WESTERNPORT WATER

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Our Ref: OUT13-02727

Mr Marcus Crudden
Essential Services Commission
Spring Street
MELBOURNE VIC 3000

water@esc.vic.gov.au

Dear Marcus,

Thank you for the opportunity to comment on the Draft Determination outcomes.

Westernport Water acknowledges the extensive work involved in the review of water plans, updating the financial templates as a result of the audit of water plans, and notes the changes proposed in Westernport Water's draft determination and financial template. Our responses to the draft determination are attached and grouped into the following categories:

1. Operating costs
2. Capital program
3. New Customer Contributions
4. Service Standards and Guaranteed Service Level
5. Tariffs and Charges

We welcome your feedback and advice on attached responses and proposals for inclusion and amendment into our Final Water Plan 3 Determination.

If you have any questions or need further clarification, please contact Kylie White on 5956-4121.

Yours sincerely

Murray Jackson
Managing Director

c.c Trevor Nink (Chairman)

1. Response to Draft Determination – OPERATING COSTS

Page Ref.	ESC Draft Determination Details	WPW response and proposal
p.7	**Table 8 – Adjustments to Operating Expenditure - Electricity**	(a) WPW ***does not*** agree with the ESC's adjustments to electricity costs proposed in the draft determination. As communicated to the ESC's auditors, the 2010/11 baseline data provided to in WP3 submission included an error in ***usage*** for one of our main sites – Cowes Wastewater Treatment Plant ('WWTP'). The impact of correcting usage error and applying new electricity contract prices resulted in reduced WP3 electricity estimate by a cumulative value of $162,000 (over 5 years). This information was provided to ESC, but is summarised again below: • Reduction in costs Yr1 of WP3 has been revised from 4% to 3.5% based on new information from Procurement Australia – electricity contract. • Average increase in consumption WP2 is 5% per annum compared with forecast over WP3 of 2% per annum. This is due to the additional costs of electricity in our processes (Reuse), and growth assumptions. Refer Appendix 1a (our ref TRIM INT12-09535) for WPW proposed WP3 path for electricity costs. **ESC financial template has been updated to reflect WPW electricity costs.**
p.7	**Table 8 – Adjustments to Operating Expenditure – Defined Benefits**	(b) WPW acknowledges that the DBS annuity payment could be treated as an annuity (OPEX) to be spread over a longer period for recovery, however note the inconsistent treatment of these costs for the Rural water corporations in the draft determination. Westernport Water seeks the ESC's response to consistently treat defined benefit costs as either a one off opening balance adjustment or as a full recovery of cost in WP3 (Yr1). **ESC financial template has been updated with Yr1 recovery of defined benefits costs of $666k.** *Is ESC going to provide any guidance on what should be included in WP3 for the next shortfall funding call?* *WPW has not included any assumptions for this item in WP3*
p.7	**Table 8 – Adjustments to Operating Expenditure – Chemical costs**	(c) WPW supports the recommendation of using 1% increase in chemical costs beyond 2012/13 based on the water volume demand over the WP3 period, as proposed in the draft determination and financial template.
p.7	**Table 8 – Adjustments to Operating Expenditure – GSL costs**	(d) WPW supports the recommendation to reduce GSL expenditure, as proposed in draft determination and financial template.
p.7	**Table 8 – Adjustments to Operating Expenditure – Road Relocation costs**	(e) WPW supports the ESC's recommendation to treat the council road relocation expenditure of $600K as CAPEX purely for determining pricing. However, the financial templates with draft determination proposals has treated the recovery of these costs over the asset life of 100 years.

Page Ref.	ESC Draft Determination Details	WPW response and proposal
		WPW ***does not*** support this long term recovery of the road relocation costs and proposes to spread the recovery of the $600k over WP3 and WP4 only. **The ESC financial template has been updated with WPW response to spread recovery over two water plan periods.** The ESC's treatment of road relocation expenditure does not alter the accounting and tax treatment of these operational costs. The impact on WPW will be additional borrowings, rather than recovery from tariffs, which will impact cash flow.
p.7	**Table 8 – Adjustments to Operating Expenditure – Other**	(f) WPW ***does not*** support the removal of $7k associated with the additional costs of monitoring for BoM. **The ESC financial template has been updated with WPW response.**
p.7	**Table 8 – Adjustments to Operating Expenditure – Environmental Contributions**	(g) WPW supports the reduction of Environmental Contribution to reflect real costs over the Water Plan 3 period, as proposed in draft determination and financial template.
p.7	**Table 8 – Adjustments to Operating Expenditure – Licence Costs**	(h) WPW has not received any notification from DoH or EPA that our licence fees will be reducing. WPW have a works approval to upgrade our wastewater treatment plant flow capacity, with will increase our licencing costs based on additional flow. WPW ***does not*** support the reduction in licence fees, as proposed in draft determination and financial templates. **The ESC financial template has been updated with WPW response.**

