

25 January 2008-01-25

The Chairman
Essential Services Commission
Level 2
35 Spring Street
MELBOURNE 3000

Dear Mr Wilson,

2008 Water Price Review – Water Plans Issues Paper December 2007.

Thank you for the opportunity to respond to the Water Price Review Issues Paper. The following comments are provided on behalf of Wannon Water:

Chapter 2 – Issues for this review

2.1.1 Drivers of Forecast Operating Expenditure.

On the advice of Wannon Water's consultant, Utilacor, provision for a 100% increase in electricity costs has built into the current Water Plan templates as the existing electricity supply contract will conclude on the 30th June, 2008. The price of electricity under Wannon Water's current contract delivers a lower cost than the current pricing of the Strategic Purchasing contract utilised by 13 of the current water corporations.

Utilacor is preparing a tender for the provision of an electricity supply beyond 1 July 2008, and the result of this tender should be known by the end of February 2008 in time for input to the Commissions draft determination. If not able to be included in this draft determination – the information will certainly be available for the final determination by the Commission in June 2008.

2.1.2 Productivity Improvements

Wannon Water draws the Commission's attention to Section 7.1.3 Justification of Forecast Expenditure Levels, and section 7.1.4 Productivity Improvement components of Wannon Water's Water Plan. Wannon Water will incur additional costs of implementing systems and procedures to ensure service standards and occupational health and safety compliance are maintained to a consistent standard across the organisation. These costs will be offset from 2012-13 through the delivery of planned productivity improvements associated with the implementation of the Mobile Information Management System and implementation of SCADA (a remote site data gathering, control and reporting system).

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2.2.1 The Profile of Forecast Capital Expenditure.

The Commission has correctly sought to review profile of capital expenditure given that many Corporations have front loaded the profile of their capital works program. In Wannon Water's case the front loading is due to one essential project, being the Hamilton-Grampians pipeline of \$33.4 Million and the construction of new office accommodation in Warrnambool which will provide considerable efficiency gains. Other projects included in the first two years of the regulatory period reflect the risk ranking employed to evaluate the priority of projects.

Wannon Water is confident that it will deliver capital works scheduled for the early years of the regulatory period. Design of the key projects for year 1 of the regulatory period will be completed in advance of the commencement of the 2008-09 year to ensure that project milestones are achieved.

2.2.2 Deliverability of Capital Projects.

Wannon Water has a proven track record of delivering the capital works program and is on track to deliver \$31.5M of capital works in 2007-08. Wannon Water entered into a contract over a five year period with major engineering consultancy firm to ensure that consultant engineering services were dedicated to meeting Wannon Water's design milestones for delivery of the capital works program over the regulatory period.

2.4 Foregone Revenue from the First Regulatory Period.

Wannon Water is seeking to recover lost revenue and additional expense incurred due to the drought to the extent of \$1.14M. (Refer Wannon Water's Water Plan page 9, 29 & 30).

Recovering the foregone revenue from the first regulatory period adds a 0.3% increase in prices which amounts to an annual increase for each customers total bill of around \$2.40.

2.5 Demand

Wannon Water is concerned that the Demand section of Water Plan may not been treated conservatively enough.

Wannon Water's forecast demand was based on an expected 10.2% reduction in the 2006-07 year. However water consumption for systems that have not been subjected to water restrictions is tracking lower than expected.

For example: for the 6 month period ending 31 December, 2007 the Otway system (which includes Warrnambool,) demand was 14.9% lower than for the same period in 2006 and demand was also lower than the past five years. This demand reduction has occurred regardless that the Otway system:

- Has not been subject any form of water restrictions. The permanent water saving rules were introduced during the year, and
- Population growth resulting in 1200 more homes than five years ago.

2.5.1 Restrictions on Usage

Table 2.1 shows Wannon Water as having PWS in the actual column and N/A in the forecast columns whereas in fact, this should be shown as PWS in all columns.

2.5.2 Sustainable Water Strategies/Water Supply Demand Strategies.

In reference to the comment that Wannon Water has set a target of a 30% reduction on average 1997 residential consumption to be achieved by 2015, Wannon Water has already achieved a 14.1% reduction in demand (2371ML) for the last 18 month period ending 31 December 2007 and is now concerned that should this continue the rate of achievement will be greater than 30%.

