

29 January 2013
Our ref: C/13/1120

Mr Merv Geddes
Secretary
Gippsland Resource Group
2/6 Chestnut Avenue
Morwell VIC 3840

Dear Mr Geddes

GIPPSLAND WATER - PRICES

I am writing to respond to issues which you raised during the public forum on Gippsland Water's Water Plan held in Traralgon on 6 December 2012. This is an open letter and will be sent to those mentioned in the list below and will be placed on our website. These matters you raised were that:

- the published prices for Gippsland Water's residential customers are higher than were authorised in its 2008 Determination
- the approved prices in the Determination included inflation
- the price formula in the Determination did not include the compounding of price rises.

We engaged Deloitte to examine Gippsland Water's prices to ensure they were not higher than those approved in the 2008 Determination. Deloitte also examined whether the methodology for adjusting prices established in the Determination had been followed. The report by Deloitte is attached to this letter.

The report confirms that:

"the approved tariffs for Gippsland Water for residential volumetric, fixed (20mm) and residential sewerage (connected) for 2008-09 to 2012-13 are in compliance with the ESC's 2008 Price Determination."

In particular, Deloitte found that:

- the prices paid by Gippsland Water's customers were not higher than those in the Determination. In fact, for residential sewerage customers the published prices were lower than approved

- that the price changes approved in the 2008 Determination were maximum *real* changes and so did not include inflation
- the price formula in the Determination requires prices to be compounded.

I trust this independent review will alleviate your concerns about the accordance of Gippsland Water's prices with the ESC's 2008 Determination.

Yours sincerely



David Heeps
CEO

CC

Office of the Minister for Water
Mr Jadon Mintern, Parliament of Victoria
Mayor, Latrobe City Council
CEO, Latrobe City Council
Cr Christine Sindt, Latrobe City Council
Cr Peter Gibbons, Latrobe City Council
David Mawer, Managing Director, Gippsland Water
Consumer Utilities Advocacy Centre

Mr Jason Fitts
Water Regulation
Essential Services Commission
Level 37
No.2 Lonsdale Street
Melbourne 3000, Australia

11 January 2013

Dear Jason

RE: Gippsland Water Price Control 2008-13

As requested, Deloitte has reviewed the application of Gippsland Water's price control for the regulatory period 2008 to 2013. In particular, we have assessed whether Gippsland Water's prices charged to residential customers over the period have been in compliance with the ESC's 2008 Price Determination.

The following sections set out our analysis of Gippsland Water's prices.

ESC's 2008 Price Determination

The ESC's 2008 Price Determination for Gippsland Water (2008 Price Determination) sets out the maximum scheduled prices that Gippsland Water could charge in 2008-09 (the first year of the regulatory period) and the maximum real (excluding inflation) adjustment that could be made to prices for years 2009-10 to 2012-13. These scheduled prices and real price adjustments (% changes year on year, known as Prescribed Price Movements or PPM) reflect the ESC's final decisions on Gippsland Water's revenue requirements for the 2008-13 regulatory period.

The 2008 Price Determination contains the formula used by the ESC to adjust Gippsland Water's prices annually to account for inflation and the PPM.

$$P_t = P_{t-1} \times CPI_t \times (1 + PPM_t)$$

Where:

P_t = the price component for regulatory year t

P_{t-1} = the price component for regulatory year t - 1

CPI_t = the Consumer Price Index, All Groups Index for Eight Capital Cities for the March Quarter immediately preceding the regulatory year, divided by the same indicator for the March quarter in the previous regulatory year

PPM_t = the Prescribed Price Movement for the price component for the regulatory year t (as set out in Schedule 2 of the 2008 Price Determination).

This formula clearly requires that CPI and PPM adjustments are to be applied to the previous year's actual prices. We note that the 2008 Price Determination states that variable water and wastewater charges are to be rounded down to 4 decimal places, while all other charges are rounded down to 2 decimal places.

The ESC has requested Deloitte to assess compliance with the 2008 Price Determination for three Residential Water Tariff and Wastewater Tariff Services:

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- Water Usage Charge – Consumption Charge – Treated Water (per kL)
- Service Availability Charge (per annum) – 20mm Connection
- Wastewater Tariff – Service Availability Charge (per annum) – Connected Property.

The ESC has indicated that the approach taken to calculate annual tariff movements was identical across all Gippsland Water's services, although it noted that the calculation methodology was revised after 2009-10. Specifically, the ESC changed from using a price with full floating decimals (unlimited decimal places) to the published price (two or four decimal places, depending on the tariff). The change in methodology has not had any material impact on customer prices.

