

Your Ref:
Our Ref:
Contact: Paul O'Donohue
Direct Dial: 03 5320 3165
Doc. Code: RF:POD



7 Learmonth Road
Wendouree Victoria 3355
PO Box 152 Ballarat
Victoria 3353 Australia
Telephone 1800 061 514
Facsimile (03) 5320 3299

02 May 2013

Email: water@esc.vic.gov.au
marcus.crudden@esc.vic.gov.au

Cc: aobrien@chw.net.au

This document, including any attachments, may contain privileged and confidential information intended only for the addressee named above. If you are not the intended recipient please notify us. Any unauthorised use, distribution or reproduction of the content of this document is expressly forbidden.

Re: Central Highlands Water - Water Plan 3 Draft Decision Submission

Please find attached a submission on the ESC's Draft Pricing Decision from Central Highlands Water.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Paul O'Donohue'.

Paul O'Donohue
Managing Director

CHW Water Plan 3 Draft Decision Submission

Central Highlands Water (CHW) CHW makes this submission in response to the Essential Service Commission's (ESC) Draft Pricing Decision, released in March 2013. CHW's response focuses on the key areas of:

1. Operational expenditure
2. Capital expenditure
3. Service Standards
4. Miscellaneous charges
5. New Customer Contributions

As per the ESC's approach, unless otherwise referenced in this submission, CHW accepts the ESC position as outlined in the Draft Decision.

1. OPERATIONAL EXPENDITURE

Labour

CHW's Labour costs were reduced by \$9.567m as detailed in section 4.2.1 of the Consultant's report. This resulted in CHW's labour expense being held flat (i.e. zero growth) in real terms across Water Plan 3 (WP3).

However, this outcome is contradictory to the principles outlined in the consultant's overview document and restated in the final report as follows:

- Applying wage increases set out in existing Enterprise Bargaining Agreements (EBA) to apply until the EBA expires

CHW's existing EBA, which expires in July 2015, allows for salary increases of up to 4% plus movements through salary bands where relevant criteria are met in terms of efficiency offsets and exceeding individual objectives respectively. Importantly the efficiency offsets to these increases in labour costs do not have to be achieved in labour costs for the existing EBA. CHW will separately provide the ESC confidential documentation submitted to the Department of Treasury and Finance as part of the EBA approval process outlining where these costs savings would be achieved outside the labour cost category.

Furthermore, CHW has exceeded the requirement to achieve a 1% p.a. productivity improvement in Business As Usual (BAU) costs largely driven by these labour offset initiatives. This outcome is clear from the ESC template (both the CHW submission and the ESC adjusted template post the draft decision).

This productivity outcome does not appear to have been taken into account in either the consultant's final report or the ESC's draft decision. The implication is that CHW is being asked to achieve a productivity improvement far in excess of ESC stated 1% p.a. hurdle.

CHW spent a considerable amount of time explaining this to the consultants, detailing the issue in our formal response to the initial consultant report and also discussed with the ESC in February.

In summary, the outcome of the consultant's recommendation is contrary to CHW's obligations under a legal and binding EBA and sets a far higher productivity target than applied across the industry per the ESC direction. Therefore in CHW's opinion, the adjustment in the final consultant's report (and therefore draft decision) is incorrect and should be amended.

CHW's labour estimates should be maintained until 2014/15 (in line with the current EBA per the commentary above) and then held flat in real terms from 2015/16 in line with the consultant's, ESC and Government principles.

CHW's labour expense would then be reported as follows:

2013/14: \$18.375m (per CHW submission – consistent with existing EA)
2014/15: \$18.905m (per CHW submission – consistent with existing EA)
2015/16: \$18.905m (per principles of flat real growth post existing EA)
2016/17: \$18.905m (per principles of flat real growth post existing EA)
2017/18: \$18.905m (per principles of flat real growth post existing EA)

CHW will still remain above the 1% p.a. efficiency target after making these adjustments.

Power

CHW notes the recommendation made in the consultant's final report relating to three key issues:

1. Distribution charges following the expiry of the current regulatory period
2. Energy prices following the expiry of the Procurement Australia contract (query this should be 'contract')
3. Superpipe volumes

In regard to distribution charges and energy prices (issues 1 and 2 above), it is clear there are differing views on these future price paths. From CHW's perspective there is no evidence to suggest the consultant's assumptions are any more robust than the CHW assumptions. A balanced approach to achieving an outcome here would be to take a mid-point between the assumption ranges proposed by CHW and the consultant.

