



# PRICE REVIEW 2013: RURAL WATER BUSINESSES

Final Decision

June 2013

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# PREFACE

This final decision completes the Essential Services Commission's review of Victorian rural water businesses. Charges and service standards for irrigation services have been approved for the next three years for Goulburn-Murray Water, and for the next five years for Lower Murray Water (Rural) and Southern Rural Water.

For the first time, the Commission has assessed the Water Plans of Goulburn-Murray Water and Lower Murray Water (Rural) in accordance with the Water Charges (Infrastructure) Rules. This follows the Commission's accreditation by the Australian Competition and Consumer Commission to regulate the prices of irrigation and bulk water delivery services of these rural water businesses.

The Commission's main focus has been to ensure that prices are fair and reasonable, that is, as low as possible but still sufficient to recover the businesses' efficient costs of providing services.

Consistent with the Commission's charter of consultation, this review has been undertaken in an open and consultative manner. This has included the release of a draft decision in March 2013, numerous public meetings in April and May 2013, and consideration of public submissions.

The Commission's final decision resulted in price increases close to inflation over the next regulatory period. This is slightly lower than those proposed by the rural businesses.

Transparency about service delivery and value for money remain integral to the regulatory regime for the Victorian water sector. To this end, the Commission will continue to monitor and audit the performance of the rural water businesses in delivering services to their customers.

Dr. Ron Ben-David

Chairperson



# GLOSSARY

<b>2nd regulatory period</b>	The period commencing 1 July 2008 and expiring 30 June 2013.
<b>3rd regulatory period</b>	The period commencing 1 July 2013 and expiring on 30 June 2018 for Lower Murray Water (Rural) and Southern Rural Water, and on 30 June 2016 for Goulburn-Murray Water.
<b>4th regulatory period</b>	<p>For the metropolitan, regional urban and most rural water businesses, it is the period commencing 1 July 2018 and expiring on a date specified by the Commission.</p> <p>For Goulburn-Murray Water's, the 4th regulatory period commences 1 July 2016 and lasts for four years.</p>
<b>Annuity</b>	A terminating 'stream' of fixed payments.
<b>Bulk water</b>	Water supplies between water businesses.
<b>Capital expenditure</b>	Capital expenditure is incurred when a business spends money either to buy fixed assets or to add to the value of an existing fixed asset with a useful life extending beyond the taxable year.
<b>Channel</b>	The bed of a stream or river.
<b>Consumer price index (CPI)</b>	The consumer price index published by the Australian Bureau of Statistics.

<b>Customer Service Code</b>	A code issues under section under section 4F of the <i>Water Industry Act</i> which set out the terms and conditions of service and supply.
<b>Environmental contribution</b>	The Minister of Water determines an Environmental Contribution which is levied on all Victorian water businesses, to meet costs associated with managing environmental water.
<b>Megalitre</b>	1000 kilolitres = 1 million litres
<b>Murray-Darling Basin</b>	A large geographical area in the interior of southeastern Australia, whose name is derived from its two major rivers, the Murray River and the Darling River.
<b>Operating expenditure</b>	Ongoing cost for running a product, business, or system.
<b>Price determination</b>	A determination in respect of a water business made by the Commission under section 33 of <i>the Essential Services Commission Act 2001</i> and clause 8 of the <i>Water Industry Regulatory Order 2003</i> .
<b>Regulatory depreciation</b>	An amount set to allow the regulated water businesses to recover the cost of capital investments over time. Also known as Return of Assets.
<b>Revenue requirement</b>	The revenue needed by each water business to cover operating costs and taxes, and provide a return on assets and a return on assets (depreciation).
<b>Statement of Obligations</b>	There is a Statement of Obligations (SoO) for each water business, specifying a number of requirements that the individual businesses must follow. They were made by the Minister for Water under section 4I of the <i>Water Industry Act 1994</i> , commencing from 16 September 2012.

<b>Tariff structure</b>	The way prices are organised, which can provide different incentives and signals to customers. For example, two part tariff (fixed service charge and IBT variable charge).
<b>Variable charge</b>	Charge for product/service based on the quantity used. Also known as a volumetric charge.
<b>Water Charge (Infrastructure) Rules (WCIR)</b>	The Rules which apply to the regulation of entities in the Murray-Darling Basin.
<b>Water entitlement</b>	A right to use water determined by the Minister for Water under the <i>Water Act 1989 (Vic.)</i> . A water entitlement is the maximum amount of water authorised to be taken and used by a person or organisation under specified conditions.
<b>Water Plan</b>	A Water Plan is a document prepared and published by a water business, which sets out the services, key projects and prices it proposes to deliver over the next regulatory period. The primary purpose of the Water Plan is to inform and seek feedback from the public.
<b>Water shares</b>	A legally recognised, secure share of the water available to be taken from a defined water system; a water share is specified as a maximum volume of seasonal allocation that may be made against that share.
<b>Weighted average cost of capital (WACC)</b>	The rate that a company is anticipated to pay on average to all its security holders to finance its assets.





# ACRONYMS

<b>ACCC</b>	Australian Competition & Consumer Commission
<b>CPI</b>	Consumer price index
<b>EPA Victoria</b>	Environmental Protection Agency (Victoria)
<b>ESC</b>	Essential Services Commission
<b>FAL</b>	Financial accommodation levy
<b>GSL</b>	Guaranteed service levels
<b>HRWS</b>	High reliability water shares
<b>RAB</b>	Regulatory asset base
<b>SoOs</b>	Statements of Obligations
<b>WACC</b>	Weighted average cost of capital
<b>WCIR</b>	Water Charge (Infrastructure) Rules
<b>WIRO</b>	Water Industry Regulatory Order



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# SUMMARY

## BACKGROUND — THE PRICE REVIEW PROCESS

In October 2012 the Essential Services Commission commenced its review of the rural water businesses' proposals for the regulatory period commencing on 1 July 2013. Under the price review process, the rural water businesses submitted Water Plans setting out the expected costs of delivering rural services, their planned capital works programs, the forecast volumes of water to be delivered and the levels of service promised to customers.

The Commission released its draft decision in March 2013 in response to the Water Plans. The decision reflected detailed analysis by the Commission and expert consultants engaged by the Commission to assess and to advise on the demand and expenditure proposals put forward by the businesses. This decision also considered submissions from customers, water businesses and interested parties on businesses' Water Plans.

The Commission consulted publicly during this price review including:

- consulting on and releasing a guidance paper in October 2011.
- holding public forums on water plans during November and December 2012 around the state. At these forums water businesses presented their proposals and customers and community groups then responded and questioned the businesses and the Commission. The Commission repeated this process in March and April 2013 when it held public forums around Victoria on its draft decision and attended a public meeting in Mildura.
- meeting with its Customer Reference Panel, which includes consumer and business groups and individual customers to hear members' views on issues of importance for this price review.
- inviting submissions at each stage of the price review.

## CONTEXT AND KEY ISSUES

Southern Rural Water's Water Plan was assessed against the requirements of the Water Industry Regulatory Order (WIRO), consistent with previous price decisions. Lower Murray Water (Rural)'s and Goulburn-Murray Water's infrastructure assets are now covered by the Water Charge (Infrastructure) Rules (WCIR) and the associated pricing principles developed by the Australian Competition and Consumer Commission (ACCC). The ACCC has accredited the Commission to make decisions on Lower Murray Water's (Rural)'s and Goulburn-Murray Water's infrastructure assets using the WCIR framework and the pricing principles.

This regulatory period will involve more uncertainty about the pricing consequences of rural modernisation programs for the rural water businesses. Ongoing consultation about the Murray-Darling Basin Plan will also cause uncertainty for Lower Murray Water (Rural) and Goulburn-Murray Water.

## THE COMMISSION'S APPROACH

The Commission is required to assess the tariffs and revenues proposed in the businesses' Water Plans against the principles set out in the WIRO and the WCIR.

The WIRO principles require prices to be set to:

- generate the business's revenue requirement and allow it to meet the costs of delivering services to customers
- ensure the business's financial viability, including a reasonable return on capital
- reflect costs and provide incentives for sustainable water use
- take into account the interests of customers.

The ACCC requires the Commission to regulate according to the pricing principles made under the WCIR which require tariffs to be set:

- to promote the economically efficient use of water infrastructure assets
- to ensure sufficient revenue for the efficient delivery of the required services
- to give effect to the principles of user pays in for water storage and delivery in irrigation systems
- to achieve pricing transparency
- to facilitate efficient water use and trade in water entitlements.

In applying these principles, the Commission focused on ensuring prices were as low as possible but sufficient to recover businesses' efficient costs of providing services.

## **KEY OUTCOMES AND SERVICE LEVELS**

In their Water Plans, the businesses set out the levels of service that they proposed to achieve over the third regulatory period. Lower Murray Water (Rural) proposed to retain its existing service standards and to set them at a level consistent with historical performance. Southern Rural Water proposed to revise its standards to better describe service and cost outcomes expected by its customers. Goulburn-Murray Water proposed a new set of standards.

In the draft decision, the Commission proposed to approve the businesses' proposed service standards. In this final decision, the Commission has confirmed its draft decision to approve all rural businesses' service standards.

## **REVENUE REQUIREMENTS**

The Commission used independent expert consultants to review the operating and capital expenditure programs of rural water businesses. Generally, the consultants found the rural businesses were operating in an efficient manner and the proposed expenditure forecasts were reasonable. In its draft decision, the Commission adjusted the rural water businesses' revenues, and required Lower Murray Water (Rural) and Southern Rural Water to adjust their proposed prices to reflect the draft decision revenues.

In this final decision, the Commission has made minor adjustments to some businesses' revenues including an adjustment to the weighted average cost of capital (WACC) which estimates the businesses' costs of financing investments.

Table 1 compares the businesses' proposed revenue requirement, and the Commission's final decision on revenues. Appendix C provides a reconciliation between this final decision and our earlier draft decision.

**TABLE 1 REVENUE REQUIREMENTS — FINAL DECISION**

\$m 2012-13

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
<b>Goulburn-Murray Water</b>						
Proposed revenue in the Water Plan	119.2	125.1	126.8	na	na	371.1
Final decision	116.0	122.7	123.5	na	na	362.2
Revenue from proposed prices <sup>a</sup>	118.8	118.5	118.8	na	na	356.2
<b>Lower Murray Water (Rural)</b>						
Proposed revenue in the Water Plan	26.4	27.4	27.8	27.9	27.9	137.4
Final decision	26.8	27.5	27.8	27.9	27.9	137.8 <sup>b</sup>
<b>Southern Rural Water</b>						
Proposed revenue in the Water Plan	28.2	28.5	28.9	28.9	28.7	143.2
Final decision	27.7	27.5	27.8	28.1	28.0	139.1

**Note:** Goulburn-Murray Water has a three year price period for the third regulatory period. Rounding means the numbers in this table may differ slightly from actual final determination numbers.

<sup>a</sup> Goulburn-Murray Water's proposed prices recovered less than its proposed revenue and the revenue approved by the Commission in this decision. **na** Not applicable. <sup>b</sup> The allowed revenue in the final decision is higher because of revised volume estimates which have increased allowed pumping costs.

## FORM OF PRICE CONTROL

In this final decision, the Commission has confirmed its draft decision to approve the key elements of rural water businesses' proposals for price controls. That is, it has approved Goulburn-Murray Water's and Lower Murray Water (Rural)'s proposals to maintain revenue caps, and Southern Rural Water's proposal to continue to apply a hybrid revenue cap.

The Commission has approved annual rebalancing constraints of 10 per cent on individual tariffs for rural businesses so customers do not face unreasonably high year-on-year price increases. Price volatility was a concern of customers in some districts during the second regulatory period.

The Commission's final decision also requires all rural businesses seeking to make material price adjustments within the next regulatory period to consult with



customer committees and customers before they apply to the Commission as part of their annual price approval process.

## **FINANCING OF CAPITAL INVESTMENTS**

The Commission will apply a real WACC for the three rural businesses of 4.5 per cent. This is notably lower than the WACC applying in the second regulatory period of 5.8 per cent. The lower WACC is the main reason for the Commission reducing water businesses' revenue requirements.

## **RURAL TARIFF STRUCTURES**

The Commission has confirmed its draft decision to approve the tariff structures proposed by the rural water businesses. Both Goulburn-Murray Water and Southern Rural Water proposed to maintain their existing tariff structures, although Goulburn-Murray Water committed to consulting with customers during the period to develop a simplified tariff structure.

The Commission has approved Lower Murray Water (Rural)'s proposal to restructure its tariffs for the Mildura irrigation district to align them with tariffs for its other districts. Generally, it proposed to retain its tariff structures for other rural services.

## **GROUNDWATER AND MISCELLANEOUS SERVICES**

Groundwater and miscellaneous service charges make up a small proportion of rural businesses' revenue. The Commission has confirmed its draft decision approval of the groundwater charges for the rural water businesses. It has also approved the miscellaneous service charges proposed by the rural water businesses.

## **ADJUSTMENT OF PRICES DURING THE PERIOD**

In this final decision, the Commission has approved a price adjustment mechanism to account for events that are uncertain or unforeseen at the time of the final decision. In applying this mechanism, the Commission would take into account only factors that do not fall within the businesses' control. The Commission encourages the water businesses to manage such circumstances within their existing budgets, to ensure customers do not face unnecessary price changes and avoid price volatility.

The Commission will consider a reopening during the third regulatory period for Lower Murray Water (Rural), when the impact of the Sunraysia Modernisation Project is known.

