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2013 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:
SOUTHERN RURAL WATER

MARCH 2013

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SOUTHERN RURAL WATER

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 2 May 2013 resubmit:

- (a) its proposed schedule of tariffs to apply for each year of the regulatory period commencing 1 July 2013 that reflects:
 - (i) the revised revenue requirement set out in table 2
 - (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.

The Commission also requires Southern Rural Water to propose a rebalancing constraint on its tariffs, in response to this draft decision.

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 2013-14 to 2017-18 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 as set out in table 1, below.

Table 1 Approved service standards

<i>Service standard</i>	<i>Draft decision – service standards</i>				
	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Macalister Irrigation District					
Flow rate consistency - automated outlets	85%	85%	87%	87%	90%
Flow rate consistency - manual outlets	55%	57%	58%	60%	60%
Orders delivered within 1 day of requested	94%	95%	96%	97%	97%
Order delivered within AM or PM	65%	70%	72%	75%	75%
Delivery reliability (time that the delivery system is available to supply without constraint)	99%	99%	99%	99%	100%
Delivery efficiency (percentage of water released into the system delivered to customers.)	74%	74%	74%	74%	77%
Customer satisfaction (measured through a biannual customer survey.)	80%	80%	80%	80%	80%
Social benefit (percentage of outlets that are automated)	8%	9%	10%	11%	12%
Application processing	97%	98%	98%	98%	98%
Werribee Irrigation District					
Volume accuracy (percentage of orders where the actual volume delivered is within a defined range of the ordered volume)	93%	93%	94%	94%	94%
Orders delivered within 1 day of requested	70%	70%	80%	80%	80%
Delivery reliability	99.7%	99.7%	99.7%	99.7%	99.7%
Delivery efficiency	65%	65%	66%	66%	69%

<i>Service standard</i>	<i>Draft decision – service standards</i>				
	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Overall customer satisfaction	65%	65%	65%	65%	70%
Drought resilience (percentage of high reliability entitlement that can be delivered from alternative sources when river water allocation falls to 20%)	90%	TBD	TBD	TBD	TBD
Water quality(percentage of time that the salinity of recycled water is below 1800 EC)	100%	100%	100%	100%	100%
Bacchus Marsh Irrigation District					
Volume accuracy	93%	93%	94%	95%	95%
Orders delivered within 1 day of requested	70%	70%	70%	80%	80%
Delivery reliability	99.7%	99.7%	99.7%	99.7%	99.7%
Delivery efficiency	65%	66%	66%	66%	67%
Customer satisfaction	75%	75%	75%	80%	80%
Drought resilience	20%	20%	20%	20%	20%
Groundwater and Rivers					
Compliance actions within standard	91%	92%	93%	94%	95%
<i>Inspections</i>					
New extraction licences	95%	95%	95%	95%	95%
10% of new D&S bores	9.9%	9.9%	9.9%	9.9%	9.9%
All new C & D class bores	99%	99%	100%	100%	100%
All new farm dams	95%	95%	96%	96%	96%
<i>Engagement</i>					
Attending major field days	5	5	5	5	5
Local Water Reports	10	10	10	10	10
Customer Information Sessions	3	3	3	3	3
<i>Other</i>					
Customer satisfaction	75%	77%	77%	80%	80%
Stakeholder satisfaction	70%	75%	75%	80%	80%
Compliance with metering plan	72%	74%	76%	78%	80%
Urban Water and Power Companies					
<i>Roslynne</i>					
Orders released on time	95%	95%	95%	95%	95%
Release availability	99.6%	99.6%	99.6%	99.6%	99.6%
Release Accuracy - Customer orders	93%	93%	93%	93%	93%
Customer Satisfaction	73%	76%	78%	78%	80%

<i>Service standard</i>	<i>Draft decision – service standards</i>				
	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
<i>Merrimu</i>					
Orders released on time	97%	98%	99%	99%	99%
Release availability	99.6%	99.6%	99.6%	99.6%	99.6%
Release Accuracy - Customer orders	92%	95%	95%	95%	95%
Customer Satisfaction	73%	76%	78%	78%	80%
<i>Latrobe</i>					
Orders released on time	97%	97.5%	98%	98.5%	99%
Release availability	99.2%	99.4%	99.6%	99.7%	99.8%
Release Accuracy - Customer orders	84%	85%	86%	88%	90%
Customer Satisfaction	75%	79%	83%	87%	90%

