

2 May 2013

Our reference: 03/04/02/23
Your reference



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Dear Marcus,

ESSENTIAL SERVICES COMMISSION - PRICE REVIEW 2013 GIPPSLAND WATER RESPONSE TO THE DRAFT DECISION

Gippsland Water has undertaken a review of both the general and Gippsland Water specific commentary contained within the Essential Services Commission's (ESC) Draft Decision released in late March 2013. Gippsland Water's responses to a range of issues outlined in the Draft Decision are detailed below.

1. Operational Expenditure Review

In the Draft Decision (Volume 2 - table 7), the ESC proposes to remove \$8.1M from Gippsland Water's operational expenditure for the third regulatory period.

Response: Gippsland Water accepts all the adjustments proposed by the ESC.

Further comment:

Reductions in labour costs (\$7.4M) form the largest single component of this reduction. Gippsland Water's Water Plan 3 proposal was developed prior to the State Government releasing its Public Sector Workplace Relations Policies. As such, the proposal included expectations for wage increases and career progression outcomes that were not dissimilar to past practice.

Gippsland Water has now reviewed the Public Sector Workplace Relations Policies, and understands the basis for the reductions proposed in the Draft Decision. However, Gippsland Water believes that two significant issues remain to be discussed which have an industry-wide impact.

The reduction in labour costs for Gippsland Water (and several other water corporations) has been made in line with Department of Treasury advice that superannuation guarantee increases and career progression wage increases should be absorbed within the baseline wages agreement.

Gippsland Water notes that this advice is contrary to historic custom and practice, which has seen career progression increases managed completely separately to any Enterprise Agreement wage negotiation process. Gippsland Water's career progression wage increases are expected to total \$3.2M over the third regulatory period. A similar position exists with respect to superannuation guarantee increases.

Given the significant nature of these costs, Gippsland Water requests that the ESC seek independent advice from the State Government before accepting this outcome.

2. Capital Expenditure Review

In the Draft Decision (Volume 2 - table 9), the ESC proposes to remove \$9.5M from Gippsland Water's capital expenditure for the third regulatory period.

Response: Gippsland Water accepts all the adjustments proposed by the ESC, except for the removal of the Warragul to Moe Water Supply Interconnect (stage two) project.

Further comment:

The rationale provided in the Draft Decision for the removal of the project expenditure for the Warragul to Moe Water Supply Interconnect (stage two)(Volume 2 – page 8) indicates that Deloitte considered Gippsland Water's submissions but still believed extending the current agreement with Melbourne's water retailers for contingency supply is likely to be the most efficient outcome for customers, rather than building this proposed project.

The overall project to connect Warragul and Moe (both stages 1 and 2) was approved as part of Gippsland Water's Water Plan 2 proposal.

Stage 1 has been completed at a cost of \$5.02M, and \$1.28M of planning, design and construction works will be completed by the end of 2012/13 for Stage 2. The staging of these works is in accordance with approval received as part of the Water Plan 2 capital program (SKM Expenditure Forecast Review (March 2008), page 42, table 5.6).

The capital expenditure (\$8.9M) included in the third regulatory period is required to complete the second stage of the interconnection. Should the remaining stage 2 works not proceed, then as well as having \$1.28M in 'stranded assets', Gippsland Water will face the uncertainty of not being able to maintain security of supply to Warragul and Drouin.

Warragul and Drouin are rapidly growing towns. The proximity of these towns to Melbourne is contributing to this rapid growth. Good public transport and road services to Melbourne make both towns attractive to people who work in the eastern suburbs and the city.

As set out in Gippsland Water's 2012 Water Supply Demand Strategy (WSDS), the Tarago system (which includes the Warragul / Drouin sub-system) currently has a level of service below target, should the return to dry inflow scenario occur. Under the historic inflow scenario, Gippsland Water is currently only just able to meet required levels of service at current demand, without any allowance for increase in demand.

Whilst the Melbourne retailers have been generous in allowing Gippsland Water a short term agreement for access to 400ML per annum (for security of supply reasons), there is absolutely no certainty that Gippsland Water will be provided with access to this water beyond 2018. The reasons for this uncertainty are very clear. Melbourne Water and the Melbourne retailers have invested heavily in new infrastructure in recent years.

During 2009, Melbourne Water commissioned a new water treatment plant downstream of Tarago Reservoir. The new plant has the capacity to treat up to 70 million litres of water a day; and Melbourne Water has only recently completed repairs to the Tarago dam wall to bring the wall into compliance with ANCOLD guidelines, and ensure that full supply levels can be stored for future use by the retailers. The use of the Tarago Water Treatment Plant and water from Tarago Reservoir are likely to increase significantly in coming years.

While the Melbourne retailers have shown a willingness to support Gippsland Water when short-term security of supply is threatened (which is the basis behind the agreement that is currently in place), we should not rely on such cooperation in the future, should Gippsland Water fail to adequately plan for its own security of supply needs in the longer term.

