

BARWON WATER

APPLICATION FOR  
PRICE ADJUSTMENT

DECEMBER 2011

BARWON WATER  
12/2/2011

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## 1. Executive Summary

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This is an application from Barwon Water requesting the Essential Services Commission (ESC) to re-open its 2008 Pricing Review Determination (2008 Determination) under the ‘*uncertain and unforeseen events mechanism*’ of Barwon Water Determination (ESC 2008 Determination) to recover the commissioning and construction costs associated with the Melbourne to Geelong Pipeline (MGP).

### Background

As part of Barwon Water’s 2008 Final Water Plan, Barwon Water included the capital costs associated with the Melbourne to Geelong Interconnector, now known as the Melbourne to Geelong Pipeline (MGP) in the final capital program.

However, as the cost of purchasing water from the Melbourne pool was still unknown, the cost of water and the operating costs associated with running the pipeline were not included in Barwon Water’s final Water Plan.

Extensive customer consultation had also been undertaken specifically relating to the benefits from the MGP project along with the project’s impact on proposed price increases.

On release of the ESC’s Draft 2008 Determination, the MGP remained in Barwon Water’s proposed capital expenditure program and therefore in the proposed customer price increases over the 5 year water plan period.

As the project was included in the ESC’s draft determination, Barwon Water was confident this project would remain in the ESC’s 2008 Final Determination.

On release of the ESC’s Final Determination in June 2008, the Melbourne to Geelong Interconnector (now Melbourne to Geelong Pipeline) was excluded from the pricing determination and Barwon Water’s prices were adjusted accordingly.

However, the ESC included the clauses stated in *Figure 1 – ESC Statements* within the “Regional and Rural Businesses’ Water Plans 2008-2013” Final Determination.

Barwon Water commenced the construction of the pipeline in November 2010 with the forecast completion and in service date of January 2012 to be comfortably achieved.

As a result, Barwon Water is applying under Clause 4 of Barwon Water’s 2008 Determination to use the “uncertain and unforeseen events” mechanism to provide for the costs associated with the MGP into prices and therefore customer prices to be adjusted accordingly.

Based on the modelling completed by Barwon Water and discussed extensively with ESC staff (*Attachment one - minutes from meetings*), Barwon Water’s proposed price path is to adjust prices by an additional 3.5% in the final year of the 2008 Water Plan period (2012/13). Adjusting prices by 3.5% will recover a large portion of the costs associated with the project, however taking into consideration customer affordability and customer interests, Barwon Water did not increase prices more than 3.5%.

Barwon Water intends to recover the costs across all services that are currently increased by the annual price increase *Attachment two – Barwon Water proposed 2012/13 tariff schedule*. This includes:

- Water service price – Residential and Non residential
- Water volume price – Residential and Non residential
- Sewerage service price - Residential
- Sewerage service price - Non residential
- Sewerage volume price – Non residential

- Trade waste volume price – trade waste customers

This option ensures the price increases are consistent with how the current increases are applied.

The table below details a customer bill using 165kl per annum with the additional 3.5% price increase compared to no re-opening.

2012/13 - at 7.0% PLUS CPI				2012/13 - at 10.5% PLUS CPI			
RESIDENTIAL CUSTOMER - 165kL			% to total bill	RESIDENTIAL CUSTOMER - 165kL			% to total bill
<b>2012/13</b>				<b>2012/13</b>			
<b>FIXED CHARGES</b>				<b>FIXED CHARGES</b>			
Water Service Charge	\$165.20		31.54%	Water Service Charge	\$170.60		31.54%
Sewer Service Charge	\$547.92			Sewer Service Charge	\$565.84		
Special Water Quality Charge	\$0.00			Special Water Quality Charge	\$0.00		
<b>TOTAL SERVICE CHARGES</b>	<b>\$713.12</b>		<b>66.54%</b>	<b>TOTAL SERVICE CHARGES</b>	<b>\$736.44</b>		<b>66.54%</b>
<b>VARIABLE CHARGES</b>				<b>VARIABLE CHARGES</b>			
Water Volume (kL)	165			Water Volume (kL)	165		
Water Tariff (\$/kL)	\$2.1734	\$358.61	68.46%	Water Tariff (\$/kL)	\$2.2445	\$370.34	68.46%
Sewer Discharge	64%			Sewer Discharge	64%		
Sewer Volume (kL)	106			Sewer Volume (kL)	106		
Sewer Volume Tariff (\$/kL)	\$0.0000	\$0.00		Sewer Volume Tariff (\$/kL)	\$0.0000	\$0.00	
<b>Total Water Charges</b>	<b>\$523.81</b>			<b>Total Water Charges</b>	<b>\$540.94</b>		
<b>TOTAL VOLUME CHARGES</b>	<b>\$358.61</b>		<b>33.46%</b>	<b>TOTAL VOLUME CHARGES</b>	<b>\$370.34</b>		<b>33.46%</b>
<b>TOTAL WATER AND SEWER BILL</b>	<b>\$1,071.73</b>			<b>TOTAL WATER AND SEWER BILL</b>	<b>\$1,106.78</b>		
				\$ increase in total bill - No re-opening to re-opening		<b>\$35.05</b>	
				\$ increase in total bill p/w - No re-opening to re-opening		<b>\$0.67</b>	
				% increase in total bill - No re-opening to re-opening		<b>3.3%</b>	

As the table highlights, the dollar impact to a typical residential customer in the Barwon region from re-opening to recover the costs of the MGP is \$35 a year or 67 cents a week. *Attachment three provides a number of both residential, non residential and tenant bills and the impact the re-opening has to each community group.*

This option provides customers a clear, transparent and direct nexus between an increase in price at the time the MGP is constructed and commissioned. It also allows Barwon Water to receive a return on its investment via prices at the time the costs are incurred.

Barwon Water already has a range of hardships schemes in place to assist customer with paying their water and sewerage bills to mitigate the impact of price increase. These include:

- Concession card and pensioner card discounts
- Utilities Relief grant which assist suffering temporary financial crisis
- Payment plans to assist in paying bills weekly, fortnightly or monthly or otherwise

Barwon Water also provides rebates on a range of water saving products that assist customers in managing their water bills.

### Stakeholder and community engagement

Barwon Water has undertaken extensive stakeholder and community engagement on the MGP in three stages as follows:

#### 2008 Water Plan Community Engagement

- Extensive community engagement during the 2008 Water Plan development which included seeking community input into the need for the project in the context of the extended drought conditions at the time.
- Detailed consultation with customers on the specific price percentage impact the project had on the total price increase proposed by Barwon Water in its 2008 Water Plan
- Significant consultation as part of Barwon Water's 2008 Water Supply Demand Strategy preparation which positioned the MGP as forming a key component of a range of

alternative water supply options which would secure the Geelong region's water supply for the next generation.

In summary, Barwon Water customers were supportive of the project and understood that securing the water supply for Geelong came at a cost which was clearly linked to the MGP.

In addition, customers understood and supported that the pipeline may not be required on a continuous basis, but would provide security in the face of population growth and climate variability into the future.

### **Project Specific Community Engagement**

A project-specific community engagement strategy was developed and executed during the design and construction of the MGP. Stakeholders and community members were engaged via various communication tools. These included community information bulletins, media releases, website updates and briefing sessions with key stakeholders and community groups. Barwon Water also provides the opportunity for customers to provide comment via its website, written communication or verbally at any of our customer service centres.

Contractors Maloney Field Services and Abigroup conducted extensive consultation with over 50 landowners along the pipeline alignment. This included door knocks, mail outs, construction notifications, face to face meetings with individual landowners and community groups as required, telephone calls and emails.

All stakeholder and community engagement relating to the MGP has been captured and recorded in Consultation Manager and detailed monthly engagement reports have been generated for the past two years by members of the project team both within Barwon Water and within the project partner companies - KBR, Maloney Field Services and Abigroup.

Overall the landowners and the broader community have been supportive of the project with minimal objections or queries. This would suggest they understand why the pipeline is being built.

### **Re-opening 2008 Determination for MGP community engagement**

Barwon Water publicly commenced customer consultation on 18 November 2011 to update customers on Barwon Water's proposal to re-open the 2008 Determination to recover the construction and commissioning costs of the MGP which would result in a 3.5% price increase in addition to the 7.0% which was approved in Barwon Water's 2008 Determination.

This community engagement included:

- A media release which generated a front page article in Geelong's leading newspaper "The Geelong Advertiser" on Saturday 19 November 2011. The paper also included an editorial about the cost of living which referred to the costs of water. Readers of the newspaper had the opportunity to provide feedback online via the newspaper's website and some did provide comment. *Attachment four - Media releases*
- A media release to the Colac Herald which resulted in an article on page 3 in this publication, which covers the Colac region.
- The announcement of Barwon Water's intention to increase prices to recover the costs of the MGP on Barwon Water's website which provided customers with the opportunity to make comment via an online feedback form
- A presentation to Barwon Water's Customer Consultative Committee (CCC) on 30 November 2011, followed by detailed discussion, to provide an update on the project and Barwon Water's intention to re-open the 2008 Determination to increase prices to recover the costs of the MGP.

Barwon Water's CCC members were supportive of Barwon Water re-opening as they understood the need for the price increase to cover the construction costs, even though the pipeline may not be operational for a number of years due to recent good rainfall.

