

Our reference:
Your reference

9 May 2008

03/04/02/17



Essential Services Commission (via email)
Attention: Mr. Sean Crees
Level 2, 35 Spring Street
Melbourne VIC 3000

Hazelwood Road
PO Box 348
Traralgon Victoria 3844
Telephone: (03) 5177 4600
Facsimile: (03) 5174 0103
info@gippswater.com.au
http://www.gippswater.com.au

Dear Sean,

The Essential Services Commission (ESC) released its Draft Decision in relation to the 2008 Water Price Review in late March 2008. In the Draft Decision, the ESC formed preliminary views, supported by reviews undertaken by external consultants, on operational and capital expenditure, service standards and demand projections outlined in Gippsland Water's final Water Plan submitted to the ESC in early October 2007.

In the Draft Decision, the ESC recommended reductions to operational and capital expenditure, changes to demand forecasts, and proposed a change to one service standard proposed by Gippsland Water.

Gippsland Water attended the ESC's public consultation session held in the Latrobe Valley in late April 2008, to listen to the issues identified by interested members of the local community. Gippsland Water itself held six consultation sessions across the region in August 2007 to inform the community, and to take feedback on the draft Water Plan.

Gippsland Water has now considered the changes proposed by the ESC in the Draft Decision, and the issues raised by the public at the ESC consultation session, and provides the following response to the Draft Decision.

1. Issues identified in relation to Operating Expenditure

1.1 Variance from "Business As Usual" Operating Expenditure

Gippsland Water notes the detail provided in the final SKM report in relation to Gippsland Water's justification of the variance from target "business as usual" operating expenditure.



Table 6-15 (page 64) of the final SKM report outlines that within the parameters selected by the ESC (application of proposed connections growth (1.6%), and a 1% per annum reduction for productivity improvements), Gippsland Water has been able to justify over 97% of the operational expenditure set out in the final Water Plan. SKM indicate that only \$7.26M of the \$261.85M (before licence fees and environmental levy) could not be justified, after their review.

While the analysis SKM performed on the variance from “business as usual” operating expenditure demonstrates the rigour that Gippsland Water has applied to the Water Plan process, major increases in operational expenditure contribute to a very steep rise in tariffs proposed for the regulatory period, as Gippsland Water outlined in the final Water Plan.

Gippsland Water understands that the ESC has proposed reductions to operating expenditure in excess of the \$7.26M identified by SKM. A review of operating expenditure reductions outlined in table 8 (Vol. 2, page 8) indicates that the ESC Draft Decision has in fact reduced Gippsland Water’s proposed operational expenditure by \$15.1M (net of the increase in the Environmental Contribution), as outlined below.

Net Adjustment to Operational Expenditure:						
<i>\$ million in January 2007 prices</i>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
GW final Water Plan	\$51.10	\$55.39	\$55.54	\$56.81	\$57.07	\$275.91
ESC Draft Decision	\$50.09	\$53.58	\$53.22	\$53.70	\$54.01	\$264.60
ESC Adjustments	-\$1.01	-\$1.81	-\$2.32	-\$3.12	-\$3.05	-\$11.31
Environmental Contribution (add back)	-\$0.93	-\$0.85	-\$0.77	-\$0.69	-\$0.62	-\$3.86
Net Adjustment	-\$1.94	-\$2.66	-\$3.09	-\$3.81	-\$3.67	-\$15.17

1.2 Concerns with reductions in Draft Decision

After the release of the ESC’s Draft Decision, Gippsland Water raised concerns with the ESC in relation to several operating expenditure issues contained in the Draft Decision.

1.2.1 Licence Fees double counted

The Draft Decision identified that Gippsland Water had double counted \$2.61M in licence fees over the regulatory period. Gippsland Water has since proven to the satisfaction of ESC Officers that there was no double counting of licence fees. Gippsland Water was able to supply a full reconciliation of all licence fees provided in the final Water Plan. Gippsland Water understands that ESC Officers will now adjust the reduction of \$2.61M in operating expenditure before releasing a Final Decision.

Adjustment to Operating Expenditure: Licence Fees						
<i>\$ million in January 2007 prices</i>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
ESC Draft Decision	-\$0.52	-\$0.53	-\$0.52	-\$0.52	-\$0.52	-\$2.61
Agreed Movement	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0

1.2.2 Chemical Costs

The second concern related to expenditure Gippsland Water had outlined in relation to chemical expenses. The Draft Decision identified that Gippsland Water's chemical expenditure would reduce by \$3.44M from Gippsland Water's proposal over the regulatory period, confirming reductions outlined by SKM in their final report.

The magnitude of the reduction proposed was of significant concern to Gippsland Water, as it greatly exceeded the reduction that both Gippsland Water and SKM had been discussing prior to the release of the final SKM report. Gippsland Water was expecting reductions of \$1.33M, and believes that over \$2M has been inadvertently removed from chemicals expenditure.

In discussions with SKM, Gippsland Water has now proven that the final SKM report accidentally included a reduction for bulk oxygen costs which Gippsland Water had already removed from proposed expenditure in the final Water Plan. As such, Gippsland Water understands that ESC Officers will now adjust the reduction, and reflect the agreed movement outlined below before releasing a Final Decision.

Adjustment to Operating Expenditure: Chemical costs – non GWF related						
<i>\$ million in January 2007 prices</i>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
ESC Draft Decision	-\$0.56	-\$0.77	-\$0.77	-\$0.82	-\$0.52	-\$3.44
Agreed Movement	-\$0.19	-\$0.33	-\$0.33	-\$0.39	-\$0.09	-\$1.33

1.2.3 ESC and EWOV Licence Fees

A third concern related to ESC and EWOV licence fees. In the Draft Decision (table 17, Vol. 2, page 14), the ESC approved Gippsland Water's assumptions for ESC licence fees. Gippsland Water and ESC Officers have now agreed that the assumptions were too high, and should be reduced. Gippsland Water also indicated that the assumption included EWOV fees for the period. Gippsland Water understands that ESC Officers will now reflect the agreed reduction outlined below before releasing a Final Decision.