Perhaps most significantly, in the longer term, the 400ML per annum available under the current agreement will not be sufficient to maintain security of supply in any case.

Gippsland Water's WSDS has clearly identified the need for additional water beyond 2025 to meet projected demand. The growth forecast for the Tarago system is high (refer page 105 of WSDS). Demand is forecast to double within 40 years under the Victoria in Future (VIF) dwellings growth scenario. Gippsland Water's statistical forecast for demand growth is greater still due to our forecast being tailored to the urban areas (which receive town water), while the VIF forecast covers the entire statistical local area. At the same time as demand increases, yield in the Tarago system is forecast to decline due to climate change (refer page 105 of WSDS). This, combined with high growth, will quickly reduce the level of service able to be provided.

Under the previous Statement of Obligations, Gippsland Water was expected to plan its systems to provide security for the coming seven years. Completion of stage 2 of the Warragul to Moe interconnect will entail long planning and construction lead times. Construction in the latter part of the third regulatory period will ensure that the system augmentation is in place in a timely manner to provide the necessary security of supply to both Warragul and Drouin. Failing to provide infrastructure in a timely manner would be unacceptable in such an important supply system.

During the review process, Deloitte indicated that a further rationale for delaying the project was that higher prices for customers will result. Gippsland Water has determined that completion of the project, in the timeline proposed, will result in a maximum tariff impact per customer of less than \$4 per annum, in 2017/18. Gippsland Water considers this saving to be immaterial when considered against the ramifications of not maintaining security of supply in the Warragul / Drouin system.

One further aspect of the Warragul to Moe Water Supply Interconnect that should be promoted by Gippsland Water is that completion of the project will allow the flow of water in both directions; that is both from Moe west toward Warragul, and if required, from Warragul east toward Moe. The operational benefits for customers residing in the towns that currently rely on water from the Moe system (Trafalgar, Yarragon, Nilma and Darnum) are significant. The interconnection would provide Gippsland Water with significantly improved flexibility, including the ability to limit the draw of water from the Moe Water Treatment Plant when water supply or water quality issues arise. In addition, should any longer term agreement be negotiated with the Melbourne retailers for significantly more water than the current 400ML agreement, the interconnection infrastructure will allow that water to be distributed as far east as the Moe water supply system, if required.

Gippsland Water remains convinced that the Warragul to Moe interconnect project is a prudent initiative to augment the Warragul / Drouin water supply system in a timely manner. The project must now be completed to ensure that long term security of supply is maintained for two of the region's fastest growing towns. It would be unacceptable for Gippsland Water not to complete a project, originally approved in Water Plan 2, to ensure the long term security of supply for the Warragul / Drouin system.

3. Regulatory Asset Base – 2012/13 forecast

In the Draft Decision (Volume 2 - table 3), the ESC proposes to utilise Gippsland Water's forecast for capital expenditure 2012/13, as noted in the 2008 Determination, rather than accept Gippsland Water's current forecast for the 2012/13 year.

Response: Gippsland Water understands that establishing the most accurate figure in the current year can be difficult, and notes that the ESC will review and update 2012/13 actuals prior to confirming their inclusion in the Regulatory Asset Base for the fourth regulatory period (volume 1 – page 104) . Gippsland Water accepts the position proposed by the ESC.

4. Service Standards

In the Draft Decision (Volume 2 - table 1), the ESC proposes to approve each of the service standards proposed in Gippsland Water's submission.

Response: Gippsland Water notes and accepts the position proposed by the ESC.

Further comment:

Gippsland Water's acceptance includes minor adjustments made by the ESC to the following service standards:

- 'average planned customer minutes off water supply' (#8) - which has been set at 12 minutes for the third regulatory period; and
- 'average duration of planned water supply interruptions' (#12) - which has been set at 150 minutes for the third regulatory period.

5. Guaranteed Service Levels

In the Draft Decision (Volume 2 – page 4), the ESC indicates that it requires Gippsland Water to propose a GSL scheme before the ESC approves its Water Plan. The ESC notes that at a minimum, Gippsland Water's (GSL) proposal must include GSL's for –

- sewer spills in a house contained within one hour of notification; and
- unplanned water interruptions restored within five hours of notification.

Preamble:

In the Draft Decision (Volume 1 – pages 25-26), the ESC indicates that GSL's should reflect the most important aspects of service delivery identified by customers. They should be based on customer consultation and be objectively definable, easily understandable, and able to be reported.

Gippsland Water has spent considerable time and effort seeking to consult with customers on GSL's. As noted in its final proposal, Gippsland Water elected to seek direct input from customers. This input was sought via customer access to the Corporation's Share Your View website, which included a GSL survey and information sheet outlining several GSL's that Gippsland Water was seeking feedback on. In addition, a list of all GSL's in place across Victoria was provided. Customers were encouraged to advise Gippsland Water if any of these additional GSL's were of interest to them. The survey remained open for a two month period during June and July 2012.

Access to the website was widely publicised, particularly using television media and during community consultation sessions. Gippsland Water also discussed the concept of GSL's in public forums, where no significant desire for the introduction of GSL's was evident.

