

# PRICE SUBMISSION

2018

Supplementary  
information



**Response to ESC draft decision**





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## 1 Introduction

In late-September 2018, City West Water (CWW) lodged its *Price submission 2018* (original CWW submission) with the Essential Services Commission (ESC) – a proposed set of revenues and prices to apply to services delivered by CWW across the regulatory period to run from 1 July 2018 to 30 June 2023.

The ESC has had an opportunity to review our submission and we were pleased to attend and participate in the public forum on 16 April. We now welcome the opportunity to formally comment on the *City West Water draft decision: 2018 Water Price Review* (ESC draft decision).

The substantive matters raised in the ESC draft decision on which we wish to comment are set out below:

- Operating cost benchmarks (section 2)
- Capital expenditure benchmarks (section 3)
- Updated financial model (section 4)
- Annual updates to the regulated rate of return (section 5)
- Unforeseen events (section 6)

In addition, we acknowledge and respond to public submissions on the original CWW submission and the ESC draft decision (section 7).

## 2 Operating cost benchmarks

### CONTEXT

The ESC draft decision:

- (at pages 12-13) recommended the adoption of City West Water's revised West Werribee salt reduction plant operating expenditure forecast, resulting in a reduction (compared to our original submission of \$1.96 million across the 2018–23 period).
- (at page 13) agreed with our forecast of wholesale energy prices for years 1 and 2 but, citing energy market uncertainty, not for years 3, 4 and 5.

CWW's response to these aspects of the ESC draft decision follows.

### 2.1 West Werribee salt reduction plant operating expenditure forecast

As part of the Commissions' audit of our expenditures, we provided updates to the forecast operating costs for our soon-to-be commissioned West Werribee salt reduction plant.

We were able to provide these updated forecasts as we are now much closer to commissioning the plant and have more detailed information on the forecast costs to run it.

#### *CWW position*

We accept the draft ESC's decision's update to costs required to run the West Werribee salt reduction plan.

### 2.2 Energy – networks and wholesale

Following the original CWW submission we provided an updated energy networks cost forecast to the ESC. The ESC draft decision is consistent with our updated energy networks cost forecast and we accept it.

As evidenced by ESC's acceptance of years 1 and 2 wholesale energy prices, our proposed use of the ASX futures prices for energy is reasonable as a benchmark for the short to medium term. However, we acknowledge the time limitations of the ASX data series (2.5 years) and that additional assumptions are required to support wholesale energy costs beyond the ASX series. There is no strong evidence either way with respect to forecast energy prices.

We will manage this price uncertainty in years 3, 4 and 5 of the regulatory period by implementing a range of initiatives to manage energy market exposure.

#### *CWW position*

We accept the ESC draft decision's update to network and wholesale energy costs.

### 3 Capital expenditure benchmarks

#### CONTEXT

The ESC draft decision proposes to reduce CWW's capital expenditure by \$23m (out of total capex of \$549m). This reduced expenditure relates to a single CWW program, 'sewer KPI renewals'. CWW had proposed \$56.2m for this program with the ESC draft decision revising this down by \$23.3m to \$32.9m over five years.

The ESC's stated reasons were:

- CWW has met its existing service standard with its current expenditures
- CWW is relaxing its service standard and proposing higher expenditure.

CWW's response to this aspect of the ESC draft decision follows.

