



Our Ref: 4137454

10 February 2016

Mr Marcus Crudden
Director, Water
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne Vic 3000

Dear Marcus

Re: Submissions on Goulburn-Murray Water's 2016 Price Submission

Thank you for providing this opportunity for Goulburn-Murray Water (GMW) to respond to the submissions received on its Price Submission for 2016-20. We have identified the main issues raised in the submissions which we consider it important to respond, to inform the ESC's Draft Decision. Our responses are set out below.

Our 2016-2020 Water Plan is one of our most important plans. Our Water Plan describes the direction for our customers and stakeholders over the next four years. It proposes changes to customer service standards, outlines our future infrastructure investment and costs of doing business, and details our proposed pricing for our core services of water storage and delivery.

GMW's Plan demonstrates our commitment to delivering services in a way that maximises customer, community, environmental and economic benefits. Our customers over the last 3 years have told us they want stable and predictable pricing to help forward planning and risk management which will support a progressive Irrigation and Agricultural region and to ensure Goulburn-Murray Irrigation District (GMID) sustainability.

GMW has undergone substantial change throughout the current regulatory period and this will continue during the next regulatory period. Both GMW and our customers are facing a period likely to be characterised by high degrees of uncertainty.

Dry conditions, potentially lower water deliveries, water trading out of the GMID and uncertainties surrounding the outcomes of the Connections Project reset may have potentially significant impacts on GMW and our customer's future viability. We believe our 2016-2020 Water Plan provides a balanced approach to managing the various externalities and environmental risks through prudent and efficient capital and operating expenditures proposed in our pricing submission.

Connections Project

The most significant change is the Connections Project, which is a \$2 Billion modernisation of the irrigation network in the GMID. The project is funded by the Commonwealth and Victorian governments and is currently contracted to run until 2018. This project will deliver significant benefits in terms of improved service levels and productivity for our customers, improve the overall water delivery efficiency of the system and generate water savings without the need to take water from consumptive users. The Project is well advanced with 3000km of backbone completed and 3500 customers connected.



Given the unique nature and size of the project, it also has associated risks and uncertainties in relation to specific project outcomes. Over the medium to long term there are inherent uncertainties reflecting the introduction of new technology on a scale not previously implemented. This means the impact on maintenance, operations and whole-of-life asset costs will continue to be refined as the modernised network is integrated into GMW's systems and operational issues are understood. Further, uncertainties also exist in terms of the project being dependent on the timely agreement with customers in relation to on-farm and in-channel works in order to achieve outcomes.

The recent Mid-Term review report highlighted the need to 'reset' the Connections Project. The reset will investigate a range of options and make recommendations on the way in which the project will be implemented. The outcomes of the reset and any consequential impacts on GMW's revenue requirement are likely to be understood after the commencement of the pricing period, however at this point there is nothing to suggest a material impact to our 2016-2020 revenue requirements.

Efficiency

Other significant achievements continue to be realised. As a part of the Business Transformation Program GMW has undergone a reorganisation that has a greater focus on customers and efficient service delivery, demonstrating a commitment to implement cost reductions business wide and to reduce operating expenditure by \$20M per year by 2018. Our tariff structures are becoming simpler and changing to ensure they better reflect infrastructure costs. The shifting focus of the business to become more customer and efficiency oriented is reflected in the service and price proposal for the next regulatory period.

Our capital program and expenditure, compared to an asset base of \$4 Billion, is targeted to assets that reduce immediate risks and maintain service levels. Our robust asset management process that considers the entire asset portfolio in a consistent manner seeks to address an aging profile of assets which will require greater expenditure in regulatory periods beyond our 2016 Pricing Submission. While investment on infrastructure is consistent with our previous Water Plan, we remain committed to reducing our operating costs, providing predictable pricing with a structure that reflects the changing nature of our business.

GMW must ensure that its 2016 Pricing Submission drives efficiency – this plan includes savings from efficiencies that we have identified. Where we can exceed these savings through the regulatory period, GMW will provide a combination of price relief to customers and debt reduction to manage the financial sustainability of the organisation. GMW has successfully applied this approach during the current regulatory period and considers this approach prudent.

Water Resource

For the purpose of developing our water plan, we are required to project what we anticipate to be forecast water delivery volumes. Water predictions are always uncertain with drier conditions predicted resulting in greater variability and less consistency. In addition the GMID is facing further uncertainty with water resource potentially affected by outcomes of the Murray Darling Basin Plan and water moving outside the GMID as a result of water trading.

Our 2016 Pricing Submission is positioning GMW for the next four years however the impact of reducing water resource on our customers and GMW's volumetric revenue could be material. We continue to plan for these risks to enable the provision of consistent service levels with changes reflecting customer's needs.

Gravity irrigation tariffs

A number of submissions have outlined stakeholder concerns in relation to GMW's proposal to move to a uniform Goulburn-Murray Irrigation District (GMID) delivery charge, also referred to as the 'single price' proposal, away from district based pricing for gravity irrigation services. Issues have been raised about the fundamental principles of cost reflectivity (or 'user pays') versus tariff simplicity, cross subsidisation and transparency, as well as the benefits of the proposal, including reducing administrative costs and complexity.

Cost reflectivity versus tariff simplicity

We agree that cost reflective pricing is an important economic principle that should be pursued; however, there is a trade-off between tariff and administrative simplicity, and cost reflectivity. 'True' cost reflectivity, to the extent it can even be defined in a complex system such as the GMID, typically requires complex cost allocation and tariff setting, and GMW and our customers need to balance the costs and benefits of different approaches for tariffs. Taking into account the feedback from our customers and other stakeholders throughout the development of our tariff strategy, we have considered this trade-off and decided that the best option for GMW

and our customers is to move to a simplified uniform delivery charge for the GMID. This is particularly the case because the current district tariffs are based on sunk costs, and need to change to reflect the regulatory environment GMW operates in and the shift to building block regulation and away from the district annuities and bank balances.