In regard to Superpipe volumes (issue 3 above), CHW is disappointed in the response provided by the consultants in the final report as it omits a critical issue in support of CHW's submission. The consultant's report simply focusses on the probability of the forecast pumping volume required. CHW provided this probability to ensure a fully informed decision could be made. Importantly, this probability must be considered in the context of the levels of service being provided to CHW's customers. The background and context to these agreed levels of service following years of drought and water restrictions was detailed extensively in CHW's response to the initial consultant report.

However, there was no acknowledgement or understanding of this issue in the final consultant report which CHW finds disappointing.

The implication of the final consultant report (and in turn the draft decision) is that CHW cannot guarantee that the agreed levels of service can be met. CHW's submission of 1.5 gicalitres (GL) p.a. provides the appropriate balance between probability and guaranteeing customer service levels.

The combination of the recommended adjustments for electricity removes the ability for CHW to manage risk and uncertainty as allowed under the principles of the Water Industry Regulatory Order (WIRO).

Therefore, CHW seeks the following:

1. A mid-point adjustment to the distribution and energy price assumptions given the uncertain nature of future price paths; and
2. A reinstatement of the 1.5GL p.a. Superpipe pumping assumption to ensure CHW can deliver on agreed levels of service to our customers

Living Victoria – Living Ballarat

CHW and the City of Ballarat are able to confirm the external funding commitments to this stormwater harvesting and aquifer recharge pilot project, that is, an initial contribution of \$0.3 million from each organisation in 13/14 (total of \$0.6 million). In addition, it should be noted that CHW (and the City of Ballarat as joint applicant) has been short listed for the further \$0.6 million as outlined in the ESC's draft decision from the Office of Living Victoria (OLV) \$50 million program fund. The final requirement is to complete a business case by 13 May 2013 to the OLV. Final confirmation of the funding is expected prior to 30 June 2013 by OLV.

Regardless of the outcome, CHW and the City of Ballarat will seek to progress this very important project to completion. CHW requests the ESC to consider the investigation/pilot nature of the project to be operational expenditure in 13/14 rather than capital as suggested by the ESC in the draft decision. It is expected the additional \$0.6 million by OLV will be utilised as \$0.3 million in each of 13/14 and 14/15.

Defined Benefits Superannuation

CHW notes the recommendation made in the consultant's final report relating to Defined Benefit Superannuation as follows:

“Deloitte considered the submissions but still recommended that “using a ‘benchmark’ 15 year period for all businesses represents a balanced outcome which treats each business equally, allows recovery of the payment, and does not impose an undue burden on customers in the short term”

The consultant's conclusion fails to acknowledge a proposal by Australian Prudential Regulation Authority (APRA) to limit funding calls to three years. This proposal is documented in Prudential Standards SPS 160 Defined Benefits Matters. APRA has confirmed that this standard as such is final but subject to the passing of related legislation before coming into effect.

This action by APRA indicates that the current 15 year agreement with APRA used as a benchmark by the consultants, is most likely a one-off purely to alleviate the financial impost to employers based on the quantum of the recent call and the endeavours of Vision Super to reduce the potential burden for some employers who are in a difficult financial position.

Given the proposed changes to the Prudential Standard requiring three year funding plans it would be appropriate to align the ESC cost recovery process with the APRA regulations.

Therefore, CHW seeks recovery of the full Defined Benefit shortfall during WP3.

2. CAPITAL EXPENDITURE

CHW generally accepts the position of the ESC in relation to the review of CHW's capital expenditure. However, further consideration is requested in relation to the approved expenditure for the Maryborough Water Quality Project and the five year capital expenditure program.

Maryborough Water Quality Project

CHW remains concerned with the decision made by the consultants and the subsequent outcome included in the ESC Draft Pricing Decision in relation to one of the most important capital works projects that CHW intends to deliver for its Maryborough and District Supply customer base and public health regulator. It should be noted that the Maryborough water supply system is CHW's second largest water supply system, servicing some 10,500 customers (5,600 connections).

Within this response, CHW seeks to reinforce to the ESC the urgency for this water quality improvement project to be completed. Based on the current water resource position/water quality situation, CHW again stresses the urgency relating to delivery timelines. Key aspects CHW would like the ESC to consider prior to finalising the pricing decision include:

- a) The key driver for the Maryborough Project is drinking water compliance to ensure the water supply system meets CHW's agreed level of service to customers for security and Australian Drinking Water Guidelines (ADWG) 'good' water quality targets related to TDS and hardness. A secondary driver for the project is to service growth to ensure that future demands can be adequately met.
- b) The system currently fails to meet the level of water supply security that CHW has set with its customer base and the decline in water quality observed in the past 6 months will likely trigger the failure to meet ADWG 'good' standards of water quality within the next 2-3 months.
- c) The development of the proposed solution (Salt Reduction Plant) will secure a consistent water quality supply and water supply level of service/reliability of supply into the future;
- d) CHW has identified the need for an accelerated delivery program for the project that is likely to take between 18months to 24months to deliver. This has now commenced due to the low rainfall/runoff extended dry period over the past 6 months;
- e) Proposed new phasing of the Capital Works Expenditure and associated scope for this project is;
 - Year 1 – 13/14; Detailed Design and Approvals - \$0.5 million
 - Year 2 – 14/15; Construction - \$6.5 million
 - Year 3 – 15/16; Commissioning - \$3.4 million
- f) The resultant implication is that the increased operational expenditure of \$300,000 (12/13 dollars) per annum will commence in Year 3 (15/16) of Water Plan 3 and should be accounted for by the ESC in the final pricing decision;
- g) Please note CHW has provided the ESC copies of separate correspondence received by the Department of Health highlighting concerns by the department in this system and which provide regulatory support for the water quality improvements intended as outlined in CHW's submission;
- h) The ESC should also note the additional justification relating to customer complaints provided to the consultants (and ESC) on 25 January 2013.

Five Year Capital Expenditure Program

As part of its WP3 preparation, CHW has been considering the most efficient manner in which to deliver the proposed capital works program during WP3.

In the Draft Pricing Decision, the ESC has made changes to both:

- The total value to be delivered and
- The phasing of the program including moving some projects across WP3 and WP4

Based on these proposed changes, additional information, timing and requests in this submission CHW is re- considering how it will deliver the capital program over the five years. Irrespective of the outcome of the final determination, CHW is committed to delivering the full project program in a timely and efficient manner.

Proposed Capital Expenditure as per CHW’s submission:

Five Year Capital Program	TOTAL (\$M)
ESC Draft Pricing Decision	103.3
Proposed CHW adjustment	3.4
Revised Total - including Maryborough	106.7

3. SERVICE STANDARDS

In its Draft Pricing Decision, the ESC requested CHW provide further information and justification in relation to seven service standard targets. Following discussions with ESC officers, CHW confirms our understanding that the KPI target is a five year average target to be measured over the five year Water Plan 3 period, hence it is expected that in many of the annual performance reporting periods that Water Corporations will be over and under when compared to the five year average calculation. Having had this clarified, CHW has reviewed a number of the targets and further investigated the data associated with those targets that were rejected by the ESC in the CHW draft decision as follows;

1. Average time taken to attend bursts and leaks (Priority 2)

Recommendation – CHW proposes to accept a target of 70 that is consistent with the 5 year historical average of 68.6.

2. Average time taken to attend bursts and leaks (Priority 3)

Recommendation – CHW proposes the target of 720 be maintained as opposed to adopting a figure based on its five year historical average. The rationale is as below;

Rationale – CHW acknowledges that its 5 year average is substantially lower than its proposed target. It should be noted that by the nature of this Priority 3 rating, these incidents have little to no customer impact and in order to drive further business efficiencies in reducing overtime and minimise the OH&S risks associated with works undertaken at night, CHW proposes to maintain a target of 720 minutes (12 hours). This ensures that any works required to rectify Priority 3 leaks, can be undertaken the next day rather than during the night. CHW has recently introduced business process changes to ensure these activities are now to be responded to with the above drivers in mind relating to reduced overtime and reduced OH&S risks. Enabling this work to be prioritised to the next day also ensures that Priority 1 & 2 works, which are of a higher priority in terms of customer impacts, remain the focus.

3. Average unplanned customer minutes off water supply (minutes)

Recommendation – CHW proposes to accept a target of 13 that is in accordance with the 5 year historical average of 12.66.

4. Average planned customer minutes off water supply (minutes)

Recommendation – CHW proposes to retain a target of 12 minutes for this measure due to a proposed increase in planned works for the WP3 period, that were not previously undertaken during WP2. The amount of these works undertaken during WP2 was very low due to the extreme drought conditions and water resource limitations. This resulted in very little of these works being undertaken in order to conserve scarce water resources. The five year historical year average of 3.55 is therefore not reflective of the increase in planned system maintenance for WP3.

Rationale – During the last 5 years CHW was unable to undertake regular planned maintenance activities such as water mains flushing/disinfection programs that are generally widely accepted programs undertaken in the Water Industry. These programs assist in maintaining levels of disinfection stipulated by the ADWG as well as reducing customer complaints associated with water quality. CHW has experienced an increase in water quality customer complaints during WP2 that can be attributed to the lack of planned maintenance. Based upon the calculation of a typical suburb containing approximately 2300 connections and 40 km of water mains, the average planned customer minutes off water supply would increase by between 7 - 9 minutes with a 3 - 4 hour planned (mains cleaning) outage. Given this type of works has not been undertaken in the period of the 5 year average due to drought conditions and resource limitations, CHW considers a KPI of 12 be appropriate. This proposed target takes into account works currently undertaken during the previous 5 years (3.55 minutes) plus that required to undertake the proposed works (7 - 9 minutes).

