

9 May 2023

Ms Kate Symons
Chairperson
Essential Services Commission
Level 8 570 Bourke Street
Melbourne Victoria 3000

Dear Ms Symons

SRW Price Submission – Draft Decision

Southern Rural Water (SRW) is pleased to be able to respond to the Essential Services Commission's (ESC) draft determination on our Price Submission 2023-28.

SRW is committed to providing great value to our customers and community through excellence in rural water management. This has underpinned our Price Submission, enabling us to continue our modernisation program which is designed to improve our reliability and facilitate greater on farm productivity, in a cost-effective manner. More than 86% of our customers will see prices increases capped at CPI, with those in the Macalister and Werribee irrigation districts experiencing increases of 1-1.5% (+CPI) to help fund significant modernisation projects being constructed in these areas.

We welcome the ESC's support for our tariff structure and price pathways built on a proposal of prudent and efficient expenditure.

We would like to thank the Commission and its staff for the time spent reviewing our submission and the constructive discussions we have had to clarify some aspects of our submission.

Non-prescribed activities

We appreciate that different approaches have been applied to the treatment of some non-prescribed activities, notably the costs and services associated with government owned water shares, and how these were accounted for in the Price Submission and regulatory accounts. Our recent discussions have clarified this matter and provide a clear pathway for dealing with non-prescribed activities.

For the purpose of both our Price Submission and Regulatory Accounts:

- our total operational expenditure will include costs and services associated with government-owned water shares.
- our prescribed revenue requirement will exclude costs and services associated with government-owned water shares.
- costs and services associated with government-owned water shares will be charged to the shareholders as non-prescribed revenue.

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The proposed amendment does not affect our proposed prices as the revenue requirement remains the same.

Revenue requirement and operating expenditure

Our revenue requirements and operating expenditure have been adjusted in the model to reflect:

- the above approach to government-owned water shares,
- reinstatement in the regulatory depreciation, as set out below,
- latest CPI information provided by the ESC, and
- Other changes suggested by the ESC (e.g. environmental contribution).

Regulatory asset base

It is noted that the ESC has made a relatively minor adjustment to our regulatory asset base which we accept.

Regulatory depreciation

Following the lodgment of our Price Submission, we identified a version control issue with the template showing a lower level of regulatory depreciation. We subsequently submitted a revised template with data, consistent with the final document. The draft determination appears to be based on the data in the original template. It is requested that the data in the revised template be used, restoring the \$1.4m of regulatory depreciation in our 2023-28 prices.

CPI Response

As previously indicated more than 86% of our customers will see prices increases capped at CPI, with those in the Macalister and Werribee irrigation districts experiencing increases of 1-1.5% (+CPI) to help fund the significant modernisation projects being made in these areas.

The high inflation that we are currently experiencing is one of the legacies of the pandemic and of Russia's invasion of Ukraine. The pandemic interrupted the supply side of the global economy and this pushed up costs and prices. And on top of this, the monetary and fiscal policy response to the pandemic underpinned a strong recovery in demand that has also pushed up costs and prices.¹

Southern Rural Water has not been immune to these increasing costs.

- While salaries are being managed in accordance with our existing Enterprise Agreement (EA) and the Victorian government's Wages Policy, overall labour costs are further increasing due to labour market shortages and higher skill requirements leading to the recruitment of staff under the higher bands of our EA.
- Construction costs have risen to record levels in recent years on the back of COVID-19, global economic circumstances and high rates of domestic construction. This not

¹ Phillip Lowe, Governor Reserve Bank, 3 March 2023

only impacts our CAPEX costs but our OPEX through increased maintenance and repair costs via increased contractor and equipment costs.

- Similarly, information technology, electricity and insurance costs are also increasing at greater than CPI due to global economic circumstances, greater cyber security risk, increased labour costs and climate impact.

Consistent with the information that we provided to our customers through our customer engagement, our price paths exclude CPI. In line with our current practice, when the board is setting annual tariffs, consideration will be given to the factors that impact our OPEX to determine the level of CPI passed on to customers².

We will be able to reference cost changes through industry indices:

- Employee costs - We prepare an annual remuneration report for government that includes a SRW average salary value. This can be compared to reports from other water corporations.
- Maintenance costs (excluding employee costs) – We can review our costs against civil construction indices, including those provided by the ABS.
- ICT costs - We can review our costs against ICT indices, including those provided by the ABS and annual vendor software charges.
- Insurance – We can review these against our own costs and industry indices.
- Vehicle costs – We can review vehicle costs including fuel, from data supplied by our vehicle partner (Smartfleet), industry reports (RACV) and ABS data.

Consistent with our initial submission, and the outcomes of our customer consultation, SRW maintains its position that our price determination includes the ability to pass through CPI to our customers. SRW accepts the risks for increases above CPI, noting higher trends in one area will need to be offset by savings (actual) or lesser increases in other areas.

Recoverable CAPEX

We operate Lake Narracan and Yallourn Weir on behalf of the Gippsland power companies, who are the sole entitlement holders. Our role is effectively that of a facilities manager, with all expenditure associated with operating and maintaining these dams, including remedial or upgrade works, recoverable from the entitlement holders in accordance with the Bulk Entitlement Conversion Orders.

Consistent with previous Water Plans/Price Submissions we plan to charge \$8.28m to the power companies as these works as incurred and to classify these costs as non-controllable operating expenditure rather than capital expenditure.

Performance outcome measures

We have revised our performance outcome measures in line with feedback from the ESC, as attached to this letter. These changes have been made to make the measures clearer and more meaningful.

² MID = 1.5%+<CPI and WID 1.0%+<CPI.

PREMO

We welcome the ESC's assessment of our Submission as 'Standard' but seek reconsideration of the Management rating as 'Basic'.

- We have demonstrated that our proposed prices reflect only prudent and efficient expenditure, as acknowledged by the ESC.
- We have justified our commitment to cost efficiency or productivity improvements.
- We have provided evidence that there is senior level, including board level, ownership and commitment to its submission and its outcomes, most recently by our Board Chair having attended the public forum on May 1.
- We have demonstrated an "open book" approach to our Price Submission.

The principal area for concern appeared to be the treatment of non-prescribed costs. As discussed subsequent to the draft determination, the matter was not so much an error but uncertainty and inconsistency of how this matter was treated between previous submissions, the Regulatory Accounts and our Price Submission.

Any other matters were relatively minor and did not have a material impact on pricing.

We remain confident that our management rating is 'Standard'.

Environment

During the recent community forum, we heard from numerous community members, raising concerns about waterway health, diversions and the environment.

We are committed to providing great value to our customers and community through excellence in rural water management. From a community perspective this means being an effective resource manager. Our Price Submission seeks to achieve this through:

- Our modernisation program which is designed to promote a more efficient use of water with water savings shared between customers and environmental beneficiaries.
- Our automated meter reading program, which is designed to provide real time usage information so we can detect when customers are at risk of breaching their licences and entitlements.

The State Government has a major focus on the unauthorised take and use of water. Our Price Submission includes an additional allowance (\$200k per annum) for compliance activities with efficiency savings from our automated metering program also being applied to compliance activities in support of our zero-tolerance approach to water theft.

Conclusion

Once again, we thank the ESC for its draft determination and for the time spent with staff discussing our proposal.

We look forward to receiving your final determination.

In the meantime, if you have any queries, please do not hesitate to contact us at [REDACTED] and [REDACTED].

Yours sincerely,



Joanne Butterworth-Gray
Chair



Cameron FitzGerald
Managing Director