While views on the appropriate level of cost reflectivity are varied, there is significant evidence of support for GMW to have simpler tariff structures. For example, the ACCC's recent Draft Advice on the Review of the Water Charge Rules highlighted the support for simpler tariff schedules.¹ The ACCC's draft position is that new rules are needed around the information that must be provided by irrigation infrastructure operators on tariffs to provide the simplicity requested by customers. GMW's 2015 customer survey demonstrates customers' support for our bills to be easier to understand and less complex.² Uniform delivery charges will reduce complexity in tariffs, and also deliver cost savings. One submission outlined the ACCC's recent comments on postage stamp pricing.³ We would like to highlight that the comments made in the ACCC's Draft Advice in relation to postage stamp pricing do not accurately reflect our circumstances. At present the district based pricing is not based on ongoing differences in the cost to supply districts, instead district prices are based on historical sunk asset allocations and institutional boundaries. Going forward, the standardisation of service levels across districts which is occurring through modernisation, plus low customer growth, further impede the economic rationale for district based pricing.

Cross subsidisation

Some stakeholders raised questions about the impact of the uniform delivery charges on various districts, in particular the substantial price reductions proposed for Shepparton, which are relatively more than the price reductions proposed for other districts. It has been suggested that the uniform delivery charge amounts to cross subsidisation of Shepparton.

The reasons that Shepparton customers have historically paid higher prices include the fact that historically Shepparton did not benefit from prior channel and asset rationalisation as part of the early modernisation works, as well as the fact that it has had older assets requiring more maintenance and replacement capital expenditure. Due to the higher capex and maintenance, as part of the old district accruals framework, Shepparton has been paying down historic debt over time. This debt has now been repaid, allowing prices to stabilise and reflect current and future costs rather than historical investments.

In a letter of 15 January 2016 supporting the single price approach the Chair of the Shepparton WSC, Mr Craig Reynolds, has noted that:

- Common pricing exists in respect of GMW's prices for water harvesting, which adds \$2/ML to prices for Shepparton customers. Hence it seems hypocritical to socialise the cost of water harvesting but not delivery
- In the absence of single pricing Shepparton would not want to contribute to natural disaster funding in other areas of GMW's business
- Delivery of water to Broken Creek largely through the Shepparton Irrigation District would supposedly reset the boundary between Shepparton and Murray Valley resulting in further reduction in prices for Shepparton customers within the new boundary / district.

In its report submitted as an attachment to our 2016 Price Submission, Deloitte has highlighted that the historical allocation of fixed costs to the districts is relatively arbitrary, dependent on Regulatory Asset Base (RAB) allocations and the selection of district boundaries, and that moving to a uniform price does not mean that there is inefficient cross subsidisation, because such a low proportion of GMW's costs are variable, no district will be paying less than its marginal variable cost.

GMW's analysis suggests that the costs to provide services across districts are closer than the historical differences between district tariffs would imply.

Transparency

A number of stakeholders have called for GMW to recommence reporting new capital expenditure and ongoing maintenance costs on a district basis, which we ceased in 2013 with the district P&L statements. Reinstating the

¹ ACCC, *Draft Advice on the Water Charge Rules*, November 2015, p. 75.

² Bartley Consulting, *Customer Survey 2015 – Prepared for Goulburn-Murray Water*, December 2015.

³ ACCC, *Draft Advice on the Water Charge Rules*, November 2015, p. 149.

old district statements would create an administrative burden for GMW and remove some of the efficiency savings we have already realised in our head office through reductions in finance staff, for example. In addition, our view is that in the context of the government funded modernisation programs which are benefiting the entire GMID, and the increasing centralisation of our business units to reduce costs, continuing to report activities on a district basis is unnecessary. Importantly, however we continue to communicate with our customers about the need for capital and maintenance projects in each area, and information is readily available on our capital and operating investments, even if not reported as part of a P&L statement for each district.

While we acknowledge stakeholders' concerns about reducing price transparency, our tariffs are highly regulated under the regulatory environment GMW operates within. The ACCC's current review of the Water Charge Rules is considering further changes to improve the transparency of tariff schedules and reporting on prices and pass through costs. GMW supports this improvement in tariff transparency and we will continue to work with our customers to better understand how information can be presented in more accessible ways.

Centralisation of costs

Our 2016 Price Submission noted that around 65% of gravity irrigation system operating costs are incurred or shared on a system wide or multiple district basis, due to the comprehensive changes occurring as part of the Connections Project.

In calculating this proportion of centralised costs, GMW defined centralised or shared costs as those which are associated with a position which operates over several irrigation districts, which is an increasing trend. For example, water and maintenance planners now undertake planning, co-ordinating and scheduling of work on a centralised basis using a consistent GMID wide approach. Another example of centralised costs is the planning and delivery of mechanical, electrical, civil and structural maintenance. Centralisation of costs is a result of the modernisation program, but also a function of GMW's drive to improve the cost efficiency of its business and deliver savings to customers.

It is important to note that the proportion of shared costs is likely to increase in the future. New technology including remote sensing and the use of drones, and a more flexible and skilled workforce, will contribute to this. While geographic realities mean that some costs will necessarily remain district-based, these will decline over time. It is important that GMW's pricing structure reflects these changes.

