



Our Ref: TATDOC# 3594745  
Your Ref:

Mr Marcus Crudden  
Acting Director Water  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne, VIC, 3000.

2 May 2013

Dear Marcus

### **Response to ESC Draft Decision**

Thank you for the opportunity to provide a response to your Draft Decision on GMW's Water Plan 3 Submission ("submission").

GMW is facing unparalleled structural change with over 30% of irrigated water sold out of our irrigation district since 2007, significant structural change to our gravity delivery system and acknowledgement that the organisation needs to be more efficient.

With this context GMW has recently released its 5 year strategy ("Blueprint") which covers the Water Plan 3 period. This Blueprint is complementary to our submission and focuses on three key initiatives:

- Delivery of the Connections Project which will see one of the most significant changes to GMW's gravity delivery infrastructure with a halving of channel infrastructure combined with automation and importantly enhancement of customer service levels
- Complementary tariff structure reform to reflect the changes in our delivery infrastructure and levels of service
- Transformation of GMW as an organisation to achieve efficiencies and cost reductions with a target of reducing costs by \$20 million per annum in the longer term.

These initiatives are interconnected and can only be achieved together. We anticipate that the successful achievement of these initiatives will allow GMW to achieve the \$6 million of savings (at a minimum) through the Water Plan however this is subject to considerable risk arising from internal and exogenous impacts including structural, climate variability and legislative change.

## **Form of Price Control**

GMW's submission and the Draft Decision provide for GMW to apply a revenue cap. GMW is allowed to recover, at a maximum, the approved revenue cap. This form of price control allows flexibility for GMW to set prices with appropriate rebalancing constraints (discussed further below) and with annual price approvals by the regulator.

GMW's submission is to price below the revenue cap for the first year of the Water Plan in 2013-14 based on implementation of the key initiatives and subject to the management of risks facing the business.

It should be the discretion of GMW to make these pricing decisions for 2013-14 and latter years of the Water Plan, in consultation with customers, the ESC and within defined rebalancing constraints. At the time GMW will take all relevant issues into account and provide the business with optimal flexibility during a period of significant structural, climate variability and legislative change.

GMW seeks the ESC's support in maintaining prices as low as possible, while recognising appropriate levels of funding (through the revenue cap), to ensure the financial sustainability of GMW during periods of significant change.

## **Revenue Cap**

Reducing GMW's revenue cap, over and above the \$6m already promised (which exceeds the ESC's efficiency target) removes the ability of GMW's to legitimately manage its revenue and costs, in consultation with customers and the shareholder.

Although it is the aim of GMW to reduce its costs as much as responsibly possible, it cannot be assumed that savings over and above the \$6 million during the Water Plan period will be made.

G-MW notes that the proposed differential between the pricing level and revenue cap would result in a maximum increase in the revenue cap for the last two years of Water Plan 3 of approximately 4.5%. This is well within the proposed rebalancing constraint and request the ESC's support in the inclusion of the following reasonable expenditure in Water Plan 3.

### **Ex-post adjustment (drought and flood expenditure)**

The regulatory regime is underpinned by only funding foreseeable, prudent and efficient expenditure. The failure to reimburse significant unforeseen expenditure results in threats to services and viability of water corporations, should similar events be experienced in the future.

We are concerned that the rules applied to this situation actually incentivise businesses to spend unsustainably during periods of unforeseen events. This is because it is only way to receive additional funding through the ESC, as this is the only thing that will cause the business to not meet its sustainability measures (and ultimately receive funding). The economic model should actually promote innovation, efficiency and sustainability, with organisations receiving the rewards. GMW, being the not-for-profit business that it is, will most likely turn that into savings for customers regardless.

The ESC had already determined what the prudent and efficient level of expenditure was for the Water Plan 2 period. This did not include any provision for significant events like flood or drought. The 'savings' that have been identified are therefore non-genuine as they will only ever be the deferral of prudent and efficient expenditure from one period to another.

Potentially some of the expenditure was also capital in nature and could be included in the Regulatory Asset Base (RAB).

At the time of these events GMW was contacted by the ESC to determine if any assistance was required from the ESC to assist with these issues. These events resulted in \$7.9 million (net) in total unforeseen expenditure for the Water Plan #3 period. Should GMW had taken up the opportunity to have the situation reviewed at the time it is likely it would have satisfied the ESC criteria, due to the negative impacts of many years of flood and drought compounding on the organisation.

