

Our Reference: FIL12/1895
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2 May 2013

Mr. Andrew Chow
Director, Water Regulation
Essential Services Commission
Level 37, 2 Lonsdale Street
MELBOURNE VIC 3000

Dear Andrew,

North East Water Submission in Response to the Draft Pricing Determination

Please find attached North East Water's submission in response to the draft pricing determination outlined in *Price Review 2013: Regional Urban Water Business Draft Decision Volume I* and *2013-18 Water Price review Draft Decision Volume II: North East Water* handed down by the Essential Services Commission in March 2013.

North East Water has completed a comprehensive review of the decision as it relates to the industry and the Corporation's activities for the regulatory period 2013-18. In preparing this submission we recognise the efforts of the Commission in the provision of clarity on key areas of concern for North East Water. Importantly, this includes the recognition and correction of the operational labour costs error of \$3.22 million prior to this submission.

North East Water generally accepts the findings of the draft pricing decision. However, we request that the Commission reviews its decision with respect to five key areas that are of material significance to the delivery of sustainable, valued services to our customers.

The areas of concern are summarised below and detailed in Attachment One.

1. Opening Regulatory Asset Base (RAB)

Actual expenditure in Year 4 and Year 5 of the current regulatory period has markedly exceeded that anticipated in our *Water Plan 2* proposal. The additional expenditure reflects both the addition of new projects, including the Small Towns Sewerage Scheme, as well as delays to programmed capital expenditure that have been beyond the control of North East Water.

While we welcomed the incorporation of the new small town projects in the draft pricing determination, we submit that the draft determination does not reflect the timing elements beyond our control. Nor does it reflect discussions between North East Water and the Commission midway through the current regulatory period highlighting these issues. The result is a net difference in opening regulatory asset base of \$10.39 million when comparing the assumptions underpinning the draft pricing decision and the actual investment profile.

Submission: That the Commission reflects timing elements beyond the Corporation's control and WP2 mid-point discussions, by adjusting North East Water's opening RAB to reflect an additional \$10.39 million capital expenditure during Year 4 and Year 5 of the current regulatory period.

2. Service Standards

Eight of the 21 performance criteria proposed by North East Water were not approved by the Commission as they deviated from the five-year average performance delivered during the current regulatory period. We accept the rationale as it applies to six of the criteria, however we submit that in two instances the decision be reconsidered as follows:

- Unplanned Water supply interruptions per 100km (number) - The Board's position that consistently low water supply interruption rates did not warrant further reduction of performance standard from the proposed target of 14.
- Unaccounted for water - Recalculation of the actual five-year average supports a revised target for Water Plan 3 of 10%.

Submission: That the Commission reviews the pricing determination to reflect proposed targets of 14 for the *Unplanned Water Supply Interruptions per 100km* and 10% for the *Unaccounted for Water* performance standards. That North East Water adopts the five-year average for the remaining six performance standards.

3. New Customer Contributions (NCC's)

In addressing the ESC draft determination requirements for calculating NCC's, North East Water's modelling has indicated that a standard NCC for water and wastewater is \$1,400 for each service. These proposed NCC's have been calculated in accordance with the ESC's core pricing principles and consistent with our Board's intent to have new customers make an appropriate contribution to existing services.

North East Water proposes to apply standard NCC's across the North East Region unless a new development proposal is out of sequence with our forward planning and/or triggers a brought forward cost.

North East Water proposes to adopt the best practice negotiating framework developed by the industry acknowledging the benefits across the State of an aligned approach.

North East Water would welcome the opportunity to continue to validate our modelling with the ESC over the coming period to ensure that the modelling assumptions used, with regard to our unique tariff structures, is transparent and acceptable.

We also acknowledge that the current proposed NCC's of \$1,400 are higher than the current average NCC's applicable in 2012-13 and would need to be transitioned into effect. Given the impending final determination North East Water will propose that any change to NCC's not come into effect until the 2014-15 financial year.

Submission: That the Commission adopts the standard NCC's proposed by North East Water, acknowledges the adoption of the Negotiating Framework and the transitional plan for implementation.

