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2013-18 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:
EAST GIPPSLAND WATER

MARCH 2013

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EAST GIPPSLAND WATER

1. Purpose of volume II of the draft decision

The Commission is required to issue a draft decision that proposes either to:

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

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

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

In response to this draft decision, East Gippsland Water should by 2 May 2013 resubmit:

- (a) its proposed schedule of tariffs to apply for each year of the regulatory period commencing 1 July 2013 that reflects:
 - i. the revised revenue requirement set out in table 3
 - ii. the revised demand forecasts set out in tables 12–17 and
 - iii. any changes to tariff structure suggested by the Commission.
- (b) the service standards to apply over the regulatory period consistent with any revisions suggested by the Commission set out in tables 1.
- (c) the guaranteed service levels (GSLs) to apply over the regulatory period consistent with any revisions suggested by the Commission set out in table 2.

- (d) the New Customer Contribution Charges (NCC) proposal with any actions required by the Commission set out in section 16.

If a business does not submit a revised schedule of tariffs and/or the service standards to apply, or otherwise make a submission as to why it has not adopted the Commission's suggested amendments by the due date, the Commission will specify the prices, or manner in which prices are to be calculated or otherwise determined and the service standards to apply for the regulatory period 2013-14 to 2017-18 as part of its Final Determination.

3. Service standards

The Commission proposes to approve each of the service standards proposed in East Gippsland Water's Water Plan.

Table 1 Approved service standards

<i>Service standard</i>	<i>Draft decision – service standards</i>					
	<i>5 yr Avg 2008-13</i>	<i>2 013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Water						
Unplanned water supply interruptions (per 100km)	8.81	10	10	10	10	10
Average time taken to attend bursts and leaks (priority 1)	6	30	30	30	30	30
Average time taken to attend bursts and leaks (priority 2)	39.2	34	34	34	34	34
Average time taken to attend bursts and leaks (priority 3)	66.43	80	80	80	80	80
Unplanned water supply interruptions restored within 5 hours (per cent)	97.47	98	98	98	98	98
Planned water supply interruptions restored within 5 hours (per cent)	97.62	98	98	98	98	98
Average unplanned customer minutes off water supply	8.24	7	7	7	7	7

<i>Service standard</i>	<i>Draft decision – service standards</i>					
	<i>5 yr Avg 2008-13</i>	<i>2 013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Average planned customer minutes off water supply	30.37	28	28	28	28	28
Average unplanned frequency of water supply interruptions	0.1	0.1	0.1	0.1	0.1	0.1
Average planned frequency of water supply interruptions	0.21	0.3	0.3	0.3	0.3	0.3
Average duration of unplanned water supply interruptions (minutes)	82.07	75	75	75	75	75
Average duration of planned water supply interruptions (minutes)	137.26	170	170	170	170	170
Number of customers experiencing more than 5 unplanned water supply interruptions in the year	0	0	0	0	0	0
Unaccounted for water	14.66	11	11	11	11	11
Sewerage						
Sewerage blockages (per 100km)	11.92	15	15	15	15	15
Average time to attend sewer spills and blockages (minutes)	42.03	40	40	40	40	40
Average time to rectify a sewer blockage (minutes)	97.44	80	80	80	80	80
Spills contained within 5 hours (per cent)	98.94	100	100	100	100	100
Customers receiving 3 sewer blockages in the year (number)	0	0	0	0	0	0
Customer Service						
Complaints to EWOV (per 1000 customers)	No audit data available	.06	.06	.06	.06	.06
Telephone calls answered within 30 seconds (per cent)	No audit data available	96	96	96	96	96

Note Data rounded to two decimal places.

4. Guaranteed service level scheme

The Commission proposes to approve each of the proposed guaranteed service levels except as shaded or otherwise indicated in table 3. These guaranteed service levels should be reflected in East Gippsland Water's Customer Charter.

Table 2 **Proposed and approved GSL events and payment levels**

<i>Proposed level of service</i>	<i>Proposed payment</i>
Planned interruption to water supply exceeds delay specified in notice	\$65
Response to customer contact within 10 working days, if required.	\$30
Failure to update billing details	\$30
Sewage spill caused by business within house	\$1000

The Commission proposes to approve the GSL events proposed by East Gippsland Water

5. Revenue requirement

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

Table 3 **Breakdown of revenue requirement implied by ESC draft decision**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Operating expenditure	16.9	17.1	17.4	17.4	17.5
Return on existing assets	5.6	5.3	5.0	4.7	4.4
Return on new investments	0.2	0.6	1.1	1.3	1.6
Regulatory depreciation	5.9	6.3	6.8	7.2	7.5
Total	28.4	29.3	30.2	30.6	31.0

