

Goulburn-Murray Water price review 2020

Draft guidance on price submission under the WIRO

October 2018



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1. Introduction

Goulburn-Murray Water's prices are regulated under two regulatory frameworks:

- Goulburn-Murray Water's infrastructure-related services are regulated under the Commonwealth Government's Water Charge (Infrastructure) Rules (WCIR). These rules cover approximately 95 per cent of Goulburn-Murray Water's total regulated costs.
- Goulburn-Murray Water's groundwater, unregulated surface water diversions and some miscellaneous services are not infrastructure related, and are regulated under the Water Industry Regulatory Order 2014 (WIRO).¹

The purpose of this paper is to consult with stakeholders on our proposed guidance for Goulburn-Murray Water's 2020 water price review on services covered by the WIRO. We have released our final guidance paper for services covered by the Commonwealth Water Charge (Infrastructure) Rules (WCIR).² Both our WCIR guidance paper and draft WIRO guidance paper should be read concurrently. We will consider feedback prior to releasing a final guidance paper in late December 2018.

This draft guidance covers our minimum information requirements for Goulburn-Murray Water's price submission for the regulatory period 1 July 2020 - 30 June 2024. Our new incentive mechanism called PREMO will not apply to Goulburn Murray Water's services covered by the WIRO as only a small proportion of these services are part of Goulburn Murray Water's operations.

The WIRO requires us to issue guidance covering a range of matters to inform Goulburn-Murray Water's price submission, and to consult prior to issuing guidance.³ The matters we must address in our guidance are provided at Box 1.1. The decision to approve charges associated with services covered by the WIRO will be made in accordance with clauses 10 and 11 of the WIRO.

We have aligned, where possible, the regulatory requirements in this guidance with those in the guidance issued under the WCIR to minimise Goulburn-Murray Water's regulatory costs. We have referenced the WCIR guidance where it is consistent with our WIRO guidance.

¹ The remaining 5 per cent of Goulburn-Murray Water's total regulated costs are regulated under the WIRO.

² Under the WCIR we are not required to issue a draft guidance.

³ WIRO, clause 13.

Box 1.1 WIRO requirements of guidance

13. Commission guidance and price submission

(a) Before making a price determination and following consultation, including with the relevant regulated entity, the Commission must provide guidance to the regulated entity setting out:

(i) the manner in which the Commission proposes to regulate the prices which the regulated entity may charge for prescribed services for the regulatory period consistent with section 33(5) of the ESC Act and this Order;

(ii) the approach and methodology which the Commission proposes to adopt to assess a price submission and make a price determination for the regulatory period consistent with section 33(2) of the ESC Act and this Order;

(iii) the Commission's expectations of the nature and scope of matters to be addressed by the regulated entity in its price submission;

(iv) the Commission's expectations regarding customer consultation by the regulated entity in developing its price submission;

(v) the Commission's expectations of the information required to be provided by the regulated entity to enable the Commission to make a price determination;

(vi) the timing and processes the Commission proposes to follow in making a price determination consistent with section 35 of the ESC Act and the Commission's Charter of Consultation and Regulatory Practice;

(vii) the date by which the regulated entity is to deliver its price submission to the Commission; and

(viii) any other matter that the Commission considers should be included in the guidance provided to the regulated entity or in the regulated entity's price submission.

(b) The Commission may at any time vary or add to the guidance provided to the relevant regulated entity following consultation, including with the regulated entity.

2. Assessing Goulburn-Murray Water's price submission

2.1. Manner of regulating prices

Goulburn-Murray Water currently has a revenue cap form of price control. The form of control can be an important means of managing risk for water businesses and also has implications for how price changes will affect water customers.

We anticipate Goulburn-Murray Water will continue with a revenue cap form of price control, and a similar rebalancing constraint, for the next regulatory period. If Goulburn-Murray Water wishes to propose a new form of price control, we expect it to discuss this with customers and us before submitting its pricing submission.

Any change in approach will need to be justified in its price submission in accordance with the *Water Industry Regulatory Order 2014* (WIRO) framework. Further discussion on our proposed approach to the form of price control and rebalancing constraints is outlined in the *Water Charge (Infrastructure) Rules 2010* (WCIR) guidance at section 9.

2.2. Approach and methodology

We propose to continue to use the building block methodology applied at Goulburn-Murray Water's last price review. This aligns with the approach adopted for Goulburn-Murray Water's services under the WCIR. Our methodology under the WIRO guidance is similar to that under the WCIR guidance where there is overlap between the two regulatory frameworks.