2.5.3 Price Elasticity of Demand.

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

Demand is reducing through the promotion of water conservation programs and increased awareness within the community that water is a precious resource to be used efficiently. The monetary cost of water is presently not a major factor in driving water demand. Never the less, the dollar cost of water is important to some customers – particularly lower income domestic customers and major industrial customers who are now implementing WaterMaps. For these customers there is the potential that the increasing cost of water may become a material factor in influencing their demand for water.

2.6 Dealing with Uncertainty.

Q. What should be included in the mechanisms for dealing with uncertain capital projects?

Wannon Water generally considers that the inclusion of the capital works projects in a Water Plan should be sufficiently robust to not require that the Commission re-open a price determination during the five year price period.

The criteria for re-opening a price determination should be restricted to:

- Where the viability of a major project is dependant on part funding by the State or Federal Government and a decision on the Government is pending at time of the final price determination of a Water Plan by the Commission, or
- Where an unplanned event occurs that is of such magnitude that it requires the unforeseen funding of a major capital project of a scale that may materially impact on the viability of a water corporation or the provision of services to a significant number of customers, or
- Where a new regulatory obligation or revised Statement of Obligation is issued that requires a significant funding commitment by the water corporation.

Q. Are there hybrid forms of price control or other mechanisms that the Commission should consider to deal with uncertainty around demand forecasts?

Wannon Water has no comments to offer on this issue.

2.7 Prices and Tariff Structures.

The Issues Paper implies that Wannon Water is proposing to introduce an inclining block water tariffs to all customers for the first time (refer page 22). Whereas currently inclined block pricing is already in place for two thirds of the Wannon Water customers. Wannon Water inherited three very different and distinct tariff structures and a major focus has been the establishment of common tariff structures, although not uniform prices.

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

Wannon Water has standardised its tariff structures so that all customer groups, regardless of where they are situated within the geographic service area are paying tariffs based on a common tariff structural basis. This will make it easier for customers to understand the tariff charges. A number of complex tariffs will be removed from 1 July, 2008 including cistern charges in the Warrnambool zone and wastewater disposal charges in the Portland zone.

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

In Wannon Water's case – yes:

- The emphasis has been moved from the fixed service charge (currently 50-60% of the water bill) to approximately 30% of the water bill for the typical customer using 200 kLs of water per annum.
- Three tiered inclined block tariffs for water volume are being introduced for all domestic customers from 1 July, 2008.

These changes will send a stronger pricing signal consistent with the demand reduction target set out in the Water Supply Demand Strategy. The Water Plan submitted by Wannon Water incorporates an elasticity of demand adjustment of 0.1% reduction in demand for the second and third tier water volume tariffs

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

Wannon Water has gone to considerable lengths to separate the tariff structural change impacts from the general increase in prices. In the first year of the determination, customers on less than the average consumption will experience a decrease in their overall bill, while those on the average consumption will have no change in the amount paid – however, there will be a reduction in the service fee and an increase in the volumetric components. The concept is having managed the transition to the new tariff structure without unduly disadvantaging customer, then it is appropriate to apply the increases necessary to fund the business into the future. Customers who consume more than average consumption levels will pay more.

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

Wannon Water would argue that it has given every consideration to its customers in developing the tariff structural changes, and has amended its planned price increase (which originally was designed to negate the effect of the application building blocks methodology, being the over-recovering in the later part of the determination and the requirement to have a declining recovery in the following one – commonly referred to as the see saw effect) to take account of the structural changes on customers. In addition, the changes place more control of the bill with the customer, which to a large extent the level of impact is in the control of the customer.

In respect to comment made by the Commission on its paper on Review of Tariff Structures for the Minister of Finance – Wannon Water is generally supportive of the Commission’s comments. In respect to the major points listed Wannon Water would re-iterate its position.

- a) Wannon Water concurs that high volume charges of \$4-6 per kL should have a cost based justification,
- b) Wannon Water already has meter sized/connection based service fee charges and although these are diminishing in importance to the overall revenue base, Wannon Water would not wish to alter this arrangement at this time – not withstanding what might be mandated for Melbourne based Water Corporations.
- c) Wannon Water is not in favour of a combined water and sewerage tariff as a significant number of customers only have a water service, and hence there is a need for a separate water and sewerage tariffs.
- d) Wannon Water support larger increases earlier in the price period and a tapering off in the later period, so as to decrease the effects of the Commission’s building blocks model on revenue raised per annum in the succeeding price determination. (See-saw effect referred to earlier.) However, as Wannon Water plans a tariff structural change in the first year of the next determination, a significant upfront increase was not possible due to the transitional effects already in place.
- e) Wannon Water is in favour of those trade waste customers who supply above domestic strength waste being required to cover the cost of treating that additional strength waste and the proposed charges reflect this approach.
- f) Wannon Water is of the view that there should be an equitable sharing of cost based on use of the system between residential and non residential customers.
- g) Wannon Water continues to support the industry VicWater New Customer Contribution approach.
- h) Wannon Water does not support the granting of the right of “veto” over tariff structures to the Commission, on the grounds that tariff structures are developed in conjunction with customers at first hand.

