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## 2008 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:  
FMIT

MARCH 2008

**An appropriate citation for this paper is:**

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

# FIRST MILDURA IRRIGATION TRUST

## 1. Purpose of volume II of the draft decision

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

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

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

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

In response to this Draft Decision, First Mildura Irrigation Trust should by 9 May 2008 resubmit:

- (a) its proposed schedule of tariffs to apply for each year of the regulatory period commencing 1 July 2008 that reflects:
  - (i) the revised revenue requirement set out in Table 4
  - (ii) any changes to tariff structure suggested by the Commission.
- (b) the service standards to apply over the regulatory period consistent with any revisions suggested by the Commission set out in Table 1.

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

### 3. Service standards

The Commission proposes to approve each of the service standards proposed in First Mildura Irrigation Trust's Water Plan, except as indicated in table 1.

**Table 1 Approved service standards**

<i>Service standard</i>	<i>Draft decision – service standards</i>				
	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
<b>Gravity Supply</b>					
Irrigation water orders delivered on day requested (per cent)	95.00	95.00	95.00	95.00	95.00
Number of channel burst and leaks (per 100 km of channel)	30.00	30.00	30.00	30.00	30.00
Unaccounted for water (per cent)	20.00	20.00	20.00	20.00	20.00
<b>Pumped Supply</b>					
Irrigation water orders delivered on day requested (per cent)	95.00	95.00	95.00	95.00	95.00
Number of pipeline bursts and leaks (per 100 km of pipeline)	30.00	30.00	30.00	30.00	30.00
Unaccounted for water (per cent)	20.00	20.00	20.00	20.00	20.00
<b>Irrigation drainage (by district/supply system)</b>					
Availability of sub-surface drainage schemes (per cent)	97.00	97.00	97.00	97.00	97.00
<b>Licensing/administration</b>					
Processing temporary transfer of water entitlement volumes within [X] days	10.00	10.00	10.00	10.00	10.00
Processing permanent transfer of water entitlement volumes within [X] days	10.00	10.00	10.00	10.00	10.00
<b>Customer service</b>					
Complaints to EWOV	5.00	5.00	5.00	5.00	5.00
Telephone calls answered within 30 seconds	95.00	95.00	95.00	95.00	95.00

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

The targets for the service standards shown in Table xx were not proposed in FMIT's Water Plan, but were proposed before the Draft Decision.

#### 4. Guaranteed service level scheme

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

#### 5. Revenue requirement

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

Table 2 **Breakdown of revenue requirement implied by ESC draft decision**  
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-2012</i>	<i>2012-13</i>
Operating expenditure	5.10	5.04	5.10	5.12	5.14
Return on existing assets	0.48	0.44	0.39	0.35	0.31
Return on new investments	0.00	0.05	0.21	0.30	0.27
Regulatory depreciation	0.68	0.76	0.98	1.14	1.14
Tax liability	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>6.26</b>	<b>6.29</b>	<b>6.68</b>	<b>6.90</b>	<b>6.87</b>

#### 6. Rolled forward regulatory asset base

The regulatory asset base as at 1 July 2005 has been rolled forward to reflect approved capital expenditures net of customer contributions (new customer and shareholder contributions) and disposals for the 2005-06 to 2007-08 period less any approved allowance for regulatory depreciation. The rolled forward values are shown in table 3.

**Table 3 Updated regulatory asset base**  
\$ million in January 2007 prices

	<i>2005-06</i>	<i>2006-07</i>	<i>2007-08</i>
Opening RAB	0.19	4.17	6.66
<i>Plus</i> Gross Capital expenditure	4.00	2.52	1.54
<i>Less</i> Government contributions	0.00	0.00	0.00
<i>Less</i> Customer contributions	0.00	0.00	0.00
<i>Less</i> Proceeds from disposals	0.00	0.00	0.00
<i>Less</i> Regulatory depreciation	0.02	0.03	0.04
<b>Closing RAB</b>	<b>4.17</b>	<b>6.66</b>	<b>8.16</b>

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

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

**Table 4 Rolled forward regulatory asset base**  
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Opening RAB	8.2	7.5	8.5	11.2	10.1
<i>Plus</i> Gross Capital expenditure	0.1	1.7	3.7	0.1	0.0
<i>Less</i> Government contributions	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Customer contributions	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Proceeds from disposals	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Regulatory depreciation	0.7	0.8	1.0	1.1	1.1
<b>Closing RAB</b>	<b>7.5</b>	<b>8.5</b>	<b>11.2</b>	<b>10.1</b>	<b>9.0</b>