4. Electricity Expenditure (Small Sites)

Electricity expenditure for large and small sites is subject to contracted service provision purchased through Procurement Australia. While the Procurement Australia costings have been reflected in the operational expenditure for large sites, the draft price determination does not reflect the contracted purchase arrangement for small sites. This inconsistent application of the Procurement Australia contracted service to

small sites in the preparation of the draft price determination results in an anticipated shortfall of \$0.56 million over the life of the regulatory period.

Submission: That the Commission reviews North East Water's operational expenditure with respect to electricity costs for small sites to correct an expenditure shortfall of \$0.56 million over the life of the regulatory period.

5. Tradewaste Volumes

The data adopted in the draft pricing determination is inconsistent with that proposed by North East Water and the independent consultants review. Further, the data adopted by the Commission contained an error in the calculation of COD.

Submission: That the Commission reviews the tradewaste volume data to reflect the independent review.

Please contact Nicholas Moore, Manager Finance, directly on 02 6022 0509 or via email at nmoore@nerwa.vic.gov.au if you would like clarification on any of the matters raised in this submission.

Yours sincerely



Anthony Hernan
Acting Managing Director

ATTACHMENT ONE: RESPONSE TO THE DRAFT PRICING DETERMINATION

1. Opening Regulatory Asset Base (RAB)

The draft pricing decision notes that the amounts for 2012-13 rolled into the RAB for the third regulatory period are at this stage, only a forecast and those actual amounts for 2012-13 will be reviewed and updated prior to confirming their inclusion in the RAB prior to the **fourth** regulatory period.

North East Water is concerned that that this approach has a real and material impact on our revenue requirement for the 2013-18 Water Plan period. A preferred outcome would be that the opening RAB for 1 July 2013 be updated to reflect actual expenditure incurred for 2012-13 due to the material difference between the Water Plan 2 proposed Year five capital expenditure and North East Water's current capital program.

Variances in timing and cost estimates associated with the North East Water capital program were communicated to the ESC as part of the Water Pan 2 Mid-Point review.

The tables below demonstrate the impacts of changes in timing and to preliminary estimates of capital works for three key projects delivered in Year 4 and Year 5 of the current regulatory period compared with the final determination for Water Plan 2.

Table 1 - Alteration of project timing compared to Water Plan 2 profile

Water Plan 2 Capital Expenditure Projects	WP2	Actual	WP2	Actual/Under Contract
	2011-12 \$'000	2011-12 \$'000	2012-13 \$'000	2012-13 \$ 000
Bright Off-Stream Storage	0	\$1,013	0	\$3,155
Total	\$0	\$1,013	\$0	\$3,155

Table 2 - Alteration of project costing due to design changes compared to Water Plan 2 profile

Water Plan 2 Capital Expenditure Projects	WP2	Actual	WP2	Actual/Under Contract
	2011-12 \$'000	2011-12 \$'000	2012-13 \$'000	2012-13 \$ 000
Corryong Water Treatment Plant	\$1,500	\$1,144	\$1,200	\$4,296
Bundalong Augment Water Supply	\$0	\$726	\$1,000	\$3,764
Totals	\$1,500	\$1,870	\$2,200	\$8,060

The total Water Plan 2 profile for the above projects was \$3.7 million for Year 4 and 5 compared with the total actual expenditure of \$14.07 million, a difference of **\$10.39** million.

In its draft pricing determination the Commission has adopted the Water Plan 2 final determination expenditure amount of \$16.2 million for 2012-13 plus the recognition of small town sewer scheme investments of \$9.6 million, totalling \$25.8 million for the 2012-13 year. In contrast, total actual expenditure to 30 April 2013 is \$31.1 million, with expenditure for 2012-13 forecast to be approximately \$38.6 million.

The exclusion of the additional \$10.39 million in our roll forward RAB (as per our letter dated 10 April 2013 outlining in detail projected expenditure by project to 30 June 2013) results in a revenue requirement shortfall of \$3.38 million over the five year regulatory period.

Detail in relation to the impacts of changes to the profiling and cost estimates for each project is provided below.