Adjustment to Operating Expenditure: ESC Licence Fees						
\$ million in January 2007 prices						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
ESC Draft Decision	\$0.12	\$0.12	\$0.12	\$0.12	\$0.12	\$0.60
Proposed ESC Fees	\$0.06	\$0.06	\$0.06	\$0.06	\$0.06	\$0.30
Proposed EWOV Fees	\$0.02	\$0.02	\$0.02	\$0.02	\$0.02	\$0.10
Agreed Reduction	-\$0.04	-\$0.04	-\$0.04	-\$0.04	-\$0.04	-\$0.20

1.3 Changes to Draft Decision – proposed by the ESC

Since the release of the Draft Decision, Gippsland Water has been advised by the ESC that several further reductions will be applied to Gippsland Water’s operating expenditure. These reductions were not captured in the ESC Draft Decision, nor were they outlined in the recommendations made in the final SKM report. After reviewing the detail in the final SKM report, Gippsland Water understands these further reductions, totaling \$3.727M are made up as follows –

Further Adjustments to Operating Expenditure:						
\$ million in January 2007 prices						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Labour – ESC (add back)	+\$0.88	+\$0.86	+\$1.14	+\$1.44	+\$1.60	+\$5.92
Labour – SKM	-\$1.153	-\$1.125	-\$1.389	-\$1.69	-\$1.907	-\$7.264
Feasibility Studies	-\$0.29	-\$0.26	-\$0.29	-\$0.31	-\$0.22	-\$1.37
Environment	-\$0.125	-\$0.17	-\$0.14	-\$0.14	-\$0.09	-\$0.665
Native Vegetation	-\$0.19	-\$0.113	-\$0.069	\$0.07	-\$0.046	-\$0.348
Movement	-\$0.878	-\$0.808	-\$0.748	-\$0.63	-\$0.663	-\$3.727

1.4 Impact of agreed reversals and further reductions

Given that the ESC and Gippsland Water concur on the movements outlined in sections 1.2 and 1.3 above, the total value of operating expenditure approved in the Draft Decision will change as follows -

Current “proposed” Operational Expenditure:						
<i>\$ million in January 2007 prices</i>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Draft Decision	\$50.09	\$53.58	\$53.22	\$53.70	\$54.01	\$264.60
Section 1.2 Corrections	+\$0.848	+\$0.918	+\$0.908	+\$0.908	+\$0.908	+\$4.49
Section 1.3 Further Reductions	-\$0.878	-\$0.808	-\$0.748	-\$0.63	-\$0.663	-\$3.727
Revised Total	\$50.06	\$53.69	\$53.38	\$53.97	\$54.26	\$265.36

2. Comments in relation to other adjustments in Operating Expenditure

2.1 Electricity – non Gippsland Water Factory (GWF)

Gippsland Water, in its formal response to the draft SKM report supported the adoption of an industry wide approach to electricity pricing assumptions, unless water corporations already had contracts in place for part, or all, of the regulatory period. Gippsland Water also indicated that it would support any ESC led proposal to review increases in electricity pricing as part of the annual tariff review process. This would allow the prevailing SKM view of the day to be applied from 1 July 2008, but protect water corporations from significant changes in price that are to a large extent out of the corporations’ control.

The assumed electricity increase outlined in table 4.3 (Vol. 1, page 53), and the price adjustment outlined in table 8 (Vol. 2, page 8) in the ESC Draft Decision reflects a more acceptable view of likely electricity cost increases than SKM proposed in their draft report. Gippsland Water agrees that businesses will face significant increases in real energy costs, and accepts the ESC’s price adjustment, as outlined below:

Adjustment to Operating Expenditure: Electricity – non GWF						
<i>\$ million in January 2007 prices</i>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
ESC Draft Decision	+\$0.02	-\$0.33	-\$0.32	-\$0.36	-\$0.36	-\$1.35
Agreed Movement	+\$0.02	-\$0.33	-\$0.32	-\$0.36	-\$0.36	-\$1.35

2.2 Electricity – Gippsland Water Factory (GWF)

As discussed above, Gippsland Water accepts the ESC’s price adjustment in respect to Electricity. This acceptance extends to electricity costs associated with the GWF, as outlined below:

Adjustment to Operating Expenditure: Electricity – GWF

\$ million in January 2007 prices

Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
ESC Draft Decision	+\$0.00	-\$0.17	-\$0.33	-\$0.66	-\$0.66	-\$1.82
Agreed Movement	+\$0.00	-\$0.17	-\$0.33	-\$0.66	-\$0.66	-\$1.82

2.3 Labour (excluding GWF)

Gippsland Water notes the labour reductions outlined in the final SKM report, which the ESC confirms it has now adopted (see section 1.3 above). SKM indicate that reductions to the value of \$7.26M should be made to the Gippsland Water final Water Plan for regulatory purposes.

During the review process Gippsland Water has provided SKM with significant detail in relation to movements in labour costs. SKM have used 2006/07 actual costs as the base year for comparisons with proposed budgets for the regulatory period. Gippsland Water has significant concerns with the use of 2006/07 actual labour costs as the base year for comparative purposes. This concern is illustrated by comparing 2006/07 actual of \$15.16M with the 2007/08 budget of \$16.77M, an increase of \$1.61M on the prior year actual. The process for determination of BAU expenditure ignores this real movement, which over the five year regulatory period amounts to approximately \$8.0M.

Gippsland Water actual labour costs for the 2006/07 year were artificially low, and the reasons for this need to be understood and valued when determining an appropriate base year starting point. During 2006/07 Gippsland Water embarked on a Board approved organisational “refresh” which resulted in the creation of several new positions in response to increasing demands on the business across a range of regulatory issues. The timeframe for appointments to these positions meant that the full costs of several positions were not incurred during 2006/07. In fact some positions remained vacant until early November 2006 (effectively “losing” four months of labour costs). In addition, where internal appointments were made to some of these new positions, the process caused a “ripple effect” which required further recruitment to be undertaken for vacant posts as a consequence. Where external recruitment to these vacant posts occurred, Gippsland Water did not commence employment in some cases until late November 2007. Gippsland Water budgets for 2007/08 and the regulatory period include the full costs of these positions.

In addition, several other factors also lead to an increase in costs from 2006/07 to 2007/08 and beyond. These factors include the reclassification of several positions, an increase in overtime for field operations, new positions agreed for the 2007/08 year itself, and Enterprise Agreement salary increases.