2.8. Service Standards and GSL’s

Q. Do service standards proposed by businesses reflect customer preferences?

Wannon Water explored the question of GSL’s extensively with its Customer Engagement Committee and proposes to introduce two GSL’s from 1 July, 2008.

The Customer Engagement Committee indicated that multiple interruptions to the water supply, and sewer spills not contained on private property were the principle customer concerns that should be addressed through payment of GSLs.

Q. Are there other aspects of service that are important to customers for which targets should be specified?

Wannon Water’s Customer Engagement Committee was consulted and did not identify any further issues where targets should be set.

Q. Are there reasons why all businesses should not be in a position to introduce GSL schemes?

Each Water Corporation should determine its own position on the introduction of GSL’s in consultation with its customer representatives.

Q. Do the GSLs level proposed by businesses reflect the key service issues of concern to customers? Are there other aspects of service that should be included?

Refer to the comments above

Q. What exclusions, if any, should apply to the proposed GSLs?

Wannon Water is of the view that force majeure events or other events beyond the reasonable control of the Water Corporation should be excluded for example unauthorised interference with the integrity water or sewerage system infrastructure.

Q. Are the proposed payment levels reasonable?

The amount should be reasonable to the extent that it is seen to be reasonable compensation for non-compliance with key service standards. The amount paid should also be cognisant of the service breach. Wannon Water considers that that the amounts set out in its Water Plan are reasonable. (See Page 78, Wannon Water's Water Plan 2008-13)

Q. Should the GSL events and payment levels be consistent across businesses?

As stated above, a common approach is not preferred as supply systems differ across the state. Issues which matter to the customers of specific supply systems should be addressed by the relevant Water Corporation.

Chapter 3 Proposed Revenue and Demand

As a general comment, Wannon Water notes that the information contained within this report is that which was supplied in the initial Water Plan submitted and does not refer to the revised draft Water Plan subsequently submitted on the 25 November, 2008.

Table 3.5 Key Capital Expenditure Projects

In the Wannon Water segment of this table - of equal importance to the Portland Water Reclamation Plant Upgrade is the Warrnambool Reclamation Plant Upgrade which is also estimated to cost \$6.7M.

3.4.2 Weighted average Cost of Capital (WACC)

Wannon Water has elected to abide by the Commissions view of the WACC. It is noted that circumstances have changed significantly since Feb 2007 when the WACC was calculated and it is expected that the Commission will recalculate the WACC on a more appropriate basis for coming period.

3.4.3 Regulatory Depreciation

Whilst Wannon Water has taken a relatively conservative view on regulatory depreciation, both in straight line terms and the useful life, and therefore this suggestion has little practical impact, Wannon Water objects to the Commission removing the ability of Corporations to manage their cash flows with this tool. It is a mechanism available to businesses to manage their loan portfolios, (through the ability to meet adjustments to principal and interest payments). The management of debt is not factored into the Commission's considerations in any practical way beyond assumptions as the optimum gearing level.

3.5.2 Foregone Revenue

Wannon Water consider it is necessary to claw back some of the foregone revenue, but not necessary all for the overall financial well being of the business. The quantum for 2006-07 is readily identified, but at the time of writing the Water Plan, the 2007-08 amounts were very much unknown. It was considered appropriate that Corporation could manage some of this additional impost, but customers would be unduly penalised in the future if some of this lost revenue was not recouped as a component of the next determination.

3.6 Demand Forecasts

3.6.2 Overview of Forecasts

The Commission's paper contains the statement that "Wannon Water – 2 per cent decrease for total residential sales compared to a 12 per cent decrease for non residential," There is a very good reason for the dramatic decrease in consumption by non-residential demand. A major customer in Warrnambool has informed Wannon Water that the company will have its own deep geothermal bore drilled in 2007-08 to provide a non-potable supply for its process water needs. This customer currently represents 8.5% of the total supply demand in Warrnambool, and other major customers are to implement water efficiency measures and water recycling to deliver on their WaterMap undertakings.