Benefits of Uniform Delivery Charges

GMW identified material incremental savings associated with the transition to a uniform delivery charge, which commenced in the lead up to our 2016 Price Submission. Savings are due to the following impacts we are realising:

- Reduced workload in setting up the annual prices in the billing system
- Fewer data elements to be maintained
- Lower risk of errors in the pricing and data element inputs
- Simpler for staff to understand and maintain
- Fewer customer complaints due to fewer errors.

From an annual FTE perspective, these efficiencies are expected to range between \$850,000 to \$1 million per annum, including:

- Professional Services - 3 FTE reduction (one each from Budgeting & Forecasting, Pricing & Regulation, Financial Reporting)
- Customer Services - 5 FTE reduction (from Business Support, Customer Administration and Customer Service Management roles).

These savings have already been included in our 2016 pricing submission, however other efficiency savings have started to be realised in the current regulatory period and are reflected in the \$8.4 million of annual savings across the business.

There were some comments in submissions regarding the benefits of reduced price shocks due to the uniform delivery charge. Deloitte's report provided an example of the potential impact of a flood in one district should district based pricing be retained. It showed that prices would need to increase substantially in one district to recover the costs – as much as 78% in Rochester which has fewer delivery shares than other districts. Even if the costs were recovered over four years, which is more likely to be case, the flood would still require a 20%

price increase for that four year period. Although this example is hypothetical, it serves to illustrate both the benefit of sharing the cost of one-off events across districts, as well as the arbitrariness of the pricing outcomes which depend upon the allocation of delivery shares in districts.

Alternative approaches to recovering one-off costs under the district pricing model, such as sharing the costs over districts, only undermine the district pricing approach and demonstrate the validity of the uniform delivery charge strategy. While in the past, districts have independently 'saved' for and funded large capital renewals or borrowed to fund natural disaster recovery and thus avoided price shocks, these approaches are not consistent with the RAB regulatory framework, which at the global business level provides for other mechanisms such as variations or contingent projects to deal with unforeseen events. Maintaining separate accounts for each district in the context of the overarching regulatory framework adds unnecessary complexity and cost.

Finally, we note comments regarding the way in which GMW presented the overall outcome of the uniform delivery charge strategy as an average 1.5% price reduction across all districts. We agree that this is not a clear way to present the impact of the tariff changes to individual customers; however this was presented to illustrate that the overall impact on GMW will be to lower revenue and costs due to rationalisation and efficiencies. The overall impact of the transition to single pricing is forecast to be a reduction in prices for most customers, as shown in Table 52 of our 2016 Price Submission.

Diversion tariffs

Some submissions raised fundamental questions about the fairness of diversion tariffs in general, as well as the appropriateness of tariff increases over the 2016 Price Submission period.

In 2013, GMW undertook a comprehensive review of the services provided to diverters, the associated costs and tariffs. The review sought to address similar issues as those which have been raised in submissions, including concerns about the value for money of the service, and the need for a better link between the services that diverters receive, tariffs and the work that GMW undertakes.

As a part of the review, GMW was able to better define the services it provides to diverters, which include (in order of cost):

- Site compliance – including monitoring licences, capital costs of metering and operating costs of meter reading and maintenance
- Catchment and aquifer access compliance – management of the rights to use licences in a catchment or aquifer, in line with resource management plans, including protecting the rights of licence holders
- Resource management planning – development of plans, including working with stakeholders (subsidised by the Victorian Government)
- Account management – setting up and managing accounts, answering queries and issuing bills, and maintaining licensing records with the Water Registrar.

Following consultation and consideration of issues raised by customers and other stakeholders, the Diverters' Tariff Strategy was finalised and published in September 2013. While changes to the tariff structure are proposed, importantly, the strategy aims to reduce the cost of diversion services overall, improving cost effectiveness.

Some submissions raised the issue of charging on the basis of meter points, which was clearly set out in the Diverters' Tariff Strategy. Importantly, meters on service points provide two functions – both monitoring the delivery of water to customers and regulating the system to ensure services can be delivered efficiently and to a reasonable standard. Charging on the basis of service point or meter better reflects the way in which GMW's costs are incurred and hence is more cost reflective than alternatives. It is also simple to understand and will provide signals to customers who can rationalise service points on their properties. GMW will work with customers to ensure that efficient rationalisation can occur.

Submissions also raised concerns about the quality and quantity of water supplied to diversion customers. Due to the nature of diversion services, GMW cannot guarantee the quality or quantity of water supplied, however its activities in relation to resource management and planning (which are funded by diversion tariffs) seek to contribute to improved outcomes for customers.

One submission suggested that GMW's Service Point Fees for small customers are seeking to recover the costs of metering, which only provided for large customers. This is an inaccurate observation - difference in

Service Point Fees for large and small customers reflect the differences in costs to serve customers with and without meters.

GMW's consultation with customers and other stakeholders

Some submissions expressed dissatisfaction with the consultation processes that GMW undertook in relation to the 2016 Price Submission, Diverters' Tariff Strategy, and the Uniform Delivery Charge.

Customers are the centre of our business and it is for this reason we initiated improvements to our approach to consultation during the current regulatory period. We now have a more consistent and ongoing engagement strategy. This includes the ongoing business wide consultation undertaken with a wide variety of our customers and stakeholders through forums such as GMW's stakeholder breakfasts, industry meetings and customer surveys.

In relation to 2016 Price Submission development process, over a 12 month period we met frequently with our 13 Water Services Committees (WSCs), the urban water businesses and Environmental Water Holders to gain feedback. In these forums we sought customer feedback on proposed service standards, operating and capital expenditure, demands and pricing. These issues were selected based on surveys which indicated they are issues of most importance to our customers.