Gippsland Water prepared further information for SKM which provided explanations for 80% of the variation between 2006/07 and 2007/08. SKM has noted this information in the final SKM report (table 6-9, page 54), but has elected to ignore the real costs in several areas that will flow into the regulatory period.

Gippsland Water does not agree with the treatment of labour costs outlined by SKM, and does not agree that \$7.26M should be reduced from labour costs for the regulatory period. Rather than enter into another period of negotiation on this issue, Gippsland Water proposes a solution in section 3 below.

2.4 Consultant Fees and Feasibility Costs

Gippsland Water notes the reductions in consultant fees and feasibility costs outlined in the final SKM report, which the ESC confirms it has now adopted (see section 1.3 above). SKM indicate that reductions to the value of \$1.37M should be made to the Gippsland Water final Water Plan for regulatory purposes.

In arguing for the level of reduction proposed, SKM notes that the priority and urgency for Sustainability Investigations outlined by Gippsland Water needs to be considered in the context of reducing pressure on water resources given recent rains in the Gippsland region. Sadly, this view lacks an appreciation of the limited nature of Gippsland Water's major storages, and reveals a lack of understanding of the significant changes in climatic conditions in Gippsland over the past ten years, and the impact these changes are having on rainfall and inflows into Gippsland Water storages. Gippsland Water must commit to undertake reviews like the proposed Sustainability Investigations to ensure that the region remains self sufficient with respect to water supplies.

As such, Gippsland Water does not agree with the treatment outlined by SKM, and does not agree that \$1.37M should be reduced for the regulatory period. Rather than enter into another period of negotiation on this issue, Gippsland Water proposes a solution in section 3 below.

2.5 Environmental Costs

Gippsland Water notes the reductions in environmental costs outlined in the final SKM report, which the ESC confirms it has now adopted (see section 1.3 above). SKM indicate that reductions to the value of \$0.665M should be made to the Gippsland Water final Water Plan for regulatory purposes.

In arguing for the level of reductions proposed, SKM notes that each of the items contained in the detailed justification for Gippsland Water's proposed expenditure has potential merit. SKM observes however, that by approaching the justification of expenditure by delivering details of each project, Gippsland Water will have a tendency to unnecessarily inflate expenditure.

This is a somewhat perplexing argument given Gippsland Water has been requested to provide significant amounts of detail to support expenditure across the business, and the quality of this detail has been used as evidence to support the increases in expenditure proposed.

Gippsland Water proposes to absorb expenditure outlined for the development of fish ladders (\$0.4M) in the capital program for the regulatory period. Rather than enter into another period of negotiation on the balance of reductions proposed by SKM on this issue, Gippsland Water proposes a solution in section 3 below.

2.6 Native Vegetation Costs

Gippsland Water notes the reductions in native vegetation costs outlined in the final SKM report, which the ESC confirms it has now adopted (see section 1.3 above). SKM indicate that reductions to the value of \$0.348M should be made to the Gippsland Water final Water Plan for regulatory purposes.

Gippsland Water had proposed reductions of \$0.094M after an in-house review of native vegetation costs, including learnings from recent Gippsland Water Factory experiences. SKM has determined additional reductions of \$0.255M on the basis that some expenditure estimates are on the high side. From a Gippsland Water perspective these further reduction are arbitrary in nature, and are not supported by any significant review of the issues that will confront the business during the regulatory period in relation to native vegetation.

As such, Gippsland Water does not agree with the treatment of native vegetation costs outlined by SKM, and does not agree that \$0.348M should be reduced from costs for the regulatory period. Rather than enter into another period of negotiation on this issue, Gippsland Water proposes a solution in section 3 below.

2.7 Environmental Contribution

Gippsland Water notes that the Department of Sustainability and Environment has advised the ESC that the Environmental Contribution that is payable by Gippsland Water to the Government's consolidated fund will increase to \$14.86M, from \$11M that Gippsland Water had factored into the final Water Plan. As the ESC note in table 8 (Vol. 2, page 8), this is an increase of \$3.86M over the regulatory period. This increase adds further to the tariff burden imposed on Gippsland Water customers.

3. Delivering an operating expenditure of \$265.36M

In section 1.4 above, Gippsland Water outlined that the current proposed operating expenditure for inclusion in the ESC final Decision will total \$265.36M. In addition, in section two Gippsland Water has outlined that it has serious concerns about the methodology used by SKM in several areas to reduce expenditure. These reductions have been relied upon by the ESC to determine the proposed operating expenditure of \$265.36M.

Gippsland Water understands that by contesting the reductions proposed, any gains made by Gippsland Water will only serve to increase total operating expenditure, and further increase the tariff burden on Gippsland Water customers. As such, despite the concerns outlined above in relation to SKM's treatment of individual operating expenditure items, Gippsland Water proposes to accept the current ESC position that operating expenditure for regulatory purposes will be set at \$265.36M.

From a management perspective moving forward, Gippsland Water will be required to ensure that total operating expenditure is managed within the limitations set by accepting tariffs based on this value.

4. Issues identified in relation Capital Expenditure

In the Draft Decision, the ESC proposed reductions to the capital expenditure outlined in Gippsland Water's final Water Plan. Gippsland Water wishes to advise that the adjustments outlined below are accepted. Comment on a project by project basis is also provided below.

Adjustment to Capital Expenditure: All projects						
<small>\$ million in January 2007 prices</small>						
Description	2008/09	2009/10	2010/11	2011/12	2012/13	Total
GW final Water Plan	\$56.93	\$32.26	\$42.45	\$56.89	\$62.74	\$251.27
ESC Draft Decision	\$53.64	\$30.58	\$40.52	\$53.19	\$62.27	\$240.20
ESC Adjustments	+\$3.29	-\$1.68	-\$1.93	-\$3.70	-\$0.47	-\$11.07
Agreed Movement	+\$3.29	-\$1.68	-\$1.93	-\$3.70	-\$0.47	-\$11.07

4.1 Country Towns Water Supply and Sewerage Program – Coongulla / Glenmaggie

Gippsland Water had identified in the final Water Plan that the townships of Coongulla and Glenmaggie were to receive new wastewater services during the regulatory period under the Country Towns Water Supply and Sewerage program.