6. Rolled forward regulatory asset base

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

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

	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>
Opening RAB	69.0	86.7	97.0	120.9	124.1
<i>Plus</i> Gross Capital expenditure	21.8	15.8	29.1	11.3	8.4
<i>Less</i> Government contributions	0.0	0.0	0.0	0.8	2.2
<i>Less</i> Customer contributions	0.3	1.6	0.5	0.7	0.4
<i>Less</i> Proceeds from disposals	0.4	0.3	0.2	1.4	1.1
<i>Less</i> Regulatory depreciation	3.4	3.6	4.5	5.1	5.4
Closing RAB	86.7	97.0	120.9	124.1	123.5

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

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

Table 5 **Rolled forward regulatory asset base**
\$m 2012-13

	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Opening RAB	123.5	121.2	121.9	128.0	129.1	128.2
<i>Plus</i> Gross Capital expenditure	4.1	7.3	13.1	8.6	7.1	8.7
<i>Less</i> Government contributions	0.0	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Customer contributions	0.4	0.4	0.4	0.4	0.4	0.4
<i>Less</i> Proceeds from disposals	0.4	0.4	0.4	0.4	0.4	0.4
<i>Less</i> Regulatory depreciation	5.6	5.9	6.3	6.8	7.2	7.5
Closing RAB	121.2	121.9	128.0	129.1	128.2	128.7

7. Weighted average cost of capital

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

Table 6 **Real post-tax WACC**

<i>Real risk free rate</i>	<i>Equity beta</i>	<i>Market risk premium</i>	<i>Debt margin</i>	<i>Financing structure (gearing)</i>	<i>Franking credit value</i>	<i>WACC</i>
<i>per cent</i>	<i>β</i>	<i>per cent</i>	<i>per cent</i>	<i>per cent</i>	<i>γ</i>	<i>per cent</i>
0.679 – 1.023	0.65	6.0	3.03 – 4.53	60	0.5	4.7

8. Operating expenditure

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

Table 7 Proposed and approved operating expenditure assumptions
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed operating expenditure	17.0	17.2	17.9	17.8	18.1
Revisions and adjustments	-0.1	-0.1	-0.4	-0.4	-0.6
Draft decision – operating expenditure	16.9	17.1	17.4	17.4	17.5

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

Table 8 Adjustments to operating expenditure
\$m 2012-13

<i>Expenditure item</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Labour	0.10	0.00	-0.14	-0.29	-0.43
Electricity	-0.02	-0.02	-0.05	-0.08	-0.14
Carbon price	-0.08	-0.09	-0.10	-0.11	-0.10
Defined benefits superannuation costs	0.14	0.14	0.14	0.13	0.13
Chemical costs	0.00	-0.01	-0.02	-0.02	-0.03
Special O&M costs	-0.18	-0.09	-0.21	0.00	0.00
Environment Contribution	-0.01	-0.01	-0.01	-0.02	-0.02
Licence fees	-0.07	-0.02	-0.02	-0.02	-0.02
Total	-0.10	-0.09	-0.42	-0.40	-0.61

- (a) Adjustments reflect changes to wage rates (section 4.2.1 of Deloitte's expenditure report).
- (b) Adjustments reflect changes to electricity prices and energy usage—(higher water consumption recommended by Frontier Economics, and added electricity costs at three sites which were not included in original forecasts—(section 4.2.2 of Deloitte's expenditure report).

- (c) Proposed allowances for carbon price impacts were removed, due to inability to demonstrate material carbon price impacts on individual cost categories (section 4.2.3 of Deloitte's expenditure report).
- (d) Adjustments reflect recovery of \$1.47 million defined benefit superannuation payments made to Vision Super in 2012 (section 4.2.4 of Deloitte's expenditure review).
- (e) Adjustments reflect higher chemical prices, as well as additional chemical volumes associated with the Bemm River sewerage scheme (section 4.2.5 of Deloitte's expenditure report).
- (f) A large number of 'special operating projects' were identified in the water plan, allowable expenditure for these projects has been adjusted (section 4.2.7 of Deloitte's expenditure report).
- (g) Adjustments reflect recent advice from the Department of Sustainability and Environment on the environmental contribution for the next regulatory period (chapter 6 of volume I of this draft decision).
- (h) Adjustments reflect recent advice from the Department of Health and Environment Protection Authority on their respective licence fees. Also included the Commission's adjustments on the ESC licence fees (chapter 6 of volume I of this draft decision).