# 1 INTRODUCTION

The Essential Services Commission is Victoria's independent economic regulator of essential services. The Commission's role in the water industry includes regulating prices as well as monitoring the service standards of the 19 Victorian Government owned water businesses.

There are four water businesses that are commonly referred to as partly or wholly rural businesses: Goulburn-Murray Water, GWMWater, Lower Murray Water and Southern Rural Water. This paper presents the Commission's final decision on prices for Goulburn-Murray Water, Lower Murray Water's rural business and Southern Rural Water. It does not include the final decision for:

- GWMWater, which provides rural services, and retail urban water and sewerage services from a single integrated business. GWMWater is included in the regional urban final decision.
- Lower Murray Water's urban business, which is a separate business from Lower Murray Water (Rural). Lower Murray Water (Urban) is included in the regional urban final decision.

The three businesses covered by this paper are regulated under two different regulatory frameworks:

- The Commission assessed the proposals from Lower Murray Water (Rural) and Goulburn-Murray Water for irrigation and bulk water services against the Australian Competition and Consumer Commission's (ACCC) pricing principles (explained below).
- The Water Industry Regulatory Order (WIRO) applies to Southern Rural Water and all other regulated services provided by Lower Murray Water (Rural) and Goulburn-Murray Water, such as groundwater and non-infrastructure related miscellaneous services. The WIRO was updated in 2012 by the Governor in Council under the *Water Industry Act 1994*.<sup>1</sup>

The WIRO requires the Commission to approve or specify the pricing arrangements to apply to each water business for the regulatory period. The Commission must approve the pricing arrangements if it is satisfied the prices or the manner in which prices are to be calculated or otherwise determined have been developed in accordance with the procedural requirements, and comply with the regulatory principles, outlined in the WIRO.

Alternatively, the Commission may specify the prices a business may charge or the manner in which those prices are to be calculated or otherwise determined if it is not satisfied the arrangements proposed in the Water Plan were developed in accordance with the WIRO. The procedural requirements include the need for businesses to consult with customers and relevant regulatory agencies before submitting the Water Plan to the Commission for assessment.

In February 2011, the ACCC accredited the Commission to regulate the prices of irrigation and bulk water delivery services provided by Goulburn-Murray Water and Lower Murray Water (Rural) in place of the ACCC under the Water Charge (Infrastructure) Rules (WCIR). The WCIR apply to water businesses in the Murray-Darling Basin. Specifically, the Commission must use the ACCC's pricing principles – which were attached to the ACCC's final decision on the Commission's application for accreditation<sup>2</sup> – to assess rural water businesses covered by the WCIR.

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<sup>1</sup> The WIRO is available on the Commission's website.

<sup>2</sup> Australian Competition and Consumer Commission 2012, *Application by Essential Services Commission of Victoria for accreditation, final decision*, 17 February, appendix B.

Regulation under the WCIR through the ACCC pricing principles will be similar to regulation under the WIRO. The price review process, including assessments by the Commission and consultants, as well as consultation with customers, is almost identical under both systems. The main differences between regulation under the WCIR and the WIRO are as follows:

- The WCIR sets the length of the regulatory period for rural businesses: three years for the first regulatory period and four years after that. Exceptions may be made for businesses with an urban and a rural business, to align urban and rural regulatory periods. By contrast, the WIRO allows the Commission to set the length of the regulatory period.
- The ACCC's pricing principles specify several weighted average cost of capital (WACC) parameters which are to apply to businesses. The WIRO provides the Commission with more flexibility to determine WACC parameters.

In assessing the businesses' Water Plans, the Commission consulted widely and considered the information contained in the businesses' Water Plans, other information provided by the water businesses, the views and recommendations of independent experts who assessed the businesses' forecasts, issues raised in submissions and comments at public meetings held around the State.

## 1.1 WATER PRICE REVIEW

This final decision follows a period of extensive consultation by the water businesses and the Commission.

In October 2011, the Commission released a guidance paper to help the water businesses prepare their Water Plans.<sup>3</sup> The paper provided the businesses with comprehensive guidance about the Commission's expectations for the content of Water Plans. It also detailed the Commission's expectations for businesses' consultation with customers and other stakeholders to inform their Water Plans.

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<sup>3</sup> Essential Services Commission 2011, *2013 Water Price Review — guidance on Water Plans*, October.

The Commission's guidance paper noted its expectation that customer prices will reflect:

- prudent and efficient expenditure only
- ongoing productivity improvement and
- initiatives that garner customer support and reflect willingness to pay, or reflect clearly defined Government obligations.

The rural water businesses submitted final Water Plans to the Commission in October 2012. In November 2012, the Commission released a paper that provided an overview of the businesses' proposals and key issues for consultation, and invited submissions from interested parties.<sup>4</sup> In November and December 2012, the Commission held 17 public forums across the State to provide an additional opportunity for interested parties to comment on the rural businesses' proposals. The Commission also received written submissions, which can be found on the Commission's website.

The Commission released its draft decision on prices on 26 March 2013.<sup>5</sup> The draft decision sets out the Commission's initial views on the prices that will apply from 1 July 2013, based on the information available to the Commission at the time. The Commission sought feedback from interested parties on the draft decision through written submissions and public forums. The Commission held 14 public forums in April and May 2013, and also attended a public meeting organised by customers of Lower Murray Water in May 2013.

The views put forward in submissions and at public meetings, information provided by the water businesses, the views of expert consultants, and the Commission's own analysis informed the final decision on prices to apply from 1 July 2013.

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<sup>4</sup> Essential Services Commission 2012, *Summary of rural businesses' Water Plans*, November.

<sup>5</sup> Essential Services Commission 2013, *Price Review 2013: rural water businesses, draft decision, volume I*, March.

## 1.2 COMMISSION'S APPROACH TO ASSESSING PROPOSED PRICES

The Commission adopts a 'building block' approach to assess prices. The approach has four steps (figure 1.1).

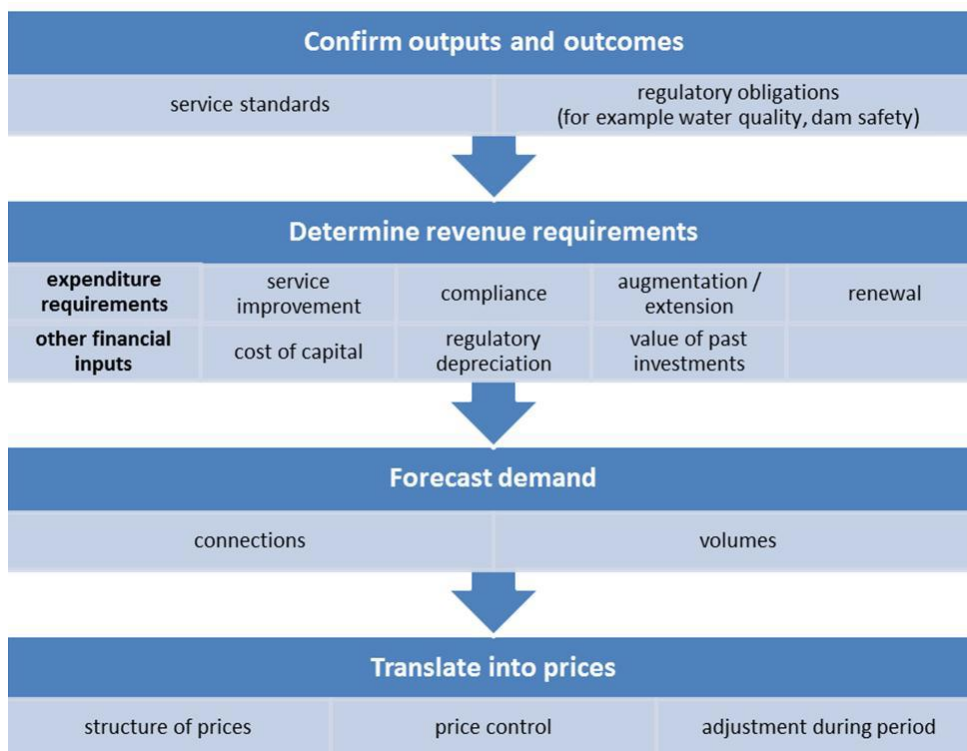
The first step is to establish the service standards and outcomes a business proposes to deliver over the regulatory period. These standards and outcomes reflect obligations imposed by the Minister for Water through the Statement of Obligations<sup>6</sup>, EPA Victoria, the Department of Health, the Department of Sustainability and Environment and customer preferences.

In the second step, the Commission determines the revenue the business requires to meet the service obligations and expected outcomes. The Commission must assess whether the business's expenditure forecasts are efficient, whether its capital works program is deliverable within the timeframes proposed, and whether its business strategy reflects a long term planning horizon. The Commission must also ensure the business receives an efficient return on its capital investments.

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<sup>6</sup> There is a Statement of Obligations (SoO) that applies to rural water business, specifying a number of requirements the business must follow. The obligations are based on a combination of water legislation requirements and government policy. They were made by the Minister for Water under section 4I of the *Water Industry Act 1994*, commencing from 16 September 2012.

**FIGURE 1.1 STEPS IN ASSESSING AND APPROVING PRICES**



The Commission makes assumptions about efficient expenditure to assess whether prices will result in the business earning sufficient revenue to deliver services. However, the assumed expenditure levels do not represent amounts a business is required to spend or direct to particular activities or projects. In consultation with customers, businesses are free to determine their expenditure priorities to reflect changing circumstances during the regulatory period and to pursue innovation and efficiencies that enable them to outperform the cost assumptions. The Commission’s methodology does not bind water businesses’ spending to particular projects or activities.

Sometimes, given changing circumstances, a business may not proceed with a project or activity that it proposed in its Water Plan and that the Commission included when calculating allowed expenditure. It might do so when it identifies, in consultation with its customers, a higher priority project or activity that should be undertaken instead. Similarly, if costs increase by more than forecast at the time of the price review, the business might defer or cancel a lower priority project or



activity to ensure projects and activities more highly valued by customers can go ahead without the business then needing to recoup a revenue shortfall from customers.

The third step in the process is to assess a business's forecast level of demand for water and sewerage services, and the assumed level of growth in customer connections.

The final step is approving the maximum prices that will apply during the regulatory period. For each business, the Commission must ensure prices will generate the business's revenue requirement, accounting for demand forecasts. It assesses whether the business's demand forecasts are reasonable and reflect the best available information. It also considers whether prices and proposed tariff structures provide appropriate signals about the costs of providing services, and provide incentives for sustainable water use.

### **1.3 STRUCTURE OF THIS FINAL DECISION**

This final decision sets out the Commission's final analysis, reasons and conclusions about the maximum prices for rural water and related services that will apply for the regulatory period commencing on 1 July 2013. This final decision should be read in conjunction with the Commission's draft decision released in March 2013.<sup>7</sup>

While the final decision provides an overview of the key issues associated with this price review, it highlights the amendments suggested in the draft decision and identifies the water businesses' responses to those suggestions. It also discusses responses to the draft decision by other stakeholders, further issues and arguments put forward by the businesses and other stakeholders and new information that has become available since the draft decision was released.

Chapter 2 of this paper sets out the Commission's assessment of the key outcomes and service levels to be delivered by the businesses during the regulatory period.

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<sup>7</sup> Essential Services Commission 2013, *Price Review 2013: rural water businesses, draft decision, volume I*, March.

Chapter 3 sets out the Commission’s decision on the total revenue required by each business, based on its operating expenditure (chapter 4), capital expenditure (chapter 5) and the costs of financing its capital expenditure program (chapter 6). Chapter 7 sets out the demand forecasts applied by the Commission to calculate approved prices for the period.

Chapter 8 outlines the form of price control applied to each business’s prices. Chapters 9–11 discuss the approved tariff structures for rural tariffs (chapter 9), groundwater tariffs (chapter 10) and miscellaneous service charges (chapter 11). Chapter 12 outlines how prices will be adjusted during the regulatory period, including mechanisms for dealing with uncertainty.

The Commission has issued each rural business with a determination that specifies the prices it may charge during the regulatory period and the manner in which those prices are to be calculated or otherwise determined in subsequent years. It includes a schedule of tariffs that may be levied from 1 July 2013 and the manner for adjusting those tariffs during the regulatory period. The determinations are available on the Commission’s website ([www.esc.vic.gov.au](http://www.esc.vic.gov.au)).

# 2 SERVICE STANDARDS

## 2.1 INTRODUCTION

Under the Water Industry Regulatory Order (WIRO), the Commission regulates standards and conditions of supply for retail water, sewerage and other declared services. It can:

- approve standards set out in a water business's Water Plan, or
- specify those standards in a code, or
- do both.

The *Rural Customer Service Code* specifies the standards and conditions rural water businesses must comply with when supplying services and granting licences to customers.<sup>8</sup> Specifically, the code can indicate whether additional expenditure is necessary to maintain or improve existing services, and whether a business can achieve cost gains by lowering service levels for customers. Businesses are required to consider customers' views and preferences about the proposed service standard targets, and their willingness to pay for improved services.

The Commission's guidance paper set out the methodology businesses should follow in developing service standards and targets.<sup>9</sup>

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<sup>8</sup> Essential Services Commission 2012, *Rural Water Customer Service Code, Issue No. 2*, June.

<sup>9</sup> Essential Services Commission 2011, *2013 Water Price Review – guidance on Water Plans*, October.

## 2.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission noted:

- Lower Murray Water (Rural) proposed to retain the standards it developed during the second regulatory period and it set targets at a level consistent with historical performance.
- Southern Rural Water proposed to revise its standards. It argued the new standards would better describe service and cost outcomes its customers expected.
- Goulburn-Murray Water also proposed a new set of standards to reflect changes in its service offerings arising from the recent gravity irrigation modernisation project.