Despite the significant effort that was made to engage customers on the GSL issue, only 40 visitors (10% of the 379 visitors to our website - and a very small percentage of our 60,000 customers) completed the GSL's survey. The survey asked visitors to select which GSL's they would prefer if a GSL scheme was available. Visitors were able to choose more than one GSL from a list of four:

- 15 (37%) chose the 'more than 5 unplanned water interruptions in a year' GSL;
- 22 (55%) chose the 'sewerage spill inside my house is not contained within one hour' GSL;
- 7 (17%) chose the 'more than 3 unplanned sewerage interruptions in a year' GSL; and
- 21 (52%) chose the 'water supply interrupted by an unplanned event for more than 5 hours' GSL.

Despite visitors being encouraged to review the entire list of Victorian water corporation GSL's provided and nominate any others they were interested in, no nominations were made. A number of customers indicated that the survey should have allowed them to have the option to say 'no' to GSL's.

Gippsland Water's Customer Consultative Committee (CCC) also reviewed the draft Water Plan 3 proposal survey questions in late June 2012. The CCC's response to the concept of GSL's was mixed. Some committee members saw merit in being proactive and demonstrating goodwill. Other members were concerned that customers should not be rewarded for something that goes wrong. No specific GSL was preferred.

Gippsland Water notes that despite the low levels of support indicated by customers for the introduction of a broader GSL scheme, the ESC nevertheless requires the introduction of a GSL scheme to ensure Gippsland Water is brought into line with other water corporations. In addition Gippsland Water notes that the two GSL's identified by the ESC reflect the two potential GSL's Gippsland Water identified for future review.

Given the ESC's requirement that Gippsland Water establish a broader GSL scheme, Gippsland Water has again considered the customer responses to the four GSL's originally proposed in the GSL survey, including consideration of the ESC's principles that GSL's be objectively definable, easily understandable, and able to be reported. Gippsland Water has determined that two GSL's will be proposed for the third regulatory period.

Response: Gippsland Water proposes an additional two GSL's to be introduced, for residential customers only, as follows -

From 1 July 2013 -

- *'a sewer spill within house, caused by a failure of Gippsland Water's system, not contained within one hour of notification'*
 - *A \$500 rebate will be provided.*
 - *The GSL does not apply:*
 - *If a sewerage spill is caused by a failure in the customers internal pipe work or customer's property connection branch*
 - *as a result of actions of the occupier or third parties*
 - *due to non standard internal plumbing, or*
 - *due to failure of the overflow relief gully.*

No later than 1 July 2014 -

- *'more than five unplanned water supply interruptions in a financial year'*
 - *A \$50 rebate will be provided.*
 - *Financial year is defined as 1 July to 30 June.*
 - *The GSL does not apply to an interruption to the water supply where:*
 - *Gippsland Water is not responsible for the interruption (as a result of the actions of the occupier or third parties)*
 - *the customer is connected to a private water main*
 - *the interruption is caused by a fault in a private water main*
 - *where a water by agreement is in place.*
 - *For both events, GSL rebates will only be provided to residential customers who are the occupiers of the serviced property, and will not be given if an event is caused by, or is the responsibility of the customer, or a third party.*

Further comment:

Gippsland Water proposes to adopt the third placed GSL in the survey, namely, 'more than 5 unplanned water interruptions in a year'; rather than the second placed 'water supply interrupted by an unplanned event for more than 5 hours'.

Gippsland Water's rationale for adopting the '5 unplanned interruptions' GSL is that for customers, this outcome represents a much lower level of service than a 'once-off' interruption that occurs for more than five hours. In addition, from a Gippsland Water perspective a GSL should not lead to behaviours that seek to limit an unplanned event. It is far more important to complete the work required, rather than be driven by a time constraint that may see work stop, only to restart at another time to avoid triggering a GSL event. In light of the above, Gippsland Water considers that the '5 unplanned interruptions' GSL is the better outcome for customers.

Gippsland Water proposes to delay the introduction of the 'more than five unplanned water supply interruptions in a financial year' GSL to no later than July 2014, to allow the Corporation to review current maintenance and geographical interface systems. Gippsland Water needs to determine how the data currently captured for service standard reporting purposes can be presented to the Corporation's customer information system to allow for automated processing of customer rebates as GSL events occur. This is expected to take some time and will include consultation with other water corporations in relation to systems integration and the management of GSL events.

Based on historical records for the past five years, the value of rebates that may be paid on an annual basis is expected to peak at approximately \$4,000 per annum. Gippsland Water has not included these costs in operational expenditure forecasts given the values are immaterial. It is likely that the costs of system automation to ensure rebate information is presented to the customer information system will far outweigh these 'benefits' provided to customers. At this time, Gippsland Water is not in a position to identify what these system implementation costs will be, and has not provided for any system integration costs in capital budgets proposed for the third regulatory period.

