



PRICE REVIEW: REGIONAL URBAN WATER BUSINSSES

Final Decision

June 2013

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PREFACE

This final decision completes the Essential Services Commission's review of regional urban Victorian water businesses. Service standards, total expenditure and a price path (with maximum water and sewerage prices) are now approved for the 12 regional urban businesses for next five years commencing on 1 July 2013.

The Commission has assessed the Water Plans of the regional urban water businesses in accordance with the Water Industry Regulatory Order. The Commission has also taken into account the views of customers and independent assessments by experts engaged to assist the Commission. In reaching its final decision, 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 and practice, this review has been undertaken in an open and consultative manner. This has included the release of a draft decision in March 2013 and numerous public meetings in April and May 2013. In total, 175 public submissions were received during the review. The Commission also met with the water businesses, community and business organisations and customer advocacy groups to obtain further information and feedback.

The Commission's final decision results in a \$200 million revenue reduction compared with the original proposals of the water businesses. Consequently, price increases are significantly lower than initially proposed in the Water Plans, though there is some variation across the State.

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, audit and publicly report on the performance of the regional urban water businesses in delivering services to their customers.

The Commission thanks the 12 regional urban water businesses and the many customers who have contributed to this price review.

Dr. Ron Ben-David

Chairperson

GLOSSARY

2nd regulatory period	The period commencing 1 July 2008 and expiring 30 June 2013.
3rd regulatory period	The period commencing 1 July 2013 and expiring on 30 June 2018.
4th regulatory period	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.
Building block	The allowed revenue of the regulated firm is equal to the sum of underlying components or building blocks consisting of the return on capital, the return of capital (also known as depreciation), the operating expenditure, and various other components such as taxes and incentive mechanisms.
Bulk water	Water supplies between water businesses.
Capital expenditure	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.
Cistern	Waterproof receptacle for holding liquids, usually water. Cisterns are often built to catch and store rainwater.



Class A	Recycled water treated to a level that allows it to be used for residential uses such as toilet flushing, washing machines and gardens. Not fit for human consumption.
Consumer price index	The consumer price index published by the Australian Bureau of Statistics.
Core miscellaneous services	'Top 10' miscellaneous services that make up a majority of the revenue from miscellaneous services.
Core service standards	<p>A common set of measurable aspects of metropolitan and regional water businesses' performance, established by the Commission. The core set is intended to reflect aspects of water businesses' services of greatest concern to customers.</p> <p>All water businesses are required to propose annual targets, in their Water Plans for each of the standards.</p>
Customer Service Code	A code issued under section under section 4F of the <i>Water Industry Act</i> which set out the terms and conditions of service and supply.
Environmental Contribution	The Minister of Water determines an Environmental Contribution which is levied on all Victorian water businesses, to meet costs associated with managing environmental water. It is levied under section 192 of the <i>Water Industry Act 1994</i> and administered by the Department of Sustainability and Environment.
EPA Victoria	EPA is part of the environment portfolio (along with the Department of Environment and Primary Industries and Sustainability Victoria) charged with protecting the Victorian environment.
Fixed charge/ fixed service fee	Charge for service that is the same regardless of the quantity used.



Form of price control	The high-level principles that determines the structure of tariffs and charges. For example, price caps or revenue caps.
Guaranteed Service Level (GSL) scheme	An arrangement whereby water businesses provide a payment or rebate on bills to customers who receive services that do not meet predefined performance levels. The scheme is a mechanism for businesses to publicly acknowledge that service levels for some customers maybe significantly worse than average, while also providing a financial incentive to the business to avoid such incidents.
Guaranteed service levels (GSL)	Predefined performance levels for a particular service standard.
Headworks	Dams, weirs and associated works used for the harvest, storage and supply of water.
Inclining block tariff (IBT)	Provide two or more prices for water used, where each price applies to a customer's use within a defined tier. Prices rise with each successive tier.
Licence Fee – Department of Health (DoH)	Fee payable to the Victorian Government determined by the Minister for Health under section 51 of the <i>Safe Drinking Water Act 2003</i> , for costs incurred by the Department of Health in administering the Safe Drinking Water Regulations.
Licence Fee – Environmental Protection Authority (EPA)	Fee payable to EPA determined by the Minister for the Environment under section 24 of the <i>Environment Protection Act 1970</i> , for costs incurred by EPA Victoria in administering discharge licences and works approvals with the amount depending on the type of operation and the volume and quality of any discharge to the environment.



Licence Fee – Essential Services Commission (ESC)	Fee determined by the Minister for Finance in consultation with the Minister for Water under section 4H(2) of the <i>Water Industry Act 1994</i> , for costs incurred by the Essential Services Commission in administering the economic regulatory framework.
Locational pricing	Prices for the same service differentiated by location.
Long run marginal cost (LRMC)	The change in total cost resulting from a one unit change in output, over a long enough timeframe such that no inputs are ‘fixed’. It is the sum of short run marginal operating and long run marginal capital costs.
Megalitre	1000 kilolitres = 1 million litres
Miscellaneous services	Prescribed services that water businesses may provide to customers. For example, new connections, special meter reads and meter testing, the provision of property information statements and review of applications to build over easements.
New customer contributions (NCC)	New Customer Contributions are an upfront payment that may be levied by a water business when a customer builds or develops a property and connects to that water business’s water, sewerage or recycled water network. Also known as developer charges.
Operating expenditure	Ongoing cost for running a product, business, or system.
Potable water	Water treated to a drinkable standard.
Pre-treatment	When a trade waste customer establishes processes to pre-treat or pre-clean trade waste before it is discharged into the sewage system.
Price cap	An imposed upper limit on the price that can be charged for each individual tariff.



Price determination	A determination in respect of a water business made by the Commission under section 33 of the <i>Essential Services Commission Act 2001</i> and clause 8 of the <i>Water Industry Regulatory Order 2003</i> .
Pricing zone	A defined geographic area that has specific water and/or sewerage prices based on local servicing costs (see locational pricing).
Recycled water	Wastewater that is treated to a standard appropriate for its intended use.
Regional urban water businesses	Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Goulburn Valley Water, Gippsland Water, North East Water, South Gippsland Water, Wannon Water, Westernport Water, GWMWater (Urban), Lower Murray Water (Urban)
Regulatory depreciation	An amount set to allow the regulated water businesses to recover the cost of capital investments over time. Also known as Return on Assets.
Reticulation	A network of local pipelines used for transporting water or sewerage.
Revenue cap	An approved maximum amount of revenue that a business is allowed to collect in each year of the regulatory period. If the business collects too much revenue, it must alter its prices to ensure that this revenue is passed back to customers in subsequent years.
Revenue requirement	The revenue needed by each water business to cover operating costs and taxes, and provide a return on assets and a return of assets (depreciation).
Rural water businesses	Goulburn-Murray Water, GWMWater (Rural), Lower Murray Water (Rural), Southern Rural Water.



Service standard targets	Specific targets proposed by businesses for each of the core service standards (see: core service standards) and any additional service standards in their water plan. Each target sets the performance the business aims to achieve for that service standard over the regulatory period.
Sewage	Liquid waste discharged into the sewerage system.
Sewerage	A physical arrangement of pipes and plant for the collection, removal, treatment and disposal of liquid waste.
Statement of Obligations	There is a Statement of Obligations for each water business, specifying a number of requirements that the individual businesses must follow. They were made most recently by the Minister for Water under section 4I of the <i>Water Industry Act 1994</i> , commencing from 16 September 2012.
Tariff basket	Allows the business to flexibility to change tariffs within a regulatory period. However, in any given year, the weighted average price change across all the business's tariffs must not exceed an approved overall percentage price for that year of the regulatory period.
Tariff schedules	A list of prices arranged or organised in a particular order.
Tariff Structure	The way prices are organised. For example, two part tariff (fixed service charge and IBT variable charge).
Third pipe/dual reticulation	The mechanism in which treated effluent or recycled water is supplied for residential urban re-use.
Trade waste	Industrial and commercial liquid waste (other than sewage) which is suitable for discharged to the sewerage system.



Trade waste customer	A customer who discharges or intends to discharge trade waste into a water business's sewer.
Variable charge	Charge for product/service based on the quantity used. Also known as a volumetric charge.
Wastewater	Includes greywater, sewage and stormwater.
Water Charge (Infrastructure) Rules (WCIR)	The Rules which apply to the regulation of entities in the Murray-Darling Basin. The rules were developed by the Australian Competition and Consumer Commission under the <i>Water Act 2007 (Cth.)</i> .
Water Plan	A Water Plan is a document prepared and published by a water business which sets out the services and key projects it proposes to deliver, as well as proposed prices, over the next regulatory period. The primary purpose of the Water Plan is to inform and seek feedback from the public.
Water storages	A space to hold water, such as a dam or reservoir.
Weighted average cost of capital (WACC)	The rate that the water business is expected to pay, on average, to all its security holders to finance its assets.





ACRONYMS

CALC	Consumer Action Law Centre
BOOT	Build-own-operate-transfer
COD	Chemical oxygen demand
CPI	Consumer price index
CUAC	Consumer Utilities Advocacy Centre
DEPI	Department of Environment and Primary Industries
DoH	Department of Health
DSP	Development serving plans
EPA Victoria	Environmental Protection Agency Victoria
ESC	Essential Services Commission
EWOV	Energy and Water Ombudsman Victoria
FAL	Financial accommodation levy
GBE	Government business enterprises
GSL	Guaranteed service levels
ISD	Intelligent Software Design
LRMC	Long run marginal cost



MRP	Market risk premium
NCC	New customer contributions
OLV	Office of Living Victoria
RAB	Regulatory asset base
SA	South Australia
SCADA	Supervisory control and data acquisition
TDS	Total dissolved solids
VCOSS	Victorian Council of Social Services
WACC	Weighted average cost of capital
WCIR	Water Charge (Infrastructure) Rules
WIRO	Water Industry Regulatory Order



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SUMMARY OF FINAL DECISION

BACKGROUND AND THE COMMISSION'S TASK

In October 2012, 12 regional urban water businesses — Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water (Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water — submitted their final Water Plans to the Essential Services Commission (the Commission) for assessment.

The businesses' Water Plans are for the five year regulatory period commencing on 1 July 2013. The Water Plans set out each business's expected costs of delivering water and sewerage services, planned capital works programs, the forecast volumes of water to be delivered and the levels of service promised to customers. Each business also proposed prices that they considered would raise sufficient revenue to recover expected costs. The Commission required the water businesses to consult with their customers when developing their Water Plans.

The Commission is required to assess proposed prices and revenue against the regulatory principles set out in the Water Industry Regulatory Order (WIRO) issued by the Minister for Water. The WIRO principles require, among other things, that prices are set to:

- generate a business's revenue requirements 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 the costs of and provide incentives for sustainable water use and
- account for the interests of customers.

The Commission's task is to approve the proposed prices or alternatively to specify prices to apply if it is not satisfied they were calculated or determined consistent with the regulatory principles.



In reaching its final decision, the Commission consulted widely and undertook an extensive analysis of the proposals included in the businesses' Water Plans. The Commission's consultation process included:

- releasing a summary paper (November 2012) and a draft decision (March 2013) for public comment
- conducting public meetings in November and December 2012, and in April and May 2013 to obtain feedback from stakeholders and
- forming and meeting with a Customer Reference Panel to obtain further information and feedback.

The Commission also worked with consultants to assess whether the businesses' proposed expenditures were reasonable.

In March 2013, the Commission released a draft decision for the regional urban water businesses, setting out its analysis, proposed adjustments and requests for further information from the businesses. Each business had the opportunity to submit any revised proposals in response to the draft decision. Generally, the 12 regional urban businesses agreed with the substantial elements of draft decisions, but proposed some modifications or clarifications.

This paper sets out the Commission's final decisions on the prices to apply from 1 July 2013. The prices or manner in which prices are determined over the regulatory period are set out in a determination specific to each business. The determinations take effect from 1 July 2013 and will apply to 30 June 2018. This final decision also contains the reasons and analysis supporting each business's determination.

KEY ISSUES

The Victorian water sector has confronted some major challenges in recent years. While the second regulatory period (2008-2013) was overshadowed by a period of drought that resulted in major investments in new sources of water supply, the third regulatory period (2013-2018) will see reduced capital spending reflecting the completion of this investment phase and more stable pricing.



The key issues for the price review included:

- ensuring water businesses continue to pursue improvements in operational efficiency and
- understanding customers' expectations and their willingness to pay for different service offerings.

Specific concerns raised by customers, and community and business groups during the price review included:

- the impact of past and proposed price increases, particularly for customers experiencing financial hardship
- the implementation of any proposed price increases, namely, whether increases should be 'smoothed' over a number of years rather than implemented as a 'one-off' initial increase
- the mix of fixed and variable water charges and the consequences for different customer groups such as tenants (who only directly pay the variable charge)
- expectations that service levels should at least be maintained and
- support for introducing a guaranteed service level scheme for all businesses.

Unless otherwise specified, all values shown in this final decision and supporting material are nominated in \$2012-13. In other words, prices will be adjusted each year to correct for actual inflation.

FINAL DECISION OUTCOMES

This final decision is largely consistent with the Commission's draft decision in March 2013. Discussed below are the key outcomes of this final decision.

SERVICE STANDARDS

In most instances, the regional urban water businesses will maintain their service standards during the coming five years (see chapter 3). Further, all regional urban water businesses have introduced guaranteed service level (GSL) schemes. These schemes will compensate customers when they experience long or frequent disruptions to water services or sewage spills.



REVENUES

The businesses identified their revenue requirements for the third regulatory period in their Water Plans. These revenue forecasts reflected their expected operating expenditure, a return on assets (existing and new assets) and regulatory depreciation (return of assets). The 12 water businesses covered in this final decision sought total revenues of \$4.2 billion over the next five years. The Commission's final decision results in a revenue requirement for the 12 regional businesses of \$4.0 billion, \$200 million lower than proposed by the businesses. This is consistent with the draft decision. This downward adjustment to their proposed revenue mainly reflects the Commission's decision not to approve all the expenditure sought by the water businesses in their Water Plans and the lower costs of financing capital investments. By way of comparison, in the last price review (2008-13) the Commission approved \$3.7 billion for the same 12 businesses.

Table 1 presents each business's revenue requirement. Revenue requirements are discussed further in chapter 4.

TABLE 1 TOTAL REVENUE REQUIREMENTS – FINAL DECISION
\$m 2012-13

	Proposed by business	Final decision	Difference	Difference per cent
Barwon Water	919.9	872.3	-47.6	-5.2
Central Highlands Water	414.2	390.8	-23.3	-5.6
Coliban Water	520.2	467.0	-53.1	-10.2
East Gippsland Water	153.6	149.1	-4.5	-2.9
Gippsland Water	569.8	545.1	-24.7	-4.3
Goulburn Valley Water	348.2	324.5	-23.6	-6.8
GWMWater	295.7	280.5	-15.2	-5.1
Lower Murray Water (Urban)	162.3	158.9	-3.4	-2.1
North East Water	275.7	261.6	-14.1	-5.1
South Gippsland Water	135.7	126.6	-9.1	-6.7
Wannon Water	328.7	318.7	-10.0	-3.0
Westernport Water	102.4	95.5	-6.9	-6.7
Total revenue requirement	4 226.3	3 990.7	-235.6	-5.6

The Commission's main adjustments that resulted in the lower revenue requirement include:

Operating expenditure (chapter 5)

The Commission's final decision results in a total operating expenditure benchmark over five years from 1 July 2013 of around \$2496 million, which is \$69 million (or 2.7 per cent) lower than the total proposed by the water businesses in their Water Plans. The businesses' operating expenditure is slightly higher than the Commission's draft decision, reflecting additional information received from water businesses.

Capital expenditure (chapter 6)

The Commission's final decision results in a total capital expenditure benchmark over five years from 1 July 2013 of \$1433 million which is \$47 million (or 3.2 per cent) lower than proposed by the water businesses in their Water Plans. The Commission has approved some further increases to businesses' capital expenditure after the businesses provided additional information.

Financing costs (chapter 7)

The Commission approved a real post tax weighted average cost of capital of 4.5 per cent, reflecting current market conditions. This is significantly lower than the 5.8 per cent that applies in the current regulatory period and slightly lower than the 4.7 per cent in the Commission's draft decision.

PRICES

The 12 water businesses proposed average price increases over the regulatory period ranging from -3.4 per cent to 28.3 per cent. In its draft decision, the Commission proposed to accept price changes ranging from -10.8 per cent to 20 per cent over the period. Following the adjustments made by the Commission and businesses' responses to the draft decision, the Commission has accepted price adjustments that range from -7.6 per cent to 16.0 per cent over the coming five years.

Table 2 outlines the proposed and final prices for each regional urban water business. Chapter 2 discusses price outcomes in greater detail.



TABLE 2 AVERAGE PRICE CHANGES - PROPOSED BY BUSINESSES AND FINAL DECISION COMPARISON 2013-14 TO 2017-18
 \$m 2012-13

	Proposed by business	Final Decision	Difference <i>per cent</i>
Barwon Water	0.7	-7.6	-8.3
Central Highlands Water	8.4	1.1	-7.3
Coliban Water	28.3	16.0	-12.3
East Gippsland Water	6.9	0.2	-6.7
Gippsland Water	5.0	-3.1	-8.1
Goulburn Valley Water	12.6	-1.2	-13.8
GWMWater	12.4	3.1	-9.3
Lower Murray Water (Urban)	11.4	9.2	-2.1
North East Water	12.0	-3.2	-15.2
South Gippsland Water	10.2	-4.8	-15.0
Wannon Water	-3.4	-5.9	-2.6
Westernport Water	18.6	0.4	-18.2

In most instances, the proportional reduction in prices exceeds the reduction in revenues. This is because of variations in the forecasts for water consumption and customer numbers over the next five years (see chapter 9).

HOUSEHOLD BILLS

Consistent with its draft decision, the Commission's final decision means household water and sewerage bills will not increase as much as sought by the businesses in their Water Plans. Table 3 presents indicative bills for owner-occupiers in 2012-13 and 2017-18, comparing the prices proposed by the businesses' in their Water Plans and prices resulting from the Commission's final decision. Table 4 compares indicative bills for tenants. These estimates exclude the impact of inflation.



The typical bills shown in tables 3 and 4 are based on typical consumption figures for owner-occupiers and tenants, respectively, in the largest town serviced by each water business (some water businesses vary prices by location). Bill outcomes will vary for individual customers.

TABLE 3 INDICATIVE ANNUAL RESIDENTIAL OWNER-OCCUPIER BILLS – FINAL DECISION^a
\$2012-13

	Current bill	Bills based on businesses' proposals		Bills based on final decision	
	2012-13	2013-14	2017-18	2013-14	2017-18
Barwon Water	1 049	1 050	1 055	1 032	967
Central Highlands Water	1 147	1 245	1 245	1 160	1 160
Coliban Water	1 003	1 153	1 297	1 153	1 197
East Gippsland Water	1 102	1 123	1 126	1 064	1 080
Gippsland Water	1 236	1 249	1 298	1 198	1 198
Goulburn Valley Water	819	839	926	813	804
GWMWater	1 168	1 204	1 323	1 193	1 193
Lower Murray Water (Urban)	774	809	881	805	864
North East Water	836	855	935	827	806
South Gippsland Water	956	969	1 068	926	926
Wannon Water	1 163	1 131	1 131	1 104	1 104
Westernport Water	1 029	1 044	1 214	1 024	1 024

Note: Real values. ^a Bills are calculated using each business's average consumption.

TABLE 4 INDICATIVE ANNUAL RESIDENTIAL TENANTS BILLS – FINAL DECISION^a
\$2012-13

	Current bill	Bills based on businesses' proposals		Bills based on final decision	
	2012-13	2013-14	2017-18	2013-14	2017-18
Barwon Water	338	338	340	332	311
Central Highlands Water	235	255	255	238	238
Coliban Water	328	346	390	346	359
East Gippsland Water	224	258	340	251	272
Gippsland Water	312	315	328	302	302
Goulburn Valley Water	248	254	280	248	248
GWMWater	321	330	363	328	328
Lower Murray Water (Urban)	174	196	214	195	209
North East Water	417	427	467	413	402
South Gippsland Water	189	193	218	185	185
Wannon Water	264	263	263	262	262
Westernport Water	108	129	150	130	130

Note: Real values. ^a Bills are calculated using businesses' average consumption.



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 the prices and the monitoring of service standards of the 19 Victorian Government owned water businesses.

This is the Commission's fifth review of water prices. The Commission previously completed price reviews in June 2005 for 17 metropolitan and regional businesses, in June 2006 for five rural businesses, in June 2008 for regional and rural businesses and Melbourne Water's drainage and waterways, and in June 2009 for metropolitan retail businesses and Melbourne Water bulk supplies.

This final decision covers the 12 regional urban water businesses that submitted final Water Plans to the Commission in October 2012:

- Barwon Water
- Central Highlands Water
- Coliban Water
- East Gippsland Water
- Gippsland Water
- Goulburn Valley Water
- GMMWater
- Lower Murray Water (Urban)¹
- North East Water
- South Gippsland Water
- Wannon Water
- Westernport Water.

¹ Lower Murray Water's rural business is covered in the rural final decision.



This paper sets out the Commission's analysis, reasons and conclusions about the prices that will apply from 1 July 2013. This final decision should be read in conjunction with the Commission's draft decision released in March 2013.² Separate final decisions were prepared for rural and greater metropolitan water businesses.

1.1 LEGISLATIVE FRAMEWORK

In carrying out its role, the Commission is guided by the regulatory framework set out in the *Essential Services Commission Act 2001* and the *Water Industry Act 1994*. The *Water Industry Act* sets out additional objectives and provides for the Governor in Council to set out more detail on the regulatory framework in a *Water Industry Regulatory Order (WIRO)*.³

The WIRO requires the Commission to approve or specify the price arrangements for each water business for each regulatory period. The Commission must approve the price arrangements if satisfied the prices, or the manner in which prices are to be calculated or otherwise determined, comply with procedural requirements and the regulatory principles in the WIRO. If not satisfied, the Commission may specify the prices a business may charge, or the manner in which those prices are to be calculated or otherwise determined.

Procedural requirements include the need for businesses to consult with customers and relevant regulatory agencies before submitting their Water Plans to the Commission for assessment. The WIRO sets out regulatory principles the businesses must comply with in proposing prices and the Commission must comply with in approving prices (this is discussed in more detail below).

² Essential Services Commission 2013, *Price Review 2013: regional urban water businesses – draft decision, volume I*, March.

³ The WIRO is available on the Commission's website.



BOX 1.1 THE COMMISSION'S REGULATORY OBJECTIVES

The *Essential Services Commission Act* (ESC Act) outlines the objective and the matters the Commission must consider in undertaking its functions across all industries. The Commission's objective is to promote the long term interests of Victorian consumers in terms of the price, quality and reliability of essential services. In pursuing this objective, the Commission must have regard to the following matters, as set out in section 8(A) of the ESC Act:

- efficiency in the industry and incentives for long term investment;
- the financial viability of the industry;
- the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries;
- the relevant health, safety, environmental and social legislation applying to the industry;
- 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;
- consistency in regulation between States and on a national basis;
- any matters specified in the empowering instrument.

Continued on next page

BOX 1.1 CONTINUED

The *Water Industry Act* (section 4C) contains the following additional objectives (which take precedence over the objectives of the ESC Act in the event of conflict) that the Commission must meet in regulating the water sector:

- wherever possible, ensure the costs of regulation do not exceed the benefits
- ensure regulatory decision making and regulatory processes have regard to any differences in the operating environments of regulated entities
- ensure regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities.

The Commission must also have regard to the procedural requirements and regulatory principles in the Water Industry Regulatory Order (see box 1.2 for the WIRO's regulatory principles).



1.2 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.⁴ 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. The Commission's guidance paper noted its expectation that customer prices will reflect:

⁴ Essential Services Commission 2011, *2013 Water Price Review — guidance on Water Plans*, October.

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

The Commission also allowed flexibility for the businesses to adapt to changing industry conditions and customer needs. The Commission provided a framework for businesses to provide customers with tariff choice, and for businesses to apply for a regulatory period of more than five years, for example.

Further, to increase customer protection the Commission required all Victorian water businesses to propose a Guaranteed Service Level (GSL) scheme for the third regulatory period. Under the scheme, businesses provide an automatic rebate to customers who receive a level of service that is significantly worse than the average level of performance expected by most customers. The scheme helps businesses to identify the worst served customers and specific service areas that require improvement. In addition, the scheme provides financial incentives for businesses to focus on providing good quality, reliable service to all customers.

The regional urban 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, key issues for consultation, and invited submissions from interested parties.⁵ In November and December 2012 the Commission held 17 public meetings across the state to provide an additional opportunity for interested parties to comment. The Commission received 63 written submissions.

The Commission released its draft decision on prices on 26 March 2013.⁶ The draft decision set 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 submissions and public meetings. The Commission held 14 public meetings in April and May 2013. The Commission received 112 written submissions in response to the draft decision. The views put forward at public meetings and in submissions,

⁵ Essential Services Commission 2012, *Summary of regional businesses' Water Plans*, November.

⁶ Essential Services Commission 2013, *Price Review 2013: regional urban water businesses – draft decision, volume 1*, March.



information provided by the water businesses, the views of the Commission's expert consultants, and the Commission's own analysis informed the final decision.

1.3 COMMISSION'S APPROACH TO ASSESSING PROPOSED PRICES

The Commission is required to assess the prices proposed by the water businesses against the regulatory principles of the WIRO.

In deciding whether to approve a business's proposed prices, the Commission must be satisfied those prices provide the business with sufficient revenue to meet its obligations and deliver the level of service customers require. Revenue must be sufficient to allow the business to recover operating expenditure and the cost of financing capital expenditure, as well as to receive a reasonable return on assets, but not allow monopoly profits.

The Commission must also be satisfied that expenditure forecasts reflect the efficient delivery of the outcomes proposed in the Water Plan and account for a long term planning horizon, signal to customers the costs of using water and sewerage services, and give customers incentives to use water sustainably.

The full list of the WIRO regulatory principles is provided in box 1.2. The WIRO was enhanced in 2012 to include new clauses that provide for customer tariff choice and strengthen requirements for cost-reflective new customer contributions. The changes also established that accounting for low income and vulnerable customers is a standalone regulatory principle rather than a subordinate of the pricing principles (as was the case previously).



BOX 1.2 WIRO REGULATORY PRINCIPLES

Clause 14(1) of the WIRO requires the Commission to be satisfied prices are set so as to:

- 1** provide for a sustainable revenue stream to the regulated entity that nonetheless does not reflect monopoly rents or inefficient expenditure by the regulated entity
- 2** allow the regulated entity to recover its operational, maintenance and administrative costs
- 3** allow the regulated entity to recover its expenditure on renewing and rehabilitating existing assets
- 4** allow the regulated entity to recover:
 - a** a rate of return on assets as at 1 July 2004 that are valued in a manner determined by, or at an amount otherwise specified by, the Minister at any time before 1 July 2004
 - b** a rate of return on investments made after 1 July 2004 to augment existing assets or construct new assets
 - c** in the case of Gippsland and Southern Rural Water Corporation only, all costs associated with existing debt incurred to finance expenditure prior to 1 July 2006 in a manner determined by the Minister at any time before 1 July 2006
 - d** investment in an asset or asset class as at 1 July 2004 using the value calculated in the manner determined by, or the amount otherwise specified by, the Minister for that asset or asset class at any time before 1 July 2004
 - e** investment in an asset or asset class made after 1 July 2004 to augment existing assets or construct new assets.

Continued next page

BOX 1.2 CONTINUED

- 5** provide appropriate incentives and signals to customers or potential customers about:
 - a** the sustainable use of Victoria's water resources by reference to the costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers), including costs associated with balancing supply and demand
 - b** the costs associated with servicing a new development in a particular location.
- 6** provide the regulated entity with incentives to pursue efficiency improvements and to promote the sustainable use of Victoria's water resources
- 7** enable customers or potential customers of the regulated entity to readily understand the prices charged by the regulated entity for prescribed services, or the manner in which such prices are to be calculated or otherwise determined
- 8** provide for an appropriate adjustment mechanism to minimise the extent of any under- or over-recovery of revenue for the costs associated with the desalination plant during a regulatory period
- 9** where appropriate, facilitate choice and innovation in the prescribed services and associated prices offered to customers.

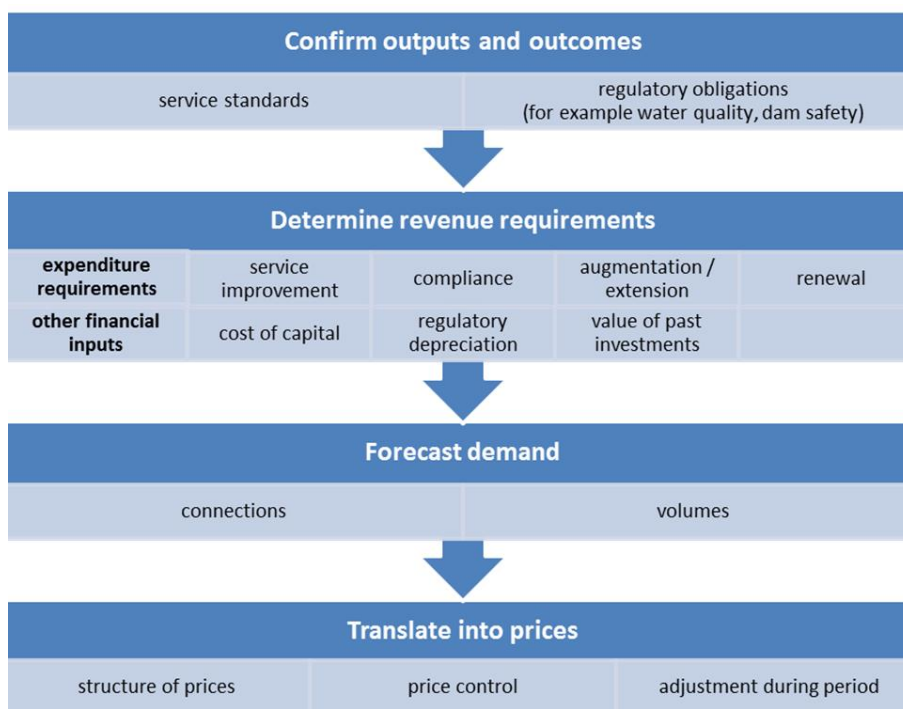
The Commission must be satisfied the expenditure forecasts contained in the Water Plan reflect the efficient delivery of the proposed outcomes contained in the Water Plan and account for a planning horizon that extends beyond the term of the Water Plan and

The Commission must account for the interests of customers of the regulated entity, including low income and vulnerable customers.

Source: Water Industry Regulatory Order, clause 14(1).

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

FIGURE 1.1 STEPS IN ASSESSING AND APPROVING PRICES



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,⁷ EPA Victoria, the Department of Health, the Department of Environment and Primary Industries, and customer preferences.

⁷ There is a Statement of Obligations that applies to each water business specifying a number of requirements the business must follow. There are additional Statements of Obligations for City West Water, South East Water, Yarra Valley Water and Melbourne Water for managing augmented water supply. The obligations are based on a combination of water legislation requirements and government policy. They were made by the Minister for Water under section 41 of the *Water Industry Act 1994*, commencing from 16 September 2012.

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.

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. The Commission fully expects water businesses 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 assumed 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 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. In accordance with the WIRO, 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.



