

In reply please quote: D2023/025248
Enquiries to: Steven Waterhouse

9 May 2023

Mr Marcus Crudden
Executive Director, Price Monitoring and Regulation
Essential Service Commission

By email: water@esc.vic.gov.au

Dear Marcus,

WATER PRICE REVIEW 2023 - RESPONSE TO WANNON WATER DRAFT DECISION

Thank you for the Commission's draft decision (dated 6 April 2023) on Wannon Water's Price Submission 2023-28 as a part of the 2023 Water Price Review.

We recognise that both the Commission and Wannon Water have a mutual objective to ensure excellent value at affordable prices for water customers and communities in South West Victoria. We appreciate the preliminary views and insights the Commission has made in its draft decision and equally appreciate the opportunity to respond.

Our response is provided in the context that the revenue requirement in the draft decision, adjusted for inflation and cost of debt, remains considerably higher than our proposed Revenue raised from tariffs.

Affordable bill outcomes remain at the forefront of our proposal and response. Our residential customers' bill has decreased every year for the past ten years. This decrease has occurred despite significant cost increases experienced during recent years. In proposing small increases in our proposal, customers' bills in 2027/28 will remain considerably lower than they were in 2013/14.

Our responses, attached to this letter, are aimed at providing sufficient detail to address the matters raised in the draft decision. In particular we have addressed in detail the material matters, being:

- Operating expenditure increase during the baseline year
- Consideration of inflation on our forecast costs and impacts on customers
- Proposals to reduce expenditure (capital and operating)

I encourage Commission officers to reach out to Wannon Water officers should they require additional context or supporting information. We look forward to discussing our response.

Yours sincerely



SIMON HERMANS
Acting Managing Director

WANNON WATER'S RESPONSE TO ESSENTIAL SERVICES COMMISSION WANNON WATER DRAFT DECISION 2023 WATER PRICE REVIEW

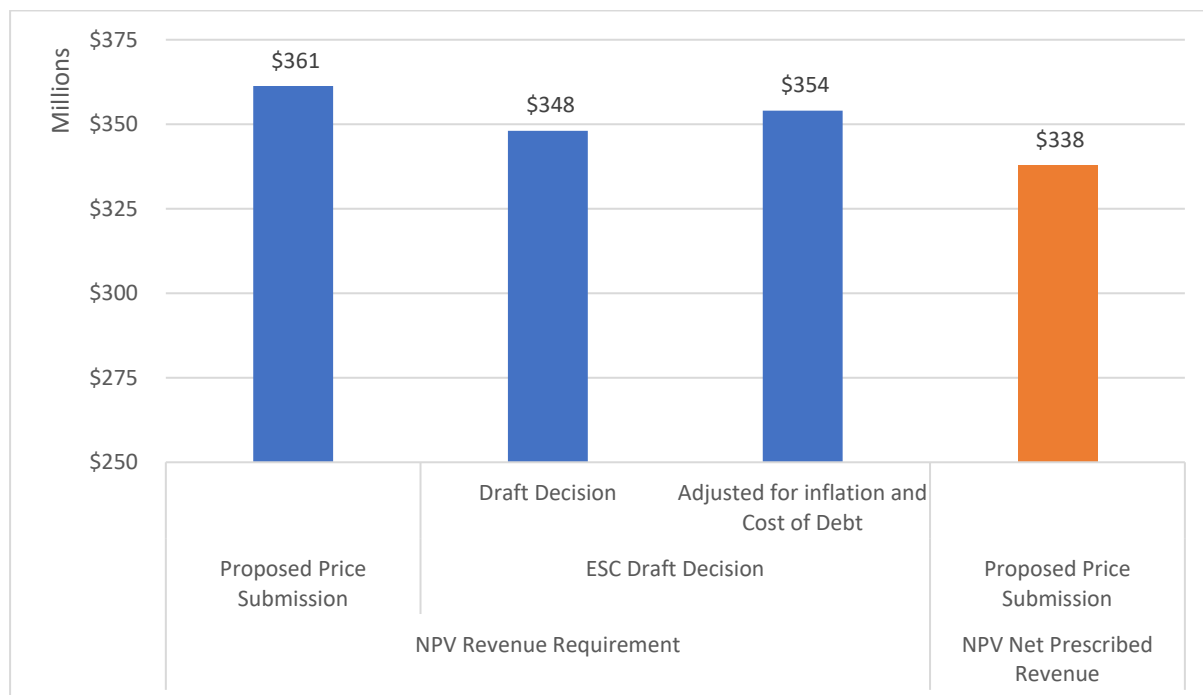
1.0 Context

Our responses to matters raised in the draft decision are made in the circumstances that:

- Projected revenue from customers remains significantly lower than adjusted revenue requirement
- Our proposed tariff increases are not impacted by proposed adjustments

1.1 Revenue Requirement

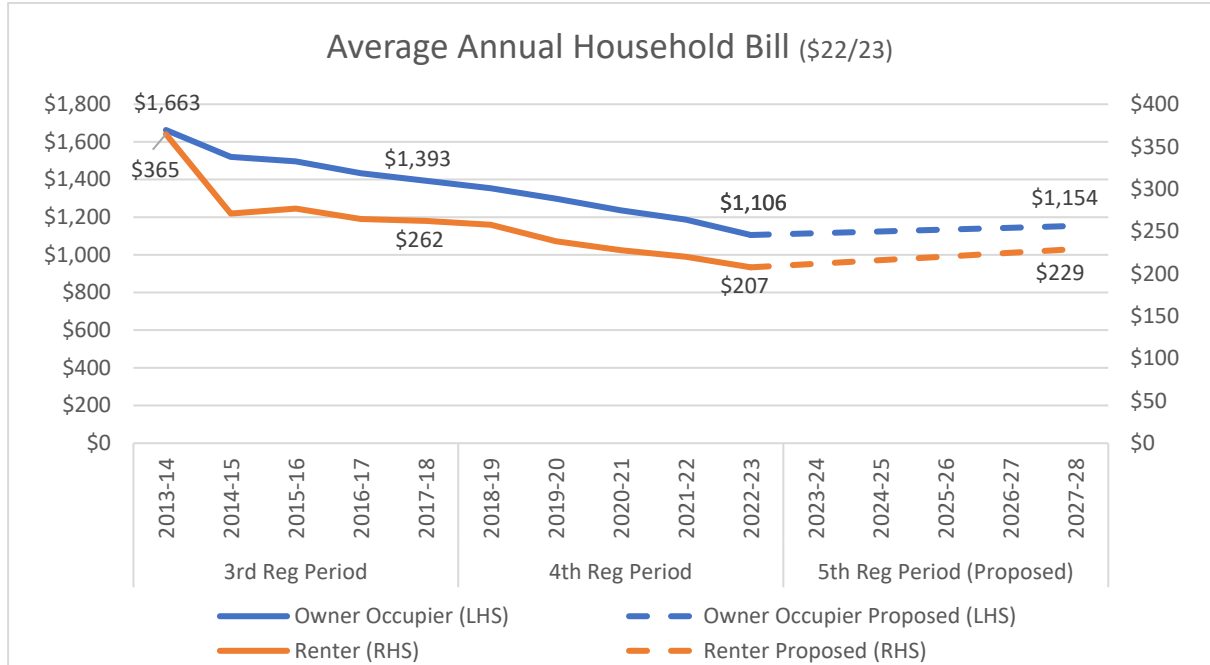
We note the adjusted revenue requirement in the draft decision. After adjusting for inflation and cost of debt forecasts, the NPV Revenue Requirement remains considerably higher than our proposed NPV Net Prescribed Revenue. The draft decision focuses heavily on the building blocks that make up the revenue requirement and does not highlight this macro outcome.