Standards proposed by the rural businesses varied from business to business but broadly related to service delivery (for example, percentage of irrigation water delivered on day requested), efficiency (for example, water delivered as a percentage of volume released) and customer satisfaction (for example, number of complaints per 2000 customers).

The Commission's draft decision noted rural water businesses consulted adequately with customers in developing their service standards. Further, the Commission found the proposed service standards were consistent with the methodology prescribed by the Commission in its guidance paper. For these reasons, the Commission proposed to approve all service standards proposed by the rural water businesses.

## 2.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission received no submissions about its draft decision on service standards.

## 2.4 FINAL DECISION

The Commission has approved the service standards and targets proposed by Goulburn-Murray Water, Lower Murray Water (Rural) and Southern Rural Water.

The rural water businesses are required to amend their customer charters to reflect the Commission's decision.



# 3 OVERVIEW OF REVENUE REQUIREMENT

## 3.1 INTRODUCTION

The Commission must be satisfied prices are set at a level that generates sufficient revenue for a water business to recover the efficient cost of delivering services over the next regulatory period. It must also ensure prices do not allow a business to collect revenue that reflects monopoly rents or inefficient expenditure.<sup>10</sup>

The Commission used the ‘building block’ approach to estimate the revenues that Goulburn-Murray Water, Lower Murray Water (Rural) and Southern Rural Water require to deliver proposed service standards and outcomes over the next regulatory period. Under this approach, the revenue requirement reflects operating expenditure and a return on the regulatory asset base (RAB) updated each year to reflect any additional capital expenditure (net of asset disposals) and regulatory depreciation.

The Commission uses the revenue requirements only to assess whether prices will allow businesses to earn sufficient revenue to deliver services. The revenue requirements do not represent amounts that businesses are required to spend or direct to particular activities or projects. In consultation with customers, businesses are free to determine their own expenditure priorities, given changing circumstances, and to pursue innovation and efficiencies that enable them to outperform the revenue benchmarks.

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<sup>10</sup> The Commission’s requirements for revenue are set out in the Water Industry Regulatory Order for Southern Rural Water, and in the Australian Competition and Consumer Commission’s pricing principles for Goulburn-Murray Water and Lower Murray Water (Rural). The Commission assessed GWMWater’s pricing proposal in the decision on regional water businesses.

## **3.2 OVERVIEW OF DRAFT DECISION**

The Commission reviewed the rural water businesses' revenue proposals and adjusted the estimated revenue requirements to reflect its view of the efficient level of expenditure and the efficient costs of financing assets. The Commission's draft decision was to slightly reduce revenue requirements from those proposed by the businesses in their Water Plans.

In their Water Plans, Goulburn-Murray Water and Southern Rural Water raised the following matters about their revenue requirements.

### **3.2.1 GOULBURN-MURRAY WATER'S FORGONE REVENUE**

Goulburn-Murray Water sought an allowance for forgone revenue of \$7.9 million to reflect the under-recovery of revenue from the second regulatory period, due predominately to floods. In the draft decision, the Commission proposed not to approve Goulburn-Murray Water's proposal because:

- the events listed by Goulburn-Murray Water had downward effects on costs as well as revenues (that is, they had both positive and negative financial impacts)
- events such as floods may be partly insurable (that is, the business could manage this risk)
- the business's proposed prices were set at lower than its proposed revenue cap, which indicates it can fund part of any shortfall within its proposed revenue cap without adjusting for forgone revenue
- its proposed forgone revenue would not comply with the Australian Competition and Consumer Commission's (ACCC's) pricing principle of providing sufficient revenue to allow efficient delivery of the required services.

### **3.2.2 ANNUITIES**

The Commission proposed to approve Goulburn-Murray Water's proposed incorporation of two large negative annuities into the RAB, subject to the business providing updated figures on the size of the annuities. This proposal would not affect customers' prices; it is designed so a single form of regulatory treatment applies to all of Goulburn-Murray Water's accounting for assets and liabilities.



The Commission proposed to approve Southern Rural Water's proposal to phase out its irrigation annuities. Other rural water businesses have already removed annuities.

### **3.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT**

Of the three businesses, only Goulburn-Murray Water responded to the draft decision on its revenue requirement.

#### **3.3.1 GOULBURN-MURRAY WATER FORGONE REVENUE**

Goulburn-Murray Water submitted that its application for forgone revenue should be considered in the context of it having committed to achieving efficiencies of \$6 million (which exceeds the Commission's required efficiency target). However, it argued this reduction should not lower its revenue requirement in case the efficiencies are not achieved.

Goulburn-Murray Water submitted the following in its application for forgone revenue:

- The regulatory regime is underpinned by funding only foreseeable, prudent and efficient expenditure. The failure to reimburse significant unforeseen expenditure threatens services and the viability of water corporations.
- The rules applied encouraged businesses to spend unsustainably during unforeseen events to obtain additional funding through the Commission (when businesses do not meet sustainability measures).
- The Commission determined prudent and efficient expenditure for the second regulatory period that did not provide for significant events such as floods or drought. The 'savings' identified were simply the deferral of prudent and efficient expenditure from one period to another. Some expenditure was capital in nature and could be included in the RAB.
- At the time of the floods and drought the Commission contacted Goulburn-Murray Water to determine whether the business needed assistance.

Goulburn-Murray Water also sought clarity on whether the Water Industry Regulatory Order (WIRO) or the ACCC's pricing principles applied to a consideration of its forgone revenue.

The Commission considers any adjustment to Goulburn-Murray Water's revenue cap for additional expenditure arising from the 2011 floods would have been an adjustment under the Commission's 2008 price determination and should have been assessed under the WIRO framework.

Although the revenue forecast for the second regulatory period did not specifically provide for the flood and drought events, Goulburn-Murray Water experienced positive and negative variations in both its costs and revenues; that is, the net effect did not leave a shortfall in funds to cover its costs. Goulburn Murray Water underspent its capital expenditure in the second regulatory period. The Commission is interested in the net effect of these variations, not the gross impact of individual events. Goulburn-Murray Water completed the regulatory period without a materially adverse change to its net operating financial position. Therefore, allowing Goulburn-Murray Water to recover this revenue in the third regulatory period would increase prices without any commensurate benefit for customers. The Commission confirms the draft decision not to approve Goulburn-Murray Water's application for these events.

### **3.3.2 RURAL ANNUITIES**

The Commission did not receive any submissions on the draft decision to approve Goulburn-Murray Water's proposed incorporation of annuities into the RAB (subject to it providing the updated figures for the size of the annuities). Goulburn-Murray Water provided the updated figures. The Commission has approved Goulburn-Murray Water's proposed incorporation of the annuities into the RAB.

The Commission did not receive any submissions on the draft decision to approve Southern Rural Water's proposal. Therefore, the Commission approves Southern Rural Water's proposal to phase out its irrigation annuities.

### 3.3.3 FINAL DECISION

The Commission's final decision results in small changes to rural businesses' revenue requirements compared with those proposed in their Water Plans. The changes generally reflect downward adjustments to most businesses' forecasts of capital expenditure and operating expenditure, including:

- the impact of changed assumptions about the weighted average cost of capital (WACC) and, therefore, the cost of financing the businesses' proposed capital programs. The Commission updated the WACC to reflect current market conditions
- Lower Murray Water (Rural) has an increased allowance for its expenditure on energy and has also increased its forecast volumes of water use.

The Commission has considered the businesses' feedback on the proposed revenues in the draft decision. Table 3.1 outlines the final decision on revenue allowances compared with the businesses' proposals in their Water Plans. This comparison, including the draft decision, is in appendix C.

**TABLE 3.1 REVENUE REQUIREMENTS — FINAL DECISION**

\$m 2012-13

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
<b>Goulburn-Murray Water</b>						
Proposed revenue in the Water Plan	119.2	125.1	126.8	na	na	371.1
Final decision	116.0	122.7	123.5	na	na	362.2
Revenue from proposed prices <sup>a</sup>	118.8	118.5	118.8	na	na	356.2
<b>Lower Murray Water (Rural)</b>						
Proposed revenue in the Water Plan	26.4	27.4	27.8	27.9	27.9	137.4
Final decision	26.8	27.5	27.8	27.9	27.9	137.8 <sup>b</sup>
<b>Southern Rural Water</b>						
Proposed revenue in the Water Plan	28.2	28.5	28.9	28.9	28.7	143.2
Final decision	27.7	27.5	27.8	28.1	28.0	139.1

**Note:** Goulburn-Murray Water has a three year price period for the third regulatory period. Rounding means the numbers in this table may differ slightly from actual final determination numbers.

<sup>a</sup> Goulburn-Murray Water's proposed prices recovered less than its proposed revenue and the revenue approved by the Commission in this decision. **na** Not applicable. <sup>b</sup> The allowed revenue in the final decision is higher because of revised volume estimates which have increased allowed pumping costs.

### Goulburn-Murray Water

The Commission's final decision for Goulburn-Murray Water's allowed revenue is \$362.2 million compared with the business's proposed revenue requirement of \$371.1 million across three years. Given that Goulburn-Murray Water's proposed prices will raise less revenue than the Commission's approved revenue, the Commission has approved Goulburn-Murray Water's proposed prices for the first year of its regulatory period. Prices in later years will vary under Goulburn-Murray Water's revenue cap to ensure that the business only earns the allowed revenue. Goulburn-Murray Water has indicated it will apply price increases above inflation of 1.5 per cent per year (which is consistent with the final decision).

## **Lower Murray Water (Rural)**

The Commission's final decision for Lower Murray Water (Rural)'s allowed revenue is \$137.8 million compared with the business's proposed revenue requirement of \$137.4 million in its Water Plan. The increased revenue allows for an approved revision to Lower Murray Water (Rural)'s energy costs which reflect higher pumping costs and an air scouring program in the Millewa area. Despite the small increase in revenue, prices will be lower on average, reflecting forecast increases in volumes of water use.

The Commission has approved Lower Murray Water (Rural)'s prices for the first year of its regulatory period, which match the revenue requirement. Prices in later years will vary under Lower Murray Water (Rural)'s revenue cap to ensure the business earns only the allowed revenue.

In most of Lower Murray Water (Rural)'s irrigation districts, prices will be as described in the rural tariffs chapter of this decision:

- price increases less than inflation in the Red Cliffs district
- 1.5 per cent above inflation in the Robinvale district
- 2.1 per cent above inflation for the Mildura irrigation and drainage district
- 3.0 per cent above inflation for the Mildura High Pressure System.

## **Southern Rural Water**

The Commission's final decision for Southern Rural Water's allowed revenue is \$139.1 million compared with the business's proposed revenue requirement of \$143.2 million. The Commission has approved Southern Rural Water's proposed prices for the first year of its regulatory period. Prices in later years will vary under Southern Rural Water's revenue cap part of its hybrid price control, to ensure the business earns only allowed revenue. On average, Southern Rural Water's price increases for the period will be close to the level of inflation.

### 3.4 FINAL DECISION

The Commission has not approved Goulburn-Murray Water's application for forgone revenue.

The Commission has approved Goulburn-Murray Water's proposed incorporation of annuities into the RAB.

The Commission has approved Southern Rural Water's proposal to phase out its irrigation annuities.

# 4 OPERATING EXPENDITURE

## 4.1 INTRODUCTION

In their Water Plans, the rural water businesses set out their forecast operating expenditure over the next regulatory period (1 July 2013 to 30 June 2018).<sup>11</sup> They also outlined the relationship between expenditure and their delivery of obligations and service outcomes.

The Commission assessed Southern Rural Water's proposed operating expenditure against the requirements of the Water Industry Regulatory Order (WIRO).

The WIRO requires the Commission to ensure prices (1) provide businesses with a sustainable revenue stream that does not reflect monopoly profits or inefficient expenditure, and (2) are determined in a way that incentivises businesses to pursue efficiency improvements over the regulatory period. The Commission must also be satisfied that the proposed expenditure forecasts are efficient and account for a planning horizon that extends beyond the regulatory period.<sup>12</sup>

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<sup>11</sup> Goulburn-Murray Water's price period will run for three years from 1 July 2013, not five.

<sup>12</sup> WIRO, clause 14.



The Commission assessed the operating expenditure proposals of Goulburn-Murray Water and Lower Murray Water (Rural) against the requirements of the Australian Competition and Consumer Commission's (ACCC) Water Charge (Infrastructure) Rules (WCIR).<sup>13</sup>

The Commission undertook the assessments against the WIRO and the WCIR in a similar manner, separately assessing the businesses' forecasts of:

- business-as-usual expenditure, which incorporates the required productivity hurdle and is adjusted for growth relative to current expenditure
- additional expenditure required to meet new obligations (over and above business-as-usual expenditure)
- regulatory charges, bulk water charges and the environmental contribution.

In its analysis, the Commission had regard to its consultant, Cardno's, detailed assessments of the businesses' operating expenditure forecasts. Each business was given an opportunity to respond to the consultant's expenditure assessment before the Commission released its draft decision. The consultant's reports are available on the Commission's website ([www.esc.vic.gov.au](http://www.esc.vic.gov.au)).

In its draft decision, the Commission sought to identify the extent to which the businesses' proposals reflected efficient operating expenditure.<sup>14</sup> When it considered a proposal did not represent efficient expenditure, it recommended adjustments to reduce what is allowed in pricing.

