18 April 2023

Marcus Crudden
Executive Director, Price Monitoring and Regulation
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Dear Marcus,

RESPONSE TO 2023–28 WATER PRICE REVIEW DRAFT DECISION

We welcome the Commissions draft decision on our 2023 – 28 Price Submission, covering the period from 1 July 2023 to 30 June 2028.

The Commission requested we respond to the following:

1. Treatment of income tax;
2. Forecast capital expenditure for the 2022/23 year;
3. Recovery of 2022/23 shared assets costs through New Customer Contributions;
4. The impact of VIF2022 population projections on our demand assumptions;
5. To be more explicit with respect to outcomes measures; and
6. Advising of material impacts on our expenditure, revenue or pricing assumptions.

We have carefully considered each of these requests and our responses are as follows:

1. Treatment of Income Tax (Sections 4.6 and 5.5 of Draft Decision)

We proposed that our submission would not include forecast benchmark for income tax liability for the 2023–28 pricing period, despite our expenditure forecast at the time indicating we would become liable for income tax during the period.

Our proposal was based on the fact that we were seeking a ruling from the Australian Taxation Office (ATO) regarding the treatment of gifted assets which if successful, would mean that we wouldn't be liable for income tax during the pricing period.

We also proposed that in the event we were to receive an unfavourable ruling from the ATO, we would have a tax pass through mechanism to recover tax liability.

We understand the Commission's view is that the benchmark adopted for income tax should reflect the income tax obligation applicable at the time, or alternatively, we could absorb the impact of any tax payments for customers. As a result, it advised that it did not accepted our income tax allowance as proposed and asked that we respond to confim our approach.

In February 2023, we received further advice that our 2021/22 and forecast 2022/23 income tax deductions were such that we will now not be liable for income tax payments until post 2027/28.

This means that we are very certain that we will not be liable for an income tax payment during the 2023-28 pricing period.

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We accept the Commission's draft decision to include income tax liability within our financial model. Consequently, we will also remove the requirement for an income tax pass through mechanism.

Our acceptance of the Commission's decision means that our benchmark for tax included within the financial model will be reflective of income tax obligation applicable at the time of the Commission's final decision.

Should we become liable for income tax during the period for unforeseen reasons, we will absorb it on behalf of our customers.

2. Forecast capital expenditure for the 2022/23 year and recovery of 2022/23 shared assets costs through New Customer Contributions (Section 4.3.2 of Draft Decision)

We proposed to use our actual 2022/23 forecast CAPEX for the 2022/23 year of $51.0m, which is $9.3m higher than the benchmark allowance of $41.7m.

As a result, this meant that the opening value for our Regulatory Asset Base (RAB) at 1 July 2023 and subsequent forecast values for 2023 - 28 would be higher by the $9.3m forecast overrun of the 2018 determination for 2022/23 capital expenditure.

In its draft decision, the Commission disagreed with our proposed forecast RAB. It pointed out that its guidance had specified the amount reflected for 2022/23 in the forecast regulatory asset base should be calculated based on the gross capital expenditure forecast adopted in the 2018 Price Determination, less any contributions (net capital expenditure).

The Comission found that we hadn't sufficiently justified allowing additional amounts above the 2022/23 benchmark adopted at the 2018 water price review for the Drouin Wastewater Treatment Plant project and shared assets.

It also commented that shared assets expenditure are typically recovered through new customer contributions, noting we are proposing to introduce a fee structure of this nature from 1 July 2023.

We accept the Commission's draft decision and we will amend our 2022/23 CAPEX forecast to align with the 2018 determination allowance for 2022/23.

We will also seek to recover the 2022/23 forecast shared assets expenditure using our Average Incremental Cost New Customer Contribution methodology.

3. The impact of VIF2022 population projections on our demand assumptions (Section 5.1 of draft decision)

Our new connections growth assumptions (demand) involved a review of actual new connections growth over the previous decade compared to new connections growth assumptions for the same period, which were reflective of the Victoria in Future (VIF) estimates available at the time of developing our 2013 and 2018 Price Submissions.

This analysis revealed that actual year-on-year connections growth for the decade averaged 18% greater than the VIF projections would have suggested, after allowing for the sharp downturn in new connections growth in 2017 following the sudden closures of former major local employers Hazelwood Power Station and Carter Holt Harvey, as well as the closure of Energy Brix in 2014.

It also took the sharp increase in new connections growth in the 2020/21 year into account, caused by the regional growth boom following the relaxation of COVID-19 measures by the Victorian Government.

With the above in mind, we proposed forecast demands above VIF2021 in our submission.

In its draft decision, the Commission proposed to accept our demand forecasts for the purposes of setting maximum prices on the basis that they were developed consistently with the its guidance.

It also noted that following the lodgment of our submission, updated Victorian Government population and dwelling forecasts had been made available (VIF2022) to us, requesting that we demonstrate how we have considered them and if required, identify and justify any changes to our demand forecasts.

Our analysis of the VIF2022 estimate data found that population and dwelling growth is forecast to be around 19.8% greater than the previous year's predictions for the three primary local government areas we service, being the Baw Baw Shire, Wellington Shire and Latrobe City Councils.

