



29 January 2008

Angelina Garces  
Essential Services Commission  
Level 2, 35 Spring St  
Melbourne VIC 3000

Dear Angelina

### **Essential Services Commission 2007, 2008 Water Price Review — Water Plans**

We note the release of the above paper, and welcome the opportunity to respond to the specific issues raised, as well as to reinforce some key aspects of our proposals. Our responses below are addressed under the headings from the issues paper.

#### 2.1.1 Drivers of forecast operating expenditure

We have not adjusted our forecast operating expenditure in response to predicted electricity increases or above-CPI labour increases.

We believe that a more appropriate mechanism for addressing these issues is through the use of an appropriate inflation factor within the regulatory framework, and in respect of this we reinforce our proposition from the first determination process that we employ an inflator, alternative to CPI, that is more representative of the mix of costs faced by the water industry. We request that the ESC investigate this further in consultation with the industry.

Similarly, we believe that history would support the proposition that cost inflators for water infrastructure construction are quite different from operating cost inflators, and should be treated as such within the regulatory framework. Again, we request that the ESC investigate this further in consultation with the industry.

#### 2.3 Renewals annuity

The paper questions whether there are benefits from all of the rural businesses adopting a consistent approach to recovering expenditure on renewing or rehabilitating assets.

Whilst there may be some marginal savings in the assessment and determination process, we believe that the more important consideration is customer engagement and acceptance of pricing principle. Our customer committees currently view the renewals annuity as providing some certainty of continued investment and expenditure on infrastructure and therefore some assurance of business continuity and system availability. We do not recognise sufficient potential benefits to justify working through this with our customer groups at this time.

### 2.6 Dealing with uncertainty

Our ability to manage uncertainty remains a particular concern for us, and is reflected in two aspects of our business:

- increasing volatility in our operating environment – as evidenced by recent fire and flood incidents; and
- the lack of capacity for pricing for risk within our regulatory pricing model – particularly as we have no opening RAB on which to generate a return on investment.

Our Water Plan proposes a number of mechanisms for dealing with uncertainty, including our form of price control and the identification of potential Water Plan variations. Nonetheless, we remain concerned about our level of exposure to unforeseen events, and would like to consider further measures, including the possibility of rolling forward adverse expenditure outcomes, and including within our revenue requirement an explicit contingency provision, with associated rules on how this contingency would be utilised and rolled-forward. We would welcome the opportunity to discuss this issue further with Commission.

### 2.7 Prices and tariff structures

The paper poses the following questions with regard to tariff proposals.

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

In response, we reinforce that our Water Plan has not proposed tariffs, but rather proposes a process for annual tariff setting. Furthermore, our tariffs are currently predominantly entitlement based, and we anticipate that with unbundling this will continue to be the case, and so will provide little capacity for influencing customer behaviour.

Our Water Plan provides indicative impacts on customers based on average increases, and we will continue to refine this analysis as we work through our tariff unbundling and 2008/09 tariff approval processes.

### 2.8 Services standards and GSLs

The paper asks:

- 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?

In developing the suite of performance indicators for our Water Plan, we undertook extensive analysis of what is important to our customers and significantly enhanced

and extended the number of performance indicators. In setting the proposed targets, we:

- reviewed our past performance and identified those areas where our performance fails to meet customer expectations;
- identified improvements in customer service that will flow from projected expenditure in the Water Plan;
- reviewed feedback from customer surveys that indicates that most customers believe we currently provide a good standard of service; and
- assessed the costs of enhancing key indicators, as we are keenly aware that the program of work required to meet our obligations and provide step changes in service levels will mean that bills will have to go up.

#### 2.8.1 Guaranteed service levels (GSLs)

The paper asks:

- 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 consistent across businesses?

With our MID2030 program proposing significant service level changes through an infrastructure investment program for the Macalister irrigation district, and our Western Irrigation Futures project commencing to address similar considerations in our Werribee and Bacchus Marsh irrigation districts, it is not timely to consider GSLs during the next regulatory period.

Notwithstanding, these projects have a large service delivery component, and in the case of MID2030, we will be considering the potential for differential pricing based on service levels.

#### 4.1 Impact of proposed prices

The footnote to table 4.1 states that “Southern Rural Water did not provide the Commission with sufficient information to enable it to calculate the required average annual price change.”

We believe that sufficient information has been provided. Nonetheless, we will be happy to work further with Commission staff and consultants to explain how the indicative tariff impacts are derived from our operating and capital expenditure and from the various initiatives described in our Water Plan.

#### 4.9.1 Bulk water services

We would reinforce whilst our role in headworks management is often misconstrued as that of a wholesaler providing bulk water to retail water business, in fact our role is more akin to a facilities manager, and the “product” of our headworks business is the operation and maintenance of the dams under our stewardship. The various Bulk Entitlement Orders under which we operate specify the manner on which the costs of operating and maintenance the storages are determined and apportioned amongst the entitlement holders.

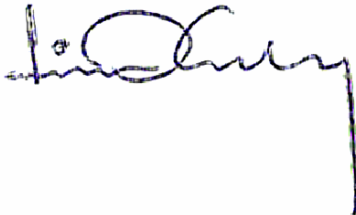
As such we do not have, and do not propose, a “bulk water tariff”. Where table 4.10 , which lists proposed prices for bulk water services in \$/ML, identifies our data as “not provided”, it would be better described as “not applicable”.

#### Tables 4.11, 4.12, 4.13, 4.14, 4.15

Again, we would reinforce that our Water Plan does not propose tariffs, but provides indicative tariffs for the purposes of assessing the impacts of our various initiatives and expenditures. Our proposed form of price control includes an annual tariff setting process.

I hope this assists in your determination process, and we look forward to your further consultation. For further information, do not hesitate to call on 0409 506231.

Yours sincerely



**LINCOLN EDDY**  
**Commercial & Policy Analyst**