The operating expenditure adopted by the Commission does not represent the amount that a business must spend or allocate to particular operational, maintenance and administrative activities. Rather, it is a benchmark which represents assumptions about the overall expenditure that the business is to recover through prices, and that the Commission considers sufficient for the business to operate and to maintain services over the regulatory period.

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<sup>13</sup> The WCIR are in chapter 1.

<sup>14</sup> WIRO, clause 14(1)(b).





If a business operates inefficiently or incurs additional expenditure on other activities, and its actual operating expenditure during the regulatory period exceeds the benchmarks used to set prices, then the business will bear those additional costs (rather than customers doing so via higher prices). The converse is true if the business makes an efficiency gain during the regulatory period.

## 4.2 OVERVIEW OF DRAFT DECISION

In the draft decision, the Commission noted the businesses proposed relatively flat labour costs over the third regulatory period, conservative energy expenditure, and a general decline in water conservation and drought management expenditure from that in the second regulatory period. It proposed to approve the businesses' proposed recovery of defined benefits superannuation payments, consistent with its advice to the regional water businesses (that is, to adopt the benchmark 15 year recovery period at a 5.75 per cent interest rate).<sup>15</sup> This approach resulted in a small adjustment for Goulburn-Murray Water.

The Commission also adjusted the businesses' forecasts to ensure regulatory licence fees and the environmental contribution were consistent with the latest advice provided by the regulatory agencies that charge these fees.

Table 4.1 compares the businesses' operating expenditure forecasts with the Commission's draft decision.

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<sup>15</sup> Essential Services Commission 2013, *Price review 2013: Regional urban water businesses draft decision – volume 1*, March, pp. 52–4.



**TABLE 4.1 OPERATING EXPENDITURE — BUSINESSES’ PROPOSALS  
COMPARED WITH THE DRAFT DECISION**

\$m 2012-13

	Total proposed by business	Total proposed in draft decision	Difference	
			<i>\$m</i>	<i>per cent</i>
Goulburn-Murray Water <sup>a</sup>	297.72	297.52	-0.20	-0.07
Lower Murray Water (Rural)	103.06	103.06	0.00	0.00
Southern Rural Water	104.56	104.52	-0.04	0.00

<sup>a</sup> Goulburn-Murray Water’s price period will run for three years from 1 July 2013.

### 4.3 RESPONSES AND COMMISSION’S ASSESSMENT

The businesses accepted the Commission’s draft decision on non-controllable costs, which included licence fees, the environmental contribution and bulk water charges. But they made submissions on their forecast controllable operating expenditure. The Commission considered these responses to the draft decision and adjusted the forecast operating expenditure only when:

- the business provided further information or arguments to support its original forecasts
- errors were identified in assumptions or forecasts of the draft decision
- other regulators imposed additional obligations that were not known, or could not have reasonably been known, when the business submitted its Water Plan
- the business proposed a material adjustment, with a change in expenditure so great that prices may not allow a business to recover sufficient revenue, or the business may significantly over-recover revenue.



### 4.3.1 ADDITIONAL INFORMATION IN SUPPORT OF WATER PLAN FORECASTS

Goulburn-Murray Water provided more information to justify its proposed additional operating expenditure to account for a carbon price. It provided a Deloitte study and its calculation of proposed adjustments.<sup>16</sup>

Deloitte's simulation showed a carbon price would have increased Goulburn-Murray Water's operating expenditure by around 0.65 per cent from 2011-12 to 2012-13, with increases of 0.01 per cent expected in 2012-13 and 2013-14, and 0.04 per cent in 2014-15. Key expenditure items affected by a carbon price are energy, general contractors and services, and fleet fuel.

The Commission does not consider Goulburn-Murray Water's proposal is justified, for the following reasons:

- The energy costs forecast in Goulburn-Murray's Water Plan and approved by the Commission in its draft decision allow for the impact of a carbon price.<sup>17</sup>
- The price framework does compensate businesses for the secondary price impacts of the carbon tax through annual inflation (the consumer price index) adjustments.
- Goulburn-Murray Water's submission was based on a high carbon price post transition—that is, the estimated 0.65 per cent average increase in total operating expenditure was based on a high carbon price scenario for 2015 and onwards. Recent government announcements on the carbon price post-2015 indicate this scenario will not be the case. The consultant's report also included a low carbon price scenario which showed a modest impact post transition.
- Most businesses in a competitive market are unlikely to be able to pass on fully any cost impacts of the carbon tax to their customers. This expectation is consistent with the results of the Australian Industry Group's recent survey of manufacturing, services and construction services on the impact of the carbon price.<sup>18</sup>

<sup>16</sup> Deloitte 2012, *Carbon price impact analysis: Goulburn-Murray Water*, October.

<sup>17</sup> In the Deloitte study, calculations were in 2011-12 real prices. If the amounts are converted to 2012-13 prices, Deloitte's estimate of annual energy costs (with a carbon price) is lower than Goulburn-Murray Water's forecast in its Water Plan.

<sup>18</sup> Australian Industry Group 2013, *Feedback – Water Price Review 2013-14 to 2017-18*.



The Commission does not consider Goulburn-Murray Water’s proposed adjustments for a carbon price on non-energy items are material enough to increase the risk that the business will not recover sufficient revenue over the regulatory period. Goulburn-Murray Water has not demonstrated the impacts will be materially above those already compensated for by the energy price adjustment and CPI pass through.

### 4.3.2 NEW EXPENDITURE ITEMS

In its submission on the draft decision, Lower Murray Water (Rural) proposed expenditure that was not included in its original Water Plan forecasts. The Commission engaged Deloitte to consider this proposal, and then adjusted Lower Murray Water (Rural)’s operating expenditure forecasts as noted in table 4.2.

**TABLE 4.2 NEW EXPENDITURE ITEMS FOR LOWER MURRAY WATER (RURAL) — FINAL DECISION**

Business’s proposal	Commission’s response
Additional energy costs of \$2.5 million due to higher rural water demand.	<b>Accepted</b> — The Commission accepted the updated water demand forecast and requested Deloitte to assess the proposed expenditure increase. Deloitte advised the energy forecast is reasonable. The Commission adjusted the expenditure forecast accordingly.
New operating expenditure of \$0.3 million for the Millewa air scouring activity in 2013-14.	<b>Accepted</b> — The Commission accepted Lower Murray Water (Rural)’s reasoning for its need for the project. It noted Lower Murray Water (Rural)’s Customer Committee supported the proposed expenditure.
Defined benefits superannuation costs. Lower Murray Water (Rural) provided updated costs that it accrued in 2012 for defined benefits superannuation, as well as the split of the costs between its rural and urban services. This results in a net increase of \$0.6 million to the rural business.	<b>Accepted</b> — The Commission considered Lower Murray Water (Rural)’s approach is consistent with the benchmark approach adopted for the draft decision, so it approved the forecast allowance and allocated the costs across the business’s rural and urban components as proposed.



### 4.3.3 OTHER ADJUSTMENTS

The Environmental Contribution levy is held constant in nominal terms across the regulatory period. The Commission updated the consumer price index (CPI) estimates used to deflate these figures to convert to real \$2012-13, resulting in a small increase in the allowance in the operating expenditure benchmarks for the final decision.

## 4.4 FINAL DECISION

The Commission considers the operating expenditure benchmarks adopted in the final decision will allow the businesses sufficient expenditure to operate and deliver their proposed services. It confirms its draft decision to approve \$297.5 million of operating expenditure for Goulburn-Murray Water over its three year regulatory period. It also confirms its draft decision to approve \$104.5 million in operating expenditure for Southern Rural Water.

The Commission has approved Lower Murray Water (Rural)'s proposed adjustments to its operating expenditure.

The Commission's final decision is outlined in table 4.3.



**TABLE 4.3 OPERATING EXPENDITURE, 2013-14 TO 2017-18 — FINAL DECISION**

\$m 2012-13

	Total proposed in draft decision	Final decision					Total	Difference	
		2013-14	2014-15	2015-16	2016-17	2017-18		<i>\$m</i>	<i>per cent</i>
Goulburn-Murray Water <sup>a</sup>	297.52	97.64	100.86	99.04	na	na	<b>297.54</b>	0.02	0.0
Lower Murray Water (Rural)	103.06	21.23	21.14	21.28	21.42	21.43	<b>106.51</b>	3.45	3.3
Southern Rural Water	104.52	21.36	21.05	20.86	20.71	20.56	<b>104.53</b>	0.01	0.0

<sup>a</sup> Goulburn-Murray Water's price period will run for three years from 1 July 2013. **na** Not applicable.

# 5 CAPITAL EXPENDITURE

## 5.1 INTRODUCTION

In their Water Plans, the rural water businesses set out their forecast capital expenditure over the next regulatory period (1 July 2013 to 30 June 2018).<sup>19</sup> Capital expenditure is a key component of the rural water businesses' revenue requirements for the regulatory period.

The Commission assessed Southern Rural Water's proposed capital expenditure against the requirements of the Water Industry Regulatory Order (WIRO).

The WIRO requires the Commission to ensure prices provide businesses with a sustainable revenue stream that does not reflect monopoly profits or inefficient expenditure, and that allows businesses to recover expenditure on renewing and rehabilitating existing assets. The Commission must also be satisfied that the proposed expenditure forecasts are efficient and account for a planning horizon that extends beyond the regulatory period.<sup>20</sup>

The Commission assessed the capital expenditure proposals of Goulburn-Murray Water and Lower Murray Water (Rural) against the requirements of the Australian Competition and Consumer Commission's (ACCC) Water Charge (Infrastructure) Rules (WCIR).<sup>21</sup>

The assessments against the requirements of both the WIRO and the WCIR are undertaken in a similar manner.

The Commission engaged the consultant Cardno to review the prudence and efficiency of the capital expenditure proposals. The Commission had regard to

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<sup>19</sup> Goulburn-Murray Water's price period will run for three years from 1 July 2013, not five.

<sup>20</sup> WIRO, clause 14.

<sup>21</sup> The WCIR are discussed in chapter 1.



Cardno's findings and recommendations in making its draft decision on capital expenditure. The businesses were given an opportunity to respond to Cardno's assessment prior to the release of the Commission's draft decision. Cardno's final reports are available on the Commission's website ([www.esc.vic.gov.au](http://www.esc.vic.gov.au)).

## 5.2 OVERVIEW OF DRAFT DECISION

For its draft decision, the Commission identified and assessed the major projects that comprise a significant proportion of each business's total capital expenditure forecast, rather than assessing each business's whole capital expenditure forecast. The assessment separated out gross capital expenditure and net capital expenditure (which excludes projects that will receive funding from government or through customer contributions).

Cardno undertook a detailed assessment of the Water Plans and consulted with the businesses as part of the Commission's draft decision process. It recommended no adjustment to the businesses' capital expenditure forecasts. It concluded the forecasts are appropriate in relation to each business's key drivers and obligations, and noted all businesses provided robust justifications and reasonable cost estimates for the key projects reviewed.

In making its draft decision, the Commission generally accepted Cardno's recommendations on the capital expenditure forecasts for each business. As shown in table 5.1, the Commission proposed to approve total capital expenditure as proposed in the businesses' Water Plans.

The Commission noted Goulburn-Murray Water and Southern Rural Water spent significantly less than their capital expenditure allowance for the second regulatory period. Lower Murray Water (Rural) spent \$13 million (23 per cent) more than its allowance. All three businesses forecast reduced capital expenditure in the next regulatory period.





During the expenditure review, Lower Murray Water advised:

- the Commonwealth Government recently announced \$103 million of funding is available for the Sunraysia Modernisation Project
- the project is likely to change the operating circumstances of Lower Murray Water (Rural), so the business's Water Plan and price determination will likely need revisiting
- an adjustment will not be needed for at least one year, and not until further details are known
- it wished to proceed with this price determination as per the September 2012 Water Plan.

The Commission noted in its draft decision that it will monitor Lower Murray Water (Rural)'s plans for the Sunraysia Modernisation Project before making its final decision.



**TABLE 5.1 CAPITAL EXPENDITURE, 2013-14 TO 2017-18 — BUSINESSES' PROPOSALS COMPARED WITH THE DRAFT DECISION**

\$m 2012-13

	Total proposed by business	Total proposed in draft decision					Total	Difference	
		2013-14	2014-15	2015-16	2016-17	2017-18		\$m	per cent
Goulburn-Murray Water (net) <sup>a</sup>	82.6	22.1	33.8	26.7			<b>82.6</b>	0.0	0.0
Goulburn-Murray Water (gross)	84.2	22.4	34.3	27.4			<b>84.2</b>	0.0	0.0
Lower Murray Water (Rural) (net)	34.1	17.8	9.1	2.5	2.3	2.4	<b>34.1</b>	0.0	0.0
Lower Murray Water (Rural) (gross)	34.1	17.8	9.1	2.5	2.3	2.4	<b>34.1</b>	0.0	0.0
Southern Rural Water (net)	45.6	10.2	8.6	8.9	8.5	9.4	<b>45.6</b>	0.0	0.0
Southern Rural Water (gross)	63.3	15.0	15.2	12.1	11.0	10.0	<b>63.3</b>	0.0	0.0

**Note:** Net capital expenditure excludes projects that will receive funding from government or through customer contributions.

<sup>a</sup> Goulburn-Murray Water's regulatory period will run for three years from 1 July 2013.