In the Draft Decision, the ESC indicated that expenditure on both projects would be deferred until 2011/12, and flow into the following regulatory period (table 10, Vol.2, page 9 – note a). Gippsland Water sought clarification from the ESC on the treatment of these projects, as the movements outlined in table 10 of the Draft Decision contradict the statement at note (a). In table 10, the ESC bring forward expenditure Gippsland Water had proposed for 2013/14 into 2012/13 to allow both projects to be completed by the end of 2012/13.

Gippsland Water has now confirmed with the ESC that the Department of Sustainability and Environment sought that the projects be completed by the end of 2012/13. Thus table 10, indicating a bring forward of expenditure was correct. Gippsland Water wishes to advise that the adjustments outlined can be delivered, and are accepted.

4.2 Gippsland Water Factory – Amenities Centre

In the Draft Decision, the ESC indicated it had removed \$2.4M of the capital cost associated with the construction of the Amenities Centre. Gippsland Water had included the full project cost of \$4.9M in the final Water Plan, which included both the educational experience proposed in the original request for proposal, and a range of essential site operations buildings (control room, laboratories and reception and administrative offices).

The ESC decision confirms a view held by SKM that there is no obligation to develop the educational component of the Amenities Centre. SKM did recognise Gippsland Water's concerns

about taking into account the essential nature of the site operations buildings, and the costs attributable to these buildings by proposing to include \$2.5M for the project in regulatory expenditure.

Gippsland Water wishes to advise that the adjustment outlined is accepted. In accepting the adjustment however, Gippsland Water notes that a contract for the construction of the Amenities Centre has already been signed, with the approval of the Gippsland Water Board. As such, contract expenditure to the value of \$4.9M will be incurred, and construction will include the educational experience.

The impact of accepting the Draft Decision will mean that tariff increases will not fund the educational experience component of the Amenities Centre. The \$2.4M capital reduction will be self funded by Gippsland Water.

4.3 Water Supply Augmentation Projects

Gippsland Water outlined several projects in the final Water Plan that originated from the corporation's Water Supply Demand Strategy. Four of these projects have been identified in the ESC Draft Decision as areas where reductions in capital expenditure can be made.

4.3.1 Warragul to Moe Interconnection

The Draft Decision proposes to reduce expenditure on the Moe - Warragul Interconnection project from a total of \$8M in regulatory period, to \$6.8M. Gippsland Water concedes that this project remains no further advanced than an options study at this time. As such the reduction in expenditure on this project is accepted.

4.3.2 Groundwater Projects

In the final Water Plan, Gippsland Water planned to fund a series of groundwater projects identified as key water augmentation projects in the corporation's Water Supply Demand Strategy. These projects included work at Moe, Warragul and Mirboo North during the regulatory period. The Draft Decision proposes to remove all expenditure for these groundwater projects.

Gippsland Water conceded during the review process that all three projects remained no further advanced than an options study at this time. SKM support was sought to provide a pool of funds for the three projects, to allow planning and feasibility work to be undertaken on the three projects. Gippsland Water notes that the ESC has adopted SKM's recommendation to allow \$3.0M during the regulatory period for this purpose.

On this basis, the removal of all funding for individual groundwater projects is accepted.

4.4 Drouin WWTP Upgrade

In the Draft Decision, the ESC has adopted the SKM recommendation to defer expenditure on the Drouin WWTP Upgrade for one year. The \$3.4M of expenditure outlined by Gippsland Water was considered reasonable and prudent.

While Gippsland Water accepts the timing change proposed by the ESC, it should be noted that timing changes will be subject to discussion and approval by the EPA who have a clear expectation on a timeframe for environmental improvement at this location.

5. Issues identified in relation to demand forecasts

Gippsland Water acknowledges the changes in demand forecasts recommended in the final PWC report, and included in the ESC's Draft Decision. The position adopted in the final PWC report has moved significantly from the draft PWC report. Gippsland Water had raised significant concerns with the draft PWC report, many of which have been addressed in the PWC final report.

Gippsland Water contends that average annual growth rates proposed by PWC of 1.6% per annum across the region remain at the upper end of expectations. The Gippsland Water approach of identifying growth by town provides more certainty with respect to demand forecasts, and did allow for significant growth in several major regional towns including Warragul, Drouin and Traralgon.

Gippsland Water notes however that the ESC has signaled that due to continuing significant uncertainty around demand and supply levels, that it proposes for the second regulatory period to monitor the level of demand and water restrictions over the period. Where the ESC considers actual demand levels are sufficiently different from those assumed at the time of the price determination, it proposes to conduct a within-period review to assess the impact on businesses' revenues. Indications are that such a review could be initiated by the ESC, or requested by a business. Where the ESC finds a material impact on revenue, prices may be adjusted during the period.

Given this within-period review mechanism is put in place, Gippsland Water will accept the changes outlined in the Draft Decision despite concerns about achieving growth at this level over the regulatory period. Agreed demand components are outlined below -

Changes to Demand Forecasts					
Description	2008/09	2009/10	2010/11	2011/12	2012/13
Total Water Connections (No.)	59,983	60,858	61,747	62,649	63,565
Total Sewerage Connections (No.)	51,206	51,968	52,741	53,526	54,323
Total Residential Water Consumption (ML)	10,448	10,253	10,062	9,875	9,692
Total Water Consumption (ML)	14,011	13,826	13,645	13,469	13,296

6. Service Standards

6.1 Approved Service Standards

The ESC has proposed to approve all but one of the twenty one approved service standards identified by Gippsland Water in the final Water Plan. The ESC requested that Gippsland Water review the “average duration of unplanned water supply interruptions” standard, as noted below.

Gippsland Water originally proposed to maintain a target of 118.7 minutes for average duration of unplanned water supply interruptions. This is 21 per cent above the three year average (98.4 minutes). Gippsland Water cited new occupational health and safety requirements as the reason for the proposed increase. Following a request for further information from the ESC, Gippsland Water revised the target to 115 minutes, still a 17 per cent increase over the three year average.

In response to the ESC’s request, Gippsland Water indicated that before any work commences to restore water services, a 12 page Job Safety Analysis (JSA) must be completed, a process that is estimated to take between 18-20 minutes. The revised target for this indicator is based on the simple addition of the three year average and the average time taken to complete a new JSA (19 minutes).

The ESC noted that Gippsland Water’s actual performance for this indicator is lower than most businesses and that 115 minutes is amongst the highest proposed for this measure. The ESC indicated that a target of 110 minutes may be more realistic for this standard, and requested that Gippsland Water indicate why a target of 110 minutes would not be reasonable.