Barwon Water has not received any additional customer feedback on its intention to apply to the ESC increase prices by 3.5%. No calls were received through the Customer Service Centre in this regard, following the announcement. This would suggest customers understand the need for Barwon Water to apply to re-open the price determination and do not oppose it.

Barwon Water has met with the Essential Services Commission on a regular basis to provide updates and request support as the application was being prepared.

Barwon Water has also provided regular updates to the Department of Sustainability and Environment (DSE) which has supported the application to re-open to recover the costs of the construction of the project.

Barwon Water has also obtained the Minister for Water's support for our application and has provided updates to the Minister when necessary on the progress of the application.

Barwon Water strongly believes and based on feedback from customers to date and more so, lack of feedback, re-opening the 2008 Water Plan to account for the delivery of the MGP is the best option and engagement opportunity for Barwon Water's customers. This is based on:

- re-opening provides customers with a clear and obvious link between the costs of the construction of the pipeline and the requested price increase.
- relating a price increase in future years to an asset that is already built is not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period.
- relating a price increase in future years to an asset that is already built is unfair and confusing for customers. For Barwon Water to justify and explain an additional 3.5% price increase to our customers in 2013 Water Plan for an asset that was constructed and in service effectively 12-18 months after the completion date is inconsistent, unfair more confusing and difficult for customers to understand when no other project has been treated this way.

It is also important to note that Barwon Water's theme for the 2008 Water Plan, which is widely accepted by Barwon Water's stakeholders and customers, is 'building for the future' with the significant focus on water security and meeting a growing population.

When the project was considered and subsequently commenced, the State of Victoria was in record breaking drought conditions with the real possibility of Melbourne and Geelong running out of potable water by 2012.

Barwon Water stepped up to customers' expectations and values by commencing water security projects, including the MGP, to ensure customer water security was to never be a concern again. Barwon Water invested in a suite of water security assets including the MGP and therefore the cost of the asset should be recognised at the time it is available for service in line with all other projects that were identified in the 2008 Water Plan.

Barwon Water is now planning for the future and is proposing new theme for the 2013 Water Plan, which we believe meets customer values and expectations of today and for the future. This is based on 'consolidation, efficiency and minimal (if not zero) prices increases.

It would be contradictory to start the 2013 regulatory period with 'price increases' due to the MGP, and would also make it very difficult to communicate such a theme with customers.

### Dealing with Significant changes in price increases

One of the ESC's main concerns of Barwon Water re-opening is the potential for it to result in a 'scissor effect' on pricing. In other words, price increases going 'up' in the final year of the 2008 Water Plan, but immediately going 'down' in the 2013 Water Plan period.

- for Barwon Water to achieve an overall customer '*dollar price decrease*' in the 2013 Water Plan, Barwon Water would need a 'real' price percentage decrease greater than CPI.
- Barwon Water has undertaken significant preparation for the 2013 Water Plan and a negative 'real' price percentage increase (greater than CPI) is unlikely. In reality, Barwon Water will be challenged to deliver a 0% real price increase.
- Should Barwon Water deliver a 0% price increase, with the addition of CPI, customers will still be faced with an overall dollar price increase.
- Therefore, as indicated within this submission, the potential for a scissor effect is very unlikely

Our stakeholder and engagement initiatives relating to the MGP are further detailed in Section 7 Stakeholder and community engagement



## 2. Introduction

Barwon Water's 2008 Water Plan was submitted to the ESC in October 2007.

As part Barwon Water's final 2008 Water Plan, Barwon Water included the capital costs associated with the MGP in the final capital program.

However, as the cost of purchasing water from the Melbourne Water pool was still unknown, the water and the operating costs associated with running the pipeline were not included in Barwon Water's final Water Plan.

Extensive customer consultation had also been undertaken specifically relating to the benefits including water supply diversity and security from the MGP project along with the project's impact on proposed price increases. This resulted in the project being supported by customers, stakeholders and the community.

The ESC's Draft 2008 Determination included the MGP in Barwon Water's proposed capital expenditure program and this was reflected in the proposed customer price increases over the 5 year water plan period.

On release of the ESC's Final Determination in June 2008, surprisingly, the Melbourne to Geelong pipeline was excluded from the pricing determination and Barwon Water's prices were adjusted accordingly.

**Table 1** ESC Draft Determination prices compared to Final Determination prices

*ESC Draft Determination prices compared to Final Determination prices (excludes CPI)*

Price Increase %	2008/09	2009/10	2010/11	2011/12	2012/13
<b>Draft Determination</b>	11.4	11.4	11.4	11.4	11.4
<b>Final Determination</b>	11.1	11.1	7.0	7.0	7.0

However, ESC included the following clauses within the "Regional and Rural Businesses' Water Plans 2008-2013" Final Determination.

*Figure 1 – ESC Statements*

**Page 69, 2008 Water Price Review Final Decision, Essential Services Commission, Victoria**

<b>Attachment 5A Summary of adjustments to capital expenditure for the final decision</b>		
	<i>Proposed adjustment</i>	<i>Final decision</i>
Barwon Water	The Commission has determined that the Melbourne Interconnector be removed from the forecast and prices will be adjusted when it comes into service.	Accepted.

**Page 175, 2008 Water Price Review Final Decision, Essential Services Commission, Victoria**

*"Due to the high level of uncertainty regarding capital expenditure, the Commission will allow businesses to apply for adjustments in respect of projects that are currently included in the capital expenditure assumptions, where costs differ significantly from those included for the purposes of this Decision, as well as projects that have been identified by businesses as uncertain and other projects that were not identified at the time of this Decision.*

*The businesses and the Commission have already identified a number of capital projects that are likely to be subject to this mechanism.*

*These include:*

- *The Melbourne Interconnector (Barwon Water) — the capital expenditure associated with this project has been excluded from the forecasts used to determine prices for this regulatory period. When the project is complete and comes into service, prices will be adjusted to reflect the project costs as well as the capitalised interest cost (based on the WACC) incurred during construction less any government contributions.*

Barwon Water commenced the construction of the pipeline in November 2010 with the forecast completion and in service date of January 2012 to be comfortably achieved.

As a result, Barwon Water is applying to use the “uncertain and unforeseen events mechanism” within the ESC 2008 Determination to provide for the costs associated with the MGP into prices and therefore customer prices to be adjusted accordingly.

This application is based on the guidance paper provided by the ESC.

### **Structure of Application**

Section 3 of this report outlines the purpose for Barwon Water applying to re-open and the benefits it provides to customers and external stakeholders.

Section 4 provides an overview of the methodology and models that were used in the development of this application.

Section 5 outlines the financial outcomes from the modelling and the financial implications to the business.

Section 6 details the proposed price adjustments, the proposed pricing strategy and the impact on the 2013 Water Plan period prices.

Finally, section 7 details customer and stakeholder consultation including how Barwon Water dealt with low income and vulnerable customers and taking into account our customers preferred pricing option.

### 3. Purpose for Re-opening

As stated in the Introduction, as part of Barwon Water's 2008 Final Water Plan, Barwon Water included the capital costs associated with the Melbourne to Geelong Interconnector, now known as the Melbourne to Geelong Pipeline (MGP) in the final capital program.

However, on release of the ESC's Final Determination in June 2008, the MGP was excluded from the pricing determination and Barwon Water's prices were adjusted accordingly, however as stated in *Figure 1 – ESC Statements*, the ESC provided Barwon Water the ability to apply to re-open once the MGP came into service.

Barwon Water commenced the construction of the pipeline in November 2010 with the forecast completion and in service date of January 2012 to be comfortably achieved.

The main reasons for Barwon Water's application to re-open the 2008 Determination to adjust prices for the MGP are as follows:

- Provides customers with a clear and obvious link between the costs of the project and the price increase. Relating a price increase in future years to an asset that is already built is confusing and not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period.
- Allows Barwon Water to recover a higher proportion of the costs associated with the MGP and strengthens the link to the additional price increase in the 2008 Water Plan.
- Allows Barwon Water the potential to commence the 2013 Water Plan period in a better financial position and minimised the potential price increase in the 2013 Water Plan period
- Provides Barwon Water less reliance on debt when commencing the 2013 Water Plan period and is more inline with the regulatory framework which aims to recover costs of projects through customer prices once they are available for service.
- Provides a much clearer link between the increase in price and the costs associated with the MGP.

## 4. Overview of Methodology

### Model development

Barwon Water has used the 2008 Final determination regulatory model as the foundation for calculating the revised prices which include the costs associated with the MGP.

### Assumptions used

The following base assumptions have been used when modelling the pricing adjustments for the MGP.