## 5.3 RESPONSES AND COMMISSION'S ASSESSMENT

Goulburn-Murray Water, Lower Murray Water (Rural) and Southern Rural Water accepted the proposed capital expenditure forecasts in the Commission's draft decision. Southern Rural Water subsequently advised the Commission that the Victorian Government will provide \$16 million towards the Macalister Irrigation District 2030 upgrade program (MID2030) over the next three years.<sup>22</sup>

### 5.3.1 MACALISTER IRRIGATION DISTRICT (MID)

The Victorian Government announced on 7 May 2013 that \$16 million would be available for the Macalister Irrigation District.<sup>23</sup> As a result, Southern Rural Water's forecast capital expenditure for the third regulatory period changed after the Commission's draft decision. Southern Rural Water indicated to the Commission that this will reduce net capital expenditure by \$4 million, thereby reducing the amount to be recovered from customers through pricing by a small amount.

Southern Rural Water has not provided the Commission with the detailed breakdown of the revised expenditure, so a proxy was used for pricing purposes.

### 5.3.2 SUNRAYSIA MODERNISATION PROJECT

The Commonwealth Government announced in November 2012 that \$103 million would be made available for the Sunraysia Modernisation Project. Lower Murray Water (Rural) indicated to the Commission that it would need time to evaluate the pricing impact of this funding, and it elected to proceed with its Water Plan submission. It indicated that it would apply for a price determination re-opening, if warranted, during the regulatory period. Lower Murray Water (Rural)'s submission on the draft decision did not comment on the Sunraysia Modernisation Project.

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<sup>22</sup> For its draft decision, the Commission accepted Cardno's recommendations on the MID2030. Cardno concluded that the MID2030 leading works projects are appropriate for providing improved service to Southern Rural Water's customers, and were 'supported by adequate analysis and reasonable cost estimates and it is realistic to expect that these works can be delivered in the timeframes proposed'.

<sup>23</sup> Victorian State Budget 2013-14 released on 7 May 2013.



On 22 March 2013, the Victorian Government announced \$555 000 had been secured to complete a business case for the project. The business case is due for submission to the Commonwealth Government by the end of June 2013, 'to allow it to review and make a decision on final funding early in the new financial year'.<sup>24</sup>

The Commission expects Lower Murray Water to keep it apprised of the pricing impact of any material operational changes resulting from the Sunraysia Modernisation Project. It anticipates that a mid-period price re-opening request from Lower Murray Water is likely. Chapter 12 sets out the Commission's mechanism for adjusting prices through a re-opening.

## 5.4 FINAL DECISION

The Commission confirms its draft decision to adopt Goulburn-Murray Water's and Lower Murray Water (Rural)'s proposed capital expenditure forecasts as the benchmarks for the third regulatory period. It notes Lower Murray Water (Rural) is likely to apply for a mid-period price determination re-opening to account for any material operational changes when the Sunraysia Modernisation Project begins.

The Commission has adopted Southern Rural Water's revised capital expenditure forecast (which accounts for the MID2030 project funding) as the benchmark for the third regulatory period.

The Commission considers the capital expenditure benchmarks adopted in this final decision will allow each business to deliver its proposed services and meet known regulatory obligations. Net capital expenditure excludes any government or customer contributions.

The gross amount is the total amount of projects proposed (including government funding). The net amount is what is recovered from customers through prices. The Commission's final decision is outlined in table 5.2.

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<sup>24</sup> Minister for Agriculture and Food Security 2013, '\$550 000 secured for Sunraysia business case', Media release, 22 March.



**TABLE 5.2 CAPITAL EXPENDITURE, 2013-14 TO 2017-18 —FINAL DECISION**

\$m 2012-13

	Total proposed in draft decision	Final decision					Total	Difference	
		2013-14	2014-15	2015-16	2016-17	2017-18		<i>\$m</i>	<i>per cent</i>
Goulburn-Murray Water (net) <sup>a</sup>	82.6	22.1	33.8	26.7	na	na	<b>82.6</b>	0.0	0.0
Goulburn-Murray Water (gross) <sup>a</sup>	84.2	22.4	34.3	27.4	na	na	<b>84.2</b>	0.0	0.0
Lower Murray Water (Rural) (net)	34.1	17.8	9.1	2.5	2.3	2.4	<b>34.1</b>	0.0	0.0
Lower Murray Water (Rural) (gross)	34.1	17.8	9.1	2.5	2.3	2.4	<b>34.1</b>	0.0	0.0
Southern Rural Water (net)	45.6	2.2	3.6	11.9	11.5	12.4	<b>41.6</b>	-4.0	-8.8
Southern Rural Water (gross)	63.3	15.0	18.2	15.1	14.0	13.0	<b>75.3</b>	12.0	19.0

<sup>a</sup> Goulburn-Murray Water's regulatory period will run for three years from 1 July 2013.



# 6 FINANCING CAPITAL INVESTMENTS

## 6.1 INTRODUCTION

Under the Water Industry Regulatory Order (WIRO) and the Australian Competition and Consumer Commission's (ACCC's) Water Charge (Infrastructure) Rules (WCIR), the Commission must approve a rate of return that will apply to each water business's regulatory asset base (RAB). The requirements of the WIRO apply to Southern Rural Water. The WCIR requirements apply to Goulburn-Murray Water's and Lower Murray Water's rural operations.

This chapter sets out the Commission's final decision on the rural water businesses' financing of capital investments — namely, regulatory asset values, the rate of return on investments, and regulatory depreciation.

## 6.2 ROLLFORWARD OF THE REGULATORY ASSET BASE

### 6.2.1 OVERVIEW OF DRAFT DECISION

To calculate the opening RAB the Commission assessed actual net capital expenditure for the period 2007-08 to 2011-12 and then businesses' forecasts for 2012-13.

When assessing actual net capital expenditure for the period 2007-08 to 2011-12, the Commission compared spending with 2008 determination forecasts.

When a business underspent relative to the forecast, the Commission proposed to roll forward the amount actually invested. If expenditure was less than 10 per cent above the forecast, the Commission also proposed to roll forward the amount actually invested on the basis that such a divergence is within reasonable bounds (given capital costs can be lumpy in nature). If expenditure was 10 per cent or



more than the forecast, then the Commission proposed to roll forward the amounts above the forecast only if a business justified the expenditure as being prudent and efficient.

For 2012-13, the Commission proposed in its draft decision to roll forward forecast net capital expenditure provided by all businesses.

Table 6.1 shows the amounts that the Commission's draft decision approved for inclusion in each businesses' RAB at 1 July 2012, and the forecast amounts at 1 July 2013. The only adjustment that the Commission made in its draft decision was to include the asset base of First Mildura Irrigation Trust (FMIT) in Lower Murray Water's (Rural) RAB, to reflect the merger in 2007-08.

**TABLE 6.1 PROPOSED REGULATORY ASSET BASE ROLL FORWARD — DRAFT DECISION**  
\$m 2012-13

	<b>Goulburn-Murray Water</b>	<b>Lower Murray Water (Rural)</b>	<b>Southern Rural Water</b>	<b>Total</b>
<b>Closing RAB at 1 July 2007</b>	<b>113.0</b>	<b>9.2</b>	<b>5.5</b>	<b>127.7</b>
<i>Plus</i> net capital expenditure 2007-08 to 2011-12	103.1	59.9	46.9	209.9
<i>Less</i> regulatory depreciation 2007-08 to 2011-12	26.1	7.6	12.3	46.0
<i>Less</i> proceeds from disposal of assets 2007-08 to 2011-12	0.0	2.2	4.3	6.5
Adjustments		9.6		9.6
<b>RAB at 1 July 2012</b>	<b>190.0</b>	<b>68.9</b>	<b>35.8</b>	<b>294.7</b>
<i>Plus</i> net capital expenditure (forecasts provided by businesses) 2012-13	26.4	7.0	6.6	39.9
<i>Less</i> regulatory depreciation 2012-13	6.2	2.5	4.0	12.6
<i>Less</i> assumed proceeds from disposal of assets 2012-13	0.0	0.0	0.7	0.7
<b>RAB at 1 July 2013</b>	<b>210.2</b>	<b>73.4</b>	<b>37.7</b>	<b>321.2</b>





## 6.2.2 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission received a submission from Lower Murray Water (Rural) and Goulburn-Murray Water in response to its draft decision on rolling forward the RAB.

Lower Murray Water (Rural) submitted that its Water Plan had already included FMIT's regulatory asset value in its proposed RAB. Thus, the Commission's inclusion of FMIT's regulatory asset value in its draft decision was made in error. The Commission has corrected this error in this final decision.

Goulburn-Murray Water proposed to resolve annuities with short lives (10 years or less) in accordance with the approach set out in the Commission's Water Plan 1 determination. That approach was to return surplus annuities and to recover deficit annuities through pricing and/or capital expenditure.

For annuities with lives longer than 10 remaining years, Goulburn-Murray Water proposed arrangements that fit the standardised RAB approach. Only negative annuities remain for those with a life longer than 10 years. So, a positive RAB adjustment will result for each annuity based on the closing value as at 1 July 2013 and the remaining life will depend on the initial life minus seven years (the total period covered by the first and second regulatory period). Woorinen with a 75 year original life, for example, would have a 68 year life as at 1 July 2013.

The Commission accepted Goulburn Murray Water's proposal because the proposed conversion of these negative annuities to the RAB provides a simpler approach than does the current arrangement, and will result in lower prices. Further, the Commission encourages a transition from annuities to the RAB because it promotes consistency between businesses.



### 6.2.3 FINAL DECISION

The Commission has approved the amounts in table 6.2 for inclusion in each business's RAB at 1 July 2012.

Forecast amounts for years from 2012-13 are set out in the final determinations for each business. These are the amounts reflected in approved prices. The Commission will review forecast net capital expenditure for those subsequent years as part of the next price review.

**TABLE 6.2 REGULATORY ASSET BASE AT 1 JULY 2012 — FINAL DECISION**  
\$m 2012-13

<b>Water business</b>	<b>Final decision</b>
Goulburn-Murray Water	190.0
Lower Murray Water (Rural)	61.8
Southern Rural Water	35.8

## 6.3 RATE OF RETURN

The water businesses are allowed to recover a rate of return on existing assets and on new capital expenditure. To estimate an efficient rate of return, the Commission uses a weighted average cost of capital (WACC), which reflects the cost of the two alternative sources of finance – debt and equity. The Commission's WACC is expressed in real post-tax terms.

The Commission determined a rate of return for Southern Rural Water consistent with the requirements of the WIRO. That is, it calculated the business's rate of return in a way that is consistent with its calculation for regional urban and metropolitan water businesses.

The Commission has assessed the rate of return for Goulburn-Murray Water and Lower Murray Water (Rural) against the requirements of the WCIR. The calculation of the WACC under the WCIR varies slightly from the approach under the WIRO.



### 6.3.1 OVERVIEW OF DRAFT DECISION

#### Southern Rural Water

In the draft decision, the Commission calculated a feasible range for the WACC of 4.1–5.3 per cent. It calculated this range by adopting probable ranges for the real risk-free rate of return and the debt margin, and point estimates for other parameters. From the feasible range, the Commission adopted a WACC estimate of 4.7 per cent.

In deciding to propose a WACC in the middle of the range, the Commission had particular regard for current borrowing costs, which are near historic lows. Adopting a WACC at the lower end of the range could create undue risk that businesses would not be able to cover their borrowing costs in the third regulatory period, if borrowing costs increase. Table 6.3 outlines the assumptions adopted by the Commission for the individual WACC components.

**TABLE 6.3 REAL POST-TAX WACC (SOUTHERN RURAL WATER) – DRAFT DECISION**

WACC parameter	Value
Risk free rate of return	0.679 – 1.023
Equity beta	0.65
Equity (market risk) premium	6.0
Debt margin	3.03 – 4.53
Financing structure (debt/assets)	60
Franking credits	0.5
Forecast inflation	2.40 – 2.75
Vanilla post-tax WACC (real) range	4.1 – 5.3
Vanilla post-tax WACC (real) point	4.7



Key elements of the Commission’s draft decision on the WACC were:

- Risk-free rate: the Commission estimated a range for the real risk free rate based on the average nominal yield on 10-year Commonwealth Government Securities, taking into account market estimates of inflation.
- Debt margin: The debt margin range is based on the estimated additional cost of debt for a company with a BBB- to BBB+ rating, over the risk free rate
- Adopting point estimates for the equity beta, market risk premium, financing structure and value of imputation credits which reflect previous decisions by the Commission and/or generally accepted regulatory precedent.

### **Goulburn-Murray Water and Lower Murray Water**

The WCIR approach to the WACC is similar to that of the WIRO. The two approaches differ only in that the WCIR pricing principles specify:

- yields of BBB+ rated corporate bonds with 10 year maturity should be used to estimate a debt margin
- an equity beta of 0.7 should be used.

For the draft decision on Goulburn-Murray Water and Lower Murray Water (Rural), the Commission proposed to adopt a real post-tax WACC of 4.7 per cent (the upper end of this range) for regulatory consistency. This rate is consistent with rates used for the other water businesses in Victoria (including Lower Murray Water’s urban operation). Table 6.4 outlines the assumptions that the Commission adopted for the individual WACC components.

**TABLE 6.4 REAL POST-TAX WACC FOR GOULBURN-MURRAY WATER AND LOWER MURRAY WATER (RURAL) – DRAFT DECISION**

<b>WACC parameter</b>	<b>Value</b>
Risk-free rate of return	0.679 – 1.023
Equity beta	0.7
Equity (market risk) premium	6.0
Debt margin	3.03 – 3.25
Financing structure (debt/assets)	60
Franking credits	0.5
Forecast inflation	2.4 – 2.75
Vanilla post-tax WACC (real) range	4.2 – 4.7
Vanilla post-tax WACC (real) point	4.7



### 6.3.2 UPDATING THE WACC ESTIMATE

No businesses responded to the Commission's draft decision on the WACC. The Commission has considered changes in financial market conditions since the draft decision. This section sets out the Commission's analysis on the WACC adopted for the final decision. The only WACC parameters that have changed since the draft decision are the estimate of the risk free rate, and the debt margin.

