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## 2008 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:  
WESTERNPORT WATER

MARCH 2008

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

## 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, Westernport Water 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 3
  - (ii) the revised demand forecasts set out in Tables 12-16 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 1-2.

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 Westernport Water'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>3yr Avg 2003-06</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
<b>Water</b>						
Unplanned water supply interruptions (per 100km)	31.6	45.0	44.9	44.9	44.9	44.9
Average time taken to attend bursts and leaks (priority 1) (minutes)	6.0	30.0	30.0	30.0	30.0	30.0
Average time taken to attend bursts and leaks (priority 2) (minutes)	252.3	120.0	120.0	120.0	120.0	120.0
Average time taken to attend bursts and leaks (priority 3) (minutes)	1434.0	1440.0	1440.0	1440.0	1440.0	1440.0
Unplanned water supply interruptions restored within 5 hours (per cent) - proposed	1.0	1.0	1.0	1.0	1.0	1.0
Planned water supply interruptions restored within 5 hours (per cent)	1.6	1.0	1.0	1.0	1.0	1.0
Average unplanned customer minutes off water supply (minutes)	41.1	45.0 <b>b</b>	45.0 <b>b</b>	44.0 <b>b</b>	42.0 <b>b</b>	43.0 <b>b</b>
Average planned customer minutes off water supply (minutes)	70.0	37.0 <b>b</b>	37.0 <b>b</b>	37.0 <b>b</b>	37.0 <b>b</b>	37.0 <b>b</b>
Average frequency of unplanned water supply interruptions (number)	0.4	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>
Average frequency of planned water supply interruptions (number)	0.3	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>	0.3 <b>b</b>
Average duration of unplanned water supply interruptions (minutes)	110.2	180.0 <b>b</b>	180.0 <b>b</b>	180.0 <b>b</b>	180.0 <b>b</b>	180.0 <b>b</b>

<i>Service standard</i>	<i>Draft decision — service standards</i>					
	<i>3yr Avg 2003-06</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Average duration of planned water supply interruptions (minutes)	253.0	112.0 <b>b</b>	112.0 <b>b</b>	112.0 <b>b</b>	112.0 <b>b</b>	112.0 <b>b</b>
Number of customers experiencing 5 unplanned water supply interruptions in the year (number)	5706.0	4500.0	4500.0	4500.0	4500.0	4500.0
Unaccounted for water (per cent)	12.9	13.0	13.0	13.0	13.0	13.0
<b>Sewerage</b>						
Sewerage blockages (per 100km)	13.6	15.0	15.0	15.0	15.0	15.0
Average time to attend sewer spills and blockages (minutes)	147.0	60.0	60.0	60.0	60.0	60.0
Average time to rectify a sewer blockage (minutes)	384.0	210.0	210.0	210.0	210.0	210.0
Spills contained within 5 hours (per cent)	100.0	100.0	100.0	100.0	100.0	100.0
Customers receiving 3 sewer blockages in the year (number)	n.p.	0.0	0.0	0.0	0.0	0.0
<b>Customer Service</b>						
Complaints to EWOV (per 1000 customers)	4.0 <sup>a</sup>	1.1 <b>b</b>	1.1 <b>b</b>	1.1 <b>b</b>	1.1 <b>b</b>	1.1 <b>b</b>
Telephone calls answered within 30 seconds (per cent)	93	90	90	90	90	90
<b>Minimum Flow Rates</b>						
	<i>20mm</i>	<i>25mm</i>	<i>32mm</i>	<i>40mm</i>	<i>50mm</i>	
Flow rate (litres per minute)	15	30	60	90	na	

**Note** Data rounded to one decimal place. **n.p.** = Not provided. <sup>a</sup> This is a two year average of the actual number of complaints received by EWOV (i.e. not normalised per 1000 customers) <sup>b</sup> amended by the business in the lead up to the Draft Decision

Where the proposed service standard target deviated from Westernport Water's actual three year average performance or did not appear to make sense, the Commission sought further information from the business. The table above indicates which of the standards were amended by the business in the lead up to the Draft Decision.

The Commission also notes that Westernport Water has proposed the additional service standards outlined in table 2.

**Table 2 Additional service standards**

<i>Service standard</i>	<i>3yr Avg 2003-06</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Recycled water target (per cent)	n.p.	20.0	20.0	20.0	20.0	23.0 <sup>a</sup>
Biosolids reuse (per cent)	n.p.	0.0	0.0	10.0 <sup>a</sup>	10.0 <sup>a</sup>	20.0 <sup>a</sup>
Environmental discharge indicator	n.p.	100.0	100.0	100.0	100.0	100.0
Drinking water quality indicators	n.p.	100.0	100.0	100.0	100.0	100.0

**Note** Data rounded to one decimal place. **n.p.** = Not provided. <sup>a</sup> amended by the business in the lead up to 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 3 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	9.28	9.13	9.25	9.17	9.12
Return on existing assets	3.62	3.54	3.46	3.39	3.32
Return on new investments	0.07	0.23	0.39	0.73	1.24
Regulatory depreciation	1.34	1.59	1.77	1.90	2.03
Tax liability	0.00	0.00	0.00	0.00	0.00
<b>Total</b>	<b>14.31</b>	<b>14.50</b>	<b>14.87</b>	<b>15.20</b>	<b>15.71</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 5.