We acknowledge that the Commission when reviewing this response may make further amendments to our revenue requirement. We offer to liaise with Commission officers at the appropriate stage regarding any implementation matters that may arise because of adjusting revenue requirement.

1.2 Customer Bills

The draft decision does not impact our proposed approach to offset customer bill increases by utilising balance sheet capacity. Our customers' bills have decreased over the past 10 years, and even with small bill increases (before inflation), they remain well below 2013/14 levels. In that context we feel that proposed minor tariff increases are a slight correction to recent negative tariff movements. Again, we note that the draft decision does not provide this macro view.



2.0 Operating Expenditure

The draft decision on page 26 adopts a provisional controllable operating expenditure baseline of \$44.98 million based on the Commission's expenditure consultant's advice. This includes reductions from our proposed baseline totalling \$2.2 million, also based on consultant's advice.

The draft decision highlights an increase in operating costs from the 2020/21 to 2021/22 financial years. On page 26 it requests us "...to provide a clear account of its controllable operating expenditure and the shifts that occurred in 2021/22". We clarified with Commission officers that the statement on page viii requesting us "to provide sufficient justification to demonstrate its forecast expenditure is prudent and efficient, and will deliver the outcomes expected by its customers and to meet regulatory and policy obligations" relates to the shifts that occurred in 2021/22.

There were no queries from the Commission during their six month review period, and in the context that our response is expected within 20 business days, we clarified with Commission officers what "sufficient justification" and "clear account" means. We understand the request is to provide explanation for the operating expenditure increases from 2020/21 to 2021/22 and additionally to provide explanation why the increases that occurred are ongoing in nature.

Our response in this section is in three parts. Firstly, addressing the controllable operating expenditure shifts that occurred in 2021/22. Secondly responding to the proposed baseline operating expenditure reductions. And finally responding to the operating expenditure reduction resulting from the removal of the Great Tasting Water capital project.

2.1 Controllable operating expenditure shifts that occurred from 2020/21 to 2021/22

Our price submission (page 65) provided a comprehensive summary of the 16 per cent increase in operating expenditure during the 2021/22 year compared to our approved 2021/22 controllable operating expenditure forecasts. During their review of operating expenditure, FTI Consulting interrogated in detail our 2021/22 baseline operating expenditure. This review required provision of detailed information and responses to follow up queries. It also assessed the reductions we included in our baseline totalling \$4.65 million.

The increase in expenditure during the 2021/22 year is aligned to the reasons provided to FTI Consulting to substantiate the 16 per cent increase in operating expenditure compared to our approved 2021/22 controllable operating expenditure forecasts.

FTI Consulting's final assessment was that "most of the expenditure in the baseline year of 2021/22 appears reasonable, and does not appear to include any items that are non-recurring". We provide this as initial context, as it is therefore reasonable to conclude that despite the increases in expenditure during 2021/22 the proposed baseline operating expenditure is prudent and efficient.

In demonstrating operating expenditure changes between 2020/21 and 2021/22, we have excluded the two material amounts that occurred during 2021/22 but were adjusted out of the baseline in our price submission:

As per pricing model, *Opex_Breakdown* tab

Total controllable operating expenditure – 2022	\$51.30M
Total controllable operating expenditure – 2021	<u>\$43.34M</u>
Change in controllable operating expenditure	\$ 7.96M
Less: Non-cash, capital expenditure write-offs	(\$ 2.53M)
Less: IT Project write-offs (new Accounting Standard)	<u>(\$ 1.46M)</u>
Increase in controllable operating expenditure to be explained	<u>\$ 3.97M</u>

Our response concentrates on demonstrating the impact specific drivers had on operating costs in the 2021/22 year in comparison to the 2020/21 year. The table below equates to \$3.97 million as outlined above, with detailed explanations per driver following the table. Detailed transaction level information was shown to Commission officers during discussions and is available on request.

Operating cost centre	Cost Driver (\$M)						Total
	1 Digital transformation incl cyber resilience	2 Regulation and compliance	3 COVID-19 impacts	4 Observed price/ cost increases	5 Other	6 Non- Recurring	
Employee costs	0.24	0.29	0.32		0.12		0.97
Chemicals				0.14			0.14
Consultant and Contractor support	0.23	0.38	0.02	0.40	0.07	0.28	1.38
Electricity					0.10		0.10
Insurance				0.11			0.11
Subscriptions & Licence Fees	0.64						0.64
Fuel				0.11			0.11
Training Expenditure (incl. Travel costs)			0.13				0.13
Other					0.39		0.39
TOTAL	1.11	0.67	0.47	0.76	0.68	0.28	3.97

1. Digital transformation, incl cyber resilience

We developed a Digital Strategy in 2019 which sought to build our capacity to deliver enhanced digital outcomes throughout the business.

Digital Strategy Action Plans are developed on a biannual basis. There are action plans for nine Product Lines and Support Functions each with between two and five initiatives per year. When delivered, these initiatives progress us towards our target state.

