SOUTHERN Rural Water

9 May 2008

Sean Crees
Director Regulation (Water)
Essential Services Commission

Dear Sean

2008 Water Price Review — Draft Decision

We note the recent release of the Essential Services Commission's draft decision in response to our 2008-13 Water Plan. As previously communicated, we are currently finalising our unbundled tariff structures and associated implementation proposals, and so will provide our schedule of tariffs by 20 May 2008 for you consideration.

In general we are pleased with the outcomes of the process to date, and with the common-sense approach endorsed by the Commission for dealing with uncertainty. We suggest only minor modification to the adjusted revenue requirement proposed in the draft decision – as follows:

- recognition of "real" increases in labour and electricity costs;
- removal of proposed productivity adjustment, on the basis that our Water Plan contained significant savings as compared to our baseline expenditure;
- removal of proposed adjustment to capital expenditure, on the basis that this derives from an incorrect assumption;
- two minor corrections to our capital expenditure; and
- refinement to the rolled-forward regulatory asset base.

These adjustments have been included in the financial template and the schedule of amendments, and are further explained in Attachment A.

Do not hesitate to contact me on 0409 506231 to discuss these amendments, and we will otherwise submit our proposed tariffs by 20 May 2008.

Yours sincerely

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ATTACHMENT A

‘REAL’ LABOUR AND ELECTRICITY INCERASES

In our earlier responses to issues papers and consultants report, we indicated that no provision had been made within our submission for above-CPI increases in specific costs. We expressed a preference for seeing this issue addressed through the selection of an inflation factor more appropriate to the water industry than CPI.

In the absence of such an approach, we have calculated the impacts of the percentage increases proposed in the draft decision upon our costs.

In doing so, we have used actual 2006/07 data as a calculation base, plus those subsequent adjustments which we anticipate will continue throughout the regulatory period. This creates a base labour cost, in 2006/07 dollars, of $11,996k, of which $9,477k relates to prescribed activities. Using a compound real increase of 1.25%, as proposed in the draft decision, creates subsequent increases across the regulatory period of $118k, $120k, $121k, $123k and $126k.

Similarly, we have applied the proposed real increases from the draft decision to our actual 2006/07 electricity cost of $56k for prescribed services, supporting and increase of $7k for 2008/09, and $8k for the subsequent years.

PROPOSED PRODUCTIVITY ADJUSTMENT

In building our Water Plan revenue requirement, we commenced with a “baseline” operating expenditure representing our 2006/07 budget, and then adjusted this for identified incremental costs and productivity savings.

Within our Water Plan, we identified average annual savings in excess of 3% beyond the operating expenditure component of our 2007/08 revenue cap. However, in translating our submission into the standard financial template, many of our incremental costs were classified as “business as usual”, thus diluting the percentage representation of our productivity savings.

We find no analysis within the expenditure review to support the proposal for additional productivity savings, and believe that our identified savings averaging 3% of our prior operating revenue requirement is an appropriate financially responsible proposition.

METERING PROGRAM

The expenditure review and draft decision propose an adjustment to our proposed metering program on the basis our proposed cost partly represents operating expenditure (though curiously proposes no compensatory increase in operating expenditure).

The costs of meter maintenance and reading are NOT included in the proposed capital amount, and have in fact been correctly identified as operational costs associated with the initiative (though not at $120k).

We can not determine the source of this misunderstanding, as the project submission, of which a copy was provided to the consultant, clearly identifies the project components.

MINOR ADJUSTMENTS

Finally, we have taken this opportunity to correct two minor errors in the template as originally submitted, and to refine the classification of assets in our opening regulatory asset base.

We have included within our 2006/07 capital expenditure an additional $62k within our headworks business, with an asset life of 15 years. Whilst not an amount of major significance, this adjustment will align our regulatory asset base at 1 July 2007 with our management accounting records, and is reconcilable to our 2007/08 financial statements.

Also, in examining the metering program above, we noted that an annual forecast customer contribution of $420k per year appeared only in 2008/09 and had been omitted from subsequent years.

Finally, in reconciling our regulatory base, we have revised the schedule to reflect more accurately the remaining lives of our regulatory assets.