6. New Customer Contributions

In the Draft Decision (Volume 2 – page 14), the ESC indicates that it requires Gippsland Water to undertake a range of actions to bring proposed changes to the new customer contributions regime to a conclusion for the third regulatory period.

Response #1: Gippsland Water can confirm that it has made the following amendments:

- The new customer contributions model has been amended to reflect the ESC direction in relation to tax costs and the change to the weighted average cost of capital;
- Capital costs for Water Plan 2 projects in the new customer contributions model have been reviewed in light of SKM findings, and revised to take into account the NCC's that have already been received in Water Plan 2. This has resulted in minor reductions to the capital costs included in the original model.

Response #2: Gippsland Water can confirm that it has considered the following issues:

- The availability of maps to show areas where standard NCC apply, and where out of sequence charges apply
 - Infrastructure Sequencing Plans currently exist. It is Gippsland Water's intention to make these plans publically available on the Corporation's website. These plans will show areas where standard NCC apply and where negotiated NCC apply. Developers were provided with samples of these plans at a recent consultation session;
- Consultation with stakeholders following the Draft Decision
 - Consultation with stakeholders has been undertaken with 13 attendees (including both local developers and design consultants from across the region) attending an information session in late April. Attendees have been encouraged to raise any issues they have with;
 - The proposed changes to the NCC regime; and
 - The Negotiating Framework;with Gippsland Water and (or) the ESC as part of the consultation process;
- Review incremental costs in light of SKM's findings, which were adopted by the ESC in the Draft Decision
 - The SKM report and the information in the ESC's Draft Decision have both been considered with Gippsland Water amending incremental costs within the new customer contributions model, but only to the extent that those costs can be defended at a later date, if necessary;
- The cost reflectivity of the NCC proposal, in particular more location specific NCC
 - Gippsland Water agrees that the Water Industry Regulatory Order (2012) includes a requirement that 'prices be calculated to provide appropriate incentives and signals to customers or potential customers about the costs associated with servicing a new development in a particular location' (section 14(a)(v)(B)).

Gippsland Water understands that most 'urban' and metropolitan water corporations have proposed standard charges to apply across their region. This is Gippsland Water's preferred approach, given that all Gippsland Water tariffs are based on 'postage-stamp pricing' principles. From a Gippsland Water perspective, new customer contributions should be treated no differently.

Gippsland Water currently provides developers with strong 'location-based' pricing signals under the current NCC regime. These pricing signals take the form of 'brought forward' charges (also known as 'out of sequence' charges, and, moving forward, a 'negotiated NCC'). A "brought forward" charge does not seek to impede development, it simply provides a strong pricing signal to developers in relation to specific locations that fall outside the water corporation's expected timely development sequence. Under the present NCC regime, a developer may be required to contribute up to 70% of the total cost of the shared asset infrastructure required to service the development, depending on individual circumstances.

Gippsland Water notes that the new NCC regime proposed for the third regulatory period by the ESC will allow for the retention of 'brought forward' charges. Based on the ESC's recently released Metropolitan Water Businesses Draft Decision the 'brought forward' charge is likely to revert back to a year by year calculation, based on the number of years the shared asset is being brought forward (rather than the current three-tier system - 0%, 40% and 70%) the ESC established for use in the second regulatory period. This change is supported by Gippsland Water as the 'sliding scale' approach will defuse what has been a major source of disputes during the second regulatory period.

In summary, Gippsland Water considers that the appropriate mechanisms are currently in place for the Corporation to provide location-based pricing signals to developers, based on the continued use of 'brought forward' charges during the third regulatory period.

- Consultation with other water corporations to develop a best-practice Negotiating Framework
 - Response: Gippsland Water provided a copy of its own proposed Negotiating Framework to VicWater for review by other water corporations;
 - Gippsland Water has also reviewed the proposed industry 'best-practice' framework developed in conjunction with VicWater;
 - In addition, Gippsland Water has also sought a legal review of its proposed Negotiating Framework to ensure that the framework and terms used within it do not conflict with the Water Act 1989 and other relevant legislation. The legal review has identified a range of concerns with the Gippsland Water proposal, which may also be relevant to the industry 'best-practice' proposal;
 - Gippsland Water will submit its Negotiating Framework, inclusive of the revisions proposed in the legal review, for consideration by the ESC separately;
 - In developing an industry 'best-practice' framework, Gippsland Water notes that a range of items within the Negotiating Framework will differ from corporation to corporation, particularly items such as response times to developer requests.

Response #3: Gippsland Water modelling for a standard NCC:

Gippsland Water's current models for water and wastewater NCC have been provided to the ESC for review. At present, Gippsland Water modelling for the third regulatory period is resulting in the following outcomes:

- Water Standard NCC – per connection - \$nil
- Wastewater Standard NCC – per connection - \$nil

Gippsland Water is concerned that any immediate change from the current standard NCC of approximately \$1,217 per service per lot, to \$nil from July 2013 will impact the tariffs paid by our customer base. Where NCC modelling outcomes propose a significant increase in standard NCC's, the ESC has signalled an expectation that water corporations will propose a 'glide-path' transition to the full standard NCC during the third regulatory period, rather than implement the full standard NCC in year one of the third regulatory period. Indeed, the ESC has generally favoured a 'glide-path' approach to any significant price increases within the industry since regulation commenced.