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

	<i>2005-06</i>	<i>2006-07</i>	<i>2007-08</i>
Opening RAB	51.95	52.47	55.87
<i>Plus</i> Gross Capital expenditure	2.84	5.52	6.56
<i>Less</i> Government contributions	0.00	0.00	0.00
<i>Less</i> Customer contributions	0.45	0.44	0.48
<i>Less</i> Proceeds from disposals	0.36	0.06	0.12
<i>Less</i> Regulatory depreciation	1.51	1.63	1.84
<b>Closing RAB</b>	<b>52.47</b>	<b>55.87</b>	<b>60.00</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 5 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	60.0	61.0	62.8	63.5	71.7
<i>Plus</i> Gross Capital expenditure	2.9	4.0	3.0	10.7	8.9
<i>Less</i> Government contributions	0.0	0.0	0.0	0.0	0.0
<i>Less</i> Customer contributions	0.5	0.5	0.5	0.5	0.5
<i>Less</i> Proceeds from disposals	0.1	0.1	0.1	0.1	0.1
<i>Less</i> Regulatory depreciation	1.3	1.6	1.8	1.9	2.0
<b>Closing RAB</b>	<b>61.0</b>	<b>62.8</b>	<b>63.5</b>	<b>71.7</b>	<b>78.0</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 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</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 7 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	9.07	8.94	9.05	8.97	8.91
Revisions and adjustments	0.21	0.20	0.20	0.20	0.21
Draft decision — operating expenditure	9.28	9.13	9.25	9.17	9.12

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

**Table 8 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>
Increased electricity charges	0.02	0.04	0.05	0.05	0.05
Update water supply demand strategy	0.03	0.00	0.00	0.00	0.00
Environmental contribution adjustment	0.16	0.16	0.16	0.15	0.15
DHS licence fee adjustment	0.001	0.001	0.001	0.001	0.001
<b>Total</b>	0.21	0.20	0.20	0.20	0.21

- (a) No business revisions were proposed after the submission of the Water Plan
- (b) Electricity expenditure adjustments reflect changes to consumption and pricing recommended by SKM (SKM section 6.3.1). SKM's forecasts of electricity prices are discussed in section 3 of the expenditure review.



- (c) A decision not to proceed with an interconnecting pipeline with Melbourne has resulted in Westernport Water's Water Supply Demand Strategy being out of date. SKM has recommended the inclusion of expenditure in 2008-09 for the development of a new strategy (SKM section 6.4)
- (d) Advice was received from the Department of Human Service on their licence fees and the Department of Sustainability and Environment on the environmental contribution for the regulatory period. Adjustments were made so operating expenditure reflected the Department's advice (Draft Decision section 4.9)

## 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**  
\$ 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	2.80	3.95	16.32	4.19	2.38
Draft decision — capital expenditure	2.85	4.00	3.02	10.69	8.88

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

**Table 10 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>
Raising of Candowie Reservoir	0.05	0.05	-13.1	6.5	6.5
Desalinisation Option: Design	0		-0.2		
Total ESC Adjustment	0.05	0.05	-13.3	6.5	6.5

- (a) Raising of Candowie Reservoir - SKM recommended deferring the construction related expenditure for the raising of the Candowie Reservoir (\$13.5M) to the end of the second regulatory period, and spreading it over the last two years of regulatory period (SKM, section 5.2).
- (b) Desalinisation Option Study — SKM considered an appropriate and reasonable quantum of expenditure for the initial feasibility study work should be \$300K in aggregate given the uncertainty as to whether a connection will be found to be desirable (SKM, section 5.2).

Westernport 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>
Raising of Candowie Reservoir	2012-13
Water quality improvement (Ozone/GAC)	2011-12
Land purchases (Candowie catchment)	2012-13
Bass River Augmentation	2009-10
Under channel pipeline	2008-09
Cowes Basin Reactivation	2011-12
Cowes WWTP Stage 3 upgrade	2011-12
Bass River Pipeline extension to Ian Bartlett WTP	2009-10

## 10. Demand forecasts

- (a) The Commission has made the following assumptions about demand for various services over the regulatory period.
- (b) The Commission has adjusted proposed demand forecasts where shaded or otherwise indicated.

**Table 12 Number of water connections**

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-2013</i>
<b>Residential</b>					
Proposed connections	13,231	13,496	13,766	14,041	14,322
Draft decision — connections	13,383	13,651	13,924	14,202	14,486
<b>Non-residential</b>					
Proposed connections	765	771	777	783	789
Draft decision — connections	1,036	1,045	1,054	1,063	1,072
<b>Total</b>	<b>13,996</b>	<b>14,277</b>	<b>14,543</b>	<b>14,824</b>	<b>15,111</b>
Draft decision — total connections	14,419	14,696	14,978	15,265	15,558

The number of sewerage connections has been adjusted to reflect revisions by Westernport Water and PWC's advice (see the PWC report).

