions. It possible that IPART could set a draft set of shares prior to the ACCC price determination and then finalise them post the ACCC's determination or as part of one option?

MS TAPPER: I guess our initial thinking was that the process would be similar - it would be a review, a draft and a final - but that would have to be completed before State Water makes its submission, so it would probably have to be in the year before State Water making its submission.

MS CHOU: The indication we have had from the ACCC is that they would like certainty around state government contributions prior to the start of the price review process.

MS CHADWICK: Which I think highlights then some of the differences between the first three options. Number one is a separate process; so it is another engagement, more

submissions - time.

The second one is in fact turning the status quo into a formula, but maybe it could generate some inflexibility in the future if State Water's business fundamentally changed, and I am not in a position to have any view about the likelihood of State Water's business having fundamental changes.

The third option is that they will keep a little bit of flexibility and do that intensive process, but only do it about every 10 years. So they have different administrative costs.

MR HOWE: I think the first option is by far the most attractive especially if you are looking for efficiency and equity. The only possible shortcoming with that is the potential for the ACCC determination to ultimately set the incentive structures and then you have already done the cost shares almost or if they change their investment in their business, sort of the fundamental of the business, in the determination, that then presumably can impact again on cost shares. I don't know what the risks of that would actually be, although, in those options, I would think, like Raveen, that option 1 is the preferred option.

THE CHAIRMAN: My recollection is that cost shares have not changed very much from determination to determination. They tend to be pretty stable.

MR HOWE: But if, for example, you had a huge investment in dams --

THE CHAIRMAN: Sure, sure.

MR HOWE: -- it is very important.

MS WELLS: While we are technically indifferent between each of the four options, just on a practical note we have time frames that we work towards when we are putting together a submission. A really important part of that is putting together what our future costs will be, talking with customers about those costs, and draft prices, all of which takes a lot of time.

We also have to go to cabinet, of course, to get all of this signed off. So fitting in another review in the midst of that, whilst it is possible, it elongates the time frame. It means, for example, that we would presumably need to know our draft operating and capital budgets even further in advance, which creates more uncertainty. By the time you are in the current determination, you might actually be dealing with projections that are four or five years old, realistically speaking, given that the ACCC, as we all know is slightly less timely in its deliberation of pricing determinations than IPART.

MR CULLETON: I have to say that of those options, the option which concerns me the most is the last one because, quite frankly, it allows the New South Wales government to act far more unilaterally. I could see that that would be an exercise driven by treasury without much consultation and we would just cop it in the neck.

MS CHOU: To clarify, under any of those options the New South Wales government still would have --

MR CULLETON: I understand that implicitly, but I think this process imposes some discipline --

MS WADE: That's right.

MR CULLETON: -- and it provides for some transparency. That doesn't.

Also I think we benefit from having IPART doing it a number of times because at least you get some corporate knowledge outside of government brought to bear. Whereas if it is an independent approach, we could go to KPMG the next time we do it and the time after that, we could go to somebody else and somebody else and we would end up with these wild swings and roundabouts. As an industry, we need certainty, like any industry.

MS McLEOD: Could I clarify with State Water's submission to the ACCC, when do you need to have that in for the next determination?

MR CARUANA: We have been given a deadline of 1 May next year for a 1 July 2014 start date. So 14 months before the prices are due start, we need to put it in. The next determination period will be say three-year period so 2014 to 2017. After that it will be four years.

MS McLEOD: Effectively if you have to get your submission to cabinet, it would need to be finished probably February; is that right?

MR CARUANA: We are targeting a March submission.

MS WELSH: Realistically speaking, we are hoping to have numbers finalised by sort of the end of October/November so we can go to the last round of CSCs, the full round of the CSCs, before we then go to cabinet. So we need something by November/December. That is when we are going out to do significant consultations.

With this process, I would like to think that once we have come up with a decision, that can then feed into future processes. I think this one is an unusual one on many fronts in terms of planning and being able to talk to customers and doing something systematically and methodically.