On this basis, Gippsland Water believes that where modelling outcomes propose a \$nil standard NCC, the ESC should also consider a 'glide-path' transition to a \$nil standard NCC. This transition could occur across the five years of the third regulatory period, rather than immediately in 2013/14. This would reduce the impact of a \$nil NCC on Gippsland Water's customer base during the third regulatory period. As such, subject to any NCC regime changes that may occur after Gippsland Water's response is submitted to the ESC, Gippsland Water requests that the ESC considers approving a glide path approach to a \$nil standard NCC.

For discussion purposes, one simple 'glide-path' approach toward a \$nil standard NCC in the last year of the third regulatory period could be as follows:

- 2012/13 current - \$1,217.30 (450-1,350sqm property)
- 2013/14 - \$1,000 (all properties)
- 2014/15 - \$750 (all properties)
- 2015/16 - \$500 (all properties)
- 2016/17 - \$250 (all properties)
- 2017/18 - \$nil (all properties)

For the sake of clarity, Gippsland Water has not included any revenues that may arise from a transition approach to a \$nil standard NCC in the final templates submitted to the ESC. This is a reduction of \$13.0M from Gippsland Water's final Water Plan 3 proposal. Gippsland Water estimates that the 'glide-path' approach outlined above would recover approximately \$5.4M in revenues over the third regulatory period.

Response #4: Gippsland Water negotiated NCC:

Discussion in the Metropolitan Water Businesses Draft Decision in relation to the calculation of the 'brought forward' charge (negotiated NCC) cited two potential methods of calculation. While both produce the same result when applied to a particular capital value, Gippsland Water has a preference for the calculation that determines a simple percentage by year.

As such, Gippsland Water proposes to adopt the calculation proposed by the ESC (refer page 324) for the calculation of a negotiated NCC for each year of the third regulatory period:

- Negotiated charge = $1 - [1 / (1 + r)^n]$ where
 - r = implied pre-tax weighted average cost of capital
 - n = the number of years the asset is being brought forward

Use of this calculation will allow the ESC and water corporations to develop a simple table outlining years brought forward, and the 'brought-forward' percentage applicable that can then be applied to any applicable shared asset.

Response #5: Gippsland Water other issues:

Gippsland Water notes that it continues to hold concerns in relation to the manner in which incremental revenue is included in the NCC models. The models appear to include more revenue (full tariffs for each new customer) than should be provided for on an incremental basis. Gippsland Water will continue to review this issue and raise any findings with the ESC.

7. Demand Forecasts

7.1 Connections Growth

In the Draft Decision (Volume 2 - tables 10 and 11), the ESC proposes to approve Gippsland Water's forecasts for both residential and non-residential connections growth during the third regulatory period.

Response: Gippsland Water notes and accepts the position proposed by the ESC.

Further comment:

Please note however, that the data contained within tables 10 and 11 does not reflect 'year-end' values, as outlined in Gippsland Water's final proposal. The data actually represents 'mid-point' values (at 31 December each year). Mid-point values are used in annual revenue calculations. Table headings should clearly notate the distinction between 'mid-point' and 'year-end' values.

7.2 Residential and non-residential water consumption

In the Draft Decision (Volume 2 – page 11), the ESC provides comment on Gippsland Water's forecasts for both residential and non-residential water consumption during the third regulatory period. In particular, the ESC state that:

- Gippsland Water has based its forecasts on the 2011/12 year with a 2 per cent annual decline extrapolated forward;
- Frontier Economics did not agree with this approach because it was not a sufficient robust demand forecasting method; and
- The Commission agrees with Frontier Economics assessment that Gippsland Water's modelling techniques were not sufficiently robust and beneath the standards of other businesses.

Response: Gippsland Water does not accept the position proposed by the ESC.

Further comment:

In response to the comments in the Draft Decision, Gippsland Water notes that:

- At no time has Gippsland Water ever based its forecasts on the 2011/12 year. To do so would not be sensible given the 2011/12 year was an extremely wet year, even by Gippsland's standards; and
- At no time has Gippsland Water's proposal ever been to extrapolate a 2% per annum decline from 2011/12, across the third regulatory period.

In addition, Gippsland Water observes that only two differences exist between the approach taken by Frontier Economics and its own approach:

- Frontier Economics has provided for a reduction in demand based on price elasticity during the second regulatory period - with only the size of the reduction now different to Gippsland Water's approach; and
- Gippsland Water originally forecast a further price elasticity reduction during the third regulatory period (as nominal price increases of 18% were expected). Frontier has also provided an elasticity reduction for the third regulatory period, albeit a much smaller value than that used by Gippsland Water.