Further, in consulting on the draft of this submission we:

- Mailed all of our customers providing them with a summary of the key proposals, inviting them to attend public forums and provide written feedback;
- Developed a webpage providing online information to the general public;
- Released a series of fact sheets;
- Ran 25 customer forums, attracting 289 customers. These forums provided customers not actively engaged via the WSCs the opportunity to understand the proposals in the draft submission and provide their feedback, this included 3 sessions with 36 large account customers;
- Further engaged the WSCs at their annual workshop where, during the breakout sessions for gravity irrigation and diversions, key issues in relation to pricing were discussed;
- Placed articles in our irrigator e-news with invitations to provide feedback as well as in regional newspapers; and
- Held additional customer information sessions based on customer requests, where customers were unable to attend planned session times.

The Diverters' Tariff Strategy was developed over the period from July to September 2013 by a representative working group made up of groundwater, unregulated surface water and regulated surface water diverter customers. A draft strategy was provided to stakeholders and comments were received from a wide number of customers.

The discussion around the merits of moving to a uniform price has been held with customers and stakeholders over several years, having first been raised in a 2010 GMW media release, well before consultation on the 2016 Price Submission commenced. We have addressed the majority of the views of our customers and note again that there is support for our Uniform Delivery charge in the community. For example, in the letter from the Chairman of the Shepparton WSC cited above, Mr Reynolds also noted that GMW consulted with WSCs in 2013 and Committee Chairs agreed there would be a single price across all areas. Further evidence of support for single pricing is discussed in the context of the Newgate research outlined below.

In response to comments that GMW did not consult on its proposed Entitlement Storage Fees for the 2016 Price Submission, we note that no changes to the tariff structure are proposed. GMW has proposed an increase of CPI + 1% for the Goulburn System and CPI for the Murray system. GMW has received no specific feedback on this increase in its water plan consultation.

We have considered the concerns raised about customer representation at our forums and information sessions and GMW continues to improve its approaches to consulting with its customers in seeking customer input and feedback on its Water Plan and pricing submission.

Customer Research

GMW has recently undertaken two significant pieces of research into customer views on a range of customer service, consultation and pricing issues. This research, in the form of GMW's 2015 Annual Customer Survey and an independent report prepared by Newgate Research, is summarised below.

GMW's 2015 Annual Customer Survey

GMW's 2015 Annual Customer Survey was carried out by Bartley Consulting. 751 customers were surveyed in late October / early November via telephone, with the average interview taking 15 minutes and covering a range of topics, including GMW's overall performance, service delivery, customer service and consultation. The survey results include:

- Over 70% of customers gave GMW's communication and consultation a rating of 7 out of 10 or more indicating they are 'quite satisfied' or more - and 32% of customers rated it 9 or 10 out of 10 ('very satisfied'). This is an increase on the 2014 result of 65% of customers giving a rating of 7 out of 10 or more.⁴
- When these results are analysed according to the service that is provided to each customer, it is apparent that 68% of gravity irrigation customers gave a communication and consultation rating of 7 out of 10 or more.⁵
- 58% of customers are either 'quite satisfied' or better with the way in which GMW is providing opportunities for customers to express their views and concerns.
- Overall, 60% of customers believe that GMW is good at listening to customers. Among gravity irrigation customers, the result is even higher – 62%.⁶

In the context of the comments made in submissions, these survey results suggest that while there are some customers who are not satisfied with GMW's communication and consultation processes, and we agree that this is an area that requires further improvement, overall the majority of customers are satisfied with this aspect of GMW's service.

Newgate Research

In late 2015 GMW engaged Newgate Research to undertake an in-depth and independent qualitative research study into customer perceptions of GMW and its proposed transition to a uniform delivery charge structure. The research involved 62 in-depth interviews conducted in December 2015 and January 2016 with a random sample of customers of varying sizes and from across GMW's six gravity irrigation districts. Each interview lasted an hour on average.

A full copy of the independent Newgate report is provided as an attachment to this letter. Key general findings from the research are as follows:⁷

- Most customers felt their delivery service needs were being met (74%) or exceeded (6%). However for 19% service was below expectations
- Opinions were divided about the value for money of the delivery service, with an average rating of 5.2 out of 10
- Awareness of the Price review process was quite high at 73% overall.

⁴ Bartley Consulting, *Customer Survey 2015 – Prepared for Goulburn-Murray Water*, December 2015, p. 42.

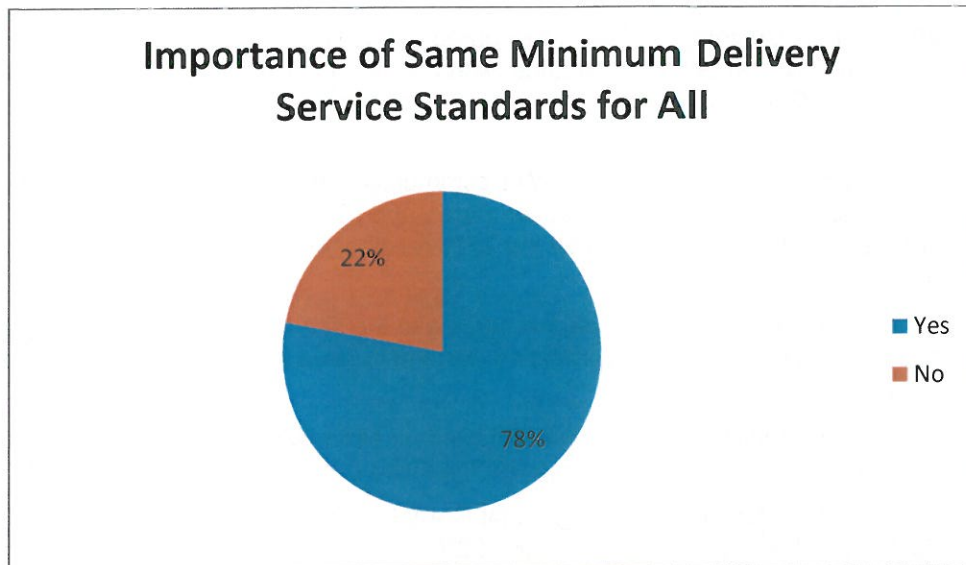
⁵ Bartley Consulting, *ibid.*, p. 42.