Of specific note during 2020/2021, expenditure increased to a new and ongoing level following the COVID-19 pandemic. Like most organisations, IT team resourcing was stretched to deliver beyond business as usual tasks. This meant beginning implementation of most initiatives from our Digital Strategy was pushed back from 2019/20 and 2020/21 to 2021/22. There are ongoing programs of works planned in this area.

Similarly, a Cyber Resilience Strategy and action plan is in place. Again, costed initiatives are forecast and delivered on an annual basis. This area increased during 2021/22 as the need to do mitigate cyber security risks increased drastically during that period.

Operating expenditure increased to provide additional resourcing and support to deliver identified initiatives, and equally for the cost of new software licences. During 2021/22 the following new systems introduced step changes in cost to the organisation:

- Maximo (SaaS) – maintenance planning and scheduling
- ELMO – Human Resource
- Lean IX – IT Mapping Tool
- NTT Australia – Uptime and security
- TheSoCo – Document Control
- Schneider Electric IT – System management and automation

The strategies and actions plans are available on request.

We expect the level of expenditure incurred in future years to increase compared to 2021/22, particularly as more systems move to a SaaS delivery method and as expectations and obligations to mitigate cyber security related risks grow.

2. Regulatory and compliance obligations

A comprehensive list of new obligations was provided in our price submission on page 65. Those new obligations that commenced and impacted our operating expenditure in the 2021/22 year included:

- Environmental Protection Act
The latest environmental laws came into effect on 1 July 2021. The changes increased our obligations to take proactive steps to prevent and minimise harm to the environment and human health.

To meet the new general environmental duties within the Act, during 2021/22 we:

- increased our consideration of options to mitigate environmental risks
- increased our activity to document the reasons why the risk mitigation is or isn't 'reasonably practicable' in light of the particular facts or our circumstance of the time

- commenced a continuous review of our internal environmental policies and procedures.
- Minister's Letter of Expectations
Changes in recent years have increased obligations to meet the ongoing expectations of the Victorian Government. Areas that specifically had impacts on 2021/22 costs include:
 - Demonstrating reasonable progress in integrating climate change adaptation into planning and decision making in the business
 - Supporting Government forums and urban water security planning
 - Building extensive and effective community engagement and partnerships
 - Complying with the Victorian Government Social Procurement Framework
 - Implementing commitments within Integrated Water Management (IWM) Forum Strategic Directions Statement including demonstrate leadership by collaborating with local partners in implementation.
 - Compliance with the Gender Equality Act (see below)

- Gender Equality Act
Our obligations under this Act commenced on 31 March 2021. The Act includes 5 key tasks to meet our obligations:
 1. Promote gender equality
 2. Conduct gender impact assessments
 3. Undertake a workplace gender audit
 4. Create a Gender Equality Action Plan
 5. Report on progress

Activity during 2021/22 to meet compliance dates¹ included undertaking and submitting a workplace gender audit and development and submission of our first Gender Equality Action Plan. In preparation for ongoing commitments we also established capability to capture workplace gender equality indicators and to undertake gender impact assessments during 2021/22.

Our ongoing obligations include:

- considering, promoting and taking positive action towards achieving gender equality when developing and delivering policies, programs and services that have an impact on the public
 - regular workplace gender audits,
 - undertaking actions to meet our GEAP targets,
 - capturing, recording, and reporting gender equality data,
 - reviewing policies, programs and services and
 - undertaking gender impact assessments when developing policies and programs and in delivering services that are to be provided to the public, or have a direct and significant impact on the public.
- Security of Critical Infrastructure Act

¹ Implementation timelines: <https://www.genderequalitycommission.vic.gov.au/what-you-need-to-do-to-comply> (accessed 28 April 2023)

Reforms were introduced in 2022 to broaden the number of sectors captured as critical infrastructure. This included the addition of water and sewerage infrastructure. This increased our obligations as owners and operators of critical infrastructure assets to build a more comprehensive understanding of threats. In particular enhancing our risk management, preparedness, prevention and resilience capabilities increased our operating expenditure.

Given the breadth and complexity of these new requirements we increased capacity within the business and used contractors and consultants to assist us to assess the requirements and undertake actions to ensure we moved towards compliance and meeting expectations. We consider the activities listed above are business as usual tasks now, requiring ongoing internal and external resources to ensure we meet legislative obligations, our Statement of Obligations and the expectations of our Minister.

3. COVID-19 impacts

Our employee turnover rate during the 2020/21 and 2021/22 years was much higher than experienced previously. This reduced employee benefits operating expenditure as we carried vacancies whilst endeavouring to attract replacement resources during those years. The uplift in operating expenditure in the 2021/22 year was the result of commencing to return towards 'normal' staffing levels, in particular in our Development Services and Maintenance teams, during the second half of the 2021/22 year. We note our baseline adjustments includes \$0.40 million in additional expenditure to return us to pre-COVID-19 resource levels which has largely occurred during 2022/23.

Our staff development was impacted by COVID-19 in 2020 and 2021, reducing well below pre-COVID-19 expenditure levels. The increase in 2021/22 expenditure reflects a slight correction towards pre-COVID-19 expenditure levels.

4. Observed price / cost increases

We observed a number of input cost increases during 2021/22 when compared to 2020/21. Some of these were likely partially driven by COVID-19 impacts, however we have allocated them in this driver.

Chemicals

Prices for chemicals increased across both water and sewer treatment cost centres. In particular we note liquid alum fluctuated from \$208.40 to \$293.50 per ton during the year, liquid polymer increased by 5 per cent and the fuel levy applied later in the 2021/22 year increased our costs.

Water sampling and testing contract

Our contract price to undertake sampling and testing increased by \$0.40 million during 2021/22. This is an ongoing cost and was (and remains) reflective of market conditions.

Insurance

We have participated in a joint procurement process with Victorian water industry colleagues for many years. Renewals for the 2021/22 year saw significant increases in insurance premiums

impacted by unprofitable insurers loss ratios and COVID-19 losses beginning to impact those loss results further.

All classes of insurance premiums increased from 1 July 2021, some up to 90 per cent. The weighted average increase was close to 40 per cent.

Fuel

Fuel use is not inconsequential for us. Our service region is large and our people commute considerable distances to provide services in remote locations. Price increases reflected the ABS index which showed a 32.1 per cent annual change in fuel costs from June 2021 to June 2022.

