



Level 2, 35 Spring St
Melbourne 3000, Australia
Telephone +61 3 9651 0222
 +61 1300 664 969
Facsimile +61 3 9651 3688

2008 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:
SOUTHERN RURAL WATER

MARCH 2008

An appropriate citation for this paper is:

Essential Services Commission 2008, *2008 Water Price Review Draft Decision Volume II: Southern Rural Water*, March.

1. Purpose of volume II of the draft decision

The Commission is required to issue a Draft Decision that proposes either to:

- (a) approve all of the prices which a regulated entity may charge for prescribed services, or the manner in which such prices are to be calculated or otherwise determined, as set out in the regulated entity's water plan, until the commencement of the next regulatory period or
- (b) refuse to give the approval referred to above and specifies the reasons for the Commission's proposed refusal (which may include suggested amendments to, or action to be taken in respect of, the Water Plan that, if adopted or taken, may result in the Commission giving that approval) and the date by which a regulated entity must resubmit a revised Water Plan or undertake such action as to ensure compliance.

This Volume of the Draft Decision summarises for each business the suggested amendments or actions that if adopted or taken may result in the Commission giving its approval to the relevant business's proposed prices or the manner in which such prices are to be calculated or otherwise determined. The main reasons for suggested amendments or actions are summarised. More detailed reasons for the Commission's suggested amendments are outlined in Volume I of the Draft Decision.

2. Actions to be taken in response to this draft decision

In response to this Draft Decision, Southern Rural Water should by 9 May 2008 resubmit:

- (a) its proposed schedule of tariffs to apply for each year of the regulatory period commencing 1 July 2008 that reflects:
 - (i) the revised revenue requirement set out in Table 3
 - (ii) any changes to tariff structure suggested by the Commission.
- (b) the service standards to apply over the regulatory period consistent with any revisions suggested by the Commission set out in Tables 1–2.

If a business does not submit a revised schedule of tariffs and/or the service standards to apply, or otherwise make a submission as to why it has not adopted the Commission's suggested amendments by the due date, the Commission will specify the prices, or manner in which prices are to be calculated or otherwise determined and the service standards to apply for the regulatory period 2008-09 to 2012-13 as part of its Final Determination.

3. Service standards

The Commission proposes to approve each of the service standards proposed in Southern Rural Water's Water Plan, except as indicated in table 1.

Table 1 Approved service standards

<i>Service standard</i>	<i>Draft decision – service standards</i>				
	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Gravity Supply					
Irrigation water orders delivered on day requested (per cent)					
Number of channel burst and leaks (per 100 km of channel)					
Unaccounted for water (per cent)				by region	below
Irrigation drainage (by district/supply system)					
Availability of surface drainage schemes (per cent)					
Licensing/administration					
Applications for surface diversion, groundwater or supply-by-agreement licences determined within [X] days (per cent)					
Processing permanent transfer of surface diversion or groundwater licences within [X] days (per cent)					
Processing temporary transfer of water entitlement volumes within [X] days (per cent)					
Processing permanent transfer of water entitlement volumes within [X] days (per cent)					
Number of diversion licences metered or assessed for metering at 30 June (per cent)					
Volume of total surface water and groundwater entitlements metered at 30 June (per cent)					
Customer service					
Complaints to EWOV					
Telephone calls answered within 30 seconds					

Note Data rounded to one decimal place. **n.p.** = Not provided.

According to Southern Rural Water, the business currently does not have the systems in place that would allow them to measure the percentage of telephone calls answered within 30 seconds and are therefore unable to put forward a target for this standard.

The Commission also notes that Southern Rural Water has proposed the additional service standards outlined in table 2.