The building block methodology sets revenue to reflect efficient costs of service provision. Further, it provides for the financial viability of the regulated business, making it consistent with the WIRO's efficiency and financial viability requirements. The building block methodology is outlined in more detail in the WCIR guidance at section 2.3.

We will assess Goulburn-Murray Water's price submission according to our legal requirements as set out in Attachment 1.

2.3. Nature and scope of price submission

Goulburn-Murray Water's price submission must provide sufficient information for us to assess its proposals for services, expenditure, revenue and tariffs. A significant amount of the information we require should be readily available to Goulburn-Murray Water, and should be relevant for other purposes such as corporate planning or project justification and prioritisation. Goulburn-Murray

Water will need to supply information relating to its expenditure, demand, revenue and prices for those tariffs that are regulated under the WIRO.

2.4. Length of regulatory period

We propose Goulbourn-Murray Water continue with a four year regulatory period for its services regulated under the WIRO. This will be consistent with the requirements under the WCIR which only provides for a four year regulatory period for WCIR regulated services.

2.5. Goulburn Murray Water's engagement on price submission

Goulburn-Murray Water must engage with its customers during the development of its price submission. We will assess whether Goulburn-Murray Water has engaged thoroughly with customers on its proposals, particularly with those customers affected by the proposals.

To facilitate our assessment, Goulburn-Murray Water's price submission must detail the nature and extent of its engagement processes, including matters on which it has engaged, and customers' responses.

2.6. Financial model

Goulburn-Murray Water must complete the financial model prepared by us to accompany its price submission. The financial model enables Goulburn-Murray Water and us to estimate prices, and provides detailed information that allows us (with the assistance of consultants where appropriate) to evaluate assumptions used to estimate prices. One financial model combining both WCIR and WIRO regulated services will need to be completed. Further discussion on our expectations on Goulburn-Murray Water's financial model is outlined in our WCIR guidance at section 2.2.2.

2.7. Regulatory Asset Base (RAB) roll forward

The RAB represents the unrecovered cost of prudent capital expenditure. This is the value on which a business can expect to earn a return (return on capital), and the value that is returned to the business over the economic life of the assets (as regulatory depreciation). The RAB is updated each year to reflect any additional capital expenditure net of contributions (from government and customers), proceeds from asset disposals, and regulatory depreciation. It is also adjusted for inflation. Further discussion on our proposed approach on the RAB roll forward is outlined in the WCIR guidance at section 7.2.

2.8. Cost of capital

The rate of return is used to calculate a return on a business's investments in regulated assets. We will decide what rate of return is used for Goulburn-Murray Water for the next regulatory period. We

propose to base it on the approach specified by the WCIR, consistent with our approach in the 2016 final decision.⁴ Further discussion of our approach to assessing the rate of return is set out in the WCIR guidance at section 7.3.

2.9. Miscellaneous services

Goulbourn-Murray Water's prices for miscellaneous services must be set according to actual costs calculated on the basis of the aggregate of:

- direct third party or contractor invoice cost
- direct marginal internal costs, including labour, materials and transport costs and
- a fair contribution to overheads.

For bank dishonour, debt collection and legal fees, the third party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

2.10. Information requirements of price submission

1. Goulburn-Murray Water's price submission needs to explain and justify its proposed prices.
2. The submission must demonstrate how Goulburn-Murray Water has had regard to the matters in clause 11 of the WIRO, while giving emphasis to matters related to economic efficiency and financial viability (consistent with clause 8 of the WIRO).⁵
3. The price submission must demonstrate how Goulburn-Murray Water provided stakeholders with a clear understanding of its price proposals and provide sufficient information for us to analyse and review its proposals. Goulburn Murray Water should consider the needs of different stakeholders that are likely to have an interest in its submission. For example, customer committees and customers must be consulted on issues such as prices and levels of service.
4. Goulburn-Murray Water will be required to complete a financial model, and include the model with its price submission. Goulburn Murray Water should submit financial data for its groundwater and unregulated surface water services on a stand-alone basis to enable us to assess its cost reflectivity.

⁴ Essential Services Commission 2016, *Goulburn-Murray Water Price Review 2016— final decision*, June.

⁵ The matters referred to in clause 11 of the WIRO have been grouped into themes in Attachment 1.