Assumption	Assumption used	Comment
Dollar amounts	Real 2007 dollars (exclude CPI%)	All dollar amounts are in 2007 \$ to be consistent with Barwon Water's final determination
WACC rate	5.8%	As per ESC's 2008 Final determination. A WACC rate of 5.8% has also been used for the 2013 Water Plan estimates. This assumption was made due to the volatile nature of the WACC rate depending on current market rates. Barwon Water will update the WACC rate as part of the 2013 Water Plan process. The WACC rate used for the 2013 Water Plan does not directly impact the price increase of 3.5% that Barwon Water is proposing in its application.
Asset life	80 years	As part of the Water industry's asset revaluation review undertaken by engineering firm AECOM, it was confirmed the GRP pipe used for the MGP had a useful life of 80 years. To provide consistency with the asset revaluation review which has been endorsed by VAGO <sup>^</sup> Barwon Water believe this is the best basis for depreciation
Depreciation method	Straight line	In 2010/11, all regional water corporations were required to undertake a full infrastructure revaluation. As part of the revaluation there was consensus from <sup>^</sup> VAGO, DTF, DSE and VGV that straight line depreciation method would be used for the revaluation and would meet all requirements and provides a consistent approach across government sectors. Barwon Water is aware that the financial depreciation can differ from the regulatory depreciation; however, to provide consistency, transparency and simplicity, the same method will be applied for regulatory purposes.
Capital expenditure	\$66.6m (\$80m nominal)	Based on actual and forecast expenditure as outlined in 2011/12 Corporate Plan.
Government contributions	\$20.0m	As committed to by State Government
Operating expenditure	\$0.75m	Based on 1,000ML for utilities, contractors and chemicals/materials. This relates to the incremental cost of delivering water via the pipeline to the treatment plant. No costs have been included that would be already part of Barwon Water's current treatment costs.
Purchase price of water	\$1.0m	Based on Melbourne Water's cost allocation model and BW using 1,000ML in 2011/12. (refer to supporting documentation)

<sup>^</sup> VAGO - Victoria's Auditor General's Office  
DTF – Department of Treasury and Finance  
DSE – Department of Sustainability and Environment  
VGV – Victorian Government Valuer

The final prices in Barwon Water's determination were based on a total revenue requirement and revenue provided through customer prices as detailed in Table 2 below.

**Table 2 2008 Determination revenue requirement and prescribed revenue (2007 \$real)**

Description	2008/09 \$m	2009/10 \$m	2010/11 \$m	2011/12 \$m	2012/13 \$m	Total \$m
Total Operating Expenditure	73.10	77.73	74.5	75.32	77.20	<b>377.85</b>
Return on existing assets	28.30	27.41	26.53	25.70	24.93	<b>132.87</b>
Return on new assets	3.09	7.73	11.21	14.98	18.24	<b>55.25</b>
Regulatory depreciation	15.29	17.81	20.42	21.70	23.74	<b>98.96</b>
Total revenue required	<b>119.77</b>	<b>130.69</b>	<b>132.66</b>	<b>137.70</b>	<b>144.11</b>	<b>664.93</b>
Total net revenue from customers	<b>107.01</b>	<b>124.27</b>	<b>136.02</b>	<b>145.47</b>	<b>155.66</b>	<b>668.43</b>

The total revenue required for Barwon Water translates into the maximum price increase per annum that can be charged to recover the revenue through customer prices as detailed in Table 3 Maximum price increases per annum

**Table 3 Maximum price increases per annum**

Price Increases PA	11.1%	11.1%	7.0%	7.0%	7.0%
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The assumptions table above details the source and comments to the costs Barwon Water has included that are associated with the construction and commissioning costs of the MGP.

**Table 4 MGP costs (2007 \$real)**

Description	2008/09 Actual \$m	2009/10 Actual \$m	2010/11 Actual \$m	2011/12 Budget \$m	2012/13 Budget \$m
Megalitres used	0	0	0	1,000	0
Total Capital cost	0.72	4.99	37.87	22.34	0.70
Government contribution	0	0	6.00	14.00	0
Operating costs	0	0	0	0.80	0
Cost of water	0	0	0	1.00	0

The costs resulted in an increase to Barwon Water's revenue requirement as follows:

**Table 5 Revised Revenue Requirement**

Description	2008/09 \$m	2009/10 \$m	2010/11 \$m	2011/12 \$m	2012/13 \$m	Total \$m
Total Operating Expenditure	73.04	77.41	74.15	76.64	77.68	378.92
Return on existing assets	28.30	27.41	26.53	25.70	24.93	132.87
Return on new assets	3.11	7.89	12.11	17.20	21.13	61.44
Regulatory depreciation	15.35	17.98	20.82	22.51	24.76	101.42
Total revenue required	<b>119.80</b>	<b>130.41</b>	<b>133.61</b>	<b>142.05</b>	<b>148.50</b>	<b>674.37</b>

To ensure Barwon Water's revenue collected from customers continues to match the revenue required to operate the business efficiently, Barwon Water requires prices to be adjusted in 2012/13. This results in the revised net prescribed revenue as shown in Table 6 Revised Net Prescribed revenue

**Table 6 Revised Net Prescribed revenue (2007 \$)**

Revised Net Prescribed revenue	2008/09 \$m	2009/10 \$m	2010/11 \$m	2011/12 \$m	2012/13 \$m	Total \$m
Original	107.0	124.3	136.0	144.0	153.6	<b>665.0</b>
Revised	107.0	124.3	136.0	145.5	160.6	<b>673.5</b>
Variance	0.0	0.0	0.0	1.5	7.0	<b>8.5</b>

Barwon Water has completed various pricing options which are detailed in Consideration of pricing options section below.

### Review of operational and capital expenditure

#### Project specific

When deciding whether to re-open the 2008 Determination the main two considerations are:

1. The impact it will have on Barwon Water's financial position
2. Price impact on customers and clear message to customers

One of the main reasons Barwon Water is applying to re-open is to provide customers with a clear and obvious link between the costs of the project and the price increase.

Relating a price increase in future years to an asset that is already built is confusing and not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period.

#### 2008 Water Plan review

The ESC highlighted in the 2008 final determination that the revenue requirement adopted by the ESC for each business over the regulatory period is a benchmark used solely to assess whether prices will result in businesses' earning sufficient revenue to deliver services and meet any obligations imposed by regulatory agencies.

These benchmarks do not represent the amount businesses are required to spend or to direct to particular activities or projects. The businesses are free to determine their own expenditure priorities in light of changing circumstances and to pursue innovation and efficiencies that enable them to outperform the revenue benchmarks.

As with capital expenditure, the benchmarks (*for operating expenditure*) adopted by the ESC for each of the businesses do not represent amounts that the businesses must spend or allocate to particular operational, maintenance and administrative activities. They represent assumptions about the overall level of expenditure to be recovered through prices that the ESC considers to be sufficient to operate the business, and to maintain assets over the regulatory period.

It is important to recognise that where a business's actual operating expenditure or capital expenditure during the regulatory period exceeds the benchmarks used to set prices because of inefficiency or additional expenditure on other activities, this will result in lower profits rather than higher prices. The converse is true where an efficiency gain is made during the regulatory period.

### Barwon Water's Operating Environment 2008 Water Plan Period

Due to extreme drought conditions since the commencement of the 2008 Water Plan period, Barwon Water has re-prioritised and brought forward various projects to ensure security of supply to our customers both now and for the future. This includes investing in projects to diversify our water supply options to provide a more robust and drought resistant water supply system.

Coupled with the changing capital expenditure program, there has been a change in operating costs compared to Barwon Water's 2008 Final Determination.

Table 7 highlights the changes in capital expenditure compared to the 2008 Final determination.

**Table 7 Capital Expenditure Variance (2007 \$)**

Description	2008/09 Actual \$m	2009/10 Actual \$m	2010/11 Actual \$m	2011/12 Forecast \$m	2012/13 Forecast \$m
Capital costs 2008 Determination	114.45	75.90	101.49	82.83	62.70
Revised capital costs	80.40	86.30	154.60	174.70	157.90
<b>Variance (decrease)</b>	<b>(34.1)</b>	<b>10.4</b>	<b>53.1</b>	<b>91.9</b>	<b>95.2</b>

### **Main variances from Determination**

The major capital variances from the 2008 Determination are outlined in Table 8 Major Capital Variance below

**Table 8 Major Capital Variance (2007 \$)**

Project	Pricing Determination \$m	Proposed Expenditure \$m	Variance \$m	Offset (govt. funding etc.) \$m
Melbourne – Geelong Pipeline	-	80.00	80.00	20.00
Black Rock Recycled Water Plant	-	38.30	38.30	10.00
Armstrong Creek recycled water transfer & distribution	-	26.80	26.80	-
Torquay recycled water dual pipe scheme	-	12.50	12.50	8.00 (2.50 in 2013 Water Plan)
Northern Water Plant ( <i>cost increase</i> )	69.40	91.00	1.60	20.00(Fed. Gvt & Shell)
Cowies Creek sewage pumping station replacement	-	9.40	9.40	-
Colac Pipeline future stages (timing brought forward for delivery efficiency)	4.40	13.00	8.60	-
Meredith water supply improvements ( <i>drought project</i> )	-	6.70	6.70	-
Lovely Banks basins lining and covering ( <i>cost increase</i> )	5.10	10.60	5.50	-

Sewer main replacements <i>(scope increase)</i>	5.30	10.60	5.30	-
Birregurra sewerage scheme <i>(cost increase)</i>	6.80	10.90	4.10	-
Wye River / Separation Creek Sewerage <i>(on hold)</i>	4.80	-	(4.80)	(1.60)
Moolap sewerage scheme <i>(on hold)</i>	9.00	-	(9.00)	
<b>Total change to capex since Price Determination</b>	<b>437.00</b>	<b>632.50</b>	<b>195.5</b>	<b>~58.00</b>

**Table 9 Government Contributions variance (2007 \$)**

Government/Customer Contributions	2008/09 Actual \$m	2009/10 Actual \$m	2010/11 Actual \$m	2011/12 Forecast \$m	2012/13 Forecast \$m	Total \$m
2008 Determination	5.00	5.90	30.20	44.30	15.60	101.0
Revised contributions	9.40	10.50	21.10	51.40	31.40	123.8
<b>Variance (decrease)</b>	<b>4.40</b>	<b>4.60</b>	<b>(9.10)</b>	<b>7.10</b>	<b>15.80</b>	<b>22.8</b>

Table 10 Operating expenditure details the operating expenditure including forecast for 2011/12 to 2012/13. It shows forecast expenditure above target of approximately \$3.9M.