Table 2 Additional service standards

<i>Service standard</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Macalister irrigation district					
Flow Rate Consistency - Automated System	75.0	76.0	77.0	78.0	79.0
Flow Rate Consistency - Manual System	TBD	TBD	TBD	TBD	TBD
Average Order Lead Time	TBD	TBD	TBD	TBD	TBD
Delivery Reliability	99.0	99.0	99.0	99.0	99.0
Delivery Efficiency	66.0	67.0	68.0	70.0	74.0
Customer Satisfaction Index	76.00	n/a	78.00	n/a	80.00
Werribee & Bacchus Marsh irrigation district					
Volume Consistency	90.00	91.00	92.00	93.00	95.00
Average Order Lead Time	TBD	TBD	TBD	TBD	TBD
Delivery Reliability	99.0	99.0	99.0	99.0	99.0
Delivery Efficiency	72.00	72.00	72.00	72.00	72.00
Customer Satisfaction Index	76.00	n/a	78.00	n/a	80.00
Headworks					
Release Reliability	95.00	95.00	95.00	95.00	95.00
ANCOLD Dam Monitoring Compliance	99.0	99.0	99.0	99.0	99.0
Portfolio Risk	100.00	100.00	100.00	100.00	100.00
Bulk Entitlement Breaches	TBD	TBD	TBD	TBD	TBD
Licensing					
Farm Dam Construction Licences 60 days					
Bore Construction Licences 14 days	100.00	100.00	100.00	100.00	100.00
Surface And Groundwater Licences 60 days	100.00	100.00	100.00	100.00	100.00

Note Data rounded to one decimal place.

4. Guaranteed service level scheme

The business has not proposed to introduce a GSL scheme in the forthcoming period.

5. Revenue requirement

The Commission has adopted the following assumptions in relation to the revenue required over the regulatory period.

Table 3 Breakdown of revenue requirement implied by ESC draft decision
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-2012</i>	<i>2012-13</i>
Operating expenditure	17.69	17.22	17.19	16.82	16.62
Return on existing assets	1.41	1.31	1.20	1.11	1.02
Return on new investments	0.23	0.68	1.32	2.67	4.93
Regulatory depreciation	1.91	2.32	2.71	2.93	3.46
Adjustments from previous period	2.13	2.13	2.13	2.13	2.13
Renewals annuity	1.74	1.74	1.74	1.74	1.74
Total	25.12	25.40	26.30	27.40	29.91

6. Rolled forward regulatory asset base

The regulatory asset base as at 1 July 2005 has been rolled forward to reflect approved capital expenditures net of customer contributions (new customer and shareholder contributions) and disposals for the 2005-06 to 2007-08 period less any approved allowance for regulatory depreciation. The rolled forward values are shown in table 5.

Table 4 Updated regulatory asset base
\$ million in January 2007 prices

	<i>2005-06</i>	<i>2006-07</i>	<i>2007-08</i>
Opening RAB	1.47	2.80	4.65
<i>Plus</i> Gross Capital expenditure	1.58	2.31	19.92
<i>Less</i> Government contributions	0.00	0.00	0.00
<i>Less</i> Customer contributions	0.00	0.00	0.00
<i>Less</i> Proceeds from disposals	0.00	0.00	0.00
<i>Less</i> Regulatory depreciation	0.24	0.46	0.64
Closing RAB	2.80	4.65	23.93

The regulatory asset base as at 1 July 2007 will be rolled forward to reflect approved estimates of capital expenditure net of customer contributions (new customer and shareholder contributions) and disposals for the 2007-08 to 2012-13 period less any approved allowance for regulatory depreciation.

The Commission has adopted the following assumptions in relation to regulatory asset base over the regulatory period:

Table 5 **Rolled forward regulatory asset base**
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Opening RAB	23.9	29.7	35.3	47.5	76.5
<i>Plus</i> Gross Capital expenditure	12.0	11.7	15.0	32.1	45.7
<i>Less</i> Government contributions	3.7	3.7	0.0	0.0	0.0
<i>Less</i> Customer contributions	0.5	0.1	0.1	0.1	0.1
<i>Less</i> Proceeds from disposals	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Regulatory depreciation	1.9	2.3	2.7	2.9	3.5
Closing RAB	29.7	35.3	47.5	76.5	118.6

7. Weighted average cost of capital

The Commission has adopted a weighted average cost of capital (WACC) of 6.1 per cent for all water businesses. The table below outlines the individual components for the WACC.