1.4 STRUCTURE OF THIS FINAL DECISION

This paper sets out the Commission's analysis, reasons and conclusions about the prices that will apply from 1 July 2013.

Chapter 2 of this paper provides an overview of customer bills and prices. Chapter 3 sets out the Commission's assessment of the key outcomes and service levels to be delivered by the businesses during the regulatory period and the GSL schemes proposed by the businesses.

Chapter 4 sets out the Commission's decision on the total revenue required by each business, based on its operating expenditure (chapter 5), capital expenditure (chapter 6) and the costs of financing its capital expenditure program (chapter 7). Chapter 8 sets out the demand forecasts applied by the Commission to calculate approved prices for the period.

Chapter 9 discusses the form of price control applied to each business's prices. Chapters 10-16 discuss the approved tariff structures for retail water (chapter 10), recycled water (chapter 11), retail sewerage (chapter 12), trade waste (chapter 13), new customer contributions (chapter 14), miscellaneous charges (chapter 15) and GWMWater's and Coliban Water's other tariffs (chapter 16). Chapter 17 outlines how prices will be adjusted during the regulatory period, including mechanisms for dealing with uncertainty.

In addition, the Commission issues each regional urban water 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. It includes a schedule of tariffs that may be charged from 1 July 2013 and the manner for adjusting those tariffs during the regulatory period. The determinations are also available on the Commission's website (www.esc.vic.gov.au).





2 PRICES AND CUSTOMER BILLS

2.1 PRICES

Based on the Commission's final decision, half of the regional urban water businesses will have real price increases and half will have real price decreases over the next regulatory period. Average prices approved under the final decision are lower than those proposed in the Water Plans for all businesses. Table 2.1 compares the total price changes proposed by each regional urban water business in their Water Plans with the Commission's final decision (measured as an average of the price changes across water, sewerage and other services).

Barwon Water, Gippsland Water, Goulburn Valley Water, North East Water, South Gippsland Water and Wannon Water will all have real price decreases over the next regulatory period. Barwon Water will have the biggest percentage real decrease in prices over the next regulatory period, with a decrease of 7.6 per cent.

Based on the Commission's final decision, Central Highlands Water, Coliban Water, East Gippsland Water, GWMWater, Lower Murray Water (Urban) and Westernport Water will all have real price increases over the next regulatory period. Coliban Water will have the biggest percentage increase in prices over the next regulatory period with an increase of 16.0 per cent. However, these price increases have been moderated through this price review.

Westernport Water and North East Water will have the greatest reduction in prices from those that they proposed with a decrease of 18.2 per cent and 15.2 per cent, respectively. Lower Murray Water (Urban) and Wannon Water will have the smallest change from its proposal with a decrease of 2.1 and 2.6 per cent, respectively.



TABLE 2.1

ESTIMATED AVERAGE ANNUAL PRICE RISE — FINAL DECISION

\$2012-13, percentage change

	Final decision					Total final decision	Total proposed by businesses	Change
	2013-14	2014-15	2015-16	2016-17	2017-18			
Barwon Water	-1.5	-1.6	-1.6	-1.6	-1.6	-7.6	0.7	-8.3
Central Highlands Water	1.1	0.0	0.0	0.0	0.0	1.1	8.4	-7.3
Coliban Water	7.8	3.8	2.0	0.9	0.8	16.0	28.3	-12.3
East Gippsland Water	-1.6	0.4	0.4	0.6	0.5	0.2	6.9	-6.7
Gippsland Water	-3.1	0.0	0.0	0.0	0.0	-3.1	5.0	-8.1
Goulburn Valley Water	-0.5	-0.2	-0.2	-0.2	-0.2	-1.2	12.6	-13.8
GWMWater	1.9	0.6	0.3	0.1	0.1	3.1	12.4	-9.3
Lower Murray Water (Urban)	1.8	1.8	1.8	1.8	1.8	9.2	11.4	-2.1
North East Water	-0.6	-0.6	-0.6	-0.6	-0.6	-3.2	12.0	-15.2
South Gippsland Water	-3.3	-0.5	-0.5	-0.5	0.0	-4.8	10.2	-15.0
Wannon Water	-5.9	0.0	0.0	0.0	0.0	-5.9	-3.4	-2.6
Westernport Water	0.4	0.0	0.0	0.0	0.0	0.4	18.6	-18.2

2.2 CUSTOMER BILLS

As a result of this final decision, household water and sewerage bills will not increase as much as sought by the businesses in their Water Plans.

Note that the Commission's final decision does not include the effect of inflation, that is, it is expressed in *real dollar terms* (in 2012-13 dollars). Nominal prices can be calculated by including inflation using the Consumer Price Index (CPI).

2.2.1 OWNER-OCCUPIER BILLS

Table 2.2 compares illustrative bills in 2013-14 and 2017-18 for owner-occupiers, based on the prices proposed in the businesses' Water Plans and prices resulting from the Commission's final decision (in real \$2012-13).

Based on this final decision, Gippsland Water and GWMWater will have the highest indicative customer bills for owner-occupiers in 2013-14 at \$1198 per year and \$1193 per year, respectively. Lower Murray Water (Urban) and Goulburn Valley Water will have the lowest average customer bills in 2013-14 at \$805 and \$813, respectively.

From 2012-13 to the end of the regulatory period in 2017-18, Coliban Water and Lower Murray Water (Urban) have the greatest dollar increase in indicative owner-occupier customer bills, with real increases of \$193 and \$91 per household, respectively. Barwon Water and Wannon Water will have the greatest real dollar decreases in indicative owner-occupier bills, of \$82 and \$58 per customer, respectively.



TABLE 2.2 INDICATIVE ANNUAL RESIDENTIAL OWNER-OCCUPIER BILLS^a
\$2012-13

	Current bill	Bills based on businesses' proposals		Bills based on final decision	
	2012-13	2013-14	2017-18	2013-14	2017-18
Barwon Water	1 049	1 050	1 055	1 032	967
Central Highlands Water	1 147	1 245	1 245	1 160	1 160
Coliban Water	1 003	1 153	1 297	1 153	1 197
East Gippsland Water	1 102	1 123	1 126	1 064	1 080
Gippsland Water	1 236	1 249	1 298	1 198	1 198
Goulburn Valley Water	819	839	926	813	804
GWMWater	1 168	1 204	1 323	1 193	1 193
Lower Murray Water (Urban)	774	809	881	805	864
North East Water	836	855	935	827	806
South Gippsland Water	956	969	1 068	926	926
Wannon Water	1 163	1 131	1 131	1 104	1 104
Westernport Water	1 029	1 044	1 214	1 024	1 024

Note: Real values. ^a Based on the businesses' proposed prices and final decision prices. Bills are calculated using each business's average consumption.

Customer bills from 1 July 2014 in table 2.2 do not include inflation. Table 2.3 shows 2013-2014 residential owner-occupier bills including inflation of 2.5 per cent. That is, it shows the difference in the average customer will see on their bills as the next five year regulatory period commences.



TABLE 2.3 INDICATIVE ANNUAL RESIDENTIAL OWNER-OCCUPIER BILLS

	Current	Approved 2013-14	Difference
	<i>\$2012-13</i>	<i>\$2013-14</i>	
Barwon Water	1 049	1 058	9
Central Highlands Water	1 147	1 189	42
Coliban Water	1 003	1 181	178
East Gippsland Water	1 102	1 091	-11
Gippsland Water	1 236	1 227	-9
Goulburn Valley Water	819	833	14
GWMWater	1 168	1 223	55
Lower Murray Water (Urban)	774	826	52
North East Water	836	848	12
South Gippsland Water	956	949	-8
Wannon Water	1 163	1 132	-31
Westernport Water	1 029	1 050	21

2.2.2 TENANT BILLS

Based on this final decision, North East Water and Coliban Water will have the highest indicative customer bills for tenants in 2013-14 at \$413 and \$346 per customer, respectively. Westernport Water and South Gippsland Water will have the lowest indicative tenant customer bills in 2013-14 at \$130 and \$185 per customer, respectively (table 2.3).

From 2012-13 to the end of the regulatory period in 2017-18, East Gippsland Water and Coliban Water will have the greatest real dollar increase in indicative bills for tenants with an increase of \$48 and \$31 per customer, respectively. Barwon Water, and North East Water will have the greatest real dollar decrease in indicative tenant customer bills, of \$26 and \$15 per customer, respectively.



TABLE 2.3 INDICATIVE ANNUAL RESIDENTIAL TENANT BILLS
\$2012-13

	Current bill	Bills based on businesses' proposals		Bills based on final decision	
	2012-13	2013-14	2017-18	2013-14	2017-18
Barwon Water	338	338	340	332	311
Central Highlands Water	235	255	255	238	238
Coliban Water	328	346	390	346	359
East Gippsland Water	224	258	340	251	272
Gippsland Water	312	315	328	302	302
Goulburn Valley Water	248	254	280	248	248
GWMWater	321	330	363	328	328
Lower Murray Water (Urban)	174	196	214	195	209
North East Water	417	427	467	413	402
South Gippsland Water	189	193	218	185	185
Wannon Water	264	263	263	262	262
Westernport Water	108	129	150	130	130

Note: Real values. ^a Based on the businesses' proposed prices and final decision prices. Bills are calculated using each business's average consumption.

Estimates of tenant bills from 1 July 2014 do not include inflation. Table 2.4 show 2013-14 bills including inflation of 2.5 per cent.



TABLE 2.4 INDICATIVE ANNUAL RESIDENTIAL TENANT BILLS

	Current	Approved 2013-14	Difference
	<i>\$2012-13</i>	<i>\$2013-14</i>	
Barwon Water	338	341	3
Central Highlands Water	235	244	9
Coliban Water	328	355	27
East Gippsland Water	224	257	33
Gippsland Water	312	310	-2
Goulburn Valley Water	248	255	6
GWMWater	321	336	15
Lower Murray Water (Urban)	174	200	26
North East Water	417	423	6
South Gippsland Water	189	189	0
Wannon Water	264	268	5
Westernport Water	108	134	26





3 SERVICE STANDARDS AND GSL

3.1 INTRODUCTION

The Commission regulates standards and conditions for supplying retail water, sewerage and other declared services. Clause 15 of the Water Industry Regulatory Order (WIRO) states the Commission may specify standards and conditions of services and supply with which a regulated entity is obliged to comply in connection with the provision of declared services. It may approve standards set out in a Water Plan, specify those standards in a code, or do both. The Commission established a core set of service standards, based on consultation.

The Customer Service Code requires water businesses to propose targets for the core set of service standards, as well as any additional standards, in their Water Plans.⁸ These service standard targets reflect the level of service they aim to achieve over the regulatory period. The core standards are listed table 3.1.

In addition to service standards, businesses are required to maintain a guaranteed service level (GSL) scheme. The schemes involve the provision of payments or rebates to customers that experience certain supply problems or do not receive defined levels of service.

GSLs should reflect the most important aspects of service delivery identified by customers. GSLs should be based on customer consultation and be objectively definable, easily understandable and able to be reported. Payment amounts must give incentives for businesses to deliver appropriate service levels, not to compensate the customer.

⁸ Essential Services Commission 2012, *Urban Water Customer Service Code*, Issue No.8, June.



TABLE 3.1 CORE SERVICE STANDARDS — URBAN WATER BUSINESSES

Retail water
Number of unplanned water supply interruptions (per 100 kilometres)
Average time taken to attend bursts and leaks (minutes)
Unplanned water supply interruptions restored within [X] hours (per cent)
Planned water supply interruptions restored within [X] hours (per cent)
Average unplanned customer minutes off water supply (minutes)
Average planned customer minutes off water supply (minutes)
Average frequency of unplanned water supply interruptions (number)
Average frequency of planned water supply interruptions (number)
Average duration of unplanned water supply interruptions (minutes)
Average duration of planned water supply interruptions (minutes)
Number of customers experiencing [X] unplanned water supply interruptions in the year
Unaccounted for water (per cent)
Minimum flow rates at 20 millimetres (mm), 25 mm, 32 mm, 40 mm, 50 mm
Retail sewerage
Number of sewerage blockages (per 100 kilometres)
Average time to attend sewer spills and blockages (minutes)
Average time to rectify a sewer blockage (minutes)
Spills contained within [X] hours (per cent)
Customers receiving [X] sewer blockages in the year (number)
Retail customer service
Complaints to Energy and Water Ombudsman (Victoria) (EWOV) (per 1000 customers)
Telephone calls answered within 30 seconds (per cent)

3.2 OVERVIEW OF DRAFT DECISION

3.2.1 SERVICE STANDARDS

The Commission's draft decision noted core service standard targets should reflect the historical five-year average performance, unless otherwise justified (for example, to reflect customer feedback).



The Commission proposed to approve, in full, the service standard targets proposed by Coliban Water, East Gippsland Water, Gippsland Water, GWMWater (Rural), and Lower Murray Water (Urban). The proposed targets were either consistent with the five-year historical performance, or businesses justified the variation (if the proposed targets varied from the historical five-year performance).

The Commission proposed not to approve, in full, the targets proposed by the businesses listed in table 3.2. Table 3.2 also summarises the number of service standard targets the Commission proposed to approve or not approve. For the targets not approved, the Commission sought further information for proposed targets different to the historical five-year average performance.

TABLE 3.2 SERVICE STANDARD TARGETS NOT ACCEPTED IN FULL — DRAFT DECISION
number of targets

Water Business	Commission proposed to approve	Commission proposed not to approve
Barwon Water	6	15
Central Highlands Water	14	7
Goulburn Valley Water	14	7
GWMWater (Urban)	14	7
North East Water	13	8
South Gippsland Water	18	3
Wannon Water	8	13
Westernport Water	20	1

3.2.2 GUARANTEED SERVICE LEVELS

The Commission proposed to accept all GSLs and rebate amounts the regional urban water businesses proposed, except Gippsland Water who did not propose any GSLs other than the hardship related GSL mandated by the Commission. The Commission required Gippsland Water to propose additional GSLs in response to the draft decision.



3.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

All water businesses whose service standard target proposals the Commission proposed not to accept in full (Barwon Water, Central Highlands Water, Goulburn Valley Water, GWMWater (Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water) responded to the Commission's draft decision. Gippsland Water also submitted a response on its GSL scheme.

The Commission received no responses on service standards from those businesses whose service standard targets and GSL schemes the Commission proposed to accept in full. The Commission's final decision approves the service standard targets and the GSLs proposed by these businesses (Coliban Water, East Gippsland Water, Gippsland Water, GWMWater (Rural), and Lower Murray Water (Urban)).

The service standard targets and GSLs the Commission approved will be published in a revised Customer Service Code after the final decision is released.

3.3.1 SERVICE STANDARDS

After considering responses to its draft decision, the Commission has also approved in full the service standard targets proposed by the following:

- Barwon Water
- Central Highlands Water
- Goulburn Valley Water
- North East Water
- Wannon Water.

These businesses either revised proposed service standard targets to be consistent with the five-year historical average, or sufficiently justified proposing a target different to the historical five-year average.

The Commission has not approved in full the service standard targets proposed by GWMWater (Urban), South Gippsland Water and Westernport Water.

GWMWater (Urban)

GWMWater did not revise its urban core service standard targets in response to the draft decision. GWMWater argued it exceeded its targets in the second regulatory period but should not increase the target to reflect historical



performance, because this would compromise its internal 2 per cent productivity targets.

The Commission does not accept GWMWater’s justification for departing from its historical average for some service standard targets. The Commission considers internal productivity targets do not adequately justify compromising service outcomes, in the absence of customer consultation demonstrating support for lower service levels as a trade-off for increased productivity.

The Commission set targets that reflect the historical average. These targets will be reflected in the Customer Service Code.

TABLE 3.3 GWMWATER (URBAN) - TARGETS NOT APPROVED

Service standard	5-year average	Proposed target	Commission decision
Average time taken to attend bursts and leaks (Priority 1) (minutes)	24.48	30	Set target to 5-year average
Average time taken to attend bursts and leaks (Priority 2) (minutes)	26.33	40	Set target to 5-year average
Average time taken to attend bursts and leaks (Priority 3) (minutes)	31.76	40	Set target to 5-year average
Average unplanned customer minutes off water supply (minutes)	15.93	20	Set target to 5-year average
Average duration of unplanned water supply interruptions (minutes)	83.05	100	Set target to 5-year average
Average time to attend sewer spills and blockages (minutes)	21.54	30	Set target to 5-year average
Average time to rectify a sewer blockage (minutes)	113.09	130	Set target to 5-year average

South Gippsland Water

South Gippsland Water’s submission stated the Commission’s approach to setting service standard targets at historical performance averages was not optimal. However, for the three targets the Commission proposed not to approve, South Gippsland Water proposed revised targets that were closer to the five-year historical average.



The Commission has approved the proposed targets for:

- average time taken to attend bursts and leaks (priority 3)
- average duration of planned water supply interruptions and
- average unplanned customer minutes off water supply.

Further, the Commission does not accept South Gippsland Water's argument that setting targets at historical averages is not optimal. In approving service standard targets, the Commission is mindful that its most important objective is to ensure prices are set to maintain existing service levels as a starting point (see chapter 1).

TABLE 3.4 SOUTH GIPPSLAND WATER – FINAL DECISION
targets not approved in the draft decision

Service standard	5-year average	Target proposed in water plan	Target proposed in response to draft	Commission decision
Average time taken to attend bursts & leaks (priority 3)	374.44	600	500	Accept
Average duration of planned water supply interruptions (minutes)	220.79	250	240	Accept
Average unplanned customer minutes off water supply (minutes)	22.11	30	25	Accept

Westernport Water

Westernport Water submitted it did not wish to revise its target for 'sewerage blockages per 100 kilometres' because in any given year its actual performance may be well above or below the five-year average.

The Commission does not accept this justification. The Commission considers businesses should seek to achieve the targets on average, over a five-year period. The Commission has set a target for 'sewerage blockages per 100 kilometres' to reflect the five-year historical average.



TABLE 3.5 WESTERNPORT WATER - TARGETS NOT APPROVED

Service Standard	5-year average	Proposed Target	Commission Decision
Sewerage blockages (per 100 kilometers)	6.4	10.8	Set target to 5-year average

3.3.2 GUARANTEED SERVICE LEVELS

Gippsland Water

Gippsland Water responded to the Commission’s requirement that the business propose a GSL scheme. The business proposed two GSLs (in addition to the hardship related GSL):

- more than 5 water supply interruptions in any 12 month period and
- sewer spills within a house not contained within an hour.

The Commission has accepted the GSLs proposed by Gippsland Water. The Commission has also approved the GSL schemes and rebate amounts proposed by other regional businesses.

TABLE 3.6 GUARANTEED SERVICE LEVELS – GIPPSLAND WATER^a

GSL	Rebate amount
A sewer spill within a house, caused by a failure of Gippsland Water’s system, not contained within one hour of notification	\$500
More than five unplanned water supply interruptions in a financial year	\$50

^a In addition to the hardship-related GSL.



3.4 FINAL DECISION

The Commission has approved all service standard targets proposed by Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater (Rural), Lower Murray Water (Urban), North East Water, South Gippsland Water and Wannon Water and will reflect these in the Customer Service Code.

The Commission has not approved the targets proposed by GWMWater (Urban) for the below service standards and has revised them to reflect the historical average:

- Average time taken to attend bursts and leaks (Priority 1) (minutes)
- Average time taken to attend bursts and leaks (Priority 2) (minutes)
- Average time taken to attend bursts and leaks (Priority 3) (minutes)
- Average unplanned customer minutes off water supply (minutes)
- Average duration of unplanned water supply interruptions (minutes)
- Average time to attend sewer spills and blockages (minutes)
- Average time to rectify a sewer blockage (minutes)

These targets will be reflected in the Customer Service Code.

The Commission has not approved the target proposed by Westernport Water for 'Sewerage blockages (per 100 kilometers)' and has revised it to reflect the historical average. This target will be reflected in the Customer Service Code.

Continued on next page



FINAL DECISION - CONTINUED

The Commission has approved all guaranteed service levels and rebate amounts proposed and will reflect these in the Customer Service Code.

All businesses are required to revise their Customer Charters to reflect the Commission's final decision by 30 August, 2013.





4 OVERVIEW OF REVENUE REQUIREMENT

4.1 INTRODUCTION

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

The Commission used the 'building block' approach to derive forward looking estimates of the revenue that the businesses require to deliver proposed service standards and outcomes over the regulatory period. Under this approach, the revenue requirement for a business reflects operating expenditure and a return on the regulatory asset value (RAB) that is updated each year to reflect any additional capital expenditure (net of asset disposals, customer and government contributions), and regulatory depreciation.

4.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission reviewed the businesses' assumptions about expenditure, demand, and the return on and of assets for the next regulatory period. Each business's revenue requirement was adjusted to reflect the Commission's view of the efficient level of revenue that would enable the businesses to deliver on their service obligations over the next regulatory period.

The Commission's draft decision resulted in a \$185.1 million (or 4.4 per cent) decrease in the revenue requirement for the regional urban water businesses, compared to the proposals in their Water Plans. The Commission's draft decision reduced the revenue requirement for all regional businesses as shown in table 4.1.



4.3 IMPACT OF FINAL DECISION

The Commission's final decision accounts for stakeholder submissions to the draft decision, revisions from the businesses, and new information that it received since the draft decision. It also updated its view on an appropriate rate of return.

The final decision provides gross total revenue of \$3.99 billion for the regulatory period, which is not materially different from the draft decision. The total revenue requirement for each business is shown in table 4.1 which compares the proposals in their Water Plans, the draft decision and the final decision.



TABLE 4.1 REVENUE REQUIREMENTS — FINAL DECISION
\$m 2012-13

	Proposed by business	Draft decision	Final decision	Difference between final decision and draft decision	
				<i>\$m</i>	<i>per cent</i>
Barwon Water	919.9	880.6	872.3	-8.2	-0.9
Central Highlands Water	414.2	396.9	390.8	-6.1	-1.5
Coliban Water	520.2	498.7	467.0	-31.7	-6.4
East Gippsland Water	153.6	149.5	149.1	-0.4	-0.3
Gippsland Water	569.8	552.2	545.1	-7.2	-1.3
Goulburn Valley Water	348.2	328.0	324.5	-3.4	-1.0
GWMWater	295.7	281.3	280.5	-0.8	-0.3
Lower Murray Water (Urban)	162.3	158.0	158.9	1.0	0.6
North East Water	275.7	258.0	261.6	3.6	1.4
South Gippsland Water	135.7	125.8	126.6	0.8	0.6
Wannon Water	328.7	315.8	318.7	2.9	0.9
Westernport Water	102.4	96.3	95.5	-0.8	-0.8
Total revenue requirement	4 226.3	4 041.1	3 990.7	-50.5	-1.2

Relevant adjustments are discussed in chapter 5 (operating expenditure), chapter 6 (capital expenditure), chapter 7 (financing capital investments) and chapter 14 (new customer contributions).

The reasons for the difference between the revenue requirement each business proposed and the Commission's final decision varied for each business. However, the Commission's final decision is driven by several main factors:

- the impact of changed assumptions about the weighted average cost of capital (WACC), and therefore the cost of financing proposed capital programs
- reductions to proposed operating and capital expenditure and
- the impact of the new customer contribution proposals submitted after the Water Plans.

The lower revenue requirement determined for each business also results in lower prices (see chapter 2).



5 OPERATING EXPENDITURE

5.1 INTRODUCTION

In their Water Plans, the regional urban water businesses set out assumptions underpinning their forecast operating expenditure over the next regulatory period (1 July 2013 to 30 June 2018), and outlined the relationship between expenditure and the delivery of obligations and service outcomes.

The Water Industry Regulatory Order (WIRO) requires the Commission to ensure the prices levied by the businesses provide them with a sustainable revenue stream that does not reflect monopoly profits or inefficient expenditure, and the manner in which prices are determined provides incentives for the businesses to pursue efficiency improvements over the regulatory period.⁹ The Commission must also be satisfied that the proposed expenditure forecasts are efficient and account for a planning horizon that extends beyond the five-year regulatory period.¹⁰

The Commission's approach to assessing the businesses' operating expenditure was to assess separately the forecasts related to:

- bulk water charges
- 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 and the environmental contribution.

The Commission had regard to detailed assessments by its consultants Deloitte and Cardno of the businesses' operating expenditure forecasts. Each business

⁹ WIRO, clause 14(1)(a)(iii) and (iv).

¹⁰ WIRO, clause 14(1)(b).



was given an opportunity to respond to the consultant's expenditure assessment before the Commission released its draft decision. The consultants' reports are available on the Commission's website.

In the draft decision, the Commission sought to identify the extent to which the businesses' proposals reflected efficient levels of operating expenditure.¹¹ When it considered a proposal did not represent efficient expenditure, it recommended reducing or removing that expenditure and corresponding adjustments were made to reduce prices.

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 that represents assumptions about the overall level of expenditure to be recovered through prices, and that the Commission considers sufficient to operate the business and to maintain services over the regulatory period.

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 via higher prices). The converse is true if the business makes an efficiency gain during the regulatory period.

5.2 OVERVIEW OF DRAFT DECISION

In the draft decision, the Commission proposed to approve total operating expenditure over five years of \$2.5 billion, which was \$84 million (or 3.3 per cent) lower than the total proposed in businesses' Water Plans (table 5.1). The difference was largely explained by adjustments to proposed labour and energy costs, and to defined benefits superannuation payments and various other operating expenditure items. 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 relevant regulatory agencies.

¹¹ WIRO, clause 14(1)(b).



**TABLE 5.1 OPERATING EXPENDITURE — BUSINESS PROPOSALS
COMPARED WITH THE DRAFT DECISION**
\$m 2012-13

	Total proposed by business	Total proposed in draft decision	Difference	
			\$m	per cent
Barwon Water	480.3	474.2	-6.1	-1.3
Central Highlands Water	269.7	253.2	-16.4	-6.1
Coliban Water	337.5	332.7	-4.8	-1.4
East Gippsland Water	87.8	86.2	-1.6	-1.8
Gippsland Water	361.8	353.7	-8.1	-2.2
Goulburn Valley Water	218.9	207.1	-11.8	-5.4
GWMWater ^a	160.1	151.5	-8.6	-5.4
Lower Murray Water (Urban)	95.2	94.4	-0.8	-0.8
North East Water	188.7	173.5	-15.3	-8.1
South Gippsland Water	84.4	80.4	-4.1	-4.8
Wannon Water	216.5	212.1	-4.4	-2.0
Westernport Water	63.7	62.0	-1.7	-2.7
Total operating expenditure	2 564.8	2 481.1	-83.7	-3.3

^a Includes GWMWater's actual and forecast expenditure for its rural operations.

5.3 RESPONSES AND COMMISSION'S ASSESSMENT

A number of businesses responded to the expenditure adjustments reflected in the Commission's draft operating expenditure forecasts. These responses included the provision of further information or arguments to support the original forecasts, further adjustments to the businesses' original forecasts, and errors or omissions identified by the businesses. The Commission considered the businesses' responses to the draft decision, and adjusted in this final decision the forecast operating expenditure for each business if justified.



5.3.1 ADDITIONAL INFORMATION IN SUPPORT OF WATER PLAN FORECASTS

Some businesses provided additional information to support their Water Plan forecasts, mostly in response to direct requests in the draft decision. Table 5.2 shows the Commission’s response for its final decision.

TABLE 5.2 ADDITIONAL INFORMATION IN SUPPORT OF WATER PLAN FORECASTS

Business proposal	Commission response
Central Highlands Water	
<p><i>Energy and distribution prices</i> — business advised a more balanced approach would be to take a mid-point between the assumption ranges proposed by Central Highlands Water and Deloitte.</p>	<p>Not accepted — The Commission still considers the Procurement Australia tender outcome is the more appropriate benchmark for assessing energy cost increases because it is the most up-to-date market information.</p>
<p><i>Energy</i> — business requested a reinstatement of the 1.5 gigalitres per year Superpipe pumping assumption, to ensure Central Highlands Water can deliver on agreed levels of service to its customers.</p>	<p>Accepted — The Commission considered Central Highland Water’s proposal is justified, and adjusted the operating expenditure forecast to reflect the proposal.</p> <p>Deloitte also recalculated the energy cost forecasts of five water businesses, including Central Highlands Water, to take into account the S-factor component of the network price change in 2013-14. Deloitte noted the changes are relatively small.¹²</p> <p>The Commission increased the draft decision allowance by \$1.17 million to reflect Central Highlands Water’s proposal and to account for the S-factor.</p>

¹² Wannon Water observed Deloitte did not take into account the S-factor component of the network price change. Deloitte agreed with Wannon Water’s observation and noted the actual S-factor adjustments on 1 January 2013 of 3.16 per cent for SP Ausnet and 2.49 per cent for Powercor (plus 1.42 per cent Victorian Bushfire Royal Commission factor added to SP AusNet’s prices) were higher than Deloitte’s assumptions. Deloitte adjusted energy cost forecasts for Central Highlands Water, Goulburn Valley Water, South Gippsland Water, Wannon Water and Westernport Water to reflect the updated S-factor. Deloitte did not adjust the other water businesses’ energy forecasts for the S-factor, either because the approved allowance for 2013-14 was already marginally higher or the business’s energy costs model was already based on the updated distribution tariffs.



Business proposal	Commission response
<p><i>Living Victoria/Living Melbourne (Ballarat)</i> — business requested its proposed expenditure for the Ballarat West aquifer storage and recovery project be treated as operating expenditure as proposed in its Water Plan, not capital expenditure as per the draft decision.</p>	<p>Not accepted — The Commission confirmed its draft decision to treat the proposed expenditure as capital expenditure for regulatory (pricing) purposes, given the nature of activities involved.</p>
<p>Coliban Water</p>	
<p><i>Water quality</i> — business provided additional information to support proposal for increased pipeline cleaning costs, including a letter of support from the Department of Health.¹³ It requested the draft decision allowance of \$1.5 million be increased to the original request of \$4.4 million.</p>	<p>Partly accepted — The Commission discussed with the Department of Health (DoH) the need for the widespread mains cleaning in the Coliban Water system, and DoH noted its support for this undertaking. The Commission accepts the need for this work.</p> <p>Coliban Water claimed it did not have any expenditure for mains cleaning in its 2011-12 baseline year, and requested the full program amount of \$4.4 million as new expenditure. The Commission expects mains cleaning should form a part of the base maintenance program for all water businesses, so Coliban Water should cover part of this work by reprioritising its existing maintenance budgets.</p> <p>In recognition of the increased mains cleaning program, the Commission considered provision of additional expenditure for 50 per cent of the requested amount to be reasonable, and increased the draft decision allowance by \$0.74 million for this work.</p>
<p><i>Bulk water</i> — business submitted a revised forecast that is \$0.79 million higher than the original proposal, and it noted the following:</p> <ul style="list-style-type: none"> • Original forecast did not include a component for the low pressure reliable water supply from the East Loddon Pipeline, commissioned in 2012. • Revised expenditure was adopted Goulburn-Murray Water prices (with 2013-14 adjusted for actual inflation of 2.5 per cent). 	<p>Partly accepted — Coliban Water provided evidence of payments that it made to Goulburn-Murray Water for the East Loddon Pipeline. The Commission accepted Coliban Water's adjustment of additional \$0.41 million on bulk water for this pipeline.</p> <p>The Commission did not accept the proposed additional allowance to account for updated Goulburn-Murray Water prices because the Commission did not make any adjustments to the latter's prices.</p>

¹³ Department of Health letter to Coliban Water, dated 16 April 2013.



