



PRICE REVIEW 2013:RURAL WATER BUSINESSES

Draft Decision – Executive Summary

March 2013

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 that will be delivered and the levels of service promised to customers.

Consultation with stakeholders is an important part of the price review process. To inform water businesses and their customers of our expectation regarding the water planning process, we released a guidance paper in October 2011. In November 2012, we released a paper summarising the businesses' proposals and highlighting issues on which we were seeking stakeholder comments. The Commission received five written submissions. In addition during November and December 2012 we held public meetings around the state where the water businesses presented their proposals. Customers and community and business groups, then had the opportunity to respond.

The Commission has also formed a Customer Reference Panel. It includes consumer and business representative groups as well as individual customers. The panel provides the Commission with its views on the issues its members consider important for its price review.

This draft decision is the next stage in the Commission's consultation process. As well as undertaking its own analysis, the Commission also engaged expert consultants to assess and provide advice on the demand and expenditure proposals put forward by the businesses.

Interested parties can comment on the Commission's approach and proposed decisions before it makes its final decision in June 2013, by either making a written submission or attending public meetings in April 2013.

CONTEXT AND KEY ISSUES

Southern Rural Water's Water Plan will be assessed to the *Water Industry Regulatory Order (WIRO)*, consistent with previous price decisions. However, Lower Murray Water (Rural) and Goulburn-Murray Water are also now covered under the Australian Competition and Consumer Commission (ACCC) framework and the Commission will regulate them under licence from the ACCC, and assess their proposed tariff structures against the ACCC's Water Charge (Infrastructure) Rules (WCIR).

The next regulatory period will see continuing uncertainty about rural modernisation for Lower Murray Water (Rural), Goulburn-Murray Water and Southern Rural Water. Ongoing consultation with 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 ACCC pricing principles which were made under the WCIR and require tariffs to be set to:

- promote the economically efficient use of water infrastructure assets

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

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

KEY OUTCOMES AND SERVICE LEVELS

At the start of the second regulatory period, rural water businesses proposed targets for a core set of service standards provided by the Commission. However, the variability of the districts serviced by the rural businesses meant a single set of standards could not reflect the diverse needs of all rural customers. For this reason, the rural water businesses developed standards that reflect their unique operating environment and customers' preferences, based on consumer consultation and experience.

Lower Murray Water (Rural) proposed to retain its standards and 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, and Goulburn-Murray Water proposed a new set of standards to reflect its operations.

The Commission proposes 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.

The businesses' revenue requirements comprise their forecast operating expenditure, a return on assets (existing and new assets) and regulatory depreciation (return of assets).

Table 1 compares the businesses' proposed revenue requirements to the revenue from their proposed price increases. Each business proposed to recover less from prices than their calculated revenue requirement. Goulburn-Murray Water has a three year price period for the next regulatory period.

TABLE 1 REVENUE REQUIREMENT – PROPOSED COMPARED WITH DRAFT DECISION
(\$m 2012-13)

	2013-14	2014-15	2015-16	2016-17	2017-18	Total WP3
Goulburn-Murray Water						
Revenue from proposed prices	118.8	119.5	119.6	n/a	n/a	357.9
Proposed revenue	119.2	125.1	126.8	n/a	n/a	371.1
Draft Decision	115.6	121.5	122.3	n/a	n/a	359.4
Lower Murray Water Rural						
Revenue from proposed prices	26.1	26.7	27.4	28.0	28.6	137.0
Proposed revenue	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
Southern Rural Water						
Revenue from proposed prices	28.2	28.4	28.7	28.9	28.6	142.8
Proposed revenue	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

Note: Goulburn-Murray Water has a three year price period for the third regulatory period. Rounding means the numbers here may differ slightly from actual draft decision numbers.

Based on this draft decision reduction in revenue requirements, there is some scope for small price reductions for Southern Rural Water and Lower Murray Water

(Rural) customers. The businesses will need to propose how they intend to pass on these reductions to prices for different services and districts in response to this draft decision. In the case of Goulburn-Murray Water, the prices proposed are below the draft decision revenue requirements even with the revenue reductions identified by the Commission. The Commission proposes to approve Goulburn-Murray Water's proposed prices.

FORM OF PRICE CONTROL

The Commission proposes to approve key elements of rural water businesses' proposals for price control, including Goulburn-Murray Water's and Lower Murray Water's proposals to maintain revenue caps, and Southern Rural Water's proposal to continue to apply a hybrid revenue cap.

The Commission proposes for all rural businesses to include rebalancing constraints within their price controls so customers do not face unreasonably high year-on-year price increases. This was a concern of customers in some districts during the second regulatory period.

The Commission has not approved Goulburn-Murray Water's proposed rebalancing constraint as it did not sufficiently protect customers against price volatility. The Commission requires the business to resubmit a proposal for a rebalancing constraint.

The Commission 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 CAPITAL INVESTMENTS

The Commission applied a real weighted average cost of capital (WACC) for the three rural businesses of 4.7 per cent. This is notably lower than the current WACC of 5.8 per cent. This reduction is the main reason for the Commission's proposed revenue reductions.

RURAL TARIFF STRUCTURES

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 with the aim of developing simplified tariffs.

The Commission approved Lower Murray Water's proposal to restructure its tariffs for the Mildura irrigation district to align them with its other districts. Generally the business proposed to maintain 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 proposes to approve the groundwater charges for the rural water businesses. It also proposes to approve the miscellaneous service charges proposed by Lower Murray Water (Rural). However, it requires additional information from Southern Rural Water and Goulburn-Murray Water before it will approve their miscellaneous service charges.

ADJUSTING PRICES DURING THE PERIOD

The Commission proposes to approve 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 will take into account only factors that do not fall within the businesses' control. The Commission strongly encourages the water businesses to seek to manage such circumstances within their existing budgets, to ensure customers do not face unnecessary price changes and avoid price volatility.

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