However, GMW did not take up this offer (choosing to defer the adjustment to Water Plan #3) because:

- GMW was able to appropriately manage cash flows during this period through various measures.
- It was also considered more efficient (for GMW and the ESC) to address this issue in combination with the next regulatory review, rather than opening up an existing determination (including all reviews and consultation requirements) at the time of drought and flood.
- From a regulatory perspective it was also uncertain if this would trigger the earlier implementation of ACCC regulation.

GMW also seeks clarity from the ESC as to which set of rules should apply in this situation. The ambiguity results as GMW was being covered under transitional arrangements under the Commonwealth Water Act and associated Rules, which allowed a transition where an existing determination was already in place. A mid-determination (Water Plan 2) adjustment could have triggered the early introduction of ACCC regulation. This determination (Water Plan 3) is also being assessed under ACCC regulation and their rules and guidelines should be applied to this request.

### **Carbon tax adjustment**

GMW proposed the inclusion of additional funding requirements associated with the Carbon Tax, following the submission of the final Water Plan. The ESC requested further information in its draft decision to support this proposal. GMW has since provided the ESC with detailed reports and analysis to substantiate the proposed adjustment.

GMW will continue to discuss the inclusion of costs associated with the Carbon Tax and provide any further information to the ESC, as required.

### **Rebalancing constraint**

GMW has adopted a focus on price stability over 2011-12 and 2012-13 which is also evident Water Plan 3 through the proposal of a rebalancing constraint.

The ESC endorsed GMW's approach for the inclusion of a rebalancing constraint, but has not accepted the current proposal. The ESC has instead suggested that individual prices should be subject to the constraint, rather than a typical customer (as proposed).

As GMW is currently undertaking a significant tariff reform process a constraint on adjusting individual prices will have a significant impact on implementation of this program. The tariff restructure and implementation of this process has not been completed and accordingly we require flexibility to effect changes in tariffs.

We consider that it is more appropriate to have the constraint applied to a pre-defined typical customer, as this will recognise the total impact on a customer, rather than an individual price (as some of the proposed reforms will increase prices, but lower others). This approach has also been used in recent consultation processes with our customers.

The 15% rebalancing constraint was also consulted on with customers and was derived based on potential price impacts associated with the structural changes arising from the Connections Project and water reductions through the Murray Darling Basin Plan.

Notwithstanding this, GMW is willing to accept the ESC's suggestion of a rebalancing constraint set to individual tariffs. GMW proposes that this amount should be set at 10%. A rebalancing constraint lower than 10% would significantly reduce GMW's ability to deal with structural change of the business, other risks to the business and threaten financial sustainability.

GMW also notes when it seeks to implement these reforms it will provide an additional submission to the ESC on the proposed changes to tariffs outside of the Water Plan 3 determination. This will be supported by its own consultation program and separately assessed by the ESC.

### **Miscellaneous fees**

GMW's tariff reforms process currently underway examines the many miscellaneous tariffs that currently exist in GMW's tariff schedule, with the aim of reducing the volume of these significantly. Should specific tariffs be approved by the ESC this may limit the ability of GMW to undertake the necessary reforms in line with our Blueprint.

As a result GMW request the ESC approve Miscellaneous fees on cost recovery principles, while these reforms are being undertaken. This approach is consistent with previous determinations.

### **Additional information requests**

The ESC made a number of requests in its draft decision document, some of which have only been clarified recently. G-MW will agree the timing for the provision of all detailed information to the ESC, as to not unnecessarily delay the finalisation of this process. It is also noted that the majority of the information to be provided is confidential in nature and should not form part of a public submission.

**Timing of final decision (meeting ACCC notification requirements)**

GMW notes the requirements of the ACCC for notifying customers and the potential conflict with the tariff review process. GMW requests the support of the ESC to resolve this determination as promptly as possible, in order to have as little impact on customers as possible.

Should you have any questions, or require anything further please do not hesitate to contact myself or Daniel Mongan on (03) 58263475.

Yours sincerely

A handwritten signature in black ink, appearing to read 'G. Hanlon', with a long horizontal flourish extending to the right.

Gavin Hanlon  
MANAGING DIRECTOR