We have concluded that our proposed demand forecasts are now closely aligned to the revised VIF2022 forecast. On that basis, we don't propose to change our demand forecasts from those already embedded in our submission.

4. Be more explicit with outcome measures (Section 3 of the Draft Decision)

We proposed a set of 19 performance measures and targets across our six customer outcomes. These are set out on pages 61 to 66 of our submission.

The Commission's draft decision found that our intentions were clear and will provide a sound basis to track performance and delivery against each outcome. It also found however, that most of our proposed measures were not well presented and required reworking to meet the Commission's requirements. (Section 3.2.3 of the draft decision) and committed to working with us to ensure the final set of measures address the matters identified.

We have since worked with the Commission to address the matters identified and the completed outcomes reporting template is attached to this letter.

5. Material impacts on our expenditure, revenue or pricing assumptions

The Commission's guidance (Section 3.23.8) requires us to promptly advise the Commission of any substantial post-submission impacts that were unknown at the time of the submission to our expenditure, revenue or pricing assumptions. This position was reiterated in the ESC's draft decision (Section 4).

Two unforeseen events have materialised since our submission was lodged, both relating to major customers.

The first was an announcement made by Saputo Dairy Australia on 9 November 2022 that it would be permanently closing its Maffra production facility by March 2023.

Saputo is accounted for as a non-residential commercial customer within our regulated business, generating a net $730,000 revenue per annum.

In February 2023, it advised that all milk processing equipment on site would either be deployed to other factories across its portfolio or sold to third parties.

All that will remain at site is a small administrative building hosting around ten employees and their truck operations, with water service requirements now expected to be minimal.

The second was an announcement made in February 2023 by our largest customer Opal Australia that it would immediately close its M5 (white) paper machine located at the Maryvale mill.

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So far, the closure of the M5 machine has seen raw water consumption at the mill reduce by 34% and trade waste discharges to the Gippsland Water Factory decrease by 52%.

The observed reduction in water services since the announcement was made has resulted in a net revenue reduction of around $700,000 per annum.

In March 2023, Opal advised us that it was considering its options in relation to its M2 machine. While still speculative, our assessment is that the risk of further plant closures at the site remains very high, presenting a further significant revenue risk to us.

Our current contract with Opal expires in June 2027 and at this stage, we are assuming we will re-contract for the 2027/28 year.

We initially informed the Commission that we were intending to formally advise of material variations relating to the two events above in our response to its draft decision during March 2023, and again in more detail at the public forum hosted by the Commission on 6 April 2023.

The decision to do so was made on the basis that these two events have had (and will continue to have) a significant impact on net revenue. With this in mind, we are seeking to recover these revenue losses through tariffs within the 2023-28 pricing period.

Tariff impacts of our responses

The customer tariff impact of our responses to the Commission's draft decision are summarised in the table below.

Tariff values are reflected in $Jan23, meaning that inflation impacts are not accounted for.

Annual ave. bill by customer type $Jan 23	2022-23 $	2023-24 $	2024-25 $	2025-26 $	2026-27 $	2027-28 $
Full service residential						
Original 2023 Price Submission	1362.90	1279.26	1277.34	1275.43	1273.52	1271.60
Post Draft Decision responses	1362.90	1291.01	1289.07	1287.14	1285.20	1283.28
Residential tenant						
Original 2023 Price Submission	366.31	343.83	343.32	342.80	342.29	341.77
Post Draft Decision responses	366.31	346.99	346.47	345.95	345.43	344.91
Full service non-residential						
Original 2023 Price Submission	2258.12	2130.43	2128.00	2125.57	2123.14	2120.72
Post Draft Decision responses	2258.12	2149.70	2147.24	2144.79	2142.34	2139.90
Property investor						
Original 2023 Price Submission	996.59	935.43	934.03	932.63	931.23	929.83
Post Draft Decision responses	996.59	944.02	942.60	941.19	939.77	938.36

In summary, when compared to 2022/23 average tariffs:

- Residential customers will save $79.63 (originally $91.30) on average per annum
- Residential tenants will save $21.40 (originally $24.54) on average per annum
- Non-residential customers will save $118.22 (originally $137.40) on average per annum
- Property investors will save $58.23 (originally $66.76) on average per annum
- New Customer Contributions (Developer Charges) will increase by $70.41 in the Warragul/Drouin systems and $135.74 in the Traralgon systems. All other systems remain unchanged

Our proposals made in response to the Commissions' draft decision have been developed with our commitments to customers firmly in mind.

Importantly, the tariff savings proposed in year one will help to mitigate a significant proportion of the anticipated inflation adjustment for the 2023-24 financial year, following the final determination.

Please find attached to this letter:

a) Our revised financial model reflecting revised inputs and prices; and

b) Updated Outcomes Reporting Template

We acknowledge that our final revenue requirement and prices will be based on latest available information and that the Commission's final determination will adjust for:

- any changes due to feedback received in response to the draft decision;
- changes in forecast license fees, environmental contributions and bulk charges from both Melbourne Water and Southern Rural Water; and
- cost of debt and inflation.

An updated financial model will be provided to the Commission as inputs associated with each of these become known.

Should you require further information, please contact Melissa Thek, General Manager Business Transformation.

Yours sincerely,

[redacted]

Sarah Cumming
Managing Director

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