5. All financial values in Goulburn-Murray Water's price submission and financial model must be in real 2019-20 dollars (with the March quarter 2019 CPI as the base).
6. Goulburn-Murray Water's written submission and its financial model must be consistent.
7. Goulburn-Murray Water must separately list its top main miscellaneous services (by forecast revenue) for the next regulatory period and the following period up until at least 2027-28, in the financial model.

Any changes made by Goulburn-Murray Water to its proposals during the price review must be reflected by Goulburn-Murray Water in its financial model. Any adjustments to the model made by Goulburn-Murray Water must be explained to our satisfaction. We will retain discretion not to incorporate any adjustments to Goulburn-Murray Water's financial model in our assessment of prices if the reasons for the changes are unclear or not justified.

3. We are seeking your feedback on our draft guidance

3.1. Approach to consultation by the commission during the price review

We will tailor our consultation to reflect stakeholder comments and work already undertaken by Goulburn-Murray Water. We will make our papers and Goulburn-Murray Water's submissions (including Goulburn-Murray Water's submitted financial model) available on our website (www.esc.vic.gov.au).

3.2. Due date and timing and processes

Table 3.1 Indicative Consultation Timetable

Indicative dates	Activity
October 2018	draft WIRO and WCIR guidance released
December 2018	final WIRO guidance released
15 November 2019	final price submission submitted to the commission
November 2019 to February 2020	commission assesses the price submission and Goulburn-Murray Water responds to Commission and consultant queries
March 2020	commission releases draft decision
March 2020 to April 2020	commission consultation on draft decision
June 2020	commission releases final decision

3.3. How to provide feedback on the draft guidance

Stakeholders may wish to provide feedback on this guidance before we finalise it. Written comments received by 4 December 2018 will be considered by us.

We would prefer to receive written comments via water@esc.vic.gov.au

You can also send comments by mail to:

Water Team

Essential Services Commission

Level 37, 2 Lonsdale Street

Melbourne VIC 3000

Our normal practice is to publish feedback on our website. If there is information that Goulburn Murray Water or a customer does not want disclosed publicly, because it is confidential or commercially sensitive, the matter should be discussed with our staff before lodging the submission.

We are seeking your feedback on our draft recommendations

Essential Services Commission **Goulburn-Murray Water price review 2020**

Attachment 1

Matters that water businesses and the commission must have regard to

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
<ul style="list-style-type: none"> • promotion of efficient use of prescribed services by customers [cl 8(b)(i), WIRO] • promotion of efficiency in regulated entities as well as efficiency in, and the financial viability of, the regulated water industry [cl 8(b)(ii), WIRO] • provision to regulated entities of incentives to pursue efficiency improvements [cl 8(b)(iii), WIRO] • efficiency in the industry and incentives for long term investment [s 8A(1)(a), ESC Act] • efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry [s 33(3)(b), ESC Act] • financial viability of the industry [s 8A(b)(1), ESC Act] 	<ul style="list-style-type: none"> • particular circumstances of the regulated industry and the prescribed goods and services for which the determination is being made [s 33(3)(a), ESC Act] • return on assets in the regulated industry [s 33(3)(c), ESC Act] • ensure that regulatory decision making and regulatory processes have regard to any differences between the operating environments of regulated entities [s 4C(b), WI Act] 	<ul style="list-style-type: none"> • in performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers [s 8(1), ESC Act] without derogating from that objective. The Commission must in seeking to achieve the objective have regard to the price, quality and reliability of essential services [s 8(2), ESC Act] • enable customers or potential customers of the regulated entity to easily understand the prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated [cl 11(d)(i), WIRO] • provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible [cl 11(d)(ii), WIRO] • take into account the interests of customers of the regulated entity, including low income and vulnerable customers [cl 11(d)(iii), WIRO]

Benchmarking	Health, safety and social obligations	Other
<ul style="list-style-type: none"> any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries [s 33(3)(d), ESC Act] 	<ul style="list-style-type: none"> the relevant health, safety, environmental and social legislation applying to the industry [s 8A(1)(d), ESC Act] to ensure that regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities [s 4C(c), WI Act] 	<ul style="list-style-type: none"> the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries [s 8A(1)(c), ESC Act] consistency in regulation between States and on a national basis [s 8A(1)(f), ESC Act] the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for—(i) consumers and users of products or services (including low income and vulnerable consumers) (ii) regulated entities [s 8A(1)(e), ESC Act] wherever possible, to ensure that the costs of regulation do not exceed the benefits [s 4C(a), WI Act]