Business proposal	Commission response
East Gippsland Water	
<p><i>Special Operations & Maintenance</i> – East Gippsland Water submitted that the forecast for 2016-17 and 2017-18 should be \$0.710 million, consistent with the first three years.</p>	<p>Accepted — The Commission accepted East Gippsland Water’s reasoning and increased the draft decision allowance by \$0.25 million to reflect the proposal.</p>
Goulburn Valley Water	
<p><i>Site restoration costs</i> — business argued Deloitte’s interpretation of sites for clean-up was incorrect. It requested the Commission reinstate the proposed expenditure for 2013-14 and 2014-15.</p>	<p>Partly accepted — The Commission discussed the issue with Deloitte, which acknowledged some costs relate to only investigations and not clean-up. Deloitte recommended reinstating the expenditure forecast except for the \$0.55 million contingency. The Commission increased the draft decision allowance by \$1.21 million to reflect Deloitte’s revised recommendations for site restoration costs.</p>
South Gippsland Water	
<p><i>Labour</i> — business advised its new EBA has been approved by the Department of Treasury under the old wage policy and is with the Minister for sign-off. It requested its labour costs be adjusted based on the recently approved EBA, not the new wages policy.</p>	<p>Accepted — Deloitte recalculated the labour energy forecasts based on the recently approved EBA. The Commission increased the draft decision allowance by \$0.25 million to reflect Deloitte’s revised forecasts.</p>
<p><i>Living Victoria/Living Melbourne</i> — business advised the Office of Living Victoria (OLV) accepted, after the release of the draft decision, the business’s proposed Nyora Wastewater treatment plant managed aquifer recharge feasibility project. It requested an additional \$0.125 million operating expenditure in 2013-14, and noted the remaining \$0.125 million is proposed for OLV funding.</p>	<p>Partly accepted — The Commission accepted the proposal but not as operating expenditure. Given the nature of the proposed activities, the Commission treated the proposed expenditure as capital expenditure for regulatory (pricing) purposes.¹⁴</p> <p>The Commission included additional gross capital expenditure of \$0.25 million in 2013-14, comprising \$0.125 million net capital expenditure and \$0.125 million OLV contribution.</p>

¹⁴ In its final report, Deloitte recommended that proposed operating expenditure for Living Victoria/Living Melbourne be disallowed and removed \$0.25 million from the operating expenditure forecast which the Commission adopted for its draft decision. However, the Commission notes that South Gippsland Water’s proposed operating expenditure for Living Victoria/Living Melbourne in its original Water Plan was \$0.50 million not \$0.25 million. For the final decision, the Commission corrected the error by removing the balance of \$0.25 million from the operating expenditure forecast. As discussed above, a gross capital expenditure of \$0.25 million has been allowed for Living Victoria/Living Melbourne.



Business proposal	Commission response
Wannon Water	
<p><i>Chemical costs</i> — business disagreed with no real increase in prices and submitted that historical information is considered the most reliable and realistic approach to account for future prices.</p>	<p>Not accepted — The Commission noted Wannon Water did not provide any additional information or evidence (from its suppliers) to support its proposed real increases in chemical costs.</p>
<p><i>Minor new initiatives</i> — business noted Deloitte’s lack of consideration of minor new initiatives. It provided detailed justifications for each of the 21 minor new initiatives that Deloitte recommended for withdrawal from operating expenditure.</p>	<p>Partly accepted – The Commission considered that proposed operating expenditure relating to new capital investments to be completed in 2012-13 and in the next regulatory period is justified. The Commission reinstated the proposed operating expenditure of \$0.48 million for these new costs.</p>
Westernport Water	
<p><i>Energy</i> — business disagreed with draft decision and provided additional information to support its proposal based on higher growth assumptions.</p>	<p>Not accepted — The additional information provided had already been provided to Deloitte during the expenditure review and was the basis of Deloitte’s final recommendation. Deloitte maintained the requested 5 per cent increase in electricity use was not justified, noting water (and recycled water) sales growth is less than 2 per cent. Deloitte recommended the Commission maintain its draft decision, which is based on 2 per cent growth assumptions.</p>
<p><i>Other items</i> — business disagreed with the draft decision to remove \$7000 for additional costs of monitoring for the Bureau of Meteorology from 2013-14.</p>	<p>Not accepted — Westernport Water did not provide any additional information to support its proposed adjustment.</p>

5.3.2 ERRORS OR OMISSIONS IN THE DRAFT DECISION

A number of businesses proposed adjustments that reflected errors or omissions in the operating expenditure analysis in the draft decision. The Commission also identified further adjustments recommended by its consultants that were not reflected in the draft decision. The Commission reviewed the information provided, with advice from the consultant when required, and adjusted the forecasts to reflect the changes in table 5.3.



TABLE 5.3 ERRORS OR OMISSIONS IN THE DRAFT DECISION

Business proposal	Commission response
Barwon Water	
<p><i>Labour</i> — business noted the 2012-13 and 2013-14 labour cost forecasts were not corrected by Deloitte to align with the timing of Barwon Water’s Enterprise Agreement (EA).</p>	<p>Accepted — Deloitte recalculated the labour cost forecasts to align with the timing of Barwon Water’s EA. The Commission increased the draft decision allowance by \$0.28 million to reflect Deloitte’s revised estimates.</p>
Central Highlands Water	
<p><i>Labour</i> — the current Enterprise Bargaining Agreement (EBA) will expire in July 2015 and allows for salary increases of up to 4 per cent plus movements through salary bands, but Deloitte recommended no real increase in labour costs over the next five years.</p>	<p>Party accepted — Deloitte recalculated the labour cost forecasts to reflect the 4 per cent nominal increase in wages allowed in Central Highlands Water’s EBA. The Commission did not accept the allowance for movements through salary bands, consistent with its approach for metropolitan water businesses. The Commission increased the draft decision allowance by \$2.22 million to reflect Deloitte’s revised estimates.</p>
<p><i>Biosolid Strategy Implementation</i> — Deloitte recommended this expenditure be reduced by \$0.75 million but the Commission did not reflect it in the operating expenditure forecast in the draft decision.</p>	<p>The Commission corrected the error by decreasing Central Highlands Water’s total operating expenditure forecast by \$0.75 million.</p>
<p><i>Defined benefit superannuation costs</i> — In its draft decision, the Commission allowed the recovery of defined benefit superannuation costs based on 15 years recovery period at 5.75 per cent interest rate (section 5.3.4). However the Commission did not remove Central Highland’s defined benefit adjustments of \$5.4 million in the ‘PrevPerAdj_FO’ sheet of its financial template.</p>	<p>The Commission corrected the error by removing \$5.4 million from the ‘PrevPerAdj_FO’ sheet of Central Highlands Water’s financial template, for the final decision.</p>
Coliban Water	
<p><i>Biosolids re-use</i> — Deloitte recommended capitalising this expenditure but the Commission did not reflect it in the capital expenditure forecast in the draft decision.</p>	<p>Accepted — In its final report, Deloitte noted the capital expenditure component of the biosolids re-use but was silent on whether it recommended allowing these costs in prices. Deloitte confirmed to the Commission that it had assessed the capitalised component of expenditure as efficient and had intended to recommend it, but inadvertently omitted this in its final report. The Commission adjusted Coliban Water’s capital expenditure to reflect the proposed expenditure of \$2.5 million.</p>



Business proposal	Commission response
<p><i>Build Own Operate Transfer (BOOT) schemes</i> — business noted Deloitte had accepted the corrected BOOT payments provided by Coliban Water, but the Commission did not reflect this change in the operating expenditure forecast.</p>	<p>Accepted — The Commission adjusted Coliban Water’s operating expenditure to reflect the total BOOT expenditure of \$0.13 million.</p>
<p>Goulburn Valley Water</p>	
<p><i>Energy</i></p>	<p>Deloitte recalculated the energy costs forecasts of five water businesses, including Goulburn Valley Water, to take into account the S-factor component of the network price change in 2013-14. The Commission increased the draft decision allowance by \$0.04 million to account for the S-factor.</p>
<p>GWMWater</p>	
<p><i>Labour</i> — business noted Cardno’s adjustments on labour costs were based on incorrect information.</p>	<p>Accepted — On the request of GWMWater, Cardno investigated the issue and confirmed the error. It recommended the Commission reinstate GWMWater’s original forecast of \$2.19 million, and the Commission accepted this recommendation.</p>
<p>North East Water</p>	
<p><i>Energy</i> — business argued its small sites were not adjusted for Procurement Australia’s quotes.</p>	<p>Accepted — The Commission discussed the issues with Deloitte, which has revised the energy forecasts to adjust the small sites for Procurement Australia’s quotes. The Commission increased the draft decision allowance by \$0.25 million to reflect Deloitte’s revised forecasts.</p>
<p>South Gippsland Water</p>	
<p><i>Energy</i></p>	<p>Deloitte recalculated the energy costs forecasts of five water businesses, including South Gippsland Water, to take into account the S-factor component of the network price change in 2013-14. The Commission increased the draft decision allowance by \$0.02 million to account for the S-factor.</p>



Business proposal	Commission response
<p><i>Defined benefit superannuation costs</i> — In its draft decision, the Commission allowed the recovery of defined benefit superannuation costs based on 15 years recovery period at 5.75 per cent interest rate (section 5.3.4). However the Commission did not remove South Gippsland Water’s defined benefit adjustments of \$1.3 million in the ‘PrevPerAdj_FO’ sheet of its financial template.</p>	<p>The Commission corrected the error by removing \$1.3 million from the ‘PrevPerAdj_FO’ sheet of South Gippsland Water’s financial template, for the final decision.</p>
<hr/> <p>Wannon Water</p>	
<p><i>Energy</i> — business argued Deloitte, in adjusting distribution charges, did not consider the S and L factors. It requested the S factor be considered, given its material impact.</p>	<p>Accepted — The Commission discussed the issue with Deloitte, which revised the energy costs forecast to adjust the distribution charges for the S factor in 2013-14. The Commission increased the draft decision allowance by \$0.03 million to account for the S-factor.</p>
<hr/> <p>Westernport Water</p>	
<p><i>Energy</i></p>	<p>Deloitte recalculated the energy costs forecasts of five water businesses, including Westernport Water, to take into account the S-factor component of the network price change. The Commission increased the draft decision allowance by \$0.01 million to account for the S-factor.</p>



5.3.3 NEW EXPENDITURE ITEMS

In their submissions on the draft decision, some businesses proposed additional expenditure to their Water Plan proposals (table 5.4). These are typically small amounts.

TABLE 5.4 NEW EXPENDITURE ITEMS

Business proposal	Commission response
Barwon Water	
Business requested water storage costs (\$0.125 million) to be paid to the metropolitan retail businesses over the third regulatory period.	Accepted — The Commission agreed Barwon Water has this obligation under its Bulk Entitlement Order 2010 and increased the operating expenditure forecast accordingly.
Central Highlands Water	
Business requested operating expenditure for the Maryborough water fluoridation plant, now government funding has been allocated to build the new facility. Expects operation from January 2015. Initial request for annual operating expenditure of \$97 500 revised down to \$40 000.	Accepted — The Department of Health confirmed an allocation of \$1.2 million in capital funding for a new water fluoridation plant at Maryborough. ¹⁵ The Commission allowed corresponding operating expenditure of \$20 000 for 2014-15 and \$40 000 per year from 2015-16 to 2017-18.
Goulburn Valley Water	
Business requested operating expenditure for the Kilmore water fluoridation plant, now government funding has been allocated to build the new facility. Expects operation from January 2015.	Accepted — The Department of Health confirmed an allocation of \$1.2 million in capital funding for a new water fluoridation plant at Kilmore. ¹⁶ The Commission allowed corresponding operating expenditure of \$16 000 for 2014-15 and \$32 000 per year from 2015-16 to 2017-18.
Lower Murray Water (Urban)	
Business requested additional energy costs of \$1.27 million due to higher water demand and electricity prices in the past 12 months. It noted this is in line with its current retail supplier's pricing based on Lower Murray Water's future water demand.	Partly accepted — The Commission agreed with Deloitte's recommendation that Lower Murray Water's energy forecast is reasonable. However, the Commission removed the proposed allowance for green energy purchase, because it does not consider green energy purchase is a regulatory obligation. It adopted a total adjustment of \$0.80 million on Lower Murray Water's energy costs forecast.
South Gippsland Water	
Business requested \$40 000 additional expenditure to dry and stockpile its bio-solid waste at Leongatha wastewater treatment site.	Accepted — The Commission accepted South Gippsland Water's reasoning for the proposal and adjusted the operating expenditure forecast to reflect the proposal of \$40 000 per year over the regulatory period.

¹⁵ Department of Health letter to Central Highlands Water, dated 8 April 2013.

¹⁶ Department of Health letter to Goulburn Valley Water, dated 8 April 2013.



5.3.4 DEFINED BENEFIT SUPERANNUATION PAYMENTS

In their Water Plans, the businesses proposed various approaches to recovering the costs of their required defined benefits superannuation payments. To ensure these costs were reflected consistently in pricing for all customers, in its draft decision the Commission adopted a benchmark approach to recovering these payments. Five businesses agreed with the Commission's approach or did not comment. Table 5.5 sets out the approaches that the remaining businesses proposed to recover the superannuation payments.

TABLE 5.5 BUSINESSSES' SUBMISSIONS ON DEFINED BENEFIT SUPERANNUATION PAYMENTS

Business	Business submissions
Central Highlands Water	Proposed recovery over five years
Coliban Water	Proposed the cost be capitalised in 2013-14
Goulburn Valley Water	Proposed recovery over five years
Lower Murray Water	Provided the total defined benefit superannuation costs it accrued in 2012, and the split of the costs between its rural and urban services
South Gippsland Water	Proposed recovery over five years
Wannon Water	Proposed upfront recovery in 2013-14, and noted it will be \$0.29 million worse off (in net present values terms) under the Commission's approach of 15 year recovery (compared with upfront recovery in 2013-14)
Westernport Water	Proposed upfront recovery in 2013-14

The Commission confirms its draft decision to adopt the benchmark approach of cost recovery over 15 years at 5.75 per cent interest rate. It agreed with Deloitte's view that this benchmark approach 'represents a balanced outcome which treats each business equally, allows recovery of the payment and does not impose an undue burden on customers in the short term'.¹⁷ But it notes businesses are free to make their required payments to Vision Super using the approach that is most beneficial to their circumstances.

¹⁷ Deloitte 2013, *Essential Services Commission, expenditure review – Water Plan 3: final overview document*, February, p. 28.



The Commission accepted Lower Murray Water’s downward revision of defined benefit superannuation payments, and allocation of the recovery between the urban and rural components of the business.

5.3.5 ENVIRONMENTAL CONTRIBUTION AND LICENCE FEES

The Commission also adjusted the businesses’ forecasts to ensure licence fees and the environmental contribution are consistent with the latest advice provided by relevant regulatory agencies. Several businesses responded to the draft decision, and table 5.6 outlines the Commission’s final decision.

TABLE 5.6 ENVIRONMENTAL CONTRIBUTION AND LICENCE FEES

Business proposed adjustment	Commission response
Coliban Water	
<i>Environmental contributions</i> — business argued its forecasts in its Water Plan are the correct amount.	Not accepted — The Commission confirmed its draft decision to adopt the latest information provided by the Department of Environment and Primary Industries on environmental contributions.
South Gippsland Water	
<i>Licence fees (EPA Victoria)</i> — business noted it made an error in the Water Plan submission template by inadvertently including in the licence fees section an annual payment of \$50 000 to EPA Victoria for joint catchment management activities.	Accepted — The Commission accepted South Gippsland Water’s reasoning for the proposed adjustment and added \$50 000 back into the operating expenditure forecast for each year.



Business proposed adjustment	Commission response
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Westernport Water

Licence fees (DoH and EPA Victoria) — business argued it has not received any notification from DoH or EPA Victoria that its licence fees will be reduced. It requested that its Water Plan forecasts be reinstated.

No accept — The Commission confirmed its draft decision to adopt the latest advice from the regulators. EPA Victoria noted to the Commission that some water businesses might not have been aware of the changes to their licence fees under the new regulations.¹⁸ Westernport Water will be informed of its EPA licence fee, reduced under the new fee regulations, with its next invoice in June 2013.

Licence fees (EPA Victoria) — business advised it has a works approval to upgrade the Cowes wastewater treatment plant that will incur a licence fee increase once completed due to higher discharge volume.

Accepted — EPA Victoria provided the Commission with the new licence fee amount for the higher discharge volume, to apply from 2015-16. The Commission adjusted Westernport Water’s operating expenditure accordingly (additional allowance of \$6333 per year from 2015-16 to 2017-18).

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.

5.4 FINAL DECISION

Based on the draft decision and additional information provided by the water businesses, the Commission adopted the operating expenditure benchmarks in table 5.7. The Commission considers the benchmarks provide a sufficient level of expenditure for the businesses to operate and deliver their proposed services.

¹⁸ EPA Victoria 2013, *Greater Metropolitan Water Price Review — draft decision*, May.



TABLE 5.7 OPERATING EXPENDITURE, 2012-13 TO 2017-18 — FINAL DECISION
 \$m 2012-13

	Draft decision	Final decision					Total	Difference	
		2013-14	2014-15	2015-16	2016-17	2017-18		\$m	per cent
Barwon Water	474.2	94.7	94.7	94.7	95.4	95.2	474.8	0.5	0.1
Central Highlands Water	253.2	50.7	50.9	51.2	51.3	51.9	256.1	2.8	1.1
Coliban Water	332.7	66.3	66.6	67.2	67.4	66.7	334.0	1.3	0.4
East Gippsland Water	86.2	16.9	17.1	17.4	17.5	17.6	86.5	0.3	0.3
Gippsland Water	353.7	71.2	70.7	71.0	70.4	70.4	353.8	0.1	0.0
Goulburn Valley Water	207.1	42.6	41.7	41.1	41.6	41.4	208.5	1.4	0.7
GWMWater	151.5	31.8	30.9	30.8	30.4	29.9	153.7	2.2	1.5
Lower Murray Water (Urban)	94.4	19.1	19.2	19.6	19.2	19.3	96.4	1.9	2.1
North East Water	173.5	35.2	35.4	35.4	35.4	35.5	177.0	3.5	2.0
South Gippsland Water	80.4	16.4	16.3	16.4	16.0	15.8	80.8	0.5	0.6
Wannon Water	212.1	42.9	43.1	42.5	42.3	41.8	212.7	0.6	0.3
Westernport Water	62.0	12.4	12.4	12.4	12.4	12.4	62.0	0.0	0.1
TOTAL	2 481.1	500.3	499.1	499.8	499.3	497.9	2 496.3	15.2	0.6



6 CAPITAL EXPENDITURE

6.1 INTRODUCTION

Capital expenditure is a key component of the regional urban water businesses' revenue requirements.

The Water Industry Regulatory Order (WIRO) requires the Commission to ensure the prices levied by the businesses provide them with a sustainable revenue stream that does not reflect monopoly profits or inefficient expenditure, and that allows the business to recover expenditure on renewing and rehabilitating existing assets.¹⁹ The Commission must also be satisfied that the proposed expenditure forecasts are efficient and account for a planning horizon that extends beyond the five-year regulatory period.²⁰

The Commission considered detailed assessments by its consultants Deloitte and Cardno of the businesses' capital expenditure forecasts for the next regulatory period (1 July 2013 to 30 June 2018). The businesses were given an opportunity to respond to the consultants' assessment prior to the release of the Commission's draft decision. The consultants' reports are available on the Commission's website.²¹ In doing so, the regulatory framework requires the Commission to seek to align the costs recovered from customers for large capital works with the benefits to be derived from those customers over the life of the assets.

In making its final decision, the Commission considered the businesses' submissions in response to the draft decision, as well as other stakeholders' submissions and in some cases sought additional information from our consultants. It adjusted the relevant benchmarks when appropriate.

¹⁹ WIRO, clause 14(1)(a)(iii) and (iv).

²⁰ WIRO, clause 14(1)(b).

²¹ www.esc.vic.gov.au



6.2 OVERVIEW OF DRAFT DECISION

The Commission's draft decision on total forecast capital expenditure was \$120 million (or 8 per cent) lower than that proposed by the businesses in their Water Plans (table 6.1). In making its draft decision, the Commission generally agreed with Deloitte's and Cardno's recommendations on the capital expenditure proposals. Given the much smaller level of capital works intended for the next regulatory period compared with the second regulatory period, both Deloitte and Cardno considered the businesses generally have the capacity to deliver their proposed capital works as forecast.

The Commission proposed adjustments to forecast capital expenditure programs put forward in the Water Plans when:

- a key project could not be delivered within the proposed timeframe
- a water business did not provide adequate information to justify the project expenditure or the forecast cost estimate
- the water business provided insufficient evidence of having considered alternatives.

A number of projects were not sufficiently justified in the Water Plans, but the Commission allowed the businesses to provide additional information to justify those projects.



TABLE 6.1 CAPITAL EXPENDITURE, 2012-13 TO 2017-18 — 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
Barwon Water	360.0	94.3	64.3	68.9	61.3	45.8	334.6	-25.5	-7.1
Central Highlands Water	100.1	26.3	16.3	22.6	13.0	25.1	103.3	3.2	3.2
Coliban Water	178.0	33.7	29.8	28.7	24.4	28.5	145.1	-32.9	-18.5
East Gippsland Water	46.1	7.3	13.1	8.6	7.1	8.7	44.8	-1.2	-2.7
Gippsland Water	202.9	41.2	54.7	38.0	26.0	33.5	193.5	-9.5	-4.7
Goulburn Valley Water	166.8	31.2	29.3	30.4	28.2	25.9	145.0	-21.8	-13.1
GWMWater	87.6	32.3	21.3	16.8	9.2	13.0	92.6	5.0	5.7
Lower Murray Water (Urban)	55.3	15.9	12.5	10.2	6.5	8.9	53.9	-1.4	-2.5
North East Water	78.9	18.7	15.0	12.3	15.2	10.9	72.2	-6.7	-8.5
South Gippsland Water	72.0	9.5	7.4	8.9	9.6	9.8	45.3	-26.7	-37.0
Wannon Water	109.0	21.0	21.8	18.9	22.9	18.4	103.0	-6.0	-5.5
Westernport Water	23.5	7.1	3.5	4.1	6.2	6.0	26.9	3.4	14.5
TOTAL CAPITAL EXPENDITURE	1 480.2	338.6	289.1	268.4	229.6	234.5	1 360.2	-120.1	-8.1

6.3 RESPONSES AND COMMISSION'S ASSESSMENT

In response to the draft decision, businesses provided further information on issues raised in the draft decision or other issues that were identified following the release of the draft decision. The Commission considered these responses and adjusted the capital expenditure for each business only when:

- a business provided further information or arguments to support its original forecasts, or
- errors were identified in the assumptions or forecasts adopted by the Commission in its draft decision.

6.3.1 ADDITIONAL INFORMATION IN SUPPORT OF WATER PLAN FORECASTS

Most regional urban water businesses provided additional information to support their Water Plan forecasts. Much of this information was directly requested in the Commission's draft decision. Table 6.2 shows the Commission's response for its final decision.



TABLE 6.2 ADDITIONAL INFORMATION IN SUPPORT OF WATER PLAN FORECASTS

Business proposal	Commission response
Barwon Water	
<i>Sewer mains (replacement/rehabilitation)</i> — requested the Commission reassess the project to correct a miscalculation by Deloitte.	Not accepted — Deloitte advised the Commission that its final recommendations were based on the revised data provided by Barwon Water in January 2013 and does not believe there has been a miscalculation. The Commission verified the numbers in question and agreed with Deloitte’s observations.
Central Highlands Water	
<i>Living Victoria/Living Melbourne (Ballarat)</i> — business requested its proposed expenditure for the Ballarat West aquifer storage and recovery project be treated as operating expenditure as proposed in its Water Plan, not capital expenditure as per the draft decision.	Not accepted — The Commission confirmed its draft decision, as discussed in table 5.2 in chapter 5. This project will remain as capital expenditure.
<i>Maryborough water fluoridation plant</i> — government funding is now available to proceed with construction of the new facility.	Accepted — The Department of Health confirmed an allocation of \$1.2 million in capital funding for a new water fluoridation plant at Maryborough. ²² The Commission has adjusted Central Highlands Water’s government contributions to reflect full funding with no net capital expenditure increase required.
<i>Maryborough water quality improvement project</i> — business submitted that it has additional support from the Department of Health for this project, so requested the Commission to reinstate the full expenditure for this project.	Accepted — The Department of Health advised this upgrade is required now to ensure good water quality for good use of the soon-to-be fluoridated town water. The Commission has adjusted the capital expenditure forecast to reflect the original Water Plan proposal.
Coliban Water	
<i>Harcourt rural modernisation project</i> — business provided an updated business case, letters from two shire councils and a letter from Harcourt Water Services Committee. It requested expenditure be reinstated as per its Water Plan, plus some additional costs.	Accepted — The Commission considers the business provided the additional information requested for this project to proceed as per the Water Plan. See below for more detailed discussion on this decision.

²² Department of Health letter to Central Highlands Water, dated 8 April 2013.



Business proposal**Commission response**

Bridgewater and Laanecoorie water treatment plant upgrades — business provided additional justification, including support from the Department of Health.

Accepted — The Department of Health gave its support for these upgrade projects to occur within the next regulatory period.²³ The Commission reinstated the full expenditure proposed in Coliban Water's Water Plan.

Gippsland Water

Warragul-Moe water supply interconnect stage two — business argued the project must now be completed to ensure long term security of supply is maintained for two of the region's fastest growing towns. It considered it unacceptable to not complete the project (originally approved in Water Plan 2), to ensure the long term security of supply for the Warragul/Drouin system.

Not accepted — The Commission asked Deloitte to review this matter. Deloitte maintained its view that additional water supply from the Melbourne system is the most cost-effective long term solution, and noted the volumes for Warragul and Drouin are small compared with the overall Melbourne water demand.

At the time of approving this project under Water Plan 2, water supplies for Melbourne were very tight, and supply from Tarago Reservoir for Warragul and Drouin was not certain. However, new water supply infrastructure has secured supply for Melbourne, and Tarago can supply the future requirements of Warragul and Drouin.

Gippsland Water completed stage 1 of this project (the Yarragon-Darnum interconnection), which now supplies 1.2 million litres of water per day to Darnum. However, the actual cost of this first stage was considerably higher than the expected cost.

If circumstances change, Gippsland Water is still free to implement stage 2 of the project and seek cost recovery at the end of the regulatory period.

Goulburn Valley Water

Kilmore water fluoridation plant — government funding is now available to proceed with construction of this new facility.

Accepted — The Department of Health confirmed an allocation of \$1.2 million in capital funding for a new water fluoridation plant at Kilmore.²⁴ The Commission has adjusted Goulburn Valley Water's government contributions to reflect full funding with no net capital expenditure increase required.

²³ Department of Health letter to Coliban Water, dated 16 April 2013.

²⁴ Department of Health letter to Goulburn Valley Water, dated 8 April 2013.



Business proposal

Commission response

South Gippsland Water

Poowong, Loch, Nyora sewerage scheme — business advised it will undertake a complete review of the scope of the scheme and potential solutions, with the aim of improving the cost–benefit ratio (6–9 months). It requested a notional \$20 million be allowed in the capital program for the third regulatory period.

Foster wastewater treatment plant-rising main pipeline and storage — business argued that omission of the project may result in the Foster water treatment plant being issued with another pollution abatement notice (PAN) from EPA Victoria. It noted this could potentially require all capital expenditure to be performed immediately to meet the previously issued PAN.

Accepted — The Commission considered South Gippsland Water’s new proposal of \$20 million to be a more reasonable cost, and has adjusted the capital expenditure forecast accordingly to reflect this in pricing. See below for more detailed discussion on this decision.

Accepted — In light of EPA Victoria’s support for this project to proceed during the next regulatory period to avoid the risk of further pollution infringements, Deloitte recommended allowing the proposed \$1.04 million expenditure in 2017-18.²⁵ The Commission has reinstated the proposed expenditure.

Wannon Water

Casterton water treatment plant install clarifier — business argued that the project is needed to meet peak demand while maintaining water quality. It noted no evidence or information in Deloitte’s draft and final reports indicated it recognised the project is required to meet peak day demands. It provided a letter of support from the Department of Health.²⁶

Wyatt St bore construction — business advised it undertook the independent risk assessment requested in the draft decision, and results showed not replacing the Wyatt St bore represents a ‘very high’ risk for Wannon Water and its Portland customers. It provided results of the risk assessment.

Accepted — The Commission discussed this matter with the Department of Health. The department indicated its concern with balancing water quality against demand, and supported the implementation of this project during the third regulatory period on water quality grounds. The Commission reinstated this project as per the original Water Plan proposal.

Accepted — Wannon Water satisfied the Commission’s requirements in the draft decision. The Commission reinstated the full expenditure proposed in Wannon Water’s Water Plan.

Westernport Water

Candowie reservoir road movement — business accepted draft decision but recommended changing the 100 year asset life for depreciation purposes to 10 years only (WP3 and WP4 duration).

Partly accepted — The Commission agrees 100 years is too long for a sealed road but 10 years is too short. Accounting guidance suggests 40 years is appropriate.²⁷ The Commission has adjusted the depreciation schedule accordingly.

²⁵ EPA Victoria letter to South Gippsland Water, dated 4 May 2013.

²⁶ Department of Health letter to Wannon Water, dated 25 January 2013.

²⁷ Source: *Income Tax Assessment Act 1997*, division 43.



Coliban Water — Harcourt rural modernisation project

The Commission's draft decision stated:

Based on information received from Coliban Water, Deloitte did not consider a compelling case had been made for the project to proceed as planned. It therefore recommended that the project be removed from the expenditure forecast (\$27.06 million). Deloitte also recommended possibly re-including this project in the forecast if Coliban can provide evidence of customer willingness to pay for the reticulation system and the backbone component of the project.²⁸

And further:

The Commission agrees with Deloitte's observation that Coliban Water had not provided adequate information in support of the Harcourt rural modernisation project. On this basis, the Commission has excluded from this draft decision the revenue sought in support of the Harcourt rural modernisation project. Coliban Water is required to provide the Commission with material clearly demonstrating the benefits of, and support for, this project prior to our final decision.²⁹

In response to the draft decision, Coliban Water provided the further information requested by the Commission. It included updated information following the completion of the 'Offer to Sell' buy-back proposal to the rural customers, which indicated Coliban Water could purchase 2.1 gigalitres per year of licence volumes, effectively halving the volume requirements of the Harcourt rural system. This outcome exceeded Coliban Water's expectations of around 25 per cent buy-back. This allowed further optimisation of the modernised scheme design to reflect the lower volumes required and one third of existing customers electing to exit the scheme.

²⁸ Essential Services Commission 2013, *Price Review 2013: regional urban water businesses — draft decision, volume 1*, March, table 7.5, p. 92.

²⁹ Essential Services Commission 2013, *Price Review 2013: regional urban water businesses — draft decision, volume 1*, March, p. 93.



The Commission also received four submissions, from the Harcourt Water Services Committee, the Macedon Ranges Shire Council, the Mount Alexander Shire Council and a fruit grower rural customer from Harcourt Valley. They all expressed support for the project to proceed as planned.

