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2008 WATER PRICE REVIEW

REGIONAL AND RURAL BUSINESSES' WATER PLANS 2008-2013

MELBOURNE WATER'S DRAINAGE AND WATERWAYS WATER PLAN 2008-2013

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EXECUTIVE SUMMARY

The Commission's task

In October 2007, 16 water businesses servicing rural and urban customers, submitted Water Plans to the Commission for assessment.[1] Melbourne Water also submitted a Water Plan for its waterways and drainage services.[2] These Water Plans set out the revenue and hence prices that each business sought to deliver water, sewerage and other related services for the five year regulatory period from 1 July 2008.

The three metropolitan retailers and Melbourne Water (in the case of bulk water and sewerage services) were not required to submit Final Water Plans to the Commission as a part of this process. Interim price increases, determined by the Minister for Water for 2008-09, have been adopted for these businesses.[3] The decisions made by the Commission with regard to new customer contributions, recycled water and miscellaneous charges as part of this price review process will apply to the metropolitan retailers and Melbourne Water.

The Commission is required to assess proposed prices and revenue against the principles set out in the Water Industry Regulatory Order (WIRO). Ultimately, the Commission must decide whether to approve the proposed prices or alternatively to specify the prices to apply if it is not satisfied that they were calculated or determined consistent with the regulatory requirements.

In assessing the businesses' Water Plans, the Commission has consulted widely, had regard to the information contained in the businesses' Water Plans, other information provided by the water businesses, the views and recommendations of consultants who assessed the businesses' forecasts, issues raised in submissions and comments at public meetings held around the State.[4]

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1 The businesses subject to this review include Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water, North East Water, South Gippsland Water, Wannon Water, Westernport Water, Western Water, FMIT, Goulburn-Murray Water and Southern Rural Water.

2 Melbourne Water submitted a final Water Plan for its waterways and drainage services in November 2007.

3 The Commission has released Determinations for these businesses setting out approved prices for 2008-09 that are consistent with the interim price increases set out in the Water Industry Regulatory Order and the businesses' Statements of Obligations.

4 The Commission received almost 80 submissions in response to the Draft Decision and conducted 16 public meetings. The details of these submissions and meetings are set out in Appendix A).

In March 2008, the Commission released a Draft Decision for the regional and urban businesses subject to this review setting out its view of the amount of revenue that is required by each business to deliver its proposed services and program of works. For most businesses the Commission's Draft Decision increases the amount of revenue that each business may recover compared to what they originally sought. The Commission also released a Draft Decision on Melbourne Water's drainage and waterways charges in May 2008.

The Draft Decisions set out the Commission's detailed analysis, proposed adjustments and requests for further information from the businesses. Each of the businesses was given the opportunity to submit a revised pricing proposal in response to the Draft Decision. Many of the proposed adjustments made by the Commission have been accepted by the businesses. However, there were a number of proposed adjustments that were not accepted by the businesses and in a number of cases businesses proposed further revisions.

The Commission has considered the businesses' revised pricing proposals and the further issues raised by the businesses and other stakeholders. As a result, it has decided to not approve the businesses' proposed prices or the manner in which they are to be determined because they need to be adjusted to reflect the Commission's Final Decision on:

- the amount of revenue that is required by each business to deliver its proposed services and meet obligations over the regulatory period
- the level at which prices should be set and adjusted each year in order to recover the revenue required over the regulatory period
- the basis on which prices should be structured to be consistent with the principles set out in the Water Industry Regulatory Order (WIRO).

The prices or the manner in which prices are to be determined over the regulatory period are set out in a Determination specific to each business. The Determinations take effect from 1 July 2008 and will apply until the later of 30 June 2013 or when the Commission makes a new Determination. The detailed reasons and analysis supporting the Commission's Determination for each business are set out in this Final Decision.

Overview of final decision outcomes

The businesses proposed average real price increases ranging from 0.3 per cent to 17.2 per cent per annum (excluding inflation) over the five year regulatory period, reflecting total forecast revenue across all businesses of around $4.2 billion.

The average annual price increases implied by the Commission's Draft Decision (excluding inflation) ranged from 1.1 per cent for Lower Murray Water (rural services) to 17.4 per cent for Gippsland Water (see table 1).

The Draft Decision on Melbourne Water's drainage and waterways services allowed for a total revenue requirement of $897.7 million compared to the $846.9 million sought by Melbourne Water in its Water Plan.

Table 1 **Total revenue and average annual real price increase**

	Businesses' proposals		*Draft decision*		*Final decision*	
	Revenue requirement	*Average annual change*	*Revenue requirement*	*Average annual change*	*Revenue requirement*	*Average annual change*[a]
	$ million	per cent	$ million	per cent	$ million	per cent
Urban businesses						
Barwon	686.50	10.6	702.51	11.5	664.93	9.5[b]
Central Highlands	356.61	11.3[c]	355.59	10.9[c]	316.55	10.1
Coliban	380.43	13.1	376.93	12.8	377.21	12.8
East Gippsland	109.23	5.4	114.97	7.3	113.37	6.8
Gippsland	433.74	17.2[d]	437.96	17.4[d]	417.04	14.9
Goulburn Valley	242.49	5.9	256.60	8.3	252.87	7.7
GWMWater	224.27	5.9	233.08	7.3	228.36	6.6
Lower Murray (urban)	124.48	4.1	127.33	4.8	126.16	4.3
North East	210.31	8.4	213.46	8.5	211.82	9.4
South Gippsland	96.66	4.3	100.53	5.9	98.91	4.9
Wannon	236.86	6.1	233.89	5.9	232.29	6.6
Western	286.45	10.9	279.12	10.0	274.71	8.8
Westernport	71.22	4.7	74.59	5.6	73.26	4.9
Total urban	**3 459.26**		**3 506.56**		**3 387.48**	
Rural businesses						
FMIT	31.95	6.5	32.99	7.7	31.38	10.7
Goulburn-Murray	519.05	2.2	523.78	2.5	518.68	1.1
Lower Murray (rural)	72.30	0.3	73.98	1.1	74.03	0.9
Southern Rural	138.20	**e**	134.13	**e**	133.12	6.8
Total rural	**761.50**		**764.88**		**757.21**	
All businesses	**4 220.76**		**4 271.45**		**4 144.68**	

Note Average annual price change compared to 2007-08 prices. It represents the amount that current prices need to increase to match the present value of the revenue requirement and implies a smoothed increase in prices over the period. **a** Some businesses have applied non-smoothed price increases across services and tariff components. **b** Does not reflect the impact of the Melbourne Interconnector. The costs associated with the Interconnector will be rolled into the asset base towards the end of the period and will add around 1 per cent to average prices. **c** Proposed a non smoothed increase of 25 per cent in the first year of period followed by 5.5 per cent for each remaining year. **d** Proposed a non smoothed increase of 23 per cent for each of the first and second years of the period followed by 10 per cent for each remaining year. **e** Southern Rural Water did not provide the Commission with sufficient information to enable it to calculate the required average annual price change.

For most businesses, the average annual price increases implied by the Draft Decision were higher than the businesses' own proposals. This largely reflected a change in the assumptions regarding the weighted average cost of capital (WACC) and therefore the cost of financing the businesses' proposed capital program.

Overall, the average price increases (before adjusting for inflation) implied by the Final Decision for each business range from 0.9 per cent for Lower Murray Water's rural services to 14.9 for Gippsland Water (see table 1). For most businesses the average price implied by the Final Decision is lower than that implied by the Draft Decision. For a number of businesses the Final Decision is lower or fairly close to what was originally proposed. However, only four businesses have annual price increases of over 10 per cent.

As part of this Final Decision, the Commission has adjusted the businesses' revenue benchmarks from those set out in the Draft Decision to reflect:

- an updated estimate of the weighted average cost of capital (WACC) which has decreased from 6.1 per cent to 5.8 per cent consistent with the Commission's views on the assumptions underlying the calculation of the WACC
- its assessment of the arguments and information put forward to justify or revise the original operating and capital expenditure forecasts and (in some cases) further expenditure items that were not included in the original forecasts
- its assessment of the likely demand for each businesses' services, which influences expenditure requirements and the translation of revenue into prices.

It is important to note that the average price increases outlined above represent an average annual price outcome across the range of services provided by each business. It reflects the amount that current prices need to increase to match the present value of the revenue requirement and implies a smoothed increase in prices over the period. The extent to which prices for particular services will increase over each year of the regulatory period depends on the extent to which the rate of increase has been applied equally across services and individual tariff components.

Table 2 sets out indicative household bills based on average consumption. By the end of the regulatory period a number of businesses will have average household bills over $1000 (in real terms). The actual impact on individual customer bills will depend on a number of factors including the extent to which businesses have adopted a non smoothed increase in prices, adjust prices for each service or tariff component, any changes to tariff structures and each customer's actual consumption pattern.

Table 2 **Average real household bills**
Urban businesses

	Average consumption	*2007-08 bill*	*2012-13 bill*	*Change (per cent)*
Barwon	216	691	991	43.3
Central Highlands	185	756	1046	38.5
Coliban	210	586	931	59.0
East Gippsland	196	680	1013	48.9
Gippsland	219	672	1152	71.4
Goulburn Valley	315	537	766	42.6
GWMWater	237	772	1027	33.1
Lower Murray (urban)	552	635	775	22.1
North East	304	640	947	48.0
South Gippsland	152	769	895	16.4
Wannon	195	705	1058	50.1
Western	232	711	966	35.7
Westernport	113	764	927	21.4

Note Average household based on largest regional centre for each business. Actual impact on individual households will depend on extent to which businesses have adjust prices for each service or tariff component, any changes to tariff structures and each customer's actual consumption pattern.

In response to the Draft Decision a number of stakeholders have raised concerns about the affordability of the proposed price increases, particularly for those customers who may already be facing financial difficulty. The Commission acknowledges that the magnitude of the proposed average price increases approved by the Final Decision may be of concern to some customers. It notes that for most the average price increase set out in the Final Decision are less than those in the Draft Decision and compared to what the was originally proposed by the businesses.

Having undertaken an extensive review of the businesses' proposed expenditure forecasts, it is the Commission's view that these prices reflect the efficient costs of delivering, what for most businesses is, an ambitious program of works over the next five years. A significant proportion of the capital expenditure program forecast to be completed over the regulatory period relates to improving the security of supply, improving reliability and servicing new towns.

The Commission is generally satisfied that the businesses have appropriate hardship policies and mechanisms in place to help deal with those customers facing significant price increases. The Commission will audit the businesses' hardship policies and their application of collection and restriction processes as part of its next annual audit process.

It is also worth noting that as part of the 2008-09 budget, the government announced that it would increase the concessions cap by 14.8 per cent to $182 from 1 July 2008.[5]

Overall, the Commission's Final Decision seeks to balance customers' long term interests by ensuring that businesses have sufficient revenue to deliver the required services on a value for money basis, thereby limiting the extent to which prices may need to rise significantly in the future to address any conservatism in this regulatory period.

Key issues for the final decision

This Final Decision sets out the Commission's analysis and reasoning for not approving the prices proposed by the businesses' in their Water Plans. It provides an overview of the key issues associated with this review and focuses on those areas where the Commission (in its Draft Decision) suggested amendments.

The Decision also outlines the extent to which the businesses have given effect to the suggested amendments, any further issues or arguments raised by the businesses and other stakeholders, and the Commission's final analysis, reasons and conclusions regarding proposed revision. To fully understand the detailed analysis and reasons underpinning the Commission's Final Decision, it is important to consider the content of the Draft Decision.

Adjustments to the revenue requirement

In some cases to deal with particular circumstances, it may be necessary to adjust a business's revenue requirement to deal with concerns about financial viability or to protect the interests of customers. For this Final Decision the Commission has made adjustments to the revenue requirements for Coliban Water and Gippsland Water.

Coliban Water

The Commission's Draft Decision provided for an adjustment to Coliban Water's revenue requirement due to concerns over financial viability. The proposed adjustment reflected Coliban Water's unique circumstances in that it was required to finance its expenditure on the Superpipe for the first regulatory period itself, as this expenditure was not foreshadowed and hence not reflected in the prices approved by the Commission.

In response to the Draft Decision Coliban Water has indicated that its 2007-08 capital expenditure needed to be adjusted, resulting in an increased opening regulatory asset base (RAB). Consequently, under the building blocks approach Coliban Water will receive more revenue than that proposed in the Draft Decision. Therefore, the Commission has reduced the adjustment to Coliban Water's revenue requirement compared to the Draft Decision. The revenue requirement

[5] The water and sewerage concession provides a 50 per cent discount on water consumption, sewerage disposal and service charges up to a maximum cap.

adjustment continues to provide an average interest cover of 1.5 given the higher opening RAB.