**Table 10 Operating expenditure variance (2007 \$)**

Operating Expenditure	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Forecast	2012/13 Forecast	Total \$m
Expenditure	67.80	69.30	70.00	80.40	86.30	<b>374.00</b>
2008 Determination	73.10	77.70	74.50	75.30	77.20	<b>377.90</b>
<b>Movement</b>	<b>5.30</b>	<b>8.40</b>	<b>4.50</b>	<b>(5.10)</b>	<b>(9.10)</b>	<b>3.90</b>

As can be seen, expenditure tracked below target for the first 3 years of the regulatory period.

However, expenditure is forecast to be higher than the determination for the 2011/12 and 2012/13 years. The key reasons for increased operational expenditure are provided in the table below.

This rise in base operating costs will have an impact on the operating costs moving into the 2013 Water Plan period.



**Table 11 Operating expenditure movement to date**

Description	Movement	Key reason for difference
<b>2010/11 to 2011/12</b>		
Biosolids – new plant	\$6.9M	New plant and ongoing cost
Biosolids – Werribee	(\$1.5M)	Ceasing the requirement to trip waste to Werribee treatment Plant
Labour	\$1.7M	Includes EBAG and new billing system employees
MGP	\$1.8M	One-off year of MGP operations this year and purchase of 1,000ML of water from Melbourne Water for commissioning pipeline.
Miscellaneous	\$1.5M	Miscellaneous expenditure
<b>Total</b>	<b>\$10.4M</b>	
<b>2011/12 to 2012/13</b>		
Contractors	\$6.9M	Aquaduct demolition – One off cost - out in 2013/14 Outfall Cleaning – One off cost - out in 2013/14 NWP Ops costs - Continuing costs Black Rock RW Ops Costs - Continuing costs
Consultants	(\$0.8M)	Includes Customer Systems Projects by \$260k & Anglesea Bores by \$264k
Labour	\$1.3M	Includes EBAG, continuation of new billing system until 2013/14 at which contract is terminated.
MGP	(\$1.8M)	One-off decrease of MGP operations and purchase of water from prior year.
<b>Total</b>	<b>\$5.6M</b>	

### Current status of forecast costs - 2008 Determination

Barwon Water has commenced developing its 2013 Water Plan. As part of this project, Barwon Water has undertaken an extensive and robust review of its operating and capital expenditure forecasts to identify opportunities for business efficiencies and savings to reduce the impact on future prices to customers.

Barwon Water is currently considering the following options as part of its review and approach for the 2013 Water Plan.

- Back-ending depreciation - Identifying capital projects that have the ability to defer or ramp up depreciation due to the asset being used less in the first years.  
This would include assets such as growth assets associated with new developments, where customers take up is slow over the 2013 Water Plan period and gradually increases in future water plan periods as customers take up lots in the new developments. The depreciation profile would be more in line with the new customer revenue.
- Deferring assets from the RAV, until the asset is required for service. Assets that Barwon Water would consider deferring would include recycled water assets, whereby, due to slower than predicted development of new dual pipe developments, the asset will not be required until the 2018 Water Plan.

Barwon Water will consider these options to achieve the most realistic and business reflective revenue requirement for the 2013 Water Plan period.

Barwon Water has commenced a very detailed review of its operating expenditure to ensure the 2011/12 forecast and the 2013/13 budget are realistic and provide a realistic foundation for the 2013 Water Plan base line operating expenditure.

This has included the development of a intricate labour review and other key operating expenditure variations from the 2008 Water Plan to ensure all costs are justifiable.

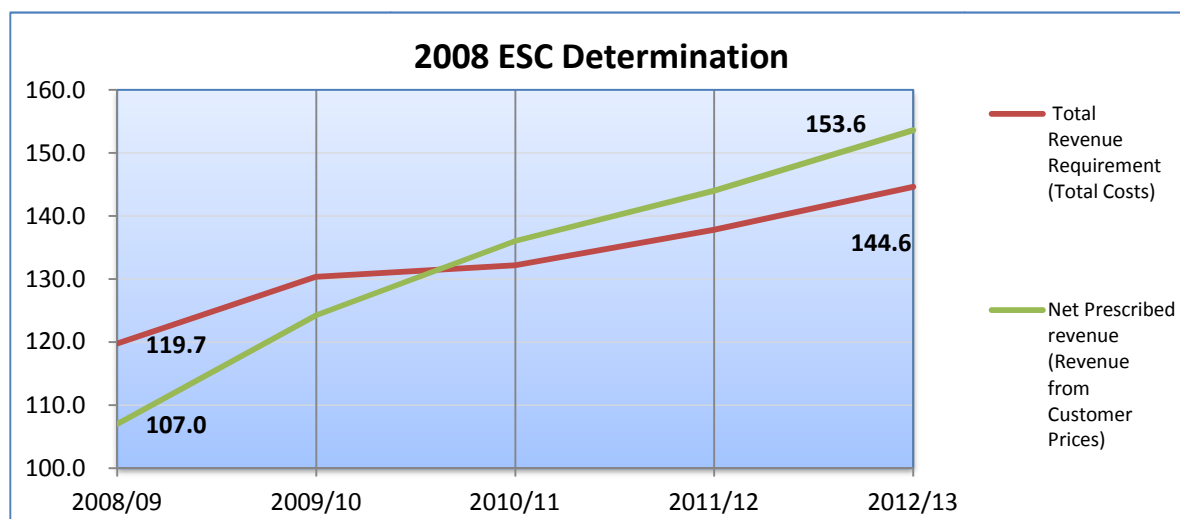
It should be noted that all costs, including labour costs have been justified and subsequently approved by the Minister for Water as part of Barwon Water's Corporate Planning process which is undertaken on an annual basis.

### Impact on Revenue Requirement

The table and graph below outlines Barwon Water's Original 2008 Determination.

1. Revenue required (total costs of the business formulated from the regulatory model)
2. Revenue expected to be collected via prices to customers

Original 2008 Determination	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Revenue Required (Total costs of business)	119.7	130.3	132.2	137.8	144.6	<b>664.7</b>
Revenue collected from customers through prices	107.0	124.3	136.0	144.0	153.6	<b>665.0</b>
<i>Yearly variance</i>	<i>(12.7)</i>	<i>( 6.1)</i>	<i>3.9</i>	<i>6.2</i>	<i>9.0</i>	<b><i>0.3</i></b>



If revenue predictions were consistent with the 2008 Water Plan Determination, the graph reflects that by 2012/13 the revenue collected from customer is actually higher than the revenue required to operate the business. This is referred to the "scissor effect" as the two paths cross during the period. This in theory will result in a slight customer price decrease in the Water Plan 3 as the revenue collected from customers is already above the cost required to operate the business.

This assumes all costs going forward are increasing by CPI only.

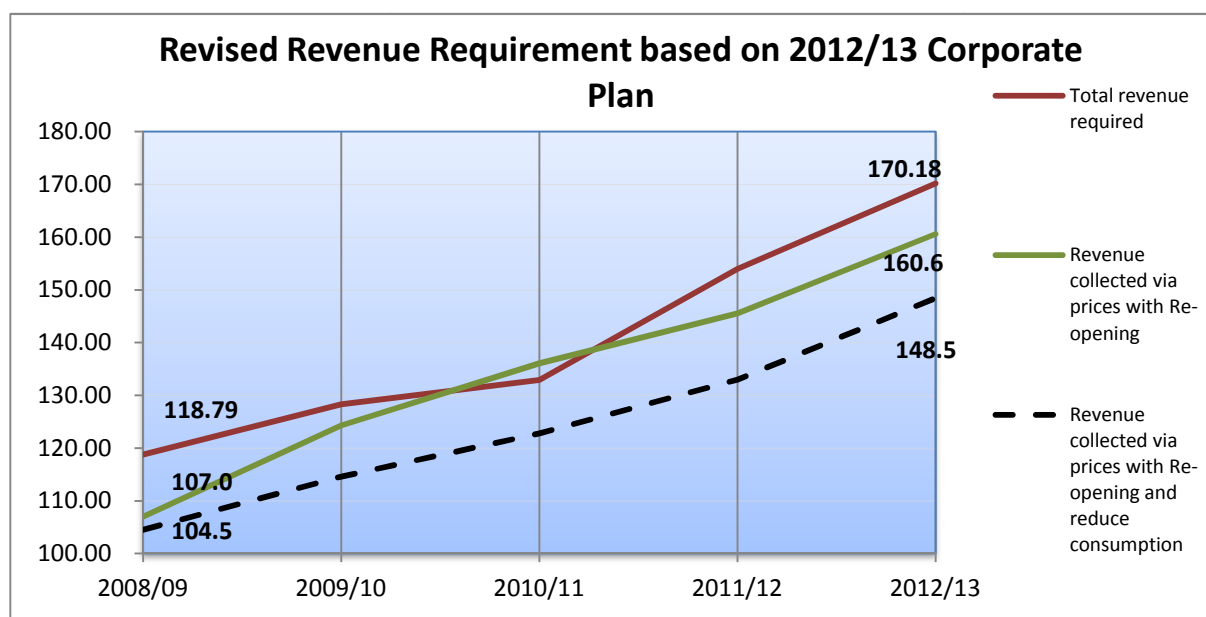
However, there have been three main reasons why Barwon Water's revenue requirement and revenue expected to be collected via customer prices has changed from the 2008 Determination; these are:

- Customer consumption.
  - This has been much lower than forecast due to ongoing drought and restrictions which has resulted in approximately \$60m loss in revenue. Critically this has resulted in a permanent change in consumption;
- Additional investment in capital.