5. Other

Employee benefits and consultant and contractor support

Increases in expenditure associated with resourcing:

- the maintenance centre function, to support delivery of reactive and proactive maintenance works ensuring our increasing asset management obligations are met
- the customer relations function, to support customer experience including enhancing support for vulnerable customers
- the engagement function, to increase our stakeholder engagement stewardship approach

Electricity

Increases in electricity expenditure were driven by a correction in energy usage following two years of lower than usual usage. Usage from 2018/19 to 2021/22 is provided below to demonstrate this along with total water consumption, being the primary driver for our energy use year on year.

Year	Usage (Mwh)	Water Consumption (ML)
2018/19	21,761	11,986
2019/20	19,275	11,470
2020/21	18,616	10,987
2021/22	21,270	11,676

6. Non-Recurring

This expenditure has been removed within the \$4.13 million adjustments for non-recurring expenditure items incurred in 2021/22 from the 2021/22 baseline year – see page 38 of our price submission.

2.2 Proposed baseline operating expenditure reductions.

The draft decision includes reductions from our proposed baseline totalling \$2.2 million, being:

- Operating projects – \$1.2 million
- Contractor support – \$1.0 million

Despite our proposal to under-recover revenue requirement, and that these adjustments have not impacted that position nor proposed tariffs, our intent in responding here is to ensure that an appropriate operating expenditure forecast is set during this review. An accurate controllable operating expenditure goes some way to ensuring that when developing our next price submission our actual expenditure is being compared to a realistic approved 2026/27 controllable operating expenditure.

Operating Projects

We acknowledge FTI Consulting's review of this area of our expenditure. Their report clearly indicates a level of confusion on their part with the nature of these expenses. Despite efforts to rectify this confusion from our end during their review, the final report recommended reducing our expenditure on these projects by \$1.2 million on the basis of an absence of clarity.

Below is a table of expenditure on our operating projects over the most recent completed five years. Expenditure fluctuates project to project, year to year, however this table demonstrates:

1. The projects deliver on obligations a water entity is required to undertake
2. The projects are programs of ongoing works, classified as projects to ensure sufficient rigour in managing outcomes and spend (ie project management)
3. Adjustments totalling over \$4 million for non-recurring operating project expenditure related to the 2021/22 year was made in our price submission
4. The total of \$1.92 million after baseline adjustments is lower than the five year average (\$2.02 million)

Operating Project Summary	2017-18 \$M	2018-19 \$M	2019-20 \$M	2020-21 \$M	2021-22 \$M
Capex project write-offs (Accounting Adjustments)	-	-	-	-	2.41
Capital Project Investigations	0.13	0.04	0.21	0.37	0.44
Enhancing treatment capacity for growing industry	-	-	-	0.20	0.25
Cyclical Consultancies	0.15	0.16	0.09	0.12	0.18
Decommissioning of assets	-	0.02	-	-	-
Incident Management	0.86	0.04	0.53	0.62	0.49
IT Projects - previously capitalised (change in Accounting Standard)	-	-	-	-	1.35
Lagoon de-sludging program	0.71	0.13	0.04	0.17	0.42
Maintenance Programs	0.43	0.55	0.18	0.19	0.03
Monitoring Programs	0.02	0.04	0.01	0.00	-
Non-Revenue Water - leakage detection and repair	0.14	0.04	0.08	0.09	0.08
Sewer CCTV Monitoring	0.37	0.37	0.39	0.35	0.16
Other	0.17	0.10	0.06	0.01	0.14
TOTAL OPERATING PROJECTS	2.96	1.50	1.58	2.12	5.97
Less: Non-cash, capital expenditure write-offs	-	-	-	-	(2.41)
Less: IT Project write-offs (new Accounting Standard)	-	-	-	-	(1.35)
Less: Reduction for Lagoon de- sludging program	-	-	-	-	(0.28)
OPERATING PROJECTS, after Baseline Adjustments	2.96	1.50	1.58	2.12	1.92

The proposed adjustment in the draft decision would reduce expenditure on these programs to approx. \$0.8 million per annum. This will impact our delivery of services to customers and has the potential to impact our compliance obligations in the future.

We submit that the \$1.2 million is required expenditure to maintain current levels of customer service and that this should be re-instated in our baseline operating expenditure.

Contractor Support

In the context that we propose to under-recover revenue requirement, and given the short period of time to respond to the draft decision, we respond only to the proposed expenditure reduction relating to cyber security in this section.

FTI Consulting's recommendation, accepted by the Commission, is to exclude expenditure related to contractor support including for cyber resilience expert support. Their recommendation is based on us not adequately explaining the drivers of the expenditure increase compared to approved 2021/22 controllable opex per the 2018 determination and not separately identifying and costing this.

Our response deals with both matters

- The driver of the expenditure increase compared to approved 2021/22 controllable opex per the 2018 determination.

FTI Consulting's final report states that cyber security is an important issue for all water businesses as well as utilities and other corporations more generally and that one of the unforeseen changes that have impacted costs since the previous water price review in 2017-18 includes the "ramping up of the need to do more to mitigate cyber security risks".

We agree with these statements and submit that the driver of our costs incurred in 2021/22 related to contractor support for cyber security is:

1. clearly explained by the unforeseen change in expectation,
 2. aligned with requirements from regulatory/legislative obligations, and
 3. ongoing in nature.
- Separately identifying and costing the expenditure

Our system clearly identifies and costs expenditure. This level of detail was not requested by FTI Consulting during their review. Their final report details confusion between costs incurred regarding digital transformation, which includes an aspect of cyber resilience, and the engagement of expert resource support to complement our existing capacity and capability. The latter is the matter in contention here.

FTI Consulting's final report includes a summary of our response to their high level queries in this space:

"Cyber security: This relates to expert advice and support to ensure the risk of exposure to cyber threats was minimised as much as practicable. Wannon Water indicated that this expertise was not available in-house, nor does it consider it prudent and efficient to recruit these highly remunerated roles."

We engage an organisation to provide a Managed ICT Security Services. Like most other organisations we are not able to do this specialist work in-house. This service commenced in 2021/22 at a cost of \$13,232.82 (excl GST) per month. Subsequently from July 2022 onwards we have accessed a more competitive price through the Victorian Government Contract for the provision of:

1. Security Operations Centre at a cost of \$6,891.50 (excl GST) per month, and
2. Threat Intelligence Service at a cost of \$4,901.75 (excl GST) per month

We can provide invoices that support this expenditure.

The annual ongoing expenditure is forecast at \$141,519 (excl GST) for this managed service.