⁶ Bartley Consulting, *ibid.*, p. 44.

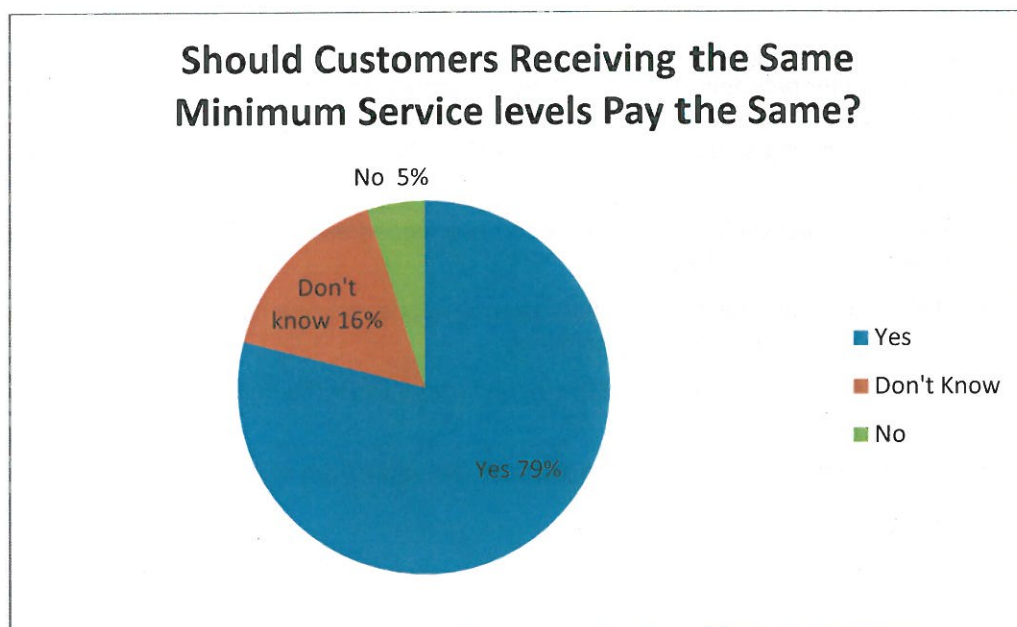
⁷ Newgate Research, *Goulburn-Murray Water 2016 Water Plan Customer Research, Draft Report*, January 2016, p. 5.

In respect of uniform delivery charges, customers were asked a series of in-principle questions, followed by questions based on specifics of the proposed changes. In relation to the in-principle questions, Newgate found as follows:⁸

- Most participants thought it was quite important for customers across all irrigation areas to receive the same minimum service levels, with an average importance rating of 7.8 out of 10. Refer figure below.

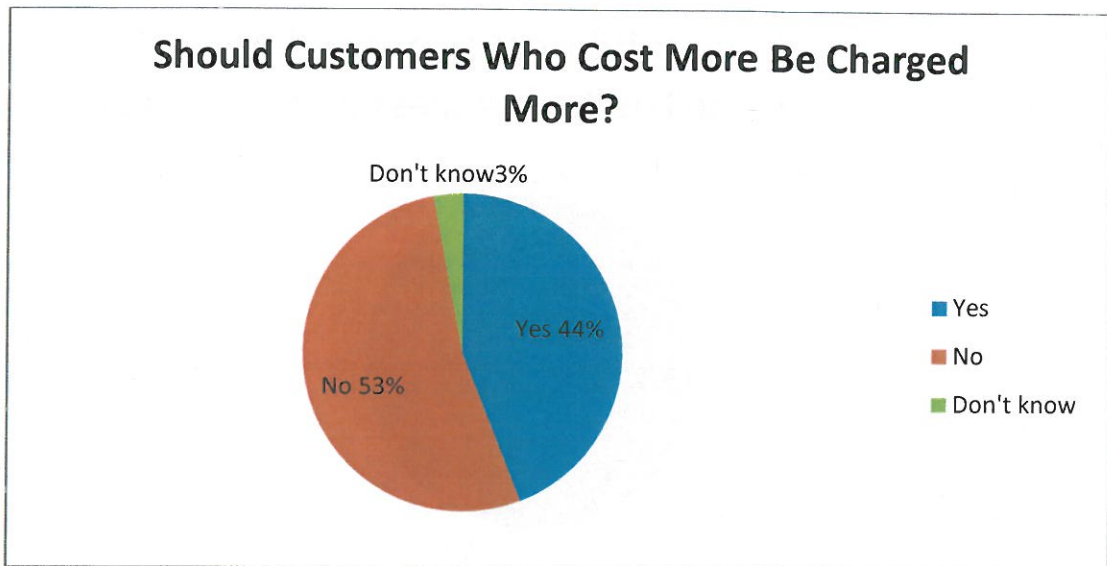


- Most (79% overall) also thought that customers who receive the same minimum delivery service levels should be charged the same prices. This sentiment ranged from 64% in Central Goulburn to 100% in Shepparton. See figure below.