Looking forward:

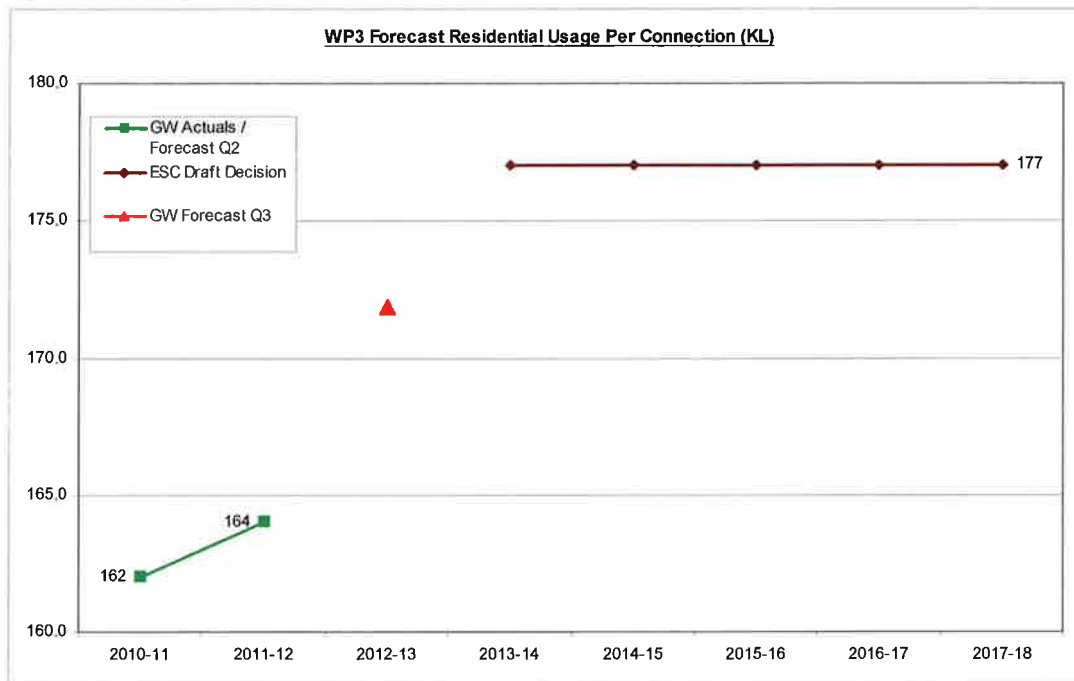
Rather than continue to argue the merits of the various approaches to volumetric water consumption forecasts, Gippsland Water would prefer to focus on the appropriateness of the outcomes determined by Frontier Economics and accepted by the ESC.

Response: After considering the outcomes proposed in the Draft Decision, Gippsland Water remains concerned that average residential and non-residential consumption for the third regulatory period is overstated.

Further comment:

Figure 1 below demonstrates the reason for this concern, comparing the average residential consumption adopted in the Draft Decision (approx 177 kL per annum) with recent historical records. Gippsland Water provided a 2012/13 quarter 2 forecast to Frontier Economics for consideration. Our quarter 2 forecast, made before a very dry summer eventuated, was 170kL per connection. Our 2012/13 quarter 3 forecast data (171.8kL) is new, and is based on actuals to the end of March 2013, including revised expectations given the very dry summer period.

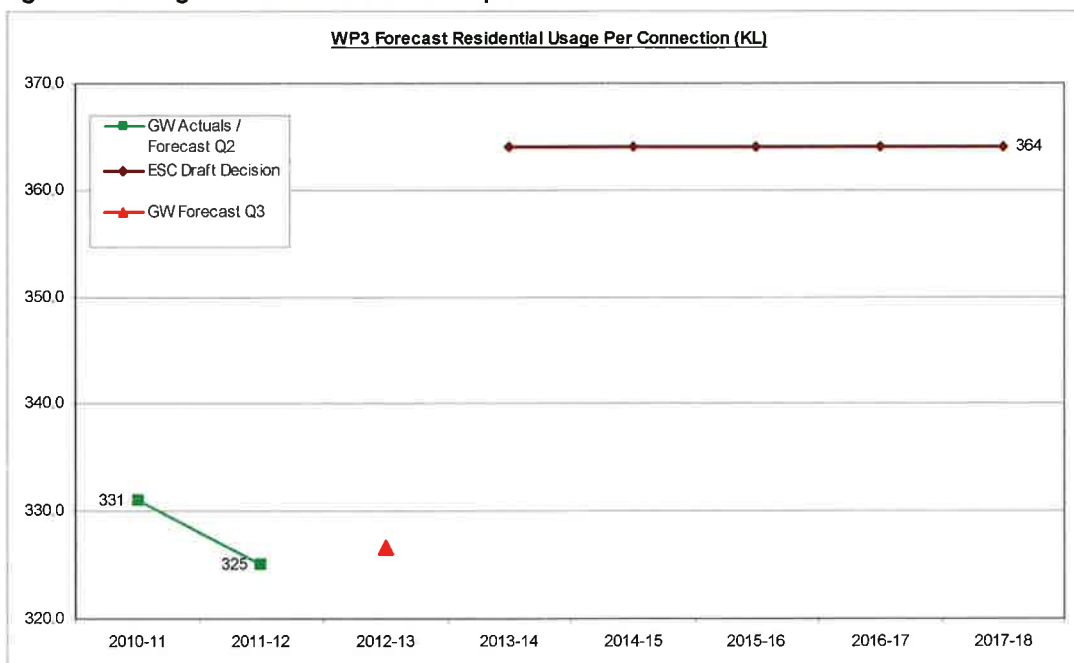
Figure 1: Average residential consumption