The Commission had approved this project under Water Plan 2, with the approved project timeline extending into the Water Plan 3 regulatory period. The key driver for this project was water supply security due to the prevailing drought, and the Commission notes this urgency is no longer present since the drought broke in 2010. However, the project is well underway, and Harcourt customers expect it will be completed according to the original timeline.

The Commission accepts Coliban Water's additional information to support proceeding with the Harcourt modernisation project. The \$27.1 million proposed in the business's Water Plan has been reinstated in the capital expenditure benchmarks.

South Gippsland Water — Poowong, Loch and Nyora sewerage scheme

The Commission's draft decision stated:

In its final report, Deloitte recommended a small cost adjustment for South Gippsland Water's proposed Poowong/Loch/Nyora sewerage scheme, and to delay the project by one year. Deloitte noted that South Gippsland Water had recently commenced a broader review of wastewater treatment and reclaimed water management options for the scheme, including consideration of regional wastewater treatment in conjunction with South East Water.

The Commission considers the proposed scheme to be costly (about \$40 000 per connection) and has received a submission expressing community concern at the proposal. The Commission supports further examination of potentially more cost-effective options for this sewerage scheme. Given that this review has only just commenced, the Commission proposes to not allow the capital expenditure for this project requested in South Gippsland Water's Water Plan, but will allow \$1.5 million in the first year to support feasibility work exploring further options. Should a project proceed during the period, efficient capital costs can be dealt with either via a pass through mechanism once completed or they can be rolled-



*in to the regulatory asset base with capitalised interest at the end of the regulatory period.*³⁰

At the time of making the draft decision, South Gippsland Water was evaluating some new lower-cost project design options, including pumping the sewage to South East Water's nearby Lang Lang wastewater treatment plant. The final design and a corresponding detailed cost estimate for this project were still uncertain.

The Commission received 67 written stakeholder submissions from:

- South Gippsland Shire Council, Yannathan Road Development Group, Nyora Primary School, Nyora Public Hall Committee, Loch Community Development Association, LNP Waste Water Action Group
- non-residential customers JHB Window Cleaning and United Dairy Power
- Poowong, Loch and Nyora residential customers.

These submissions supported the need for the project to proceed during the next regulatory period and opposed further delays.

In addition, some 40 representatives attended the Commission's April public forum in Leongatha on its draft decision. The EPA Victoria also gave its support for the project.³¹

Subsequent to the draft decision, South Gippsland Water submitted a new proposal that \$20 million of capital expenditure be provided in the third regulatory period for this project. It also undertook to complete a broader review to improve the project's cost-benefit ratio over the next six to nine months. The Commission accepts South Gippsland Water's revised proposal for this project, and has adjusted the capital expenditure forecast to allow for \$20 million for this project's completion by 2017-18.

³⁰ Essential Services Commission 2013, *Price Review 2013: regional urban water businesses — draft decision, volume 1*, March, pp. 93–94.

³¹ EPA Victoria letter to South Gippsland Water, dated 4 May 2013.



In making this decision, the Commission notes the following:

- For assessing the amount to be rolled in to the regulatory asset base at the end of the period, the efficient capital expenditure benchmark for this project should be based on the lowest cost option at the time of making this final decision, or any future lower cost option identified.
- South East Water indicated it supports receiving the sewage into its Lang Lang wastewater treatment plant, and noted such an approach has cost advantages for both water businesses.
- South East Water is planning an upgrade of the Lang Lang facility and requires South Gippsland Water's commitment before it proceeds.
- If adopted, the Lang Lang option would avoid the need for South Gippsland Water to build and operate a new wastewater treatment plant. Any cost–benefit assessment of the options should account for the sale of the land already purchased for the treatment plant in Nyora if that plant is not required.

6.3.2 ERRORS OR OMISSIONS IN THE DRAFT DECISION

A number of businesses sought adjustments that reflected errors or omissions in relation to the capital expenditure adjustments proposed in the draft decision. The Commission reviewed the information provided, and table 6.3 shows the adjusted forecasts.



TABLE 6.3 ERRORS OR OMISSIONS IN THE DRAFT DECISION

Business proposal	Commission response
Barwon Water	
Colac water sources expansion — business accepted the draft decision but noted the basis of the Commission’s decision to remove (majority of) the expenditure is due to Deloitte’s misunderstanding of the underlying supply and demand modelling. It requested the Commission review the statements on the deferment of this project for accuracy, and seek a correction to the errors in Deloitte’s report.	Accepted — Deloitte agreed with Barwon Water’s response, and stated. ‘We accept Barwon Water’s assertions that, contrary to our final report, it has appropriately taken into account the impact of restrictions and appropriately used the 1997-99 period of low inflows to the Colac system for modelling purposes’. ³² This further advice was publicly released on the Commission’s website with the final decision.
East Gippsland Water	
Replacement of main supply pipeline under Mitchell River at the Lind Bridge in Bairnsdale — business noted the draft decision did not reflect that Deloitte accepted the expenditure for this additional project in its report.	Accepted — The Commission has adjusted the capital expenditure forecast to include the recommended expenditure for this project.
Wy Yung basin tank or liner — Deloitte recommended project deferment to WP4 but agreed expenditure for planning should be allowed. East Gippsland Water accepted Deloitte’s recommendation, but noted inclusion of the \$0.21 million budget for planning was overlooked.	Accepted — The Commission agreed and adjusted the capital expenditure accordingly to include the \$0.21 million for planning.
Goulburn Valley Water	
Sewer main relining or replacement program — business argued Deloitte’s recommendation is based on an incorrect interpretation of data. (Deloitte’s report incorrectly stated all the sewer mains in the backlog list are identified as ‘either low or medium risk’.)	Accepted — The Commission sought further information from Deloitte on this issue. Deloitte confirmed it incorrectly interpreted some data and revised the expenditure forecast accordingly. The Commission adopted Deloitte’s recommended revised allowance.

³² Deloitte 2013, *Further advice to the Commission in relation to regional urban water businesses’ submissions on expenditure*, May.



Business proposal	Commission response
South Gippsland Water	
IT capital costs — business noted Deloitte recommended this project but the Commission did not include it in the draft decision expenditure forecast.	Accepted — The Commission adjusted the capital expenditure forecast to include the proposed IT capital costs.
Wannon Water	
Konongwootong operating activities — business argued Deloitte recommended adjustments to the proposed operating expenditure but overlooked the proposed capital expenditure component.	Accepted — The Commission asked Deloitte to verify this matter. Deloitte confirmed the capital expenditure component of the project should have been included. The Commission adjusted Wannon Water’s capital expenditure program to reflect the proposal.
Westernport Water	
Coves wastewater treatment plant upgrade — business disagreed with the draft decision to exclude the expenditure from the capital program.	The expenditure had been included in the proposed capital benchmark for the Commission’s draft decision. However, the commentary for table 10 in volume II stated the project had not been accepted. The commentary should have been updated to reflect Deloitte’s final recommendation to accept the expenditure. No change required because the expenditure is already included.
Water main replacement — business argued the Commission should give allowance for the last two years of the period as well as the first three, and provided justifications.	Not accepted — The Commission confirmed with Deloitte that these issues had been raised and considered during the expenditure review. The Commission confirmed its draft decision to remove the forecast expenditure for 2016-17 and 2017-18 because the scope of works was not identified by Westernport Water.

6.3.3 NEW EXPENDITURE ITEMS

South Gippsland Water proposed additional expenditure to that included in its Water Plan forecasts. It advised the Office of Living Victoria (OLV) accepted its proposed Nyora Wastewater Treatment Plant managed aquifer recharge feasibility project. It thus requested an additional \$0.125 million of operating expenditure in 2013-14. It noted OLV would also provide \$0.125 million dollar-for-dollar funding for this project. As discussed in chapter 5 (table 5.2), the Commission accepted this proposal but as capital expenditure for pricing purposes, comprising \$0.125 million net capital expenditure and \$0.125 million OLV funding.



6.4 FINAL DECISION

Based on the draft decision and additional information provided by the water businesses' in their submissions, the Commission adopted the capital expenditure benchmarks in table 6.4. It considers the benchmarks provide sufficient expenditure for the businesses to deliver their proposed services and meet known regulatory obligations.

The Commission's final decision provided for total capital expenditure of \$1.4 billion over the third regulatory period for the regional urban water businesses.

The Commission will monitor the progress of each water business in delivering its key capital projects. The annual performance report will provide an opportunity for businesses to explain any changes in the timing or scope of their major capital projects, and the implications for any outcomes to which they committed in their Water Plans.



TABLE 6.4 CAPITAL EXPENDITURE, 2012-13 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		\$m	per cent
Barwon Water	334.6	94.3	64.3	68.9	61.3	45.8	334.6	0.0	0.0
Central Highlands Water	103.3	27.0	17.3	22.6	19.0	21.8	107.6	4.4	4.3
Coliban Water	145.1	58.6	36.3	30.0	25.1	29.4	179.3	34.2	23.5
East Gippsland Water	44.8	10.5	13.1	8.6	7.3	8.7	48.2	3.4	7.6
Gippsland Water	193.5	41.2	54.7	38.0	26.0	33.5	193.5	0.0	0.0
Goulburn Valley Water	145.0	31.7	30.7	30.8	28.6	26.2	148.0	3.1	2.1
GWMWater	92.6	32.3	21.3	16.8	9.2	13.0	92.6	0.0	0.0
Lower Murray Water (Urban)	53.9	15.9	12.5	10.2	6.5	8.9	53.9	0.0	0.0
North East Water	72.2	18.7	15.0	12.3	15.2	10.9	72.2	0.0	0.0
South Gippsland Water	45.3	11.4	12.6	15.3	16.3	11.1	66.7	21.4	47.3
Wannon Water	103.0	20.9	25.4	21.6	22.9	18.4	109.2	6.2	6.0
Westernport Water	26.9	7.1	3.5	4.1	6.2	6.0	26.9	0.0	0.0
TOTAL	1 360.2	369.7	306.7	279.2	243.5	233.7	1 432.8	72.6	5.3



7 FINANCING CAPITAL INVESTMENTS

7.1 INTRODUCTION

The Water industry Regulatory Order (WIRO) requires prices allow each water business to recover the cost of capital investments (which are initially funded by the water business) over time through regulatory depreciation, and to recover financing costs through a return on assets. In doing so, the regulatory framework requires the Commission to seek to align the costs recovered from customers for large capital works with the benefits to be derived from those customers over the life of the assets.

This chapter sets out the Commission's final decision on the regional urban water businesses' financing of capital investments, namely the roll forward of regulatory asset values, the rate of return on investments, and regulatory depreciation. The chapter also sets out the Commission's final decision on the adjustments to revenue sought by water businesses to reflect foregone revenue or financial viability.



7.2 ROLLFORWARD OF THE REGULATORY ASSET BASE

7.2.1 OVERVIEW OF DRAFT DECISION

To calculate the opening Regulatory Asset Base (RAB) for each business at 1 July 2013 the following formula was used:

$$\begin{aligned} \text{Opening RAB 1 July 2013} = & \text{Opening RAB at 1 July 2007} \\ & \text{plus Capital expenditure (net)}_{2007-08 \text{ to } 2011-12}^{33} \\ & \text{(minus) Regulatory depreciation}_{2007-08 \text{ to } 2011-12} \\ & \text{(minus) Proceeds from disposal of assets}_{2007-08 \text{ to } 2011-12} \\ & \text{plus Assumed capital expenditure (net)}_{2012-13} \\ & \text{(minus) Regulatory depreciation}_{2012-13} \\ & \text{(minus) Assumed proceeds from disposal of assets}_{2012-13} \end{aligned}$$

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

Where a business underspent relative to forecast, the Commission proposed to roll forward the amount actually invested. If expenditure was less than 10 per cent above forecast, the Commission also proposed to roll forward the amount actually invested on the basis that such a divergence is within reasonable bounds, given the lumpy nature of capital costs. If expenditure was 10 per cent or more than forecast, the Commission proposed to roll forward the amounts above forecast only if a business justified the expenditure was prudent and efficient.

For 2012-13, the Commission proposed to roll forward the lesser of:

- actual net capital expenditure or
- the 2008 determination forecast of 2012-13 net capital expenditure.

³³ Capital expenditure (net) is equal to gross capital expenditure minus any customer or government contributions.



The Commission's draft decision noted that this approach to 2012-13 capital expenditure gives businesses an incentive to deliver projects on schedule. Even if unintentional, project delays unduly benefit businesses because they earn a return on the investment even though the project is not completed. The Commission only included expenditure above the 2012-13 forecast if businesses provided sufficient justification (for example, if the expenditure was a result of factors beyond the direct control of the business).

Table 7.1 shows the amounts the Commission's draft decision proposed to include in each businesses' RAB at 1 July 2012, and forecast amounts at 1 July 2013.³⁴ The Commission's proposed adjustments mainly reflected the approach to 2012-13 capital expenditure. For more information see the Commission's draft decision.³⁵

³⁴ Because final capital expenditure amounts for 2012-13 are not yet known, the current estimates will be updated to reflect actual amounts and confirmed for inclusion in the RAB as part of the next price review (subject to the prudence and efficiency of the expenditure).

³⁵ Essential Services Commission 2013, *Price Review 2013: Regional urban water businesses – draft decision, volume 1*, March, pp 99-107.



TABLE 7.1 PROPOSED REGULATORY ASSET BASE ROLLFORWARD – DRAFT DECISION
 \$m 2012-13

	BW	CHW	CW	EGW	GW	GVW	GMMW	LMW-U	NEW	SGW	WNW	WPW	Total
Opening RAB as at 1 July 2007	536.7	146.5	80.2	69.0	249.5	155.8	103.0	69.8	121.8	70.2	127.3	68.8	1 798.7
Plus net capital expenditure 2007-08 to 2011-12	545.2	179.8	249.2	79.9	300.4	130.3	221.8	84.1	81.8	49.2	144.6	30.9	2 097.2
Less regulatory depreciation 2007-08 to 2011-12	106.9	32.9	34.5	22.0	53.0	37.1	26.8	18.3	29.4	15.4	26.2	10.0	412.5
Less proceeds from disposal of assets 2007-08 to 2011-12	6.6	4.8	0.2	3.4	2.7	3.8	9.0	2.5	2.5	2.6	6.8	0.6	45.4
Adjustments	9.3				-41.6								
RAB as at 1 July 2012	977.8	288.6	296.1	123.5	452.6	245.2	288.9	133.1	171.8	101.4	239.0	89.2	3 405.8
Plus net capital expenditure (forecasts approved for the second regulatory period) 2012-13	66.2	18.5	30.4	3.7	46.3	13.2	18.3	9.3	24.0	15.4	13.5	9.9	268.7
Less regulatory depreciation 2012-13	28.1	9.0	10.1	5.6	12.8	9.3	7.4	4.4	7.9	3.5	5.9	2.4	106.5
Less assumed proceeds from disposal of assets 2012-13	1.7	1.2	0.0	0.4	0.6	0.8	2.2	0.6	0.0	0.4	0.7	0.1	8.6
RAB as at 1 July 2013	1 014.3	296.8	315.0	121.2	485.5	248.2	297.6	137.4	187.9	113.0	245.9	96.6	3 559.5

The Commission's draft decision noted Barwon Water recorded the greatest expenditure above forecast over the period from 2007-08 to 2011-12. This mainly reflected spending on three recycled water projects: the Black Rock Recycled Water Plant, the Armstrong Creek Recycled Water project, and the Torquay Recycled Water Dual Pipe project. It also reflected expenditure for the Colac Pipeline Future Stages project and the Meredith Water Supply Improvement project.

The Commission's draft decision proposed to include costs for the Colac Pipeline Future Stages in Barwon Water's RAB. It also proposed to include costs for the Meredith Water Supply Improvement project, subject to Barwon Water providing cost-benefit analysis before the final decision.

While the Commission proposed to include costs for the Black Rock Recycled Water Plant, the Armstrong Creek Recycled Water project, and the Torquay Recycled Water Dual Pipe project in Barwon Water's RAB, this was conditional upon the business providing information that demonstrated the costs of these projects will be borne by the beneficiaries.

Specifically, the Commission requested Barwon Water provide additional information that considered:

- recovering costs from new customer contributions
- profiling depreciation to better align cost recovery with asset utilisation and
- locational tariffs for the areas that benefit from the projects.

7.2.2 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission received a number of submissions following its draft decision. Business submissions covered two issues: rolling forward actual net capital expenditure for the period 2008-09 to 2011-12, and 2012-13 forecast net capital expenditure.



Actual net capital expenditure — 2007-08 to 2011-12 assessment

Barwon Water

Barwon Water provided further cost-benefit analysis for the Meredith Water Supply Improvement project, which included the GHD final report on the Meredith Water Treatment Plant investigation.³⁶ The report from GHD highlights the different business cases Barwon Water considered before finalising its proposed approach. The Commission is satisfied the project is justified on cost-benefit grounds. The Commission will roll forward \$7.6 million into the RAB.

For the Black Rock Recycled Water Plant and Armstrong Creek Recycled Water projects, Barwon Water contended the new framework for new customer contributions (NCC — discussed in chapter 14) will help ensure the costs of the recycled water scheme are attributed fairly to the beneficiaries.

It also stated the depreciation profile for the recycled water projects should not be changed any further, because the majority of the expenditure for these projects was incurred in 2012-13 (under the Commission's preferred approach to treating 2012-13 capital expenditure, Barwon Water would not recover a substantial proportion of depreciation related to the projects until the fourth regulatory period).

Further, Barwon Water considered there is no basis for locational tariffs for these recycled water projects, given the broader benefit they provide in freeing up water for use elsewhere in its region. It also undertook modelling to determine the magnitude of a separate NCC for the Armstrong Creek corridor. The results showed there is no material difference between the total (water, recycled water and sewerage) NCC in Barwon Water's proposal, and a standalone NCC.

The Commission agrees Barwon Water will recover the majority of costs for these projects through NCCs. That is, beneficiaries will contribute significantly to the cost of capital works incurred. Further, Barwon Water demonstrated costs for total NCCs do not vary significantly by location. However, the Commission considers all depreciation on the expenditure incurred for these projects should be deferred until the fourth regulatory period. This better aligns Barwon Water's recovery of depreciation with customer use of the infrastructure.

³⁶ GHD 2009, *Report on Meredith WTP improvement/replacement investigation options report* — available on the Commission's website.



Coliban Water

Coliban Water requested \$2.4 million be recognised in 2011-12 for its contribution to the East Loddon project, which was necessary expenditure to provide water supply to the Loddon towns of Serpentine and Jarklin. Coliban Water also requested \$1.0 million of flood insurance they received be treated as a negative asset to be rolled into the RAB in 2011-12. These proposals were not originally included in Coliban Water's Water Plan.

The Commission proposes to roll the full amount of \$2.4 million into Coliban Water's RAB in 2011-12. Coliban Water justified the expenditure, and its net capital expenditure over the 2007-08 to 2011-12 period is \$18.8 million below the approved forecast. The Commission also accepts Coliban Water's proposal that \$1.0 million in flood insurance payments be treated as a negative asset to be rolled into their RAB in 2011-12. This will ensure the insurance payment Coliban Water received is returned to customers.

Table 7.2 shows the difference between the draft and final decision for the RAB as at 1 July 2012 for each business.

TABLE 7.2 COMPARISON: RAB AS AT 1 JULY 2012 - COMPARISON OF DRAFT AND FINAL DECISIONS
\$m 2012-13

Water business	Draft decision	Final decision
Barwon Water	977.8	977.8
Central Highlands Water	288.6	288.6
Coliban Water	294.8	297.5
East Gippsland Water	123.5	123.5
Gippsland Water	452.6	452.6
Goulburn Valley Water	245.2	245.2
GWMWater	288.9	288.9
Lower Murray Water (Urban)	133.1	133.1
North East Water	171.8	171.8
South Gippsland Water	101.4	101.4
Wannon Water	239.0	239.0
Westernport Water	89.2	89.2



Forecast net capital expenditure — 2012-13 assessment

The Commission's preferred approach is to fix 2012-13 net capital expenditure at the forecasts approved for the second regulatory period, to help minimise incentives for businesses to delay capital works until the last year of the regulatory period. The Commission assessed each business's submission on its merits. Where the Commission considered the delay in capital works was beyond control of the business (for example, deferrals caused by delays in Victorian Civil and Administrative Tribunal hearings or other bodies), this amount will be rolled into the RAB on top of the 2008 determination forecasts.

North East Water has advised in their submission that the Bright Off-Stream Storage project was in effect put on hold from October 2010 due to State Government elections and the Minister for Water's request to stop work while the review of the site selection process was undertaken. Other delays were also experienced in respect of the negotiations with the Department of Environment and Primary Industries in relation to the environment cost sharing arrangements towards increasing the storage from 360 megalitres to 520 megalitres.

Wannon Water presented a number of projects which were delayed due to various reasons including rezoning by the Glenelg Shire Council, delays in VCAT panel hearings, negotiations with the DEPI and Corangamite Shire Council and awaiting approvals from VicTrack, V-line and Warrnambool City Council.

Table 7.3 shows the additional amount to be included in 2012-13 net capital expenditure above the amounts allowed in the Commission's draft decision.



**TABLE 7.3 FURTHER AMOUNTS APPROVED TO BE ROLLED INTO
2012-13 NET CAPITAL EXPENDITURE — FINAL DECISION**
\$m 2012-13

Capital project	Amount
North East Water	
Bright Off-Stream Storage	3.2
Wannon Water	
Portland Water Reclamation Plant Upgrade Project	5.3
Portland–West Portland Sewerage Scheme (Backlog area)	2.4
SCADA/Telemetry Installations — stage 3	1.0
Konongwootong Reservoir Stabilising Berm	0.9
Port Campbell – Timboon Feeder Main Replacement	0.8
Warrnambool – South Warrnambool Feeder Main	0.2
Warrnambool Brine Facility	0.2

Given the Commission’s assessment of Coliban Water’s financial viability (see section 7.5), the Commission allows the full business proposed net capital expenditure in 2012-13 to be rolled into the RAB. This adjustment will result in an additional \$10.7 million being rolled into Coliban Water’s forecast RAB.

The Commission rejects a number of submissions from businesses to have additional capital expenditure amounts included above the 2012-13 forecasts. The Commission considers the delays were within the businesses’ control.

Table 7.4 shows the difference between the draft and final decision for the RAB as at 1 July 2013 for each business.



TABLE 7.4 COMPARISON OF DRAFT AND FINAL DECISION, RAB AS AT 1 JULY 2013
\$m 2012-13

Water business	Draft decision	Final decision
Barwon Water	1 014.3	1 014.3
Central Highlands Water	296.8	296.8
Coliban Water	315.0	328.4
East Gippsland Water	121.2	121.2
Gippsland Water	485.5	485.5
Goulburn Valley Water	248.2	248.2
GWMWater	297.6	297.6
Lower Murray Water (Urban)	137.4	137.4
North East Water	187.9	191.2
South Gippsland Water	113.0	113.0
Wannon Water	245.9	256.7
Westernport Water	96.6	96.6

7.2.3 FINAL DECISION

The Commission approves amounts for inclusion in each business's RAB as at 1 July 2012 as set out at table 7.5.

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



TABLE 7.5 RAB AS AT 1 JULY 2012 — FINAL DECISION
\$m 2012-13

Water business	Final decision
Barwon Water	977.8
Central Highlands Water	288.6
Coliban Water	297.5
East Gippsland Water	123.5
Gippsland Water	452.6
Goulburn Valley Water	245.2
GWMWater	288.9
Lower Murray Water (Urban)	133.1
North East Water	171.8
South Gippsland Water	101.4
Wannon Water	239.0
Westernport Water	89.2

7.3 RATE OF RETURN

The WIRO allows businesses 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 WACC is expressed in real post-tax terms and is applied at a common rate to each business's forecast RAB for each year of the next regulatory period to calculate an allowance for return on assets.

7.3.1 OVERVIEW OF DRAFT DECISION

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



The Commission considered borrowing costs (which were near historic lows) when proposing a WACC in the middle of the range. 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 7.6 outlines the Commission’s assumptions for the individual WACC components.

TABLE 7.6 REAL POST-TAX WACC — 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 average nominal yield on 10-year Commonwealth Government Securities, accounting for 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
- The Commission adopted point estimates for the equity beta, market risk premium, financing structure and value of imputation credits reflecting previous decisions by the Commission and/or generally accepted regulatory precedent.



7.3.2 SUBMISSIONS AND COMMISSION'S ASSESSMENT

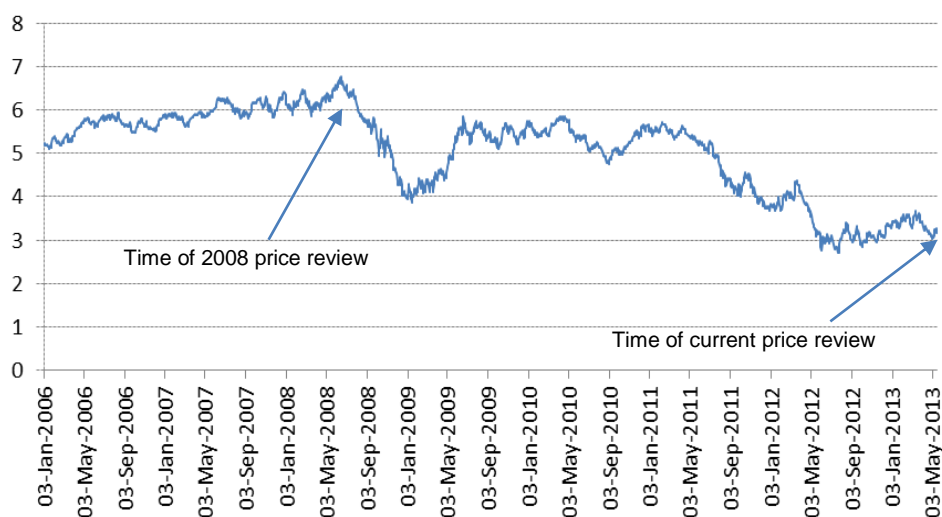
Water businesses' submissions

The Commission received a number of submissions from water businesses on the rate of return proposed in the draft decision. The responses were generally related to the proposed reduction in the WACC, and how this may affect financial risk and/or the business's financial position.

- Barwon Water suggested that a higher WACC than the 4.7 per cent adopted in the Commission's draft decision may be more appropriate as it would better take into account possible increases in interest rates. Coliban Water considered that any further lowering of the WACC (beyond what was proposed in the draft decision) could result in the corporation's true interest repayments being less than the contribution financing costs make to the revenue requirement.
- Westernport Water submitted the proposed WACC took into account current market conditions, but not future market conditions.

However, the WACC adopted in the draft decision reflects a prolonged downward shift in borrowing costs since the last price review as illustrated by the movement in nominal yields on Commonwealth Government 10 year bonds (figure 7.1).

FIGURE 7.1 COMMONWEALTH GOVERNMENT 10 YEAR BOND YIELDS
nominal per cent per year



Data source: Reserve Bank of Australia.

The Commission considers it appropriate for the WACC for the next regulatory period to reflect the latest information on borrowing costs. The uncertain and unforeseen events mechanism included in the pricing framework provides an avenue for businesses or the Commission to reopen determinations on the basis of changed financial conditions, should there be justification to do so.

Further, adopting the yield on a government bond with a 10 year term to maturity to estimate the risk free rate means the Commission's estimate of the WACC takes into account market expectations of future borrowing costs (because this is implied in the bond yield).

Consumer representative group submission

The Consumer Action Law Centre, Consumer Action Utilities Centre, and the Victorian Council of Social Service submitted the Commission should:

[set the WACC based upon the businesses actual cost of capital (given the fact that they are government-owned), rather than theoretically constructed private businesses.

As noted in the draft decision, the Commission considers that the estimate of the cost of capital should be based on an industry benchmark (that reflects efficient financing arrangements) rather than utility specific costs.³⁷

Using a benchmark WACC (rather than using a business-specific approach) ensures that regulated entities have an incentive to adopt efficient financing structures. That is, using a benchmark WACC means customer prices will only reflect the assumption about efficient financing costs, and not the impact of any inefficient financing arrangements or structures adopted by a water business.

A discussion of estimated actual borrowing costs facing the water businesses is provided in section 7.3.3.

The joint submission also noted there is significant difference between the WACC recommended by the Independent Pricing and Regulatory Tribunal (IPART) in its

³⁷ The submission from CALC, CUAC and VCOSS was also supported by Community Information and Support Victoria, Good Shepherd Youth and Family Services, and National Seniors Australia.



draft March 2013 determination for Hunter Water, and the WACC of 4.7 per cent adopted in the Commission's draft decision. There were two main reasons for this variation in the respective draft decisions:

- IPART adopted a lower real risk free rate, mainly reflecting its use of a debt instrument with a five year term to maturity to estimate the risk free rate while the Commission used a 10 year instrument.
- IPART adopted a lower debt margin, reflecting its approach of estimating the debt margin based on BBB to BBB+ rated debt, whereas the Commission estimates the margin based on BBB- to BBB+ rated debt.

Different measurement periods for market related data also contributed to the differences.

The Commission notes that IPART's final decision approved a WACC of 4.6 per cent for Hunter Water for the period of 2013-2014 to 2016-17. The methodology used by IPART varied from its draft to final decision for Hunter Water. Updated market data also resulted in IPART increasing its WACC estimate.³⁸ The Commission's estimation of the WACC is the same as that used in past price reviews.

7.3.3 ANALYSIS OF WACC PARAMETERS

The Commission has considered the responses to the draft decision and changes in financial market conditions since the draft decision. The only WACC parameters that have changed since the draft decision are the estimate of the risk free rate, and the debt margin.

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 2.4-2.75 per cent.

³⁸ See 2013 IPART, *Hunter Water Corporations water, sewerage, stormwater, drainage and other services, Review of prices 1 July 2013 to 30 June 2017, final report*, June.



The Commission used the same approach to estimating the real risk-free rate for the final decision. It 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.³⁹

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 which imply an average inflation rate of around 2.7 per cent per year 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.

For the purpose of estimating a real risk free rate of return, the Commission considers that an inflation range of between 2.3 per cent and 2.8 per cent is a reasonable longer term inflation forecast given recent trends in inflation, and the range of 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 per cent 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+ credit rating. The draft decision adopted a debt margin range of 3.03-4.53 per cent, based on estimates provided by PricewaterhouseCoopers (PwC).

The Commission has adopted the same approach for the final decision. The Commission engaged PwC to provide updated estimates of the debt margin. PwC

³⁹ Reserve Bank of Australia 2013, *Data series: capital market yields – government bonds – daily* (table F2).



derived an estimate of the 10 year BBB+ debt risk premium by taking Bloomberg's BBB fair value curve to seven 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.⁴⁰

PwC provided estimates of average debt margins for BBB+ to BBB- rated bonds over the 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 range for the debt margin is lower than the range adopted in the draft decision.

Interest rates applying to new borrowings

As for the draft decision, the Commission has used data from the Treasury Corporation of Victoria (TCV) to estimate the interest rates applying to new borrowings raised by the water businesses (noting the water businesses must borrow through TCV). While not directly used to calculate the WACC, it is important that the estimate of the WACC has regard for actual borrowing costs facing the water businesses.

Since the draft decision, the Victorian Government has raised the Financial Accommodation Levy (FAL) 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 TCV, benefit from State Government guarantees on their loan.

The increase in the FAL (all other things being equal) will raise 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.

⁴⁰ For more detail on the methodology, see PricewaterhouseCoopers 2013, *Estimating a debt risk premium*, May.



