

File ref: AD/06/3443

9 November 2017

Dr Ron Ben-David
Chairman
Essential Services Commission
Level 37, 2 Lonsdale Street Melbourne 3000
Via email: water@esc.vic.gov.au

Dear Ron

SUBMISSION ON WATER CORPORATION WATER PRICING PROPOSALS

Thank you for the opportunity to participate in the Essential Services Commission ('the Commission') water pricing review. The Victorian Environmental Water Holder (VEWH) provides the following submission to this process.

The VEWH has reviewed the price submissions of the five water corporations that provide environmental water services. They are:

- Grampians Wimmera Mallee Water (GMMWater)
- Southern Rural Water (SRW)
- Lower Murray Water (LMW)
- Coliban Water (CW)
- Central Highlands Water (CHW).

Barwon Water's price submission was also reviewed in anticipation of it becoming a future provider of environmental water services. Melbourne Water and Goulburn Murray Water are also important water corporations for VEWH, however, they are not part of this price review cycle.

The VEWH has significant statutory responsibilities for managing and delivering environmental water for the benefit of all Victorians. VEWH is a **significant customer** of water corporations and their services are critical in ensuring the effective utilisation of Victoria's reserve of environmental water. Water corporation fees and charges represent about 60% of VEWH's current operating budget and total around \$5.5m per annum. Water corporations are critical partners in the delivery of environmental and community outcomes under the Victorian Environmental Watering Program. Environmental water services are an important function of many Victorian water corporations. Since the VEWH's establishment in 2011, the Victorian Environmental Watering Program has delivered 4,924 gigalitres of water to 197 river reaches and wetlands.

As a relatively young discipline of the Victorian water industry, there is still some work to be done to clarify the services and applicable charging arrangements for environmental water. The Victorian Government's *Water for Victoria* document commits to undertaking work in 2017-18 to clarify these arrangements.

Current charging arrangements are specified in Bulk or Environmental Entitlement Orders, and there is a history of inconsistent approaches to applying these charging arrangements between water corporations. There is also some inconsistency in interpreting environmental water services as prescribed or not, including where they are the same or similar to other bulk water services. The Department of Environment Land Water and Planning is undertaking a review which will address these issues.

Overall, water corporations appear to have made minimal price changes for the main environmental water services, pending resolution of the state-wide policy.

Recommendation 1.

In making its Determinations, the Commission should recognise the likelihood of changes within the pricing period for environmental water services, and give guidance on how changes should be made and approved and the principles to be applied, as would other customers facing an uncertain price path.

Were the Commission to recognise that services provided in relation to VEWH held environmental water are 'non - prescribed services', then care should be taken to ensure that the revenue, operating and capital expenditure requirements of water corporations in relation to this water are included in the ESC's financial template as 'non-prescribed services' to ensure appropriate separation and greater transparency of charging arrangements being applied to this water.

The effective and sustainable use of environmental water greatly depends on a range of services provided by water corporations.

The services provided by water corporations include:

- inputs to annual planning processes
- delivery of environmental water through the management of water storages, release of water in accordance with annual watering plans, and delivery via distribution systems
- data, measurement, accounting and reporting
- associated works.

These services play a key role in assisting VEWH to provide the effective, efficient and sustainable management of the environmental water entitlements to provide for healthy waterways and catchments throughout Victoria. For its part, VEWH's ambitions for environmental water services and charges are to:

- provide certainty to both environmental water holders and water corporations
- be consistently applied state-wide
- be forward looking and promote positive, dynamic partnerships between agencies
- be fair, efficient, clear and predictable to support decision making and explanation to all stakeholders
- support the integrity of the entitlement framework
- enable and facilitate innovation and flexibility
- ensure appropriate transition arrangements to support any changes to current charging practice.

VEWH will be commencing discussions with a number of water corporations about drafting a Service Level Agreement (SLA). The aim is to produce SMART (specific, measurable, achievable, relevant and time-bound) service commitments and publicly report back against these commitments. It is hoped that this will facilitate a greater understanding between water

corporations and the VEWH of the nature of services required and provided, the appropriate and associated costs, and how these may differ from other water corporation customers.

Recommendation 2.

The Commission should recognise the role of more formalised Service Level Agreements for environmental water services as being consistent with the PREMO framework and incorporate them into their Determinations, should time permit and this be appropriate under current regulatory treatment of these services.

In future price submission processes, VEWH believes there is an opportunity to improve how it is treated as a customer under all elements of the PREMO framework. There is room for water corporations to expand the content in the written submissions detailing costs and pricing. More explanation around their cost building blocks, cost structures across vertically and horizontally integrated elements of their business, and more detail around cost allocation. Additional engagement and reporting against outcomes would also help to highlight the valuable work that water corporations do in relation to environmental water management. Similarly, additional information would enable different users of water corporation services to better understand the nature and cost of their services compared with other customers.

Environmental water as a prescribed service

GWMWater, SRW and LMW appear to treat environmental water services and charges as regulated services, typically linked to their bulk water services. CHW and CW have not mentioned environmental watering services and charges in their submissions, consistent perhaps with a non-prescribed service. This may be a function of the materiality of environmental water charges to their businesses but highlights a need for clarity.