We submit that the \$0.14 million is required expenditure to mitigate the cyber security risk and that \$0.14 million should be re-instated in our baseline operating expenditure.

2.3 Great Tasting Water operating expenditure

The draft decision provides for reduced capital expenditure to progress this project, however it removes all the new operating expenditure proposed in our price submission.

We are committed to delivering the project (see 3.1 Great Tasting Water section), and as such we will incur additional operating costs relating to the new treatment infrastructure.

We request that the proposed removal of all operating expenditure be revisited. We would welcome a conversation with the Commission to agree on an appropriate operating expenditure amount and the timing of this.

If these costs are not included in controllable operating expenditure projections in the final determination, we request at a minimum that it be noted in the final decision that we expect to exceed the approved 2026/27 total controllable opex per 2023 determination by \$0.39 million, being the amount proposed in our price submission for that year. It would also appear prudent to allow for the proposed operating costs associated with this project in regulatory period six.

3.0 Capital Expenditure

3.1 Great Tasting Water

The draft decision on page 33 adopts an amount of \$1.6 million over the regulatory period to enable the project to commence. This is based on the Commission agreeing with their consultant's view that there is a high level of uncertainty regarding the timing and delivery of the project in the regulatory period. Additionally, the Commission have a view that given the delays experienced in delivering the Warrnambool STP project, that we should be carrying all the risk associated with this project. The Commission recognised the priority that customers have placed on the project.

Our confidence levels regarding timing and delivery of this project remain considerably higher than that of FTI Consulting and the Commission. Our price submission proposed to take on a significantly increased share of risk and protecting customers bills from increasing beyond what they could have been. Reducing the amount related to this project on the basis of risk sharing in isolation of our whole submission appears inconsistent.

However in the context of under recovering our revenue requirement, we note the reduction in capital expenditure and accept the \$1.6 million allocation to progress the project.

We remain committed to providing a solution to the communities who have provided compelling feedback over many years. Despite the allocation of funding being significantly less than required to achieve our price submission commitment, we will provide a solution to at least one community during this regulatory period. We will finance the project through increased borrowings and note for future reference, that we will seek to roll actual capital expenditure incurred for this project into the RAB from 1 July 2028.

With \$1.6 million allocated to enable the project to commence during the 2023-28 period, we propose that the remaining \$14.2 million proposed be included in the 2028-32 period. This would provide a full picture of the funding to complete the project, albeit over a longer period, and is consistent with the Commission's view regarding the timing of the project. In the updated Price Review Model we have included \$14.2 million spread evenly over the first three years of the 2028-32 period².

We note the draft decision did not consider that this project was a key driver to deliver *Outcome 4: Improve water quality to identified communities*. Our capacity to deliver upon all proposed measures within the reduced total capital expenditure will be negatively impacted. These targets are now considered stretch targets.

In accepting the draft decision and maintaining our proposed measures and targets, we are taking on additional risk on behalf customers and are proposing a significant improvement in customer value. This should be considered when the Commission further contemplates their PREMO assessment following our overall response.

² DD_WNW_2023 Price Review Model, Capex_FO input sheet, cells V43 – X43

3.2 Warrnambool STP Upgrade

The draft decision on page 46 requests us to update our proposal to exclude costs in relation to the Warrnambool Sewage Treatment Plant (STP), until the upgrade works are completed and operational.

We understand the concept the draft decision describes, being customers shouldn't be paying for the Warrnambool STP project until it is complete.

We note that:

1. In the context of under recovering revenue requirement there is not a compelling reason to make this change – customer bills are lower than they could otherwise be and that 'reduction' could be associated with reducing tariffs as the Warrnambool STP project is not complete.
2. Our proposal includes 2022/23 capital expenditure of \$14.25 million be added and included in our RAB starting balance. This amount is significantly less than our \$53.6 million forecast capital expenditure in 2022/23. The difference is largely due to the Warrnambool STP project. We expect, and note for future reference, that we will seek to roll actual capital expenditure incurred for this project into the RAB from 1 July 2028, meaning customers will not be paying for this significant proportion of expenditure during this 2023-2028 period.
3. New operating expenditure related to the Warrnambool STP is included after the project is complete and the plant operational.
4. Our proposed baseline operating expenditure does not include any expenditure associated with this project.

We are amenable to excluding capital expenditure in relation to the Warrnambool STP project until the upgrade works are completed and operational on the basis that:

1. It does not impact our under-recovery of revenue requirement position,
2. We proposed that our customers pay less than the Water Price Review approach allows during the regulatory period,
3. It does not impact proposed tariffs, and
4. The solution that a water corporation allow for capital expenditure only when a project is complete should not be considered a precedent.

We are fortunate to have the balance sheet capacity to move the \$52.79 million capital expenditure proposed during years 2023/24 and 2024/25 to the 2025/26 year when we expect the project to be completed. Before allowing for any costs associated with financing the \$52.79 million during those two years, the impact is a reduction in NPV Revenue Requirement of \$2.1 million over the period.

This change has been made in the updated Price Review Model³.

³ DD_WNW_2023 Price Review Model, Capex_FO input sheet, cells Q42 – S42

3.3 Other

We draw the Commission's attention to a statement in the draft decision on page 34 which reads:

"Wannon Water has not specifically identified any project costs it has excluded where there is uncertainty in timing, cost, scope and benefits of capital expenditure."

We assume that if this view is widely held it has likely had a negative impact on the Commission's assessment of our PREMO rating.

Given that we feel compelled to offer the following response to correct the misinformation:

- We specifically stated in our price submission on page 29 that we deferred "...\$15 million in projects until our next price submission, ensuring customer bills aren't higher than they need to be, and that there is a higher likelihood of the program being delivered." This was almost 10 per cent of our proposed capital investment program.
- Our 'Register of capital expenditure projects deferred' was referenced in our price submission on the same page. This was not requested during the Commission's review and remains available upon request.
- There were other references to prioritisation of projects / programs in our price submission, most notably on page 13 where we disclosed our approach to allocating risk within our capital investment plan.