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 3.8-4.9 per cent, as shown in table 7.7. The Commission has adopted the same values for the equity beta, market risk premium, and financing structure as 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 water businesses will likely face from 1 July 2013, taking into account the impact of the FAL. The Commission considers that adopting a WACC below 4.5 per cent would create an undue risk that the water businesses would not be able to recover the costs of finance over the next regulatory period.

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

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.⁴¹
- the 4.6 per cent WACC adopted by IPART in its June 2013 final decision for Hunter Water.⁴²

In 2013-14, the Commission will commence a review of the rate of return methodology. The review will include an assessment of alternative approaches, and inform the Commission's 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.

⁴¹ Essential Services Commission of South Australia 2013, *SA Water's water and sewerage revenues 2013-14 to 2015-16*, May.

⁴² 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.



TABLE 7.7 REAL POST TAX WACC – FINAL DECISION

WACC parameter	Value
Risk free rate of return	0.422 – 0.913
Equity beta	0.65
Equity (market risk) premium	6.0
Debt margin	2.97 – 4.01
Financing structure (debt/assets)	60
Franking credits	0.5
Forecast inflation	2.30 – 2.80
Vanilla post tax WACC (real) range	3.8 – 4.9
Vanilla post tax WACC (real) point	4.5

7.3.4 FINAL DECISION

The Commission has adopted a real post tax weighted average cost of capital of 4.5 per cent.

7.4 DEPRECIATION

7.4.1 OVERVIEW OF DRAFT DECISION

Regional urban water businesses were asked to identify key projects and their expected date for completion as part of their proposals. In general most businesses provided this information before the draft decision, and the Commission accepted their depreciation forecasts. Barwon Water, Gippsland Water, Goulburn Valley Water and South Gippsland Water did not provide sufficient detail. For these businesses, the Commission requested a breakdown of expenditure and completion dates for significant capital projects.



7.4.2 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission is satisfied with the updated depreciation forecasts provided by Barwon Water (with the exception noted below), Gippsland Water, Goulburn Valley Water and South Gippsland Water.

As noted earlier, the Commission proposes to defer the depreciation for recycled water projects (Black Rock Recycled Water, Armstrong Creek Recycled Water and Torquay Recycled Water Dual Pipe) of \$2 million (for spending over 2008-09 to 2011-12). The decision to defer depreciation is based on the Commission's aim to better align depreciation incurred with customer uptake.

7.4.3 FINAL DECISION

The Commission confirms its draft decision to approve the depreciation forecasts for Central Highlands Water, Coliban Water, East Gippsland Water, GWMWater, Lower Murray Water (Urban), North East Water, Wannon Water and Westernport Water.

The Commission is satisfied with the depreciation forecasts from Barwon Water, Gippsland Water, Goulburn Valley Water and South Gippsland Water in response to the Commission's draft decision.

The Commission proposes to defer \$2 million of depreciation for Barwon Water's three recycled water projects; Black Rock Recycled Water Plan, Armstrong Creek Recycled Water Transfer and Distribution and Torquay Recycled Water Dual Pipe to the fourth regulatory period.



7.5 OTHER ADJUSTMENTS TO REVENUE REQUIREMENT

7.5.1 OVERVIEW OF DRAFT DECISION

In their Water Plans, Central Highlands Water and Coliban Water included amounts in their revenue requirement to reflect a forecast revenue 'shortfall' for the second regulatory period (for both businesses, mainly reflecting lower than forecast demand).

Central Highlands Water

The Commission proposed not to approve Central Highlands Water's claim for a \$22 million upward adjustment to its RAB to reflect a revenue shortfall in the second regulatory period. The Commission considered that Central Highlands Water would continue to operate at a sufficient interest cover ratio over the next regulatory period (averaging around two).⁴³ Further, the Commission noted that Central Highlands Water had not consulted with customers on their proposal to recover a revenue shortfall, prior to submitting their Water Plan for the Commission's assessment.

Coliban Water

The Commission proposed not to approve Coliban Water's proposal to include \$89.5 million in its RAB to reflect a revenue shortfall. The Commission considered that a revenue shortfall does not justify an adjustment to its RAB. However, the Commission acknowledged that there may be a case to adjust its revenue requirement on the grounds of financial viability. Under the WIRO, the Commission is required to set prices that allow a business to generate sustainable revenue stream.⁴⁴

In the draft decision, the Commission required Coliban Water to undergo a financial review between the draft and final decision to provide assurance that an increase in revenue requirement is justified on the grounds of financial viability.

⁴³ An interest cover ratio is a measure of how easily a company is able to pay interest on outstanding debt. For price regulation purposes, it is calculated by dividing the water businesses funds from operations by its interest expenses for the same period (on a cash accounting basis). An interest cover below 1.5 could indicate that the business' ability to meet its interest expenses is questionable. An interest cover ratio below 1 indicates that a business is not generating sufficient revenues to meet its interest expenses.

⁴⁴ WIRO clause 14(1)(i).



7.5.2 SUBMISSIONS AND COMMISSION'S ASSESSMENT

Central Highlands Water

Central Highlands Water did not respond to the Commission's draft decision not to adjust its RAB to reflect a revenue shortfall. The Commission's final decision does not approve an adjustment to the RAB for Central Highlands Water to reflect the revenue shortfall, on the basis that Central Highlands Water will continue to operate at a sufficient interest cover ratio over the next regulatory period. Further, the Commission noted that Central Highlands Water had not consulted with customers on their proposal to recover a revenue shortfall, prior to submitting their Water Plan for the Commission's assessment.

Coliban Water

In response to the Commission's draft decision, Coliban Water noted its support for the inclusion of an appropriate RAB adjustment and the proposed independent review of its financial viability. Coliban Water considered that the draft decision had too limited a focus on interest cover and submitted that the review of financial viability should consider all other financial indicators relevant to the water industry.

Review of Coliban Water's financial viability

Following the draft decision, the Commission engaged Deloitte to undertake a review of Coliban Water's financial viability. The Deloitte report makes the following key points:⁴⁵

- Coliban Water is projected to face financial viability challenges. This observation was based on estimates for key financial metrics (table 7.8). These metrics for Coliban Water were significantly worse than those of other Victorian water businesses.
- An adjustment to Coliban Water's revenue requirement is appropriate, consistent with the WIRO requirement to provide for a sustainable revenue stream.

⁴⁵ Deloitte 2013, *Coliban Water – Financial Analysis*, June (available on the Commission's website).



TABLE 7.8 ESTIMATED FINANCIAL METRICS: NO ADJUSTMENT TO COLIBAN WATER'S REVENUE REQUIREMENT

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
EBITDA	35.1	44.4	47.3	50.4	52.9	56.9
Net cash flow	(54.0)	(34.7)	(30.4)	(26.7)	(21.5)	(24.8)
Debt	357.8	392.7	423.1	449.9	471.5	496.4
Equity	856.0	836.8	816.8	797.0	776.6	756.9
Gearing	29.5%	31.9%	34.1%	36.1%	37.8%	39.6%
FFO	3.5	5.7	7.9	9.6	10.6	13.3
FFO Interest Cover	1.12	1.17	1.23	1.27	1.28	1.34
FFO / Debt	1.0%	1.5%	1.9%	2.1%	2.2%	2.7%
EBITDA / Interest Expense	1.2	1.3	1.4	1.4	1.4	1.5
Debt / EBITDA	10.2	8.8	8.9	8.9	8.9	8.7
Debt / RAB	96.9%	102.6%	103.5%	103.8%	104.2%	103.5%

Deloitte modeled a range of scenarios to examine the financial impact on Coliban Water (Deloitte 2013, p. 17). Deloitte also considered a longer term perspective of Coliban Water's financial position by including indicative estimates for the fourth regulatory period (2018-19 to 2022-23).

Commission's assessment

The adjustment sought by Coliban Water in its Water Plan resulted in estimated interest cover averaging 1.5 times over the third regulatory period, with interest cover reaching 1.5 in 2015-16 and increasing thereafter.

The Commission considers targeting an interest cover of 1.5 times by the end of the third regulatory period more appropriately balances supporting the business's transition to improved financial viability (accounting for the regulated nature of the business), while minimising the impact on prices. This approach is also consistent with Deloitte's views. Coliban Water's management should also seek to further improve the business's financial position by seeking to outperform regulatory benchmarks.

Informed by the Deloitte assessment, the Commission has approved an adjustment to Coliban Water's revenue requirement on financial viability grounds. The



Commission considers that this is consistent with the WIRO's requirement that prices are set to enable a business to generate a sustainable revenue stream.

The Commission has made an adjustment that allows Coliban Water to achieve an interest cover of 1.5 (based on the information currently available) by the end of the third regulatory period (2017-18).

Method to adjust Coliban Water's revenue requirement

The Commission considers that as a general principle, the capital costs of an asset should be recovered over a period that approximates the useful life of the asset. This approach ensures that customers contribute to the costs of assets as they receive the benefits of those investments. In most cases, this means that capital costs are recovered by businesses through customer prices over multiple regulatory periods.

This approach is well established in regulated industries, and forms a key part of the building block methodology used by the Commission to calculate maximum prices (see chapter 1 for more discussion on the building block methodology). Businesses are no worse-off as they are allowed to generate a return on their investment (which includes a component to cover estimated costs of finance) and a return of their investment (through a depreciation allowance) over the assets life.

The Commission notes that Coliban Water's initial regulatory asset base (approved in 2004) was set on the assumption that its Build Own Operate Transfer (BOOT) scheme payments (representing a significant part of the businesses capital works program) were not treated as capital expenditure and thus not included in Coliban Water's initial RAB. The payments were assumed to be an operating cost. While treating the payments as an operating cost supports business cash flow, it means that the asset base does not increase over time to reflect the gradual acquisition of assets that would have otherwise occurred under accounting rules.

The BOOT payments relate to water treatment facilities at Bendigo, Kyneton and Castlemaine, and a wastewater treatment facility in Echuca.

Given that Coliban Water proposed an adjustment to its RAB in its Water Plan (arguing that its RAB was too low), the Commission has taken the opportunity to revisit its treatment of Coliban Water's BOOT payments, consistent with the general principle noted above: namely, that the capital cost of an asset should, in general, be recovered by a business over a period that approximates the useful life of the asset, resulting in a better matching of economic costs and benefits.



The Commission has adjusted Coliban Water’s revenue requirement by including an estimate of the capital components of Coliban Water’s BOOT payments for each year of the next regulatory period in its RAB, consistent with the profile shown in table 7.9. The amounts reflect the fixed costs payable by Coliban Water for services provided under the BOOT schemes (with the fixed costs an approximation of the capital costs of the projects). The cumulative addition to the RAB over the next five years is \$26.5 million.

TABLE 7.9 COLIBAN WATER BOOT PAYMENTS – ADDITION TO RAB
\$2012-13

	2013-14	2014-15	2015-16	2016-17	2017-18
Capitalised amount	5.6	5.4	5.3	5.2	5.0

Capitalising the capital component of the BOOT payments will support Coliban Water’s financial viability over the long term, as it will enable the business to generate a return on and of capital over the life of the asset.

However, while providing longer term financial viability benefits, the capitalisation has an adverse impact on Coliban Water’s near term cash flow. A separate adjustment (through supplementing revenue) is required to allow Coliban Water to achieve an interest cover of 1.5 times by the end of the next regulatory period. The net change to Coliban Water’s revenue requirement as a result of these adjustments is \$11 million (in present value terms) over the next regulatory period.

Based on financial viability forecasts provided by Deloitte, the Commission considers that following the adjustments Coliban Water will be in a position to satisfy financial viability thresholds.

Estimated impact on customer prices

The Commission estimates that the adjustments described above accounts for around 4 per cent of the 16 per cent increase in Coliban Water’s prices.

The Commission recognises its final decision will affect the ability of some customers to pay their bills. This is despite the Commission’s final decision to approve an average price increase that is significantly lower than Coliban Water originally proposed in its Water Plan (around 28 per cent), and lower than the average price increase approved in the draft decision (20 per cent).



Coliban Water proposed measures to improve support to customers experiencing financial hardship. This recognises the relatively large price increases it proposed for the third regulatory period.

Estimated impact on Coliban Water's financial position

Based on the Commission's final decision to approve an adjustment on financial viability grounds, Coliban Water will be in a position to achieve an interest cover of 1.5 times by 2018-19 (the end of the third regulatory period). Without the adjustment, interest cover in 2017-18 would be around 1.3 times. Funds from operations improves from around \$13 million to \$25 million in 2017-18 as a result of the adjustment, and debt/RAB moves from 104 per cent to 93 per cent (the decline representing an improvement in the measure).

Note that the estimates above are benchmarks. As noted above, Coliban Water may be able to achieve a better financial outcome if it pursues additional efficiency gains.

7.5.3 FINAL DECISION

The Commission has approved an adjustment to Coliban Water's revenue requirement on the grounds of financial viability by rolling into the RAB an estimate of the capital component of its annual BOOT payments, and a separate revenue subsidy. The net impact on its revenue requirement for the third regulatory period is \$11 million in present value terms.



8 DEMAND

8.1 INTRODUCTION

The regional urban water businesses' demand forecasts directly affect the prices that customers will pay during the third regulatory period (1 July 2013 to 30 June 2018) for the following key services:

- water
- sewerage
- trade waste and
- recycled water.

The key demand parameters that influence prices and revenue for the regional urban water businesses are the numbers of water and sewerage connections, and the total volume of water sold. Generally, regional businesses generate more than half of their tariff revenue from fixed charges. So, the numbers of water and sewerage connections are a very important demand factor influencing revenue.

8.2 OVERVIEW OF DRAFT DECISION

The Commission engaged Frontier Economics to help review and assess the demand forecasts proposed by the regional urban water businesses. The consultant's detailed review encompassed water, sewerage, recycled water and trade waste. Key issues in the assessment included the businesses' assumptions about future connections growth and the impact of changing supply conditions. The Commission considers Frontier Economics' recommended demand forecasts reasonably account for expected customer growth and water consumption assumptions.



Before the Commission made its draft decision, the businesses were invited to comment on the Frontier Economics' report, which is available on the Commission's website.⁴⁶

The Commission did not adjust the demand forecasts submitted by Barwon Water, Goulburn Valley Water and Wannon Water. For the other regional urban water businesses, the draft decision's main adjustments to the demand forecasts proposed in their Water Plans included:

- increased forecast residential water and sewerage connections for East Gippsland Water, Lower Murray Water (Urban) and Westernport Water, to reflect Victoria In Future's household growth projections
- increased residential and non-residential sewerage connections for Coliban Water
- increased non-residential water and sewerage connections for East Gippsland Water, Lower Murray Water (Urban) and North East Water
- increased non-residential water connections for South Gippsland Water and Westernport Water
- increased water volume forecasts for Central Highlands Water, East Gippsland Water, Gippsland Water, GMMWater, Lower Murray Water (Urban), South Gippsland Water and Westernport Water
- revised non-residential sewage volume forecasts for Coliban Water and Gippsland Water
- revised trade waste customer numbers for East Gippsland Water, Gippsland Water and Lower Murray Water (Urban)
- revised trade waste volumes for Coliban Water and North East Water.

The Commission also requested East Gippsland Water clarify its recycled water revenue in response to the draft decision.

In most cases, the businesses accepted the recommended adjustments. Gippsland Water did not agree with Frontier Economics' approach to reviewing its forecasts. North East Water resubmitted its forecasts after Frontier Economics submitted its final report.

Tables 8.1 to 8.4 detail the Commission's draft decision on water connections and volumes.

⁴⁶ www.esc.vic.gov.au



TABLE 8.1 DRAFT DECISION — WATER CONNECTIONS
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>per cent</i>
Barwon Water	143 819	146 647	149 477	152 423	155 563	2.0
Central Highlands Water	65 884	66 888	67 909	68 946	70 001	1.5
Coliban Water	69 653	70 817	72 000	73 204	74 428	1.7
East Gippsland Water	22 547	22 927	23 314	23 708	24 131	1.7
Gippsland Water	66 053	67 149	68 245	69 341	70 437	1.6
Goulburn Valley Water	56 673	57 467	58 272	59 089	59 916	1.4
GWMWater	31 083	31 318	31 557	31 794	32 033	0.8
Lower Murray Water (Urban)	34 514	34 872	35 232	35 597	35 964	1.0
North East Water	47 920	48 589	49 268	49 956	50 653	1.4
South Gippsland Water	20 636	20 935	21 240	21 545	21 854	1.4
Wannon Water	41 802	42 242	42 693	43 129	43 554	1.0
Westernport Water	15 899	16 240	16 592	16 952	17 319	2.2

Note: Excludes vacant land, fire services and other standalone fixed charges.



TABLE 8.2 DRAFT DECISION — WATER CONSUMPTION
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>per cent</i>
Barwon Water	30 191	30 876	31 542	32 082	32 704	2.0
Central Highlands Water	11 130	11 310	11 480	11 650	11 851	1.6
Coliban Water	16 305	16 464	16 630	16 811	17 000	1.0
East Gippsland Water	4 549	4 617	4 686	4 755	4 829	1.5
Gippsland Water	12 762	12 952	13 142	13 332	13 522	1.5
Goulburn Valley Water	22 500	22 700	22 800	23 000	23 200	0.8
GWMWater	8 030	8 096	8 131	8 233	8 322	0.9
Lower Murray Water (Urban)	16 552	16 677	16 804	16 932	17 061	0.8
North East Water	11 405	11 717	12 035	12 362	12 697	2.7
South Gippsland Water	4 574	4 572	4 573	4 614	4 658	0.5
Wannon Water	11 537	11 471	11 558	11 645	11 734	0.4
Westernport Water	1 632	1 661	1 691	1 722	1 753	1.8



TABLE 8.3 DRAFT DECISION — SEWERAGE CONNECTIONS
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>per cent</i>
Barwon Water	129 305	131 847	134 391	137 040	139 863	2.0
Central Highlands Water	55 218	56 214	57 263	58 399	59 558	1.9
Coliban Water	62 454	63 537	64 639	65 723	66 825	1.7
East Gippsland Water	21 667	22 036	22 410	22 791	23 201	1.7
Gippsland Water	57 174	58 389	60 079	61 889	63 119	2.5
Goulburn Valley Water	48 878	49 562	50 255	50 959	51 673	1.4
GWMWater	24 474	24 917	25 125	25 335	25 543	1.1
Lower Murray Water (Urban)	29 540	29 907	30 277	30 651	31 028	1.2
North East Water	43 126	44 237	44 886	45 515	46 161	1.7
South Gippsland Water	17 631	17 924	18 223	18 513	19 348	2.4
Wannon Water	35 246	35 621	36 000	36 370	36 731	1.0
Westernport Water	16 692	17 128	17 578	18 042	18 519	2.6

Note Excludes vacant land and other stand-alone fixed charges.



TABLE 8.4 DRAFT DECISION — SEWAGE VOLUME
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>per cent</i>
Barwon Water	2 883	2 948	3 012	3 063	3 123	2.0
Central Highlands Water	434	460	488	517	548	6.0
Coliban Water	956	965	975	985	995	1.0
East Gippsland Water	na	na	na	na	na	na
Gippsland Water	1 175	1 178	1 181	1 183	1 186	0.3
Goulburn Valley Water	1 172	1 181	1 190	1 200	1 210	0.8
GWMWater	813	818	0	0	0	na
Lower Murray Water (Urban)	na	na	na	na	na	na
North East Water	na	na	na	na	na	na
South Gippsland Water	194	194	194	194	194	0.0
Wannon Water	na	na	na	na	na	na
Westernport Water	na	na	na	na	na	na

Note Sewage volumes relate to non-residential services for all businesses. Excludes contract volumes.
na Not applicable.



8.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

This section details the regional urban water businesses' responses to the draft decision, and the Commission's assessment of those responses. Annexure A to the pricing determination for each business contains detailed tables on the Commission's final decision on demand forecasts for that business.

When the Commission adjusted businesses' forecasts in the draft decision, the businesses generally accepted the adjustments. Five water businesses — Central Highlands Water, GWMWater, Lower Murray Water (Urban), Wannon Water and Westernport Water— agreed to the draft decision on demand. The remaining businesses put forward alternative forecasts. In most cases, these alternatives represented minor changes from the draft decision assumptions due to updated information, an inadvertent error, or in the case of Gippsland Water, a disagreement with the Commission's draft decision.

Table 8.5 summarises the businesses' proposed revisions to their demand forecasts. The Commission has accepted the revisions in table 8.3 because they represent either error corrections or reasonable revisions to reflect updated information.



TABLE 8.5 BUSINESSES' RESPONSES TO THE DRAFT DECISION

Response to the draft decision

Barwon Water

Barwon Water proposed a 266 megalitre annual reduction in its non-residential water volume from October 2013, because of Fonterra's closure of its Colac facility (which used an annual average of 266 megalitres over the past five years).

Barwon Water proposed a 85 megalitre annual reduction in its non-residential water volume and a 50 megalitre annual reduction in its non-residential sewage volume from October 2016, because of Ford's closure of its Geelong facility (which used an annual average of 85 megalitres of water and generated an average 50 megalitres of over the past five years).

The Commission identified an error in recycled water volumes in the draft decision template. It rectified the error for the final decision.

Coliban Water

Coliban Water proposed to reduce its forecast rural water demand from 6000 megalitres per year to 4000 megalitres per year. It stated this revision reflects recent demand conditions. Coliban Water's most recent forecast of 2012-13 volumes has an upper bound estimate of 4863 megalitres.

Coliban Water proposed to reduce its forecast rural customers in the Harcourt area due to higher than expected numbers of customers exiting the system.

The Commission provided guidance to Coliban Water that it could apply a trade waste total dissolved solids (TDS) charge only at sewerage treatment plants that can remove or reduce salt loads. In its submission to the draft decision, Coliban Water reduced its TDS forecasts in line with the Commission's guidance.

East Gippsland Water

East Gippsland Water revised its residential water volume forecasts using a more robust methodology and proposed to reduce its average residential water volume from 150 kilolitres per year to 145 kilolitres per year.

It proposed to adjust its non-residential sewerage connection growth rate to match its growth rate for non-residential water connections.

It proposed to reduce its number of minor trade waste connections for its base year (to reflect more accurate data) and project growth at the same rate as the draft decision.

It provided its recycled water volumes in response to a request from the Commission in its draft decision.

Goulburn Valley Water

Goulburn Valley Water noted an inadvertent revision had occurred in the non-residential sewage volumes in volume II of the draft decision. Its forecasts should not have had any revisions.

North East Water

North East Water noted an inadvertent error in its chemical oxygen demand (COD) trade waste amounts in volume II of the draft decision. The correct figures were in the business's data template.

South Gippsland Water

South Gippsland Water proposed to adjust its base year average customer volume to allow for non-residential vacant land in its east/west area from 350 kilolitres per year to 335 kilolitres per year.



8.3.1 GIPPSLAND WATER

Gippsland Water did not agree with Frontier Economics' water and sewage volume recommendations in the consultant's draft report, which the Commission adopted for the draft decision. The Commission reviewed Gippsland Water's concerns with Frontier Economics' advice and agreed with the consultant's assessment that the water business's modelling techniques were not sufficiently robust, and that its methodology and approach had not met the standards of other businesses. The Commission offered to undertake independent demand modelling after the draft decision if Gippsland Water remained concerned.

In response to the draft decision, Gippsland Water engaged Oakley Greenwood to review the draft decision and Frontier Economics' report, and develop new demand forecasts. Gippsland Water proposed new forecasts for residential and non-residential water and sewage volumes based on Oakley Greenwood's recommendations.⁴⁷

The Commission engaged Frontier Economics to review Oakley Greenwood's demand forecasts for Gippsland Water. Frontier Economics was concerned with Oakley Greenwood's residential modelling assumptions about water use efficiency and the probability of water restrictions.⁴⁸

For this reason, the Commission engaged Intelligent Software Design (ISD) to develop a model to forecast residential volumes. ISD developed an end-use model to forecast residential volumes. The Commission considers the ISD forecasts are more robust, given the information available to ISD, and it has adopted them for the final decision.

Frontier Economics found Oakley Greenwood's non-residential water use forecasts were more robust than those informing its own recommendations to the Commission before the draft decision. It recommended adopting Oakley Greenwood's new non-residential water forecasts.⁴⁹ The Commission has adopted Oakley Greenwood's non-residential water and sewage volumes for the final decision.

⁴⁷ Oakley Greenwood 2013, *Independent assessment of volumetric demand forecasts*, April.

⁴⁸ Frontier Economics 2013, *Gippsland Water response to the draft decision*. May, p. 7-8.

⁴⁹ Frontier Economics 2013, *Water Price Review: demand forecasts*, February.



8.4 FINAL DECISION

For the purposes of the final decision the Commission has:

- accepted the demand forecasts for Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water, North East Water, South Gippsland Water, Wannon Water and Westernport Water.
- accepted Gippsland Water's demand forecasts except for residential water and sewage volumes
- revised the forecast of residential water and sewage volumes for Gippsland Water.

Tables 8.6–8.9 set out the key assumptions for customer numbers and demand for the final decision.



TABLE 8.6 FINAL DECISION – WATER CONNECTIONS
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>per cent</i>
Barwon Water	143 818	146 646	149 476	152 422	155 562	2.0
Central Highlands Water	65 884	66 888	67 909	68 946	70 001	1.5
Coliban Water	69 653	70 817	72 000	73 204	74 428	1.7
East Gippsland Water	22 547	22 927	23 314	23 708	24 131	1.7
Gippsland Water	66 053	67 149	68 245	69 341	70 437	1.6
Goulburn Valley Water	56 673	57 467	58 272	59 089	59 916	1.4
GWMWater	31 083	31 318	31 557	31 794	32 033	0.8
Lower Murray Water (Urban)	34 494	34 828	35 161	35 497	35 836	1.0
North East Water	47 920	48 589	49 268	49 956	50 653	1.4
South Gippsland Water	20 636	20 935	21 240	21 545	21 854	1.4
Wannon Water	41 802	42 242	42 693	43 129	43 554	1.0
Westernport Water	15 899	16 240	16 592	16 952	17 319	2.2



TABLE 8.7 FINAL DECISION — WATER CONSUMPTION
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>per cent</i>
Barwon Water	29 992	30 610	31 276	31 752	32 353	1.9
Central Highlands Water	11 130	11 310	11 480	11 650	11 851	1.6
Coliban Water	16 305	16 464	16 630	16 811	17 000	1.0
East Gippsland Water	4 452	4 519	4 585	4 653	4 725	1.5
Gippsland Water	12 219	12 334	12 459	12 574	12 680	0.9
Goulburn Valley Water	22 500	22 700	22 800	23 000	23 200	0.8
GWMWater	8 030	8 096	8 131	8 233	8 322	0.9
Lower Murray Water (Urban)	16 543	16 656	16 770	16 884	17 000	0.7
North East Water	11 405	11 717	12 035	12 362	12 697	2.7
South Gippsland Water	4 551	4 550	4 551	4 592	4 635	0.5
Wannon Water	11 537	11 471	11 558	11 645	11 734	0.4
Westernport Water	1 632	1 661	1 691	1 722	1 753	1.8



TABLE 8.8 FINAL DECISION – SEWERAGE CONNECTIONS
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>no.</i>	<i>per cent</i>
Barwon Water	129 305	131 847	134 391	137 040	139 863	2.0
Central Highlands Water	55 218	56 214	57 263	58 399	59 558	1.9
Coliban Water	62 454	63 537	64 639	65 723	66 825	1.7
East Gippsland Water	21 638	21 977	22 320	22 670	23 043	1.6
Gippsland Water	57 174	58 389	60 079	61 889	63 119	2.5
Goulburn Valley Water	48 878	49 562	50 255	50 959	51 673	1.4
GWMWater	24 474	24 917	25 125	25 335	25 543	1.1
Lower Murray Water (Urban)	29 511	29 854	30 197	30 542	30 891	1.1
North East Water	43 126	44 237	44 886	45 515	46 161	1.7
South Gippsland Water	17 501	17 859	18 223	18 513	19 348	2.5
Wannon Water	35 246	35 621	36 000	36 370	36 731	1.0
Westernport Water	16 692	17 128	17 578	18 042	18 519	2.6



TABLE 8.9 FINAL DECISION — SEWAGE VOLUME
residential and non-residential

	2013-14	2014-15	2015-16	2016-17	2017-18	Average annual growth 2013-14 to 2017-18
	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>ML</i>	<i>per cent</i>
Barwon Water	2 883	2 948	3 012	3 026	3 073	1.6
Central Highlands Water	434	460	488	517	548	6.0
Coliban Water	956	965	975	985	995	1.0
East Gippsland Water	na	na	na	na	na	na
Gippsland Water	1 082	1 083	1 085	1 086	1 086	0.1
Goulburn Valley Water	1 162	1 162	1 162	1 162	1 162	0.0
GWMWater	813	818	0	0	0	na
Lower Murray Water (Urban)	na	na	na	na	na	na
North East Water	na	na	na	na	na	na
South Gippsland Water	194	194	194	194	194	0.0
Wannon Water	na	na	na	na	na	na
Westernport Water	na	na	na	na	na	na



9 FORM OF CONTROL

9.1 INTRODUCTION

The Water Industry Regulatory Order (WIRO) provides water businesses with the flexibility to propose prices, or the manner in which prices are calculated or otherwise determined. Water businesses can propose pricing formulas, price caps or pricing principles, which are the different forms of price control. The various price controls 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.

9.2 OVERVIEW OF DRAFT DECISION

Table 9.1 compares the current, proposed and draft decision forms of control for the regional urban water businesses.



TABLE 9.1 REGIONAL URBAN WATER BUSINESSES' FORM OF PRICE CONTROL — DRAFT DECISION

Water business	Current (to 30 June 2013)	Proposed (1 July 2013–30 June 2018)	Draft decision
Barwon Water	Price caps	Price caps	Price cap hybrid
Central Highlands Water	Price caps	Price caps	Price cap hybrid
Coliban Water	Price caps	Demand adjusted revenue cap	Water and sewerage not approved: tariff basket for rural services
East Gippsland Water	Price caps	Tariff basket	Price cap/tariff basket
Gippsland Water	Price caps	Price caps	Price cap hybrid
Goulburn Valley Water	Price caps	Price caps	Price cap hybrid
GWMWater	Price caps	Revenue cap	Revenue cap
Lower Murray Water (Urban)	Price caps	Tariff basket	Price cap/tariff basket
North East Water	Price caps	Price caps	Price cap hybrid
South Gippsland Water	Price caps	Price caps	Price cap hybrid
Wannon Water	Price caps	Price caps	Price cap hybrid
Westernport Water	Price caps	Price caps	Price cap hybrid

Note: These forms of control are explained in the Commission's draft decision (pp 145-147).

For businesses applying for tariff baskets, the Commission proposed:

- to approve price caps for East Gippsland Water for the first year of the regulatory period, and approve the business's proposal for a tariff basket for the remainder of the regulatory period. The Commission proposed to approve East Gippsland Water's proposed rebalancing constraint of plus or minus 3 per cent.
- to approve price caps for Lower Murray Water (Urban) for the first year of the regulatory period, and the proposed tariff basket for the remainder of the regulatory period. The Commission proposed to approve Lower Murray Water's (Urban) proposed rebalancing constraint of 10 per cent.

The Commission proposed to approve GWMWater's application for a revenue cap and its proposed rebalancing constraint of plus or minus 10 per cent.