Gippsland Water has again reviewed the data around this service standard. While Operations personnel hold some concerns about achieving a target set at 110 minutes, Gippsland Water will accept the movement proposed by the ESC for this service standard. Gippsland Water notes that this change will have a flow on effect to the “Average unplanned minutes off water supply” service standard, which will now change from 16.1 minutes to 15.4 minutes.

6.2 Additional Service Standards

The ESC has proposed to approve all the additional service standards identified by Gippsland Water in the final Water Plan.

Gippsland Water notes that given the deferral of capital expenditure in the Draft Decision proposed for the Coongulla / Glenmaggie Country Towns Waste Scheme, the additional standard for CTWSS connections must be amended. The connections for Glenmaggie (77) in 2011/12 will now not occur until 2013/14, and must be removed from table 2 (Vol.2, page 5).

7. Other matters - Pricing

7.1 Weighted Average Cost of Capital (WACC)

Gippsland Water understands that the movement in WACC proposed by the ESC in the Draft Decision is based on upward pressure in the real risk free rate, and increases in debt margins. These changes have seen the ESC adopt a WACC of 6.1% in the Draft Decision, compared to the WACC of 5.1% used by Gippsland Water in the final Water Plan, based on advice from the ESC. Gippsland Water estimates that this change in WACC has added approximately \$17M to the Revenue Requirement for the five year regulatory period.

Gippsland Water has reviewed the components that make up the WACC calculation, and discussed the change in WACC with the ESC since the Draft Decision was released. The ESC adopts an industry wide WACC, based on a “well managed business”. Gippsland Water sought to determine whether a specific WACC, adjusted for Gippsland Water should be considered, given the magnitude of tariff increases already proposed, if changes would lead to a reduction in tariffs.

After a review of both debt margins, and Gippsland Water’s financing structure, and a discussion with Treasury Corporation Victoria about the likely changes to the Financial Accommodation Levy (FAL), Gippsland Water has concluded that customers would face a higher WACC if a Gippsland Water specific WACC was sought. While some relief would be likely be gained from a FAL perspective, the financing structure, which currently assumes a debt level of 60% would likely fall below 60%, and thus markedly increase the WACC from the 6.1% that the ESC is seeking to apply. As such, Gippsland Water does not seek a business specific WACC.

7.2 Price Path

The selection of an appropriate price path is an issue for both the ESC and Gippsland Water to resolve. Gippsland Water, in its final Water Plan noted that a smoothed price path would lead to under recovery in the first years of the period, and over recovery in the later years. Therefore, prices at the beginning of the third regulatory period may be higher than required going forward, leading to a ‘see-saw’ effect on prices.

In its submission to the Commission’s December 2007 Issues Paper, Gippsland Water stated that it outlined three proposed price paths (including a smoothed price path, the approach proposed in the Water Plan and a greater up-front increase) during six community consultation sessions across its region. Along with concerns about the overall increase in tariffs, Gippsland Water customer feedback confirmed that customers were concerned about limiting the increase in the later years of the period. Under Gippsland Water’s proposals, prices are 100 per cent higher at the end of the period compared to the start of the period.

During customer consultations, Gippsland Water made it clear that regardless of the price path proposed, the business would still recover the same amount of revenue from customers, the only difference being the stage of the regulatory period that the revenue is recovered in.

Gippsland Water contends that the price path proposed is not inconsistent with the Water Industry Regulatory Order (WIRO). Further, Gippsland Water notes that neither written responses from customers to the ESC, nor comments made during the ESC's recent public consultation have raised any issues with the price path proposed.

7.3 Dealing with Uncertainty

In the Draft Decision, the ESC identified that "pass-through" mechanisms that allowed a pricing decision to be reopened were most appropriate for uncertain events that could be identified, but for which the impacts could not be predicted with any certainty prior to making a price determination. The ESC indicated that such events should be clearly observable and verifiable and outside the control of the business.

Gippsland Water outlined several issues of uncertainty in its final Water Plan. A full discussion of each issue was contained within the final Water Plan. Gippsland Water notes that one issue identified in the final Water Plan, the Water Security Investment Strategy - Latrobe System, remains as an issue of uncertainty for Gippsland Water.

In addition, Gippsland Water has now considered the implications of the reductions outlined by the ESC in the Draft Decision. Of particular note in terms of uncertainty was the decision to remove all project funding for capital expenditure in respect of the Moe Groundwater, Warragul Groundwater and Mirboo North Groundwater projects.

Capital expenditure was removed, as these projects are currently at options study stage and because there may be some interaction between the needs of these projects. SKM recommended that only minor expenditure be allowed for planning and feasibility to be undertaken in the next regulatory period. Gippsland Water now wishes to include each of the three groundwater projects as key areas of uncertainty.

To summarise, Gippsland Water requests that the ESC identify the following projects as issues of uncertainty –

- Water Security Investment Strategy - Latrobe System
- Moe Groundwater Project;
- Warragul Groundwater Project; and
- Mirboo North Groundwater project.

Gippsland Water has also determined a trigger mechanism for these projects. Gippsland Water proposes that where –

- project costs are finalised;
- appropriate levels of approval are obtained (as project costs dictate); and
- Gippsland Water can justify that these projects will be delivered in the regulatory period;

then the ESC will consider an adjustment to Gippsland Water's price determination.

7.4 Update on expected Capital Expenditure for 2007/08

In discussion with the ESC, Gippsland Water identified significant capital expenditure that would occur in the last six months of the 2007/08 financial year. Gippsland Water will provide the ESC with an update on 2007/08 capital expenditure, to assist in the determination of the most likely closing value for calculation of the “Regulatory Asset Base”. Gippsland Water proposes that this update will be based on April 2008 actuals, combined with estimates for May and June 2008. This update will be forwarded to the ESC by Friday 16th May.

Gippsland Water will brief the ESC on the progress of construction of the Gippsland Water Factory, to ensure that this major capital investment is captured correctly in the “Regulatory Asset Base” calculation. This advice will include details with respect to any under expenditure during 2007/08 that will now be delivered in 2008/09, in addition to the capital budget for the project outlined in the final Water Plan for 2008/09.