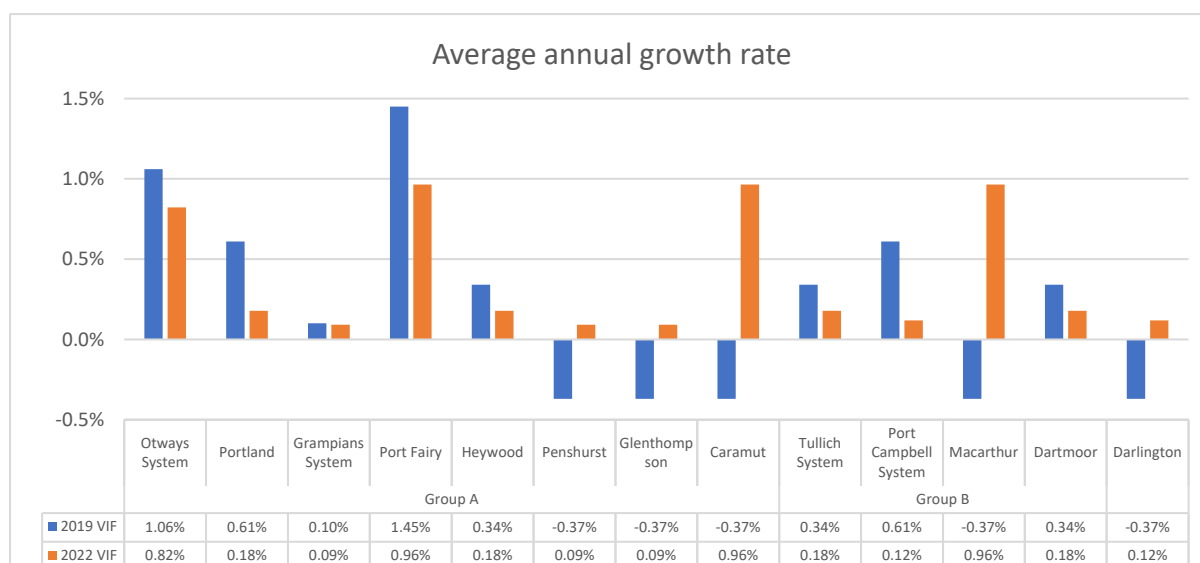
These disclosures should be considered when the Commission is reconsidering their assessment of PREMO.

4.0 Demand

The draft decision on page 42 included a request that we “...demonstrate how it has considered these [Victorian Government population and dwelling growth] updated estimates and if required, identify and justify any changes to its demand forecasts.”

We have reviewed the Unpublished Victorian Government Victoria in Future (VIF) Projections, 2022 and compared them to the VIF 2019 projections used to inform our price submission growth and demand assumptions.

For our service region population VIF 2022 projections have reduced when compared to VIF 2019 projections. This is demonstrated per service system and tariff category in the graph below:



For Group A, which comprises 92 per cent of our residential customers, our price submission proposed a weighted average growth rate of 0.8 per cent calculated from the VIF 2019 projections for the 2023-28 period. Applying VIF 2022 projections, the revised weighted average is 0.6 per cent. If adjusted, the impact on water demand is a 215,654kL reduction over price submission period.

For Group B, our price submission proposed a weighted average growth rate of 0.3 per cent, increasing to 0.4 per cent, calculated from the VIF 2019 projections for the 2023-28 period. Applying VIF 2022 projections, the revised weighted average is 0.2 per cent. If adjusted, the impact on water demand is a 8,611kL reduction over price submission period.

Darlington’s demand would increase by 115kL if the growth rate was amended from 0.4 per cent to 0.1 per cent.

These overall results are consistent with an overall reduction in state wide growth in VIF 2022 projections when compared to VIF 2019 projections.

We note for clarity that there are some clear anomalies with the annual growth rate data presented above. VIF 2019 included Victoria in Future Small Areas (VIFSA), being sub Local Government Areas (LGA) defined by DELWP based on Statistical Area Level 2 of the Australian Statistical Geography Standard. VIF 2022 projections are provided at LGA level, a higher aggregate level compared to VIFSA. This has impacted our alignment of growth projections for Penshurst, Glenthompson,

Caramut, Macarthur and Darlington in particular. For example, Peshurst is in the LGA of Southern Grampians, with the majority of its population in Hamilton. Likewise, Carmaut is in the LGA of Moyne, whose growth is influenced by Port Fairy. We would expect Peshurst and Carmaut's growth to be significantly lower than the LGA growth rate.

The impacts on water demand outlined above are not material over the five year period. We propose to retain our higher demand projections, which increases the risk we take in relation to revenue over recovery.

5.0 Tariff Structures and Prices

5.1 Prices

The draft decision on page 46 requests us to “propose updated prices that reflect our draft decision and any updates to its revenue requirement.”

Whilst the revenue requirement has been amended, the draft decision does not impact our proposed prices as stated on pages 72 – 75 of our price submission. These are the prices we continue to seek approval for.

Our proposal to under-recover revenue requirement remains. Should the Commission make adjustments to revenue requirement that see it move below NPV Net Prescribed Revenue as per the Price Review Model, then we would welcome a conversation about prices.

5.2 Considering the impact of inflation

The draft decision states we “must demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and whether these impacts are reasonable taking into account that some of its key costs are unlikely to increase as much as near-term inflation.” (pg46)

We acknowledge that there is no cost index, including Consumer Price Index (CPI), that aligns with our cost profile. We have experienced, and expect to experience again, that some of our costs will increase by less than CPI while others will increase by more. We acknowledge that the price review model requires medium term forecasts, and by their nature there will be occasions where actual costs are higher and lower than forecasts. Our price submission clearly indicates that we are wearing the risk of higher costs on behalf of customers.

We expect material expenditure increases compared to our price submission forecasts. Electricity and capital expenditure are provided below as examples. We also expect increases beyond CPI in IT, insurance and consultant related expenditure. Our price submission did not include additional increases for these expenditure items.

- Electricity – a recent update to the Schneider electricity price forecasts indicates that energy price forecasts in our price submission are considerably lower than updated forecasts. The below table demonstrates the expected change in electricity price over the regulatory period.

Year	Price Submission (2022)		Updated Report (2023)		Change	
	Peak (excl. loss factor, per KWh)	Off-Peak	Peak (excl. loss factor, per KWh)	Off-Peak	Peak	Off-Peak
2023-24	\$0.06606	\$0.04538	\$0.06598	\$0.04533	-0.1%	-0.1%
2024-25	\$0.06774	\$0.04616	\$0.09670	\$0.06710	42.8%	45.4%
2025-26	\$0.07151	\$0.04873	\$0.09464	\$0.06502	32.4%	33.4%
2026-27	\$0.07613	\$0.05188	\$0.08610	\$0.05915	13.1%	14.0%
2027-28	\$0.07238	\$0.04932	\$0.09455	\$0.06496	30.6%	31.7%

The ABS Producer Price Index for March 2023 showed a 22.6 per cent increase year on year for electricity and gas prices.