In its draft decision, the Commission proposed not to approve Coliban Water's application for a demand adjusted revenue cap. The Commission had two concerns about Coliban Water's proposal:

- The additional complexity of the proposed form of price control may not contribute significantly to achieving Coliban Water's objective of risk sharing. Rather, the business may be able to achieve its objectives through a revenue cap with a rebalancing constraint, which would be both simpler and more transparent.
- The proposal and resulting changes in prices may be too complicated to communicate effectively to customers. The Commission has previously emphasised the importance of customer understanding of tariffs, and it was concerned the proposed form of price control may lead to customer confusion.

The Commission's view was that a simpler form of revenue cap may be an appropriate form of price control. The Commission was not satisfied, on the basis of the information received, of the additional benefits of the proposed demand adjusted revenue cap.

The Commission was also concerned that the proposal did not appear to satisfy the WIRO's requirements of efficient pricing. Specifically, Coliban Water proposed that miscellaneous services, which should be priced to reflect cost, would be included in the revenue cap meaning that their prices could fluctuate in the revenue cap independent of underlying costs.

The Commission proposed not to approve Coliban Water's application for a demand adjusted revenue cap and required Coliban Water to:

- explain how the additional complexity of the proposed form of price control contributes significantly to achieving the business's objective of risk sharing
- explain how it proposes to communicate this proposal to customers, or
- propose an alternative form of price control. If Coliban Water proposes a form of price control that enables price variations, then it must also propose a rebalancing constraint.

For businesses that proposed price caps (see table 9.1), the Commission proposed a hybrid form of control in the draft decision; businesses could use price caps but could also apply to the Commission for a tariff basket during the regulatory period. This would help businesses manage uncertainty by allowing any reasonable rebalancing of tariffs that can be justified during the regulatory period. The



Commission expected businesses would consult with customers on tariff charges before applying for a tariff basket.

Under a hybrid form of price control, any approved price adjustments must be consistent with the tariff basket approach, including limiting average annual price increases across the range of tariffs to the average increase under a tariff basket. Businesses applying to the Commission within the third regulatory period to adjust their tariffs are required to clearly articulate their new tariff strategy.

The Commission proposed to require any regional urban water businesses proposing to shift from a price cap to a tariff basket during the third regulatory period:

- to consult with customers before proposing the tariff basket
- to provide evidence of customer consultation (including customer consultative committees) and
- to provide a statement about customer impacts and how the business would address those impacts.

9.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

Coliban Water was the only regional urban water business to respond on its form of control. It submitted a revised proposal for a demand adjusted revenue cap by amending the services it would cover:

- The demand adjusted revenue cap would apply to urban water charges only (fixed and variable), including both treated and untreated water. The individual prices to be set annually in response to the revenue cap amount would have an upper constraint of 6 per cent with no limit on tariff decreases.
- A tariff basket would apply to rural services, and fixed and variable sewerage charges to facilitate proposed sewerage tariff reform. Including rural services in the tariff basket will allow Coliban Water to modify the revenue share attributable to rural and urban customers if necessary. A 6 per cent rebalancing constraint is proposed for tariff basket services. Coliban Water will propose rural services tariffs and a rebalancing constraint to apply from 2014-15 following customer consultation in the 2013-14 financial year.
- Price caps would apply to fire services, trade waste fixed and variable charges, and land development related core miscellaneous services.



- Cost recovery principles would apply to core miscellaneous services in years two to five of the next regulatory period, and non-core miscellaneous services.

Coliban Water submitted it would use its annual communications plan for the annual tariff approval process to explain any over (and under) collection of revenue compared with forecasts and the offsetting but small reduction (or increase) in prices in the following year. Coliban Water stated it would also use customised bill messaging, media releases and social media, where appropriate, to ensure effective customer engagement.

Coliban Water submitted that in the event that the demand adjusted revenue cap is not approved, Coliban Water proposed that these services instead be covered by a tariff basket which is also in line with customer wishes.

The Commission has decided not to approve Coliban Water's proposed form of control. The reasons for this are:

- The Commission considers the demand adjusted revenue cap is overly complex and Coliban Water has not been able to explain it adequately to the Commission raising sufficient doubt about its ability to explain this complex argument to customers.
- The Commission is not satisfied with Coliban Water's explanation that a tariff basket approach is an appropriate fall-back option in place of a demand adjusted revenue cap given that a revenue cap would appear to better solve Coliban Water's financial viability concerns.
- The Commission considers that some of Coliban Water's concerns about incurring additional costs, such as pumping costs, could be dealt with using direct methods such as 'pass-throughs' rather than through the form of control explained chapter 17.
- The Commission considers Coliban Water's revised proposal should consider the Commission's final decision on Coliban Water's revenue and other matters which have implications for financial viability which could affect Coliban Water's choice of a form of control.



The Commission has decided:

- to apply a price cap for Coliban Water for the first year of the regulatory period
- to require Coliban Water to resubmit a form of control proposal within 90 days of the Commission's final decision
- to make a separate decision on Coliban Water's form of control to apply from the second and subsequent years of Coliban Water's regulatory period
- in the absence of a resubmission, a price cap form of price control will continue.



9.4 FINAL DECISION

The Commission has approved a hybrid form of price control, whereby:

- it has approved price caps for Barwon Water, Central Highlands Water, Gippsland Water, Goulburn Valley Water, North East Water, South Gippsland Water, Wannon Water and Westernport Water and
- these businesses may propose to move to a tariff basket at the time of an annual price review within the period.

Where a business proposes to transfer to a hybrid form of price control during the next regulatory period, it is required to consult with customers prior to seeking Commission approval.

The Commission has approved GMMWater's application for a revenue cap and proposed rebalancing constraint of plus or minus 10 per cent.

The Commission has approved price caps for East Gippsland Water for the first year of the regulatory period, and approves the business's proposal for a tariff basket for the remainder of the regulatory period. The Commission approves East Gippsland Water's proposed rebalancing constraint of plus or minus 3 per cent.

The Commission has approved price caps for Lower Murray Water (Urban) for the first year of the regulatory period, and has approved the business's proposal for a tariff basket for the remainder of the regulatory period. The Commission has approved Lower Murray Water (Urban)'s proposed rebalancing constraint of 10 per cent.

The Commission has decided: to apply a price cap for Coliban Water for the first year of the regulatory period; to require Coliban Water to resubmit a form of control proposal within 90 days of the Commission's final decision; and to make a separate decision on Coliban Water's form of control to apply from the second year of Coliban Water's regulatory period.





10 RETAIL WATER SERVICES TARIFFS

10.1 INTRODUCTION

The 12 regional urban water businesses provide retail water services. Retail water services are prescribed services under the Water Industry Regulatory Order (WIRO) and are subject to price regulation by the Commission.

The tariffs proposed by the regional urban water businesses for the third regulatory period can be broadly classified as two part tariffs. These are tariffs comprising a fixed component that is independent of use and a variable component reflecting metered water use. Two part tariffs may include a single usage charge with a constant price per kilolitre of water for all customers or an inclining block structure, where prices increase as successively higher amounts of water are consumed.

10.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission proposed to approve all of the regional businesses' retail water tariff proposals for the third regulatory period because they are consistent with the regulatory principles in the WIRO.

The Commission proposed to approve the following nine regional urban water businesses' proposals to maintain their existing two part tariffs for residential customers:

- Barwon Water's, East Gippsland Water's, Gippsland Water's, Goulburn Valley Water's, GWMWater's, North East Water's and South Gippsland Water's proposals to continue with a fixed service charge and a single variable charge.
- Lower Murray Water (Urban)'s and Wannon Water's proposals to maintain a fixed service charge and a three tier inclining block tariff.



The Commission proposed to approve the following three regional urban water businesses' proposals to simplify their three tier inclining block tariffs:

- Central Highlands Water's proposal to move from a three tier inclining block tariff to a two tier variable charge.
- Coliban Water's proposal to move from a three tier inclining block tariff to a single variable charge.
- Westernport Water's proposal to move from a three tier inclining block tariff to a single variable charge.

The Commission proposed to approve the following three businesses' proposals to restructure geographic pricing zones:

- Coliban Water's proposal to combine its two pricing zones (central and northern) for variable water tariffs over seven years, beginning in 2013-14.
- North East Water's proposal to introduce three water pricing zones for its fixed water charge by the end of the third regulatory period.
- South Gippsland Water's proposal to align the fixed water prices in its east/west and southern districts by 1 July 2016.

For non-residential customers, the Commission proposed to approve all regional urban water businesses' proposals to maintain a two part tariff comprising a fixed service charge and a single variable charge.

In its draft decision, the Commission required Central Highlands Water, Coliban Water and North East Water to provide further information on how they will inform customers of their tariffs, given they are proposing tariff changes. The Commission also required Coliban Water and North East Water to provide information on how they will address adverse customer impacts.

10.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

In response to the draft decision, the businesses provided more information on their tariff proposals and programs for informing and address negative customer impacts, where requested to do so. The Commission also received customer submissions about the structure of retail water tariffs.



10.3.1 CUSTOMER SUBMISSIONS

Customer submissions supported greater emphasis on variable charges compared to fixed charges because they give customers greater control over their bills. At the Commission's public forum in Cowes (29 April 2013), a customer requested that variable prices represent a greater proportion of her water bills. Another submission suggested people should not be charged high fixed costs because it provides no incentive to cut back on water usage.⁵⁰ Another customer supported a 'user pays system' and removing fixed water and sewerage tariffs for property owners' primary residence.⁵¹

The Commission also received customer submissions supporting the three tier inclining block tariff structure. At the Commission's public forum in Bendigo (18 April 2013), one customer supported inclining block tariffs to encourage sustainable water use. Another customer opposed Central Highlands Water's proposal to move to a two tier inclining block tariff structure.⁵²

Given the uncertainty of views expressed by customers, the Commission considers businesses are best placed to design tariff structures in consultation with their representative customers.

10.3.2 RESPONSES TO DRAFT DECISION

In response to the draft decision, the three water businesses mentioned above provided more information on how they will inform customers of their tariffs and address customer impacts. Table 10.1 shows the businesses' responses.

⁵⁰ Leibrecht S 2013, *Submission to the Water Price Review draft decision 2013-18*, 12 May.

⁵¹ Crawford B 2013, *Submission to the Water Price Review draft decision 2013-18*, 27 March.

⁵² Name withheld 2013, *Submission to the Water Price Review draft decision 2013-18*, 1 May.



TABLE 10.1 BUSINESSES' RESPONSE TO DRAFT DECISION

how businesses propose to inform customers and address any negative customer impacts

Tariffs proposed in draft decision	Business response
Central Highlands Water	
Move from a three tier inclining block tariff to two tiers.	Inform customers via customer bills when the first billing cycle starts.
Coliban Water	
Move from a three tier inclining block tariff to a single variable charge and consolidate its variable water pricing zones over seven years.	Inform customers by direct mail, online campaigns, information packages, bill inserts and tailored communication to key stakeholders. Introduce a hardship scheme to help mitigate negative customer impacts.
North East Water	
Introduce three pricing zones for its fixed water charge.	Advertise tariffs in local and community newspapers, attach a quarterly newsletter to bills and provide a fact sheet on its website. For customers experiencing hardship, operate a hardship relief program and provide a customer assistance supervisor.

The Commission reviewed the information provided by Central Highlands Water, Coliban Water and North East Water and is satisfied they have put in place effective communication strategies and where necessary, strategies to mitigate negative customer impacts.

10.4 FINAL DECISION

The Commission has approved the proposed retail water tariff structures for — Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water(Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water.



11 RECYCLED WATER

11.1 INTRODUCTION

Recycled water is sewage treated to the quality required for its intended reuse. Recycled water may be used for non-residential purposes (including watering golf courses and recreational parks) and for residential purposes (including toilet flushing and outdoor use).

Regional urban water businesses more commonly provide recycled water to non-residential customers. In some cases, recycled water is provided to residential customers via a dual reticulation (or 'third pipe') system.

Retail recycled water services are prescribed services under the Water Industry Regulatory Order (WIRO) and are subject to price regulation by the Commission.

11.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission proposed to approve both the pricing principles and the scheduled prices for recycled water services proposed by the regional urban water businesses.

The Commission proposed to approve the proposals to continue to use the recycled water pricing principles adopted in the 2008 water price decision for non-residential customers. These principles require recycled water prices:

- to have regard to the price of any substitutes and customers' willingness to pay
- to cover the full cost of providing the service (with the exception of services related to specified obligations or maintaining balance of supply and demand) and
- to include a variable component.



In addition to the pricing principles, the Commission proposed to approve the following proposed scheduled charges for non-residential class A recycled water customers.⁵³

- Coliban Water's proposal to set its recycled water fixed charge at 50 per cent of the potable water fixed price and the variable charge at 75 per cent of its central zone variable price.
- Westernport Water's proposal to set the fixed charge and variable charge at 40 per cent of the residential potable water price for recycled water.

For residential customers in third pipe estates, the Commission proposed to accept the following scheduled recycled water charges:

- Barwon Water's proposal to set its recycled water variable charge at 80 per cent of the potable water variable price and no fixed charge.
- Coliban Water's proposal to set its recycled water fixed charge at 50 per cent of the potable water fixed price and a variable charge at 75 per cent of its central zone variable price.
- Westernport Water's proposal to set its recycled water fixed and variable charges at 56 per cent of the residential potable water price.

The Commission considered the proposed scheduled charges for both residential and non-residential customers are consistent with the Commission's recycled water pricing principles. They include a variable component and are linked to the potable water price.

In its draft decision, the Commission concluded that the recycled water tariffs comply with the regulatory principles in the WIRO and therefore the Commission confirms its draft decision.

11.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

The Commission did not receive any submissions from customers or customer groups about the structure of recycled water tariffs.

⁵³ Class A recycled water contains very low levels of potential pathogens. It is suitable for garden/lawn watering and toilet flushing. Class A recycled water is not currently permitted for uses such as human drinking water or bathing.



11.4 FINAL DECISION

The Commission has approved the residential recycled water tariffs proposed by Barwon Water, Coliban Water and Westernport Water.

The Commission has approved the non-residential scheduled recycled water tariffs proposed by Coliban Water and Westernport Water.

The Commission has approved the recycled water pricing principles proposed by all 12 regional urban water businesses — Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water(Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water.





12 RETAIL SEWERAGE SERVICES TARIFFS

12.1 INTRODUCTION

All regional urban water businesses provide retail reticulated sewerage services. They include collecting and treating water borne waste from households and businesses. Sewerage services typically require large expenditure on transportation networks, pumping stations and sewerage treatment plants.

Retail sewerage services are prescribed services under the Water Industry Regulatory Order (WIRO) and are subject to price regulation by the Commission.

12.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission proposed to approve all of the regional businesses' retail sewerage tariff proposals for the third regulatory period.



Specifically, the Commission proposed to approve all regional urban water businesses' proposals to maintain a fixed charge for residential sewerage tariffs. For non-residential sewerage tariffs, the Commission proposed to approve Barwon Water's, Central Highlands Water's, Coliban Water's, East Gippsland Water's, Gippsland Water's, Goulburn Valley Water's and Wannon Water's proposals to maintain a two part tariff structure with a fixed charge and a single variable component. It also proposed to approve the following five businesses' non-residential sewerage tariff structures:

- Lower Murray Water (Urban)'s and North East Water's proposals to maintain fixed charges only.
- GWMWater's proposal to phase out its non-residential variable charge during the third regulatory period, maintaining only a fixed charge.
- South Gippsland Water's and Westernport Water's proposals to continue to vary sewerage charges for non-residential customers based on the number of cisterns (toilets).

The Commission proposed to approve proposed modifications to non-residential sewerage tariffs by the following water businesses:

- Coliban Water's proposal to change its non-residential fixed sewerage charge based on water meter size and business type to a single fixed charge.
- North East Water's proposal to remove cistern based charges for non-residential customers, maintaining only fixed sewerage charges.

The Commission proposed to approve the following three businesses' proposals to restructure geographic pricing zones:

- Coliban Water's proposal to combine its three fixed residential sewerage pricing zones into one zone in 2013-14. For non-residential customers, Coliban Water proposed to combine the three zones by 2015-16.
- North East Water's proposal to reduce the number of geographic zones from 10 to four for both residential and non-residential fixed sewerage tariffs, transitioning the charges over the five year regulatory period.
- Wannon Water's proposal to reduce the number of geographic zones from five to three for residential and non-residential fixed sewerage tariffs in the first year of the regulatory period.

In its draft decision, the Commission assessed businesses' sewerage tariff proposals based on customer impacts of any proposed changes. The Commission



was satisfied formal consultation on sewerage tariffs demonstrated stakeholder support for businesses' proposals.

The Commission required Coliban Water and North East Water to provide further information on how they will inform customers of their tariffs. The Commission also required North East Water to provide information on addressing any negative customer impacts.

12.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

In response to the draft decision, the businesses provided more information on their proposals and programs for informing and mitigating negative customer impacts, where required to do so. The Commission also received one customer submission about the structure of retail sewerage tariffs.

12.3.1 CUSTOMER SUBMISSIONS

The Commission received a customer submission expressing concern with South Gippsland Water's non-residential cistern based charges.⁵⁴ The customer suggested South Gippsland Water's cistern based charges be abolished and replaced with sewerage charges based on actual hotel occupancy rates.

The Commission considers cistern charges are not directly related to sewage discharge and therefore do not provide appropriate signals to sewerage system users. However, sewerage charges based on hotel occupancy rates may not be a practical alternative.

As this submission was only received very late into the water price review, South Gippsland Water customers have not had sufficient time to comment or be consulted on any potential impacts of removing these charges. The Commission has supported businesses moving away from cistern based charges and will explore the issue with South Gippsland Water during the third regulatory period. South Gippsland Water and Westernport Water are the only two regional urban water businesses that still apply cistern based charges to sewerage.

⁵⁴ Govers G 2013, *Submission to Water Price Review draft decision 2013-18*, 7 May.



12.3.2 RESPONSES TO DRAFT DECISION

In response to the draft decision, the water businesses provided more information on how they will inform customers of their tariffs and address any negative customer impacts. Table 12.1 shows the businesses' responses.

TABLE 12.1 BUSINESSES' RESPONSE TO DRAFT DECISION
how businesses propose to inform customers of their tariffs

Tariffs proposed in draft decision	Business response
Coliban Water	
Move towards one pricing zone for residential and non-residential fixed sewerage prices.	Inform customers by direct mail, online campaigns, information packages, bill inserts and tailored communication to key stakeholders.
North East Water	
Reduce the number of geographic zones from 10 to four for both residential and non-residential fixed sewerage tariffs.	Advertise tariffs in local and community newspapers, attach a quarterly newsletter to bills and provide a fact sheet on its website. For customers experiencing hardship, operate a hardship relief program and provide a customer assistance supervisor.

The Commission reviewed the information provided by Coliban Water and North East Water and is satisfied the businesses have effective communication strategies.

12.4 FINAL DECISION

The Commission has approved the retail sewerage tariff structures proposed by all 12 regional urban water businesses — Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water(Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water.



13 TRADE WASTE

13.1 INTRODUCTION

Trade waste involves discharging of waste other than normal domestic sewage into the sewerage system. Customers seeking to discharge trade waste into the sewerage system must first obtain the consent of the relevant water business. The water businesses establish acceptance limits for trade waste, which partly depend on the businesses' treatment plant capabilities. Waste that does not fall within acceptance limits — for example, waste with high concentrations of contaminants (such as heavy metals or toxic substances) — must be pre-treated by customers before they discharge it into the sewer.

Trade waste is charged separately from normal sewerage charges. As well as fixed and variable charges, trade waste charges include parameters that measure the level of contaminants such as biochemical oxygen demand and suspended solids. Water businesses adopt different parameters, depending on their trade waste customers. Charges and discharge conditions for trade waste customers with particularly large or unique loads are sometimes determined on a case-by-case basis.

13.2 OVERVIEW OF DRAFT DECISION

The Commission considers trade waste prices must provide appropriate signals to trade waste customers about the relative merits of discharging into the sewerage system compared with alternatives such as waste minimisation and on-site treatment. Cost-reflective pricing will strengthen incentives for efficient and sustainable water use and waste discharge, including providing appropriate incentives for investments in changing production methods or extending on-site treatment to reduce trade waste to efficient and sustainable levels.



In its draft decision,⁵⁵ the Commission proposed to approve the trade waste tariffs proposed by all regional urban water businesses because they were consistent with the Water Industry Regulatory Order (WIRO). However, the Commission required all regional urban water businesses to continue to include the Commission's trade waste pricing principles in their tariff schedules and to use pricing principles when determining trade waste charges for customers to whom scheduled prices do not apply.

Coliban Water, Goulburn Valley Water and North East Water were required to provide more information on the following areas:

- Classification structures – Coliban Water, Goulburn Valley Water and North East Water were required to include a clearly defined classification structure so potential customers could determine their classification of trade waste customer and the associated costs if they became a trade waste customer.
- Coliban Water –
 - Coliban Water was required to include its pricing principles in its price schedule.
 - Coliban Water cannot charge trade waste customers a total dissolved solids (TDS) charge if the treatment plant does not remove or reduce salt from the customers' waste.

13.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

13.3.1 COLIBAN WATER

Coliban Water provided more detail on its trade waste tariff structure. It provided the pricing principles it proposed to use to determine charges for major trade waste customers. Coliban Water's proposed pricing principles elaborated on the Commission's trade waste pricing principles 'for customers wishing to connect to the network and to provide further clarity for customers where scheduled charges do not apply'.⁵⁶ However, the Commission does not approve these principles as it

⁵⁵ Essential Services Commission 2013, *Price Review 2013: Regional Urban Water Businesses — draft decision, volume 1*, March.

⁵⁶ Coliban Water 2013, *Submission to the Water Price Review draft decision 2013-18*, May.



does not want inconsistency between the pricing principles of regional urban water businesses and Coliban Water did not consult on these proposed principles with customers. The Commission requires Coliban Water to use the Commission's pricing principles. The Commission's principles are shown in Coliban Water's determination.

Coliban Water also revised its demand forecasts for billable units of TDS over the third regulatory period (see chapter 8). Overall, Coliban Water reduced the forecast demand for TDS services and will not levy this charge if a treatment plant does not remove salt. This satisfies the Commission's requirements.

Coliban Water explained its classification structure as follows:

Coliban Water considers the tariff reforms as proposed maintain the current major trade waste classification structure as outlined in our customer charter. Trade waste tariff reforms provide generic pricing principles and a single pricing schedule for all customers, replacing locational pricing. The classification framework for determining a major trade waste customer remains unchanged.⁵⁷

Coliban Water has two trade waste classifications: major trade waste customers and minor trade waste customers, based on its trade waste charter.⁵⁸ The Commission considers this an appropriate classification structure.

13.3.2 GOULBURN VALLEY WATER

Goulburn Valley Water provided more detail on the classification structure of its trade waste charges. This classification structure will be available in Goulburn Valley Water's website.⁵⁹ The Commission has approved this trade waste classification structure.

⁵⁷ Coliban Water 2013, *Submission to the Water Price Review draft decision 2013-18*, May 2013, p. 29.

⁵⁸ Coliban Water's Trade Waste Customer Charter is available on its website www.coliban.com.au

⁵⁹ www.gvwater.vic.gov.au/



13.3.3 NORTH EAST WATER

North East Water proposed a new classification structure that rates customers based on the risk that their discharge poses to the sewerage system. It provided the Commission with additional information on the methodology used to determine trade waste classifications. The documents provided will enable potential customers to determine how they would be classified and the associated costs if they were to become a trade waste customer. These documents are available on North East Water's website.⁶⁰ The Commission has approved this trade waste classification structure.

13.4 FINAL DECISION

The Commission has approved the trade waste tariff structures proposed by the 12 regional urban water businesses and requires all businesses to use the pricing principles listed in their determinations when charging for miscellaneous services.

⁶⁰ www.nerwa.vic.gov.au



14 NEW CUSTOMER CONTRIBUTIONS

14.1 INTRODUCTION

New customer contributions (NCC) (also known as developer charges) are an upfront charge that a water business may levy when a customer builds or develops a property and connects to that water business's water, sewerage or recycled water network. As part of its role in regulating water prices, the Commission is required to approve the NCCs to be paid by developers and property owners or the manner in which NCCs are calculated.

This chapter sets out the Commission's final decision for the regional water businesses' NCCs.

Details on the NCC framework, core pricing principles and negotiating framework can be found in the Commission's draft decision.⁶¹

14.2 OVERVIEW OF DRAFT DECISION

In its draft decision, the Commission was generally satisfied that most regional water businesses applied the core pricing principles in developing their NCCs. However, the Commission's analysis showed there was potential for the businesses to consider more cost reflective NCCs and, to improve the transparency of where and when standard NCCs or Negotiated NCCs would be levied. Hence the Commission proposed to approve the manner in which the water

⁶¹Essential Services Commission 2013, Price review 2013: Regional urban water - draft decision, volume I, March.



businesses determine their NCC charges subject to a number of specific actions being undertaken. These actions included:

- Further assessment by businesses to improve the cost reflectivity of their NCC, particularly in offering more location specific NCC where possible.
- Improving the transparency of their NCC by providing maps to show the boundaries around the areas (or towns) within which standard NCC apply. Alternatively businesses should define any threshold that must be met to levy an NCC.
- Updating the NCC calculation model following the Commission's draft decision on parameters such as demand and expenditure forecasts and the weighted average cost of capital (WACC).
- Further consultation with stakeholders following the release of the draft decision on issues including the need for a transition plan.
- Further consultation with other regional water businesses to develop a best practice negotiating framework.

The Commission also required businesses that did not propose a NCC (using the core pricing principles) for water and sewerage, to review their calculations following specific comments from the Commission and its consultants. These businesses were Central Highlands Water, Coliban Water, Gippsland Water and North East Water.

14.3 RESPONSES TO DRAFT DECISION

All of the regional water businesses responded to the Commission's draft decision on NCC. However, the Commission did not receive any submissions from developers or the public in response to this matter.

Table 14.1 summarises the standard NCC proposed by the regional water businesses in response to the Commission's draft decision.



TABLE 14.1 STANDARD NCC PROPOSED BY REGIONAL WATER BUSINESSES
\$2012-13

	Water	Sewerage	Recycled water
Barwon Water	2 549 ^b	821	
Central Highlands Water	1 213	0	
Coliban Water	1 443	1 443	722
East Gippsland Water	0	0	
Gippsland Water	0	0	
Goulburn Valley Water ^a	2 600	0	
GWMWater	Case-by-case	Case-by-case	
Lower Murray Water (Urban)			
0-750 square metres	1 065.50	1 950.50	
> 750 square metres	2 131	3 091	
North East Water	750	1 750	
South Gippsland Water			
Water all areas	2 030		
Sewerage except, PLN & AI		2 030	
Poowong Loch Nyora		10 000	
Alberton – lot with dwelling ^e		10 000	
Alberton – vacant lot ^e		5 000	
Wannon Water			
Warrnambool ^c – g corridor	4 200	800	
Warrnambool ^d – r harvest	2 000	800	
Warrnambool – other	800	800	
Hamilton & Portland	800	1 700	
All other towns	800	800	
Westernport Water	2 500 ^b	850	

^aAll businesses except Goulburn Valley Water propose NCC on a per lot basis. Goulburn Valley Water proposes NCC on a per new connection basis. ^bincludes class A recycled water. ^c Warrnambool growth corridor ^d Warrnambool roof harvest scheme. ^e Based on South Gippsland Water's latest submission.

In summary:

- The level of all water businesses' standard NCC except Westernport Water have changed from the levels proposed in their December 2012 submissions.
- All water businesses except GWMWater propose to levy standard NCC. GWMWater will levy NCC on a case by case basis in accordance with the Commission's NCC principles.



- Proposed NCC range from zero to \$10 000 per lot. The highest NCC is for connection to sewerage infrastructure in Poowong Loch Nyora. This charge is proposed by South Gippsland Water.⁶²
- Barwon Water and Westernport Water propose a combined NCC for water and recycled water.

14.4 COMMISSION'S ASSESSMENT

The Commission has assessed each water businesses response to the draft decision as follows:

- Have businesses confirmed that NCC are calculated in accordance with the core NCC pricing principles?
- Are the revised standard NCC appropriately cost reflective?
- Have the businesses proposed location specific NCC?
- Have the businesses addressed the other actions required in the draft decision?

To assess whether the businesses proposals are appropriately cost reflective the Commission undertook a review of:

- expenditure forecasts underpinning the standard NCC calculations of selected businesses,⁶³ and
- the models used to calculate standard NCC.

14.4.1 SUMMARY OF ASSESSMENT

Table 14.2 provides a summary of the Commission's assessment of each regional water businesses' response to the draft decision.

Further details on the Commission's assessment of the regional water businesses proposals can be found in sections below and appendix C.

⁶² South Gippsland Water has advised the Commission that it has consulted with developers on this NCC. The NCC applies to developments that are not subject to the \$800 cap.

⁶³ The Commission engaged Sinclair Knight Merz to undertake this task.



TABLE 14.2 SUMMARY OF ASSESSMENT

	Have businesses confirmed that NCC are calculated in accordance with the core NCC pricing principles?	Are the revised Standard NCC appropriately cost reflective?	Have the businesses proposed location specific NCC?	Have the businesses addressed the other actions required in the draft decision?
Barwon Water	Yes	Yes	Yes	Yes
Central Highlands Water	Yes	Yes	No (with reasons)	Yes
Coliban Water	Yes	Yes	No (with reasons)	Yes
East Gippsland Water	Yes	Yes	Yes	Yes
Gippsland Water	Yes	Yes	Yes	Yes
Goulburn Valley Water	Yes	Yes	No (with reasons)	Yes
GWMWater	Yes	Yes	Yes	Yes
Lower Murray Water (Urban)	Yes	Yes	Yes	Yes
North East Water	Yes	Yes	No (with reasons)	Yes ^a
South Gippsland Water				
- Sewerage	Yes	Yes	Yes	Yes
- Water	Yes	Yes	No (with reasons)	Yes
Wannon Water	Yes	Yes	Yes	Yes
Westernport Water	Yes	Yes	Yes	Yes

^a North East Water will commence consultation with stakeholders shortly.

All regional water businesses have met the assessment criteria.

The Commission is satisfied that all regional water businesses have calculated standard NCC and will calculate any Negotiated NCC in accordance with the core pricing principles.

South Gippsland Water - Poowong Loch Nyora (PLN)

The standard NCC for sewerage infrastructure in PLN is the highest to apply during the third regulatory period.

As a part of the expenditure review the Commission's consultants reviewed the expenditure underpinning the standard NCC in PLN. The review found that if the portion of capital expenditure that could be reasonably attributed to growth was included, the NCC would be \$27 972 per lot.

In response to stakeholder concerns about a NCC of this level, South Gippsland Water proposed a standard NCC for PLN of \$10 000 per lot. The NCC is scheduled to apply from the fifth year of the third regulatory period. This is when construction of the sewerage infrastructure is expected to be complete.

Based on the findings of the expenditure review, the Commission has approved the standard NCC for sewerage connections in PLN.

Zero standard NCC

East Gippsland Water and Gippsland Water have calculated a zero standard NCC for water and sewerage infrastructure, and Central Highlands Water and Goulburn Valley Water have proposed a zero standard NCC for sewerage infrastructure.⁶⁴

Typically, NCC will be higher in areas where new infrastructure needs to be (or has recently been) constructed to service growth. Conversely, NCC will be lower if the costs of growth are expected to be offset by the revenue collected from the new customers.