2. CAPITAL PROGRAM

Report Ref.	Audit findings and recommendations	WPW response and proposal
p.8	**Capital Expenditure** **Table 9 and 10**	WPW supports the increased CAPEX program, which reflects our revised estimates of contingency costs associated with the top projects (listed in Table 11, p.10 of draft determination) for a total of $2.97M WPW supports the inclusion of the road relocation costs into the CAPEX program ($600k) but ***does not*** support the treatment of recovery of costs over the asset life of 100 years by adding onto the Candowie Growth project, as reflected in the draft determination financial templates ('New Initiatives' tab, line 274). **The ESC financial template has been updated with WPW response regarding recovery of road relocation costs over a maximum 10 year asset life, as a separate asset in the 'New Initiatives' tab, line 329).** *Further responses to Capital Expenditure adjustment included in following sections:*
p.9	**Capital Expenditure – Table 10** **(b) Cowes – WWTP upgrade**	WPW ***does not*** agree with the ESC draft determination comments regarding deferral of the Cowes WWTP upgrade. Deferring the project will mean that Licence conditions, plant performance and growth will not be addressed and this will not be acceptable to the EPA. The ESC's auditors stated in their report that the information in the Project Proposal indicates that compliance has been achieved at the CWWTP between 2009 – 2012. While overall flows were down due to drought conditions between Jun 2006 and Feb 2010 they have since returned to pre-drought levels and are forecast to increase in line with the growth being experienced on Phillip Island. The Project Proposal (Our ref: INT12-03052) provided to the ESC's auditors clearly states that plant performance deteriorates when flows in excess of 6ML/d are experienced. This has led to multiple breaches of the EPA Notification Limits. In addition we are still in breach of the SEPP requirements for discharges to ocean. The suggestion by the Auditors that the proposed 100m mixing zone enables discharge to comply with the SEPP is only partially correct. The 100m mixing zone will only be allowed by the EPA provided WPW shows evidence that it is undertaking works that will allow the zone to be reduced or removed. This is the essence of the Works Approval process we are currently undertaking with the EPA. The Auditors have incorrectly referred to the 30A approval as being for non-routine discharge at the CWWTP. In fact the 30A approval relates to non-routine discharges at the King Rd WWTP (KRWWTP). EPA have since provided an approval for the CWWTP upgrade to commence.
p.9	**Capital Expenditure – Table 10** **(c) Water main Replacement**	WPW **does not** support the reduction in water main replacement program for 2016/17 and 2017/18 of $200k ea year. WPW calculated the estimate for replacements based on average costs per year experienced over last water plan period.

Report Ref.	Audit findings and recommendations	WPW response and proposal
		The costs associated with 2013/14 to 2015/16 program reflect a more detailed assessment of main replacement requirements, and WPW supports the inclusion of additional contingency costs associated with this program of works. **The ESC financial template has been updated to with WPW response regarding the mains replacement program.** Further clarification of our position, as provided in our initial response to audit findings: Strategically across the Australian water industry the potential issues around AC pipes has been recognised (refer WSAA Investigation project – Management of Asbestos Cement Pipes Oct 12). The WPW Water Asset Management Plan has identified that 225 mm AC water mains circa 1962 are a strategic priority for WPW. However operationally there is insufficient performance or condition data currently available to be able to prioritise the renewal / replacement of these assets. As highlighted by the Auditors in their Additional CAPEX questions from 22 Nov 2012 *'WPW intends to undertake a formal criticality assessment of all water main segments to determine where the high impacts lie within the system.'* As such no specific replacement programs were developed for the 225mm AC mains although a general allowance of $200k (2016/17) and $200k (2017/18) was made based on our WP2 experience. In developing the specific water main replacement project for WP3 other operational data was accessed. Over WP3 we have identified CI mains in Dalyston and Corinella for renewal / replacement due to; a) The number of pipe or fitting failures on the Dalyston 1973 era CICL asset (7No bw 2006 and 2012) b) The criticality of the Corinella 1972 era CICL as a single supply main to Corinella and Coronet bay WP3 represents a shift for WPW to a more planned renewal / replacement program. The program will be progressively developed as we undertake condition and criticality assessments. The $70k allowance for replacement of a section of HOBAS main is a legacy operational issue from a previous burst that has not yet been addressed. The HOBAS pipe in question connects a section on the San Remo bridge to a section on Phillip Island. This pipe is currently not in use until these works are completed.
p.5	**Section 6 – rolled forward regulatory asset base**	WPW proposes to include additional CAPEX ($4M) and additional OPEX ($1.3) costs into the asset base opening balance (template RollForward_FO) to reflect additional expenditure on Candowie upgrade and other capital projects incurred in 2012/13 as well as 2012/13 road relocation costs not included in 2012/13 forecast. The calculation of the revenue requirement in the template (Rev&RAV_FO) does not pick up the forced/amended opening asset balance reflected in the RollForward_FO tab, and therefore the revenue requirement is not accurately reflecting the regulatory depreciation.