Table 6 **Real post-tax WACC**

<i>Real risk free rate</i>	<i>Equity beta</i>	<i>Market risk premium</i>	<i>Debt margin</i>	<i>Financing structure</i>	<i>Franking credit value</i>	<i>WACC</i>
<i>(per cent)</i>	<i>(β)</i>	<i>(per cent)</i>	<i>(per cent)</i>	<i>(per cent)</i>	<i>(%)</i>	<i>(per cent)</i>
3.41	0.65	6.00	1.95	60	0.5	6.1

8. Operating expenditure

The Commission has made the following assumptions about operating expenditure forecasts over the regulatory period:

Table 7 **Proposed and approved operating expenditure assumptions**
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Proposed operating expenditure	17.53	17.15	17.21	16.94	16.83
Revisions and adjustments	0.16	0.07	-0.02	-0.12	-0.21
Draft decision – operating expenditure	17.69	17.22	17.19	16.82	16.62

The Commission's assumptions reflect the following adjustments to Southern Rural Water's proposed operating expenditure forecasts:

Table 8 **Adjustments to operating expenditure**
\$ million in January 2007 prices

<i>Expenditure item</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Productivity adjustment	0.00	-0.08	-0.16	-0.25	-0.33
Environmental contribution	0.16	0.15	0.14	0.13	0.12
Total	0.16	0.07	-0.019	-0.118	-0.207

- (a) No business revisions were proposed after the submission of the Water Plan
- (b) Advice was received from the Department of Human Service on their licence fees and the Department of Sustainability and Environment on the environmental contribution for the regulatory period. Adjustments were made so operating expenditure reflected the Department's advice (Draft Decision section 4.9)

9. Capital expenditure

The Commission has made the following assumptions about capital expenditure forecasts over the regulatory period:

Table 9 Proposed and approved capital expenditure assumptions
\$ million in January 2007 prices

		<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Proposed capital expenditure	Gross	12.09	11.87	15.12	32.21	45.79
	Net	7.80	8.03	14.99	32.08	45.67
Draft decision – capital expenditure	Gross	11.97	11.75	15.00	32.09	45.67
	Net	7.68	7.91	14.87	31.97	45.55

The Commission's assumptions reflect the following adjustments to Southern Rural Water's proposed capital expenditure forecasts:

Table 10 Adjustments to capital expenditure
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Metering Program	-0.12	-0.12	-0.12	-0.12	-0.12
Total ESC Adjustment	-0.12	-0.12	-0.12	-0.12	-0.12

- (a) Metering program - Cardno recommended that an allowance for meter reading and repair/maintenance of water meters be removed from the expenditure forecast (Cardno, section 4.2)
- (b) Macalister Irrigation District – The proposed expenditure for this project has not been included in prices by Southern Rural Water, as there is uncertainty surrounding government funding being granted and therefore no adjustment has been made. However if this funding was granted during the period Southern Rural Water's determination could be adjusted to include the government contribution for this project and any impact on prices.

Southern Rural Water has identified the following key capital projects to be undertaken during the regulatory period.

Table 11 Key capital projects

	<i>Expected completion date</i>
Macalister Irrigation District 2030	Post 2012-13
Channel Automation	2009-10
Metering Program	2012-13
Macalister Irrigation District Carp Damage (Renewal)	2012-13
Melton Embankment Program	2012-13

10. Demand forecasts

The Commission has adopted Southern Rural Water's proposed demand forecasts.

11. Form of price control

- (a) The Commission proposes to approve a revenue cap for Southern Rural Water's services excluding recycled water and fee-based (diversions) applications and individual price caps for its recycled water and fee-based (diversions) applications.
- (b) Southern Rural Water should submit a schedule of prices to apply from 1 July 2008 for all its services, as well as a process in which tariffs can be adjusted on an annual basis for its recycled water and fee-based (diversions) applications.
- (c) Southern Rural Water may apply for an adjustment to its prices or tariff strategy at the time of the annual price review. It would have to demonstrate in its application to the Commission that it has clearly articulated a new tariff strategy (or explained how the proposed price changes are consistent with its existing tariff strategy), undertaken appropriate customer consultation and addressed customer impacts. The average annual price increase across the range of tariffs could not be greater than the average increase calculated under a tariff basket approach. The Commission may then approve amended individual price caps for the remainder of the regulatory period.