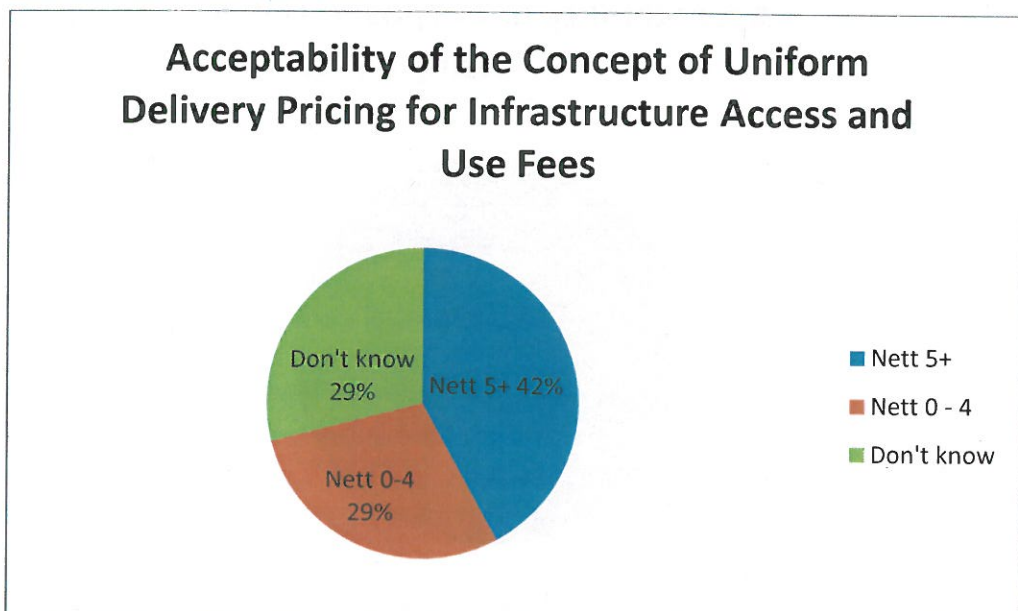
⁸ Newgate Research, *ibid.*, p. 5.

- A small majority (53%) felt that even though it costs more to deliver services to some customers, those customers shouldn't necessarily be charged more – and that prices should probably be 'evened out' or 'averaged' across all customers.



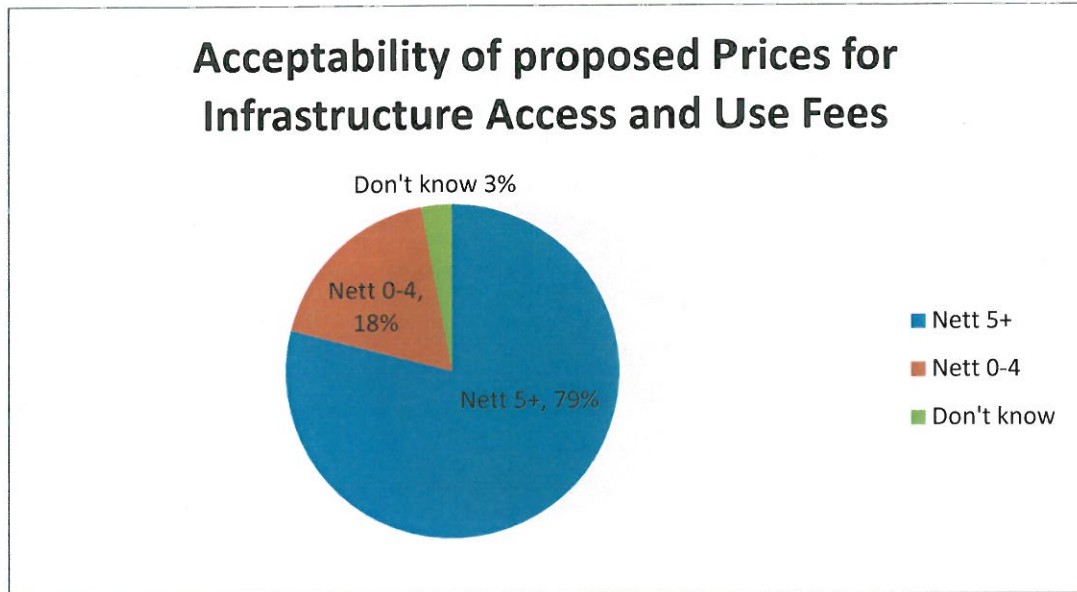
In respect of the proposed uniform delivery charge changes Newgate found that:⁹

- The concept and rationale for the transition to uniform pricing for the Infrastructure Access Fee (IAF) and Infrastructure Use Fee (IUF) was outlined to all participants and the acceptability of this was measured using the same rating scale. In principle acceptability was reasonably high, with 55% of the research participants rating this 7 or higher, and an average of 6.1. Indeed, three quarters (74%) rated this 5 or more, while 11% felt this was not at all acceptable. See figure below.