- to diversify water supply and mitigate drought impacts; and
- Additional operating expenditure forecast in 2011/12 and 2012/13
  - due to increased costs to operate additional capital expenditure. *(as detailed above)*

The revised revenue requirement and revenue collected via customer prices is outlined below.

Revised forecast based on 2011/12 Corporate Plan	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Revenue Required (Total costs of business)	118.8	128.3	132.9	154.0	170.2	<b>704.2</b>
Revenue collected from customers through prices (incl additional 3.5% for re-opening)	107.0	124.3	136.1	145.5	160.6	<b>673.5</b>
Revenue collected from customers through prices (incl additional 3.5% for re-opening) <b>and reduced consumption</b>	104.5	114.6	122.8	133.0	148.5	<b>623.3</b>
<i>Yearly variance</i>	<i>(11.8)</i>	<i>(4.1)</i>	<i>3.2</i>	<i>(8.5)</i>	<i>(9.6)</i>	<i>(30.7)</i>
<i>Yearly variance including reduced consumption</i>	<i>(14.3)</i>	<i>(13.8)</i>	<i>(10.1)</i>	<i>(21.0)</i>	<i>(21.7)</i>	<i>(80.9)</i>



As the table and graph highlight, Barwon Water's total revised revenue requirement (total costs of the business) has increased due to additional expenditure in capital expenditure and operating expenditure.

In conjunction with this, Barwon Water's revenue collected via revenue prices has decreased due to the lower than forecast consumption levels.

Barwon Water intends to absorb the reduction in revenue due to low consumption levels. However, it is quite clear that Barwon Water's revenue required to operate the business is above the revenue collected via customers, and not the reverse where a price reduction would be required for Water Plan 3.

Based on costs remaining similar for Water Plan 3, Barwon Water requires prices to increase to ensure revenue collected from customer recovers the revenue required to meet the business operations this is including re-opening in the 2012/13 year the additional 3.5%.

### 2013 Water Plan indicative forecasts

Barwon Water has provided initial capital and operating cost projections for the 2011/12 Corporate Planning process, however, it should be noted that Barwon Water is currently undertaking an extensive process to develop and further refine the 2013 to 2018 projections to be included in the draft 2013 Water Plan.

Based on the current 2013 Water Plan forecasts Barwon Water's total revenue requirement is detailed in the table below along with the proposed prescribed revenue collected from customer which includes increasing prices in the final year of the 2008 Determination by 3.5% for the costs associated with the MGP.

2008 and 2013 Water Plan Pricing Paths	2008/09	2009/10	2010/11	2011/12	2012/13	Total 2008WP	2013/14	2014/15	2015/16	2016/17	2017/18	Total 2013WP
Total revenue requirement	119.7	130.3	132.2	137.8	144.6	<b>664.6</b>	171.0	175.2	176.4	177.8	179.0	<b>879.4</b>
Revenue collected via customer prices <u>without</u> re-opening	107.0	124.3	136.0	144.0	153.6	<b>664.9</b>	153.6	164.5	176.3	189.3	201.5	<b>885.1</b>
Revenue collected via customer prices <u>with</u> re-opening	107.0	124.3	136.1	144.0	160.6	<b>672.0</b>	156.7	166.1	176.3	187.4	197.5	<b>884.1</b>

2008 ESC Determination and Revenue and 2013 Forecast Revenue Requirement



The main points to the table and graph above are:

#### *2008 Water Plan*

- The 2008 period reflects Barwon Water's revenue requirement as per ESC's determination
- The revenue collected from customers is outlined two ways.
  - The original prices as per the 2008 Determination.
  - The purple line reflects the 2008 Determination and also includes the additional 3.5% price increase in 2012/13 to recover some of the costs associated with the MGP.
- The 2008 period does not include any additional costs above the original determination nor does it include any reductions in revenue due to lower than forecast consumption.

#### *2013 Water Plan*

1. Capital Expenditure. The 2013 period reflects Barwon Water's forecast revenue requirement which includes capital expenditure that was invested in during the 2008 Water Plan period which was either:
  - Brought forward from future years due to regional developments occurring earlier than scheduled time frames
  - Drought related capital expenditure due to the longer than anticipated drought conditions.
  - The additional costs were partially offset by deferring projects which did not result in a significant impact due to deferring.
  - The additional capital expenditure results in a sharp increase to Barwon Water's revenue requirement in the 2013/14 year.
2. Forecast consumption. The 2013 period reflects Barwon Water's forecast consumption levels based on a medium climate level.
  - As a result of the ongoing drought during the 2008 Water Plan, Barwon Water remained on Stage 4 restrictions for approximately 2 years longer than forecast. This resulted in significant reduction in actual customer consumption compared to forecast customer consumption.
  - Barwon Water is not looking to recover this loss in revenue from consumption, however, it does mean Barwon Water commences the 2013 Water Plan on lower consumption levels than what was forecast in the 2008 Water Plan.
  - This results in an automatic decrease to revenue collected through customers and hence the reason revenue from customer decreases at the start of the 2013 Water Plan period.
3. Operating costs. Barwon Water's forecast 2011/12 and 2012/13 operating costs are currently above the 2008 Determination and as a result, the base year flows on to the 2013 Water Plan period. Barwon Water is undertaking extensive analysis on forecast operating costs and opportunities to bring the 2011/12 and 2012/13 years back into line with the original determination.

The combination of the 3 key areas highlighted above, re-opening to recover costs associated with the MGP does not result in a scissor effect in the 2013 Water plan period.

In fact, re-opening will provide a customers with a reduced price increase.

The table below outlines the Barwon Water's indicative capital and operating costs forecasts for the 2013 Water Plan period.

**Table 12 DRAFT expenditure forecasts – 2013 Water Plan (2007 \$)**

Description	2013/14 \$m	2014/15 \$m	2015/16 \$m	2016/17 \$m	2017/18 \$m
Capital costs	110.12	80.65	39.80	33.90	34.59
Government/Customer Contributions	6.64	8.22	5.77	5.77	5.77
Operating Expenditure	86.50	86.59	86.86	88.15	88.51

### Review of Demand forecasts

The ESC recognised the level of uncertainty around demand forecasts in the 2008 Water Plan. Therefore the ESC provided in the final determination the ability for businesses to apply to re-open if there were significant variations between actual demand levels and the demand forecasts approved in the final determination.

The ongoing drought conditions during the last five years resulted in Barwon Water remaining on stage four restrictions for a year and a half longer than was expected in the demand forecasts.

This has resulted in actual customer consumption being significantly lower than forecast. However, due to Barwon Water's ability to manage its overall business operations, the loss in revenue due to the loss in demand has not adversely effected the overall businesses financial viability the main impact from the loss in revenue is being unable to provide a dividend to the shareholder, the State Government.

### **Project specific**

Over the next five years, Geelong's water demand will be largely satisfied by surface water and groundwater, which are the lowest cost supplies.

High rainfall in 2010 and 2011 has lifted Geelong's storage levels to more than 90%. This combined with the addition of more secure water sources, has allowed Barwon Water to ease restrictions to Permanent Water Saving Measures on 1 March 2011.

Barwon Water will optimise its water sources that minimise price rises for its customers.

For the Geelong system this plan is based on the following rationale:

1. The water consumption outlook takes account of the full range of climate variation. The forecast trend sits between the recent climate extremes experienced over the last two years.

Given the large catchments inflows in 2010/11, much of the regions water requirements will be provided by surface water, groundwater and new recycled water sources.

2. Despite predictions of strong population growth, the Bureau of Meteorology has predicted average to above average rainfall in the short term. This combined with the lingering effects of many years of water restrictions, may result in a slow return to pre-restrictions consumption levels.
3. Alternative water sources, such as the Northern Water Plant and the Black Rock Recycled Water Plant will begin to replace drinking water supply within the next two years. These deductions have been made based on anticipated recycled water usage and the timing of commissioning of these projects.

Based on the above optimisation and current water storage levels, Barwon Water is only expecting to use water from the MGP for commissioning purposes only of 1,000ML in 2011/12.