**Table 13 Number of sewerage connections**

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-2013</i>
<b>Residential</b>					
Proposed connections	12,156	12,399	12,647	12,900	13,158
Draft decision — connections	12,322	12,568	12,819	13,075	13,337
<b>Non-residential</b>					
Proposed connections	2,363	2,384	2,406	2,428	2,450
Draft decision — connections	2,803	2,823	2,849	2,875	2,901
Proposed — total connections	14,519	14,783	15,053	15,328	15,608
Draft decision — total connections	15,125	15,391	15,668	15,950	16,238

The number of sewerage connections has been adjusted to reflect revisions by Westernport Water and PWC's advice (see the PWC report).

**Table 14 Residential water consumption**  
ML

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-2013</i>
Proposed average consumption (kL)	102	101	100	99	98
Draft decision — average consumption (kL)	86	92	98	104	112
Proposed total residential consumption	1,345	1,358	1,372	1,386	1,400
Draft decision — total residential consumption	1,151	1,252	1,363	1,484	1,616

Residential water consumption has been adjusted to reflect revisions by Westernport Water and PWC's advice (see the PWC report).

**Table 15 Non-residential water consumption**  
ML

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-2013</i>
Proposed non-residential consumption	455	460	464	469	474
Draft decision — non residential consumption	544	549	555	561	566

Non-residential water consumption has been adjusted to reflect revisions by Westernport Water and PWC's advice (see the PWC report).

**Table 16 Total water consumption**  
ML

	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-2013</i>
Proposed total consumption	1,800	1,818	1,836	1,855	1,873
Draft decision — total consumption	1,695	1,802	1,919	2,044	2,181

Adjustments to total water consumption reflect revisions by Westernport Water and PWC's advice (see the PWC report).

## 11. Form of price control

- (a) The Commission proposes to approve individual price caps for Westernport Water.
- (b) Westernport Water should submit a schedule of prices to apply from 1 July 2008, as well as a process in which tariffs can be adjusted on an annual basis.
- (c) Westernport Water may apply for an adjustment to its prices or tariff strategy at the time of the annual price review. It would have to demonstrate in its application to the Commission that it has clearly articulated a new tariff strategy (or explained how the proposed price changes are consistent with its existing tariff strategy), undertaken appropriate customer consultation and addressed customer impacts. The average annual price increase across the range of tariffs could not be greater than the average increase calculated under a tariff basket approach. The Commission may then approve amended individual price caps for the remainder of the regulatory period.

## 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 17.

**Table 17 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	0.02	0.02	0.02	0.02	0.02
Environment Protection Authority	0.03	0.03	0.03	0.03	0.03
Department of Human Services	0.01	0.01	0.01	0.01	0.01

<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. Retail water tariffs**

The Commission proposes to approve Westernport Water's proposed tariff structure on the basis that it is consistent with the WIRO.

### **14. Retail sewerage tariffs**

The Commission proposes to approve Westernport Water's proposed tariff structure on the basis that it is consistent with the WIRO.

### **15. Recycled water**

- (a) The Commission is proposing to approve/Westernport Water's proposed pricing principles on the basis that they are consistent with the principles below.
- (b) The Commission considers that Westernport 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) 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. Customer contributions

- (a) The Commission proposes to approve Westernport Water's proposed new customer contributions.
- (b) Approval is subject to an adjustment clarifying that recycled water services, due to their unique nature, will not be subject to a scheduled charge but rather will be regulated by the Commission's proposed pricing principles for recycled water.

Table 19      **New customer contributions charges**  
\$ per lot

	<i>Category 1<sup>a</sup></i>	<i>Category 2<sup>b</sup></i>	<i>Category 3<sup>c</sup></i>
Water	550.00	1,100.00	2,200.00
Sewerage	550.00	1,100.00	2,200.00

<sup>a</sup> For developments which are designed in a manner that will have minimal impacts on future water resource demands (lot sizes typically no greater than 450 square meters). <sup>b</sup> For water sensitive urban developments which will require further investment in infrastructure within a six year period to service these developments (lot sizes typically between 450 and 1,350 square metres). <sup>c</sup> For developments that will create demand for water resources over and above high-density, water efficient homes (lot sizes typically exceeding 1,350 square metres).

## **17. Miscellaneous charges**

- (a) Westernport Water did not identify a core set of miscellaneous services in its Water Plan, instead proposing a slightly revised version of its existing schedule.
- (b) In response to this Draft Decision, Westernport Water is required to submit:
  - (i) a core set of miscellaneous services, which would be expected to generate at least 75 per cent of miscellaneous revenue
  - (ii) proposed prices for core miscellaneous services for 2008-09
  - (iii) a brief definition of each core miscellaneous service, describing the nature of the service provided and the circumstances when the charge will apply.
- (c) The Commission proposes to approve Westernport Water's proposals for adjusting miscellaneous charges over the regulatory period.