Gippsland Water

In response to concerns raised by stakeholders about the affordability of Gippsland Water's proposed average annual price increase and the impact of the increase in expected costs associated with the Gippsland Water Factory, the Commission has made an adjustment to Gippsland Water's revenue requirement.

The Commission's analysis suggests that it is possible for Gippsland Water to absorb some of the additional costs incurred in constructing the Gippsland Water Factory. Based on its analysis the Commission has identified that the roll forward of the regulatory asset base could be reduced by $30 million (approx half of the increased costs) while continuing to maintain or exceed the relevant financial benchmarks as well as allowing Gippsland Water to meet all its service obligations.

On balance, the adjustment reflects the Commission's consideration of the WIRO requirement to ensure business viability and protect customer interests in response to the unique circumstance faced by Gippsland Water.

Expenditure forecasts

In response to the Draft Decision a number of businesses accepted the adjustments made by the Commission to the operating and capital expenditure forecasts for the regulatory period. A number also sought further revisions to the forecasts to correct for errors, provided further argument or information in support of the original forecasts and proposed further adjustments to the original forecasts.

In assessing the businesses' responses to the Draft Decision the Commission has further adjusted the relevant benchmarks for each business only where:

- errors have been identified in the assumptions or forecasts adopted by the Commission in its Draft Decision
- businesses have provided further information or arguments to support their original forecasts
- additional obligations have been imposed by other regulators that were not known or could not have reasonably been known at the time the Water Plans were submitted
- material adjustments have been proposed, such that the change in expenditure is so great as to create significant risk that prices may not recover sufficient revenue or may significantly over recover revenue.

Operating expenditure

The Commission's Draft Decision provided for total operating expenditure across all the regional businesses of $2 777 billion over the regulatory period. This represented a reduction of 2.2 per cent from the expenditure proposed by the urban businesses and 0.4 per cent for the rural businesses.

The Draft Decision on Melbourne Water's drainage and waterways services allowed for total operating expenditure of $453.7 million. For the Final Decision, the

Commission has made no further adjustments to Melbourne Water's operating expenditure forecasts.

The Final Decision provides for $2.764 billion in operating expenditure over the regulatory period, this is 0.5 per cent less than that reflected in the Draft Decision and 2.3 per cent less than originally proposed by the businesses (see table 3). The most significant change between the benchmarks adopted by the Commission in the Draft and Final decisions was a reduction in the Environmental Contribution.

Table 3 **Operating expenditure — business proposals, draft decision and final decision**
$ million in January 2007 prices

	Proposed	*Draft decision*	*Final decision*	*Difference between proposal and final decision*	*Difference between draft and final*
	$ million	$ million	$ million	per cent	per cent
Urban businesses					
Barwon	396.19	389.00	377.85	-4.6	-2.9
Central Highlands	228.09	230.83	228.49	0.2	-1.0
Coliban	262.32	259.66	259.75	-1.0	0.0
East Gippsland	62.72	63.14	63.08	0.6	-0.1
Gippsland	275.90	264.59	263.06	-4.7	-0.6
Goulburn Valley	160.31	162.60	162.02	1.1	-0.4
GWMWater	127.87	128.81	127.85	0.0	-0.7
Lower Murray (urban)	85.25	83.03	83.95	-1.5	1.1
North East	140.07	136.93	137.47	-1.9	0.4
South Gippsland	61.28	62.39	61.67	0.6	-1.2
Wannon	169.00	156.70	155.99	-7.7	-0.5
Western	207.25	188.02	189.50	-8.6	0.8
Westernport	44.94	45.96	45.61	1.5	-0.8
Total urban	**2 221.20**	**2 171.66**	**2 156.28**	**-2.9**	**-0.7**
Rural businesses					
FMIT	26.12	25.50	25.32	-3.0	-0.7
Goulburn-Murray	438.77	435.11	438.79	0.0	0.8
Lower Murray (rural)	57.92	59.77	58.11	0.3	-2.8
Southern Rural	85.66	85.55	85.72	0.1	0.2
Total rural	**608.47**	**605.93**	**607.95**	**-0.1**	**0.3**
All businesses	**2 829.67**	**2 777.60**	**2 764.22**	**-2.3**	**-0.5**

Capital expenditure

The Commission's Draft Decision provided for $2.52 billion in proposed capital expenditure over the period compared to $2.54 billion forecast by the businesses in their Water Plans. Most businesses accepted the adjustments proposed in the Draft Decision.

The Commission's Final Decision provides for $2.45 billion in proposed capital which is 2.5 per cent lower than the Draft Decision and 3.3 per cent less than originally proposed by the businesses (see table 4). The businesses' proposed capital expenditure programs are dominated by a small number of significant projects and a number of projects are aimed at improving security of supply, reliability and servicing new towns.

The Draft Decision on the Melbourne Water's drainage and waterways services allowed for total capital expenditure of $589.5 million. For the Final Decision, the Commission has made no further adjustments to Melbourne Water's capital expenditure forecasts.

A key issue for the forthcoming regulatory period remains whether the businesses have the resources to deliver their capital programs within the proposed timeframes. Major projects often require detailed planning and approvals before they can proceed and the completion of major projects in the period will impact on the delivery of some of the smaller proposed projects. There has already been major slippage of projects from the current year into 2008-09 for a number of businesses. Deliverability is also likely to be an issue across the State and nationally in terms of the overall capacity of the sector to access resources.

Table 4 **Capital expenditure — business proposals, draft decision and final decision**
$ million in January 2007 prices

	Proposed	*Draft decision*	*Final decision*	*Difference between proposal and final decision*	*Difference between draft and final*
	$ million	$ million	$ million	per cent	per cent
Urban businesses					
Barwon	563.1	562.99	437.38[a]	-22.3	-22.3
Central Highlands	140.32	158.77	169.86	21.0	7.0
Coliban	214.1	191.43	196.43	-8.3	2.6
East Gippsland	56.17	56.17	56.17	0.0	0.0
Gippsland	251.27	240.2	232.95	-7.3	-3.0
Goulburn Valley	112.9	113.71	113.11	0.2	-0.5
GWMWater	341.35	341.47	341.47	0.0	0.0
Lower Murray (urban)	57.4	64.86	68.68	19.7	5.9
North East	99.55	102.68	109.84	10.3	7.0
South Gippsland	47.9	53.99	53.99	12.7	0.0
Wannon	110.09	116.76	125.45	13.9	7.4
Western	128.59	129.49	129.49	0.7	0.0
Westernport	29.65	29.45	29.45	-0.7	0.0
Total urban	**2 152.39**	**2161.97**	**2064.26**	**-4.1**	**-4.5**
Rural businesses					
FMIT	2.53	5.54	5.54	118.9	0.0
Goulburn-Murray	204.49	196.03	222.38	8.8	13.4
Lower Murray (rural)	61.26	39.17	46.32	-24.4	18.3
Southern Rural	117.06	116.49	116.49	-0.5	0.0
Total rural	**385.34**	**357.23**	**390.73**	**1.4**	**9.4**
All businesses	**2 537.73**	**2 519.2**	**2 454.99**	**-3.3**	**-2.5**

[a] The cost of the Melbourne Interconnetor is not reflected in this number, these costs will be rolled into the asset base and reflected in price towards the end of the period.

Demand forecasts

In the Draft Decision, the Commission made adjustments to most of the businesses demand forecasts to reflect assumptions about the impact of:

- population growth and demographic changes (with growth rates revised upwards for a number of businesses)
- future rainfall levels, water inflows and climate change

- restriction levels applying to water consumption
- price and tariff structure changes on water consumption (including applying price elasticity where businesses had not done so) and
- water conservation measures adopted during the regulatory period.

Overall, for urban water businesses these changes were relatively minor in most cases, but were more significant for Central Highlands Water, Gippsland Water, North East Water and Westernport Water. The Commission accepted the demand forecasts proposed by the five rural water businesses, with the exception of Lower Murray Water.

In response to the Draft Decision, most businesses accepted the Commission's proposed adjustments, but a number put forward alternative forecasts. On the basis of the information provided by these businesses the Commission's Final Decision has adopted revised forecasts provided by FMIT, Wannon Water and Western Water. It has not accepted the adjustment proposed by Westernport Water. The Commission has made no further adjustments to the demand forecasts adopted in the Draft Decision for the remaining businesses.

The Final Decision and Determinations set out a mechanism to deal with demand uncertainty over the regulatory period. Where actual demand turns out to be materially different from the demand forecast used to set prices the businesses or the Commission will be able to seek to adjust prices during the period.

Tariff structures

The Commission has assessed the basis on which the businesses propose to structure their tariffs in order to recover the required revenue over the regulatory period. The structure of tariffs and the level at which charges are set to provide important signals to customers about the costs of providing services and also the incentives to use resources more efficiently.

In the Draft Decision the Commission generally proposed to approve the businesses proposed tariff structures. However, it sought further information from a number of businesses on the customer impacts of the proposed changes and on how those tariff structures changes were going to be implemented over the regulatory period.

The Commission's Final Decision has approved the tariff structures proposed by most businesses. However, it still has some concerns about the customer impacts and implementation of a number of tariff reforms for some businesses. It has not approved the proposed tariffs for these businesses and has specified alternative tariffs. The Commission has not approved:

- GWMWater's revised Wimmera Irrigation Area tariff at this time. Due to the long term nature of the current drought and high level of uncertainty about when and to what extent services will be restored in the Wimmera Irrigation Area and the level of expenditure that will be required, the Commission has approved the drought tariffs only. GWMWater can apply to the Commission to have the revised irrigation tariff structure introduced as part of the annual tariff approval process, should services be restored within the regulatory period.

- GWMWater's proposed pipeline tariff structure. After considering a range of factors, the Commission is not satisfied that the proposed pipeline tariff structure Is consistent with the WIRO. GWMWater will be required to resubmit a revised tariff structure to apply from the second year of the regulatory period. For 2008-09, the Commission has approved pricing principles for GWMWater's pipeline services.
- Goulburn-Murray Water's proposed entitlement storage fee and bulk water charges. Although the Commission considers that there may be merit in moving to a basin system of pricing, it has some concerns about the differing treatment of customers with and without land. Therefore it has maintained the entitlement storage fee at 2007-08 levels for 2008-09 and removed the without land charge, resulting in one charge for customers with land and customers without land. With regard to the bulk water charges the Commission has maintained prices at 2007-08 levels for 2008-09.
- North East Water‘s increase in the variable water charge. The Commission has smoothed the increase in the variable water charge to take place evenly over the course of the regulatory period. The Commission has also adjusted the fixed access charge for water to ensure that North East Water earns sufficient revenue to meet its revenue requirement. The variable usage charge for water will still be the same as proposed by North East Water at the end of the period, reflecting North East Water's stated intention to provide customers with more control over their bills and incentives for the sustainable use of water.
- Wannon Water's salt charge for trade waste customers discharging to the Warrnambool treatment plant because it is not consistent with the Commission's pricing principles. It has approved the salt charge for the Hamilton treatment plant for 2008-09, but has specified an annual real price increase consistent with the average price increase across all services for each remaining year of the regulatory period.

Adjusting prices during the regulatory period

The Commission has approved individual price caps for all of the urban businesses, Lower Murray Water’s urban services and GWMWater. Individual price caps are also approved for Southern Rural Water’s recycled water services and fee-based (diversions) applications. The Commission has approved revenue caps for FMIT, Goulburn-Murray Water, Lower Murray Water’s rural services and Southern Rural Water’s services excluding recycled water and fee-based (diversions) applications.

Businesses subject to individual price caps have the flexibility (through a hybrid form of price control) to seek to change their proposed tariff structures over the regulatory period. In doing so, they would need to demonstrate to the Commission that they had consulted effectively with their customers and have addressed any customer impacts. Given that the Commission has not approved GWMWater’s pipeline tariff structure, GWMWater will be required to submit a revised tariff strategy and tariff schedule to apply from 2009-10. At any time during the regulatory period GWMWater can seek to have its revised Wimmera Irrigation Tariff approved by the Commission through the hybrid form of price control.

The Commission has also introduced an adjustment mechanism to deal with uncertainties for Goulburn-Murray Water and Southern Rural Water. Until the scope and funding arrangements for the Foodbowl Modernisation Project, the Macalister Irrigation District projects and the Werribee Irrigation District Recycled Water Scheme have been clarified, the forecasts for operating and capital expenditure for these businesses are so uncertain that the revenue requirements for the regulatory period cannot be calculated with sufficient confidence.

Goulburn-Murray Water and Southern Rural Water are required during 2008-09 to submit to the Commission amended revenue requirements for the years 2009-10 to 2012-13, accompanied by a detailed explanation of their calculation and evidence that they have consulted customers (including water service committees).