#### Southern Rural Water

##### *Risk free rate*

In its draft decision, the Commission constructed a range for the real risk-free rate using the average yield of 3.448 per cent on nominal Commonwealth Government Securities over the 40 day trading period to 28 February 2013, and an inflation range of 2.4 and 2.75 per cent.

For the final decision, the Commission has adopted the same approach to estimating the real risk-free rate as proposed in the draft decision. The Commission has used the average yield on nominal Commonwealth Government Securities over the 40 day trading period to 5 June 2013 to calculate a nominal risk-free rate of 3.234 per cent.<sup>25</sup>

In regard to the inflation forecast, the Commission notes that Consumer Price Index results for the March quarter 2013 indicated an annual inflation rate of 2.5 per cent. The Commission has also had regard for longer-term inflation forecasts provided by Deloitte Access Economics. These forecasts imply an inflation rate averaging around 2.7 per cent per annum over the next regulatory period.

The Commission notes that some market practitioners forecast lower inflation, particularly in the near term. Some forecasts are below the mid-point of the Reserve Bank of Australia's target band of 2-3 per cent each year. The Department of Treasury and Finance forecast inflation to be around 2.5 per cent for 2012-13. National Australia Bank forecast inflation of 2.1 per cent in 2013 and 2.2 per cent in 2014.

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<sup>25</sup> Reserve Bank of Australia data series: *Capital Market Yields – Government Bonds – Daily* (table F2).



For the purposes of estimating a real risk free rate of return, the Commission considers that an inflation range of between 2.3 and 2.8 per cent is a reasonable longer term inflation forecast given recent trends in inflation, and longer-term forecasts.

Together with the nominal risk-free rate of 3.234 per cent, this inflation range results in a feasible range for the real risk-free rate of between 0.422 and 0.913 per cent.

### *Debt margin*

In the draft decision, the Commission derived a range for the debt margin by estimating the additional cost of debt (on top of the risk free rate) for a company with a BBB- to BBB+ rating. The draft decision adopted a debt margin range of 3.03 per cent to 4.53 per cent, based on estimates provided by PricewaterhouseCoopers (PwC).

The Commission engaged PwC to provide updated estimates of the debt margin. PwC derived an estimate of the 10 year BBB+ debt risk premium by taking Bloomberg's BBB fair value curve to 7 years, and extrapolating to 10 years based on the average increment in the debt risk premium observed for pairs of bonds of different terms to maturity. PwC then estimated the incremental debt risk premium for BBB and BBB- rated bonds.<sup>26</sup>

PwC provided estimates of average debt margins for BBB+ to BBB- rated bonds over the 40 day trading period to 24 May 2013. Within this trading period, the average annual margin implied by this range of bonds was 2.97 per cent (the low recorded over the 40 day trading period) to 4.01 per cent (the high recorded over the trading period).

The Commission has adopted PwC's estimates for the final decision. The range for the debt margin is lower than the range adopted in the draft decision.

### *Interest rates applying to new borrowings*

As noted in the draft decision, the Commission has obtained data from the Treasury Corporation of Victoria (TCV) to estimate the interest rates applying to

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<sup>26</sup> For more detail on the methodology, see PricewaterhouseCoopers 2013, *Estimating a debt risk premium*, May.



new borrowings raised by the water businesses (noting that the water businesses must borrow through TCV). While not a direct input to the calculation of the WACC, it is important that the estimate of the WACC has regard for actual borrowing costs facing the water businesses.

The Commission notes that since the draft decision, the Victorian Government has raised the Financial Accommodation Levy from 110 basis points to a default rate of 252 basis points in 2013-14 (the default rate applying to an entity with a credit rating of BBB). The FAL applies to new borrowings made by Government Business Enterprises (GBEs), including the water businesses. It is intended to account for the difference between normal commercial interest rates paid by private businesses, and rates paid by GBEs who, by borrowing through the Treasury Corporation of Victoria, have the benefit of State Government guarantee on their loan.

The increase in the FAL (all other things being equal) will have the effect of raising the interest rates payable on new debt for the water businesses.

On 24 May 2013, yields on 10 year TCV bonds were approximately 4 per cent. Allowing for debt raising costs (around 0.165 per cent) and the FAL (using the 2.52 per cent default rate to apply to BBB rated entities from 1 July 2013), implies that interest rates on new borrowings will be around 6.7 per cent.

#### *Updating the WACC estimate*

Using the updated figures for the risk free rate and the debt margin, the Commission has calculated a feasible range for the real post-tax WACC of between 3.8 and 4.9 per cent, as shown in table 6.5. The Commission has adopted the same values for the equity beta, market risk premium, and financing structure that were adopted for the draft decision.

The Commission has decided on a WACC of 4.5 per cent for the next regulatory period. The Commission has had particular regard for the borrowing costs that will likely face the water businesses from 1 July 2013, taking into account the impact of the FAL.

A WACC of 4.5 per cent (real post tax terms) implies nominal borrowing costs of around 6.9 per cent to 7.3 per cent in nominal terms, depending on the inflation assumption used. The Commission considers that a lower WACC would create an undue risk that Southern Rural Water will not be able to cover borrowing costs should interest rates increase.



**TABLE 6.5 REAL POST TAX WACC (SOUTHERN RURAL WATER) – FINAL DECISION**

<b>WACC parameter</b>	<b>Value</b>
Risk free rate of return	0.4220 – 0.913
Equity beta	0.65
Equity (market risk) premium	6.0
Debt margin	2.97 – 4.01
Financing structure (debt/assets)	60
Forecast inflation	2.30 – 2.80
Vanilla post tax WACC (real) range	3.8 – 4.9
Vanilla post tax WACC (real) point	4.5

### **Goulburn-Murray Water and Lower Murray Water**

The Commission has derived an updated feasible range for the WACC for Goulburn-Murray Water’s and Lower Murray Water’s rural operations that is consistent with the WCIR requirements for businesses operating in the Murray-Darling Basin.

Apart from the range assumed for the debt margin and the value adopted for the equity beta, the Commission used the same parameters to estimate the WACC for Goulburn-Murray Water and Lower Murray Water as for Southern Rural Water (table 6.6). PwC estimated a debt margin range for BBB+ rated bonds of 2.97 to 3.16 per cent. The Commission’s feasible range for the WACC for Goulburn-Murray Water and Lower Murray Water is 3.9 to 4.5 per cent.

The Commission’s final decision is to adopt a WACC for Goulburn-Murray Water and Lower Murray Water of 4.5 per cent, for regulatory consistency. This rate is consistent with rates adopted for the other water businesses in Victoria. It also means Lower Murray Water will have a consistent WACC across its rural and urban operations.





**TABLE 6.6 REAL POST TAX WACC (GOULGURN-MURRAY WATER AND LOWER MURRAY WATER) – FINAL DECISION**

<b>WACC parameter</b>	<b>Value</b>
Risk free rate of return	0.422 – 0.913
Equity beta	0.70
Equity (market risk) premium	6.0
Debt margin	2.97 – 3.16
Financing structure (debt/assets)	60
Forecast inflation	2.30 – 2.80
Vanilla post tax WACC (real) range	3.9 – 4.5
Vanilla post tax WACC (real) point	4.5

The Commission notes that to calculate its estimate of the WACC for the third regulatory period it has used the same approach as it did in the 2008 and 2009 price reviews.

In setting a WACC of 4.5 for all rural water businesses, the Commission has also noted:

- the 4.5 per cent WACC adopted by the Essential Services Commission of South Australia in its May 2013 final decision for SA Water’s water and sewerage revenues.<sup>27</sup>
- the 4.6 per cent WACC adopted by IPART in its June 2013 final decision for Hunter Water.<sup>28</sup>

In 2013-14, the Commission will commence a review the rate of return methodology. The review will include an assessment of alternative approaches, and inform our approach to estimating the rate of return for water businesses for the fourth regulatory period. The Commission will involve all interested parties in its review.

<sup>27</sup> Essential Services Commission of South Australia 2013, *SA Water’s water and sewerage revenues 2013-14 to 2015-16*, May.

<sup>28</sup> IPART 2013, *Hunter Water Corporation’s water, sewerage, stormwater drainage and other services Review of prices from 1 July 2013 to 30 June 2017*, June.



### 6.3.3 FINAL DECISION

The Commission has adopted a real post-tax WACC of 4.5 per cent for Southern Rural Water, Goulburn-Murray Water and Lower Murray Water.

## 6.4 DEPRECIATION

In their Water Plans, the rural water businesses generally forecast regulatory depreciation for the third regulatory period based on a straight line approach. That is, they will depreciate an equal amount of an asset each year based on the expected useful life of that asset. Given many projects in the rural sector are government funded, they do not incur regulatory depreciation, so have no impact on prices.

In its draft decision, the Commission proposed to approve the depreciation forecasts for all rural businesses. It received no submissions on its draft decision.

### 6.4.1 FINAL DECISION

The Commission has approved the depreciation forecasts of Goulburn-Murray Water, Lower Murray Water (Rural) and Southern Rural Water.



# 7 DEMAND

## 7.1 INTRODUCTION

The water businesses' demand forecasts directly affect the prices customers will pay during the period. Changes in customer numbers and consumption are important determinants of the capability of the water infrastructure to provide services and of the need for expenditure on renewal and augmentation.

The prices for the following key services are influenced by forecast demand for:

- irrigation (including volumes, service points and delivery shares)
- bulk water services
- domestic and stock connections and deliveries
- drainage (including volumes and connections) and
- groundwater (including volumes and licences).

The rural businesses operate under a revenue cap form of price control and generate over half of their revenue from fixed charges. This makes the first year of forecast connections and volumes the most important. Revenue caps can correct for any over-recovery or under-recovery of revenue caused by differences between forecast and actual demand, following the first year of a regulatory period.

## 7.2 OVERVIEW OF DRAFT DECISION

The rural water businesses' Water Plans included forecasts of volumes for irrigation, stock and domestic, and surface and groundwater diversions (see volume II of the draft decision). Some businesses included drainage volumes where customers received this service. The rural water businesses generally based their forecasts on observations over recent years.



The Commission engaged Frontier Economics to assist in reviewing and assessing the demand forecasts put forward by the water businesses. The review encompassed irrigation, bulk water services, domestic and stock connections and deliveries, drainage and groundwater. Key issues explored included the businesses' assumptions about future connections growth and the uncertainty facing the rural sector. The businesses were given an opportunity to comment on the consultant's report before the draft decision. The report is available on the Commission's website.<sup>29</sup>

The Commission's draft decision generally accepted the recommendations Frontier Economics made about the demand forecasts of customer numbers and delivery volumes. The Commission considered Frontier Economics' recommendations were reasonable. The Commission approved all forecasts proposed by Goulburn-Murray Water, Southern Rural Water and Lower Murray Water (Rural) in their Water Plans, except the following:

- Goulburn-Murray Water indicated it submitted incorrect forecasts of delivered volumes for 2014-15 and 2015-16. In its Water Plan, it forecast delivery volumes at 110 per cent of irrigator high reliability water shares (HRWS) for 2013-14 to 2015-16. Goulburn-Murray Water identified this assumption was correct for 2013-14, but revised the assumption to delivery volumes at 100 per cent of irrigator HRWS for 2014-15 and 2015-16. The Commission proposed to accept the revised delivery volumes.
- Southern Rural Water assumed increased HRWS in the Macalister/Thomson system would not increase delivery volumes. Frontier Economics recommended increasing the delivery volume forecast to account for the forecast increase in HRWS. Southern Rural Water acknowledged the new HRWS will result in higher usage and proposed average usage of 70 per cent of the new water shares. The Commission agreed with Frontier Economics' recommendations and proposed to adopt the revised volumes.<sup>30</sup>

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<sup>29</sup> [www.esc.vic.gov.au](http://www.esc.vic.gov.au)

<sup>30</sup> Essential Services Commission 2013, *Price Review 2013: rural water businesses, draft decision, volume I*, March, table 7.1.



## 7.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

This section details businesses' responses to the draft decision and the Commission's assessment of those responses. Detailed tables containing the Commission's final decision on demand forecasts for each business are set out in annexure A to the determination issued for each business.

In response to the draft decision, Goulburn-Murray Water accepted the Commission's draft decision about demand forecasts. Lower Murray Water (Rural) and Southern Rural Water accepted the Commission's draft decision on most demand parameters but proposed revised volume forecasts (based on updated volume information).

Table 7.1 summarises the businesses' proposed revisions to their demand forecasts.

**TABLE 7.1 RESPONSES TO THE DRAFT DECISION**

Response to the draft decision	Final decision
<b>Lower Murray Water (Rural)</b>	
Lower Murray Water (Rural) proposed an increase to its delivery volumes to reflect actual consumption in what it views as a more average year than the second regulatory period.	<b>Accept</b> – as it reflects updated consumption figures for the current summer.
<b>Southern Rural Water</b>	
Southern Rural Water proposed a reduction in delivery volumes for the Macalister/Thomson irrigation district based on consultation with its Macalister Consultative Committee.	<b>Accept</b> – because the revised allocations were developed on the recommendation of the business's consultative committee.

## 7.4 FINAL DECISION

The Commission has accepted the demand forecasts for Goulburn-Murray Water, Lower Murray Water (Rural) and Southern Rural Water.