12. Pass through mechanisms

Businesses may apply to the Commission to adjust their prices either at the end of the regulatory period or during the regulatory period for specified costs where these are materially different from the costs included for the purposes of the Determination. Pass through mechanisms may apply in the following cases:

- (a) Prices will be adjusted at the end of the regulatory period to reflect any difference between assumed and actual licence fees levied by the EPA, DHS and the ESC. To avoid any doubt, the assumed licence fees payable for each year of the regulatory period are set out in Table 12.

Table 12 Approved licence fee assumptions^a
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-2012</i>	<i>2012-2013</i>
Essential Services Commission	0.03	0.03	0.03	0.03	0.03
Environment Protection Authority	0.00	0.00	0.00	0.00	0.00
Department of Human Services	0.00	0.00	0.00	0.00	0.00

^a Included in forecasts of business as usual operating expenditure.

- (b) Prices will be adjusted at the end of the regulatory period to reflect the additional net operating costs associated with meeting changes in legislative obligations during the regulatory period where:
- (i) the impact on costs is equivalent to at least 5 per cent of the business's revenue over the regulatory period
 - (ii) changes in costs relate to changes in primary Acts and legislative instruments, including regulations; in taxes (or fees or similar charges) excluding income tax, penalties and interest on taxes, stamp duty, financial institutions duty or similar taxes and levies; to EPA licence requirements; and/or to the Statement of Obligations
 - (iii) the change in legislative obligation was unforeseen and not already reflected in expenditure forecasts
 - (iv) additional capital costs will be rolled into the regulatory asset base at the beginning of the next regulatory period where the expenditure is assessed as being prudent and efficient, and prices will be adjusted to reflect any associated financing costs.
- (c) Prices may be adjusted during the regulatory period to reflect costs associated with catastrophic events, such as fire, earthquake or act of terrorism, where:
- (i) the impact on costs is so significant as to prevent the business meeting its service requirements and obligations without compromising its financial viability during the period
 - (ii) the business can demonstrate that it had taken appropriate steps to plan for or manage the potential impact of such an event.
- (d) Prices may be adjusted during the regulatory period to reflect expenditure relating to major capital projects where:
- (i) the business has separately identified any uncertain major capital projects and excluded those projects from its expenditure forecasts
 - (ii) the Commission has identified the project as an uncertain major capital project in the Final Determination

- (iii) the application process for determining the amount, nature and timing of any adjustment will be set out in the Final Determination.
- (e) Prices may be adjusted during the regulatory period to reflect any significant differences between actual and forecast demand levels where:
 - (i) the Commission determines that actual demand levels are significantly different from those forecast for the purposes of the Final Determination
 - (ii) the Commission finds a material impact on the business's revenues.

13. Tariffs

- (a) Southern Rural Water did not propose individual tariffs in its Water Plan.
- (b) In response to the Draft Decision, Southern Rural Water is required to propose individual tariffs for each service component in each year of the regulatory period. The proposed tariffs should be consistent with the Draft Decision on Southern Rural Water's revenue requirement and demand and should show consideration of the issues raised in Chapter 13 of Volume I.

14. Recycled water

- (a) The Commission considers that Southern Rural Water should set its recycled water prices according to a set of principles that ensure that prices:
 - (i) have regard to the price of any substitutes and customers' willingness to pay
 - (ii) cover the full cost of providing the service (with the exception of services related to specified obligations or maintaining balance of supply and demand)
 - (iii) include a variable component.
- (b) Where a business does not propose to fully recover the costs associated with recycled water, it must demonstrate to the Commission that:
 - (i) it has assessed the costs and benefits of pursuing the recycled water project
 - (ii) it has clearly identified the basis on which any revenue shortfall is to be recovered
 - (iii) if the revenue shortfall is to be recovered from non-recycled water customers, either that the project is required by 'specified obligations' or that there has been consultation with the affected customers about their willingness to pay for the benefits of increased recycling.