Recommendation 3.

In the review of the pricing submissions, the Commission should:

- ***clarify which approach is currently correct, noting the ongoing DELWP review***
- ***test if the tariffs (or block revenue) proposed by water corporations are cost reflective and in doing so, ensure greater transparency for the bulk water costs and charges for environmental water***
- ***ensure costs of non-prescribed activities have been properly identified and excluded from the regulated costs.***

VEWH as a customer

It is acknowledged that for some water corporations, VEWH is a very small customer in revenue terms. This may in part explain why VEWH has had limited engagement in the price submission processes of all water corporations. Where engagement has taken place, VEWH considers its involvement to be limited to 'inform' under the IAP2 framework.

In 'outcomes' of the PREMO framework, there should be greater emphasis on environmental water outcomes or performance levels. VEWH's suggestions around the development of Service Level Agreements with individual water corporations could be a key enabler of performance monitoring and reporting.

Consultation on the current DELWP environmental water charges review may have also limited any extra consultation by water corporations. If environmental water is formally included under the PREMO framework in the future, there may be an opportunity to be more explicit about engagement with traditional utility customers, environmental water customers and government stakeholders.

Recommendation 4.

In its next Guidance, the Commission should ensure water corporations better engage with VEWH in setting environmental outcomes and performance measures, consistent with what occurs with other customers.

Specific comments – GMMWater

Discussions held between GMMWater and VEWH

GMMWater made use of an Environmental Water Pricing Working Group as part of their price review process. The VEWH has welcomed the establishment of this customer consultative group and participated in three meetings throughout 2017. VEWH considers that its involvement in this group, however, has still largely been at the ‘inform’ end of the IAP2 spectrum and future expectations around customer engagement could be strengthened under the PREMO framework.

The key issues discussed with VEWH at the last Working Group meeting held on 18 August 2017 that remain unresolved include:

- the GMMWater cost allocation framework for headwork charges
- uncertainty in the event of water trade, and how variable usage based headworks charges would be applied to VEWH in purchases from other customers (including customers on bespoke supply by agreement contracts)
- cost and pricing principles for the costs associated with specific effort-related services that VEWH may seek.

Recommendation 5.

Prior to issuing its Determination, the Commission should seek clarification from GMMWater about these unresolved issues, particularly as they may become issues for VEWH as a possible future regulated customer during this next regulatory period.

Price increases for the Commonwealth Environmental Water Holder (CEWH)

GMMWater proposes to increase charges to the CEWH by 19 per cent over two years. The stated reason is the finalisation of a move to full cost recovery that had been mooted for a disbanded irrigation district. A concern for VEWH relates to any future cost implications.

Recommendation 6.

In its review, the Commission should consider if full cost recovery:

- ***is required by National Water Initiative commitments***
- ***applies in circumstances where there is no on-going irrigation function***
- ***is consistent with the opening Regulated Asset Base established by the Minister***
- ***is consistent with the costs of the services now being provided to the CEWH***
- ***is cost reflective based on CEWH's share of the headworks costs to be recovered from customers and any agreements entered into as part of the transfer of water rights to the Commonwealth.***

Capital program consultation

GWMWater is proposing significant dam safety works at Lake Fyans. The VEWH has had limited consultation on this proposed project, and in particular whether or not the works will have any financial impact on VEWH charges.

Whilst fully supportive of dam safety compliance, VEWH is unaware if any modified operational arrangements were considered, and would be a feasible alternative to this expenditure.

In assessing the prudence and efficiency of this expenditure, the Commission should review the options that GWMWater considered before electing to proceed with the proposed works.

Form of price control

GWMWater proposes to apply a weighted average price cap. It seems to be driven in part by revenue uncertainty due to the DELWP review into environmental water charges. There is however no rebalancing constraint proposed, which could lead to price shocks for customers, including VEWH.

It also appears that GWMWater has 'priced-in' only 1.5% of its proposed 2.5% efficiency target, to accommodate the revenue uncertainty of the DELWP review.

Recommendation 7.

VEWH is uncertain what impact arises from the proposed works at Lake Fyans and the weighted average price cap, and requests the Commission to investigate.

Specific comments – SRW

SRW proposes to increase charges for the storage service provided under the Blue Rock Bulk Entitlement Order by 3.03% (real). The bulk entitlement allows for a proportion of costs to be charged to VEWH. VEWH would benefit from being provided with a copy of the calculations for this bespoke arrangement, as per the Bulk Entitlement.

VEWH also notes that no tariff schedule has been included.

Recommendation 8.

The Commission should seek a full tariff schedule for SRW including for headworks charges in the Macalister system where VEWH is currently paying charges.

Thank you for the opportunity to provide this submission to your price review process. Please contact me or our Co-Executive Officers, Sarina Loo or Trent Wallis if you require additional information and/or would like us to expand on any areas contained in this submission.

Yours sincerely

A handwritten signature in black ink that reads "Denis Flett". The signature is written in a cursive, flowing style.

Denis Flett
Chairperson