Although the majority of Wannon Waters customer are in a plentiful water supply area, it is very clear that the water conservation message is being received and being acted upon.

Chapter 4 Proposed Prices and Tariff Structures

4.1 Impact of Proposed Prices

Wannon Water has no issue with the comments made by the Commission in this section, which are primarily statements of fact. Wannon Water would like to reiterate that considerable effort has been made to address the impacts as a result of the restructure of tariffs and its Water Plan features a range of innovative measures to assist customers who may experience financial hardship. This will ensure that there is a safety net for those that require it.

4.2 Price Control.

The Commission has stated that a tariff basket approach may not be the best approach where significant tariff restructure is involved. Wannon Water is of the opinion that there is no problem with implementation of the tariff basket approach as:

- The tariff restructure will be implemented on day one of the price determination period,
- There are no further planned restructures of the tariffs in the price determination, and
- Prices are effectively set for the first year of the determination.

The tariff basket approach can then be used in the second and subsequent years to make any necessary adjustments within the proposed constraints.

Table 4.3 – Proposed form of price control.

It should be noted that Wannon Water has had the benefit of a tariff basket in part of its business – namely for the former Portland Coast Water Authority tariffs.

4.3 Urban Retail Water Services

The Issues Paper contains the comment that businesses proposing to introduce inclining block tariffs have not provided an assessment of the administrative costs involved in introducing a new tariff structure. In Wannon Water's case – it should be noted that as part of the business already has an inclining block tariff, there are minimal administrative costs to be incurred in extending the inclining block tariff structure to the remainder of the residential customers. The Wannon Water billing system already has the functionality to accommodate inclined block tariffs.

It should also be noted that the Wannon Water tariffs included in the Issues Paper are those of the initial draft Water Plan submission and not those of the revised draft Water Plan submitted on the 25th November, 2007.

In respect to vacant land service charges – although Wannon Water levies a full fixed service charge for water, it should be recognised that this is one third the average residential bill. It was on this basis that sewerage charge was also limited to one third the average residential bill.

Table 4.4 Proposed Tariff Structure

This table implies that Wannon Water only has an inclining block tariff in the former Portland Coast Water service area (which was a three tier inclined block water volume tariff). However Wannon Water also has a two tier inclined block tariff for water volume in the former South West Water Authority service area. Only the former Glenelg Water customers have a single volume tariff for water.

Table 4.6 Proposed tariff structure for sewerage services

This table includes the comment c) Usage charges apply only to non –residential customers with water consumption > 750 kL per month, when in fact this should read > 750 kL per annum.

4.5 New Customer Contributions

Wannon Water continues its support for the Victoria Water Industry Association proposal as spelt out in the Issues Paper. The comments in respect to allocation of costs and their alignment to developer “benefits” are noted, however Wannon Water contends that the present system whilst not perfect is working well and is readily understood by all developers operating in its service area.

4.6 Trade Waste Charges

Wannon Water has no further comment to put forward.

4.7 Recycled Water pricing

Wannon Water has no further comment to put forward.

4.8 Miscellaneous fees & charges

Wannon Water has provided a full suite of miscellaneous charges, but would support an industry wide process to develop a core set of service charges. Wannon Water would welcome the concept that non core service charges should be Non-scheduled and set on a pricing principles basis.

4.9.1 Bulk water services.

Wannon Water notes the statement of fact that GWMwater supplies bulk water to Wannon Water. Of interest is the proposed price rise of 13.9% per annum over the regulatory period. Wannon Water would appreciate that the opportunity to include actual price cost for the purposes of the final determination.

Chapter 5 Service Standards GSLS and Other Outcomes

5.1 Core service standards.

Wannon Water reviewed the customer service standards in consultation with its Customer Engagement Committee. The Committee supported maintaining the existing service standards and noted the high level of customer satisfaction.

In respect to Unaccounted for Water, it is believed that the current recording systems, and in particular the relevant bulk metering could be improved upon which will show an increase in unaccounted for water. On the other hand, the quality of reticulation systems are being continuously improved with known trouble spots being eliminated.

5.2 Additional service standards.

Service standards should be driven by customers. At this stage there are no apparent issue being sought by customers in the form of improvements to service standards or additional service apart from upgrading the supply security of Hamilton water supply system. This specific issue is being driven through the major capital works project. – Hamilton Grampians Pipeline Project.

Yours sincerely



Grant Green
Managing Director