⁶⁴ East Gippsland Water and Gippsland Water have proposed transitional arrangements.



Transition arrangements

Barwon Water, Lower Murray Water (Urban) and South Gippsland Water have proposed transition arrangements because their proposed standard NCC are higher than the scheduled NCC under the existing framework.

East Gippsland Water and Gippsland Water have proposed transition arrangements because a zero standard NCC for water and sewerage is calculated using the core pricing principles. These businesses have proposed to steadily reduce their NCC from the existing levels to zero in 2017-18.

The Commission considers that each of these businesses' transition arrangements is reasonable.



14.5 FINAL DECISION

Core pricing principles

The Commission has approved the core pricing principles as the methodology to be adopted by all regional water businesses for determining NCC, as set out below.

Standard and Negotiated NCC will:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

Notes:

- 1 Given that NCC are to be based on the net incremental cost of connection (for example, incremental costs net of incremental benefits), in this context, the costs referred to in the efficient pricing bound are the net costs, specifically the avoidable net cost of connection and standalone net cost of connection.
- 2 Where the connection arrangement requires assets to be gifted, the value of gifted assets will be excluded for the purposes of calculating net costs.
- 3 Incremental costs may include financing costs associated with constructing an asset sooner than planned. Refer to section 14.5.2.

Continued on next page

FINAL DECISION - CONTINUED

Standard NCC

The Commission has approved the standard NCC for Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, Lower Murray Water (Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water, as shown in table 14.3.

Transition arrangements

The Commission has approved the transition arrangements for Barwon Water, East Gippsland Water, Gippsland Water, Lower Murray Water (Urban) and South Gippsland Water



TABLE 14.3 APPROVED STANDARD NCC –FINAL DECISION
\$2012-13, per lot

	2013-14	2014-15	2015-16	2016-17	2017-18
Barwon Water					
Water ^a	1 883	2 549	2 549	2 549	2 549
Sewerage	821	821	821	821	821
Central Highlands Water					
Water	1 213	1 213	1 213	1 213	1 213
Sewerage	0	0	0	0	0
Coliban Water					
Water	1 443	1 443	1 443	1 443	1 443
Sewerage	1 443	1 443	1 443	1 443	1 443
Recycled Water	722	722	722	722	722
East Gippsland Water					
Water					
<450 square metres	500	400	300	150	0
450-1350 square metres	1 000	750	500	250	0
>1350 square metres	2 000	1 500	1 000	500	0
Sewerage					
<450 square metres	500	400	300	150	0
450-1350 square metres	1 000	750	500	250	0
>1350 square metres	2 000	1 500	1 000	500	0
Gippsland Water					
Water	1 000	750	500	250	0
Sewerage	1 000	750	500	250	0
Goulburn Valley Water^b					
Water	2 331	2 331	2 331	2 331	23 31
Sewerage	0	0	0	0	0
GWM Water^c					
	Case-by-case	Case-by-case	Case-by-case	Case-by-case	Case-by-case
Lower Murray Water (Urban)					
Water					
0-750 square metres	972.57	1 336.54	1 700.50	1 700.50	1 700.50
>750 square metres	1 945.17	2 673.08	3 401.00	3 401.00	3 401.00
Sewerage					
0-750 square metres	783.74	958.87	1 134.00	1 134.00	1 134.00
>750 square metres	1 567.50	1 917.75	2 268.00	2 268.00	2 268.00
North East Water					
Water	750	750	750	750	750
Sewerage	1 750	1 750	1 750	1 750	1 750

	2013-14	2014-15	2015-16	2016-17	2017-18
South Gippsland Water					
Water					
<450 square metres	900	1 150	1 450	1 750	2 030
450-1350 square metres	1 370	1 530	1 700	1 875	2 030
>1350 square metres	2 365	2 290	2 225	2 155	2 030
Sewerage (excludes PLN & Alberton)					
<450 square metres	900	1 150	1 450	1 750	2 030
450-1350 square metres	1 370	1 530	1 700	1 875	2 030
>1350 square metres	2 365	2 290	2 225	2 155	2 030
Sewerage (Poowong Loch Nyora)	na	na	na	na	10 000
Sewerage lot with dwelling (Alberton) ^d	10 000	10 000	10 000	10 000	10 000
Sewerage vacant lot (Alberton) ^d	5 000	5 000	5 000	5 000	5 000
Wannon Water					
Warrnambool – growth corridors					
Water	4 200	4 200	4 200	4 200	4 200
Sewerage	800	800	800	800	800
Warrnambool – roof harvesting					
Water	2 000	2 000	2 000	2 000	2 000
Sewerage	800	800	800	800	800
Warrnambool – all other areas					
Water	800	800	800	800	800
Sewerage	800	800	800	800	800
Hamilton and Portland					
Water	800	800	800	800	800
Sewerage	1 600	1 600	1 600	1 600	1 600
All other towns					
Water	800	800	800	800	800
Sewerage	800	800	800	800	800
Westernport Water					
Water ^a	2 093	2 093	2 093	2 093	2 093
Sewerage	464	464	464	464	464

^a includes class A recycled water. ^b charge is per new connection ^c case by case for all services ^d for lots outside of the scheme boundary but still able to connect to the Alberton system - Details on the Alberton sewerage scheme can be found in appendix C. **na** Not applicable.

14.5.2 OTHER ELEMENTS OF FINAL DECISION

Incremental financing costs

The Commission has approved the following formula as the method to calculate incremental financing costs.

The Commission considers that all water businesses should calculate incremental financing costs (IFC) using this formula:

$$\text{IFC} = (1 - [1 / (1+r)^n]) \times \text{cost of capital being provided sooner than planned}$$

where:

r = estimated pre-tax WACC

n = the number of years the asset is required sooner than planned.

The Commission expects that water businesses will review their capital works programs on an annual basis and update their development serving plans (DSPs) accordingly. DSPs show the timing of a logically sequenced expansion of a business's water, sewerage and recycled water networks. They help the businesses explain to developers the basis for recovering incremental financing costs. The Commission expects the water businesses to make these DSPs publicly available.

Under the new framework, the developer who makes the incremental financing cost payment may negotiate with the water business to be reimbursed (a portion of the financing costs) when other developers connect (to the asset that was brought forward).



Gifted Assets

The 2008-2013 water price determinations required developers to provide (or gift) reticulation assets to serve their development and connect to the water business networks.⁶⁵

The Commission has approved the following treatment of gifted assets.

The Commission considers that under the NCC framework it is acceptable for a water business to require developers to provide and gift to the water business specified assets as a condition of connection provided that the water business:

- makes clear to potential developers which assets a developer will be responsible for providing and gifting, and which will be provided by the water business
- confirms that negotiation of any non-standard connection and associated charges will be undertaken in accordance with the water business's published negotiating framework
- where the connection arrangement requires assets to be gifted, the value of gifted assets will be excluded for the purposes of calculating net costs.

Note: refer to appendix C for more details on gifted assets.

The Commission will monitor the gifting arrangements imposed by the water businesses. If stakeholders raise concerns the Commission will consider developing binding principles to guide the classification of gifted assets.

⁶⁵ Reticulation assets are the assets that connect a development to the water business's network, they are defined in the Essential Services Commission 2011, *Water industry new customer contributions — guideline*, May.



14.5.3 FURTHER ACTIONS IN REGULATORY PERIOD 3

The Commission appreciates the efforts the water businesses have made to prepare their first NCC proposals under a tight timeline. Over the third regulatory period the Commission will work with stakeholders to bed down the NCC framework. The Commission will:

- Issue a guideline in 2013-14 to provide greater clarity and consistency in the application of all the elements of the NCC framework.

In addition, the Commission will:

- Undertake a review in 2015-16 on how the NCC framework sits within broader *Living Melbourne*, *Living Victoria* and other Government policies on infrastructure provision and of any practical issues businesses and developers have encountered since its implementation. The findings will inform the need for any refinements to the framework for the fourth regulatory period or further guidance on its operation.
- Provide non-binding advice to water businesses and developers in the event of potential dispute.
- Undertake annual audits of each water business to ensure that the framework is working as intended.
- Monitor the gifting arrangements prescribed by the water businesses. If concerns are raised by stakeholders, the Commission will consider developing binding principles to guide the classification of gifted assets.



15 MISCELLANEOUS SERVICES

15.1 INTRODUCTION

As well as providing water, sewerage and other primary services, regional urban water businesses provide miscellaneous services. These may include providing services such as new connections, special meter reads and meter testing, providing property information statements and reviewing applications to build over easements. Miscellaneous services are prescribed services under the Water Industry Regulatory Order (WIRO) and are therefore subject to price regulation by the Commission.

The Commission requires each business to identify a core set of miscellaneous services which includes the business's most important miscellaneous services, particularly those expected to generate a significant proportion of total miscellaneous services revenue. Examples of core miscellaneous services include meter reading, the provision of information statements and the installation of new meters. Businesses are required to include their core miscellaneous services in their price schedules and these services are required to form part of the Commission's approved price determinations. Core miscellaneous services should be priced using pricing principles that comply with the WIRO.

Water businesses can either set a standard price for services based on the pricing principles and list the price in their pricing schedules, or apply the principle of actual costs on a case-by-case basis when charging for noncore miscellaneous services. For many services (for example, a meter accuracy test), businesses could set a standard price and review it annually to ensure it was cost reflective. In other cases, especially for services provided infrequently (such as larger meter



installations), businesses could apply services at actual cost on a case-by-case basis.⁶⁶

15.2 OVERVIEW OF DRAFT DECISION

In its draft decision,⁶⁷ the Commission proposed to approve the miscellaneous fees and charges proposed by all regional urban water businesses except for Coliban Water. The Commission required additional information from all businesses.

- Further definition – The Commission required all businesses to provide definitions for connection fees, information fees and meter reading fees, if they were not included in their core sets of miscellaneous services. The Commission considers these are common services provided by the regional urban water businesses and would like to be able to compare the service levels provided and the prices of water businesses.
- New Customer Contributions (NCC) – The Commission required all regional urban water businesses to define and specify any fees relating to developers. The Commission considered water businesses should not have miscellaneous services related to administration fees for development outside of the NCC framework. There is a newly established NCC framework and the Commission wants to prevent a transfer of costs from NCC related charges to miscellaneous services charges.
- Detailed definitions – The Commission requires Central Highlands Water to submit more detailed definitions of its core miscellaneous services. This is to help customers understand what is provided for the fee. The Commission considered the definitions provided by Central Highlands Water did not provide sufficient detail.
- Price increases – Coliban Water was required to provide more information to justify its proposed price increases for its miscellaneous services charges.

⁶⁶ GMMWater provided a list of core miscellaneous services charges that covered both their urban and rural operations. For this chapter, discussions and decisions on GMMWater's miscellaneous charges will apply to both their urban and rural operations.

⁶⁷ Essential Services Commission 2013, *Price Review 2013: Regional urban water businesses — draft decision, volume I*, March.



15.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

15.3.1 FURTHER DEFINITIONS

The Commission required all businesses to provide definitions for connection fees, information fees and meter reading fees, if they were not included in their core sets of miscellaneous services. These definitions were included in the businesses' determinations.

15.3.2 NEW CUSTOMER CONTRIBUTIONS

The Commission required all regional urban water businesses to define and specify any fees relating to developers, to prevent a transfer of costs from NCC related charges to miscellaneous services charges arising in the third regulatory period. Appendix D summarises submissions.

The Commission approves the miscellaneous services relating to developers and does not believe they conflict with the NCC framework. Central Highlands Water, Gippsland Water, GWMWater, North East Water and Westernport Water did not indicate any miscellaneous services relating to NCCs.

The Commission will not approve any new miscellaneous services charges relating to NCCs during the third regulatory period. The Commission will review the NCC framework during the third regulatory period. The Commission will also review any miscellaneous services charges relating to NCCs to ensure they are appropriate.

15.3.3 CENTRAL HIGHLANDS WATER

Central Highlands Water provided more detailed definitions of its miscellaneous services. These definitions are available in Central Highlands Water's price determination. The Commission has approved these definitions.

15.3.4 COLIBAN WATER

Coliban Water proposed a first year price increase of inflation only and requested flexible prices after the first year of the third regulatory period to 'ensure that



movements in prices reflect the cost of service delivery'.⁶⁸ It requested core miscellaneous services charges be set 'at cost' for the remainder of the regulatory period.

The Commission has not approved this approach. The Commission requires scheduled prices for core miscellaneous services so customers know how they will be charged for specific services. If the services are charged 'at cost' the customer is uncertain of the price. The Commission requires Coliban Water to increase core miscellaneous services fees by inflation only for each year of the third regulatory period and must have scheduled prices for the entire regulatory period. This is reflected in Coliban Water's price determination.⁶⁹

15.4 FINAL DECISION

The Commission has approved the miscellaneous services charges proposed by Barwon Water, Central Highlands Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water (Urban), North East Water, South Gippsland Water, Wannon Water and Westernport Water.

The Commission has not approved Coliban Water's miscellaneous services charges to be charged 'at cost' after the first year of the third regulatory period and approved increases to core miscellaneous services charges by inflation only for each year of the third regulatory period.

⁶⁸ Coliban Water 2013, *Submission to the Water Price Review draft decision 2013-18*, 2 May 2013, p. 34.

⁶⁹ Coliban Water's price determination is available on the Commission's website: www.esc.vic.gov.au



16 GMMWATER AND COLIBAN WATER OTHER TARIFFS

16.1 INTRODUCTION

GMMWater and Coliban Water provide both urban and rural services to their customers. This chapter on GMMWater's and Coliban Water's rural tariffs is included in the regional businesses' final decision to ensure that the Commission's assessment and conclusions on GMMWater's and Coliban Water's proposals form one decision. It also recognises the integrated nature of GMMWater's and Coliban Water's operational and supply arrangements.

16.2 OVERVIEW OF DRAFT DECISION

16.2.1 GMMWATER

In its draft decision, the Commission proposed to approve most of GMMWater's proposed tariffs and charges including:

- a recreation contribution charge which would be levied on all customers to cover the costs of providing services for recreational water uses
- an irrigation charge (ex headworks) to apply to the Commonwealth Government for storing environmental water and
- groundwater tariffs including GMMWater's proposed rebalancing of groundwater prices to reflect the common costs of providing groundwater services to its customers.

The Commission proposed not to approve GMMWater's proposed increase in the excess water charge which applies to customers exceeding their water allowance. The Commission considered the existing gap between the excess charge and the



usage charge is sufficient to continue to generate an incentive during the third regulatory period.

To ensure regional urban water businesses adequately consult with customers, the Commission proposed to include in GMMWater's determination a requirement that GMMWater consult with customers before proposing a material tariff change at annual tariff reviews.

16.2.2 COLIBAN WATER

In the draft decision, the Commission proposed to approve Coliban Water's proposed rural tariffs. Coliban Water's proposals for its unmodernised system (where infrastructure was not upgraded) were:

- a price reduction of 3 per cent (average real) in 2013-14
- a major tariff review in 2013-14 to set prices for 2014-15 onwards
- converting the capacity charge from a volumetric charge to a fixed charge and
- introducing an excess usage fee as an incentive to obtain water from water markets.

For its modernised system Coliban Water proposed:

- a meter size based service fee to align with the pressurised water system
- an infrastructure fee based on licence volume
- an excess use fee to encourage trade and
- applying termination fees based on the Australian Competition and Consumer Commission rules.

16.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

16.3.1 GMMWATER

Following the draft decision GMMWater submitted it would not challenge the Commission's decision not to allow the proposed increase in the rural pipeline excess charge.



Recreation water charge

The Commission considers GMMWater consulted adequately with customers on the proposed recreation contribution charge and there is strong community support for the charge.

16.3.2 COLIBAN WATER

The Commission considers Coliban Water has consulted adequately on its proposals to change several aspects of its rural tariffs for its modernised and unmodernised systems, designed to suit the new circumstances of its modernised system and to facilitate water trading. Coliban Water will propose additional reforms during the regulatory period for rural areas. The Commission considers the proposed tariffs meet the WIRO requirements.

16.4 FINAL DECISION

The Commission has approved GMMWater's and Coliban Water's proposed rural tariff structures except for GMMWater's proposed increase in the excess water use charge.





17 ADJUSTING PRICES

17.1 INTRODUCTION

Water businesses' forecasts of future demand for their services and the cost of delivering those services can involve a significant degree 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). These fluctuations are left to the water business to manage in the interests of ensuring customers can have confidence in the predictability of prices they will be charged. The regulatory framework administered by the Commission seeks to provide the water businesses appropriate incentives to operate efficiently in managing uncertainty.



There may, however, be circumstances that are beyond the scope of the water business to manage their within the prices approved at the start of the 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 provides two mechanisms that allow its five-year determination to be revisited:

- A 'pass through' mechanism (in the form of higher customer prices) of the costs of dealing with an uncertain event efficiently once it becomes known. This mechanism applies where the likelihood of an event is reasonably well known, but the costs associated with responding to that event are not confidently identifiable at the time of the Commission's price decision.
- Re-opening price determinations in response to uncertain and unforeseen events mechanism. This mechanism sets out a process for applying for a price adjustment, either during or at the end of the regulatory period, to take into account events that were uncertain or unforeseen at the time of the price review.

17.2 OVERVIEW OF DRAFT DECISION

17.2.1 PROPOSED PASS THROUGHS FOR THIRD REGULATORY PERIOD

Three water businesses proposed the Commission approve automatic pass throughs should certain costs eventuate. Barwon Water proposed pass throughs for any requirement for water from the Melbourne supply system, changes in licence fees, the expenditure impact of changes in legislation or regulation and other (not specified) events. Gippsland Water proposed a pass through for any unanticipated increase in the price of chemicals and other goods and services caused by the carbon tax. Coliban Water proposed pass through costs associated with variations in expenditure.⁷⁰

In its draft decision, the Commission proposed to not approve the pass throughs proposed by Gippsland Water and Coliban Water. The Commission proposed to approve Barwon Water's pass through event for water from the Melbourne supply

⁷⁰ For more information, see Essential Services Commission 2013, *Price Review 2013: Regional water businesses draft decision – volume 1*, March, p. 257.



system, subject to the business providing the Commission with principles to guide the pass through and how the adjustment mechanism would work. The Commission proposed to not approve the other pass throughs proposed by Barwon Water.

The Commission considered the proposed pass throughs (excluding Barwon Water's proposal for treating costs of water orders from the Melbourne supply system) are best addressed through the uncertain and unforeseen events mechanism. In its draft decision, the Commission indicated that it only considered pass throughs in instances where the event is predictable and unique to a particular business. For other events, the Commission proposed the uncertain and unforeseen events mechanism would apply.

17.2.2 UNCERTAIN AND UNFORSEEN EVENTS MECHANISM

The Commission proposed to approve an uncertain and unforeseen events mechanism to allow 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, 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 the business cannot control or efficiently manage without undermining service delivery to customers. The mechanism would be similar to the one the Commission approved for the 2008 water price review.

In its draft decision, the Commission 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 considerations — allows it to limit a re-opening of determinations to the single event. 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 affecting costs or revenues. The Commission placed particular emphasis on



financial viability ratios in assessing the appropriateness of a mid-period price adjustment. The Commission expects businesses to demonstrate they have exercised appropriate risk management processes to mitigate and plan for such events wherever possible.

17.3 SUBMISSIONS AND COMMISSION'S ASSESSMENT

17.3.1 PROPOSED PASS THROUGHS FOR THIRD REGULATORY PERIOD

Barwon Water and Coliban Water provided feedback on the Commission's draft decision on pass throughs. The Commission did not receive feedback from Gippsland Water.

Barwon Water

Response to the draft decision

Barwon Water provided the Commission with more information on how prices would be adjusted for any water taken from the Melbourne water system via the Melbourne Geelong Pipeline. Barwon Water proposed adjusting residential and non-residential variable water prices by an approximation of the actual bulk water cost the business incurred, applying in the period over which the water order is made. The adjustment would depend on forecast demand.⁷¹ Barwon Water would consult with customers before any adjustments to the prices are made.

Commission's assessment

The Commission agrees only variable water prices should be adjusted (for residential and non-residential customers). Further, the Commission considers that the adjustment should apply in the period over which the water order is made. This approach is cost reflective and provides appropriate signals about resource use. Any differences between forecast and actual costs of water orders will be accounted for through an adjustment to prices in the following year. The Commission notes the low likelihood of Barwon Water ordering water from the Melbourne system in the next regulatory period.

⁷¹ The formula Barwon Water used to calculate the increase in cost per customer over the period in which the order of water is made can be found in: Barwon Water 2013, *Response to draft decision*, May, p.30.



Coliban Water

Response to the draft decision

Coliban Water considered pass throughs more cost reflective and argues that excluding these events would leave it financially exposed.

Commission's assessment

The Commission reaffirms its views the pass throughs proposed by Coliban Water are best addressed through the uncertain and unforeseen events mechanism. The pass throughs proposed by Coliban Water are not unique to that business.

17.3.2 UNCERTAIN AND UNFORSEEN EVENTS MECHANISM

Coliban Water

Response to the draft decision

Coliban Water stated the re-opening mechanism can be improved. While it supported a mechanism that does not solely rely on financial viability indicators to adjust prices, it is concerned the 'single event' mechanism could be used to single out cost reductions without taking into consideration other reasonable cost increases.

Commission's assessment

The Commission's proposal to allow for a 'single event' mechanism is intended to apply where an event is material, and for which the impacts can be isolated from other factors impacting the business's costs and revenues.

The 'single event' mechanism could be used in circumstances such as the introduction or the withdrawal of a tax.

The proposed mechanism would ensure the Commission can re-open determinations, if justified, in a more timely way. The Commission considers this flexibility will deliver outcomes that are in the best interests of customers and businesses, and is consistent with the principle that customers only pay for services they receive.



17.4 FINAL DECISION

The Commission has not approved the pass throughs proposed by Gippsland Water and Coliban Water. The Commission has approved, with modification, Barwon Water's pass through event regarding any requirement for water from the Melbourne supply system (details are specified in Barwon Water's determination). The Commission has not approved Barwon Water's other pass through events.

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 will include new provisions that in certain cases—only for those where an uncertain and unforeseen event is material, and the effects can be isolated from broader operational considerations — allows the Commission to have the discretion to limit a re-opening of determinations to a 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 reopening of a price determination to take effect at any time within the regulatory period. Details on the mechanism are specified in the determinations for each water business.



APPENDIX A – SUBMISSIONS

TABLE A.1 SUBMISSIONS TO REGIONAL DRAFT DECISION

Submission	Date
Adrienne Evans	3 May 2013
Amanda Taylor	2 May 2013
Anna Armstrong	22 April 2013
Anne and George Hendry	28 April 2013
Anthony Golding	19 April 2013
Anthony Golding	20 April 2013
Arch Janssen	23 April 2013
B. Duffy	22 April 2013
Beveridge Williams	2 May 2013
Bill Hessels	23 April 2013
Blyth Meechan	28 April 2013
Brian Knight	6 May 2013
Bruce Crawford	27 March 2013
Carolyn Elsworthy	17 April 2013
Charlie Tagliaferro	24 April 2013
Cheryl and Robert Wiseman	24 April 2013
Chris Spencer	29 April 2013
CJ Norquay and DM King	27 April 2013
Connor Russell	30 April 2013
Daryl McCulloch	22 April 2013
David Bell	11 April 2013
Dawn and Robert Bennell and Edna Slaughter	30 April 2013
Dean Russell	30 April 2013
Desirae Hancock	2 May 2013
Dianne Cowling	12 April 2013
Don Albanese	29 April 2013
Drew Henry	24 April 2013



Dylan Russell	30 April 2013
Energy and Water Ombudsman Victoria (EWOV)	16 May 2013
Glenn Baker	20 April 2013
Graeme Draffin	7 June 2013
Harcourt Water Services Committee	2 May 2013
Hardwicks Meat	24 April 2013
Howard Booth	23 April 2013
Ian Culley	2 May 2013
Ian Simmons	28 April 2013
Ivan Smith	28 April 2013
Jackie Willman	2 May 2013
Jim Bott	2 May 2013
Jim Foley	2 May 2013
Jimmy Foster	30 April 2013
Joan Lock	25 April 2013
John and Diane Hallas	25 April 2013
Jon Whykes - Recreational Lakes Alliance	21 May 2013
Josh Russell	6 May 2013
Julie King	30 April 2013
Kate Zizys	15 April 2013
Keith White	22 April 2013
Kylie Pattison	17 April 2013
Lachlan Meechan	28 April 2013
Laurie Gregg	23 April 2013
Libby Janssen	23 April 2013
Loch Community Development Association	30 April 2013
Loch Nyora Poowong Waste Water Action Group	2 May 2013
Lorraine Brunt	2 May 2013
Louise Foster	30 April 2013
Margot Foley	2 May 2013
Mark Bull	16 May 2013
Mark Cairns	28 April 2013
Melanie Wallace	2 May 2013
Merrilyn Whitecross	26 March 2013
Michael Brunt	2 May 2013
Michael Hancock	2 May 2013
Nancy Paterson	27 April 2013
Noel Gregg	23 April 2013



Nyora Primary School	2 May 2013
Nyora Public Hall Committee	24 April 2013
Nyora Recreation Reserve Committee	16 April 2013
Patricia McCraw	28 April 2013
Paul Lewis	1 May 2013
Pauline O'Dea	6 April 2013
Pauline O'Dea	6 April 2013
Poowong Recreation Committee	1 May 2013
Richard Griffiths	30 April 2013
Rob Geislere	16 April 2013
Robyn and David Mills	24 April 2013
Ryley Russell	30 April 2013
Shannon Meechan	28 April 2013
Ship Inn Motel and Function Centre	14 May 2013
Shirley Faux	26 April 2013
South Gippsland Shire Council	22 April 2013
Sue Lafferty	19 April 2013
Sylvia Casey	25 April 2013
Sylvia Leibrecht	12 May 2013
Tammy Logan	2 May 2013
Tim Armytage	21 April 2013
Tim Robertson	2 May 2013
Tom and Loris Moss	23 April 2013
Trevor Dance	13 May 2013
United Dairy Power	22 April 2013
Wayne Bradley	29 April 2013
Wilma Van Doorn	29 April 2013
Yannathan Road Development Group	23 April 2013

Note: Submissions are available at the Commission's website: www.esc.vic.gov.au





APPENDIX B – DOCUMENTS ATTACHED

TABLE B.1 DOCUMENTS ATTACHED

Document
Deloitte 2013 – <i>Coliban Water Financial Analysis</i> , June.
Deloitte 2013 – <i>Further advice to the Commission in relation to regional water business' submissions on expenditure – letter</i> , May.
Frontier Economics 2013 – <i>Gippsland Water's response to the draft decision</i> , June.
PricewaterhouseCoopers 2013– <i>Estimating a debt risk premium</i> , May.
Sinclair Knight Merz 2013 - <i>New Customer Contributions – Review capital and operating expenditure</i> , June.

Note: Documents attached are available at the Commission's website: www.esc.vic.gov.au





APPENDIX C – NEW CUSTOMER CONTRIBUTIONS

This appendix provides more detail on matters discussed in chapter 14. These are:

- assessment of responses to the draft decision
- standard NCC proposals
- final adjustments
- gifted assets
- Alberton sewerage scheme – transition arrangements.

C.1 ASSESSMENT OF WATER BUSINESS RESPONSES TO THE DRAFT DECISION

The Commission has assessed each water businesses response to the draft decision as follows:

- Have businesses confirmed that NCC are calculated in accordance with the core NCC pricing principles?
- Are the revised standard NCC appropriately cost reflective?
- Have the businesses proposed location specific NCC?
- Have the businesses addressed the other actions required in the draft decision?

C.1.1 ASSESSMENT AGAINST CORE PRICING PRINCIPLES

The core NCC pricing principles (box C.1) were set out in the Commission's 2012 NCC guidance paper which noted that the principles represent the minimum



requirements that the Commission would expect of an NCC for the NCC charge to be fair and reasonable as required by the *Water Act 1989*.

Core pricing principles – NCC guidance paper

The Commission will be approving the core pricing principles as the method by which NCC are to be calculated. The core pricing principles will be included in each regional water businesses water price determination.

The core pricing principles are described in box C.1.

BOX C.1 CORE NCC PRICING PRINCIPLES

Standard and negotiated NCC will:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

Interpretation and application of core NCC pricing principles

The Commission's 2012 NCC Guidance Paper and the associated NCC estimator included notes on the interpretation and application of the core NCC pricing principles in calculating charges. The Commission considers that the principles need to be applied consistently across the water businesses. Accordingly, it notes the following points of clarification and definition:

- **Costs in efficient pricing bound:** Given that NCC are to be based on the net incremental cost of connection (for example incremental costs net of incremental benefits), the costs referred to in applying the efficient pricing bound are the net costs, specifically the avoidable net cost of connection and standalone net cost of connection.



- **Gifted assets:** Gifted assets are discussed in chapter 14.5.1, where the connection arrangement requires assets to be gifted. The value of these gifted assets will be taken into account in the net costs.
- **Financing and bring forward costs:** Financing and bring forward costs are discussed in chapter 14.5.1. Incremental costs may include financing costs associated with constructing an asset sooner than planned.

How the Commission has assessed the regional water businesses' proposals

The Commission has assessed each regional water businesses to ensure that, during the third regulatory period:

- businesses have confirmed that NCC have been calculated in accordance with the core pricing principles
- the negotiating framework contains the core pricing principles
- proposed standard NCC are based on the core pricing principles.

Standard NCC

The Commission has reviewed the businesses' models to calculate standard NCC. The purpose of the review is to assess whether each regional water business's model takes into account relevant costs and revenues. The review found that all of the regional water businesses have based their calculations of standard NCC on the core pricing principles.

Central Highlands Water, Coliban Water, Gippsland Water and North East Water have now all calculated standard NCC in accordance with the core pricing principles.

GWMWater has not proposed standard NCC for the third regulatory period. It proposes to levy NCC on a case-by-case basis in accordance with the core pricing principles.

Negotiating framework

The negotiating framework sets out the procedural and information requirements that are relevant to application of NCC. The negotiation framework applies to both standard and negotiated NCC.



In the analysis that informed the draft decision, the Commission found that each regional water business had prepared a negotiating framework that included the core pricing principles. However there were some inconsistencies in the information provided in the framework between the businesses. As a result the Commission required the regional water businesses to work together to develop a best practice negotiating framework (based on the 2012 NCC guidance paper) that could be applied across the industry. The Victorian water industry association (VicWater) convened a working group to undertake this task. The result of this work was a flexible template that covered the key elements (including the core pricing principles) that also allowed the water businesses to incorporate processes and procedures specific to them.

The Commission has reviewed the template framework prepared by the working group and is satisfied that it includes the core pricing principles. The Commission is satisfied that each regional water business has a negotiating framework that incorporates the core pricing principles.

Confirmation by businesses

In the draft decision, the Commission sought confirmation from each regional water business that it had calculated standard NCC and would calculate negotiated NCC in accordance with the core pricing principles.

All the regional water businesses have confirmed that:

- their proposed standard NCC are based on these principles
- negotiated NCC or setting of any alternative NCC during the 2013-18 Water Plan period will be calculated in accordance with these principles.

In other words, the regional water businesses have proposed that, going forward, all standard and negotiated NCCs will be calculated by applying the core NCC pricing principles.