The following table sets out the approved price for 2008-09 and PPMs for 2009-10 to 2012-13 for these services, as published in the 2008 Price Determination.

Table 1: ESC Published Prices and Prescribed Price Movements for Gippsland Water

	2008-09	2009-10	2010-11	2011-12	2012-13
Water Residential Volumetric (per kL)	\$1.2388	23%	4.30%	4.30%	4.30%
Water Residential 20 mm (per annum)	\$107.12	23%	4.30%	4.30%	4.30%
Sewerage Residential Connected (per annum)	\$503.85	23%	4.30%	4.30%	4.30%

Source: ESC - 2008 Water Price Review - Gippsland Water Determination 1 July 2008 - 30 June 2013, June 2008, Schedule 2.

CPI movements

The 2008 Final Determination requires that the March Quarter CPI All Groups Index for Eight Capital Cities must be used to determine the adjustments to prices to account for inflation. Table 2 sets out our calculation of the relevant CPI index for 2009-10 to 2012-13 and the CPI adjustment factors to be used in the price control (year t divided by year t-1).

Table 2: CPI movements

	2009-10	2010-11	2011-12	2012-13
March Quarter - All Groups Index - Eight Capital Cities	166.2	171.0	176.7	179.5
CPI movement for use in price formula	1.0247	1.0289	1.0333	1.0158

Source: Australian Bureau of Statistics, 6401.0 – Consumer Price Index, Australia, June 2012.

Assessment of compliance

(a) 2008-09 tariffs

The ESC's determination specifies the prices that should have been charged in 2008-09, as set out in Table 3:

Table 3: 2008-09 tariffs

	2008-09
Water Residential Volumetric (\$ per kL)	1.2388
Water Residential 20 mm (\$ per annum)	107.12
Sewerage Residential Connected (\$ per annum)	503.85

Gippsland Water publishes its residential water tariffs on its website following the ESC's annual Tariff Approvals, in the form of an official notice.

In addition to the official notice, Gippsland Water actually reproduces the ESC's Tariff Schedule, demonstrating its compliance with the approved tariffs.

We have reviewed the official notice issued by Gippsland Water for 2008-09 and can confirm that the prices set out in the notice are as per the ESC's determination.

(b) 2009-10 to 2012-13 tariffs

In order to test Gippsland Water's compliance with the price control for 2009-10 to 2012-13 water period, we have applied the formula set out in the 2008 Price Determination using Gippsland Water's published tariffs for 2008-09 as the starting point, the determined PPMs for 2009-10 to 2012-13 and the CPI data in Table 2. The price control formula is:

$$P_t = P_{t-1} \times CPI_t \times (1 + PPM_t)$$

The results of our calculation represent the maximum prices that Gippsland Water could have charged to be compliant with the 2008 Price Determination, as presented in the following table.

Table 4: Deloitte calculation of annual price movements in accordance with 2008 Price Determination (\$ nominal)

	2008-09	2009-10	2010-11	2011-12	2012-13
Water Residential Volumetric (\$ per kL)	1.2388	1.5613	1.6754	1.8056	1.9130
Water Residential 20 mm (\$ per annum)	107.12	135.0000	144.8700	156.1300	165.4200
Sewerage Residential Connected (\$ per annum)	503.85	635.0100	681.4400	734.4300	778.1400

The following table lists the differences between the prices actually charged by Gippsland Water, as set out in the annual official Tariff Notices and the calculated maximum compliant tariffs in Table 4, with negative numbers indicating that prices charged were less than the price cap and positive numbers indicating prices charged were above the price cap.

Table 5: Compliance with 2008 Price Determination – difference between prices charged and price cap (\$ nominal)

	2009-10	2010-11	2011-12	2012-13
Water Residential Volumetric (\$ per kL)	0	0	0	0
Water Residential 20 mm (\$ per annum)	0	0	-0.01	0
Sewerage Residential Connected (\$ per annum)	0	0	0	-19.39

As Table 5 demonstrates, we have not identified any instances whereby Gippsland Water's prices were in breach of the 2008 Price Determination. In 2012-13, the approved fixed price for sewerage is actually lower than the maximum price Gippsland Water could have charged in accordance with the 2008 Price Determination. We understand that this was due to a rebalancing between residential and non-residential tariffs.

Conclusion

Our review has found that the approved tariffs for Gippsland Water for residential volumetric, fixed (20mm) and residential sewerage (connected) for 2008-09 to 2012-13 are in compliance with the ESC's 2008 Price Determination.

Yours sincerely



Paul Liggins
Partner
Deloitte Touche Tohmatsu

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