7.5 Miscellaneous Services

Gippsland Water has identified a ‘core’ set of miscellaneous services, consisting of the business’s most important miscellaneous services which are expected to generate a significant proportion of total miscellaneous revenue. Gippsland Water proposed core set that has significantly reduced from its current schedule of miscellaneous services.

7.5.1 Miscellaneous Services Definitions

To improve customer understanding about the nature of the service and the circumstances in which the charge would apply, the ESC requested that businesses provide a clear definition each core miscellaneous service included in the approved price schedule. Gippsland Water has provided definitions – please refer to attachment one of this response.

7.5.2 Schedule of charges covers 75% or more of Miscellaneous Services Income

The ESC noted a preference for businesses to recover a significant percentage of their miscellaneous revenue through their core services. The Commission considered that a percentage of greater than 75 per cent constituted a significant amount.

Gippsland Water confirms that the percentage of total revenue expected to be received through the core services identified constitutes greater than 80% of total revenue attributable to miscellaneous services.

8. Other matters – Non Pricing

8.1 Allocation of costs for Reticulation Assets

In the Draft Decision, the ESC sought views in relation to apparent anomalies created by the current method of classifying infrastructure for new developments. The ESC indicated that an appropriate response may be to allocate costs for reticulation infrastructure to developers based on the portion of infrastructure required to service their particular development, with water

businesses making up the balance, to be recovered from future development or over time through prices.

The ESC requested that businesses provide their viewpoints on the possible application of this approach, including:

- the incidence of situations where developers pay for a greater capacity in reticulation than is required by their development, and
- possible mechanisms for allocating costs to developers based on system capacity requirements.

Gippsland Water has for some time adopted a policy of funding “upsizing” contributions for reticulation assets, where a whole of catchment solution requires a different outcome than the development itself. For example, Gippsland Water will fund cost of the pipe size difference (not depth) when 225mm sewer is required for a whole of catchment solution, but the development only requires 150mm sewer. Where a pump station is concerned, Gippsland Water will fund the cost differential between what will service the development, and the whole of catchment solution (this generally is 10-20% of the asset cost).

This approach to the issue provides developers with a reasonable outcome, and does not require the business to maintain records of costs to be distributed to other developers in future years. As the ESC outlines in the Draft Decision, these costs are then recovered over time through prices.

8.2 Allocation of costs for Shared Assets

In the Draft Decision, the ESC sought views in relation to possible alternatives to the calculation of bring forward charges for shared infrastructure. The purpose of this non-scheduled charge is to provide a price signal for this out of sequence development.

Given that the estimation of bring forward periods is typically imprecise, the ESC considered that there may be merit in creating a scale of bring forward periods with a general application, for example:

- 0-5 years – no bring forward;
- 6-10 years – contribution defined as 35 per cent of the as constructed cost of shared assets;
- 11-15 years – contribution defined as 50 per cent of the as constructed cost of shared assets; and
- >15 years – contribution defined as 70 per cent of the as constructed cost of shared assets.

Gippsland Water believes that this approach is not a fair and consistent approach for the development industry. The current approach applies a rising scale for contributions, based on the number of years a development is “out of sequence”. While there is room for conjecture about how far out of sequence a development is, the difference in contributions between years is not marked, and allows both developers and businesses some room to negotiate. Under the alternative proposed by the ESC, marked differences would result between a development that is five years out of sequence, compared with a development that is considered six years out of

sequence. Gippsland Water believes that this alternative approach would in fact increase the number of disputes that occur with developers on this issue, with water businesses likely to argue that the brought forward is always six, eleven etc. years, while developers only see five and ten year periods.

If the calculation of the brought forward period is imprecise, as the ESC indicates, Gippsland Water suggests that rather than adopt the alternative proposed, why not consider a consistent approach across the industry using the region or towns average connection figures (for example: actual connection figures for the last five years). This would be a common sense approach that developers could quickly see the rationale behind, and may alleviate a majority of concerns.

8.2 Trade Waste – pricing principles

In the Draft Decision, the ESC indicated that Gippsland Water was required to set out and apply specific trade waste pricing principles which would be applicable to those customers for whom scheduled prices do not apply.

Gippsland Water proposes to adopt the trade waste pricing principles outlined by the ESC in the Draft Decision, as detailed below:

- (i) volumetric and load based prices should, to the extent practicable, reflect the long run marginal cost (LRMC) of trade waste transfer, treatment and disposal;
- (ii) the total revenue received from each customer should be greater than the cost that would be avoided from ceasing to serve that customer, and (subject to meeting avoidable cost) less than the stand alone cost of providing the service to the customer in the most efficient manner;
- (iii) the methodology used to allocate common and fixed costs to that customer should be clearly articulated and be consistent with any guidance provided by the Commission;
- (iv) prices should reflect reasonable assumptions regarding the volume and strength of trade waste produced by that customer;
- (v) depreciation rates and rates of return used to determine prices should be consistent with those adopted by the Commission in this Determination;
- (vi) Customers should be provided with full details of the manner in which prices have been calculated. Where applying these principles results in significant changes to prices or tariff structures, arrangements for phasing in the changes may be considered and any transitional arrangements should be clearly articulated.

8.3 Major clients – equity in tariffs

In the Draft Decision, the ESC noted that it was not always clear how businesses had allocated costs between residential and non-residential customers. In addition, the ESC noted that often the prices charged to non-residential customers are not reflected in the businesses' tariff schedule having been the subject of a separate negotiation process and reflected in long term contracts. The ESC indicated that few businesses had provided details of contracts where scheduled prices do not apply, and without access to these contracts the Commission has not been able to assess whether costs have been allocated to some non-residential customers on a reasonable basis.

The ESC also noted that Gippsland Water was proposing to levy significantly lower variable usage charges for major customers than for residential and other non-residential customers, however this charge would be subject to the same increases applied to other customers.

The ESC indicated that it was of the view that where customers are receiving the same service they should be subject to the same prices, and sought an explanation from Gippsland Water as to why their major customers are subject to different prices to the rest of the customer base.