As noted in Gippsland Water’s final Water Plan 3 proposal the 2010/11 and 2011/12 years were wet years, even by Gippsland’s standards. This has resulted in the low average consumption volumes reflected in figure 1. These values should approximate the lowest demands Gippsland Water could expect during the third regulatory period. The quarter three 2012/13 forecast is perhaps the most enlightening information given the 2012/13 summer period has been very dry. At a forecast level of 171.8kL per connection, this ‘very dry’ year fails to even reach the ‘average’ proposed in the Draft Decision.

The same issue arises with non-residential consumption. Figure 2 below compares the average non-residential consumption adopted in the Draft Decision (364kL) with recent historical records. At a forecast level of 326.7kL per connection, again, the 2012/13 ‘very dry’ year fails to even reach anywhere near the ‘average’ proposed in the Draft Decision.

Figure 2: Average non-residential consumption



7.3 External review of residential and non-residential water consumption

Given the concerns outlined above, Gippsland Water engaged Oakley Greenwood to conduct an independent assessment of volumetric demand forecasts. The key requirements in the initial brief provided to Oakley Greenwood were to:

- compare Gippsland Water's recent actual water demands (with a particular focus on the recent wet summers of 2010/11 and 2011/12 and the very dry summer of 2012/13) to the recommendations provided by Frontier Economics and adopted by the ESC in the Draft Decision; and
- provide a report advising Gippsland Water of any gaps that have been identified, and advice on whether these gaps were material, and warranted inclusion in Gippsland Water's response to the ESC's Draft Decision.

After completing the initial review, Oakley Greenwood recommended that Gippsland Water 'do not accept the ESC's Draft Decision for residential and non-residential water demand, on the grounds that assumptions used to inform that Draft Decision were incorrect'.

Oakley Greenwood were then requested to re-estimate Gippsland Water's volumetric demand forecasts for the third regulatory period where appropriate. In response to this request, Oakley Greenwood has:

'deconstructed GW's demand forecasts, and utilising accepted and appropriate forecasting methodologies, transparently reviewed the key drivers of demand in the region (e.g. price elasticity, probability of restrictions, water efficiency and climate), using the best available information.

Where Oakley Greenwood undertook any quantitative analysis, it was conscious of ensuring that all results were statistically unbiased, and accounted for any changes to tariff structures and elasticities. This approach was consistent with the ESC's Terms of Reference for the consultant's review of demand forecasts, and formed the basis of Oakley Greenwood's assessment'.

Gippsland Water will provide the ESC with a copy of Oakley Greenwood's independent assessment of volumetric demand for review. As such, only a short extract is provided for information purposes in this response. In particular, Oakley Greenwood:

- 'considers the evidence outlined within (their) report indicates that Frontier Economics has, on the balance of probabilities, over-estimated average consumption within the base year
 - Analysis of historical and year-to-date rainfall data indicates that, ceteris paribus, 2009/10 is not exactly representative of an average rainfall year, rather, it is slightly below average. This indicates that if anything, average consumption is statistically biased upwards if based on 2009/10 average consumption;
 - Furthermore, year-to-date consumption in the 2012/13 year is significantly below 2009/10 levels at the equivalent time, despite year-to-date rainfall being below average (and lower than the 2009/10 year);
- considers that a more robust forecast of 2012/13 demand would be based upon year-to-date consumption patterns, adjusted further for a return to more normal climatic conditions, and the estimated consumption for the remaining quarter of the year, with this being based on actual 2009/10 consumption for the April-June period; and

- considers that this approach, which uses the best available (and latest) information, is more consistent with the criteria set out in the ESC's terms of reference for the consultant's review of demand forecasts.

7.4 External review of non-residential wastewater forecasts

One final issue in relation to demand forecasts is how to approach non-residential wastewater volumetric forecasts. Gippsland Water has previously advised that there is a high level of complexity in calculating non-residential wastewater volumes. The non-residential volumetric charge can only be applied where a non-residential customer uses in excess of 100kL of water in any four month period, otherwise no charge applies. The charge is further complicated by the type of activity the customer undertakes.

Given these complexities, and significant historical variation, Gippsland Water has for some time adopted a forecast position which is based on the median, non-residential, 'wastewater to water volume' percentage, using prior year actuals data. For the Water Plan 3 proposal, the median used was 35.07%. The Draft Decision has been based on Frontier's determination that this value should be 39%.