## 7. Weighted average cost of capital

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

**Table 5 Real post-tax WACC**

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

## 8. Operating expenditure

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

**Table 6 Proposed and approved operating expenditure assumptions**  
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Proposed operating expenditure	5.14	5.18	5.24	5.26	5.29
Revisions and adjustments	-0.04	-0.14	-0.14	-0.14	-0.14
Draft decision – operating expenditure	5.10	5.04	5.10	5.12	5.14

The Commission's assumptions reflect the following adjustments to First Mildura Irrigation Trust's proposed operating expenditure forecasts:

**Table 7 Adjustments to operating expenditure**  
\$ million in January 2007 prices

<i>Expenditure item</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Productivity improvement	-0.04	-0.04	-0.04	-0.04	-0.04
Electricity cost reduction	0.00	-0.10	-0.10	-0.10	-0.10
Environmental contribution	-0.002	-0.002	-0.001	-0.001	0.000
<b>Total</b>	-0.04	-0.14	-0.14	-0.14	-0.14

- (a) No business revisions were proposed after the submission of the Water Plan
- (b) The productivity adjustment reflects a reduction above any other adjustments required to achieve its productivity target. The productivity target reflects a 1 per cent growth adjusted productivity improvement over its 2006-07 business as usual operating expenditure, as discussed in section 4.2 of Volume 1

- (c) CARDNO accepted electricity expenditure for 2008-09 as it is the last year of their current contract but recommended a 10% reduction to the proposed electricity expenditure for the remainder of the regulatory period (CARDNO, p 8)
- (d) The Commission adjusted the environmental contribution to reflect advice from the Department of Sustainability and Environment (Draft Decision section 4.7)

## 9. Capital expenditure

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

**Table 8 Proposed and approved capital expenditure assumptions**  
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Proposed capital expenditure	0.06	0.86	1.49	0.06	0.06
Draft decision – capital expenditure	0.05	1.72	3.67	0.05	0.05

The Commission's assumptions reflect the following adjustments to First Mildura Irrigation Trust's proposed capital expenditure forecasts:

**Table 9 Adjustments to capital expenditure**  
\$ million in January 2007 prices

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
K East Pipelines		0.308			
K West		0.049			
T South		0.244			
E Pipelines		0.297			
L South Sub-Area			2.184		
Benetook Pumps		-0.031			
Drainage pump replacement	-0.008	-0.008	-0.008	-0.008	-0.008
<b>Total ESC Adjustment</b>	<b>-0.008</b>	<b>0.862</b>	<b>2.176</b>	<b>-0.008</b>	<b>-0.008</b>

Cardno noted that the costs included in the 2008 water Plan have been taken directly from the 2005 Master Plan. No provision has been made to inflate the prices to January 2007 prices and the Master Plan has mistakenly been assumed to be the dollars of the day. Cardno consider there to be issues with the robustness of the initial cost estimates used in the 2005 Master Plan. (Cardno, section 5)

Cardno recommended that each of the pipeline replacement projects included in FMIT's capital program for 2009-10 and 2010-11 be increased by a nominal 125% from the initial estimates included in the 2005 Master Plan. (Cardno, section 5)



All of the capital projects in the Water Plan include a contingency of 40%, including those related to pump and electrical works replacement. Cardno recommended a 15% contingency on cost estimates inflated up to January 2007 levels. (Cardno, section 5)

First Mildura Irrigation Trust has identified the following key capital projects to be undertaken during the regulatory period.

**Table 10 Key capital projects**

	<i>Expected completion date</i>
K East Pipelines	2009-10
K West	2009-10
T South	2009-10
E Pipelines	2009-10
L South Sub-Area	2010-11
Benetook Pumps	2009-10
Drainage pump replacement	2012-13

## 10. Demand forecasts

The Commission has approved the demand forecasts as proposed by FMIT..

## 11. Form of price control

- (a) The Commission proposes to approve a revenue cap for First Mildura Irrigation Trust.
- (b) First Mildura Irrigation Trust should submit a schedule of prices to apply from 1 July 2008.

## 12. Pass through mechanisms

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

- (a) Prices will be adjusted at the end of the regulatory period to reflect any difference between assumed and actual licence fees levied by the EPA, DHS and the ESC. To avoid any doubt, the assumed licence fees payable for each year of the regulatory period are set out in Table 11.

**Table 11 Approved licence fee assumptions<sup>a</sup>**  
\$ million in January 2007 prices

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

<sup>a</sup> Included in forecasts of business as usual operating expenditure.

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

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

### **13. Tariffs**

- (a) The Commission proposes to approve the tariff structures and associated price paths proposed by First Mildura Irrigation Trust.
- (b) First Mildura Irrigation Trust is required to clarify whether it proposes to charge termination fees in the next regulatory period. If so, First Mildura Irrigation Trust should propose a method for calculating termination fees that is consistent with the principles recommended by the ACCC.