For Southern Rural Water, the amended revenue requirements will relate to its services that are subject to a revenue cap. Southern Rural Water will also be required during 2008-09 to submit to the Commission a revised tariff schedule to apply from 2009-10 for its recycled water services and fee-based (diversions) applications (that are subject to individual price caps).

The Commission has modified the mechanism proposed in its Draft Decision to increase businesses' flexibility to apply for adjustments to deal with the impact of uncertain or unforeseen events as well as the Commission's flexibility to make appropriate adjustments.

The Final Decision also provides a mechanism for dealing with uncertainty associated with the businesses' demand and capital expenditure forecasts. The businesses or the Commission can seek to make a within period adjustment either to increase prices for higher than expected costs and/or weaker than expected demand or to reduce prices for lower than expected costs and/or stronger than expected demand.

In the case of capital expenditure businesses can seek an adjustment in respect of projects that are currently included in the capital expenditure assumptions, where costs differ significantly from those included for the purposes of this Decision, as well as projects that have been identified by businesses as uncertain and other projects that were not identified at the time of this Decision. The businesses and the Commission have already identified a number of capital projects that are likely to be subject to this mechanism. These include the Melbourne Interconnector (Barwon Water) and Merbein pipeline (Lower Murray Water).

Service standards and guaranteed service levels (GSLs)

Core service standards

In their Water Plans, most urban businesses proposed targets that were consistent with actual performance over the first regulatory period. For some businesses this represented a deviation from the targets approved by the Commission for the first regulatory period. Typically, these businesses had not previously been collecting the relevant performance data or with improved monitoring and reporting systems recognised that the targets set for the first regulatory period were based on inaccurate data.

In the Draft Decision, the Commission proposed approving most of the service standard targets proposed but sought further information from a small number of businesses. For the Final Decision, the Commission is satisfied with the information provided by theses businesses and has approved service standard targets for each year of the regulatory period for all businesses with the exception of Southern Rural Water. Southern Rural Water was unable to propose targets for a number of core set of service standards and is expected to set targets for these service standards in the second year of the regulatory period. The businesses are required to amend their respective customer charters to reflect the approved service standards.

Additional targets

In their Water Plans the businesses identified a number of initiatives or programs that they intend to deliver over the forthcoming regulatory period. Often these programs or initiatives reflect obligations imposed on the businesses by other regulators (for example, the Environment Protection Authority) or the Minister for Water (through the Statement of Obligations). These initiatives or programs are typically significant drivers of expenditure and the Commission considers it important that the businesses commit to associated outcomes or targets to be delivered over the period.

Most businesses proposed outcome based targets, which the Commission has accepted. In a number of cases the Commission has set targets for some businesses for CO_2 equivalent emissions (CO_2e), recycled water and biosolids reuse.

The Commission has also approved a set of additional service standard targets for Melbourne Water's drainage and waterways services.

GSLs

Guaranteed service level (GSL) schemes require businesses to provide a rebate to customers who receive a level of service that is much worse than the performance experienced by most customers. The underlying objective of GSLs is to provide an incentive to the business to address the incidence of inferior performance rather than to provide some form of compensation to the customer. However, the rebate provided to the customer implicitly acknowledges that the worst served customers should not be paying the same as customers receiving average or better service levels.

Barwon Water and Central Highlands Water already have GSLs in place and Wannon Water and Western Water are proposing to introduce GSL schemes for the second regulatory period. The Final Decision sets payment levels for Central Highlands Water and Western Water at $50 for all GSL events with the exception of sewer spills in a house. The Commission has also made some amendments to the GSL events for Barwon Water, Wannon Water and Western Water. The businesses are required to amend their respective Customer Charters to reflect the approved GSL events and payment levels for the forthcoming regulatory period.

In the Draft Decision, the Commission expressed a view that there was scope to allow for the implementation of a GSL scheme by all urban businesses over the next 12 to 24 months. The Commission maintains this view and will continue to consult with businesses on implementation issues.

Reporting of outcomes over the regulatory period

The Commission will monitor the progress of each water business in delivering the outcomes promised. The businesses will have an opportunity through the annual performance report to explain to customers where and why projects have been delayed or replaced by other projects. It is important to note that the expenditure assumptions made by the Commission to determine prices do not represent amounts the businesses are required to spend or direct to particular activities or projects. Over the regulatory period, it is reasonable to expect that businesses may need to reprioritise or alter their capital programs in response to changing circumstances. The annual performance report will provide an opportunity for businesses to explain any changes as well as implications for any outcomes committed to in their Water Plans.

In response to concerns raised at public forums on Melbourne Water's drainage and waterways services the Commission is proposing to develop and implement monitoring and reporting arrangements for Melbourne Water's works program in the extended areas. The Commission will consult with Melbourne Water and relevant customer and stakeholder groups in developing these reporting arrangements.

Likewise in response to concerns raised by the chairs of Goulburn-Murray Water's water service committees, the Commission is proposing to develop a process of rural businesses to provide information on expenditure and outcomes at a district levels. The Commission will consult with the rural businesses and water services water committees on developing these reporting arrangements.

1 INTRODUCTION

1.1 The 2008 water price review

The Commission has received final Water Plans from the 16 Victorian water businesses providing rural and regional urban services.[6] The Commission is also required to approve prices for Melbourne Water's waterways and drainage services. These plans set out the revenue and hence prices that each business believes it needs to deliver water, sewerage and other related services for the five year regulatory period from 1 July 2008.

This is the Commission's third independent review of water prices. The Commission previously completed a review of prices for the then 17 urban metropolitan and regional businesses (June 2005) and for the five businesses providing rural services (June 2006).

On 14 August 2007, the Government announced that a review into the structure of the retail water industry in Melbourne would be undertaken by the Victorian Competition and Efficiency Commission (VCEC). It also indicated that it would implement a 14.8 per cent real increase in water prices for Melbourne's three metropolitan retailers from 1 July 2008 for one year, with existing tariff structures to remain. The Government's announcement effectively deferred the Commission's price review process for the three metropolitan retailers and Melbourne Water's bulk water and sewerage services.

On 12 June 2008, the Minister for Water amended the Statements of Obligations and the Water Industry Regulatory Order (WIRO) to require the businesses to propose and the Commission approve a 14.8 per cent increase for the three metropolitan retailers and a 23.5 per cent increase for Melbourne Water's bulk water and sewerage services. The Commission's Final Decision in respect of new customer contributions, recycled water and miscellaneous charges applies to the metropolitan retailers and Melbourne Water where relevant.

Consistent with the amended Statements of Obligations the three metropolitan retailers and Melbourne Water have submitted Water Plans to the Commission for approval. The Commission has reviewed these Plans and is satisfied that they are

[6] The businesses subject to this review include Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water, North East Water, South Gippsland Water, Wannon Water, Westernport Water, Western Water, FMIT, Goulburn-Murray Water and Southern Rural Water. Melbourne Water submitted a final Water Plan for its waterways and drainage services in November 2007. The three metropolitan retailers were not required to submit final Water Plans to the Commission.

consistent with the requirements of the amended WIRO.[7] Separate Determinations for each of the metropolitan retailers and for Melbourne Water's bulk water and sewerage services set out the approved prices for 2008-09.[8]

1.2 Legislative framework and role of the Commission

In carrying out its role, the Commission is primarily guided by the regulatory framework set out in the *Essential Services Commission Act 2001* and the *Water Industry Act 1994*. The more detailed framework is set out in the WIRO made by the Governor in Council under the Water Industry Act 1994.[9]

The Essential Services Commission Act 2001 outlines objectives to which the Commission must have regard to in undertaking its functions across all industries. The Commission's primary objective is to protect the long-term interests of Victorian consumers with regard to the price, quality and reliability of essential services. In seeking to achieve this primary objective, the Commission must have regard to:

- facilitating the efficiency, incentives for long term investment and the financial viability of regulated industries
- preventing the misuse of monopoly or transitory market power
- facilitating effective competition and promoting competitive market conduct
- ensuring regulatory decision making has regard to the relevant health, safety, environmental and social legislation applying to the regulated industry
- ensuring users and consumers (including low income or vulnerable customers) benefit from the gains from competition and efficiency and
- promoting consistency in regulation across States and on a national basis.

The Water Industry Act 1994 contains the following additional objectives that the Commission must meet in regulating the water sector:

- wherever possible, ensure that 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 and
- ensure regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities.

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[7] For the purposes of s35(1) of the Essential Services Commission Act 2001, this is the statement of purpose and reasons for the Determination of 2008-09 prices for the metropolitan retailers and Melbourne Water's bulk water and sewerage services. The chapters of this Final Decision on recycled water, new customer contributions and miscellaneous charges form the statement of purpose and reasons for the Determination relating to these services.

[8] Melbourne Water's drainage and waterways charges are subject to a separate Determination.

[9] The WIRO is available on the Commission's website.

The WIRO requires the Commission to approve or specify the pricing arrangements to apply to each of the water businesses for the regulatory period. The Commission must approve the pricing arrangements if it is satisfied that the prices or the manner in which prices are to be calculated or otherwise determined have been developed in accordance with the procedural requirements and comply with the regulatory principles outlined in the WIRO.

Alternatively, the Commission may specify the prices that a business may charge or the manner in which those prices are to be calculated or otherwise determined if it is not satisfied that the arrangements proposed in the Water Plan were developed in accordance with the WIRO. The procedural requirements include the need for businesses to consult with customers and relevant regulatory agencies before submitting the Water Plan to the Commission for assessment.

In deciding whether to approve proposed prices, the Commission must be satisfied that they provide the business with sufficient revenue over the regulatory period to deliver its regulated services. The revenue must be sufficient to allow the business to recover:

- operational, maintenance and administrative costs
- expenditure on renewing and rehabilitating existing assets
- a rate of return on past investments as at 1 July 2004 (are valued at an amount or in a manner determined by the Minister for Water) or the costs associated with any debt incurred to finance recent expenditure (in a manner determined by the Minister) and
- a rate of return on investments made after 1 July 2004.

The Commission must also ensure that:

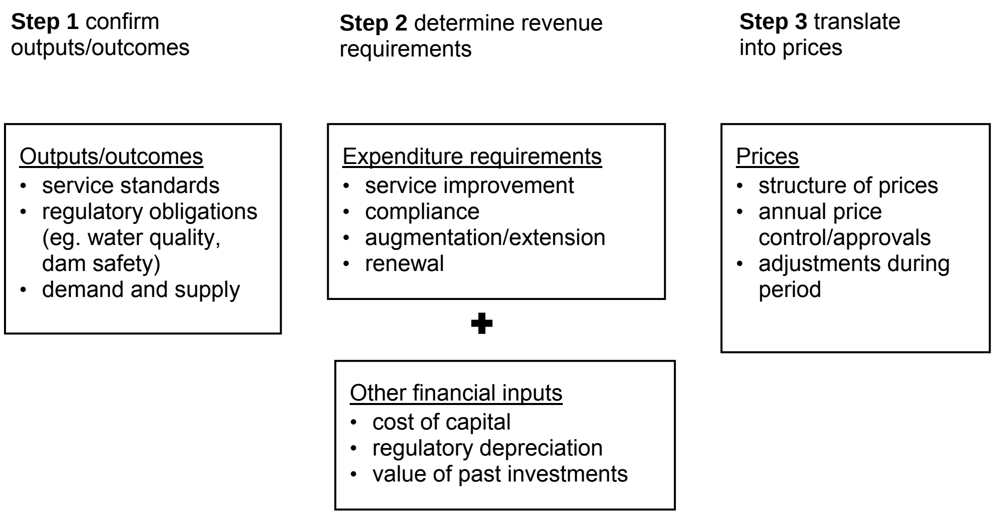
- the expenditure forecasts reflect the efficient delivery of the proposed outcomes outlined in the Water Plan and take into account a long term planning horizon
- the businesses have incentives to pursue efficiency improvements and
- customers or potential customers are readily able to understand the prices charged or the manner in which they are to be calculated or determined.

The Commission’s approach to assessing proposed prices is characterised by three steps (see figure 1.1). The first step involves establishing the service standards and other outcomes that a business proposes to deliver over the regulatory period. This includes expectations about the water delivery and supply factors that are likely to underpin the delivery of services. These standards and outcomes reflect obligations imposed by the Minister for Water through the Statement of Obligations, the Environment Protection Authority (EPA), the Department of Human Services (DHS) and the Department of Sustainability and the Environment (DSE) as well as and customer preferences for service improvements.

In the second step, the Commission assesses each of the key revenue components and proposals against the WIRO principles. The Commission makes assumptions about the level of demand and expenditure to assess whether prices will result in the business earning sufficient revenue to deliver services. The assumed expenditure levels do not represent amounts businesses are required to spend or direct to particular activities or projects. In consultation with customers, businesses are free to determine their own expenditure priorities in light of changing circumstances and to pursue innovation and efficiencies that enable them to outperform the cost assumptions.