3. New Customer Contributions

The follow comments are provided as response to ESC requirements identified in the draft determination, p. 15:

(a) **Specific Locations of NCC** – The water supply system for Westernport Water is supplied by the one water treatment plant and one reservoir. The capital costs that have been included in the model for NCC reflect the cost of this one treatment plant and the upgrade to the reservoir. There is no site specific costs that reflect a higher or lower cost that would be applicable to any sub area in the system or area that is supplied by the water system.

The recycled water system, though only currently reticulated around the Cowes area directly benefiting the newer developments, provides an overall benefit to all water users in all areas. The use of the recycled water system enables a lower demand on the high cost potable water system that will enable the current water supply sources to last longer before expensive upgrades will be required. The recycle water system provides an overall better result for the wastewater system as the decrease in effluent discharge to the ocean provides lower costs and environmental benefits to the whole community.

The main growth and costs included in NCC calculations are attributable to Cowes but also include other regional capital augmentation specifically relating to growth, for example: new holding lagoon for King Road, improvements to the system in Corinella and Coronet Bay and the operational costs of wastewater disposal for the Dalyston/Kilcunda system to South Gippsland Water.

(b) **Calculation of NCC charge:** The NCC charge has been calculated using the model as provided by the ESC based on the paper called Essential Services Commission 2012, Guidance Paper - New Customer Contributions, August 2012. The minimum pricing principles have been used having regard to using incremental infrastructure and associated costs and incremental future revenues. The NCC charges have been calculated in accordance with the pricing principles.

(c) **Transparency:** Maps have been provided by Westernport Water to show where the standard NCC is to be applied. These maps show the current planned development extents of the townships that have been included in planning the infrastructure to service the proposed development areas. Any development outside of these areas would require additional infrastructure or upgrading of existing infrastructure to cater for the additional lots. The development outside of these areas would be required to apply for non-standard NCC to be negotiated within the framework. All new development or redevelopment in these areas would be liable to pay the standard NCC.

(d) **Eligibility Criteria:** The standard NCC will be charged on all areas that have been considered in the planning maps for developments that would use the planned capital works. All developments outside the designated planned areas would have to negotiate the NCC based on the core pricing principles that would be in the Negotiating Framework. This Framework sets out the requirements and procedure to be followed to ensure a fair and equitable process for these new developments that have not been considered in the standard NCC. It is to be expected that the new developments would pay their share of augmentation of the overall system and localised augmentation to cater for this additional load on services.

(e) **The Negotiating Framework** has been the subject of working groups and meetings with the other water businesses to ensure a consistent approach to the framework across the water industry. Though the Framework may not be exactly the same the underlying principles, general format and negotiating principles would be in the framework. The Negotiating Framework for Westernport Water would follow these principles and provide a platform for discussion on the NCC for these developments.

(f) **Consultation with other water businesses** has occurred and the timeframe to estimate capital costs has been chosen for Westernport Water as 20 years. This is in general agreement with the water industry and provides the planning format of providing detailed capital plans for 5 years, rolling plans for 10 years and longer term planning for major infrastructure of 20 years. The infrastructure required by the water industry is high cost and long life that require robust planning but the drivers may change in a shorter time frame. The requirements of development, Government policy or industry regulators may change where the long term plans and projects have been identified, which could change the scope and locations of development in our NCC framework. The development industry is highly variable and difficult to forecast which calls for flexibility in planning to cater for changes in developments.

(g) **Westernport Water has consulted with our stakeholders** following receipt of the draft decision by the Essential Service Commission to advise on the proposed costs for New Customer Contributions. The consultant engineers operating in our area will be briefed on the latest NCC charges so they can inform developers that are currently or planning to develop in our region. Contact has been made to all consultants in our area on the planned NCC.

(h) **The amendments to the NCC** model have been made to correspond to the results from the ESC draft review decision on the expenditure adjustments, demand adjustments, the tax rates applicable, the recommended WACC of 4.7 % and the forecast NCC revenue already included in the draft determination financial templates reflect our assumptions regarding increased revenue from the implementation of the [new] NCC framework.