It is expected that water from the pipeline will not be required in the foreseeable future.

### 2008 Water Plan review

As stated above, the ongoing drought conditions have resulted in Barwon Water remaining on stage four restrictions until March 2010 which was two years longer than stated in the 2008 Water plan. In addition, Barwon Water did not return to permanent water saving measures until March 2011 which was again two years longer than forecast in the 2008 Determination. This has resulted in actual customer consumption being significantly lower than forecast.

Table 13 Metered Consumption Actual versus determination below outlines the 2008 determination total demand forecasts compared to actual/forecast results.

**Table 13 Metered Consumption Actual versus determination**

Total Customer Metered water consumption (kilolitres)	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Forecast	2012/13 Forecast	Total Variance
<b>2008 Determination</b>	31,438,214	34,460,589	35,742,950	35,073,512	34,369,355	<b>171,084,620</b>
<b>Actual/forecast</b>	29,557,956	27,913,271	27,509,926	27,694,940	27,934,270	<b>140,610,363</b>
<b>Variance (decrease)</b>	<b>(1,880,258)</b>	<b>(6,547,318)</b>	<b>(8,233,024)</b>	<b>(7,378,572)</b>	<b>(6,435,085)</b>	<b>(30,474,257)</b>

**Table 14 Non residential sewerage discharge for billing**

Customer* Sewerage discharge (kilolitres)	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Forecast	2012/13 Forecast	Total Variance
<b>2008 Determination</b>	2,971,826	3,257,529	3,378,749	3,276,607	3,305,056	<b>16,189,767</b>
<b>Actual/Forecast</b>	2,691,821	2,602,102	2,591,696	2,581,749	2,680,408	<b>13,147,776</b>
<b>Variance (decrease)</b>	<b>(280,005)</b>	<b>(655,427)</b>	<b>(787,053)</b>	<b>(694,858)</b>	<b>(624,648)</b>	<b>(3,041,991)</b>

\* Customer includes non residential customers only

The following tables reflect the variances between customer connections for water and sewerage

**Table 15 Total Customer connections (water)**

Total customer connections (water)	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Forecast	2012/13 Forecast	Total Variance
<b>2008 Determination</b>	132,177	134,684	137,113	139,583	142,096	<b>685,653</b>
<b>Actual/Forecast</b>	132,905	135,066	137,367	139,794	142,213	<b>687,345</b>
<b>Variance (decrease)</b>	<b>728</b>	<b>382</b>	<b>254</b>	<b>211</b>	<b>117</b>	<b>1,692</b>

**Table 16 Total Customer connections (sewerage)**

Total customer connections	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Forecast	2012/13 Forecast	Total Variance
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(sewerage)						
<b>2008 Determination</b>	118,694	120,945	123,126	125,344	127,600	<b>615,709</b>
<b>Actual/Forecast</b>	119,223	121,054	123,632	125,292	127,460	<b>616,661</b>
<b>Variance (decrease)</b>	<b>529</b>	<b>109</b>	<b>506</b>	<b>(52)</b>	<b>(140)</b>	<b>952</b>

## 2013 Water Plan indicative forecasts

### Consumption

Based on the recent rainfall within the region, Barwon Water is expecting to continue Permanent Water Saving Measures for the duration of the 2013 Water Plan. The current low consumption will rise, driven by predicted population growth and water use without water restrictions. However, a level of water consumption will be substituted with new recycled water projects, such as the Northern Water Plant and the Black Rock Recycled Water Plant.

Water supply systems other than Geelong will contribute an additional 4,230 megalitres a year. Consumption in these areas is expected to remain relatively steady in the short term (no change) due to relatively low growth rates and continuing efficiency gains.

**Table 17 DRAFT - 2013 Water Plan demand forecasts**

Total Metered Consumption	2013/14	2014/15	2015/16	2016/17	2017/18
Potable water	28,306,460	8,682,290	29,060,850	30,237,022	30,812,068
Recycled water	2,300,121	2,399,665	2,499,994	2,778,652	2,910,228
Sewerage discharge (non residential customers only)	2,809,551	2,846,854	2,884,428	3,001,169	3,058,245

### Connection Growth Projections

As outlined in Table 18 DRAFT - 2013 Water Plan connection forecasts and connection growth for both water and sewer is predicted to be approximately 1.7% across the 5 year water plan period. These projections have been sourced from the Department of Sustainability and Environment (DSE), under the Victoria in Future (VIF) 2008 Household projections.

Residential recycled water connection growth incorporates the staged development of the Armstrong Creek, Fyansford, Torquay North and Spring Creek regions with growth predictions based on forecasts from Barwon Water's Asset Planning department.

**Table 18 DRAFT - 2013 Water Plan connection forecasts**

Total connections	2013/14	2014/15	2015/16	2016/17	2017/18
Potable water	144,632	147,051	149,470	151,890	154,311
Recycled water	1,821	2,646	3,477	4,361	5,175
Sewerage discharge	129,628	131,796	133,964	136,133	138,302



## 5. Financial Outcomes

### Revised revenue requirement

As a result of the additional costs associated with the MGP, Barwon Water's total revenue requirement (relating to the MGP capital only) has increased over the 5 year regulatory period as outlined in Table 19 – Revised revenue requirement below.

Table 19 – Revised revenue requirement

Revised revenue requirement	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Original	119.77	130.69	132.66	137.7	144.11	664.93
Revised	119.97	130.46	133.08	141.92	147.75	673.18
Variance	-0.2	0.23	-0.42	-4.22	-3.64	-8.25

### Revised Net prescribed revenue

Based on Barwon Water's proposed pricing option to re-open in the final year of the 2008 water plan period for an additional 3.5% increase, the revised prescribed revenue is detailed in Table 20 – Revised net prescribed revenue.

Table 20 – Revised net prescribed revenue

Revised Net Prescribed revenue	2008/09	2009/10	2010/11	2011/12	2012/13	Total
Original	107.01	124.27	136.02	145.47	155.66	668.43
Revised	107.02	124.32	136.06	145.52	160.58	673.50
Variance	0.01	0.05	0.04	0.05	4.92	5.07

### Consideration of pricing options

The costs of the MGP can be reflected in prices via a number of options. The table below details the indicative price increase each option would have per annum.

Barwon Water modelled various options when considering adjusting prices for the MGP. The two options that were preferred are detailed in the table below.

Table 21 – Price Increase Percentage options

#### *Excludes CPI*

Scenario	2008WP	2013WP				
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Option 1 (additional 1.5%)	8.5%	1.0%	1.0%	1.0%	1.0%	1.0%
Option 2^ (additional 3.5%)	10.5%	0.0%	0.0%	0.0%	0.0%	0.0%

*^Assumes the remaining costs for the MGP will be absorbed by Barwon Water in the 2013WP period.*

#### *Includes CPI*

Scenario	2008WP	2013WP				
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Option 1 (additional 1.5%)	11.2%	3.5%	3.5%	3.5%	3.5%	3.5%
Option 2^ (additional 3.5%)	13.3%	2.5%	2.5%	2.5%	2.5%	2.5%

*^Assumes the remaining costs for the MGP will be absorbed by Barwon Water in the 2013WP period.*

### **Advantages and Disadvantages of each option**

#### **1. Re-open and recover over last year and every year per annum for next Water Plan.**

##### *Advantages*

- Customer price impacts are minimised as increases are smoothed over 6 years.
- Continues to provide a nexus between the project and when prices start to increase.
- Reduces financing costs as the project is funded earlier by customer revenue.
- Achieve ESC support more readily.

##### *Disadvantages*

- Price increases in the 2013 Water Plan period continue to relate to projects costs that were spent in the 2008 Water Plan period.
  - Does not provide a as clear a link between price increase and project costs as option 2 does
  - “Selling” a price increase to customers for something that is already being used may be difficult to achieve.
- 2. Re-open and recover 3.5% of the total 6.5% required to recover the total costs of the MGP, with the intention to absorb the remaining costs in the 2013 Water Plan period.**

One of the main reasons Barwon Water is applying to re-open is to provide customers with a clear and obvious link between the costs of the project and the price increase.

Relating a price increase in future years to an asset that is already built is confusing and not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period

##### *Advantages*

- This allows Barwon Water to recover a higher proportion of the costs associated with the MGP and strengthens the link to the additional price increase in the 2008 Water Plan.
- Provides Barwon Water with the potential to commence the 2013 Water Plan period from a zero base, rather than proposing to spread some of the cost recovery over the 2013 Water Plan period.
- Provides Barwon Water less reliance on debt at the start of the 2013 Water Plan period and is more inline with the regulatory framework which aims to recover costs of projects through customer prices once they are constructed and available for service.
- From financial perspective, a greater increase results in larger cost recovery up front and therefore more justifiable when weighed up against the costs associated of re-opening;
- Reduces the risk of Barwon Water commencing the 2013 Water Plan period with any costs linked to the MGP;
- Places Barwon Water in a better financial position when commencing the 2013 Water Plan period; and
- Provides a much clearer link between the increase in price and the costs associated with the MGP for customers.

### Disadvantages

- Barwon Water only recovers approximately \$47m of the net project cost of \$60m (\$80m less \$20m State Government contribution).
- Results in a larger price increase to customers for the one year.