# 8 FORM OF CONTROL

## 8.1 INTRODUCTION

Victorian water businesses can propose the form of price control they wish to use. Several forms of price control are used in Victoria, but revenue caps are the most common in rural areas. The various forms of price control have advantages and disadvantages in terms of risk sharing between businesses and their customers, price certainty, and flexibility to adjust prices to reflect changing circumstances. When considering an appropriate form of price control, businesses and the Commission weigh up factors including the nature and magnitude of any uncertainties, the potential impacts of unforeseen events on businesses' finances, customer preferences, and potential customer impacts.

## 8.2 OVERVIEW OF DRAFT DECISION

The Commission proposed to approve the forms of control and length of regulatory period proposed by the three rural businesses' as set out in table 8.1.

**TABLE 8.1 RURAL BUSINESSES' PROPOSED FORMS OF CONTROL**

<b>Rural water business</b>	<b>Proposed form of control</b>	<b>Proposed length of regulatory period</b>
Lower Murray Water (Rural)	Revenue cap	Five years
Goulburn-Murray Water	Revenue cap	Three years
Southern Rural Water	Hybrid revenue cap	Five years



Goulburn-Murray Water was required to propose a rebalancing constraint that applied to tariffs and charges, rather than average bills (which it proposed in its Water Plan). It was also required to submit a lower figure for its rebalancing constraint or to justify its proposal of 15 per cent if it intended to apply the rebalancing constraint to tariffs rather than bills.

The Commission proposed to require all businesses seeking a revenue cap or tariff basket to propose a rebalancing constraint to limit price volatility for customers. Lower Murray Water (Rural) and Southern Rural Water did not propose rebalancing constraints in their Water Plans and were required to respond to the draft decision with proposed rebalancing constraints.

In the draft decision the Commission proposed all rural water businesses' determinations for the third regulatory period would require businesses to consult with customers before proposing a material tariff change. Determinations would require water businesses, at their annual tariff approvals, to provide evidence of customer consultation (including customer consultative committees) and a statement on customer impacts and how the business will address those impacts.

### **8.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT**

The rural businesses responded to the requirements in the draft decision on the form of price control by proposing rebalancing constraints of 10 per cent on individual tariffs. The Commission has approved these rebalancing constraints. The rebalancing constraints will be applied at the annual tariff reviews and will apply to real tariff increases (inflation will be added after the constraint is applied).

The Commission has approved Goulburn-Murray Water's and Lower Murray Water (Rural)'s proposals to maintain revenue caps. The Commission has approved Southern Rural Water's proposal to maintain a hybrid revenue cap.

The Commission has approved Lower Murray Water (Rural)'s and Southern Rural Water's proposals for five year regulatory periods.





## 8.4 FINAL DECISION

The Commission has approved Goulburn-Murray Water's proposal to maintain a revenue cap.

The Commission has approved Lower Murray Water (Rural)'s proposal to maintain a revenue cap, and its proposed five year regulatory period.

The Commission has approved Southern Rural Water's proposed five year regulatory period and its proposal to maintain a hybrid revenue cap.

The Commission has approved Southern Rural Water's, Lower Murray Water (Rural)'s and Goulburn-Murray Water's proposed rebalancing constraints of 10 per cent on individual annual tariff increases.

Businesses' determinations for the third regulatory period will require businesses to consult with customers before proposing a material tariff change. Determinations will require water businesses, at their annual tariff approvals, to provide evidence of customer consultation (including customer consultative committees) and a statement on customer impacts and how the business will address those impacts.





# 9 RURAL TARIFFS

## 9.1 INTRODUCTION

Rural water businesses provide a range of services including bulk water, irrigation, drainage, domestic and stock and diversion services. These are monopoly services and are subject to price regulation.

The Commission regulates prices for Southern Rural Water under the Water Industry Regulatory Order (WIRO); and Goulburn-Murray Water's services and Lower Murray Water's rural services under the Water Charge (Infrastructure) Rules and the Australian Competition and Consumer Commission's (ACCC) pricing principles.

The Commission recognises rural water businesses face specific issues for tariff structures and pricing. They arise from differences in demand and supply balances in rural areas, the more specialised and commercial nature of rural water customers, and geographic and temporal differences in water usage patterns. Therefore, services, tariff structures and prices may differ significantly among water businesses and even among customers of the same water business.

The Commission considered whether businesses complied with the procedural requirements of the WIRO (for Southern Rural Water) and the WCIR (for Goulburn-Murray Water and Lower Murray Water (Rural)) and whether the necessary consultation with customers and stakeholders was effective. The Commission emphasised the importance of customer consultation in its guidance paper and assessed water businesses' customer consultation processes and customer impact assessments when considering rural tariff proposals for the third regulatory period.



## 9.2 OVERVIEW OF DRAFT DECISION

### 9.2.1 GOULBURN-MURRAY WATER

The Commission proposed to approve Goulburn-Murray Water's proposed rural tariff structures for irrigators including charges on: water and delivery shares; infrastructure access and use; and service point fees. Approved changes to tariffs and charges included:

- price increases for infrastructure access fees, to make charges more uniform across irrigation districts
- higher service point fees, to better reflect costs.

### 9.2.2 LOWER MURRAY WATER (RURAL)

The Commission proposed to approve Lower Murray Water (Rural)'s proposed changes to its tariff structures for tariffs for irrigation and drainage services for the Merbein, Red Cliffs and Robinvale regions; specific charges for stock and domestic and diverter services in Robinvale; and the Mildura district's charges for irrigation and stock and domestic services. Approved changes to tariffs and charges included:

- restructuring the Mildura district's charges to align them with those in other districts (to simplify and reduce the number of charges)
- real price rises of between -1.7 and 3 per cent in its irrigation districts
- discontinuing the region and district charges for Merbein, Red Cliffs, Robinvale, and the regional drainage charge for diverters.

The Commission considered the proposed simplified tariff structure for the Mildura irrigation district was consistent with the ACCC's pricing principles.

To ensure rural water businesses adequately consult with customers on tariffs for the third regulatory period, the Commission proposed to include in determinations a requirement that businesses consult with customers before proposing a tariff change at annual tariff reviews.



### 9.2.3 SOUTHERN RURAL WATER

The draft decision proposed to approve Southern Rural Water's charges for irrigation services (in the Macalister, Werribee, and Bacchus Marsh irrigation districts) and bulk water services (provided to urban water businesses and power companies). Approved features of the tariffs and charge proposal included:

- real price increases of 1.4 per cent or lower and maintaining its tariff structures in its irrigation districts
- increasing storage operator charges for Gippsland Water and revising its weightings for the Latrobe system.

## 9.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

### 9.3.1 GOULBURN-MURRAY WATER

Goulburn-Murray Water did not respond to the proposed tariffs in the draft decision.

#### Customer submissions

The Commission received submissions from other interested parties including comments on the following:

- Customers wanted to see the costs of delivering water reduced because of modernisation. Goulburn-Murray Water agreed its costs had changed but only some areas have been modernized. Both the old and new systems were in operation at present which meant costs had not declined yet.
- Customers thought that older channels that needed maintenance are a problem. Goulburn-Murray Water said the infrastructure and the service point fees would go up to provide funds for these.
- Customers were concerned about rises in service point fees. Goulburn-Murray Water said increases in service point fees are designed to send signals to rationalise outlets where possible.
- A customer said that drainage volume charges are unfair because variable charges assume all water is drained which fosters inefficient use of water. Goulburn-Murray Water agreed to review drainage charges.



The Commission recognises customer discontent with Goulburn-Murray Water's past engagement with customers, particularly on tariffs and charges. This was reflected in submissions to this price review. The Commission also recognises Goulburn-Murray Water is currently undertaking a substantial consultation process on its tariff and charge structures. During this consultation proposed changes to tariffs have been relatively minor. The Commission expects Goulburn-Murray Water to incorporate input from customers into its proposed tariff review.

The Commission is satisfied Goulburn-Murray Water's proposed structures for tariffs and charges meet the requirements of the ACCC's pricing principles.

### **9.3.2 LOWER MURRAY WATER (RURAL)**

The Commission requested Lower Murray Water (Rural) adjust its prices to reflect the approved maximum allowed revenue in the draft decision. Lower Murray Water (Rural) submitted the figures in table 9.1.

Following the draft decision, Lower Murray Water (Rural) submitted updated information to the Commission on factors including forecast energy costs and forecast demand. These factors are examined in chapters 4 and 7. Table 9.1 presents the price changes resulting from this updated information.



**TABLE 9.1 LOWER MURRAY WATER (RURAL) PRICES**  
real average annual bill change<sup>a</sup>

	<b>Proposed price rises</b>	<b>Proposed price rises post draft decision</b>
	<i>per cent</i>	<i>per cent</i>
Mildura irrigation and drainage	3.3	2.1
Merbein irrigation and drainage	1.7	0.3
Red Cliffs irrigation and drainage	-0.4	-1.7
Robinvale irrigation and drainage	3.0	1.5
Mildura High Pressure System	4.5	3.0
Diversions (Irrigation)	2.5	2.9
Millewa Urban (Irrigation)	0.0	0.7
Millewa Rural (Irrigation)	0.0	2.6
Other stock and domestic (Irrigation)	-0.4	-0.4

<sup>a</sup> The table shows percentage movement in the cost per ML expected for reference customers in each district. The reference customer is assumed to have 100 ML of storage entitlement and 100 ML per year usage (400 kL in the case of Millewa Urban, 4300 kL rural for customers and 1000 ML for Diversions customers). The calculation of bills excludes 'pass through' charges.

### **Mildura cost comparison**

At the Commission's public forum in November 2012, Lower Murray Water (Rural)'s customers questioned whether Lower Murray Water (Rural)'s costs for its irrigation districts were higher than other irrigation districts. The Commission engaged Indec Consulting to examine this issue and presented the findings at public forums and the public meeting in May 2013. Indec Consulting found that by one measure, costs in the Mildura district were higher than costs in South Australia's Central Irrigation Trust (CIT) district. However, Lower Murray Water (Rural) provided information which suggested that once differences in regulatory asset valuations were removed, its costs and those of other districts were comparable.

The Commission considers that the Indec Consulting report provides a basis for discussions between Lower Murray Water (Rural) and its Mildura customers on appropriate costs and levels of service. The Commission will release a second report by Indec Consulting when it is complete, to further assist discussions between Lower Murray Water (Rural) and its customers.



## Customer submissions

The Commission received comments on the draft decision for Lower Murray Water (Rural) at two public forums organised by the Commission, a privately organised meeting of local irrigators, and written submissions.

Most of the submissions were concerned about high prices for rural water services. In particular, customers were concerned that Lower Murray Water (Rural)'s costs may be higher than other water businesses without justification (investigated by Indec Consulting), and that individual items of expenditure were excessive.

The Commission investigated several items raised by customers:

- Customers raised concerns about service levels in Lower Murray Water (Rural)'s Robinvale district. The Commission has set service standards in this final decision will assess Lower Murray Water's compliance with them at the end of the third regulatory period.
- A customer raised a concern that Mildura irrigation customers were paying superannuation costs of Lower Murray Water (Rural)'s that should not apply to Mildura customers. The Commission found that Lower Murray Water (Rural)'s allocation of updated costs it accrued for a defined benefit superannuation scheme to the Mildura irrigation district was correctly applied because at the time of the merger the previous First Mildura Irrigation Trust (FMIT) had staff covered by a defined benefit superannuation scheme. The call for funds from the superannuation company included a requirement for funds to cover FMIT costs.
- A customer claimed there had been salary rises of 20 per cent for Lower Murray Water executives and that this was excessive. Overall, the Commission's review of expenditure confirmed that Lower Murray Water (Rural)'s total labour costs would increase at approximately the rate of inflation and its headcount has fallen in the current regulatory period. An increase in the number of staff in required reporting salary bands for 2011-12 accounted for an increase of 11 per cent in reported salaries. Lower Murray Water (Rural) is best placed to decide how staff costs are allocated within its overall budget. Any change in executive remuneration is in the context of overall flat labour costs in real terms.
- A customer queried whether consulting costs were included for the Sunraysia Modernisation Project business case. The Commission confirmed the costs of preparing the business cases for Sunraysia Modernisation Project (including





consultant costs) were not reclaimed in prices in the current regulatory period and were not applied for in the third regulatory period.

The Commission also received submissions from customers and Lower Murray Water (Rural) on the tariff structures for the Mildura district, particularly on whether charges appropriately relate to the costs of particular for services. The Commission is satisfied Lower Murray Water (Rural)'s proposed structures for tariffs and charges meet the requirements of the ACCC's pricing principles.

The Sunraysia Irrigators Council's written submission raised a number of points which included that the Commission was over-emphasising its responsibility to ensure sufficient revenue is raised to run Lower Murray Water (Rural)'s business, and that the Commission should focus on excessive spending on executive salaries and consultants among other matters. The submission also presented three motions passed at the 13 May Community Water meeting in Mildura which were that the meeting of customers: did not have confidence in Lower Murray Water's Board and senior management to deliver services efficiently and sustainably; demanded the Minister for Water replace the current Lower Murray Water Board with a customer elected Board; and demanded the Commission reject price rises proposed by Lower Murray Water.

After consideration of the matters raised by customers, Lower Murray Water (Rural) and information from Indec Consulting, the Commission has approved Lower Murray Water's proposed tariff structures.