4. Service Standards and GSLs

Service Standards

ESC have approved all proposed service standards with the exception of the ‘Sewerage blockages (per 100 kilometers). ESC has proposed to use the five year average actual performance. WPW does not support the use of the five year average as a target for this service standard, and believes that setting this target based on average performance over the last five years has the risk that on any one year we may be well above the average or well below the average depending on the outcomes of our preventative maintenance plan. WPW currently has the lowest amount of sewer blocks per 100 KLM, and the proposed WP3 service standard was based on a 20% improvement from WP2 targets then step improvement @ 10% from Preventative Maintenance Program (CCTV) programs benefits being realised in the later part of the WP3 period.

Guaranteed Service Levels (GSLs)

ESC draft determination regarding new GSLs includes a previous GSL regarding water interruptions that was submitted in our **draft WP3**. Initially WPW proposed that all unplanned water interruptions would be restored within 5 hours of notification as a guaranteed service level. Feedback from customer consultation placed this service as a low priority, which may be a direct result that 60% of our customers do not live permanent in our region. An alternative GSL was proposed in our **final WP3** submission. The proposed GSL is based on no more than 5 unplanned interruptions within any 12 month period.

Westernport Water seeks further clarification that the ESC approve the proposed GSL, not the GLS included in table 2 (p.4) of the draft determination.

5. TARIFFS AND CHARGES

The ESC's draft determination proposes a 0.4% average annual increase in tariffs to support the amended operating costs and capital projects. This 0.4% reflects the significant reduction in the underlying assumptions of the Weighted Average Cost of Capital (WACC), or the return on investments that Westernport Water can expect to recover from customers via tariff increases. Westernport Water acknowledges the calculation of the WACC and the impact on the draft determination pricing path, but would like to point out that this adjusted WACC reflects current market conditions, and not future market conditions that our return is required for long lived assets/investments. The reduction in WACC puts additional pressure on water corporations to fund upfront costs of investments and only recover over long periods through tariff increases.

Westernport Water has amended the ESC's draft determination financial templates to reflect above responses, applied resulting increases to tariffs, AND proposed an upfront increase of 2% rather than the proposed smooth price increases over the fiver year water plan period. Increase in tariffs, as proposed by the calculations included in the ESC's draft determination financial template (RevenuePriceCap_FO), is reproduced below:

Pricing Outputs

Estimated Price Path

2013-14	2014-15	2015-16	2016-17	2017-18	Total
2.0%	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**2.0%**

Estimated 5 year average revenue change

2.2%

Please note – all amendments proposed in WPW response are highlighted in red cells in the attached draft determination financial template.

Appendix 1a) – Revised Electricity Forecast

				SECOND REG PERIOD					THIRD REG PERIOD					
			2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	
			2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	
				Actuals			Forecast						
WP3 Original	Totals (kWh)		3,030,952	3,350,537	3,336,536	3,413,803	3,670,000	3,741,798	3,816,263	3,892,216	3,969,689	4,048,710	
	% change			*10.5*	*-0.4*	*2.3*	*7.5*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2% growth assumed*
				Average increase 5%/annum									
	Totals ($)		403,275	478,178	489,580	521,213	569,000	579,127	617,676	659,630	705,354	755,252	
	% change			*18.6*	*2.4*	*6.5*	*9.2*	*1.8*	*6.7*	*6.8*	*6.9*	*7.1*	*7% growth assumed after 2013/14*
				Average increase 10%/annum									
	Original	40% variable	161,310	191,271	195,832	208,485	227,600	231,651	247,070	263,852	282,141	302,101	
		% change		*18.6*	*2.4*	*6.5*	*9.2*	*1.8*	*6.7*	*6.8*	*6.9*	*7.1*	*As before*
		60% standing	241,965	286,907	293,748	312,728	341,400	347,476	370,605	395,778	423,212	453,151	
		% change		*18.6*	*2.4*	*6.5*	*9.2*	*1.8*	*6.7*	*6.8*	*6.9*	*7.1*	*As before*
	Original WPW WP3							579,127	617,676	659,630	705,354	755,252	
	Deloittes Recommendation							538,000	561,000	585,000	597,000	609,000	
	Revised	40% variable						223,817	228,294	232,859	237,517	242,267	3.5% reduction in 13/14 due to AGL contract. Then growth @ 2% per annum based on increase in kWh, variable charges assumed fixed for 5 years of WP3
		60% standing						347476	370605	395778	423212	453151	
	WPW revised WP3							571294	598899	628638	660729	695418	
		% change							*4.8*	*5.0*	*5.1*	*5.3*	*Revised growth of @ 5% over WP3*
	Diff from Original WPW WP3							-7834	-18777	-30993	-44625	-59834	
	Cumulative							-7834	-26610	-57603	-102228	-162061	