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 2 **Breakdown of revenue requirement implied by ESC draft decision**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Operating expenditure	21.35	21.05	20.86	20.71	20.55
Return on existing assets	1.69	1.52	1.37	1.24	1.13
Return on new investments	0.23	0.63	0.97	1.28	1.57
Regulatory depreciation	3.24	3.72	4.04	4.19	4.11
Renewals annuity	1.31	0.87	0.67	0.43	0.00
Adjustments from previous period	0.17	0.52	0.74	0.88	1.08
Total	27.99	28.31	28.65	28.72	28.45

The Commission proposes to approve Southern Rural Water's revenue proposal subject to the required amendments set out in the chapters on operating and capital expenditure, and financing capital investments.

The Commission proposes to approve Southern Rural Water's proposal to phase out its annuities.

6. Rolled forward regulatory asset base

The regulatory asset base as at 1 July 2007 will be rolled forward to reflect approved actual capital expenditure net of customer contributions (new customer and shareholder contributions) and disposals for the 2007-08 to 2011-12 period less any approved allowance for regulatory depreciation. The rolled forward values are shown in table 4.

Table 3 **Updated regulatory asset base - urban**
\$m 2012-13

	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>
Opening RAB	5.5	12.0	24.8	29.6	32.8
<i>Plus</i> Gross Capital expenditure	17.0	16.5	8.4	7.5	8.2
<i>Less</i> Government contributions	8.9	0.4	0.1	0.0	0.0
<i>Less</i> Customer contributions	0.0	0.2	0.1	0.1	1.0
<i>Less</i> Proceeds from disposals	0.8	0.8	0.7	1.2	0.8
<i>Less</i> Regulatory depreciation	0.8	2.3	2.7	3.1	3.4
Closing RAB	12.0	24.8	29.6	32.8	35.8

The regulatory asset base as at 1 July 2012 will be rolled forward to reflect approved estimates of capital expenditure net of customer contributions (new customer and shareholder contributions) and disposals for the 2012-13 to 2017-18 period less any approved allowance for regulatory depreciation.

The Commission has adopted SRW's 2012-13 proposed net capital expenditure to be rolled into the RAB.

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

Table 4 **Rolled forward regulatory asset base**
\$m 2012-13

	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Opening RAB	35.8	37.7	43.8	47.9	51.9	55.3
<i>Plus</i> Gross Capital expenditure	14.0	15.0	15.2	12.1	11.0	10.0
<i>Less</i> Government contributions	0.0	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Customer contributions	7.4	4.8	6.7	3.2	2.5	0.6
<i>Less</i> Proceeds from disposals	0.7	0.8	0.8	0.9	0.9	0.9
<i>Less</i> Regulatory depreciation	4.0	3.2	3.7	4.0	4.2	4.1
Closing RAB	37.7	43.8	47.9	51.9	55.3	59.7

7. Weighted average cost of capital

The Commission has adopted a weighted average cost of capital (WACC) of 4.7 per cent for all water businesses. The table below outlines the individual components for the WACC.

Table 5 **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 (gearing)</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>γ</i>	<i>per cent</i>
0.679 – 1.023	0.65	6.0%	3.03 – 4.53%	60%	0.5	4.7%

8. Operating expenditure

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

Table 6 **Proposed and approved operating expenditure assumptions**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed operating expenditure	21.36	21.06	20.87	20.71	20.56
Revisions and adjustments	-0.01	-0.01	-0.01	-0.01	0.00
Draft decision – operating expenditure	21.35	21.05	20.86	20.71	20.55

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

Table 7 **Adjustments to operating expenditure**
\$m 2012-13

<i>Expenditure item</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Environmental contribution	-0.011	-0.011	-0.011	-0.011	-0.011
Licence fees	0.001	0.001	0.001	0.002	0.007
Total	-0.010	-0.010	-0.010	-0.009	-0.004

- (a) Adjustments reflect recent advice from the Department of Sustainability and Environment on environmental contribution for the next regulatory period (chapter 6 of volume I of this draft decision).
- (b) Adjustments reflect recent advice from the Department of Health and Environment Protection Authority on their respective licence fees for the next regulatory period (chapter 6 of volume I of this draft decision).