Summary

Based on the findings described above the Commission is satisfied that the regional water businesses have developed their standard NCC and/or will apply any negotiated NCC based on the core NCC pricing principles.



As previously noted, the Commission considers that the core NCC pricing principles represent the minimum requirements for a charge to be fair and reasonable as required by the Water Act.

NCC, including standard or negotiated NCC, will be calculated by applying the core NCC pricing principles in box C.2.

BOX C.2 CORE PRICING PRINCIPLES – FINAL DECISION

Standard and negotiated NCC will:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

Notes:

- 1 Given that NCC are to be based on the net incremental cost of connection (for example, incremental costs net of incremental benefits), in this context, the costs referred to in the efficient pricing bound are the net costs, specifically the avoidable net cost of connection and standalone net cost of connection.
- 2 Where the connection arrangement requires assets to be gifted, the value of gifted assets will be taken into account in the net costs.
- 3 Incremental costs may include financing costs associated with constructing an asset sooner than planned. Refer to chapter 14.5.1.



C.1.2 ARE THE REVISED STANDARD NCC APPROPRIATELY COST REFLECTIVE?

Each of the water business's NCC proposals must satisfy the WIRO principle:

- clause 14(1)(a)(v) provide appropriate incentives and signals to customers or potential customers about:

(A) the sustainable use of Victoria's water resources by reference to the costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers), including costs associated with balancing supply and demand; and

(B) the costs associated with servicing a new development in a particular location.

The Commission considers that two conditions need to be met in order for (standard and negotiated NCC) to satisfy the WIRO requirement. These are:

- NCC are calculated in accordance with the core pricing principles
- NCC are based on prudent and efficient costs.

Core pricing principles

As discussed in section C.1.1 the Commission is satisfied that the regional water businesses have based their NCC proposals on the core pricing principles.

Prudent and efficient costs

The Commission has undertaken selected assessments on the reasonableness of the operating and capital expenditure forecasts underpinning the water businesses NCC proposals. In the analysis supporting the draft decision the Commission engaged Sinclair Knight Merz (SKM) to review the expenditure forecasts proposed by Barwon Water, Gippsland Water, Goulburn Valley Water and Wannon Water. SKM found each business's expenditure forecasts to be reasonable in the context of the NCC methodology. The Commission considered SKM's approach and analysis to be satisfactory.

The Commission has since undertaken a similar review on Lower Murray Water's, South Gippsland Water's and Westernport Water's responses to the draft



decision.⁷² These businesses were selected because their proposed standard NCC are relatively high when compared to other regional water businesses.

SKM's findings on the prudence and efficiency of proposed costs for these businesses are outlined below.

SKM findings on Lower Murray Water (Urban)

SKM found the following:

- the basis for growth forecasts appears to be reasonable
- most of the capital expenditure in the NCC model is related to growth. SKM notes that Lower Murray Water (Urban) has included an amount of \$200 000 per service per year to facilitate the sequencing of development. SKM does not consider that it is appropriate for Lower Murray Water (Urban) to allocate capital expenditure to promote and assist the sequencing of development.
- unit costing of infrastructure appears reasonable
- the manner in which Water Plan 2 capital expenditure has been included in the NCC calculation appears to be reasonable
- incremental operating cost estimates appear reasonable
- estimates of gifted assets appear reasonable.

Lower Murray Water (Urban) has clarified subsequently that the amounts of \$200 000 per year per service should be included because they relate to costs and forecasts to expand the infrastructure to cater for growth. Further, Lower Murray Water (Urban) added that the amounts were based on recent year's expenditure and therefore the best available estimate.

The Commission considers Lower Murray Water (Urban)'s comments in response to SKM's findings to be reasonable and allows Lower Murray Water (Urban) to include this amount in the calculation of its NCC.

⁷² The Commission engaged Sinclair Knight Merz (SKM) to undertake this review.



SKM findings on South Gippsland Water

SKM found the following:

- growth capital has been constructed during Water Plan 2 with capacity to service new customers in Water Plan 3 and beyond. The unutilised portion of this capital has not been included in the NCC calculation when there is an argument to do so
- where there are multiple drivers capital expenditure has been classified generally by its primary driver. South Gippsland Water could have better apportioned capital for inclusion in the NCC calculation
- an exception to the point above is the Poowong Loch Nyora (PLN) sewerage scheme where compliance is the predominant driver but the whole of the scheme's capital expenditure is nonetheless included in the NCC model. Inclusion of the whole of the PLN capital expenditure in the NCC calculation is inappropriate as it is largely unrelated to growth
- incremental operating cost estimates appear reasonable.

South Gippsland Water revised its NCC for PLN to only include capital expenditure that could be attributed to growth. Based on this, its revised NCC for PLN is \$27 972 per lot. It also revised its water and sewerage NCC to include growth capital constructed during Water Plan 2 and a better apportionment of capital with multiple drivers.

The Commission considers South Gippsland Water's adjustments in response to SKM's findings to be reasonable.

SKM findings on Westernport Water

A number of concerns with Westernport Water's approach were found:

- there is a lack of strategic and servicing plans for growth areas
- schemes have been wholly allocated to growth regardless of whether or not there are other drivers and regardless of whether growth is the primary or a secondary driver. There needs to be a review of the apportionment method to ensure that the NCC reasonably reflects the incremental cost of servicing the future growth
- the renewal of a number of elements for example reuse plant membranes and pumps have been included in the NCC calculation. These should be recovered through the general tariff



- further explanation of the reasons for including the San Remo reuse project in year 30 is required
- there needs to be justification for the inclusion of a number of Water Plan 2 items in the NCC. These items appear to be primarily driven by other needs – particularly renewals, compliance (security of supply).

SKM found that Westernport Water’s estimation of incremental operating costs was reasonable.

The Commission considered SKM’s approach to be reasonable. It required Westernport Water to provide a response to the key findings.

Westernport Water argued that the capital expenditure for the Cowes class A treatment plant and the Candowie reservoir should be allocated wholly to growth. It also argued that the capital expenditure for construction of the San Remo water recycling plant should be brought forward from year 30 to years 10 and 20. This is based on Government funding to undertake preliminary studies during Water Plan 3.

SKM reviewed this response and determined that was reasonable to allocate up to 90 per cent of the capital expenditure for the Candowie reservoir and up to 56 per cent of the capital expenditure for the Cowes class A plant to growth. SKM argued that it would be reasonable to attribute the capital expenditure required to construct the San Remo recycled water plant to growth because the timing was distant and this likely to have little impact on the NCC.

The Commission considers SKM’s last findings to reasonable.

Westernport Water advised that it accepted these allocations and has revised its standard NCC accordingly.

Summary – all businesses

Due to tight timelines, the Commission has not been able to undertake a review of the expenditure forecasts underpinning Central Highlands Water’s, Coliban Water’s, East Gippsland Water’s or North East Water’s NCC. However, the Commission required all the water businesses to update their NCC models to reflect its draft decision on expenditure. On this basis the Commission is satisfied that these businesses estimates of capital and operating expenditure are reasonable.



During the third regulatory period the Commission will audit the actual costs and revenues included in each regional water businesses calculation of NCC. This is to ensure that they are consistent with the core pricing principles.

The Commission is satisfied that all regional water businesses have based their standard NCC on the core pricing principles, and prudent and efficient costs. The NCCs can be considered appropriately cost reflective.

C.1.3 HAVE THE BUSINESSES PROPOSED LOCATION SPECIFIC NCC?

Standard NCC

All of the regional water businesses have considered how they could improve the cost reflectivity of their standard NCC proposals. As a result the water businesses have proposed:

- location specific standard NCC or
- uniform standard NCC for other specific reasons.

Location specific standard NCC

Barwon Water, East Gippsland Water, Gippsland Water, Lower Murray Water (Urban), South Gippsland Water and Wannon Water have either proposed NCC for particular locations or provided supporting arguments as to why their proposed uniform NCC are cost reflective.

South Gippsland Water and Wannon Water have proposed standard NCC for specific locations within their service regions.

South Gippsland Water has proposed location specific NCC for sewerage services in Poowong, Loch, Nyora (PLN). The business has proposed a water and sewerage NCC to apply in all other areas within its region.



Wannon Water has revised its NCC proposal and now proposes to levy standard NCC for water and sewerage infrastructure in five locations. These are:

- Warrnambool – growth corridor
- Warrnambool – roof water harvesting
- Warrnambool – all other areas
- Hamilton and Portland
- other towns.

On this basis the Commission considers that South Gippsland Water and Wannon have proposed cost reflective standard NCC.

Barwon Water, East Gippsland Water, Gippsland Water and Lower Murray Water (Urban) have modelled standard NCC in different locations. These businesses have found the differences in standard NCC for their major growth areas to be immaterial. On this basis uniform NCC can be considered cost reflective.

Further detail on these water businesses proposals can be found in section C.2.

Uniform standard NCC for other reasons

Central Highlands Water, Coliban Water, Goulburn Valley Water and North East Water have proposed uniform NCC for water and sewerage across their service regions.

Each business has modelled different scenarios to determine whether there are material differences in the level of NCC (for a particular service) between towns or sub regions. All business found significant variation in the level of NCC between different locations in their service regions.

The businesses provided a range of reasons for adopting a uniform NCC. These were:

- very high NCC are unacceptable to customers – Central Highlands Water
- customers should pay a similar price for a similar service – Coliban Water
- there would be inequity between towns depending on when growth assets were provided - Goulburn Valley Water
- systems are becoming increasingly interconnected and should be treated as one – North East Water.



Central Highlands Water also noted that administrative burden to unbundle costs and develop NCC by supply system would be prohibitive.

The Commission accepts that the costs of preparing location specific NCC for some of the smaller water businesses may outweigh the benefits of cost reflectivity.

While these businesses do not propose location specific standard NCC they do propose to negotiate NCC under certain circumstances during the third regulatory period.⁷³ Furthermore the businesses have the ability to recover the incremental financing costs associated with bringing forward an asset sooner than planned - this sends signals about the higher costs of developing in an out of sequence location. At a minimum these impart some degree of cost reflectivity.

The Commission requires Central Highlands Water, Coliban Water, Goulburn Valley Water and North East Water to consult with their stakeholders to investigate options for offering location specific standard NCC in the fourth regulatory period.

C.1.4 DRAFT DECISION – OTHER ISSUES

In the draft decision, the Commission required the water businesses to undertake a number of other actions in relation to their NCC proposals these are discussed below.

Consult with stakeholders

All water businesses except North East Water have consulted with stakeholders during the preparation of their NCC proposals or have commenced consultation following the draft decision.

North East Water has yet to commence consultation with their developers. This is because they have just recently finalised their standard NCC. North East Water has advised that in the period up until end June 2013 it will prepare an NCC fact sheet, write to customers and advise the new NCC and conduct one on one consultation sessions with developers as required.

⁷³ Examples include but are not limited to situations where unplanned infrastructure is required or a development requires greater/lower volumes of water or discharges greater/lower volumes of waste than a standard customer.



Improve the transparency of NCC proposals

The Commission has reviewed the water businesses responses and found that generally the businesses have improved the transparency of their NCC submissions. The businesses have submitted maps showing where standard NCC applies and described the eligibility criteria under which NCC would be negotiated.

The Commission strongly encourages the water businesses incorporate this information in their land development manuals.

Common timeframe to estimate capital expenditure

In the draft decision, the Commission required the water businesses to consult amongst themselves and develop a common timeframe to estimate capital costs over. The Victorian water industry association (VicWater) convened a working group to undertake this task. The working groups finding was that because each water business has different capital programs, then each business should have the flexibility to propose its own timeframe. The Commission has reconsidered its position on this matter and agrees with the position prepared by the working group.

The Commission considers that the key issue is ensuring that customers who pay the NCC will benefit from the capital expenditure included in the model.

Undertake modeling adjustments

All water businesses confirmed that they had made the modelling adjustments described in the draft decision.

Transition arrangements

In the draft decision, the Commission required that Barwon Water, North East Water, South Gippsland Water and Wannon Water consult with their developers to assess the need for a transition plan. In response Barwon Water, South Gippsland Water proposed to phase the increase in the NCC over a number of years (Barwon Water over two years and South Gippsland Water 5 years).

North East Water's revised standard NCC are not materially higher than those currently levied under the existing framework. As such it is not required to develop a transition plan.

Wannon Water has advised that it has consulted with developers - the feedback was transition arrangements are not required.



Summary

The Commission is satisfied that the regional water businesses have and North East Water will complete the additional actions required in the draft decision.

C.1.5 SUMMARY OF ASSESSMENT

Table C.1 provides a summary of the Commission's assessment of each regional water businesses' response to the draft decision.



TABLE C.1 SUMMARY OF ASSESSMENT

	Have businesses confirmed that NCC are calculated in accordance with the core NCC pricing principles?	Are the revised Standard NCC appropriately cost reflective?	Have the businesses proposed location specific NCC?	Have the businesses addressed the other actions required in the draft decision?
Barwon Water	Yes	Yes	Yes	Yes
Central Highlands Water	Yes	Yes	No with reasons	Yes
Coliban Water	Yes	Yes	No with reasons	Yes
East Gippsland Water	Yes	Yes	Yes	Yes
Gippsland Water	Yes	Yes	Yes	Yes
Goulburn Valley Water	Yes	Yes	No with reasons	Yes
GWMWater	Yes	Yes	Yes	Yes
Lower Murray Water (Urban)	Yes	Yes	Yes	Yes
North East Water	Yes	Yes	No with reasons	Yes ^a
South Gippsland Water sewerage water	Yes Yes	Yes Yes	Yes No with reasons	Yes Yes
Wannon Water	Yes	Yes	Yes	Yes
Westernport Water	Yes	Yes	Yes	Yes

^a North East Water will commence consultation with stakeholders shortly. **Note:** All regional water businesses have met the assessment criteria

C.2 STANDARD NCC PROPOSALS

This section provides more detail on the standard NCC that could be considered location specific.

Barwon Water

Barwon Water has proposed uniform combined water and recycled water and a uniform sewerage standard NCC to apply across area 1 during the third regulatory period. Area 1 contains the majority of existing planned growth – including the infill areas. These areas are served by the Geelong water supply and Geelong sewerage system.

Barwon Water proposed a uniform NCC across area 1 because the Geelong water supply system is highly interconnected and that between 96–98 per cent of new connections will be linked to this system. In addition investments made in new water resources and recycling will also benefit these connections.

Barwon Water has undertaken some additional modeling to determine the magnitude of a separate NCC for the Armstrong Creek growth corridor - that lies within area 1. The results show that there is no material difference between the total (water, recycled water and sewerage) NCC in Barwon Water's proposal and a standalone NCC calculated for Armstrong Creek (\$3370 and \$3711 per lot, respectively). Therefore, Barwon Water's proposal can be considered cost reflective.

Apollo Bay and Colac are also included in area 1, though they are not connected to the Geelong water supply system. Barwon Water stated that separate water NCC for Apollo Bay and Colac would be extremely high and unacceptable - \$48 900 and \$8700 per lot, respectively. It added that the net incremental cost or NCC in these areas may also be overestimated because of inclusion of postage stamp general tariffs in the calculation.

Barwon Water proposed a uniform sewerage NCC because its sewerage system is also highly interconnected with 85 per cent of all new connections draining to the Geelong sewerage system. There are some towns included in area 1 that are not connected to this system. However, the number of new connections in these towns has been very low.



East Gippsland Water and Gippsland Water

In response to the draft decision, East Gippsland Water and Gippsland Water have reviewed their NCC for both water and sewerage.

East Gippsland Water advised that it modelled NCC in specific locations. It found that regardless of whether the NCC was modelled across a specific location or the entire service region the outcome was still a zero NCC for both water and sewerage.

Gippsland Water recalculated a NCC for sewerage services in both Warragul and Drouin - this represents the largest capital expenditure program in the fastest growing towns. A zero NCC was calculated in both locations. It argued that the ability to levy charges (commonly known as bring forward charges) to recover the incremental financing costs when an asset is required sooner than planned would still enable it to provide strong signals to developers about the costs of developing in different locations.

Both East Gippsland Water and Gippsland Water proposed to transition NCC from the existing levels in 2013-14 to zero in 2017-18. East Gippsland Water proposed to retain the existing three charges based on size. Gippsland Water will base its NCC on the existing category 2 (450-1350 square metre lot) charges.

Lower Murray Water (Urban)

Lower Murray Water (Urban) proposed uniform water and a uniform sewerage NCC to apply across its service region. Lower Murray Water (Urban) found the differences between NCC calculated specifically for Mildura and Swan Hill to be immaterial.

South Gippsland Water and Wannon Water

South Gippsland Water and Wannon Water have proposed standard NCC for specific locations within their service regions.

South Gippsland Water has proposed location specific NCC for sewerage services in Poowong, Loch, Nyora (PLN). The business has proposed a water and sewerage NCC to apply in all other areas within its region.



Wannon Water has revised its NCC proposal and now proposes to levy standard NCC for water and sewerage infrastructure in five locations. These are:

- Warrnambool – growth corridor
- Warrnambool – roof water harvesting
- Warrnambool – all other areas
- Hamilton and Portland
- other towns.

Wannon Water has proposed to differentiate NCC to reflect the costs and benefits of connecting in different locations across its service region.

Wannon Water proposes a minimum NCC of \$800 per lot each for water and sewerage in locations in Warrnambool that are outside the growth corridors and roof harvesting scheme area, \$800 per lot for sewerage in the Warrnambool growth areas and roof harvesting scheme area and, \$800 per lot for water in Hamilton and Portland.

Wannon Water has proposed the minimum charge to reflect the spare capacity that is provided in the system to service growth. Wannon Water also notes that NCC are very sensitive to growth projections and in towns with little growth they would vary greatly each time a calculation was performed. Wannon Water has based its minimum charge on the charge that is levied on connections under the Country Towns Water and Sewerage Program.

Wannon Water has proposed a reduced water NCC for properties connecting under the Warrnambool roof harvesting project - these properties are located within Warrnambool's growth areas. The reduction reflects the benefits Wannon Water will receive from the scheme consistent with the methodology in the NCC framework. The key benefits are the deferral of augmentations to the existing raw water supply system and the need to develop new groundwater resources and reductions in the distances of transporting water. Wannon Water has based the reduction on the value of water harvested by each property in the scheme over 25 years.

Wannon Water has proposed a water NCC for Warrnambool's growth areas and a sewerage NCC for Portland and Hamilton that reflects the costs of servicing these locations.



Westernport Water

Westernport Water has proposed uniform combined water and recycled water NCC and a uniform sewerage NCC. Westernport Water's justification for this approach is:

- that the recycled water system provides a benefit to all water users in all areas
- that water is supplied from one reservoir and there are no site specific costs that would apply to any sub area and
- sewerage is treated at one treatment plant and there are no site specific costs that would apply to any sub area.

C.3 SPECIFIC ADJUSTMENTS

This section describes the final adjustments made to the regional water businesses standard NCC. These adjustments follow a review of the calculation models used to derive standard NCC and the review of expenditure underpinning NCC for selected businesses – Lower Murray, South Gippsland Water and Westernport Water.

In response to the draft decision each regional water business resubmitted its calculation model to the Commission for further review to ascertain whether there are any obvious modeling errors.

The review found errors in Barwon Water's, Coliban Water's, Goulburn Valley Water's, South Gippsland Water's, Wannon Water's and Westernport Water's calculation models.

Adjustments to Barwon Water's and Coliban Water's models would result in higher NCC. These businesses have advised that they are satisfied with the standard NCC proposed in their responses to the draft decision.

The Commission has made adjustments to Goulburn Valley Water's and Wannon Water's standard NCC to correct modeling errors. The adjustments lowered the Goulburn Valley Water's standard NCC for water infrastructure and Wannon Water's standard NCC for sewerage infrastructure in Hamilton and Portland.

South Gippsland Water recalculated its standard NCC based on the findings of the expenditure and calculation model review. It reported that the adjustments would



result in a standard NCC (sewerage) for Poowong Loch Nyora of \$13 658 per lot and a combined (water and sewerage) standard NCC of \$4584 per lot.⁷⁴ South Gippsland Water advised that it was satisfied with the NCC amounts proposed in the response to the draft decision.

Westernport Water recalculated its standard NCC based on the findings of the expenditure and calculation model review.

C.4 GIFTED ASSETS

The 2008-2013 water price determinations required developers to provide reticulation assets to serve their development and connect to the water business networks.

The Commission recognises that it does not have the power to require developers to provide assets to water businesses. This power may be derived by the water businesses from general provisions in the Water Act, which may form the foundation of developers 'gifting' assets to water businesses. The following provisions are examples:

- a water business has power to do all things that are necessary or convenient to be done for or in connection with, or as incidental to, the performance of its functions, including any function delegated to it (s123)
 - it is a function of a water business to supply water from its works to any person by agreement (s124(7))
 - the water businesses are given control over connections to their works and may consent to connections being made subject to any terms and conditions they think fit (ss145)
 - a water business may require property owners to 'meet or contribute to the present day cost of any works' to service their properties in certain circumstances (ss268–270).

Thus, the Commission considers water businesses should have the discretion to determine which assets are to be gifted, and to characterise the gifting as a condition of connection to the water business's works. Where applicable,

⁷⁴ South Gippsland Water's combined water and sewerage NCC will be split evenly between water and sewerage - \$2030 per service. The water NCC will apply in all areas. The sewerage NCC will apply in all areas except Poowong Loch Nyora and to connections able to be made to the Alberton sewerage scheme.



developers may appeal to VCAT on the grounds described in section 271(3) of the Water Act.

The Commission strongly encourages the regional water businesses to consult among themselves and with the development industry to establish a common basis for gifting assets. That approach could be included in the negotiating frameworks, to minimise disputes arising from this matter.

In summary, the Commission considers that it is acceptable for a water business to require developers to provide and gift to the water business specified assets as a condition of connection, provided that the water business:

- makes clear to potential developers which assets a developer will be responsible for providing and gifting, and which will be provided by the water business
- confirms that negotiation of any non-standard connection and associated charges will be undertaken in accordance with the water business's published negotiating framework
- will take account of any gifted assets in applying the NCC pricing principles in calculating its proposed charges.

There may be situations where a developer is required to provide an asset that has been designed with excess capacity to service later developments. Refer to the section below for a discussion on how water businesses may address this situation.

The Commission will monitor the gifting arrangements imposed by the water businesses. If stakeholders raise concerns the Commission will consider developing principles to guide the classification of gifted assets.

GIFTED ASSETS – EXCESS CAPACITY

There may be situations where a developer is required to provide an asset that has been designed with excess capacity to service later developments.



In this situation, the water business has two options to ensure the asset's costs are shared across those who connect to it:

- the regulatory asset base option, whereby:
 - the initial connection applicant pays their required capacity share of the asset through the calculation of their NCC
 - any remaining share of the asset's costs (when the asset has been efficiently pre-built to service future growth) would default to recovery through the RAB and prescribed retail tariffs
 - the NCC calculation for any subsequent connections would include their capacity share of the asset's cost, and the resulting NCCs revenue would be deducted from the water business' RAB
- the reimbursement option, which would involve the water business charging foundation connection(s) an upfront NCC to recover the full asset cost, with provision to reimburse those connections when subsequent connections start to use the asset.

The Commission considers that the water businesses should negotiate with developers as to the most appropriate way to address any 'pioneer' developer issue when the situation arises.

C.5 SOUTH GIPPSLAND WATER – ALBERTON SEWERAGE SCHEME

The Commission has recently approved an application made by South Gippsland Water under clause 4.4 of the existing water price determinations to levy a developer charge on existing landowners. The developer charge applies to existing landowners in Alberton who connect to the sewerage scheme. The scheme is based on full cost recovery paid for by existing landowners and Government grants. The charges are \$10 000 for allotments with a dwelling and \$5000 for vacant allotments.

The sewerage system also has capacity to connect additional landholders outside the scheme boundary. A zero NCC would be calculated for these customers under the core pricing principles. South Gippsland Water is concerned that the difference in connection costs between those in the scheme and those outside the scheme will be unacceptable.



To address this issue South Gippsland Water has proposed transition arrangements.⁷⁵ Sewerage connections (outside the scheme boundary) to an allotment with a dwelling pay \$10 000 over the third regulatory period. Sewerage connections (outside the scheme boundary) to vacant allotments pay \$5000 over the third regulatory period. Beyond the third regulatory period all sewerage connections outside the scheme boundary pay a NCC calculated in accordance with the core pricing principles.

The Commission considers that costs of servicing all customers who connect to the Alberton sewerage scheme will be similar. However due to council zoning decisions some customers are included under the scheme and others are not.

The Commission is satisfied with the transition arrangements and proposes to approve South Gippsland Water's proposed NCC for landholders (outside the Alberton sewerage scheme boundary but still able to connect to the Alberton sewerage system) over the third regulatory period.



⁷⁵ South Gippsland Water proposed these arrangements after its response to the draft decision.



APPENDIX D – NCC MISCELLANEOUS SERVICES



TABLE D.1 BARWON WATER

Service Related to NCCs	Definition
Preparation of Works Offer	Preparation of a works offer
Preparation of Non Works Offer	Preparation of a non works offer
Design Plan Audit 1-20 Lots – up to 3 Audits Sewer	Auditing of sewer design plans up to 3 audits 1-20 lot development
Design Plan Audit > Lots – up to 3 Audits Sewer	Auditing of sewer design plans up to 3 audits >20 lot development
Design Plan Audit 1-20 Lots – up to 3 Audits Water	Auditing of water design plans up to 3 audits 1-20 lot development
Design Plan Audit >20 Lots – up to 3 Audits Water	Auditing of water design plans up to 3 audits >20 lot development
Design Plan Audit >20 Lots – up to 3 Audits Recycled Water	Auditing of recycled water design plans up to 3 audits >20 lot development
Developer Works Asset Recording Fee 1-20 Lots Water	Recording water assets for 1-20 lots
Developer Works Asset Recording Fee >20 Lots Water (Including Major Infrastructure)	Recording water assets for >20 lots water including major infrastructure
Developer Works Asset Recording Fee 1-20 Lots Sewer	Recording sewer assets for 1-20 lots
Developer Works Asset Recording Fee >20 Lots Sewer (Including Major Infrastructure)	Recording water assets for >20 lots sewer including major infrastructure
Developer Works Asset Recording Fee 1-20 Lots Recycled Water	Recording recycled water assets for 1-20 lots
Developer Works Asset Recording Fee >20 Lots Recycled Water (Including Major Infrastructure)	Recording recycled water assets for >20 lots recycled water including major infrastructure
Developer Works Construction Audit 1-20 Lots Sewer	Undertake sewer construction audits for developer works 1-20lots
Developer Works Construction Audit >20 Lots Sewer (Including Major Infrastructure)	Undertake sewer construction audits for developer works >20 Lots Sewer including major infrastructure
Developer Works Construction Audit 1-20 Lots Water	Undertake water construction audits for developer works 1-20 lots
Developer Works Construction Audit >20 Lots Water (Including Major Infrastructure)	Undertake water construction audits for developer works > 20 Lots including major infrastructure
Developer Works Construction Audit 1-20 Lots Recycled Water	Undertake recycled water construction audits for developer works 1-20 Lots
Developer Works Construction Audit >20 Lots Recycled Water (Including Major Infrastructure)	Undertake recycled water construction audits for developer works >20 Lots including major infrastructure

TABLE D.2 COLIBAN WATER

Service Related to NCCs	Definition
Project Management Fees	These fees are charged for the assistance we provide developers in designing and constructing assets required to service their subdivision. This includes the assessment of design plans and inspections of works. The fee includes a fixed and variable component (per lot) to account for the size of the works.
Water and Sewer Plan Amendment	This fee covers the work associated with issuing plumbing consent for alteration of existing private drains.
Property Connection Application	Similar to Project Management Fees, this fee relates to the administration required to process a new connection application.
Consent to Erect a Structure (Buildover)	Fee associated with assessing applications to build over or near an asset.
Recycled Water – Plumbing Industry Charge	This charge represents the pass through of the Plumbing Industry Commission’s state-wide fee for inspecting a recycled water connection.
Service Related to NCCs	Definition

TABLE D.3 EAST GIPPSLAND WATER

Service Related to NCCs	Definition
Owner Financed Works Administration/Supervision Fee	East Gippsland Water offers owners and developers an engineering, planning, design and project management service to administer development of water/wastewater infrastructure. Owners and developers have the option of receiving this service from the Corporation or from a private provider. The service is for assets that are subsequently gifted to the Corporation and are not treated as growth assets.

TABLE D.4 GOULBURN VALLEY WATER

Service Related to NCCs	Definition
District Extension Fee – Application Fee	Applied to a developer where an extension of a water or sewerage district is required to service the development.
District Extension Fee – Further Costs to Extend District	Applied where the application fee does not cover the actual cost incurred to extend the district due to complexity of the district extension.
Landowner or Developer Works Charges – Feasibility Report Fee	Fee applied to assess costs and conditions for providing water or sewer services to an existing property.
Landowner or Developer Works Charges – Design, Supervision, Review and Administration Charge	Fee applied to recover costs incurred associated with developer works including design, supervision, review and administration.

TABLE D.5 LOWER MURRAY WATER (URBAN)

Service Related to NCCs	Definition
Subdivision Processing Fee	This charge is applied to all referrals and is calculated on a per lot basis plus a fee for the overall plan. The fee is not related to NCCs.

TABLE D.6 SOUTH GIPPSLAND WATER

Service Related to NCCs	Definition
NCC Charge	Fee charged to cover administration costs for time spent on processing new developer funded applications
Administration Developer Fee	The administration fee and the as constructed charge are in addition to the NCC and are pure cost recovery of time taken to process the relevant information. These have been miscellaneous charges levied by South Gippsland Water since 2005/06.
As Constructed Charge	See above
Gifted Assets	In accordance with NCC framework

TABLE D.7 WANNON WATER

Service Related to NCCs	Definition
Offer of Conditions Charge	Provides for the preparation and issue of a letter of Offer or Conditions to the developer and includes: Development services staff preparation and review costs, Administration staff costs, Asset creation staff costs, Administration costs; and Overhead costs.
Review of Design Charge (Existing Infrastructure)	Provides for the assessment of development applications where no new infrastructure is required to be constructed to service the development and includes: Development services staff preparation and review costs, Administration staff costs, Administration costs; and overhead costs.
Construction Charges (Water)	Provides for the assessment of development applications where new water infrastructure is required to service the development and includes: Development services staff preparation and review costs, Administration staff costs, Administration costs including GIS input, Water quality testing costs; and overhead costs. The charge is based on the number of new lots being created.
Construction Charges (Sewer)	Provides for the assessment of development applications where new sewer infrastructure is required to service the development and includes: Development services staff preparation and review costs, administration staff costs, administration costs including GIS input, review and processing of CCTV information; and overhead costs. The charge is based on the number of new lots being created.
Additional Auditing and Processing Charges	Provides for the additional auditing and processing time in excess of that allowed in the construction charges (water) and construction charges (sewer). This charge will be applied where initial auditing identifies non-compliance with the specified standards and includes: development services staff costs, systems operations staff costs; and overhead costs.
Bonding of Works Charge	Provides for the negotiation and preparation of an agreement where Wannon Water agrees to the issuing of a Statement of Compliance prior to the developer satisfying all of Wannon Water's requirements and includes: development services staff costs, administration costs and overhead costs.
Infrastructure Processing or Construction Fees – Non-standard Items	Provides for the provision of other non-standard services or items and will be calculated at cost including a reasonable contribution towards overhead costs.

