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Essential Services Commission
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Dear Greg

GWMWater Response – Water Plans Issues Paper

Please find enclosed the GWMWater response to the 2008 Water Price Review – Water Plans Issues Paper.

The Water Plans Issues Paper provides a very good overview of the challenges facing water businesses as represented in their Water Plans. The areas where the Paper is looking for guidance is particularly relevant and we believe that we have specifically addressed these issues in our response.

The Paper does however make representations about potential price outcomes for GWMWater across the five-year period. These are not part of the GWMWater 2008-13 Water Plan and were derived by the ESC by application of information that GWMWater was required to provide to support the Water Plan. GWMWater has always maintained that it would be unreasonable for GWMWater customers to meet the full cost of the \$248 Million ‘funding gap’ that arose from the revised estimate that was prepared to construct the Wimmera Mallee Pipeline Project (WMPP). As a result, GWMWater lodged an ‘interim’ Water Plan with a one-year pricing proposal with an expectation that an updated 2008-13 Water Plan would be lodged when consensus was reached in relation to how the funding gap would be addressed.

Since lodging the ‘interim’ 2008-13 Water Plan, we have received commitments from both State and Federal governments in relation to meeting the WMPP ‘funding gap’. We believe that these commitments are of sufficient strength to derive a five-year revenue requirement for inclusion in the Water Plan.

On the basis of the commitments received from the State and Federal governments, GWMWater will lodge an updated 2008-13 Water Plan. This is subject to GWMWater Board approval but it is anticipated that this will be lodged with the ESC in the first week of February 2008.

Yours sincerely

Mark Williams
Group Manager - Business Services



**Response to the
Essential Services Commission
2008 Water Price Review
Water Plans Issues Paper**

January 2008

TABLE OF CONTENTS

1	Executive Summary	2
2	Introduction	2
	2.1 Specific Issues Identified relevant to GWMWater’s Water Plan	3
	2.1.1 Actual and Forecast Levels of Restriction	3
	2.1.2 Detailed Pricing Proposals	4
	2.1.3 Capital Expenditure Summaries	4
	2.2 Responses to Specific Issues Raised by the Essential Services Commission	4
	2.2.1 Rural Renewal and Rehabilitation Expenditure	4
	2.2.2 Price Elasticity of Demand	5
	2.2.3 Dealing with Uncertainty	5
	2.2.4 Tariff Structures	6
	2.2.5 Customer Impact of Pricing Proposals	6
	2.2.6 Customer Service Standards	7
	2.2.7 Guaranteed Service Levels	7
3	Conclusion	8

1 Executive Summary

The ESC Issues Paper provides a very good overview of issues confronting water businesses in the development of their Water Plans.

The GWMWater Water Plan is strongly influenced by the current water supply constraints that have been exacerbated by the recent drought. In turn, the GWMWater Water Plan has been dominated by the region's response to this supply situation which has been the acceleration of the implementation of the Wimmera Mallee Pipeline Project (WMPP).

The significant lead times involved in obtaining the necessary commitments to the WMPP to the point of awarding contracts have unduly exposed the project to unfavourable construction price movements. These price movements have exceeded general price movements as represented by the Consumer Price Index. The cost to complete the WMPP has been reassessed and the cost shifted from \$440 Million to \$688 Million. This was acknowledged for the first time when GWMWater released its interim 2008-13 Water Plan.

The GWMWater Board did not believe that the region could afford the full cost of the \$248 Million 'funding gap' through price increases. As a result, it developed a pricing proposal for year one that sought to recover the revenue required for a \$440 Million project. Price increases beyond the first year were to be formalised upon resolution of the \$248 Million funding gap with the State and Federal governments.

The ESC however has chosen to apply information represented in the information templates to develop and publish some potential prices beyond the first year. These price outcomes do not reflect the position of GWMWater as they assume that GWMWater customers will be expected to meet the full extent of the increased cost of the WMPP.

Commitments have been made by both State and Federal governments in relation to additional funding and, on the basis of this, GWMWater will be lodging an updated Water Plan.

2 Introduction

The issues raised by the ESC in its review of Water Business Water Plans are comprehensive and insightful. They provide a very good overview of the complex issues water businesses are coming to terms with in the development of their Water Plans.

The planning assumptions and the investment programs have been strongly influenced by the constraints on existing water supply systems.