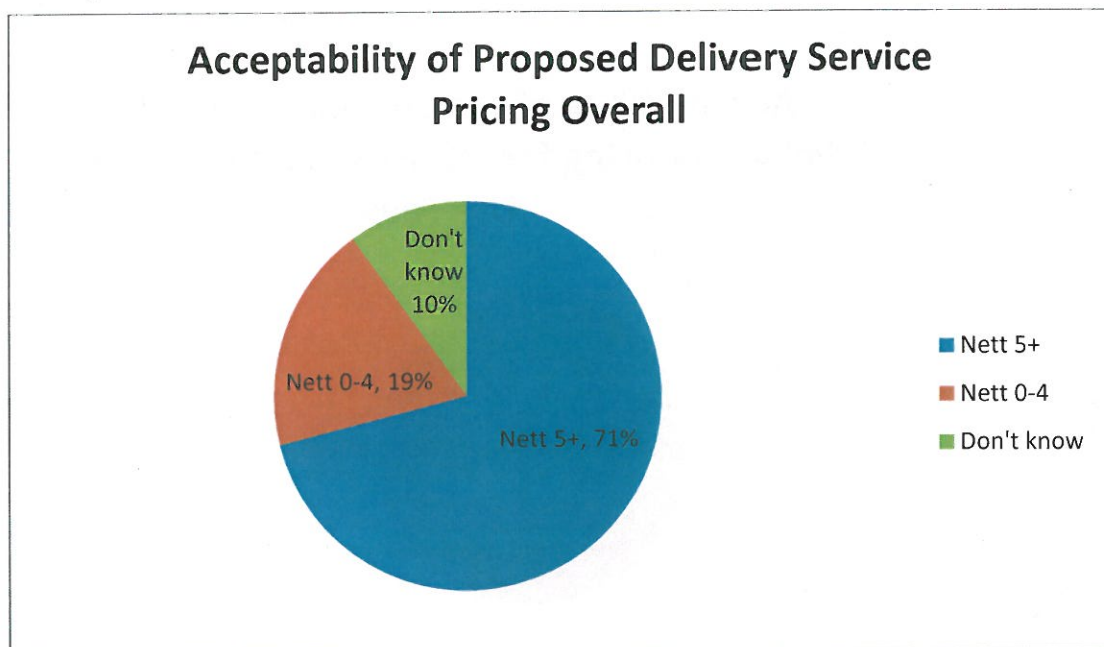


⁹ Newgate Research, *ibid*, p. 6

- Once the specific rates proposed for the IAF and IUF were explained to customers, acceptability increased further. The average rating rose to 6.6 out of 10, with two in three participants (65%) giving a relatively high rating of 7 or more. Four in five (net 79%) gave a 5 or higher, while 11% maintained that this was not at all acceptable.



- In the final part of the interview, participants were given an estimate of the effect of the proposed changes on their overall delivery service charges for the final year of the regulatory period in 2019/20 – when the new prices would be fully implemented. This included the impact of service point fee increases, and there was some drop-off in support for the proposed changes. At this point, the majority (55%) still gave a relatively high acceptability rating of 7 or more, with the average at 6.4 out of 10. Refer figure below.



- Those who were previously aware that the price review process was underway were asked to rate how acceptable they thought the proposed changes were, on a scale where 0 meant not at all and 10 meant totally acceptable. On average, ratings were reasonably low, at 4.0, and with 42% of the sample offering a rating of 5 or more. The key reason for the relatively low ratings were concerns by customers that prices would be increasing, and to a lower level that some cross subsidisation would occur.

GMW accepts that the proposed pricing changes are not universally accepted by its customers. As with any proposal of this nature, there will be resistance to change, and some customers have a financial incentive to

oppose moves to uniform delivery charges. However, the Newgate research shows that there is broad in-principle support for uniform pricing across customers that receive the same service levels, and GMW notes that once the changes were explained 79% of customers rated its acceptability as 5 or better. In the circumstances GMW considers these results sufficiently strong to proceed with the proposal.

Connections Project

Some submissions have suggested that our 2016 Price Submission should be revised to reflect the outcomes of the Mid-Term Review (MTR) of the Connections Project, which was released in November 2015. The MTR has verified some of the challenges being faced by GMW in delivering the Connections Project, and suggested some modifications to its delivery. While delivery changes are expected, at this stage consultation on reshaping the project is ongoing. GMW's Price Submissions are inherently forward looking, requiring many assumptions that reflect the best information available at the time.

Our 2016 Price Submission still reflects the best information we have about the eventual outcomes of the Connections Project, which is modernising and standardising service levels across the GMID. We believe that our customers need consistent levels of service across the GMID and the Connections Project must be reset to support this. Our fees should reflect this, and combined with greater centralised costs, it is appropriate for GMW to start making tariffs more consistent.

The Connections Project is a long term, complex program of works, with a considerable degree of uncertainty, and we acknowledge the frustration that some customers have expressed in waiting for modernisation in their area and that GMW must improve the delivery of the Project. Through the upcoming stakeholder consultations and reshaping of the program we will endeavour to reduce this uncertainty and improve our customers' experience of the program.

Other issues

Submissions touched on a range of other issues to which we would like to briefly respond:

- GMW's efficiency savings: Our 2016 Price Submission highlights that we have delivered substantial operational savings in the current regulatory period. The savings, which are in part passed through to customers via the annual price review process or reductions in forecast debt, are shown in the following extract (table 12) from our 2016 Price Submission.

	2013/14	2014/15	2015/16	Total
Approved	104.4	107.8	105.9	318.1
Actuals / forecast	97.6	93.8	102.5	293.9
Variance	- 6.8	-14.0	-3.4	-24.2