MS JONES: I am sorry, but I wish to say something again. My reading of the Commonwealth Water Act is that essentially in the Murray Darling Basin, it is redefining water as an environmental resort with production as a secondary use, which is a complete change from the way it has been seen in the past. I would imagine with that reform that there would be a big change in cost shares as well. Certainly, there is a lot more emphasis on managing for the environment and I would expect that there would be very significant changes.

MS CHADWICK: It may be, though, that what it does is generate more costs against certain activities rather than necessarily change the share of who should pay for what of an activity.

MS JONES: That would be for you to comment on, but I am just making point that philosophically the Commonwealth Water Act defines water primarily as an environmental resource with production as a secondary reason.

MS WELSH: Can I suggest that the government's buy-back program has already started allocating a lot of those costs to the government. Had it chosen to pursue its buy-back as not a buy-back but rather through the new water resource plans by, for example, increasing the amount of planned environmental water under those plans, that I think, would be a far bigger trigger for your cost shares.

MS JONES: Yes, I agree, and I also think that the whole administration of the system will be geared to different purposes and there will be, hopefully, a lot more monitoring of water quality and flows and so forth. However, that is really heavily motivated by the change in society's perception of the primary purpose of the resource and that is certainly not something that we can afford to pay for.

THE CHAIRMAN: Are there any final comments? What I take out of this is there is an attraction to the transparency and discipline of having some sort of independent process outside the government.

MR CULLETON: Absolutely.

THE CHAIRMAN: Thank you for that. I think we have completed the agenda, more or less. No; we have one more item.

SESSION 5: ASSESSING THE OPTIONS

MS CHOU: I think, given the time frame, we will just briefly touch on this. We came up with several options. We will need to assess options, whether it be for the price structures or the cost shares, to make recommendations to government.

Some of the criteria are implicit in the terms of reference in terms of assessing the impact on State Water and the NSW Office of Water and the actual impact on the state budget.

To pick up on some of the points that have been made here, we also need assess the impact on customers in any of the option that is we consider. Transparency, getting to the ease of administration and implementation issue, is also very important.

Are there any comments on those criteria?

MR CULLETON: I come back to my point that I think customer impacts is highly significant; but I think water being such a critical commodity, it needs to be seen in the context of community impacts as well.

MS McLEOD: It is linked to some of the issues Sally Jones has raised; that is, through successive IPART determinations, the Murray Valley - I think also the Murrumbidgee, but I could be corrected on that - has been deemed to be at full cost recovery of the efficient costs. At every determination or by the end of that determination, we will have reached that. But every time we go through a determination, we are not at that point because the costs have expanded. I think you have an opportunity through this process to identify the changes in the basket of costs and perhaps what is driving some of those changes.

You talk about impactor pays versus the beneficiary pays. One of my fears, reading the EWI and then reading the principles in the Water Act, is you are going to price the consumptive sector out of being able to pay for the water or pay the costs of the service. Then where does that leave you?

If, say, for example, Murrumbidgee Irrigation is not viable and Murray Irrigation is not viable, who will pay the costs of operating the dams? You are not going to pull them down. You are not going to blow up a new dam or remove any of the regulators.

I think, therefore, that there are some key issues that will happen in the next few years and I think IPART has an opportunity to contribute to that debate, whereas we can't because we just get told, "You're a vested interest; you're going to say that."

MR CULLETON: I don't think what Jenny and I just said is incompatible. What I said was not meant to be incompatible. I am certainly not at odds with Jenny; I agree. When I said "community", I meant our capacity to pay as an industry and the value that is generated off the back of our industries within the community. So I think we are in agreement. These things are complementary rather than opposing views.

MS WADE: If you push too hard, the government will pick up 100 per cent whether it likes it or not.

MS McLEOD: Yes, and there is --

MS WADE: That is the only option.

MS McLEOD: There is a point at which that becomes unsustainable.

MR HOLSE: I think the same sort of issue is raised by the idea of capping revenue in future. Basically over the determination periods, we have seen the ratcheting up of bulk water prices.