5. Average Frequency of Unplanned Water Supply Interruptions

Recommendation – Central Highlands Water proposes a target of 0.1 that is in accordance with the six year historical average, as per the rationale for the like indicator “Unplanned water supply interruptions per 100km” that has been accepted by the ESC in the Draft Pricing Decision.

6. Average Duration of Planned Interruptions

Recommendation – CHW proposes a target of 200 minutes for this measure due to an increase in planned works in WP3 that were not previously undertaken during WP2 due to extreme drought conditions and water resource limitations. The five year historical year average of 181.8 is not reflective of the proposed increase in planned system maintenance activity for WP3.

Rationale – As per the rationale supplied above for “Average planned customer minutes off water supply (minutes)”, during the last 5 years CHW was unable to undertake regular planned maintenance activities such as water mains cleaning/disinfection programs that are widely accepted programs in the Water Industry. These programs assist in maintaining levels of disinfection stipulated by the ADWG as well as reducing customer complaints associated with water quality. Based upon the calculation of a typical suburb containing approximately 2300 connections and 40 km of water mains, it would require the number of planned works undertaken to increase by 50%, with the typical duration of between 180 – 240 minutes. Adopting a target less than 200 due to the normal duration time being between 180 – 240 minutes, could reduce the effectiveness of the mains cleaning program or alternatively drive additional costs into the business.

7. Sewer blockages per 100km of mains

Recommendation – CHW proposes to accept a target of 20 that is in accordance with the 5 year historical average of 19.4.

CHW would also note that in the Draft Pricing Decision Appendices Table B2, there were a number of errors in relation to CHW’s proposed service standard targets. Similarly there appears to be errors in Table 1 of the Draft Decision Volume II document. These have been discussed with ESC staff but CHW requests they be confirmed in the Final Determination.

They include:

Document	Service Standard	Draft Decision documents	Actual target proposed
Appendices, Table B2	Unplanned water supply interruptions restored within five hours (per cent)	100%	98.7%
Appendices, Table B2	Planned water supply interruptions restored within five hours (per cent)	100%	92.6%
Draft Pricing Decision Vol II, Table 1	Complaints to EWOV (per 1000 customers)	1	0.6
Draft Pricing Decision Vol II, Table 1	Telephone calls answered within 30 seconds (per cent)	1	90%

In discussion with the ESC, CHW has also confirmed its understanding that the 'Additional Service Standards' specified in the final CHW Water Plan document, have been accepted by the ESC. These Service standards relate to Recycled Water, Biosolids Reuse, Environmental Performance and Drinking Water Compliance. CHW also notes that the ESC has confirmed, via written correspondence, that the proposed 'Risk Performance (RP)' factor in relation to performance against a range of service standard and expenditure targets, will not apply for the WP3 period.

4. Miscellaneous Charges

In the draft decision, the Commission requested CHW provide more detailed descriptions of its miscellaneous charges. The more detailed descriptions for these services are provided below:

Service	Description
Information Statements	Information statements are certificates issued by CHW that provide rate and encumbrance information to solicitors or conveyancers, representing the vendor and purchaser of a property. The solicitors and conveyancers then use the information to prepare statements under Section 32 of the Sale of Land Act and at settlement of the property, to adjust charges between the vendor and purchaser.
Meter Cost	Fee for the provision of a standard 20mm water meter
Plumbing Consent Fees	The cost for CHW to review and assess plumbing changes for a property and for property connections to CHW water / sewer mains, under Section 148 of the Water Act.
Special Meter Reading Fees	A water meter reading taken by CHW (out of billing cycle sequence) when requested by a tenants / owner vacating a property. This reading is used to calculate the final bill amount for the property.
Water Tapping Fees	This fee covers the installation of a tapping band and ferrule by CHW on a CHW water main, to service a new connection to that main.

5. New Customer Contributions (NCC's)

In its Draft Decision, the ESC requested CHW revise its NCC model to ensure it reflected costs of new connections and included the proposed capital expenditure, operational expenditure and tariff changes in the draft decision. CHW is in the process of finalising a revised model for discussion with the ESC and will then undertake additional consultation with developers. The revised model will ensure CHW has taken full account of previous and proposed growth related capital expenditure (as per the ESC model), as well as accounting for reductions in the revenue stream due to a reduced tariff path in WP3. CHW will also ensure that the new model clarifies where a standard NCC charge would apply and how out of sequence issues will be addressed. CHW proposes to have the revised NCC model finalised and presented, with consultation feedback, by the end of May 2013.