Bright Off-Stream Storage

In July 2011 the project was put on hold awaiting advice from the Minister for Water. In effect the project was on hold from October 2010 due to State Government elections and the Minister for Water's request to stop work while a review of the site selection process was being undertaken.

Further delays in this project resulted from the requirement to gain planning scheme amendment to transfer land from agricultural use to public zone usage, and the acquisition of land from the landholder.

Delays have also been experienced in respect of the negotiations with the DSE in relation to the environmental cost sharing arrangements towards the storage upsizing from 360ML to 520ML.

Clearly, these delays were beyond the control of North East Water.

The final business case was presented to our Board in May 2012 and it was not until late November 2012 that the Minister notified North East Water that the project could re-commence.

Summary of delays to this project;

- Treasury Business Case (including change of government and site selection review)
- Lodge planning application to the Minister (project called in by the Minister for Planning under section 20(4) of the Planning and Environment Act)
- Land Acquisition (amendment by land owner to exercise land, owner divest land to the Crown, seek appointment to the land manager under the Water Act).

Corryong Water Treatment Plant

In order to complete the Water Treatment Plant (WTP) contract a budgetary increase was required. In 2007, the Corryong WTP project was included in the Water Plan 2 period with a budgetary allocation of \$3,000,000. In June 2010, a business case titled "Corryong and Cudgewa Water Supply – Securing Water Quality" was endorsed by the Board with a budget allocation of \$3,515,000, which was based on the following estimates:

- Construction of a new WTP, set at \$3,015,000 (DAFF – 2.3ML/day assumed capacity)
- Construction of new Clear Water Storage (CWS) Tank, set at \$500,000 (1.3ML assumed capacity)

In order to prepare the Request for Tender for this project, a design development stage was completed in May 2011 that resulted in some necessary changes to key assumptions used for the original budgets. These changes are summarised as follows:

- An increase in plant capacity from 2.3ML/day up to 3ML/day to ensure peak daily demand could be catered for and sufficient buffer capacity provided to manage operational risks.
- An increase in CWS capacity from 1.3ML up to 2ML to:
 - allow for the future removal of the Greenham Street storage within Corryong that had been identified as a high risk in relation to supply recontamination; and
 - ensure sufficient storage capacity to cater for peak day demands and backwashing requirements.
- Need to purchase additional land to enable construction of CWS Tank with additional hydraulic head to supply Corryong and Cudgewa by gravity and associated additional infrastructure requirements to support this location.

- Need to upgrade the existing electrical power supply to the site.
- Need for a permanent backup power generator due to the remote location of the plant.
- Recognition of a “premium” to construct in the relatively remote location of Corryong.

These factors resulted in an increase to the budget allocation for this project to \$5,200,000 approved by our Board in September 2011.

Bundalong Augment Water Supply

Water Plan 2 includes the capital allocation of \$1,100,000 for capacity upgrade works on the Bundalong water system. The capital expenditure program did not include the additional costs that this project requires to incorporate the backlog area and provide for growth under the Council’s Bundalong Strategy Plan, specifically the pipeline from Yarrawonga and the backlog reticulation works.

With these additional works ensuring the long-term security of our existing customers and to facilitate the provision of services to future customers at Bundalong, the Corporation and the ESC considered this investment to be prudent and efficient when assessing our opening regulatory asset base for Water Plan 3.

The Corporation was also lobbied by residents in the Low Density Residential Zone for inclusion into the Scheme even though they were not the primary area of focus. An additional budget allocation of \$1.1 million was included in this project to support the expansion of the water supply network into this zone.

The impact of the additional works resulted in a revised total project budget of \$4.49 million.

Submission: That the Commission reflects timing elements beyond the Corporation’s control and WP2 mid-point discussions, by adjusting North East Water’s opening RAB to reflect an additional \$10.39 million capital expenditure during Year 4 and Year 5 of the current regulatory period.

2. Service Standards

The Draft Determination accepts 13 of the 21 service standards proposed by North East Water as part of its submission, rejecting eight on the grounds that they are not consistent with the five year actual average for the provision of these service outcomes.