9. Capital expenditure

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

Table 9 **Proposed and approved capital expenditure assumptions**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed capital expenditure	7.77	11.52	9.06	7.70	10.01
Draft decision – capital expenditure	7.33	13.11	8.64	7.07	8.69

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

Table 10 Adjustments to capital expenditure
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Wastewater lagoon desludge	-0.44	1.60	-0.42	-0.42	-0.42
Wy Yung basin tank or liner	0.00	0.00	0.00	-0.21	-0.90
Total ESC Adjustment	-0.44	1.60	-0.42	-0.63	-1.32

- (a) Wastewater lagoon desludge – Deloitte adjusted the proposed expenditure to reflect East Gippsland Water's revised cost estimate for the project (section 5.5 of Deloitte's expenditure report).
- (b) Wy Yung basin tank or liner – Deloitte do not considered that the risks identified by East Gippsland Water warrant the project being undertaken in the next regulatory period, therefore, it recommended that the proposed expenditure be removed from the proposed capital program (section 5.12 of Deloitte's expenditure report).

East Gippsland Water has identified the following key capital projects to be undertaken during the regulatory period.

Table 11 Key capital projects

	<i>Expected completion date</i>
Bairnsdale wastewater treatment plant upgrade	2016-17 to 2017-18
Corporate vehicles	2013-14 to 2017-18
Wastewater desludge	2013-14 to 2017-18
IT hardware/software	2013-14 to 2017-18
SCADA upgrade and support	2013-14 to 2017-18
Bairnsdale sewer master plan bridge sewer pump station	2015-16
Water renewals	2013-14 to 2017-18
Sarsfield-additional tank or liner	2014-15
Paynesville main supply pipeline (stage 2)	2015-16

10. Demand forecasts

- (c) The Commission has made the following assumptions about demand for various services over the regulatory period.
- (d) The Commission has adjusted proposed demand forecasts where indicated.

Table 12 Number of water connections

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed – total connections	22 061	22 348	22 661	22 978	23 300
Draft decision – total connections	22 547	22 927	23 314	23 708	24 131

East Gippsland Water used a combination of Victoria in Future 2008, Victoria in Future 2012 and historical growth rates to forecast connections. Frontier Economics recommended using ViF 2012 dwelling growth rates. East Gippsland Water agreed with this revision. The Commission proposes to approve the revised connections numbers from East Gippsland Water's residential and non-residential water and sewerage connections forecasts in line with Frontier Economics' recommendations.

Table 13 Number of sewerage connections

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed – total connections	21 280	21 656	21 959	22 266	22 578
Draft decision – total connections	21 667	22 036	22 410	22 791	23 201

**Table 14 Residential water consumption
ML**

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed total residential consumption	2 547	2 584	2 622	2 657	2 693
Draft decision – total residential consumption	2 923	2 973	3 024	3 075	3 130

East Gippsland Water forecast a step decline in average residential consumption without sufficient justification. Frontier Economics recommended increasing East Gippsland Water's forecast average consumption to an average of the previous regulatory period and also adjusted total volumes for changes to connections forecasts. East Gippsland Water agreed with this revision. The Commission proposes to approve the revised residential water volumes from East Gippsland Water.

Table 15 Non-residential water consumption
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed non-residential consumption	1 626	1 644	1 662	1 680	1 699
Draft decision – non-residential consumption	1 626	1 644	1 662	1 680	1 699

Table 16 Total water consumption
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed total consumption	4 173	4 228	4 284	4 337	4 392
Draft decision – total consumption	4 549	4 617	4 686	4 755	4 829

Adjusted as described above

Table 17 Trade waste connections

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed – connections	382	382	382	382	382
Draft decision – connections	408	412	416	420	425

East Gippsland Water forecast no growth in trade waste customers over the third regulatory period. Frontier Economics found this inconsistent with historical growth and recommended revising East Gippsland Water's trade waste connections growth rate. East Gippsland Water agreed with this revision. The Commission proposes to approve East Gippsland Water's revised trade waste connection numbers.

Further, East Gippsland Water did not provide any forecast of trade waste loads. We request that East Gippsland Water provide this information in response to this draft decision.

East Gippsland Water did not clarify its recycled water revenue following a query from Frontier Economics. East Gippsland Water should clarify its position in response to this draft decision.

11. Form of price control

The Commission proposes 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 proposes to approve East Gippsland Water's proposed rebalancing constraint of ± 3 per cent.

12. Retail water tariffs

- (a) The Commission proposes to approve East Gippsland Water's proposed retail water tariff structure.

13. Retail sewerage tariffs

- (a) The Commission proposes to approve East Gippsland Water's proposed retail sewerage tariff structure.