GWMWater identified these issues in its inaugural Water Plan. The solution substantially developed to satisfy the supply obligations was the Wimmera Mallee Pipeline. The

significant escalation in construction costs that has occurred across Australia however has given rise to a substantial shift in the cost to construct the WMPP to \$688 Million and this has been reflected in this 2008-13 Water Plan.

The WMPP cost shift produced a \$248 Million 'funding gap' that the GWMWater Board did not consider it could pass through to its customers in the form of price increases. As a result, pricing proposals were developed for the first year of the regulatory period that sought to recover GWMWater commitment for a \$440 Million project. Any decision on price increases beyond the first year of the regulatory period was to be considered upon resolution of the \$248 Million 'funding gap'. Since lodging the interim Water Plan, funding commitments from both State and Federal governments of \$99 Million and \$248 Million respectively have been received. On the basis of these commitments, GWMWater has been able to make formal representation about the five year outlook will submit an updated Water Plan to the ESC in the first week of February 2008 that provides identifies the revenue requirement for the five years of the regulatory period.

2.1 Specific Issues Identified relevant to GWMWater's Water Plan

2.1.1 Actual and Forecast Levels of Restriction

Table 2.1 has identified that the actual level of restriction levels in place over the regulatory period has not been nominated.

The Water Plan template made assumptions about a progressive reduction in water restrictions over time but these were not made explicit in the interim Water Plan due to the uncertainty surrounding the WMPP funding.

The WMPP plays a pivotal role in restoring supply capability by converting water losses into water that is available for consumptive use. The WMPP Project Delivery Agreement is currently silent on the distribution of water savings between consumptive users and the environment through the construction period for the WMPP.

The uncertainty as to the extent that the WMPP could be completed impacted upon the GWMWater's ability to make representation of supply capability irrespective of the relative shares between the environment and consumptive bulk entitlement holders. This needs to be considered in the context of possible inflow regimes for the Grampians catchment, and to the extent it is relied upon, the Murray and Goulburn catchments. In light of this uncertainty it was difficult to make meaningful representation of supply capability and therefore the level of water allocation / restriction to apply.

The revised WMPP funding commitments are such that GWMWater can plan with some certainty that the WMPP can be completed in the revised time frame of three and a half

years. Assumptions will be made about the relative participation in water savings as losses are avoided by construction of the WMPP.

These will be explicitly disclosed in the revised Water Plan that is to be resubmitted in February 2008.

2.1.2 Detailed Pricing Proposals

The detailed pricing proposals beyond the first year of the regulatory period do not reflect the pricing proposals adopted by GWMWater.

These price increases represent extrapolations prepared by the ESC in reviewing the information contained in the templates that were required to accompany the Water Plan. These templates represented the WMPP at the revised cost to complete the WMPP of \$688 Million. These templates did not however include any external contributions aimed at recovering the \$248 Million 'funding gap'. In addition, the GWMWater Board did not believe that the level of price increase required to meet the full extent of the \$248 Million 'funding gap' was sustainable within the region.

Representations by State and Federal governments since lodging the interim Water Plan have committed \$223 Million of the \$248 Million funding gap.

A revenue requirement that is underpinned by a tariff basket will be presented in the revised Water Plan. This will provide some more meaningful insight into the price path for year 2 to 5 of the regulatory period.

2.1.3 Capital Expenditure Summaries

The summaries of capital expenditure have specifically excluded any reference to the WMPP.

The WMPP dominates GWMWater's Water Plan and its exclusion in any commentary can potentially misrepresent GWMWater's total expenditure program.

2.2 Responses to Specific Issues Raised by the Essential Services Commission

2.2.1 Rural Renewal and Rehabilitation Expenditure

What should the Commission take into account when assessing the appropriateness of the businesses' proposals to manage the transition from a renewals annuity to a RAB approach.

Are there any benefits from all of the rural businesses adopting a consistent approach to recovering expenditure on renewing or rehabilitating assets?

These issues are influenced by the extent that water businesses have applied locality or customer group specific pricing policies. The very lumpy nature of investments only compounds this issue and makes the transition to a Regulatory Asset Base more complex.

This could be better dealt with to ensure that regulatory pricing decisions that are influenced by 'lumpy' investments are undertaken in the context of the long run marginal cost of supply.

Rural water activities should apply a consistent approach to recovering the cost of asset renewal and rehabilitation expenditure.

2.2.2 Price Elasticity of Demand

Is there other information regarding the price elasticity of demand for water that the Commission should have regard to?