The third step in the process involves determining the prices needed to meet the revenue requirement determined in the second step.

Figure 1.1 **Steps in assessing and approving prices**



1.3 The Commission's consultation process

The Commission began its consultation in late 2006 on the proposed regulatory framework and approach to approving prices to apply from 1 July 2008. Its consultation process included:

- Guidance on Water Plans (September 2006) — provided high level guidance on the structure and content of Water Plans for the second regulatory period.
- A framework and approach consultation paper (December 2006) — identified a number of key issues related to the application of the regulatory framework, process and approach that the Commission will take in assessing Water Plans for the second regulatory period.
- Meetings with businesses (January 2007) — discussed issues raised in the framework and approach paper.
- A guidance paper (March 2007) — provided further guidance to businesses on the issues raised in response to the framework and approach paper.

- Comments to businesses on the draft Water Plans (September 2007) — further guidance focussed on whether there was sufficient clarity, information and justification of businesses' proposals to enable formal assessment.
- An issues paper (December 2007) — provided an overview of the businesses' proposals and key issues on which the Commission proposed to consult during the review.
- Meetings with customer committee representatives for a number of businesses (January, February and March 2008) — to understand their involvement in developing the Water Plan and issues specific to their business.
- Continued liaison with water businesses throughout the price review process — sought further information and clarification of their proposals.
- Engagement of independent consultants — assessed aspects of the businesses' expenditure and demand forecasts.

The Commission released a Draft Decision on the regional urban and rural businesses' proposals on 28 March 2008. The Draft Decision on Melbourne Water's waterways and drainage services was released on 16 May 2008. These Draft Decisions set out the Commission's initial assessment of the businesses' proposals. In response, the businesses were required to adjust their pricing proposals to reflect the Commission's view of the amount of revenue required by each business to meet its obligations and deliver services.

The Commission has further considered the issues and information provided by businesses and other stakeholders. It conducted a series of public meetings to explain the Draft Decision to the businesses and their customers and sought comment from stakeholders (see Appendix A for details). The Commission received 75 submissions in response to the Draft Decision, including four in response to the Draft Decision on Melbourne Water's drainage and waterways charges.

Key issues were raised in submissions and at the public meetings, included:

- the affordability of the proposed average price increase set out in the Draft Decision, especially for low income earners, pensioners, large families and tenants
- concerns about the impact on particular customers of proposed changes in tariff structures
- concerns about specific projects, including the cost and structure of tariffs for the Wimmera Mallee pipeline and the cost and funding for the Gippsland Water Factory
- concerns about the delays in the completion of country town sewerage schemes.

The Commission has addressed the issues raised in submissions and at the public meetings in this Final Decision.

1.4 Structure of this final decision

This Final Decision sets out the Commission's analysis and reasoning for not approving the prices proposed by the businesses' in their Water Plans. While it provides an overview of the key issues associated with this review, it focuses on those areas where the Commission (in its Draft Decision) suggested amendments. This Final Decision also outlines the extent to which the businesses have given effect to the suggested amendments, any further issues or arguments raised by the businesses and other stakeholders, and the Commission's final analysis, reasons and conclusions regarding proposed revisions. To fully understand the detailed analysis and reasons underpinning the Commission's Final Decision, it is important to consider the content of the Draft Decision.

The Commission has issued each business with a Determination that specifies the prices which 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 levied from 1 July 2008 and the manner for adjusting those tariffs during the regulatory period. Annexure A to the Determination sets out the assumptions the Commission has made in specifying the prices to apply from 1 July 2008.

For the purposes of s35(1) of the Essential Services Commission Act 2001, this Final Decision forms the statement of purpose and reasons for the making of the Determination for each business.

Chapter 2 sets out the Commission's assessment of the key outcomes and service levels underpinning the businesses' proposed price levels over the forthcoming regulatory period.

Chapters 3 to 7 set out the Commission's views on the revenue required by each water business to deliver services and meet its obligations. The revenue requirement is used to set the prices that will apply over the regulatory period. The Commission's view on the businesses' expenditure forecasts are set out in chapter 4 (operating expenditure) and chapter 5 (capital expenditure). Issues related to financing capital investments are discussed in chapter 6 and the Commission's assessment of the businesses' proposed demand forecasts is set out in chapter 7.

Chapters 8 to 16 discuss issues related to the businesses' proposed tariff structures and how prices will be adjusted during the regulatory period. Retail water and sewerage tariffs are discussed in chapter 9, recycled water in chapter 10, trade waste charges in chapter 11, new customer contributions in chapter 12, rural services in chapter 13, miscellaneous charges in chapter 14 and Melbourne Water's drainage and waterways charges in chapter 15. Chapter 16 outlines how prices will be adjusted during the period, including the form of price control and other mechanisms for dealing with uncertainty.

2 KEY OUTCOMES AND SERVICES LEVELS

2.1 Introduction

Service standards underpin the businesses' expenditure proposals for the regulatory period and thus their proposed prices. Performance against defined service standards and targets provides a basis for assessing the extent to which additional expenditure is required to maintain or improve existing services and whether apparent cost savings were achieved at the expense of service standards to customers.

Section 2.2 discusses core services standards for urban water businesses. Beyond the core set of service standards, businesses could nominate additional service standards and outputs that reflect business specific services, local issues and other government obligations (such as those relating to sustainability). As these obligations are often significant drivers of expenditure, the Commission asked urban businesses to provide relevant output based targets as additional service standards for the forthcoming regulatory period. These are discussed in section 2.3.

Guaranteed service level (GSL) schemes are considered in section 2.4. These schemes have proven effective in assisting businesses identify their worst served customers while providing businesses with incentives to deliver acceptable service standards to all customers.

The forthcoming regulatory period marks the first time that rural businesses have been required to propose targets for the core set of service standards (as relevant to their business operations). This chapter discusses their core services standards (section 2.5), additional services standards (section 2.6) and GSLs (section 2.7).

2.2 Urban service standards

2.2.1 Overview of draft decision — urban service standards

In their Water Plans, most of the urban businesses proposed service standard targets consistent with the average actual performance achieved over the first regulatory period. The Commission proposed to approve these targets.

Where proposed service standards deviated from the three year average without sufficient explanation, the Commission sought further information from the businesses concerned. In most cases, businesses revised their targets prior to the Draft Decision to better reflect the actual three year average. In the remaining cases, with two exceptions, businesses provided sufficient explanation for the deviation. Consequently, the Commission proposed to approve all service standard targets put forward by the businesses with the two exceptions listed below.

- **Gippsland Water** — Average duration of unplanned water supply interruptions

Gippsland Water proposed a target of 118.7 minutes, which is 21 per cent above the three year average (98.4 minutes). The business cited the changed work practices to meet new Occupational Health and Safety requirements as the reason for the proposed increase.

The Commission sought further information from the business in preparing its Draft Decision. The business provided a detailed explanation of how the new procedures would impact the target and revised down its proposed target to 115 minutes (17 per cent increase above the three year average).

In comparison with other businesses, the proposed 115 minutes is amongst the longest proposed for this measure even though Gippsland Water's reported performance for this standard is shorter than most businesses. The Commission considered that a more appropriate target for this measure was 110 minutes (10 per cent increase above the three year average).

- **Lower Murray Water** — Average time to rectify a sewer blockage (minutes)

The proposed target of 105 minutes is 10 per cent higher than the 2005-06 result. In its Water Plan, the business indicated that implementation of the Road Management Act would adversely affect this service standard.

Noting that no other business had cited impacts from this Act, the Commission sought further information prior to making its Draft Decision. The business indicated that the Road Management Act was not the sole driver of the increased target but did elaborate further.

In the Draft Decision, the Commission sought further information from Lower Murray Water about the drivers of the proposed increase and how and why these drivers (including the implementation of the Road Management Act) would adversely affect this standard.

2.2.2 Responses to draft decision — urban service standards

In response to the Draft Decision, Gippsland Water and Lower Murray Water provided further information on their service standards:

- **Gippsland Water** — Average duration of unplanned water supply interruptions

Gippsland Water revised its proposed target to 110 minutes. The business also identified a consequential adjustment to the target for *average unplanned customer minutes off water supply*, reducing it from 16.1 minutes to 15.4 minutes.

- **Lower Murray Water** — Average time to rectify a sewer blockage (minutes)

Lower Murray Water identified a number of additional drivers as contributing to longer repair times. The business noted that the 2006-07 result for this indicator (102 minutes) is not inconsistent with its proposed target.

2.2.3 Final decision – urban service standards

As all outstanding issues have been resolved with respect to the urban water businesses' targets for core service standards, the Commission has approved all targets put forward.

The Commission accepted Gippsland Water's explanation for the expected 10 per cent increase in the *average duration of unplanned water supply interruptions* above the three year average performance for this indicator. The Commission also accepted that, as a result of this revision, the target for *average unplanned customer minutes off water supply* will fall from 16.1 minutes to 15.4 minutes.

The additional information provided by Lower Murray Water has satisfied the Commission that the proposed target for *average time to rectify a sewer blockage* is reasonable.

The Customer Service Code will be amened to reflect the approved service standard targets that apply in each year of the regulatory period. Each business is obliged to meet its approved service standard targets and to reflect the targets in its Customer Charter.

Final decision

The Commission approved Gippsland Water's revised targets for average duration of unplanned water supply interruptions and average unplanned customer minutes off water supply.

The Commission approved Lower Murray Water's target for average time to rectify a sewer blockage.

The Commission approved all other targets proposed by businesses for their core service standards.

All businesses must amend their respective Customer Charter to reflect the approved service standard targets for the forthcoming regulatory period.

2.3 Urban additional service standards

2.3.1 Overview of draft decision — urban additional service standards

As noted in the Draft Decision, the water businesses are subject to a number of obligations imposed by other agencies including the Department of Human Services (DHS), the Department of Sustainability and Environment (DSE) and the Environment Protection Authority (EPA). Such obligations include (but are not limited to) $CO_2{}^{e}$ emission abatement, beneficial reuse of biosolids, water reuse, sewer backlog and small town sewerage schemes.

As these obligations are often significant drivers of expenditure, the Commission asked businesses to commit to relevant outcomes as additional service standards for the forthcoming regulatory period. These targets provide a basis for assessing the extent to which additional expenditure is required.

All urban water businesses proposed targets for a varying range of additional service standards (see Volume II of the Draft Decision). The Commission commented, in the Draft Decision, on the substantial variation between businesses' interpretation of their responsibility for achieving sustainability objectives under the Statement of Obligations issued by the Minister for Water, particularly with respect to reducing CO_2 equivalent (CO_2e) emissions.

The Commission proposed to accept all targets proposed by the urban water businesses for additional services standards except where further information was required. However, the Commission noted that it would review the proposed standards to ensure they are consistent with the levels of capital and operating expenditure approved in the Final Decision.

Further information was sought from Lower Murray Water about the proposed upgrade to the Koorlong Wastewater Treatment Plant to allow the plant to supply recycled water. Information was also sought from both Lower Murray Water and North East Water regarding their proposed expenditures on green energy and the resulting impact on the businesses' total CO_2e emissions.

2.3.2 Responses to draft decision — urban additional service standards

A number of businesses revised their additional service standard targets in response to the Draft Decision, particularly where the Commission suggested a change in timing for capital projects. For example, in the case of small town sewerage backlog schemes.

- **Coliban Water** — Recycled water

Coliban Water has revised its additional service standard target for *recycled water* to be consistent with the Commission's suggested deferral of the Harcourt Recycling scheme to a later period.

Table 2.1 **Coliban Water recycled water target**
per cent

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	64	67	72	73	82
Revised target	64	67	72	73	73

- **Gippsland Water** — Country Towns Waste Scheme

Gippsland Water revised its proposed additional service standard target for the Country Towns Waste Scheme to reflect the deferral of capital expenditure for the Coongulla/Glenmaggie scheme in the Draft Decision.

Table 2.2 **Gippsland Water country towns waste scheme connections target**

	2008-09	2009-10	2010-11	2011-12	2012-13
Original target	330	0	0	77	0
Revised target	330	0	0	0	0

- **Lower Murray Water** — CO_2e emissions

The Commission sought further information from Lower Murray Water on why its proposed targets for CO_2e emissions show an 18.7 per cent increase over 2006-07 levels despite its proposal to purchase a significant quantity of green energy in the forthcoming period.

In response, Lower Murray Water explained that the Koorlong and Robinvale projects will increase CO_2e emissions. Increased energy use at Koorlong reflects the change to an activated sludge plant and aeration system. This change has resulted in the decommissioning of the business's 110 ha tree plantation which further increases net emissions.