However, this option provides a clear nexus between project costs and price increases. This option reduces price increases for the 2013 Water Plan which will benefit our customers over the subsequent five year period to 2018.

### Key financial indicators

When deciding whether to re-open the 2008 Determination the main two considerations are:

1. The impact it will have on Barwon Water's financial position.
2. Price impact on customers.

Table 221 – Financial impact analysis below outlines the impact each option has on Barwon Water's total revenue, operating cash surplus and total borrowings.

**Table 221 – Financial impact analysis**

2008 WP base includes 7% + CPI 2.5%		2013 Water Plan				
Option	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
<b>1. Re-open 2008 WP</b>	<b>+1.5%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>
Total tariff revenue <sup>1</sup>	\$167.4M	\$176.8M	\$185.8M	\$195.4M	\$207.4M	\$218.4M
Operating Cash Surplus	\$48.1m	\$43.1M	\$44.4M	\$49.1M	\$55.4M	\$67.5M
Total borrowings	\$547.7M	\$629.7M	\$676.3M	\$665.7M	\$650.7M	\$624.8M
Cash Interest Coverage ratio	2.39 times	2.05 times	1.95 times	2.00 times	2.14 times	2.45 times
<b>2. Re-open 2008 WP &amp; absorb 2013WP</b>	<b>+3.5%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
Total tariff revenue	\$170.3M	\$178.2M	\$185.6M	\$193.2M	\$203.2M	\$211.9M
Operating Cash Surplus	\$50.6M	\$45.1M	\$44.8M	\$47.7M	\$51.7M	\$61.0M
Total borrowings	\$545.3M	\$625.3M	\$671.5M	\$662.4M	\$651.1M	\$631.6M
Cash Interest Coverage ratio	2.47 times	2.11 times	1.96 times	1.97 times	2.07 times	2.26 times

### Financial Outcomes of Options

Option 1 - Barwon Water re-opens for an additional 1.5% in the final year of the 2008 Water Plan (2012/13) and 1.0% for each year of the 2013 Water Plan period, results in:

- A slightly better overall financial position by 2017/18 than Option 2.
- Debt, at \$624.8m is \$6.8m less than Option 2 by 2017/18.
- This is due to the operating cash surplus being \$6.5m more favourable than option 2 by 2017/18.

Option 2 - Barwon Water re-opens for an additional 3.5% and absorbs the remaining costs in the 2013WP results in:

<sup>1</sup> Revenue excludes revenue contributions such as Shell or developer revenue

- A strong cash surplus of \$50.6m in 2012/13 year compared to \$48.1m for Option 1.
- In 2013/14 (first year of the 2013 Water Plan) total debt is at \$625.3m which is \$4.0m less than option One.
- This provides a stronger financial base commencing the 2013 Water Plan.
- By 2017/18 the absorption of remaining costs result in the operating cash surplus at \$61.0M and total debt increasing to \$631.6M being \$6.5m higher than Option 1.

### Summary

Both options have advantages and disadvantages.

Option 1 provides Barwon Water the ability to recover the total price increase required to recover all of the costs associated with the project. However, only 1.5% is recovered in the 2008 Water Plan.

While option 2 enables Barwon Water to recover 3.5% of the total approximate 6.5% required recovering the project costs up front with the intention to absorb the remaining 3.0% in the 2013 Water Plan period.

One of the main reasons Barwon Water is applying to re-open is to provide customers with a clear and obvious link between the costs of the project and the price increase.

Relating a price increase in future years to an asset that is already built is confusing and not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period

The other main advantage of this option is that it provides Barwon Water in a much better financial position at the start of the 2013 Water Plan period as it locks in the 3.5% increase upfront. It also allows Barwon Water to commence the 2013 Water Plan without any overlapping costs from the MGP

This option also provides more certainty in recovering a larger portion up front than the risk of a smaller price increase upfront and less certainty in recovering the remaining costs during the 2013 Water Plan.

The main disadvantage of this option is that Barwon Water only recovers approximately \$47m of the total project cost of \$80m. However, the \$47m is recovered upfront; therefore, Barwon Water can commence paying off a larger portion of the debt sooner which will also result in interest payment savings.

This will result in a total price increase in 2012/13, including CPI of 2.5%, of approximately 13.3%.

This approach would allow Barwon Water to recover a significant amount of the costs at the time the project is constructed and commissioned which provides a clear nexus between the project cost and the increase in customer prices.

In addition if the price increase, due to re-opening the 2008 Water Plan, leads to minimal price increases for the 2013 Water Plan, this will benefit our customers over the subsequent five year period to 2018.

### Customer Bill Impact

Barwon Water proposes to increase each service component that is currently increased by the current 7.0% with the additional 3.5%. The key reasons for this proposal are:

- It provides consistency with how Barwon Water currently applies price increases.
- In Barwon Water's original customer consultation on pricing for the MGP, customers were consulted that the price increase associated with the MGP would be recovered across all services.
- Water used from the MGP will be discharged to Barwon Water's reclamation plant which increases the load at the plant which therefore increases costs.

Barwon Water's number one consideration is to achieve simplicity and transparency for its customers. Barwon Water believes increasing each service consistently as has occurred in previous years provides the most simple and easy to understand approach.

Barwon Water has considered what the impact of the additional incremental price increase of 3.5% has on a wide variety of customers including:

- A typical residential household using 165 kilolitres per annum
- A large residential household using 400kl per annum
- A tenanted customer who only pays the water volume charge
- A large non residential customer

Examples of these bills and the impact of the price increase from the of the bill are provided in attachment three.

**Table 23** Customer using 165kl per annum

2008 WP base includes 7% + CPI 2.5%		2013 Water Plan				
Option	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
<b>1. Re-open 2008 WP</b>	<b>+1.5%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>
<b>Annual bill</b>	\$1,087	\$1,124	\$1,162	\$1,202	\$1,243	\$1,286
<b>Total Increase per week</b>	\$2.10	\$0.72	\$0.74	\$0.76	\$0.79	\$0.82
<b>Increase from 1.5% per week</b>	<b>\$0.28</b>	<b>\$0.21</b>	<b>\$0.21</b>	<b>\$0.22</b>	<b>\$0.24</b>	<b>\$0.25</b>
<b>2. Re-open and absorb costs of MGP in 13WP</b>	<b>3.5%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
<b>Annual Bill</b>	\$1,107	\$1,134	\$1,163	\$1,192	\$1,222	\$1,252
<b>Increase per week</b>	\$2.49	\$0.53	\$0.55	\$0.56	\$0.57	\$0.59
<b>Increase from 3.5% per week</b>	<b>\$0.67</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>

Table 24 Customer using 400kl per annum

2008 WP base includes 7% + CPI 2.5%		2013 Water Plan				
Option	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
<b>1. Re-open 2008 WP</b>	<b>+1.5%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.0%</b>
Annual bill	\$1,604	\$1,659	\$1,716	\$1,775	\$1,835	\$1,898
Increase per week	\$3.10	\$1.06	\$1.09	\$1.13	\$1.17	\$1.21
<i>Increase from 1.5% per week</i>	<b>\$0.43</b>	<b>\$0.30</b>	<b>\$0.31</b>	<b>\$0.33</b>	<b>\$0.35</b>	<b>\$0.37</b>
<b>2. Re-open 2008 WP and absorb in 2013WP</b>	<b>+3.5%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>
Annual Bill	\$1,634	\$1,675	\$1,717	\$1,760	\$1,804	\$1,849
Increase per week	\$3.68	\$0.79	\$0.80	\$0.83	\$0.85	\$0.87
<i>Increase from 3.5% per week</i>	<b>\$1.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>

## 6. Proposed Price adjustments

### The proposed price adjustment

Based on the analysis and taking into consideration the customer impact analysis, Barwon Water's preferred pricing option is Option two. This results in an increase to the price per cent to 10.5% for the final year of the 2008 Water Plan. Barwon Water will re-consider recovering the remaining costs in the development of the 2013 Water Plan.

The two main objectives for Barwon Water for re-opening are:

1. To provide customers with a simple and transparent price increase which clearly link the price increase at the same time the project is completed and commissioned.
2. To provide a strong financial position at the start of the 2013 Water Plan and to receive a return on its investment via prices at the time costs are incurred.

Re-opening also provides a clear, transparent and a direct nexus between an increase in price at the time the MGP is completed and is available for service.

It is also important to note that even if with the additional 3.5% in the final year of the water plan, Barwon Water's price increases per annum over the 2008 Water Plan are on average lower than the three metropolitan retailers as shown in the table below.

**Table 25** – Comparison of Melbourne price increases to Barwon Water's price increase over the 2008 Water Plan

*All prices include CPI*

Water Business	2008/09	2009/10	2010/11	2011/12	2012/13	5 year Average
<i>CPI rate</i>	4.24%	2.47%	2.89%	3.33%	2.50%	
City West Water	19.7%	16.3%	16.3%	13.9%	11.1%	<b>15.4%</b>
South East Water	19.7%	20.1%	18.7%	13.6%	9.5%	<b>16.3%</b>
Yarra Valley Water	19.7%	20.2%	19.5%	15.1%	10.8%	<b>17.0%</b>
Barwon Water*	15.8%	13.8%	10.1%	10.6%	<b>13.3%</b>	<b>12.7%</b>

*\* Barwon Water's 13.3% in 2012/13 includes re-opening for an additional 3.5%.*

## 7. Stakeholder and community engagement

### 2008 Water Plan Community Engagement

As part of Barwon Water's 2008 Water Plan process, Barwon Water undertook extensive community engagement on the Melbourne to Geelong Pipeline project..