- The majority of cost reductions were realised through the ongoing Business Transformation Program. However, some of the reductions were due to the nature of budget structures associated with district based pricing and decision approval methods within GMW have resulted in less flexibility than is ideal to meet GMW's operating needs. The expenditure pattern for 2015/16 assessed year-to-date at the time INDEC received financial performance data reflected these limitations. However, following ongoing reviews and subsequent streamlining of these internal processes, for the remaining half of 2015/16 and beyond GMW has in place more flexible expenditure arrangements which will more easily allow expenditure to be redirected to meet changing customer needs and circumstances. For example, GMW has moved to schedule-of-rates contracts with suppliers to perform channel capacity work (weed and silt removal) which can be easily extended or reduced to reflect the actual winter works period when the channel system is emptied for maintenance. This has the potential to greatly improve water distribution flow rates as no lead-time is now required for additional market assessment and procurement.
- Recovery of costs for non-prescribed services: our recreational land and water is currently a "breakeven" business. Revenue for the 2014/15 year has been approximately \$4.6M and expenses as \$4.3M – allowing for year on year fluctuations, this is approximately breakeven.
- Fairness of termination fees: Termination fees allow GMW to recover the fixed costs of continuing to maintain infrastructure which are incurred regardless of whether a terminating customer is connected or not. The ACCC has recently recognised the importance of termination fees for maintaining sufficient

revenue to allow operators to continue to serve remaining customers.¹⁰ GMW's termination fees for irrigators are regulated, and required to reflect a multiple of the annual fixed charges, which are themselves determined by the ESC.

- Appropriateness of demand forecasts: The demand forecasts underpinning the 2016 Price Submission reflect the expected reduction in delivery shares due to drier conditions and decreasing availability of carried over allocation. While there is always substantial uncertainty in forecasting rural water use, GMW's forecasts reflect a robust analysis and consideration of likely scenarios. We acknowledge that the risk of drier conditions has increased since GMW submitted its 2016 Pricing Submission.
- Fairness of tariffs for environmental water users: The ACCC has proposed to extend the application of non-discrimination rules to all operators, including GMW.¹¹ GMW considers this change will encourage a more economically efficient allocation of water resources and infrastructure, by ensuring tariffs are designed to encourage efficient water use. GMW will continue to consult with environmental water users on an appropriate tariff design, but notes that price discrimination on the basis of the water use will not be consistent with the regulations.
- Returning spillable water revenues to customers: Spillable water revenues are inherently unpredictable and for this reason, are not incorporated into the building block revenues determined by the ESC. GMW aimed to under-recover its forecast costs each year of the current regulatory period through generating efficiencies and managing unforeseen costs and revenues within the determined revenue cap, including those from spillable water. Spillable water revenue was thus used to keep prices down for GMW customers. It is also important to note in this context that due to historic pricing decisions and investment in dam safety upgrades, the costs of operating and maintaining most of the smaller basins currently exceed the associated revenue collected. Price increases in basins for the 2016 Price Submission period are aiming to allow these services to recover costs.
- Capital underspending: The regulatory framework provides an incentive for GMW to incur only efficient capital. GMW notes that the forecast \$11.3M capex underspend in the current regulatory period is modest compared to other water utilities, and also relative to the size of the Connections Project which GMW is also delivering. GMW is confident it can deliver the forecast capex program outlined in the 2016 Price Submission, as reviews of structures and practices have identified key factors slowing the progress of the capex program.

For the remainder of 2015/16 and in subsequent years GMW will be accelerating the capital program, and also prudently adding to the 'linear program' conducted during the winter works period. This program involves remediating channel banks and linings, as well as bringing up to standard the channel access tracks. These substantial assets are in continual need of improvement due to deterioration from use. As is the case with channel capacity maintenance noted above, channel lining can be conducted by schedule-of-rates contracts already in place.

GMW has confidence that changes in its capex approach, including drawing on a combination of internal and external resources to meet peaks in construction activity, will enable the forecast capex program to be achieved.

As part of ensuring its capex planning approach is reasonable, GMW engaged UXC Consulting to review its capex approach, costing and use of new technology. UXC Limited is Australia's largest locally owned IT services company with more than 2,900 staff. A copy of UXC's January 2016 report is attached to this letter.

In summary, the UXC report found that:¹²

the GMW ICT team have followed best practice approaches to inform the forward look for the next Water Plan. The ICT team have a good understanding of the business they support and have considered the costs for various programs in the capital plan. That consideration is primarily based on maintaining a resilient ICT environment to support GMW's customers and business. Finally, the ICT team are aware of the factors impacting technology advancements and have made sufficient provision in the plans to test their hypotheses for cost effective transition into a future-proof ICT environment.

¹⁰ ACCC, *Draft Advice on the Water Charge Rules*, November 2015, p. 176.

¹¹ ACCC, *Draft Advice on the Water Charge Rules*, November 2015, p. 71.

¹² UXC Consulting, *Goulburn Murray Water Capital Plan Validation Report*, 21 January 2016, p. 5.

- GMW's financial ratios: GMW's current cash position is relatively strong. However, we note that this position is forecast to change substantially over the 2016 Price Review period. In the short term, GMW could afford to borrow more, however this would not change our overall revenue requirement which determines prices. In our view, a more prudent approach is to maintain current borrowing practices. GMW's financial indicators for the next regulatory period are within GMW's sustainable limits. These are summarised in Table 42 of our Price Review 2016 submission, for the whole of business (not just prescribed services), excluding the Connections Project. GMW is a not for profit organisation and all free cash flow is invested into capital expenditure. Given the uncertainty around water resource, in particular, GMW considers that its financial ratios are prudent and any reduction in these ratios would significantly increase risk of financial sustainability.
- Rebalancing / annual adjustment constraint: GMW is restricted from changing individual prices by more than 10% year on year as part of its price control. This constraint prevents significant price shocks during a regulatory period, while still allowing GMW the flexibility to transition to new tariff structures and move to more efficient, cost reflective pricing during the period. Should the constraint be tightened, transitioning to new tariff structures could take a substantially longer time, which would reduce the potential efficiency gains we will realise from the changes.

Should you wish to discuss any of the issues raised in our submission, please do not hesitate to contact Carmine Piantedosi on (03) 5826 3585.

Yours sincerely



John Calleja
MANAGING DIRECTOR