14. Trade waste charges

- (a) The Commission proposes to approve the trade waste tariffs proposed by East Gippsland Water.
- (b) The Commission requires East Gippsland Water to continue to include the Commission's trade waste pricing principles in its tariff schedules. East Gippsland Water is required to use the pricing principles when determining trade waste charges for customers to whom scheduled prices do not apply.

15. Recycled water

- (a) The Commission is proposing to approve East Gippsland Water's proposed pricing principles on the basis that they are consistent with the principles below.
- (b) The Commission considers that East Gippsland Water should set its recycled water prices according to a set of principles that ensure that prices:
 - i. have regard to the price of any substitutes and customers' willingness to pay
 - ii. cover the full cost of providing the service (with the exception of services related to specified obligations or maintaining balance of supply and demand)
 - iii. (iv) include a variable component.
- (c) Where a business does not propose to fully recover the costs associated with recycled water, it must demonstrate to the Commission that:
 - i. it has assessed the costs and benefits of pursuing the recycled water project
 - ii. it has clearly identified the basis on which any revenue shortfall is to be recovered
 - iii. if the revenue shortfall is to be recovered from non-recycled water customers, either that the project is required by 'specified obligations' or that there has been consultation with the affected customers about their willingness to pay for the benefits of increased recycling.

16. New Customer contributions

Table 18 **New customer contributions charges**
\$2012-13 per EQT

Water	\$550
Sewerage	\$350

Subject to East Gippsland Water amending its NCC proposal consistent with the specific actions required by the Commission described below, the Commission proposes to approve the manner in which East Gippsland Water's NCC charges are determined.

The Commission requires East Gippsland Water to:

- (a) Assess how they can improve the cost reflectivity of its NCC proposal and to present options on offering more location specific NCC. If the option is a uniform or combined NCC then the water business must demonstrate that there is little material difference between NCC calculated for specific locations or services.
- (b) Confirm that all NCC charges have been calculated in accordance the core pricing principles.
- (c) Improve the transparency of its NCC proposal by providing maps to show the boundaries around the areas (or towns) within which standard NCC apply. Or define any threshold that must be met in order for an NCC to be levied.
- (d) Clearly describe the circumstances (i.e. eligibility criteria) under which NCC will negotiated and confirm that it will apply the core pricing principles when such NCC are negotiated.
- (e) Consult with other water businesses to develop a best practice negotiating framework.
- (f) Consult with other regional water businesses to propose a common water industry timeframe to estimate capital costs.
- (g) Consult with stakeholders following the draft decision
- (h) Make other modelling adjustments:
 - i. Update calculations of standard NCC with any expenditure adjustments arising from the draft decision
 - ii. Update calculations of standard NCC with any demand adjustments arising from the draft decision
 - iii. Review NCC calculations and only include tax rates in the model only for the years the business expects to pay tax
 - iv. Update calculations of standard NCC the Commission's draft decision on the Weighted Average Cost of Capital (WACC).
 - v. Resubmit a forecast of NCC revenue for each service for each year of the third regulatory period, following changes made in accordance with the above.
 - vi. Gifted assets values in the calculation model are constant across all years. Confirm that this correct.
 - vii. Capital expenditure in the calculation model for pipes is constant across the out years. Confirm that this is correct.

17. Miscellaneous charges

- (a) The Commission proposes to approve the miscellaneous services fees and charges proposed by East Gippsland Water.
- (b) In response to this draft decision, East Gippsland Water is required to submit:
 - i. definitions and proposed charges for connection fees, information fees and meter reading fees, if these are not already included in its core set of miscellaneous services.
 - ii. if proposing any miscellaneous charges for developers:
 - o the name all charges relating to developers
 - o explain how these charges relate to NCCs
 - o define the services that will be provided for these charges.

18. Reopening Prices

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

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

Key features of the mechanism are:

- (d) A water business (by application to the Commission) or the Commission may initiate a reopening.
- (e) Prices can either be raised or reduced as a result of an uncertain or unforeseen event.
- (f) An adjustment to prices may be implemented by the Commission at any time within a regulatory period (and not only on 1 July in any year), or at the end of the regulatory period.
- (g) There will be no nominal thresholds for applications (based on differences between forecast and actual outcomes for expenditure, revenue and demand). However in applying to reopen a decision, the water business will need to demonstrate it does not have the financial resources or operational capacity to manage its exposure.

- (h) The Commission proposes to reserve the discretion to limit the reopening of a determination to a single event, rather than the full suite of factors influencing business costs and revenues where:
 - i. the impact of an uncertain and unforeseen event on business costs or revenues is material, and
 - ii. the effects of which can be isolated with certainty

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

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

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

Pass through events

East Gippsland Water did not propose any automatic pass through events for the third regulatory period.