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Water Team
Essential Services Commission
Level 37
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Dear Sir/Madam

ASSESSING THE FINANCEABILITY OF VICTORIAN WATER BUSINESSES

Thank you for the opportunity to provide comment on your consultation paper 'Assessing the Financeability of Victorian Water Businesses.

Lower Murray Water's comments are on the following page.

Yours faithfully

LORIS DAVIS
GENERAL MANAGER BUSINESS SERVICES

Introduction

We thank the Essential Services Commission (ESC) with the opportunity to respond to the ESC's consultation paper "Assessing the Financeability of Victorian Water Businesses" and the NERA Economic Consulting (NERA) report "Assessing the Financeability of Regulated Water Service Providers".

The consultation paper considered the ESC's approach to assessing the financeability of Victoria's water businesses. The ESC use a financeability assessment to help it assess whether a business' expected revenues will be sufficient to pay for operating and capital expenditure in order to deliver services, that is whether the business is financially viable.

The ESC looked at the financial indicators and their ranges which they use to undertake the financeability assessments and the nature of the data used to calculate the financial indicators.

Lower Murray Water's (LMW) comments are responses to the specific questions raised in the ESC's consultation paper.

Consideration of ESC Future Approach

1. Do stakeholders agree with NERA's view that there should be no adjustments to the financeability assessment to account for government ownership of the Victorian water businesses? Please explain the reasons for your view.

   LMW agrees with NERA's comments on making no adjustments to the financeability assessment to account for Government ownership particularly when considering competitive neutrality.

   As part of competitive neutrality Government businesses do not enjoy any net competitive advantage because of their public sector ownership. For example the Financial Accommodation Levy (FAL) or the National Tax Equivalent Regime (NTER).

   With the FAL, Government-owned entities are able to obtain loans at a more favourable interest rate because of their ownership status. As part of the FAL process, a business requires a credit rating. When obtaining a credit rating a business is rated in its own right and judged on its own practices and financial viability. This rating affects the rate of FAL a business will be charged on its borrowings. The FAL is paid by Government Business Enterprises (GBEs) to the Department of Treasury & Finance. The FAL is intended to account for the difference between normal commercial interest rates paid by private businesses, and rates paid by GBEs who, by borrowing through the Treasury Corporation Victoria, have the benefit of a State Government guarantee on their loan. This ensures Water Corporations are operating in a competitive neutral environment, therefore should be treated as a stand-alone business in assessing financeability.

   The NTER is an administrative arrangement under which relevant taxation laws will be applied notionally to the NTER entities as if they were subject to those laws. The primary objective of the NTER is to promote competitive neutrality, through a uniform application of income tax laws, between the NTER entities and their privately held counterparts.

2. Do stakeholders agree with NERA's proposition that any adjustment to prices (for financial viability reasons) should be implemented on an NPV neutral basis? Please explain.

   LMW agree with the sentiments of NERA and the ESC that any adjustment to prices (for financial viability reasons) should be implemented on an NPV neutral basis. Customers should not be paying over and above the efficient costs of the business. The adjustment to prices on a neutral basis may provide a short term measure to manage the viability of the business, but what is the long term viability. What happens at the end of the NPV neutral period? Are we assured that the increases in prices can be given back over a time period without going back down the path of financial insecurity/unviability, to which we are back at the start again.

3. Are the indicators and ranges we currently apply, or those proposed by NERA, appropriate for financeability assessments for water businesses? Please explain and/or identify any alternative indicators and ranges.

   The indicators proposed are standard indicators (or variations) used by businesses, regulators and stakeholders all over the world. There is no need to create or find indicators that are going to show virtually the same outcomes of the financeability of a business. LMW does not have any alternative indicators to put forward. LMW prefers the ranges currently set by the ESC as they are what we are working with at the moment and they are at a level that is consistent with other jurisdictions. The ESC could ask for 10 expert opinions and get 10 different answers. Does the range serve our industry correctly?

4. Is the Commission's focus on interest cover appropriate? Should the Commission weight or prioritise the indicators for the purposes of financeability assessments? Explain, and if applicable, outline weightings or the order of priority for indicators.

   Perhaps the ESC could include the capital adjusted interest cover. LMW agrees with NERA's discussion in section 4.1.2 where this metric quantifies the amount of headroom afforded by a corporation's cash flows in servicing its debt after taking into account the cost of maintaining a stable asset base. Since the water industry is a highly capital business it may be appropriate to use this metric as well.

5. Are there any profit measures (other than statutory profit) that are not beholden to individual businesses' accounting policies or different application of the accounting policies between businesses?

   No. Any profit measures have some level beholden to accounting policies and ad business application of those policies. Even in the regulatory environment there is accounting policies, especially in terms of depreciation and the length of time an asset is depreciated. Whether an asset is treated as a short/medium/long term asset will have an effect on prices and the profit on the business. Businesses can treat the depreciation rates of an asset differently to other businesses. There is always some interpretation to accounting policies that will affect profit. Even the determination of a WACC has an element of subjectivity which affects the profit of a business.

6. If the Commission were to consider using profit, should the approach be symmetric, potentially increasing prices where profits are low and decreasing prices where profits are high?

If the ESC use profit, the approach should be symmetric with a degree of subjectivity ensuring customers prices are not adversely effected. Customers would not want to see uncertainty through large price jags (increases or decreases). It would be important to consider the longer term price path to ensure large changes in prices do not occur, without the viability of the business being threatened.

7. Should the Commission make adjustments for operating leases, superannuation obligations, or capitalised interest in any financeability assessment? Please explain. Are there other adjustments that are worth our consideration and if so, what are these and why?

   These costs are included in our pricing and our costs to the business, so they should be included. The business still has to outlay the cost and recover the cost through prices, so excluding them would not give a true indication from a financeability assessment.

General Comment

The current debate of indicators and the financeability is driven from the data used. The data being used to evaluate the financeability of a business is vitally important. It doesn't matter what indicators are being used and what ranges are decided on. The issue is which data is correct – Victorian Auditor General's Office (VAGO) believe statutory values are correct while the ESC believe that regulatory values are correct. These values give different answers. Perhaps a business needs to be rated differently when comparisons are being made between statutory and regulatory values. Does a business have a different range depending on the data being used?