Table 2.3 **Lower Murray Water CO_2e emissions target**
tonnes

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	33 500	33 500	33 500	33 500	33 500

- **Lower Murray Water** — Recycled water

The Commission also sought further information about the impact of Lower Murray Water's proposed expenditure on the Koorlong Wastewater Treatment Plant on recycled water volumes. Lower Murray Water advised that the aggregate volume of recycled water produced by the business will not increase over the forthcoming period.

The Commission specified a target for this additional service standard.

Table 2.4 **Lower Murray Water recycled water target**
per cent

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	-	-	-	-	-
Revised target	62	62	62	62	62

- **South Gippsland Water** — Small town sewer connections

South Gippsland Water adjusted its additional service standard target for the number of *small town sewer connections* in line with the Commission's proposed profile for expenditure on the Poowong/Loch/Nyora small town sewer schemes until the end of the period.

Table 2.5 **South Gippsland Water small town sewerage scheme connections**

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	0	0	206	519	8
Revised target	0	0	206	2	2

- **Goulburn Valley Water** — Small town sewer scheme developed properties not connected

Goulburn Valley Water revised its additional service standard for *small town sewer scheme developed properties not connected* as the business found that the majority of the affected property owners are experiencing hardship. It has resolved to work with the owners rather than forcing connection through court action.

Table 2.6 **Goulburn Valley Water small town scheme developed properties not connected to sewer target**
per cent

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	91	93	95	95	95
Revised target	87	88	89	90	91

2.3.3 Final decision – urban additional service standards

The Commission approved all of the revised additional services standards proposed by the businesses in response to the Draft Decision. The Commission will monitor and report on progress in the delivery of all services subject to additional service standards.

As noted in the Draft Decision, each water businesses is required by its Statement of Obligations to develop and implement plans, systems and processes for managing its assets that assist the business to supply its services sustainably. The Commission also cited the Government Sustainable Energy Targets and the Victorian Renewable Energy Target (VRET) scheme in the Draft Decision. Businesses have identified expenditure related to fulfilling these obligations.

Where the urban water businesses have not committed to additional service standard targets for CO_2^e emissions, recycled water and biosolids reuse, the Commission has set a default output related target based on current service levels.

The default target for CO_2e emissions represents no net increase on 2006-07 levels for the individual businesses. This compares with an average abatement target of 9.6 per cent on 2006-07 levels by the end of the regulatory period proposed by the seven businesses that put forward targets.[10] Table 2. shows the targets for each business for the forthcoming period, with the shaded areas representing default targets set by the Commission.

Table 2.7 **Urban CO_2e emission targets**
tonnes

	2006-07	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Barwon	58 100	56 589	55 118	53 685	52 289	50 930
Central Highlands[a]		45 000	45 000	45 000	45 000	45 000
Coliban	31 053	29 500	28 730	27 950	27 170	26 400
East Gippsland	7 927	7 900	7 800	7 800	7 700	7 600
Gippsland	73 860	73 860	73 860	73 860	73 860	73 860
Goulburn Valley[b]	35 590	33 700	33 500	33 630	33 700	33 700
GWMWater[c]	16 074	44 900	52 997	55 744	56 180	56 629
Lower Murray	28 220	33 500	33 500	33 500	33 500	33 500
North East	32 722	32 722	32 722	32722	32722	32 722
South Gippsland	9 101	9 101	9 101	9 101	9 101	9 101
Wannon	41 997	38 611	37 741	38 111	38 011	37 111
Western	23 958	22 826	20 923	19 021	17 119	15 217
Westernport	4 510	4 510	4 510	4 510	4 510	4 510

Note 2006-07 results are taken from the Performance Report. **a** Central Highlands Water's data for the 2006-07 Performance Report was unreliable. A default target of no more than 45 000 CO2 equivalent was set for the business on the basis that the audited figure for 2006-07 is in line with 2005-06 emissions. **b** Goulburn Valley Water has already achieved a significant reduction in total CO2 equivalent emissions (43.8 per cent) between 2004-05 and 2006-07. **c** GWMWater's total CO2 equivalent emissions are projected to increase by 252 per cent as a result of the Wimmera Mallee Pipeline coming online. GWMWater is aiming to reduce CO2 equivalent emissions directly related to energy consumption by 15 per cent for each year of the regulatory period through the purchase of green power and other offsets.

A default target was also set for businesses that did not commit to recycled water and biosolids reuse targets. The target is based on the individual business's latest three year average performance.[11]

Lower Murray Water was the only business not to commit to a recycled water target. The Commission has set a target of 62 per cent for each year of the

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[10] Excluding GWMWater. Its emissions will more than double over the regulatory period (compared to 2006-07 levels) as a result of changing from gravity to a pumped system.

[11] These figures are from the annual Performance Report.

regulatory period, which equals the three year average (to 2006-07) recorded for recycled water.

Neither Lower Murray Water nor North East Water committed to a biosolids reuse target for the forthcoming period. Since Lower Murray Water did not recycle any biosolids in the past three years, the Commission has not set a target for this business. As North East Water beneficially reused an average of 37 per cent of biosolids produced over the past three years (to 2006-07), a target of 37 per cent has been set for each year of the regulatory period.

The Commission has accepted all other targets proposed by the urban water businesses for additional services standards.

Final decision

The Commission accepted all targets proposed by the urban water businesses for additional services standards.

The Commission has set the following businesses' individual CO_2^e emissions targets for each year of the forthcoming regulatory period on the basis of a no-net increase above 2006-07 total emissions: Central Highlands Water (45 000 tonnes), Gippsland Water (73 860 tonnes), North East Water (32 722 tonnes), South Gippsland Water (9 101 tonnes) and Westernport Water (4 510 tonnes).

The Commission has set yearly targets for recycled water of 62 per cent for Lower Murray Water.

The Commission has set yearly targets for the beneficial reuse of biosolids of 37 per cent for North East Water.

2.4 Urban guaranteed service levels (GSLs)

2.4.1 Overview of draft decision — urban GSLs

Four regional urban water businesses — Barwon Water, Central Highlands Water, Wannon Water and Western Water — are proposing GSL schemes for the forthcoming regulatory period. Two of these businesses (Wannon Water and Western Water) are proposing to introduce GSL schemes for the first time. Over 90 per cent of Victoria's residential population (including the metropolitan businesses' customers) will be provided with guaranteed minimum levels of service in the forthcoming regulatory period.

In the Draft Decision, the Commission generally proposed to approve the Guaranteed Service Level (GSL) schemes put forward by the businesses, with two exceptions:

- **Central Highlands Water**

Central Highlands Water had proposed no changes to its existing GSL scheme, where GSL events attract payments of $25. Given the magnitude of proposed increases in the average household bill for the forthcoming period, the Commission suggested that the business consider increasing the value of its GSL payments to $50.

- **Western Water**

The Commission requested that Western Water remove the proposed GSL for failure to give notice of planned water supply interruptions on the basis that the obligation already exists under the Customer Service Code.

The Commission suggested that Western Water increase the GSL payment for sewerage spills within a house not contained within 1 hour of notification from $100 to $500. The original amount proposed appeared low compared to the equivalent payments offered by other businesses.

The Commission also suggested that Western Water consider increasing the payments for its other GSL events from $25 to $50 for the same reasons outlined for Central Highlands Water.

Finally, the Commission required that Western Water adopt the exclusion clause whereby the business is not required to provide a GSL payment if the event is caused by, or is the responsibility, of the customer or a third party. This is consistent with the other businesses that offer GSL schemes.

2.4.2 Responses to draft decision — urban GSLs

In the Draft Decision, the Commission sought the views of businesses and other stakeholders on its proposal to allow urban water businesses to introduce GSL schemes during the forthcoming regulatory period as well as public comment regarding the businesses' proposed payment levels for GSL schemes for the forthcoming period.

The Energy and Water Ombudsman (Victoria) (EWOV) supported the Commission's proposal to allow for the implementation of GSL schemes by the urban water businesses over the next 12 to 24 months, subject to further analysis and monitoring. The Consumer Utilities Advocacy Centre (CUAC) strongly argued that GSL schemes should be introduced by all urban water businesses and expressed disappointment that most businesses had not proposed to introduce a GSL scheme for the forthcoming regulatory period.

In response to the Issues Paper released as part of this price review, EWOV urged the Commission to review the regional urban water businesses' costings for introducing GSL schemes. EWOV subsequently expressed the view that the existence of GSLs, when well promoted to customers, can prevent some complaints from arising. EWOV suggested that the urban water businesses should take these avoided complaint handling costs into account when assessing the benefits and costs of implementing a GSL scheme.

CUAC expressed the opinion that Western Water's GSL payment of $100 for sewerage spills within a house is inadequate and the rebate should be set at the same level as that offered by other businesses for the same event ($500).

In its response to the Draft Decision, Western Water removed failure to give notice of planned water supply interruptions from its suite of GSLs events, agreed to increase the GSL payment for sewerage spills within a house not contained within 1 hour of notification from $100 to $500, and adopted the exclusion clause proposed by the Commission. It decided not to lift the value of GSL payment for each of its other events from $25 to $50, justifying its decision by the fact that the GSL scheme is being introduced for the first time. The business implied that this decision was supported by additional customer consultation.

Central Highlands Waters indicated that it did not propose to change its current methodology or levels for GSL payments, but did not provide any reasoning for doing so.

Barwon Water highlighted a discrepancy between what it proposed in the Final Water Plan and the Draft Decision. Namely, Barwon Water proposed the following GSL event in its Water Plan, "*No more than three unplanned sewerage service interruptions* or *three sewer spills on to the customer's property per annum"*, which it proposed would attract a payment of $65. In the Draft Decision, the Commission proposed to approve a GSL for "*Maximum of three customers receiving more than three sewer blockages per year*".

Two of the nine urban businesses that have not proposed to implement GSL schemes responded to the Commission's proposal to allow urban water businesses to introduce GSL schemes during the forthcoming regulatory period.

Lower Murray Water stated that an effective approach for identifying its worst served customers is monitoring proposed service standards against actual results and customer complaints (as well as annual performance reporting through the Commission). The business believes that such monitoring also provides an incentive to deliver acceptable service standards to all customers.

Lower Murray Water commented further that GSL schemes do not necessarily provide an incentive to deliver acceptable service standards as under some circumstances it may be cheaper in the short term to continue paying GSLs rather than to fix a systemic problem.

Gippsland Water questioned whether its current performance warrants the introduction of a GSL scheme as it recorded better results on some indicators than a number of businesses with existing GSLs.[12] The Commission notes that GSLs provide an incentive to businesses to improve services provided to all customers (particularly those worst served). They are less useful as a comparative tool between businesses because, as pointed out by Gippsland Water, issues related to service provision will vary by business.

2.4.3 Final decision – urban GSLs

The Commission remains of the view that GSL schemes could be implemented by the urban water businesses over the next 12 to 24 months, subject to further analysis and monitoring. Experience in the Melbourne metropolitan water industry

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[12] These indicators include customers experiencing more than 5 unplanned water supply interruptions in a 12 month period, unplanned water supply interruptions restored within 5 hours and customers receiving more than 3 sewer blockages in the year.

and energy sectors with GSL schemes is that businesses show improved service performance and an enhanced customer service focus. The Commission considers that introducing a GSL scheme would enhance the existing performance monitoring framework.

The Commission has approved GSL schemes for Barwon Water, Central Highlands Water, Wannon Water and Western Water.

The Commission notes the responses of Central Highlands Water and Western Water in relation to GSL payment levels. However, the Commission is not satisfied that the businesses have provided sufficient reasons for maintaining GSL payments at $25 given the weight of argument in favour of increasing payments to $50.

The price increases proposed by both businesses will lead to a significant increase in average household bills in the forthcoming period. A GSL rebate serves as recognition by the business that a customer has received significantly below average service so it is important that customers do not perceive the rebate amounts as token. The Commission considers that GSL payment levels should also provide an incentive for businesses to improve services for those worst served.

On this basis, the Commission is requiring both Central Highlands Water and Western Water to adopt an increased GSL rebate value of $50.

The Commission has approved Barwon Water’s proposed GSL for sewer spills after reaching agreement with Barwon Water on providing two separate payment levels for the two events covered by the GSL:

- More than three unplanned sewage service interruptions in a 12-month period — Payment level of $65.
- More than three sewer spills on a customer’s property within a twelve month period — Payment level of $500.

The Commission has amended the wording of Barwon Water’s proposed GSL for *maximum of five unplanned water supply interruptions* to *more than five unplanned water supply interruptions in 12 months* so that it is consistent with wording for other businesses.

The Commission requires Wannon Water to amend its GSL event for *sewage spills within a house not contained within five hours of notification* to *sewage spills within a house not contained within one hour of notification*. The payment level will remain unchanged at $500. The change brings the GSL definition into line with that offered by other businesses and with the requirements of the Commission’s reporting framework.