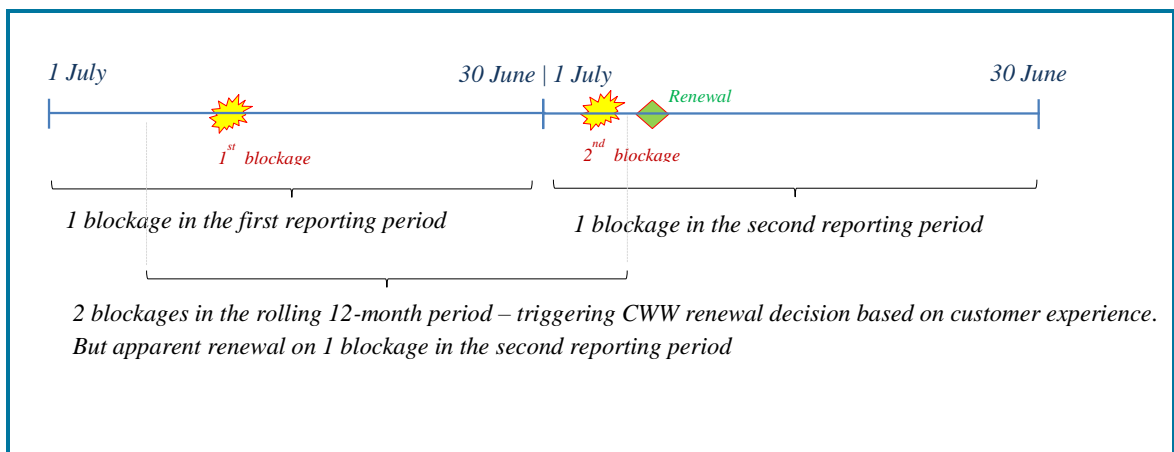
#### *Background*

#### **CWW maintains over 4,000km of sewer mains of various sizes, ages and pipe materials:**

- These pipes have a purpose; they're there to provide reliable sanitation services – to take sewage away from homes, public institutions and businesses, to be treated and returned to the environment safely.
- We actively manage these pipes to maintain reliability and this includes us taking a number of actions like:
  - monitoring their performance
  - inspecting them and clearing blockages / repairing them as required
  - replacing them when cleaning and repairs are no longer practical or cost effective.
- We replace pipes to meet defined levels of service associated with repeated interruptions.
- The original CWW submission proposed to increase expenditure on sewer pipe replacement – based on our calibrated modelling that shows that due to age-related degradation our pipes will fail at faster rates than is currently occurring, which will further impact on the quality of service we provide to our customers. For example, our sewer reticulation pipes have a design life of 90-100 years but we are currently replacing them at a rate that, on average, would require them to be in the ground for 200 years or more.
- Although we are seeing moderate numbers of repeat interruptions – as currently evidenced by the RES5 indicator – we expect repeat interruptions to increase over time, requiring us to increase our expenditures on the sewer KPI renewals program.

### The 'RES5' performance record is not an accurate reflection of customer experience:

- One of the findings in the ESC draft decision is that CWW was able to 'achieve this reduced [repeat sewer interruption] KPI under its existing program'.
- The relevant KPI is 'RES5', the definition of which is the 'number of customers receiving 3 or more sewer blockages in the reporting period' – that is, 1 July to 30 June. We believe that the RES5 is a useful measure but does not accurately reflect the lived customer experience.
- Rather, we use a rolling 12 month period to assess customer experience with sewerage network reliability. As such, our renewals program is based on the number of interruptions in that rolling 12 month period.
- The distinction between our practice and reliance only on the RES5 indicator (for the current KPI) is shown below:



For a renewal to be scheduled, customers have generally had 2 interruptions in the rolling 12 month period – so while we may not be breaching the RES5 calendar year target, we may breach the customer expectation on a rolling basis.

### Relaxation of the standard defers rather than eliminates the need to renew:

- In terms of relaxing the KPI, our analysis on failure modes shows that allowing an additional failure delays, rather than eliminates, the need to renew.
- Failures on mains in an advanced state of degradation tend to be more frequent. This is because responsive activities (repair and cleaning methods) do not necessarily fix the underlying problem but, rather, 'buy time' before the problem recurs. This is demonstrated by reference to some common failure modes below:

Cause of failure	Responsive activity	Does responsive activity prevention future failure?
<b>Crack or break with tree root penetration</b>	Cut/clear roots/blockage using high pressure water jet	NO – roots will grow back
<b>Collapse</b>	Replace affected section	YES – in respect of replaced section NO – in respect of portions not replaced
<b>Blockage due to inappropriate disposal of materials to sewer</b>	Hydrojet drain cleaning using high pressure water to cut through blockages	YES/NO – blockages reoccur if sewer has insufficient hydraulic gradient to self-clean.