- Capital – subsequent to developing our capital expenditure program for the price submission, GHD undertook a piece of work for us to understand the impact of current economic conditions as well as water sector specific factors that would impact our future costs⁴. Their analysis concluded with forecasting a 10 per cent compounding cost escalation each year after 2022/23. We continue to receive quotes and tenders associated with capital projects that indicate our proposed capital expenditure will be put under significant pressure due to contractor and materials cost increases.

The ABS Building Construction Producer Price Index for March 2023 showed a 9.6 per cent increase year on year.

To demonstrate our considerations about the reasonableness of inflation impacts we provide the following:

- We highlight that our price submission proposes to under-recover revenue requirement and that the draft decision does not alter this approach – that is, we do not seek to fully recover forecast expenditure from our customers. In balancing affordability and service delivery outcomes, we have effectively proposed to discount the impact of inflation on tariffs each year in our proposal.
- We briefly considered phasing our small annual tariff increases to weight them higher in years two to five when assumed forecast inflation is lower. This approach is inconsistent with our deliberative community panel’s recommendation for steady bill increases now rather than substantial increases later. It also impacts our proposal to increase variable water charges to provide customers with more bill control. We weight these aspects of our submission highly.
- We proposed an aggressive 1 per cent operating expenditure efficiency factor, being negative 0.3 per cent net of growth, over the period, offsetting impacts of inflation on operating expenditure in 2023/24 and subsequent years.
- We remain acutely aware of the interests of low income and vulnerable customers. Our price submission addresses this, and the draft decision (see section 5.3.3 on pg47) supported our approach including:
 - Investing \$0.5 million in proactive identification, communication & outreach programs
 - Doubling our budget for our financial support programs, which is an additional \$0.2 million into initiatives such as our bonus credit system for meeting payment instalments
 - Retaining our payment difficulty information disclosure guarantee, whereby if we restrict a customer's water supply without reasonable endeavours to contact and provide support to the customer they will receive a GSL of \$300

We consider the above approach to be sufficient to deal with impacts that high inflation might have on customers. If required we are well placed to divert even more resources to help customers manage their 2023/24 bills.

As requested we have considered our cost forecasts and conclude, on balance, to apply the 7 per cent CPI to our tariffs effective from 1 July 2023.

⁴ GHD Technical Memorandum – Business Case Addenda: Capital Cost Increases, 15 December 2022

The Commission will approve maximum tariffs, including inflation for the 2023/24 year in their final determination. Our Board is required to approve tariffs charged from 1 July 2023. This is planned to occur after the Final Determination in June 2023. When considering tariffs from 1 July 2023 our Board may consider approving a lower tariff. This has occurred previously and will be determined based on circumstances at that time.

5.3 Sixth period tariff outcomes

We note the Revenue Requirement and Net Prescribed Revenue in the Price Review Model is not balanced in the sixth regulatory period. These tariffs are not the subject of this review and we feel it is unnecessary and premature to make amendments to sixth period tariff outcomes for this response. Our preference is to wait until the Commission has considered this response. When the variables in the Price Review Model are finalised by the Commission we request the opportunity to review the tariffs in the sixth period.

6.0 New Customer Contributions

The draft decision requests at page 49-50 that we must:

1. Update its modelled new customer contributions for each area and ensure the parameters used are consistent with the financial model (including inflation, tax and regulatory rate of return) and must include all the formulae used
2. Demonstrate that the growth capital expenditure and new customer contributions revenue included in the new customer contributions model and the regulatory asset base can be reconciled
3. Provide its cost modelling for the Warrnambool roof water harvesting area to demonstrate that the \$2,200 discount is still appropriate or required
4. Provide an updated new customer contributions model for 'All other areas' to demonstrate that the \$800 new customer contribution is still cost reflective
5. Submit its transition plan towards the application of cost reflective new customer contributions
6. Set out how it proposes to fund any shortfall in revenue from new customer contributions, compared to the estimated costs of providing the service.

This is a substantial request in the context that:

- We are not proposing changes (before inflation) to our NCC charges,
- Developers have told us they value consistency/certainty of NCC charges given the long lead times with development projects,
- Our water NCC charge is already at the high end when compared to other water businesses (based on 2022/23 charges),
- Our customer growth rate is very low, meaning our NCC charges are not a material revenue item in our price submission,
- We propose to under-recover revenue requirement, and
- The time provided to respond to all the matters raised in draft decision was limited.

We have updated the Warrnambool growth area water and sewer NCC models with the parameters used in the Price Review Model. We will provide this separately to Commission officers. In summary, the NCC model outcome for water is \$7,993 and for sewer is \$3,867. Our proposed NCC charges for water and sewer in this growth area are \$5,200 and \$990 (before inflation) respectively.

We do not intend to update the NCC models for the North Dennington Growth Area and All Other Areas. New connections in these areas are small and inconsequential in terms of revenue.

Our growth capital expenditure for the Warrnambool growth area water (\$20.8 million) and sewer (\$38.7 million) NCC models is available on request. We can demonstrate that what is included in the Warrnambool growth area water and sewer NCC models and the regulatory asset base are consistent. This is best undertaken via a discussion and presentation of the data as it consists of 30 separate projects over the 10 year period. We are happy to meet with Commission officers for this purpose.

We believe the discount for the Warrnambool Roof Water Harvesting Area remains appropriate. Our key resource in demonstrating that the discount amount remains appropriate has been on leave. Our response is due prior to their return. If this remains an issue that the Commission wishes to progress then we are happy to liaise with Commission officers during their assessment period of this response.

We do not, and have never had an NCC model that demonstrates the All Other Areas NCC. For clarity we note that the proposed NCC charge is \$990 (before inflation), not \$800 as stated in the draft decision. An NCC model for these small towns would undoubtedly be a negative amount, driven by the existing spare capacity meaning new growth infrastructure is not required in the short to medium term. This NCC was set in 2013 on the basis that developers should be contributing to the increased use of the system. This was agreed by the Commission at the time. It continues to seem reasonable to have an NCC charge for these areas. Again, we are not proposing increases to this NCC charge (before inflation).