The real question from the stakeholder point of view, especially in light of the situation that I think Sally Jones has described very well, is: at what point does this thing become sustainable for customers? In other words, we cannot continually have real cost increases to customers in highly competitive industries without paying some sort of economic cost and therefore social cost as has been pointed out. So at what point does it become sustainable and what drives it towards that sustainable position for the customers?

At present I cannot see the things that are driving it towards a sustainable position. I suppose I would be thinking in terms of more drastic sort of action like the possibility of IPART considering revenue caps when doing things likes those cost shares in order to contain prices for the paying customers who are subject to international competition, basically. We just cannot keep loading up costs to these businesses and expect them to survive.

MS McLEOD: I have two points that are completely unrelated to this that I wanted to raise.

THE CHAIRMAN: Sure, we are coming to final comments.

MS McLEOD: One of our major issues is River Murray Water costs. It has not been raised today and I think it is an issue for the determination, because currently we pay our contributions to River Murray Water through our State Water and NSW Office of Water fees. It is my understanding that River Murray Water costs are outside of the ACCC determination process.

MR CARUANA: We are unsure. We are seeking legal advice on that question. In our understanding of the ACCC framework, there seem to be some questions around some of State Water's costs and the River Murray costs are one explicit example. We are unsure as to whether it fits

within the regulatory framework. As I said earlier, we are actually seeking legal advice to get an understanding of where it sits. At the moment, we are unsure if it sits inside or outside the ACCC framework.

MS CHADWICK: Thank you for bringing the issue to our attention.

MS McLEOD: I would like some clarity around that issue. There are potentially a few scenarios. One is that they are part of your bundle of costs, but nobody has actually determined their efficiency, which would be a concern for us, particularly given some of their past behaviours.

Then the other potential, I suppose, is that nobody will regulate them. Maybe treasury would say that would be okay. And the River Murray Water and also the Murray Darling Basin Authority NRM fits into the NOW component, so they are both issues. River Murray Water is more specific to the Murray and the Murrumbidgee, but the NRM stuff applies across the basin.

The other issue we have not discussed at all was the large customer rebate as a feature of the State Water tariff, which was first introduced by IPART. We obviously have an interest in that issue. It has not come up, but it is important to us.

MR STAR: I would like to endorse what John Howe has said. There has to be a point where we can't pay. Rice at 240/250 is marginal and the cotton has come back to 350 a bale. Last year it was 600. They have nearly cut our income there by half just in the cotton game.

With regard to the minimum increases that John is talking about, there will have to come a stage where you will have to say enough is enough.

MS TROPEANO: From the high security irrigator point of view, as you are probably all aware, the price we are receiving for wine grapes is very low and there is not much capacity to stay sustainable if crops keep rising and we would all be out of production too.

THE CHAIRMAN: I think it is fair to say that many of these issues will be determined by the ACCC framework for cost recovery and I guess modified by whatever we suggest about cost shares.

MS TROPEANO: There is not much point in providing the water if you have no one there to use it.

THE CHAIRMAN: I agree. That is certainly important. Perhaps not so much in these valleys but certainly in some smaller valleys up north where that is a real issue.

Are there any final comments?

CONCLUDING REMARKS

THE CHAIRMAN: Thank you very much for that. I think we have had a very interesting discussion and a number of very clear things have emerged from the discussions. That is a very good start for us in commencing our review. You have given us plenty of food for thought. Obviously I don't want to sum up or take a position at this stage, it would be quite inappropriate.

You have been very helpful and very generous in the assistance that you have provided to us and I thank you for that. We have lunch available, if you want to stay and have a discussion.

Once again thank you very much for coming and for the efforts you have made to help us in what I think is a very interesting inquiry and one which has to be done in a very short time frame.

MS CHADWICK: We have many of your emails from previous reviews or from your RSVPs. In the event that we don't, there is a register here. We will be trying to keep in touch with you, but we need you to give us your email addresses, thank you.

AT 2.06PM THE TRIBUNAL ADJOURNED ACCORDINGLY