In response to this issue, Gippsland Water provides the following comment –

- Gippsland Water has previously provided details of all major contracts to the ESC for information purposes (1st Water Plan), and will do so again should the ESC seek that same level of detail;
- During public consultation processes run by both Gippsland Water and the ESC, customers have raised concerns that major industrial users of water are being subsidised by the general customer base. Gippsland Water has provided assurances to both the ESC and the public that this is in fact not the case. This statement is supported by the following evidence –
 - Most major clients are supplied with raw, untreated water that is delivered by gravity fed systems which, while complex in nature due to their size, are simple to run and low cost to operate;
 - In contrast the water supplied to residential customers is very high quality treated water, delivered across 17 water systems, incorporating water treatment plants, pumping stations, clear water storages, and over 2000km of reticulated pipe network across the region. Put simply, the costs of providing this level of treatment and service is significantly more expensive than the raw water system supporting major clients;
 - For the purpose of business stream (or segment) reporting, Gippsland Water has for many years segregated the costs and revenues of the bulk water and bulk waste business stream. Business stream operating results are published in Gippsland Water’s Annual Report, and clearly indicate no cross subsidy exists.
- As noted above, the ESC itself raised the issue of lower variable usage charges applied to major clients, noting that “Gippsland Water was proposing to levy significantly lower variable usage charges for major customers” in the Draft Decision.

In coming to this conclusion, it appears that the ESC has relied upon a one line entry in a revenue forecast template, and determined that this data is representative of all major clients, without raising the matter with Gippsland Water for discussion. It should be noted that in the same template other major client lines appear with significant consumption, and tariffs that are identical to those applied to residential customers.

Without disclosing contract details which are confidential in nature, Gippsland Water would point out that contracts with major clients also contain fixed charges for water and waste water services. These fixed charges can significantly exceed any charges applied to

residential and other non residential customers. In other words, where lower water volumetric charges have been agreed in long term contracts, fixed charges have been set at levels far in excess of any fixed charge normally applied to residential or other non residential customers.

It should also be noted that tariff values for many major clients result from long term contracts that have been entered into with major clients. In many cases, these contracts were agreed up to a decade ago, well before water industry regulation commenced, and with contract terms of up to 30 years.

Gippsland Water remains convinced that no cross subsidy exists, and believes the information provided above supports this view.

8.4 GSL Schemes

Gippsland Water understands that the ESC is strongly in favour of adopting GSL's, as outlined in the following extracts from the Draft Decision -

“For the forthcoming regulatory period, over 90 per cent of the Victorian community will be provided with a guaranteed minimum level of service. In the Commission’s view there does not appear to be an adequate argument for not providing the remaining 10 per cent with access to a GSL scheme.

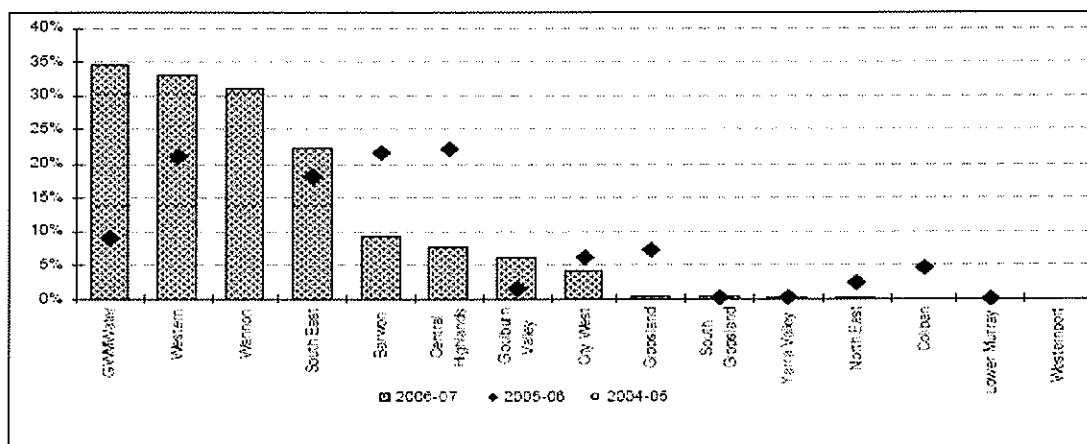
Over the next twelve months the Commission will be better placed, with three full years of audited data, to assess the need for a consistent set of GSL's to be implemented by all urban water businesses.

The Commission proposes to allow for the implementation of GSL schemes by all other urban regional water businesses during the next 12 to 24 months subject to further analysis, monitoring and consultation”.

From a Gippsland Water perspective, all water businesses face particular and sometimes unique issues. These issues can result from geographic, climatic, network and population density factors. Gippsland Water would contend that given these factors, GSL schemes do not necessarily drive comparative performance across businesses.

To illustrate this point, the figure below extracted from the 2006/07 Water Performance Report outlines that several businesses that have adopted GSL schemes have recorded poorer performance with respect to “unplanned water supply interruptions restored within five hours notification” than Gippsland Water, where a GSL scheme is not in place.

Figure 31 Planned customer-interruptions not restored within 5 hours (per cent)



In reviewing the need to introduce GSL schemes across the industry, another consideration for the ESC is whether current performance warrants the introduction of the scheme. Gippsland Water notes the information supplied by the ESC in table 2.3 (Vol. 1, page 23) of the Draft Decision. This table outlines ESC nominated services of primary concern for those receiving below average levels of service. The information provided in the table highlights Gippsland Water’s high level of performance on the three key indicators, and demonstrates that they may be little to gain from the introduction of a GSL scheme.

Gippsland Water would again point to the lack of support demonstrated in the response to a Gippsland Water survey, to gain an appreciation of wider support for the introduction of GSL’s. The findings of the customer survey were as follows:

- 45% indicated that GSL’s should be introduced;
- 28% indicated that GSL’s should not be introduced; and
- 27% indicated that they were undecided.

In responding to a question on the advantages of GSL’s:

- 60% indicated that GSL’s “ensured that work gets done on time”; while
- 59% indicated that GSL’s “made sure Gippsland Water does what is stated”.

In responding to a question on the disadvantages of GSL’s:

- 60% indicated that GSL’s meant “customers would be charged more”; while
- 49% indicated that GSL’s will “hide problems and delays”.

In responding to a question in relation to paying an additional amount to fund rebates for a GSL scheme:

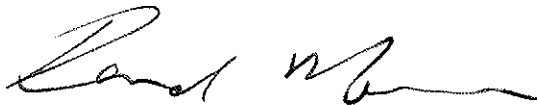
- 85% indicated that they would not be willing to pay more;
- 8% indicated that they would be willing to pay more; and
- 7% indicated that they were undecided.