### 9.3.3 SOUTHERN RURAL WATER

In response to the draft decision, Southern Rural Water informed the Commission of a customer-initiated proposal to increase the usage tariff in the Macalister Irrigation District (MID) by 10 per cent to avoid raising other tariffs during the third regulatory period. Southern Rural Water's explained the proposal as follows:

*At the direction of our Macalister Consultative Committee, we recently discussed historic usage information within the district. Within the context of declining usage, and regulation by a revenue cap, the committee endorsed a revision of the budgeted delivery volume in the MID (from 163GL to 148GL). This change results in a 10% increase to the usage tariff, and reduces the risk to irrigators that we will raise other tariffs within the Water Plan period to compensate for actual deliveries being less than the budget assumption (noting that all MID revenue is regulated by revenue cap).<sup>31</sup>*

The Commission considers this proposed tariff change is reasonable given it:

- will not alter Southern Rural Water's revenue because this charge is covered by a revenue cap
- the proposal was initiated by the Macalister Consultative Committee (a customer group).

The Commission has approved Southern Rural Water's proposed tariff structure.

## 9.4 FINAL DECISION

The Commission has approved Goulburn-Murray Water's, Lower Murray Water (Rural)'s and Southern Rural Water's rural tariff structures.

<sup>31</sup> Southern Rural Water 2013, *Submission to the Water Price Review draft decision 2013–18*, 2 May.



# 10 GROUNDWATER

## 10.1 INTRODUCTION

Groundwater is water sourced underground, usually through water bores. The rural water businesses provide groundwater services to customers such as licensing groundwater use. Groundwater services are prescribed under the Water Industry Regulatory Order (WIRO), which means the Commission can regulate groundwater prices.<sup>32</sup>

## 10.2 OVERVIEW OF DRAFT DECISION

The water businesses that provide groundwater services did not propose major changes to their groundwater charges in their Water Plans. Southern Rural Water and Lower Murray Water (Rural) did not propose any tariff restructuring. Goulburn-Murray Water proposed some rebalancing of tariffs to improve cost reflectivity.

The main elements of businesses' fees include fixed fees for licensing and variable charges for licensed water use.

The Commission proposed to approve the groundwater tariffs proposed by Goulburn-Murray Water, Lower Murray Water (Rural), and Southern Rural Water.

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<sup>32</sup> Groundwater services are not covered by the Water Charge (Infrastructure) Rules because they are not infrastructure-related.



### 10.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission did not receive any submissions on its draft decision on groundwater charges from Goulburn-Murray Water, Lower Murray Water (Rural) or Southern Rural Water, or any other interested parties.

### 10.4 FINAL DECISION

The Commission has approved the groundwater tariffs proposed by Goulburn-Murray Water, Lower Murray Water (Rural), and Southern Rural Water.



# 11 MISCELLANEOUS SERVICES

## 11.1 INTRODUCTION

As well as providing major rural water services (such as irrigation and groundwater services), rural water businesses provide miscellaneous services. Processing licence applications and licence transfers are examples of rural miscellaneous services. Miscellaneous services are part of a range of prescribed services under the Water Industry Regulatory Order (WIRO) for non-infrastructure related services and under the Water Charge (Infrastructure) Rules (WCIR) for infrastructure related services, and are subject to price regulation by the Commission.

Under the Commission's approach, each business was required to identify a core set of miscellaneous services. The core set should include businesses' most important miscellaneous services, including those expected to generate a significant proportion of total miscellaneous services revenue.

## 11.2 OVERVIEW OF DRAFT DECISION

In its draft decision,<sup>33</sup> the Commission proposed to approve Lower Murray Water (Rural)'s miscellaneous service charges because they met the requirements of the WIRO. The Commission proposed to approve Southern Rural Water's miscellaneous services charges subject to it providing definitions for its core miscellaneous services. The Commission proposed not to approve Goulburn-Murray Water's miscellaneous services and required it to provide a core set of miscellaneous services, clearly define the services, and identify the pricing principles it used to determine the charges.

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<sup>33</sup> Essential Services Commission 2013, *Price Review 2013: Regional urban water businesses — draft decision*, volume 1, March.



## 11.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

### 11.3.1 SOUTHERN RURAL WATER

In response to the draft decision, Southern Rural Water provided definitions for its core miscellaneous services. These definitions are available in Southern Rural Water's price determination. The Commission has approved these definitions.

### 11.3.2 GOULBURN-MURRAY WATER

In response to the Commission's draft decision, Goulburn-Murray Water stated it is reviewing its miscellaneous services tariffs to reduce the number. Goulburn-Murray Water stated, '...should specific tariffs be approved by the [Commission], this may limit the ability of [Goulburn-Murray Water] to undertake the necessary reforms in line with our Blueprint'.<sup>34</sup> Goulburn-Murray Water requested the Commission approve it setting miscellaneous services charges based on cost recovery principles, until its review is complete. The Commission has not accepted this proposal. The Commission considers the availability of scheduled prices for miscellaneous services is beneficial to customers. Customers should be able to obtain scheduled prices for core miscellaneous services before they request those services from a water business.

Following discussions with the Commission, Goulburn-Murray Water provided further information on miscellaneous services. This information is available in Goulburn-Murray Water's price determination. The Commission has approved these core miscellaneous services, definitions and pricing principles.

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<sup>34</sup> Goulburn-Murray Water 2013, *Submission to the Water Price Review Draft Decision 2013-18*, 2 May 2013, p. 4.



## 11.4 FINAL DECISION

The Commission has approved Lower Murray Water (Rural)'s, Goulburn-Murray Water's and Southern Rural Water's miscellaneous services.







# 12 ADJUSTING PRICES

## 12.1 INTRODUCTION

In the water industry, businesses' forecasts of future demand for their services and the cost of delivering those services can be a significant source of uncertainty. Despite this uncertainty, these forecasts are essential to determining each business's revenue requirements and price paths. The regulatory framework that governs these determinations is based on the assumption that, in most instances, the water businesses are better placed to manage this uncertainty than their customers and that one of their major roles is to manage this uncertainty on behalf of their customers.

Typically, regulators do not allow price adjustments within a regulatory period to reflect differences between the actual and forecast costs, demand or revenue (irrespective of whether these differences are to the detriment or the benefit of the water business) in the interests of ensuring customers can have confidence in the predictability of prices to be charged. Instead, the regulatory framework administered by the Commission seeks to provide the water businesses appropriate incentives to operate efficiently in managing uncertainty.

There are, however, possible circumstances that lie beyond the scope of the water business to manage within the prices approved at the start of a regulatory period. In circumstances where fluctuations and financial impacts of an event are large such that businesses are unable to manage those risks without jeopardising their service delivery obligations, the Commission approves the uncertain and unforeseen events mechanism. This mechanism sets out a process for applying for a re-opening of the Commission's price determination, either during or at the end of the regulatory period, to account for events that were uncertain or unforeseen at the time of the price review process.

The approach to adjusting prices within a regulatory period varies depending on the business. Southern Rural Water will continue to operate under the Water Industry Regulatory Order (WIRO). Lower Murray Water (Rural) and Goulburn-Murray Water are governed by the Water Charge (Infrastructure)



Rules 2010 (WCIR). Under the WCIR, the business can apply for a re-opening should an event occur during the regulatory period that materially and adversely affects the business, and the event could not reasonably have been foreseen. Further, approved prices may be varied when total expenditure required to rectify an adverse event will exceed \$15 million or 5 per cent of the businesses' total asset base, whichever is the lesser amount. Other conditions are also specified in the Australian Competition and Consumer Commission (ACCC) WCIR pricing principles document.<sup>35</sup>

## 12.2 OVERVIEW OF DRAFT DECISION

### 12.2.1 MID-PERIOD PRICE ADJUSTMENT PROCESS FOR SOUTHERN RURAL WATER

The Commission proposed to approve an uncertain and unforeseen events mechanism that sets out a process for businesses or the Commission to re-open price determinations to account for events that were uncertain or unforeseen at the time of the price review. The Commission approved an uncertain and unforeseen events mechanism in the 2008 water price review.

The Commission proposed that the uncertain and unforeseen events mechanism would account for events that were uncertain or unforeseen at the time of the price review, such as:

- unsustainable or unwarranted differences between actual and forecast demand
- changes in legislative and other government imposed obligations and
- catastrophic events (such as fire, earthquake or acts of terrorism).

The Commission proposed to only consider applications for events listed above that the business cannot control or efficiently manage without undermining its delivery of services to customers.

The Commission also proposed the mechanism will include new provisions that in certain cases — only for those where an uncertain and unforeseen event is material, and the effects of which can be isolated from broader operational

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<sup>35</sup> Australian Competition and Consumer Commission 2011, *Water Charge (Infrastructure) Rule* - pricing principles, July.



considerations — allows the Commission to limit a re-opening of determinations to the single event, rather than the full suite of factors influencing business costs and revenues (as applies under the general re-opener provision). The Commission also considered it appropriate to allow for price changes arising from the re-opening of a price determination to take effect at any time within the regulatory period.

The Commission considered a key threshold in deciding whether to approve a mid-period price adjustment is whether the business can absorb the impacts of any event that affects the costs or revenues. The Commission place particular emphasis on financial viability ratios in assessing the appropriateness of a mid-period price adjustment. The Commission also noted it expects businesses to demonstrate they exercised appropriate risk management processes to mitigate and plan for such events wherever possible.

### **12.2.2 MID-PERIOD PRICE ADJUSTMENT FOR GOULBURN-MURRAY WATER AND LOWER MURRAY WATER (RURAL)**

The Commission's draft decision noted it would consider applications for a mid-period price adjustment consistent with the WCIR.

The Commission noted the reasonable likelihood of Lower Murray Water (Rural) seeking to apply for a re-opening of their price determination. The need for a variation of prices will be influenced by the scope and scale of an infrastructure modernisation program in Lower Murray Water's regional, including the timing of government funding.

## **12.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT**

The Commission did not receive any feedback from the three rural water businesses (Lower Murray Water (Rural), Goulburn-Murray Water and Southern Rural Water).



## 12.4 FINAL DECISION

For all water businesses openly subject to the WIRO (including Southern Rural Water), the Commission has approved an uncertain and unforeseen events mechanism that sets out a process for the business or the Commission to re-open price determinations to account for events that were uncertain or unforeseen at the time of the price review.

The mechanism includes new provisions that in certain cases — only for those where an uncertain and unforeseen event is material, and the effects of which can be isolated from broader operational considerations — allows the Commission to limit a re-opening of determinations to the single event, rather than the full suite of factors influencing business costs and revenues (as applies under the general re-opener provision).

The Commission will allow for price changes arising from the re-opening of a price determination to take effect at any time within the regulatory period. Further detail is provided in the determination for Southern Rural Water.



# APPENDIX A - SUBMISSIONS

**TABLE A.1 SUBMISSIONS TO THE RURAL DRAFT DECISION**

<b>Submission</b>	<b>Date</b>
Darrin Hensgen	20 May 2013
Dianne Cowling	12 April 2013
Energy and Water Ombudsman Victoria (EWOV)	16 May 2013
Jim Belbin	15 May 2013
Merrilyn Whitecross	26 March 2013
Dominic Bartalotta	14 May 2013
Don Albanese	29 April 2012
Nancy Prevedello	17 May 2013
Mark Bull	16 May 2013
Sunraysia Irrigators Council	1 May 2013





# APPENDIX B – DOCUMENTS ATTACHED

**TABLE B.1 DOCUMENTS ATTACHED**

<b>Document</b>
Deloitte 2013 - <i>Further advice to the Commission in relation to regional water businesses' submissions on expenditure – letter</i> , May.
Indec Consulting 2013 – <i>Lower Murray Water Benchmarking comparison, final report</i> . May.
PricewaterhouseCoopers Australia 2013 - <i>Estimating a debt risk premium</i> . May.

**Note:** documents attached are available on the Commission's website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au)







# APPENDIX C – REVENUE REQUIREMENT

**TABLE C.1 REVENUE REQUIREMENTS — FINAL DECISION**

\$m 2012-13

	2013-14	2014-15	2015-16	2016-17	2017-18	Total
<b>Goulburn-Murray Water</b>						
Proposed revenue in the Water Plan	119.2	125.1	126.8	na	na	371.1
Draft decision	115.6	125.1	126.8	na	na	359.4
Final decision	116.0	122.7	123.5	na	na	362.2
Revenue from proposed prices <sup>a</sup>	118.8	118.5	118.8	na	na	356.2
<b>Lower Murray Water (Rural)</b>						
Proposed revenue in the Water Plan	26.4	27.4	27.8	27.9	27.9	137.4
Draft decision	26.3	27.3	27.6	27.7	27.8	136.7 <sup>b</sup>
Final decision	26.8	27.5	27.8	27.9	27.9	137.8
Revenue from final decision prices	26.8	27.1	27.5	28.0	28.5	137.8
<b>Southern Rural Water</b>						
Proposed revenue in the Water Plan	28.2	28.5	28.9	28.9	28.7	143.2
Draft decision	28.0	28.3	28.7	28.7	28.4	142.1
Final decision	27.7	27.5	27.8	28.1	28.0	139.1
Revenue from final decision prices	28.0	27.6	27.8	28.0	27.6	139.1

**Note:** Goulburn-Murray Water has a three year price period for the third regulatory period. Rounding means the numbers in this table may differ slightly from actual final decision numbers.

<sup>a</sup> Goulburn-Murray Water's proposed prices recovered less than its proposed revenue and the revenue approved by the Commission in this decision. <sup>b</sup> The allowed revenue in the final decision is higher because of revised volume estimates which have increased allowed pumping costs. **na** Not applicable.