Oakley Greenwood has reviewed the most recent information available on this issue. When reviewed in isolation, the 2010/11 and 2011/12 years have recorded values of 38.1% and 38.9% respectively. The forecast for 2012/13 indicates a full year value of 38.3%. Oakley Greenwood proposes the use of the 2012/13 forecast full year value.

7.5 Proposed forecasts for the third regulatory period

Oakley Greenwood has recalculated Gippsland Water's volumetric demand forecasts, taking into account the latest consumption and rainfall data, and conservatively estimated the future impacts of water restrictions, price, water efficiency investment and climate.

Based on the independent assessment conducted by Oakley Greenwood, Gippsland Water proposes that the forecasts outlined in table 1 below be adopted by the ESC for the third regulatory period:

Table 1: Proposed volumetric water consumption forecasts – Gippsland Water

Year	Residential Water		Non- Residential Water		Non- Residential Wastewater	
	Proposed	Draft Decision	Proposed	Draft Decision	Proposed	Draft Decision
2013/14	168.2	177.0	322.6	364.0	125.1	141.96
2014/15	167.4	176.9	322.6	364.0	125.1	141.96
2015/16	166.7	176.8	322.6	364.0	125.1	141.96
2016/17	165.9	176.6	322.6	364.0	125.1	141.96
2017/18	165.1	176.5	322.6	364.0	125.1	141.96

As noted above, Gippsland Water will provide the ESC with a copy of Oakley Greenwood's independent assessment of volumetric demand for review.

8. Amendment to Wastewater Volumetric Charge – property types

Gippsland Water outlined the details of the wastewater volumetric charge in its final proposal (page 101). The details included a list of property types and the level (percentage) of the wastewater volumetric charge that applies to various property types.

Gippsland Water proposes to amend the details submitted in the final proposal to clearly identify several new property types to provide further clarity for customers. The property types to be included are as follows –

- Property types designated at 95% wastewater volumetric charge
 - **Amend** from Community Services (Schools, Hospitals, Prison, Childcare Facilities) to Community Services (Schools, Hospitals, Prison, Childcare Facilities, Nursing Home/Aged Care Facility and Preschools);
 - **Add** Printers/Screen Printers, Landfill/Transfer station, Workshop.
- Property types designated at 25% wastewater volumetric charge
 - **Add** Concrete Batching Facility;
 - **Add** Parking Lot;
 - **Add** Garden Supplies.

Gippsland Water has provided a revised list of all wastewater volumetric charge property types as an attachment.

9. Price movement outcomes

Both Gippsland Water’s final proposal and the ESC’s Draft Decision have outlined the use of an average annual increase (or decrease) for the real price movements proposed. In the final proposal, Gippsland Water noted that it would continue to monitor this position in the lead up to the ESC’s final Decision in June 2013.

Gippsland Water advises that it has a clear preference for the treatment of minor price movements in the ESC’s Final Decision. In summary, Gippsland Water prefers that:

- where any large real price reduction (or increase) is approved, the ESC adopt the average annual movement approach;
- where any small real price reduction (or increase) is approved, the ESC apply the full price movement in year one of the third regulatory period. This approach confines price movements in years 2-5 to ‘CPI only’. This approach should assist customers to clearly understand the CPI based price increases in years 2-5, while Gippsland Water remains ‘no worse’ or ‘no better’ off under this approach.

For the sake of clarity, Gippsland Water advises that after including adjustments to capital expenditure and demand forecasts in the final templates submitted to the ESC, the price movements proposed in the Draft Decision have been amended as outlined in Table 2.

Table 2: Proposed real price movements (real price movements exclude CPI)

	2013/14	2014/15	2015/16	2016/17	2017/18
Draft Decision	-1.1%	-1.1%	-1.1%	-1.1%	-1.1%
GW adjusted	-0.37%	-0.37%	-0.37%	-0.37%	-0.37%
GW final response	-1.07%	Nil	Nil	Nil	Nil

Given the small magnitude of the average annual price reduction, Gippsland Water has applied an upfront reduction of 1.07% in year one, in the final templates submitted to the ESC. Gippsland Water requests that the ESC consult with the Corporation before determining how any final real price movements are allocated across the third regulatory period.

Conclusion

Gippsland Water would be happy to discuss any of the matters outlined above. In the first instance, contact should be made with our Manager Strategic Planning, Mr Kevin Enguell, via email or telephone (5177 4684).

Yours sincerely



David Mawer
MANAGING DIRECTOR

- Attachment 1: Oakley Greenwood - Independent assessment of volumetric demand (document)
- Attachment 2: Gippsland Water - Wastewater Volumetric Charge property types (document)
- Attachment 3: Gippsland Water - Revised Water Price Review 2013 templates (spreadsheet)
- Attachment 4: Gippsland Water - Revised standard NCC model - water (spreadsheet)
- Attachment 5: Gippsland Water - Revised standard NCC model – wastewater (spreadsheet)