In the Draft Decision, the ESC comment that the results of this Gippsland Water survey was misleading, because survey results suggest to the ESC that customers were not informed about the purpose that GSL schemes serve or of the potential impact on their household bill. Gippsland Water acknowledges that framing survey questions is fraught with danger. Gippsland Water engaged professional assistance in an effort to remove any undue bias from the survey questions.

While comparisons of current performance indicate that Gippsland Water continues to perform well, without the provision of GSL's, Gippsland Water would be happy to continue working with the ESC in reviewing the introduction of GSL's to customers.

Gippsland Water values the opportunity to respond to the ESC on the issues outlined above. Should the ESC require any further information, or clarification on any of the issues raised in this response, please contact Mr. Kevin Enguell, Manager Strategic Planning on 5177 4684.

Yours sincerely,

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

David Mawer
MANAGING DIRECTOR

Attachment One

Gippsland Water – Response to ESC Draft Decision Definitions for Miscellaneous Services

Water Main Tapping (per tapping)	
Description of Service	Definition
Capping of a 20mm or 25mm Service Plumber to Excavate	GW's contractor attends site to cap the existing tapping provided on the water main. This is completed by turning the ferrule off, disconnecting the copper and inserting a cap. Excavation of main to be carried out by the customer's plumber.
20mm x 100mm Main Buried Property Service up to 5 metres in road reserve	GW's contractor attends site, excavates water main and completes an under pressure water tapping.
20mm x 150mm Main Buried Property Service up to 5 metres in road reserve	GW's contractor attends site, excavates water main and completes an under pressure water tapping.
20mm x 100mm Main Buried Property Service up to 20 metres in road reserve	GW's contractor attends site, excavates water main and completes an under pressure water tapping.
20mm x 150mm Main to Meter up to 20 metres in road reserve	GW's contractor attends site, excavates water main, completes an under pressure water tapping and installs a 20mm standard meter
20mm x 150mm Main to Meter up to 5 metres in road reserve	GW's contractor attends site, excavates water main, completes an under pressure water tapping and installs a 20mm standard meter
20mm x 100mm Main to Meter up to 5 metres in road reserve	GW's contractor attends site, excavates water main, completes an under pressure water tapping and installs a 20mm standard meter.
20mm x 100mm Main to Meter up to 20 metres in road reserve	GW's contractor attends site, excavates water main, completes an under pressure water tapping and installs a 20mm standard meter

Property Service Connection Pipe Installation – Polyethylene PN12 Type 50	
Description of Service	Definition
Tapping size 20 mm length less than 5 metres (per tapping)	GW contractor provides the pipes and fittings used or intended to be used for the supply of water to a property, from the water main up to and including the meter assembly or to the stop tap / ball valve if no meter fitted.
Meter Installation (per meter)	
Description of Service	Definition
Meter size 20mm	This charge provides for GW contractor to attend site and fit a standard 20mm water meter assembly.
Meter size 25mm	This charge provides for GW contractor to attend site and fit a standard 25mm water meter assembly.
Meter Assembly Fee for Pre-Tapped Properties (per meter)	
Description of Service	Definition
Fee for a new meter and meter assembly to be installed to a pre-tapped property	This charge provides for GW contractor to attend site and fit a standard water meter assembly. A standard meter assembly is an apparatus consisting of water meter, stop valve, strainer, additional valves (if fitted) and unions required to connect these components together and to the water supply pipe work but does not include a backflow prevention device installed downstream of the outlet of the meter.
Application for Connection to Waste Water Main (each)	
Description of Service	Definition
Standard residential connection into wastewater connection point	The sewer connection application charge provides for processing of an application for a standard residential sewer connection. Once the application has been approved a Plumbing Industry Commission (PIC) number will be issued. Note that the application charge does not include the PIC fee.
Minor repairs/alterations requiring P.I.C number	The sewer connection application charge provides for processing of an application for a sewer alteration. Once the application has been approved a Plumbing Industry Commission (PIC) number will be issued. Note that the application charge

	does not include the PIC fee.
Small industrial/commercial connection	The sewer connection application charge provides for processing of an application for a sewer connection for a small industrial or industrial development. Once the application has been approved a Plumbing Industry Commission (PIC) number will be issued. Note that the application charge does not include the PIC fee.
Provision of wastewater connection point to existing wastewater main by accredited pipelayer	This charge is an audit fee for GW personnel to attend the site at the time of construction of a sewer property connection by an accredited pipelayer
Special Meter Reads (each)	
Description of Service	Definition
Special Meter read at the commencement of a tenancy and at the termination of a tenancy	This charge is for an out of the ordinary Meter read at commencement and termination of an occupancy for incoming and outgoing customers.
Information Statements (each)	
Description of Service	Definition
Preparation of a Property Information Statement, inclusive of a Special Meter Reading performed on settlement date	Information Statement upon request to provide certificate of outstanding rates and encumbrances in accordance with Section 158 of the Water Act 1989.
Restriction and Reconnection of Water Supply (each)	
Description of Service	Definition
Restriction of water supply	Restriction of water supply for non payment of water account in accordance with Gippsland Water's Customer Charter.
Reconnection of water supply	Reconnection of water supply following either payment of the outstanding Tax Invoice or a suitable payment plan being negotiated with the customer as per Gippsland Water's Customer Charter.

Application to Build over Gippsland Water's Assets and/or Easements (each)	
Description of Service	Definition
Fees for Application to Build over Gippsland Water's Assets and/or Easements	This is a charge for processing an application from a customer who wishes to construct a structure over a Gippsland Water asset and or easement.
Metered Hydrant Fees (each)	
Description of Service	Definition
Annual fee	Gippsland Water provides a metered hydrant service to registered users in accordance with the Water Act 1989.
Land Development Fees Application Fee including water supply & wastewater (each)	
Description of Service	Definition
11-20 lots in subdivision	This is a charge for processing an application from a customer who wishes to construct a structure over a Gippsland Water asset and or easement.
Land Development Fees Offer Acceptance Fee including water supply & wastewater (each)	
Description of Service	Definition
11-20 lots in subdivision	This charge is to receipt monies and process start works notice etc upon acceptance by developer of owners cost work agreements.