The five year actual used by the ESC in the Draft Determination incorporates updated audited figures for 2011-12 which were not available at the time of the WP3 submission, therefore resulting in variations compared to proposed targets calculated using averages up to 2010-11.

The following tables provide a summary of the proposed revised target for the 8 standards not approved by the ESC.

North East Water proposes a review of performance standards

Table 3 - Unplanned Water supply interruptions per 100km (number)

Performance Indicator	5 year Average to 2011-12	WP3 Submission	Revised WP3 Target
Unplanned Water supply interruptions per 100km (number)	11.91	14	14

As noted in the 2011-12 Urban Water Performance report North East Water, consistently maintained low water supply interruption rates (around 20 or less) in the last five years. Notwithstanding this, interruptions have been increasing.

The Board, in recognising North East Water's strong performance against the set service target for WP2, did not propose to drive any further service standard increases.

Table 4 - Unaccounted for Water

Performance Indicator	5 year Average to 2011-12	WP3 Submission	Revised WP3 Target
Unaccounted for Water	8.64	11	10

North East Water has recalculated the Unaccounted for Water and has produced a revised 5 year average result to 2011-12 of 9.3% which differs from the ESC calculation of 8.64%.

Table 5 - North East Water proposes to adopt the five-year average

Performance Indicator	5 year Average to 2011-12	WP3 Submission	Revised WP3 Target
Average time taken to attend bursts and leaks (priority 1) (minutes)	16.43	23	17
Average time taken to attend bursts and leaks (priority 3) (minutes)	26.10	60	27
Average planned customer minutes off water supply (minutes)	3.03	4	3.05
Average frequency of unplanned water supply interruptions (number per customer per year)	0.08	0.1	0.08
Average frequency of planned water supply interruptions (number per customer per year)	0.03	0.1	0.03
Customers receiving 3 sewer blockages in the year (number)	14	30	14

Submission: That the Commission reviews the pricing determination to reflect proposed targets of 14 for the *Unplanned Water Supply Interruptions per 100km* and 10% for the *Unaccounted for Water* performance standards. That North East Water adopts the five-year average for the remaining six performance standards.

3. New Customer Contributions (NCC's)

In addressing the ESC draft determination requirements for calculating NCC's, North East Water's modelling has indicated that a standard NCC for water and wastewater is \$1,400 for each service. These proposed NCC's have been calculated in accordance with the ESC's core pricing principles and consistent with our Board's intent to have new customers make an appropriate contribution to existing services.

North East Water proposes to apply standard NCC's across the North East Region unless a new development proposal is out of sequence with our forward planning and/or triggers a brought forward cost.

North East Water proposes to adopt the best practice negotiating framework developed by the industry acknowledging the benefits across the State of an aligned approach.

North East Water would welcome the opportunity to continue to validate our modelling with the ESC over the coming weeks to ensure that the modelling assumptions used, with regard to our unique tariff structures, is transparent and acceptable.

We also acknowledge that the current proposed NCC's of \$1,400 are higher than the current average NCC's applicable in 2012-13 and would need to be transitioned into effect. Given the impending final determination North East Water will propose that any change to NCC's not come into effect until the 2014-15 financial year.

Submission: That the Commission adopts the standard NCC's proposed by North East Water, and acknowledges the Corporation's adoption of the best practice negotiating framework and the transitional plan for implementation.

4. Electricity Expenditure (Small Sites)

The Commission adopted the Deloitte recommendation that the Procurement Australia quote for our large electricity sites contract commencing in 2013-14 be used for estimation of electricity expenditure for these sites. North East Water requested that Deloitte also use the projections from the Procurement Australia quote for small sites as the North East Water estimates were prepared prior to receiving the market tested quote from Procurement Australia.

The Deloitte report "Assessment of expenditure forecasts for regional urban water businesses" pg 12 states that they have used the Procurement Australia quote as sought by North East Water for small sites however this has not been applied or updated in the table on pg 12. Further, it could be argued that the small sites quote is more accurate than the large quote (accepted by Deloitte) as it was based on a full 12 consumption data months (May 11 to May 12) and not a pro rata year as was used for the calculation of electricity costs for large market sites.