Final decision

The Commission approved GSL schemes for Barwon Water, Central Highlands Water, Wannon Water and Western Water.

The Commission requires that, at minimum, GSL rebates be set to $50 for Central Highlands Water and Western Water, with the exception of the GSL for *sewage spills in a house not contained within a given time frame of notification*.

The Commission approved Barwon Water's sewer related GSL with two separate payment levels for the two events covered by the GSL:

1. *More than three unplanned sewage service interruptions in a 12-month period*. Payment level of $65.

2. *More than three sewer spills on a customer's property within a twelve month period.* Payment level of $500.

The Commission requires that Barwon Water amend its GSL (*maximum of five unplanned water supply interruptions*) to *more than five unplanned water supply interruptions in 12 months*. The Commission approved the payment level of $65 for this GSL event.

Wannon Water is required to amend its GSL event for sewage spills to *sewage spills in a house not contained within one hour of notification*. The payment level will remain unchanged at $500.

The Commission accepted the removal of *failure to give notice of planned water supply interruptions* from Western Water's suite of GSL events.

The Commission approved Western Water's GSL rebate value of $500 for *sewage spills within a house not contained within 1 hour of notification*.

The Commission approved Western Water's adoption of a GSL exclusion such that the business is not required to provide a GSL payment if the event is caused by, or is the responsibility, of the customer or a third party.

Barwon Water, Central Highlands Water, Wannon Water and Western Water must amend their Customer Charters to reflect the approved GSL schemes and payment levels for the forthcoming regulatory period.

2.5 Rural service standards

The Rural Customer Service Code imposes a consistent framework for the delivery of services to rural customers. The Code sets out service level requirements and standards for key matters.

Businesses were required to develop a Customer Charter informing customers about the services offered, the respective rights and responsibilities of the business and its customers, and the service standards that the business proposes to deliver over the regulatory period. The Charter must cover certain minimum information requirements set by the Customer Service Code. Businesses must amend their respective Customer Charters to reflect approved service standards. The

Commission notes that FMIT, Lower Murray Water and Southern Rural Water have failed to submit a Final Customer Charter.

For the first time, rural water businesses were required to propose targets for the core set of service standards (as relevant to their business operations) for the forthcoming regulatory period.

The Commission is currently developing an annual performance monitoring framework for the rural sector. Upon finalisation, the Commission will monitor the performance of each business against its own targets.

2.5.1 Overview of draft decision — rural service standards

All rural businesses proposed targets for standards for the forthcoming period. However, three businesses (Goulburn-Murray Water, Lower Murray Water and Southern Rural Water) did not provide targets for the full set of core service standards relevant to their business. Goulburn-Murray Water, GWMWater and Lower Murray Water proposed targets for service standards for which the Commission sought clarification and further information.

- **Goulburn-Murray Water**

The Commission proposed to approve all service standard targets proposed by Goulburn-Murray Water, with the exception of *EWOV complaints, processing permanent transfer of surface diversion or groundwater licences* and *applications for surface diversion, groundwater or supply-by-agreement licences determined within X days.* The Commission sought further information on these targets.

Goulburn-Murray Water did not propose a target for *number of channel bursts and leaks (gravity system)*.

- **Lower Murray Water**

The Commission proposed to approve all service standard targets proposed by the Lower Murray Water for its rural business, with the exception of *EWOV complaints*. Further information was sought for this indicator as the target appeared high compared to the actual number of complaints recorded by EWOV for the rural business in 2006-07 and 2005-06 and adequate explanation was not provided.

The business did not propose targets for the full core set of service standards and as such, the Commission requested that targets be proposed by the business.

- **Southern Rural Water**

The Commission asked Southern Rural Water to propose targets for the core set of service standards as relevant to its business.

Service standards for the rural businesses are listed in table 2.7.

Table 2.8 **Draft decision — rural core service standards**

	FMIT	*GMW*	*GWMW*	*LMW*	*SRW*
Gravity Supply					
Irrigation water orders delivered on day requested (per cent)	✓	✓	n.a	n.a	R
Number of channel burst and leaks (per 100 km of channel)	✓	R	n.a	n.a	R
Unaccounted for water (per cent)	✓	✓	n.a	n.a	✓
Pumped Supply					
Irrigation water orders delivered on day requested (per cent)	✓	✓	✓[a]	✓	n.a
Number of pipeline bursts and leaks (per 100 km of pipeline)	✓	✓	✓	R	n.a
Unaccounted for water (per cent)	✓	✓	✓	R	n.a
Irrigation drainage (by district/supply system)					
Availability of surface drainage schemes (per cent)	n.a	✓	n.a	n.a	R
Availability of sub-surface drainage schemes (per cent)	✓	✓	n.a	✓	n.a
Bulk Water					
Annual compliance with storage operator obligations (per cent)	n.a	n.a	✓	n.a	n.a
Licensing/administration					
Applications for surface diversion, groundwater or supply-by-agreement licences determined within [X] days (per cent)	n.a	R	✓	R	R
Processing permanent transfer of surface diversion or groundwater licences within [X] days (per cent)	n.a	R	✓	R	✓
Processing temporary transfer of water entitlement volumes within [X] days (per cent)	✓	✓	✓	R	R
Processing permanent transfer of water entitlement volumes within [X] days (per cent)	✓	✓	✓	R	✓
Number of diversion licences metered or assessed for metering at 30 June (per cent)	n.a	✓	✓	R	R
Volume of total surface water and groundwater entitlements metered at 30 June (per cent)	n.a	✓	✓	R	R
Customer service					
Complaints to EWOV	✓	b	✓	b	R
Telephone calls answered within 30 seconds	✓	✓	✓	✓	R

R Target required but not provided, ✓ Provided. **[a]** Equivalent target provided (unavailability of stock and domestic supply systems for continuous periods in excess of 8 hours) **[b]** Sought further information or revision required. **n.a** not applicable.

2.5.2 Responses to draft decision — rural service standards

The businesses' responses are set out below.

- **Goulburn-Murray Water**

In response to the Draft Decision, Goulburn-Murray Water proposed a target for the service standard *number of channel burst and leaks (gravity system)*.

Table 2.9 **Goulburn-Murray Water — number of channel bursts and leaks**

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Shepparton	46	45	44	43	42
Central Goulburn	56	55	54	53	52
Rochester - Campaspe	25	24	23	22	21
Pyramid - Boort	8	7	6	5	4
Murray Valley	34	33	32	31	30
Torrumbarry	61	60	59	58	57

The business also revised its targets for *EWOV complaints* based on the definition employed by EWOV and the Commission.

Table 2.10 **Goulburn-Murray Water — complaints to EWOV**

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	7	7	6	6	6
Revised target	48	47	46	43	40

In relation to the service standards for *processing permanent transfer of surface diversion or groundwater licences* and *applications for surface diversion, groundwater or supply-by-agreement licences determined within X days*, Goulburn-Murray Water expressed concern about setting targets in the absence of reliable historical data. A number of factors contribute to the lack of data, including the introduction of the new state-wide register (on 1 July 2007), changes to inspection and assessment processes and the record levels of applications for all transaction types received by the business in the current year.

Goulburn-Murray Water has proposed to record and review actual performance data at the end of 2007-08 and develop targets for the regulatory period based on this information in consultation with the business's water services committees and the Commission.

- **Lower Murray Water**

In response to the Draft Decision, Lower Murray Water proposed targets for the remaining core service standards for which it had not already proposed targets.

Table 2.11 **Lower Murray Water — service standard targets**

	2008-09	2009-10	2010-11	2011-12	2012-13
Number channels bursts and leaks (per 100 km) — (pumped supply)					
Whole business	54.9	44.5	35.3	36.3	37.6
Merbein	126.9	129.6	132.3	135.0	137.7
Red Cliffs	57.5	59.3	61.2	63.0	64.8
Robinvale	256.9	127.8	13.9	13.9	16.7
Millewa	5.6	6.0	6.4	6.9	7.3
Irrigation water orders delivered on day requested (per cent)	95.00	95.00	95.00	95.00	95.00
Unaccounted for water					
Merbein	15.5	15.5	15.50	15.5	15.5
Red Cliffs	11.0	11.0	11.00	11.0	11.0
Robinvale	13.0	5.0	5.00	5.0	5.0
Millewa	17.5	17.5	17.5	17.5	17.5
Applications for surface diversion, groundwater or supply-by-agreement water use licences determined within 30 days (per cent)	80.0	80.0	80.0	80.0	80.0
Processing transfer of water use licences between LMW customers within 10 days (per cent)	80.0	80.0	80.0	80.0	80.0
Processing temporary transfer of water allocations between LMW customers within 10 days (per cent)	80.0	80.0	80.0	80.0	80.0
Processing permanent transfer of water shares between LMW customers within 10 days (per cent)	80.0	80.0	80.0	80.0	80.0
Number of works licences metered or assessed for metering at 30 June (per cent)	70.0	70.0	70.0	70.0	70.0
Volume of total annual use limit metered at 30 June (per cent)	70.0	70.0	70.0	70.0	70.0
Customer Service					
Telephone calls answered within 30 seconds (per cent)	99.00	99.00	99.00	99.00	99.00

The business also revised its target for *EWOV complaints*.

Table 2.121 **Lower Murray Water — complaints to EWOV**
per 1000 customers

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	5.95	5.95	5.95	5.95	5.95
Revised target	3	3	1.3	1.3	1.3

The business requested that the target previously provided for *unaccounted for water* (which was for the entire region) be removed as targets for individual regions are being developed.

Table 2.13 **Lower Murray Water — unaccounted for water target**
per cent

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Original target	5	5	5	5	5
Revised target	Targets by region				

- **Southern Rural Water**

Southern Rural Water did not respond to the Commission's request that it propose targets for the full set of core service standards.

The Commission notes that Southern Rural Water reports equivalent indicators for National Water Commission annual reporting for half of the remaining core service standards. However, the Commission acknowledges the difficulty in proposing targets in the absence of robust past performance data.

2.5.3 Final decision – rural service standards

- **Goulburn-Murray Water**

Having discussed with Goulburn-Murray Water its concern about setting targets for *processing permanent transfer of surface diversion or groundwater licences* and *applications for surface diversion, groundwater or supply-by-agreement licences determined within X days,* the Commission accepts that the business is not yet in a position to propose targets for these service standards and will work with the business to set targets. The Commission is satisfied that the business's justification is reasonable and the proposed solution is appropriate.

- **Lower Murray Water**

The Commission notes that Lower Murray Water has proposed targets for each of the core service standards as relevant to its business for the forthcoming regulatory period.

- **Southern Rural Water**

The Commission will work with Southern Rural Water to establish targets for its core set of service standards over the coming 12 months. The Commission expects that Southern Rural Water will put in place procedures to allow it to record and report against the core set of service standards relevant to its business as set out in the Draft Decision (see table 2.8). The Commission further expects that the business will report results annually for the core set of service standards during the regulatory period to assist in establishing targets.

A target has been set by the Commission for the number of *EWOV complaints* based on the two year average recorded for the indicator.

The business has previously indicated that it currently does not have the technical capability to report results for the number of *telephone calls answered within 30 seconds* and that it is not a priority for the business during the regulatory period. Southern Rural Water is the only business to have not proposed a target for this indicator. The Commission sees no reason why the business's customers should receive worse service than customers of the other rural water businesses, who have an average target of 92.25 per cent of telephone calls answered within 30 seconds.

The Commission has set a target of 80 per cent for Southern Rural Water, which is in line with the worst performer of the rural water businesses.

For each business, the approved service standard targets that apply in each year of the regulatory period are detailed the Determination issued in respect of that business. These targets will be reflected in each business's Customer Charter and the performance of all businesses against these targets will be reported by the Commission as part of its performance reporting function.

Final decision

Goulburn-Murray Water and GWMWater must amend their Customer Charters to reflect the approved service standard targets for the forthcoming regulatory period.

FMIT, Lower Murray Water and Southern Rural Water must submit a finalised Customer Charter to the Commission by 30 July 2008, incorporating the approved service standard targets for the forthcoming regulatory period.

Goulburn-Murray Water

The Commission approved Goulburn-Murray Water's proposed targets for the service standard *number of channel burst and leaks (gravity system)* for the forthcoming regulatory period.

The Commission approved the business's revision to its targets for *EWOV complaints* based on the definition employed by EWOV and the Commission.

The Commission accepted that Goulburn-Murray Water is not yet in a position to propose targets for *permanent transfer of surface diversion or groundwater licences* and *applications for surface diversion, groundwater or supply-by-agreement licences determined within X days* and will work with the business to set targets for the indicators over the coming 12 months.

Lower Murray Water

The Commission approved Lower Murray Water's proposed targets for each of the proposed service standards for the forthcoming regulatory period.

Southern Rural Water

Southern Rural Water is required to report results for the relevant core set of service standards annually to the Commission during the regulatory period.