- As such, relaxing the KPI target from ‘no more than 3’ to ‘no more than 4’ does not change CWW’s ultimate solution to renew. Rather, it will delay renewal for a period of time.
- Detailed analysis of network data between 2007 and 2017 shows that the average interval between repeat blockages is 1.2 years (across all mains – not just those mains that display multiple interruptions in a rolling 12 month period). As such, CWW considers that in moving from our current setting of ‘no more than 3’ to our future setting of ‘no more than 4’ blockages in a 12 month period it is possible to defer CWW’s proposed increased background level of expenditure.
- As such, we propose to align the deferral of increased capital expenditure with the system average recurrence interval (1.2 years) between repeat blockages. For the purposes of resubmitting proposed expenditures, CWW has:
  - adopted the ESC draft decision proposed expenditures on this program for the first two years of RP4
  - proposed an amended set of expenditures for years 3, 4 and 5 – a level, we believe, we will need over the longer term.
- We submit a revised proposal for years 3, 4 and 5 on the basis that the AFFIRM model (upon which our proposal is based) accurately represents the relationship between customer repeat interruptions, faults and renewal activities. Details of the AFFIRM model have previously been provided to the ESC and its expenditure consultants.



*CWW position***CWW maintains that its sewer KPI program expenditure is prudent in the long run.**

Given the transition to a new KPI for sewerage service reliability, we believe that it is appropriate to delay the original CWW submission proposed increased expenditure on sewer KPI renewals. The revised proposed sewer KPI program expenditure follows:

	2018-19*	2019-20*	2020-21*	2021-22*	2022-23*	Total*
Original CWW submission	10.1	10.9	11.3	13.3	10.6	56.1
ESC's draft decision	6.6	6.6	6.6	6.6	6.6	32.9
ESC's change	-3.5	-4.3	-4.7	-6.7	-4.0	-23.3
CWW revised proposal	6.6	6.6	10.6	10.6	10.6	45.0

\* \$m, 2017-18 prices



## 4 Updated financial model

### CONTEXT

The ESC draft decision triggered a need to update CWW's financial model.

### *CWW position*

We have submitted an updated financial model. This update includes adjustments to:

- operating expenditures reflecting the draft decision
- capital expenditures reflecting CWW's revised proposal
- tariff revenue by way of an update to prices (the residential sewage disposal fee) to rebalance tariff revenues with revenue requirement.

## 5 Annual updates to the regulated rate of return

### CONTEXT

The ESC draft decision (at page 30) asked CWW to resubmit its proposed annual update to the RRR.

### *CWW position*

We propose the following steps to pass through changes in the ten year trailing average cost of debt:

- **Step 1:** obtain the real cost of equity from the ESC determination for CWW

$$CoE_t^{real} = CoE^{det}$$

- **Step 2:** determine the updated 10 year trailing average nominal cost of debt:

$$CoD_t^{nominal} = \sum_{j=t-10}^{t-1} \frac{CoD_j^{nominal}}{10}$$

- **Step 3:** convert the nominal trailing average cost of debt to its real equivalent using the inflation factor specified in the determination ( $\pi^{det}$ ) for all regulatory years:

$$CoD_t^{real} = \frac{(1 + CoD_t^{nominal})}{(1 + \pi^{det})} - 1$$

- **Step 4:** calculate the real regulated rate of return (RRR) accounting for the update to the ten year trailing average nominal debt series:

$$RRR_t^{real} = 0.4 \times CoE_t^{real} + 0.6 \times CoD_t^{real}$$



## 6 Unforeseen events

### CONTEXT

The ESC draft decision (at page 30) is not to accept City West Water's proposed adjustment mechanisms for uncertain and unforeseen events and for the environmental contribution. ESC suggests:

*The existing uncertain and unforeseen events mechanism allows for cost pass-throughs for tax changes (such as changes to the environmental contribution) or significant and unforeseen variations in actual costs from forecast. As such, there is no need for City West Water to propose a specific pass-through mechanism for these two items*

### *CWW position*

We confirm that we agree with the ESC draft decision on unforeseen and unintended events (limited price reopening) mechanism.



## 7 Acknowledgement of public submissions

The following is CWW's overview of the submissions received by the ESC and how CWW has considered such concerns in developing its submission.

### 7.1 Mainstream Aquaculture

Mainstream Aquaculture submitted that its waste discharges are of a quality that benefit CWW and, as such, warrant a pricing concession. The submission also stated that CWW's fees are high by international comparison and that that CWW's treatment processes do not remove salt and, hence, this parameter should not be priced.

#### *Industry leading engagement of non-residential customers and price reductions*

Engagement with non-residential customers was a distinguishing feature of CWW's engagement program. CWW conducted a range of non-residential forums, including specific workshops on trade waste tariffs, trade waste service offerings and service levels. Representatives from Mainstream Aquaculture were invited to attend and participated in a number of these forums.