We do not believe that cost reflective NCC charges provide the appropriate price signals to developers and our customers. We challenge the cost recovery presumption in the draft decision on the basis that the NCC model is one consideration to setting NCC charges. We also consider environmental, social and governance outcomes when considering NCC charges. These include considerations about reducing barriers to increasing affordable housing in our region, regional equity in pricing and reducing compliance risk. Our observation of the NCC model is that its outcome is prone to significant movements when parameters change in small increments. This supports our assertion that the NCC model is not the sole factor when considering what an appropriate NCC charge is. If the model is accepted as cost reflective, then the modelled outcome would change every five years and move up and down. This would not be a palatable outcome.

Given our view that NCC charges are not set at NCC model reflective pricing, responding to how we plan to transition towards cost reflective NCC charges and how we propose to fund shortfalls in revenue from NCC revenue is a moot point. We recognise that our tariff structure has cross subsidies at many levels. Cross subsidies exist as a reflection of our varied customer base, our broad regional service area, and our varied supply systems. The Commission has recognised the balance between cost reflective tariffs in our context and easy to understand tariff structures and has supported our approach to move towards the later over an extended period. Funding any NCC revenue shortfall as a result of setting a social pricing NCC has been and will continue to be one of the many cross subsidies in our revenue model.

We are aware that a number of other water corporations have proposed a new NCC model. We commit to investigating this model for use in future price submissions.

Finally, any changes to NCC charges would require engagement with those impacted. This has not occurred. The Commission should consider this when contemplating any changes to our proposal to maintain NCC charges (before inflation).

Given our response to the draft decision is to maintain our proposed NCC charges, we have not updated customer contribution forecasts in the Price Review Model. The amounts remain an accurate forecast of expected customer contribution revenue during the regulatory period.

7.0 Cost of Debt adjustment mechanism

The Commission stated in its draft decision that it agreed with the intent of our proposal to ensure that cost of debt (COD) adjustments are not applied where it is already charging below its revenue requirement.

The Commission requested (on page 50) that they “...require Wannon Water to propose an adjustment mechanism that will enable its prices to adjust downward where they would otherwise exceed the revenue requirement in a particular year. This adjustment should limit downward movements to match the revenue requirement.”

We have consulted with Commission officers regarding this matter and our response reflects the outcome of that discussion.

Our proposed prices will result in a shortfall between forecast revenue and the forecast revenue requirement in each year over the next 2023-28 regulatory period. We proposed in our price submission to include a mechanism in our determination to ensure that the gap between revenue and the revenue requirement does not increase further because of annual COD adjustments. We accept the Commission’s logic in its draft decision that our forecast revenue should not go above the revenue requirement in a particular year. This may occur when a COD adjustment is negative for a particular year.

Schedule 5b Formula 4 of Wannon Water’s 2018 price determination outlines the process for calculating the adjustment to prices to reflect changes in the COD. Our proposed adjustment mechanism is to incorporate wording into Schedule 5b of our 2023-28 price determination. The wording should reflect the following:

- COD adjustments are calculated consistent with formula 4 in Schedule 5b (no change)
- All positive COD adjustments are fully passed through prices (no change – formula 5 is applied)
- Only negative COD adjustments are passed through to prices when the adjusted revenue requirement is lower than determination revenue in that year. The COD adjustment passed through prices would be capped at the amount that determination revenue equals adjusted revenue requirement.

We don’t believe this requires a formula within the final determination. We can work together with the Commission prior to the final determination to ensure appropriate wording is included in Schedule 5b at Formula 4 that reflects the approach outlined above. As a starting point we propose the following:

Prior to applying formula 5 (apply the change in revenue requirement from formula 4) include an assessment and take the following actions:

- If the COD adjustment is positive, proceed to formula 5 (i.e. the COD adjustment is fully passed through prices)

If the COD adjustment is negative and when the adjusted revenue requirement remains higher than determination revenue in that year the COD adjustment is not passed through prices, and formula 5 is not applicable. The adjusted revenue requirement equals the determination revenue requirement plus the COD adjustment in that particular year

- If the COD adjustment is negative and when the adjusted revenue requirement is lower than

determination revenue in that year, the COD adjustment is passed through to prices but only to the extent that the adjusted revenue requirement equals the determination revenue in that particular year.

8.0 PREMO

The Commission has assessed a PREMO rating consistent with our self-assessment – being an overall Standard.

In the context that the draft decision states that our responses to the Commission’s requests will be considered in the Commission’s final assessment of PREMO we provide the following:

8.1 Management

We note the Commission has rated this lower than our self-assessment. Our response seeks to remedy this by providing adequate justification in the operating expenditure area that has influenced the Commission’s assessment of this area of PREMO.

We have addressed and justified the baseline operating expenditure matters earlier in this response. In the context of under-recovering our revenue requirement and the short timing required to provide responses to the draft decision, we have chosen to waive responding to the balance of the adjusted expenditure in this area.

We contest that the expenditure adjustments relating to the Great Tasting Water project should not impact this element of PREMO. FTI Consulting recommended the removal of capital expenditure associated with the Great Tasting Water project. The draft decision on page 28 states that the operating cost for this project were not assessed for prudence and efficiency. Given this element wasn’t tested we suggest that judgement in relation to this expenditure should not be made for the purpose of assessing a Management rating.

In support of our view that the Great Tasting Water project operating expenditure is prudent and efficient, we highlight that except for expenditure related to this project:

- All new operating expenditure evaluated during the review was assessed as prudent and efficient
- All major capital projects expenditure evaluated during the review was assessed as prudent and efficient

Our process in forecasting Great Tasting Water capital and operating expenditure did not differ to other expenditure assessed as prudent and efficient.

We submit that the weighting provided to these adjustments appears excessive, particularly given our proposed approach to under-recover revenue requirement. We note that even with all the expenditure adjustments proposed in the draft decision, our proposed prices remain well below revenue requirement.

8.2 Outcomes

The draft decision on page 15 states the Commission “...will provide Wannon Water with our standard Outcomes Reporting Template, identifying issues we have found during our preliminary review, to complete and submit with its response to this draft decision.”

We have completed the Outcomes Reporting Template and will submit this separately to Commission officers.

Our price submission referenced the availability of additional information (page 32 and referenced on each of the six measures of success tables on pages 26-32). This information was not requested by the Commission during their preliminary review and would have answered the majority of issues identified.

We encourage Commission officers to contact us to discuss any outstanding matters with our Outcome measures and targets.