The Commission will review the data reported by Southern Rural Water and set targets with the business for the core set of service standards relevant to their business in the proceeding year.

A target has been set by the Commission for the number of EWOV complaints to be received by the business (22 complaints), which is consistent with the two year average recorded to 2006-07. This target will take effect from 2008-09.

A default target has been set by the Commission for the proportion of telephone calls answered within 30 seconds by Southern Rural Water (80 per cent). This target will take effect from 2008-09.

2.6 Rural additional service standards

2.6.1 Overview of draft decision — rural additional service standards

In the Draft Decision, the Commission proposed to accept all additional service standards put forward by the rural businesses. Further information was sought from Lower Murray Water in relation to its targets for CO_2e emissions (see sections 2.3.1 and 2.3.2).

The rural water businesses did not propose any changes to their additional service standard targets.

2.7 Rural guaranteed service level (GSL) schemes

2.7.1 Overview of draft decision — rural GSLs

None of the businesses providing rural water services proposed to implement a GSL scheme for the forthcoming regulatory period. While the Commission considers that there may be benefit to the rural businesses from establishing GSL schemes, it recognises that a performance reporting and monitoring framework is still to be established for this sector and that there is a general lack of reliable historical data available.

2.7.2 Responses to draft decision – rural GSLs

The United Dairy Farmers—District Council 3 recommended that the Commission require all rural water business to establish GSL schemes for the forthcoming regulatory period.

2.7.3 Final decision — rural GSLs

The rural businesses will, for the first time this period, be required to report against their proposed targets for the core set of rural service standards as approved by the Commission. This will improve the availability of reliable historical service standard data. For a number of businesses, a number of service standards will be measured and recorded for the first time.

The Commission considers that requiring rural businesses to establish GSL schemes would not be appropriate for this forthcoming period. However, it will review the need for, and appropriateness of, a GSL scheme for rural services in preparing for the next price review when more reliable historical service standard data will be available.

2.8 Drainage and waterways service standards

2.8.1 Overview of draft decision — drainage and waterway service standards

Melbourne Water undertakes programs to improve the health of rivers and creeks, provide drainage infrastructure to service urban growth and provide sufficient levels of flood protection. It provides drainage and waterways services under a range of legislative and regulatory instruments, which are articulated in its Waterways Operating Charter.

Melbourne Water proposed a range of five year targets that it intends to achieve over the regulatory period in relation to the Regional River Health Strategy and customer service standards under its Customer Charter and the Waterways Water Quality Strategy.

In the Draft Decision, the Commission proposed that these targets be approved in Melbourne Water's determination as additional service standards.

2.8.2 Responses to draft decision — drainage and waterway service standards

The Interface Councils commented that all of the river health and water quality implementation targets included within the Consultation Draft are supported. These goals signify a clear transition to effective and integrated waterway and drainage management. The Interface Councils cautioned that in achieving the identified targets, there should not be cost shifting to local government.

At the public meetings held following the release of the Draft Decision, customers indicated their preference for receiving information on the work undertaken by Melbourne Water in their local areas, including the expenditure incurred in undertaking these works.

2.8.3 Final decision — drainage and waterway service standards

The Commission has approved the targets proposed by Melbourne Water in relation to drainage and waterway service standards. The approved service standards are set out in the Determination.

The Commission also considers that there would be merit in developing and implementing a process for monitoring and reporting on Melbourne Water's works program in the extended areas. The Commission will consult with Melbourne Water and relevant stakeholder groups over the next 6 to 12 months on the development of appropriate reporting arrangements.

Final decision

The Commission has approved the targets proposed by Melbourne Water in relation to drainage and waterway service standards.

3 OVERVIEW OF REVENUE REQUIREMENT AND DEMAND

3.1 Introduction

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

The Commission has 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 reflects operating expenditure and a return on the regulatory asset value updated each year to reflect any additional capital expenditure, net of asset disposals and regulatory depreciation.

Over the regulatory period the businesses proposed a total revenue requirement of $4.22 billion (see table 3.1). This reflects assumptions about the expenditure that the businesses propose to undertake and the return on and of assets over the regulatory period.

In the Draft Decision, the Commission reviewed those assumptions and adjusted the businesses’ own revenue requirement estimates over the regulatory period to reflect its view of the efficient level of expenditure and the efficient costs of financing assets (see table 3.1). The Draft Decision resulted in a small increase in the revenue requirement compared to what was proposed by the businesses in their Water Plans. The difference reflected adjustments for the increased cost of financing the proposed capital programs, energy and labour costs, the environmental contribution, and changes to the profile of capital expenditure over the regulatory period.

In response to the Draft Decision, a number of businesses have proposed further revisions to their expenditure and/or demand forecasts that have implications for the revenue required over regulatory period. The Commission has assessed these revisions and has updated its view on an appropriate rate of return to derive its final benchmarks of the revenue required by each business over the regulatory period.

The Final Decision provides the businesses with total revenue for $4.14 billion for the regulatory period (see table 3.1). This is 3 per cent lower than that assumed by the Commission in the Draft Decision, and 1.8 per cent lower than that originally proposed by the businesses in their Water Plan. The difference reflects updated estimates for the cost of financing the proposed capital programs and the environmental contribution and further adjustments to some business's expenditure and demand forecasts.

For the Final Decision the Commission has made no further adjustments to Melbourne Water's expenditure and demand forecasts but has made an adjustment for the cost of financing capital investment.

Table 3.1 **Total revenue requirement (all businesses)**
$ million in January 2007 prices

	Proposed by business	*Draft decision*	*Final decision*
Urban businesses			
Barwon	686.50	702.51	664.93
Central Highlands	356.61	355.59	316.55
Coliban	380.43	376.93	377.21
East Gippsland	109.23	114.97	113.37
Gippsland	433.74	437.96	415.13
Goulburn Valley	242.49	256.60	252.87
GWMWater	224.27	233.08	228.36
Lower Murray (urban)	124.48	127.33	126.16
North East	210.31	213.46	211.82
South Gippsland	96.66	100.53	98.91
Wannon	236.86	233.89	232.29
Western	286.45	279.12	274.71
Westernport	71.22	74.59	73.26
Total urban businesses	**3 459.25**	**3 506.56**	**3 385.57**
Rural businesses			
FMIT	31.95	32.99	31.38
Goulburn-Murray	519.05	523.78	518.68
Lower Murray (rural)	72.30	73.98	74.03
Southern Rural	138.20	134.13	133.12
Total rural businesses	**761.5**	**764.88**	**757.21**
All businesses	**4 220.76**	**4 271.45**	**4 142.78**

The key components of the Final Decision revenue requirement for each regional business are set out in table 3.2.

The revenue requirement adopted by the Commission for each business over the regulatory period is a benchmark used solely to assess whether prices will result in businesses' earning sufficient revenue to deliver services and meet any obligations imposed by regulatory agencies. These benchmarks do not represent the amounts businesses are required to spend or to direct to particular activities or projects. The businesses are free to determine their own expenditure priorities in light of changing circumstances and to pursue innovation and efficiencies that enable them to outperform the revenue benchmarks.

Given concerns about the degree of uncertainty surrounding capital expenditure programs and demand forecasts, the Commission's Final Decision and Determinations set out a mechanism to deal with uncertain or unforeseen events. Under the mechanism businesses can apply to the Commission to consider adjustments to approved prices within the regulatory period (see chapter 16).

Table 3.2 **Components of final decision revenue requirement**
$ million in January 2007 prices

	Operating expenditure	*Return on existing assets*	*Return on new assets*	*Regulatory depreciation*	*First period adjustments*	*Annuity*	*Tax*	*Total*
Urban businesses								
Barwon	377.85	132.87	55.25	98.97	0.00	n.a	0.00	664.93
Central Highlands	228.49	33.70	24.55	29.80	0.00	n.a	0.00	316.55
Coliban	259.75	36.29	31.72	36.27	13.19	n.a	0.00	377.21
East Gippsland	63.08	19.03	10.74	20.52	0.00	n.a	0.00	113.37
Gippsland	263.06	73.05	35.56	45.47	0.00	n.a	0.00	415.13
Goulburn Valley	162.02	39.01	17.45	34.39	0.00	n.a	0.00	252.87
GWMWater	127.85	29.19	43.30	25.70	2.32	n.a	0.00	228.36
Lower Murray (urban)	83.95	15.32	10.42	16.47	0.00	n.a	0.00	126.16
North East	137.47	31.28	15.56	27.52	0.00	n.a	0.00	211.82
South Gippsland	61.67	16.97	6.18	14.08	0.00	n.a	0.00	98.91
Wannon	155.99	33.98	18.74	23.57	0.00	n.a	0.00	232.29
Western	189.50	40.38	18.84	22.23	0.00	n.a	3.76	274.71
Westernport	45.61	16.49	2.53	8.63	0.00	n.a	0.00	73.26
Total urban	**2 156.28**	**517.55**	**288.86**	**403.61**	**15.51**	**n.a**	**3.76**	**3 385.57**
Rural businesses								
FMIT	25.32	2.07	0.83	2.82	0.34	0.00	0.00	31.38
Goulburn-Murray	438.79	27.52	19.20	24.42	8.75	0.00	0.00	518.68
Lower Murray (rural)	58.11	3.56	6.93	5.42	0.00	0.00	0.00	74.03
Southern Rural	85.72	5.75	9.17	13.11	10.65	8.72	0.00	133.12
Total rural	**607.95**	**38.90**	**36.13**	**45.77**	**19.74**	**8.72**	**0.00**	**757.21**
All businesses	**2 764.22**	**564.64**	**317.46**	**450.63**	**35.24**	**8.72**	**3.76**	**4 144.68**

n.a. Not applicable.

3.2 Adjustments to the revenue requirement

In using the 'building block' approach the Commission not only considers the reasonableness of the individual components but also the total revenue requirement in the context of each business's financial viability and the implications for customers. At times it may be necessary to make adjustments to a business's revenue requirement to ensure that businesses remain financially viable or to protect the interests of customers. For this Final Decision the Commission has made adjustments to the revenue requirements for Coliban Water and Gippsland Water.

Coliban Water

The Commission's Draft Decision provided for an adjustment to Coliban Water's revenue requirement due to concerns over financial viability. The proposed adjustment reflected Coliban Water's unique circumstances in that it was required to finance its expenditure on the Superpipe for the first regulatory period itself, as this expenditure was not foreshadowed and hence not reflected in the prices approved by the Commission. This contributed to Coliban Water's low interest cover. The adjustment endeavoured to provide Coliban Water with an average interest cover of 1.5 across the forthcoming regulatory period.

In response to the Draft Decision, Coliban Water has indicated that its 2007-08 capital expenditure needed to be adjusted, resulting in an increased opening regulatory asset base. Consequently, under the building blocks approach Coliban Water would receive more revenue than that proposed in the Draft Decision. Therefore, the Commission has reduced the adjustment to Coliban Water's revenue requirement compared to the Draft Decision. The revenue requirement adjustment continues to provide an average interest cover of 1.5 given the higher opening RAB.

Gippsland Water

A number of stakeholders have specifically raised concerns about the affordability of the proposed average price increase approved for Gippsland Water in the Draft Decision. At 17.4 per cent per annum it is the highest in the State and results in an average household bill of $1 344 in real terms by the end of the regulatory period.

Gippsland Water customers have also raised concerns about the allocation of costs between residential and non-residential customers, in the context of the Gippsland Water Factory. The Commission sought access to and was provided with further information by Gippsland Water regarding the details of its major user contracts.

The Commission also notes that the current forecast cost of the Gippsland Water Factory is significantly higher than originally proposed by Gippsland Water in the first regulatory period (approx $55 million).

It has found that Gippsland Water is in a stronger position than most businesses, with financial ratios well above the minimum requirement adopted by the Commission, which is a BBB rating.

Given these particular circumstances the Commission considers that is not unreasonable for Gippsland Water to absorb a proportion of the increased costs incurred in constructing the Gippsland Water Factory. Based on its analysis the Commission has identified that with a reduction of $30 million (approximately half of the increase in costs) in the roll forward of the regulatory asset base Gippsland

Water will continue to maintain or exceed the relevant financial benchmarks as well as meet all its service obligations. After this adjustment, Gippsland Water will still have an average interest cover of 2.2 across the forthcoming regulatory period, rising to 2.5 by the end of the regulatory period and a gearing ratio which remains below 60 per cent.

On balance, the adjustment reflects the Commission's consideration of the WIRO requirement to ensure business viability and protect customer interests in response to the unique circumstance faced by Gippsland Water.