Barwon Water raised awareness of the *Draft 2008 Water Plan* through media releases and encouraged customers to seek a copy and provide comments. Barwon Water made the *Draft 2008 Water Plan* and fact sheets for the various customer groups available on its website, as well as providing hard copies to customers who requested them. Feedback could be provided anonymously via the website, hard mail and by telephone.

Barwon Water also presented the *Draft 2008 Water Plan* to its consultative committees (Environmental Consultative Committee; Customer Consultative Committee; Trade Waste Forum), political members, media representatives, and representatives of groups that deal with customers in hardship, for example the Salvation Army. These presentations focussed on the whole plan, while also providing impacts that were specific to the customer group.

As part of this consultation, the MGP was highlighted as a key project due to its importance in securing the water supply for the Geelong region. As part of the consultation, the direct price impact of the project was detailed so customers understood the direct impact the project was having on the overall price increase.

Customers supported the project and associated price that is required to achieve water security. Customers also understood the reasons for constructing the pipeline and that it may not be required on a continuous basis, but it was available for use in times of drought and provided insurance in the face of population growth and future climate variability.

Based on this customer support, the project was included in Barwon Water's Final 2008 Water Plan and subsequently included in the ESC's 2008 Draft Determination released in March 2008 with no indication from the ESC that the Commission was considering removing it from Barwon Water's final 2008 determination.

### Project-specific community engagement

A project-specific community engagement strategy was developed and executed during the design and construction of the MGP. Stakeholders and community members were engaged via various communication tools.

These included community information bulletins, media releases, regular website updates and briefing sessions with key stakeholders and community groups. Barwon Water also provided the opportunity for customers to provide comment via its website, written communication or verbally at any of our customer service centres.

Maloney Field Services and Abigroup conducted extensive consultation with over 50 landowners along the pipeline alignment. This included door knocks, mail outs, construction notifications, face to face meetings with individual landowners and briefing sessions with community groups as required, telephone calls and emails.

Abigroup appointed a stakeholder and community engagement officer on a part-time basis, who has been responsible for all engagement during the construction process and has worked closely with Barwon Water's community engagement officer to deal with any issues as soon as they arise.

All stakeholder and community engagement activities relating to the MGP have been meticulously captured and recorded in an engagement software program called Consultation Manager. This has enabled detailed monthly engagement reports to be generated for the past two years by members of the project team both within Barwon Water and within the project partner companies - KBR, Maloney Field Services and Abigroup.



Overall the landowners and the broader community have been supportive of the project with minimal objections or queries. This would suggest they understand why the pipeline is being built. This is particularly noteworthy, considering the fact that the landowners along the alignment will not ultimately benefit from the pipeline, as they are not Barwon Water customers.

#### Re-opening 2008 Determination for MGP community engagement

Barwon Water publicly commenced customer consultation on 18 November 2011 to update customers on Barwon Water's proposal to re-open the 2008 Determination to recover the construction and commissioning costs of the MGP which would result in a 3.5% price increase in addition to the 7.0% which was approved in Barwon Water's 2008 Determination.

This customer consultation included:

- A media release which generated a front page article in Geelong's leading newspaper "The Geelong Advertiser" on Saturday 19 November 2011. The paper also included an editorial about the cost of living which referred to the costs of water. Readers of the newspaper had the opportunity to provide feedback online via the newspaper's website.
- The media release was also sent to the Colac Herald and was used to generate an article on page 3 of this publication, which covers the Colac region.
- The announcement of Barwon Water's intention to increase prices to recover the costs of the MGP on Barwon Water's website which provided customers with the opportunity to make comment via an online feedback form
- A presentation to Barwon Water's Customer Consultative Committee (CCC) on 30 November 2011, followed by detailed discussion, to provide an update on the project and Barwon Water's intention to re-open the 2008 Determination to increase prices to recover the costs of the MGP.

Barwon Water's CCC was supportive of Barwon Water re-opening. Members said they understood the need for the price increase even though the pipeline may not be used for a number of years due to recent good rainfall.

Barwon Water has not received any other customer feedback on its intention to apply to the ESC increase prices by 3.5%. This would suggest customers understand the reasons for Barwon Water to re-open.

In addition, Barwon Water representatives met with the Essential Services Commission on a regular basis to provide updates and request feedback and support as the application was being prepared.

Barwon Water has provided regular updates to the Department of Sustainability and Environment (DSE) which has supported Barwon Water's intention to re-open to recover the costs of the project.

Barwon Water also obtained the Minister for Water's support for our application and has provided updates when necessary on the progress of the application.

Barwon Water strongly believes and based on feedback from customers to date and more so, lack of feedback, re-opening the 2008 Water Plan to account for the delivery of the MGP is the best option and engagement opportunity for Barwon Water's customers. This is based on:

re-opening provides customers with a clear and obvious link between the costs of the construction of the pipeline and the requested price increase.

relating a price increase in future years to an asset that is already built is not consistent with the current regulatory framework whereby assets that are constructed and are available for service are built into the price increase in that specific regulatory period.

relating a price increase in future years to an asset that is already built is unfair and confusing for customers. For Barwon Water to justify and explain an additional 3.5% price increase to our customers in 2013 Water Plan for an asset that was constructed and in service effectively 12-18 months after the completion date is inconsistent, unfair more confusing and difficult for customers to understand when no other project has been treated this way.

It is also important to note that Barwon Water's theme for the 2008 Water Plan, which is widely accepted by Barwon Water's stakeholders and customers, is 'building for the future' with the significant focus on water security and meeting a growing population.

When the project was considered and subsequently commenced, the State of Victoria was in record breaking drought conditions with the real possibility of Melbourne and Geelong running out of potable water by 2012.

Barwon Water stepped up to customers' expectations and values by commencing water security projects, including the MGP, to ensure customer water security was to never be a concern again. Barwon Water invested in a suite of water security assets including the MGP and therefore the cost of the asset should be recognised at the time it is available for service in line with all other projects that were identified in the 2008 Water Plan.

Barwon Water is now planning for the future and is proposing new theme for the 2013 Water Plan, which we believe meets customer values and expectations of today and for the future. This is based on 'consolidation, efficiency and minimal (if not zero) prices increases.

It would be contradictory to start the 2013 regulatory period with 'price increases' due to the MGP, and would also make it very difficult to communicate such a theme with customers.

#### Dealing with Significant changes in price increases

One of the ESC's main concerns of Barwon Water re-opening is the potential for it to result in a 'scissor effect' on pricing. In other words, price increases going 'up' in the final year of the 2008 Water Plan, but immediately going 'down' in the 2013 Water Plan period.

- for Barwon Water to achieve an overall customer '*dollar price decrease*' in the 2013 Water Plan, Barwon Water would need a 'real' price percentage decrease greater than CPI.
- Barwon Water has undertaken significant preparation for the 2013 Water Plan and a negative 'real' price percentage increase (greater than CPI) is unlikely. In reality, Barwon Water will be challenged to deliver a 0% real price increase.
- Should Barwon Water deliver a 0% price increase, with the addition of CPI, customers will still be faced with an overall dollar price increase.
- Therefore, as indicated within this submission, the potential for a scissor effect is very unlikely

#### Dealing with low income and vulnerable customers

Barwon Water is extremely aware of the current customer affordability issues in society.

The primary reason for Barwon Water's proposed pricing path is to reduce the impact on customer bills while still providing a signal through price of the costs associated with water security via the MGP.

Barwon Water already has a range of hardships schemes in place to assist customer with paying their water and sewerage bills to mitigate the impact of price increase. These include:

- Concession card and pensioner card discounts
- Utilities Relief Grants which assist those suffering from temporary financial crisis
- Payment plans to assist in paying bills weekly, fortnightly, monthly or otherwise

Barwon Water also provides rebates on a range of water saving products that assist customers in managing their water bills.

#### Providing comment

Barwon Water's main feedback has been received from the CCC whereby they supported the engagement strategy and the timing of the re-opening, the main reason for this is it seen as the most logical and fair outcome for customers.

As stated above, the wider customer base was provided the opportunity to comment via Barwon Water's website and via Geelong's leading newspaper "The Geelong Advertiser" and other regional newspapers. Barwon Water did not receive any comments via these avenues and did not receive any comments by person, phone or mail.

Therefore, based on positive feedback received from the CCC and the limited response from Barwon Water wider customer base, Barwon Water has assumed that customers do not oppose Barwon Water's decision to re-open and increase prices by 3.5% in addition to the 7.0% which was approved as part of Barwon Water's 2008 Determination.

## Attachments

1. Correspondence between ESC, Barwon Water and Minister on re-opening Barwon Water's 2008 Determination for the costs associated with the Melbourne to Geelong pipeline.
2. Proposed tariff schedule including additional 3.5% in the 2012/13 year.
3. Customer bill impacts on various customer groups.
4. Media releases.