The very different rates being applied to represent price elasticity only demonstrate just how difficult it is to make any meaningful assessment of price and its impact on demand.

In the case of GWMWater, a two part tariff has been in place for just over a decade. For at least five years demand has been suppressed by the effect of restricted supply and the imposition of restrictions. The ability to undertake any meaningful time series analysis on this dataset is further impacted as the region has extreme temperature and rainfall variability across the region that have also not been representative over the last decade.

What has become apparent in more recent times has been the importance of water security. This has become particularly important for existing and new industries and it is equally important for the ESC to understand the relationship of pricing of water where there is a differing overall level of security.

2.2.3 Dealing with Uncertainty

**What should be included in the mechanisms for dealing with uncertain capital projects?
Are there any hybrid forms of price control or other mechanisms that the Commission should consider to deal with uncertainty around demand forecasts?**

The mechanisms for dealing with uncertain capital projects would be best aligned to the materiality thresholds applied by the accounting standards. The materiality threshold of

the accounting profession is 10% and where projects are less or greater than 10% this would constitute grounds for a potential reopening of the determination.

GWMWater has proposed a tariff basket within a revenue cap to deal with uncertainty. This is primarily aimed at dealing with uncertainty in relation to demand. It is considered that this is the most appropriate mechanism for GWMWater to deal with supply / demand risk.

2.2.4 *Tariff Structures*

Are the various tariff structures proposed by the businesses easy for customers to understand?

The most potentially complex tariff structure being proposed by GWMWater relates to the new Domestic and Stock pipeline tariff.

This tariff has been developed in consultation with the rural consultative committees with a view to ensuring that tariff objectives as represented in the WIRO are met.

There are no other significant changes to tariff structures being proposed by GWMWater across the regulatory period.

2.2.5 *Customer Impact of Pricing Proposals*

Are customers likely to alter/reduce their consumption in response to the tariff structures proposed by businesses?

What are the impacts on customers of the proposed price increases?

Have the businesses given appropriate consideration to the impacts of the proposed price increases on customers?

Rural tariffs have been designed to manage demand within the constraints of the WMPP.

The price impact on customers is understood and has been reflected in the Water Plan. Where these have been significant, the impacts have been the subject of specific consultation with affected customers / towns.

Customer affordability has been a significant issue for GWMWater, and it undertook its own affordability study that was independently reviewed by PricewaterhouseCoopers on behalf of the Victorian Government. This work underpinned the revised funding commitment by the Victorian Government to the WMPP.

2.2.6 Customer Service Standards

**Do the services standards proposed by the businesses reflect customer preferences?
Are there other aspects of service that are important to customers for which targets should be specified?**

The overarching customer preference and priority for the region is improved water security. This issue has dominated GWMWater's level of engagement with the community in relation to service standards.

Water quality improvements have been the subject of a consultative process with affected towns and customers. These improvements relate specifically to the extent of improvements being planned and the price implications of any water quality upgrades.

The level of engagement on other standards has been relatively minor as a result. Any engagement on service standards that would potentially underpin a GSL scheme have been relatively insignificant.

2.2.7 Guaranteed Service Levels

**Are there reasons why all businesses should not be in a position to introduce GSL schemes?
Do the GSLs levels proposed by businesses reflect the key service issues of concern to customers? Are there other aspects of service that should be included?
What exclusions, if any, should apply to the proposed GSLs?
Are the proposed payment levels reasonable?
Should the GSL events and payment levels be considered across businesses?**

The main constraint to the introduction of a GSL scheme relates to the underlying administrative mechanisms and systems to support a GSL scheme.

To the extent that businesses have or are proposing GSL schemes, the underlying performance parameters and trigger levels vary significantly. This variability includes the amount of rebate payable under these schemes.

To the extent that a GSL scheme should apply to the water industry, the types of events and the payment levels should be more consistent across all water businesses. The ESC should use the next regulatory period to develop a GSL scheme that could apply uniformly across the water industry to be implemented in the third regulatory period.

3 Conclusion

The updated Water Plan to be lodged in February 2008 will reflect the revised state and federal funding commitments. This will allow for the completion of the WMPP in three and a half years and this will be confirmed in the updated 2008-13 Water Plan. The updated Water Plan will also incorporate a revision of the supply demand capability to reflect the improved water security that will arise as a consequence of the WMPP.