9. Capital expenditure

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

Table 8 Proposed and approved capital expenditure assumptions
\$m 2012-13

		<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed capital expenditure	Gross	15.0	15.2	12.1	11.0	10.0
	Net	10.2	8.6	8.9	8.5	9.4
Draft decision – capital expenditure	Gross	15.0	15.2	12.1	11.0	10.0
	Net	10.2	8.6	8.9	8.5	9.4

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

Table 9 Adjustments to capital expenditure
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Total ESC Adjustment	0	0	0	0	0

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

Table 10 Key capital projects

	<i>Expected completion date</i>
MID 2030 leading works program: Southern Cowwarr balancing storage	2013-14 to 2017-2018
MID 2030 leading works program: Nambrok Denison regulator retrofit	2013-14 to 2017-2018
Werribee irrigation future program: piping or lining 4/1 channel	2013-14 to 2017-2018
MID 2030 leading works program: outlet rationalisation	2013-14 to 2017-2018
Interim flood capacity design at Merrimu reservoir	2013-14 to 2017-2018
MID 2030 leading works program: Eastern regulator retrofit	2013-14 to 2017-2018
Replacement of conduit at Melton reservoir	2013-14 to 2017-2018
Heyfield regulator retrofit	2013-14 to 2017-2018
Carp damage channel rehabilitation	2013-14 to 2017-2018

10. Demand forecasts

Generally, Southern Rural Water's 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 conceded that the new HRWS will result in higher usage and proposed that usage will average at 70 per cent of the new water shares. On that basis, the Commission agrees with Frontier Economics' recommendations and has adopted the revised volumes for the purposes of this Draft Decision.

Table 11 Delivery share – water usage fee
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed – Macalister/Thomson system	142 422	143 011	143 599	146 099	146 099
Draft decision – Macalister/Thomson system	142 412	142 824	143 236	144 986	144 986

11. Form of price control

- (a) The Commission proposes to approve Southern Rural Water's proposal to continue to apply a hybrid revenue cap.
- (b) The Commission proposes to require all rural water businesses to consult with customers before proposing a material tariff change to the Commission at the annual tariff approval process. The determinations will require water businesses to provide evidence of customer consultation (including customer consultative committees) and a statement about customer impacts and how the business will address those impacts.
- (c) The Commission requires Southern Rural Water to propose a rebalancing constraint on its tariffs.

12. Tariffs

- (a) The Commission proposes to approve Southern Rural Water's proposed rural tariff structures.
- (b) The Commission proposes to approve the groundwater tariffs proposed by Southern Rural Water.

13. Miscellaneous services

- (a) The Commission proposes to approve Southern Rural Water's miscellaneous service charges subject to the business defining its core miscellaneous services.

14. Reopening prices

For the third regulatory period, the Commission proposes to approve an uncertain and unforeseen events mechanism that sets out a process for a reopening of price determinations to account for events that were uncertain or unforeseen at the time of the price review, which the businesses could not control or effectively manage such as:

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

Key features of the mechanism are:

- (d) A water business (by application to the Commission) or the Commission may initiate a reopening.
- (e) Prices can either be raised or reduced as a result of an uncertain or unforeseen event.
- (f) An adjustment to prices may be implemented by the Commission at any time within a regulatory period (and not only on 1 July in any year), or at the end of the regulatory period.
- (g) There will be no nominal thresholds for applications (based on differences between forecast and actual outcomes for expenditure, revenue and demand). However in applying to reopen a decision, the water business will need to demonstrate it does not have the financial resources or operational capacity to manage its exposure.
- (h) The Commission proposes to reserve the discretion to limit the reopening of a determination to a single event, rather than the full suite of factors influencing business costs and revenues where:
 - i. the impact of an uncertain and unforeseen event on business costs or revenues is material, and
 - ii. the effects of which can be isolated with certainty

The commission will only approve a mid-period price adjustment proposed by a water business, when it is satisfied:

- (i) the event is clearly outside the business's control and not predictable with any confidence
- (j) the business has exhausted all opportunities within its control to mitigate against the circumstances in which it finds itself, including demonstrable reprioritisation of its operating and capital expenditure programs
- (k) customers are not unduly exposed to risk or price fluctuations
- (l) the impact of the event is material, clearly observable and verifiable, and
- (m) the net impact on costs or revenue of all changes that occurred during the period being considered is significant (except in cases where the Commission identifies a material event for which the effects can be isolated).

In determining whether a mid-period price adjustment is appropriate the Commission will focus on the business's ability to absorb the impacts of any event on costs or revenues, with particular emphasis on the business' viability ratios.