Deloitte have applied our pre-Procurement Australia estimate (\$0.648 million) which was significantly less than the Procurement Australia quote (\$0.809 million). Applying the Procurement Australia quote for 2013-14 and using Deloitte's assumption that prices are constant in nominal terms results in a \$0.56 million shortfall over the WP3 period and is shown in the table below.

In addition, our current small site electricity prices include a 12% discount, which will no longer be applicable from 1 July 2013.

Table 6 - North East Water Electricity reconciliation

Draft Determination

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Forecast electricity costs, real \$2012/13						
Large sites (uses the higher PA volumes)	\$ 1.624	\$ 1.640	\$ 1.659	\$ 1.659	\$ 1.659	8.240
Small sites, calculated prior to PA quote	\$ 0.648	\$ 0.680	\$ 0.714	\$ 0.750	\$ 0.787	3.579
Total	\$ 2.272	\$ 2.320	\$ 2.373	\$ 2.408	\$ 2.446	11.819

Reforecast

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
Forecast electricity costs, real \$2012/13						
Large sites (uses the higher PA volumes)	\$ 1.624	\$ 1.640	\$ 1.659	\$ 1.659	\$ 1.659	8.240
Small sites (based on confirmed PA quote)	\$ 0.809	\$ 0.821	\$ 0.835	\$ 0.835	\$ 0.835	4.136
Total	\$ 2.433	\$ 2.461	\$ 2.494	\$ 2.494	\$ 2.494	12.376

Variance

\$ 0.558

Advice from Procurement Australia indicates that the quote provided is accurate but may be understated rather than overstated when compared to the actual prices to be charged from 1 July 2013. Procurement Australia have advised that the reason for our increase in small market sites is related to large increases in network charges for our area, which are the highest of all electricity providers.

North East Water has recalculated our anticipated small site electricity for 2013-14 using the most recent 12 month consumption data which indicates that our small site electricity will be \$0.843 million for 2013-14 (calculations available on request).

The draft pricing decision indicates that the Procurement Australia tender outcomes provide up to date market information on energy prices that was not available to Corporations when preparing Water Plan submissions, yet this has not been applied.

To indicate the price increases and for comparison purposes, the actual delivered rates from 1 July 2013 for peak electricity for small sites (confirmed by AGL in contract documentation) compared to our current charges are shown in the table below:

Table 7 – Small site peak electricity charges

DB	Retail Tariff	Network Tariff	Peak 1 July 2013	Peak 30 June 2013	Variation %
SP-AUSNET	D	NEE21	24.80	22.07	12%
SP-AUSNET	E	NEE12	29.53	19.90	48%
SP-AUSNET	E1	NEE60	24.96	22.07	13%
SP-AUSNET	GD	NEE11	21.05	17.45	21%
SP-AUSNET	GHGL	NEE20	26.27	20.00	31%

As shown, the current delivered rates for all our small market tariffs are increasing between 12% and 48% on 1 July 1st 2013.

Submission: That the Commission reviews North East Water’s operational expenditure with respect to electricity costs for small sites to correct an expenditure shortfall of \$0.56 million over the life of the regulatory period.

5. Tradewaste Volumes

The ESC has adopted the recommendations of independent demand consultant Frontier. The five year actual for the years 2007-08 to 2011-12 indicates a large discrepancy in relation to our trade waste volumes, in particular Suspended Solid (SS). Sodium is also clearly outside the 5 year average and also requires adjustment.

Error

The proposed trade waste volumes for COD per the Draft Decision Volume II document are inconsistent with the consultant’s report and the data template and require revision as outlined below.

Table 8 – Comparison of COD volumes

COD	2013-14	2014-15	2015-16	2016-17	2017-18	Total
NEW WP3 Submission	2,300	2,335	2,371	2,382	2,392	11,780
Draft Decision	2,712	2,753	2,795	2,808	2,820	13,888
Data Template and Consultants Report	2,339	2,374	2,411	2,422	2,433	11,979

Submission: That the Commission reviews the tradewaste volume data to reflect the independent review.