As a result of the views expressed by Mainstream Aquaculture and other non-residential customers, CWW reviewed its proposal to reduce trade waste tariffs. One of the outcomes of this review was a proposed 18.2% real reduction in trade waste volume prices from 2017-18 to 2018-19. To CWW's knowledge, this is one of the largest proposed non-residential fee reductions state-wide. This lower fee will provide a direct benefit to all CWW's trade waste customers, including Mainstream Aquaculture.

#### *The nature of the trade waste*

CWW understands that the salt concentrations of Mainstream Aquaculture's discharges are not suitable for land application and, as a result, the full volume of its trade waste is discharged to CWW's network and is transported to Melbourne Water's Western Treatment Plant for processing. Given Mainstream's trade waste discharge is conveyed through, and treated by, the same system used by all other trade waste users on CWW's network, CWW believes it is appropriate that a common set of trade waste fees apply to all trade waste customers, including Mainstream Aquaculture. For this reason, we have not proposed either an industry-specific, or a customer-specific set of fees.

## 7.2 Anonymous

An anonymous submission expressed dissatisfaction with CWW's application of service charges to properties subject to bodies corporate – that is, sharing a 'master meter'. As a potential alternative to the current charging practices, CWW investigated a shift to meter-based charging where fixed fees would be applied based on the size of a customer's connection, rather than the number of titles behind the connection. However, CWW found insufficient customer support across the broad spectrum of non-residential customers to warrant this draft proposal for change. As such CWW instead proposed to retain its current practice of charging titled and connected properties in line with the provisions of the *Water Act 1989*.

## 7.3 Ms Carmel Jacobs

Ms Jacobs expressed dissatisfaction with receiving bills from Western Region Water Corporation and City West Water Corporation for her property in Melton. CWW currently bills the Annual Parks Charge in Melton on behalf of the Department of Environment, Land Water and Planning (DELWP). As such, Ms Jacobs, as a customer of Western Region Water Corporation, received a bill for services she receives from Western Water (that is, water and sewerage services) and a bill from CWW for the Annual Parks Charge. The service CWW provides DELWP is an unregulated service performed under contract. As such, the agreement is not subject to the 2018 Price Review. However, in line with the ESC's *2018 Water Price Review, Guidance paper*, CWW has accounted for unregulated revenues in the financial model.

## 7.4 Mr Gerald Mallon

Mr Mallon expressed his concern is that affordability is a major issue for low income and concession card holders who cannot afford water tanks. Affordability was front of mind for all customers through CWW's engagement. CWW has focussed on maintaining strong cost controls – as demonstrated by our 2% operating expenditure efficiency factor and reduced prices for all customers. We continue to partner with DHHS to apply concession to the accounts of concession card holders and will continue our hardship and water efficiency programs to assist those in need.

## 7.5 Mr Paul Rogers

Mr Rogers believed that CWW's email response time is too long. This view is consistent with CWW's engagement findings and is why we have proposed to reduce our correspondence response time from 10 business days to 1 business day.

Mr Rogers also had a preference for CWW to spend money on water infrastructure rather than IT projects. In line with this view, CWW's original proposal excluded some potential uncertain IT expenditures from its capital expenditure proposal – for example, those relating to digital metering. The IT expenditures that CWW has included in its proposal are those that provide service for which there is demonstrated customer support.



## **7.6 Ms Frances Raymundo**

Ms Raymundo disagreed with the level of CWW's network service (fixed) fees. CWW engaged broadly on its tariff proposal – engagement that included a deliberative forum on tariff structures. As outlined in the original CWW submission, we balanced numerous competing interests in setting the ratio between its fixed and variable fees. CWW acknowledges that there are differing views among its customer base on this matter. However, we believe we have struck a fair balance for our customers.

## **7.7 Dr Jeremy Lawrence**

Dr Lawrence submitted that fully variable pricing would be fairer than the current two-part tariff structure. As described in the original CWW submission, we consulted widely and thoroughly on alternative tariff structures, including fully variable pricing. Among the reasons why fully variable pricing was not pursued is that it is not cost-reflective and it would impose unfair and disproportionate costs on large households. CWW acknowledges that there are differing views among its customer base on this matter. However, we believe we have struck a fair balance for our customers.

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