The Commission recognises that increased costs will be incurred by Gippsland Water at the beginning of the regulatory period so will adopt Gippsland Water's proposed average annual real price increase of 23 per cent for each of the first two years of the period and reduce the average annual increase for the remainder of the period from 10 per cent to 4.3 per cent. The Determination also provides a general mechanism to allow for price adjustments during the period where outcomes turn out to be different to that forecast.

The impact of this adjustment as well as other adjustments detailed in the capital expenditure and operating expenditure sections is to reduce the equivalent average annual price increase from 17.4 per cent to 14.9 per cent. The average annual household bill is $1 152 in real terms at the end of the regulatory period ($192 less than that proposed by Gippsland Water).

3.3 Expenditure forecasts

Key drivers of proposed prices are the forecast operating and capital expenditure required to deliver services over the regulatory period. The key drivers of expenditure include supply augmentation, asset renewals and maintenance, changes in demand (such as customer numbers), changes in customer preferences for services, and policy and regulatory obligations imposed on the businesses.

Under the WIRO, the Commission must be satisfied that the proposed expenditure forecasts are efficient and account for a planning horizon that extends beyond the regulatory period. The WIRO also requires that prices, or the manner in which they are determined, provide incentives for the businesses to pursue efficiency improvements over the regulatory period.

In reviewing the expenditure proposals of the water businesses, the Commission has sought to ensure that the benchmark level of expenditure is both efficient and sufficient to allow continued serviceability of existing assets, with appropriate allowances for growth and new obligations over the forthcoming regulatory period.

The Commission engaged consulting firms Sinclair Knight Merz (SKM), Cardno–Atkins (Cardno) and Halcrow Pacific (Halcrow) to provide an independent assessment of the businesses' proposed expenditure. In its Draft Decision the Commission generally accepted the adjustments proposed by its consultants. In response, a number of businesses have proposed revisions to the expenditure benchmarks adopted in the Draft Decision. Proposed revisions to operating expenditure are discussed in chapter 4 and revisions to capital expenditure are discussed in chapter 5.

When considering the businesses' responses to the Draft Decision and the proposed revisions, the Commission has adjusted the benchmarks only where:

- errors have been identified in the assumptions or forecasts adopted by the Commission in its Draft Decision
- businesses have provided further information or arguments to support their original forecasts
- additional obligations have been imposed by other regulators that were not known or could not have reasonably been known at the time the Water Plans were submitted
- material adjustments have been proposed, such that the change in expenditure is so great as to create significant risk that prices may not recover sufficient revenue or may significantly over recover revenue.

For the Final Decision the Commission has assumed $2.76 billion in operating expenditure and $2.45 billion in capital expenditure (see table 3.3).

Table 3.3 **Total capital and operating expenditure (all businesses)**
$ million in January 2007 prices

	Operating expenditure			*Capital expenditure*		
	Proposed	*Draft decision*	*Final decision*	*Proposed*	*Draft decision*	*Final decision*
Urban businesses						
Barwon	396.19	389.00	377.85	563.10	562.99	437.38
Central Highlands	228.09	230.83	228.49	140.32	158.77	169.86
Coliban	262.32	259.66	259.75	214.10	191.43	196.43
East Gippsland	62.72	63.14	63.08	56.17	56.17	56.17
Gippsland	275.90	264.59	263.06	251.27	240.20	232.95
Goulburn Valley	160.31	162.60	162.02	112.90	113.71	113.11
GWMWater	127.87	128.81	127.85	341.35	341.47	341.47
Lower Murray (urban)	85.25	83.03	83.95	57.40	64.86	68.68
North East	140.07	136.93	137.47	99.55	102.68	109.84
South Gippsland	61.28	62.39	61.67	47.90	53.99	53.99
Wannon	169.00	156.70	155.99	110.09	116.76	125.45
Western	207.25	188.02	189.50	128.59	129.49	129.49
Westernport	44.94	45.96	45.61	29.65	29.45	29.45
Total urban	**2 221.20**	**2 171.66**	**2 156.28**	**2 152.39**	**2 161.97**	**2 064.26**
Rural businesses						
FMIT	26.12	25.50	25.32	2.53	5.54	5.54
Goulburn-Murray	438.77	435.11	438.79	204.49	196.03	222.38
Lower Murray (rural)	57.92	59.77	58.11	61.26	39.17	46.32
Southern Rural	85.66	85.55	85.72	117.06	116.49	116.49
Total rural	**608.47**	**605.93**	**607.95**	**385.34**	**357.23**	**390.73**
All businesses	**2 829.67**	**2 777.60**	**2 764.22**	**2 537.73**	**2 519.20**	**2 454.99**

3.4 Financing capital investments

The WIRO requires that prices are set to allow a return on past investments — as reflected in the initial regulatory asset value at 1 July 2004 — as well as a return on new assets constructed after that date.[13] This reflects the costs of financing the businesses' capital programs.

[13] Initial regulatory asset values (as at 1 July 2004) were set by the Minister for Water. Prices for the first regulatory period were set based on these initial values adjusted annually for forecasts of net capital expenditure, asset disposals and regulatory depreciation.

The regulatory asset base (RAB) is a key determinant of the return on and of assets that is reflected in the revenue requirement and thus prices. The RAB needs to be updated to reflect actual net capital expenditure and disposals for the first regulatory period. Rather than rely on regulatory accounting information to update the RAB, the Commission has used the information provided by the businesses' in their financial templates. The Commission has also made further adjustments to the 2007-08 expenditure rolled into the asset base to reflect more certain information from the businesses.

This updated RAB value then needs to be rolled forward to reflect any subsequent net capital investments, depreciation and disposals forecast to occur in each year of the forthcoming regulatory period.

In assessing the proposed rate of return on assets, the Commission has adopted a real post-tax weighted average cost of capital (WACC) approach that is consistent with an estimate of the cost of capital that a business undertaking similar activities would face.

As part of their Water Plans the businesses' proposed values ranging from 5.1 per cent to 5.3 per cent on a real post-tax basis. For the Draft Decision, the Commission updated the WACC estimate for current market conditions and adopted a real post-tax rate of return of 6.1 per cent.

Deriving a WACC requires assumptions to be made about a number of parameters. For the Final Decision the Commission has revisited the assumptions it made to derive the estimate for the WACC adopted in the Draft Decision. A WACC of 5.8 per cent has been adopted for the Final Decision.

Assumptions about RABs, regulatory depreciation and cost of capital issues are discussed in chapter 6.

3.5 Demand forecasts

Forecasts of customer growth, water deliveries and consumption of water, sewerage and other prescribed services are important factors influencing future expenditure, and also affect the prices that businesses will need to charge to meet their revenue requirement.

Unduly conservative forecasts (that is, those that understate demand) will result in customers paying prices that are higher than they otherwise would. Unduly optimistic forecasts may not enable businesses to recover their expenditure and earn a sustainable revenue stream over the regulatory period. Under either scenario, the Commission would not be satisfied that the businesses' forecasts are reasonable or that proposed prices meet the WIRO requirements.

The businesses' Water Plans set out forecasts of key demand parameters, including forecast water delivery (for rural customers), the number of water and sewerage connections, water consumption, and trade waste volumes and loads. They also present the businesses' views on the key factors likely to influence those forecasts, including the impact of removing or continuing water restrictions, the introduction of permanent restrictions, weather conditions, changes in tariff levels and structures, and estimates of population growth.

The Commission engaged PricewaterhouseCoopers (PwC) to undertake a detailed review and assessment of the businesses' demand forecasts. For the Draft Decision the Commission accepted PwC's recommendations and made adjustments to most of the businesses' forecasts.

In response, most businesses accepted the demand forecasts adopted by the Commission in its Draft Decision. A number proposed further adjustments, these adjustments and the Commission's Final Decision are discussed in chapter 7.

4 OPERATING EXPENDITURE

4.1 Introduction

The businesses set out detailed assumptions underpinning their forecast levels of operating expenditure over the regulatory period in their Water Plans. The Commission's approach to assessing the businesses' operating expenditure has been to separately assess the forecasts related to:

- business as usual expenditure — which the Commission has assumed should show productivity improvements and be adjusted for growth relative to current expenditure
- expenditure required to meet new obligations — which the Commission has assumed would be in addition to business as usual expenditure.

The Commission also had regard to detailed assessments of the businesses' operating expenditure forecasts undertaken by Cardno–Atkins (Cardno), Sinclair Knight Merz (SKM) and Halcrow Pacific (Halcrow) which each of the businesses was given an opportunity to comment on.

As with capital expenditure, the benchmarks adopted by the Commission for each of the businesses do not represent amounts that the businesses must spend or allocate to particular operational, maintenance and administrative activities. They represent assumptions about the overall level of expenditure to be recovered through prices that the Commission considers to be sufficient to operate the business, and to maintain assets over the regulatory period.

It is important to recognise that where a business's actual operating expenditure during the regulatory period exceeds the benchmarks used to set prices because of inefficiency or additional expenditure on other activities, this will result in lower profits rather than higher prices. The converse is true where an efficiency gain is made during the regulatory period.

4.2 Overview of the draft decision

In the Draft Decision, the Commission proposed to adopt benchmarks that provided for total operating expenditure across all businesses of $2.778 billion over the regulatory period. Of the total, $2.172 billion was provided for the urban businesses and $0.606 billion for the rural businesses. This reflected a reduction of 2.2 per cent from the expenditure proposed by urban businesses in their Water Plans and a 0.4 per cent reduction for rural businesses.

The largest individual percentage reductions were for Western Water with 9.3 per cent, representing a $19.23 million dollar decrease and Wannon Water with a 7.3 per cent decrease, representing a $12.3 million dollar reduction from that proposed in their Water Plans. Increases in operating expenditure ranged between 0.7 and

3.2 per cent for five businesses: Central Highlands Water, East Gippsland Water, Goulburn Valley Water, GWMWater, South Gippsland Water and Lower Murray Water's rural business (see table 4.1).

Table 4.1 **Operating expenditure (2008-09 to 2012-13)**
Business proposals compared to draft decision
$ million in January 2007 prices

	Proposed 2008-09 to 2012-13	*Draft decision 2008-09 to 2012-13*	*Difference per cent*
Urban businesses			
Barwon	396.19	389.00	-1.8
Central Highlands	228.09	230.83	1.2
Coliban	262.32	259.66	-1.0
East Gippsland	62.72	63.14	0.7
Gippsland	275.90	264.59	-4.1
Goulburn Valley	160.31	162.60	1.4
GWMWater	127.87	128.81	0.7
Lower Murray (urban)	85.25	83.03	-2.6
North East	140.07	136.93	-2.2
South Gippsland	61.28	62.39	1.8
Wannon	169.00	156.70	-7.3
Western	207.25	188.02	-9.3
Westernport	44.94	45.96	2.3
Total urban	**2 221.20**	**2 171.66**	**-2.2**
Rural businesses			
FMIT	26.12	25.50	-2.3
Goulburn-Murray	438.77	435.11	-0.8
Lower Murray (rural)	57.92	59.77	3.2
Southern Rural	85.66	85.55	-0.1
Total rural	**608.47**	**605.93**	**-0.4**
All regional businesses	**2 829.67**	**2 777.60**	**-1.8**
Melbourne Water drainage and waterways	453.7	453.7	0

Note Numbers may not add due to rounding.

In assessing the businesses' proposed operating expenditure the Commission identified the following as key issues:

- Electricity expenditure — proposed changes in Water Plans ranged from no increase to a 100 per cent increase. The Commission's consultants reviewed electricity demand assumptions and applied a reasonable forecast based on the best information available in recommending adjustments.

- Labour costs and staffing levels — in assessing labour costs the Commission considered it reasonable for businesses to have included a 1.25 per cent real annual increase in labour costs over the regulatory period. Increases in staffing levels above business as usual levels were reviewed by the expenditure consultants, with adjustments recommended for a number of businesses.
- Additional productivity adjustments — where a business was not able to justify increases in expenditure above an efficient business as usual expenditure, a productivity adjustment was included to reflect an efficient overall expenditure.
- Bulk water expenditure — adjustments were made to businesses' expenditures to reflect the Commission's Draft Decision on price increases proposed by Goulburn-Murray Water, Southern Rural Water and Melbourne Water. The Commission's consultants also reviewed proposed temporary purchases of water. Permanent water purchases are considered capital expenditure.
- Licence fees and environmental contribution — the Commission adjusted forecasts proposed by the businesses to ensure that licence fees and the environmental contribution were consistent with advice provided by regulatory agencies.
- Other adjustments — the Commission made a number of other adjustments that related to particular businesses in relation to the proposed inclusion, adjustment or removal of GSL payments, proposed audits, green power, asset write-offs and valuations, implications of changes to capital expenditure profiles and further adjustments.

4.3 Overview of responses and final decision

In response to the Draft Decision, a number of businesses questioned the expenditure adjustments reflected in the Commission's operating expenditure benchmarks. The reasons for the adjustments or revisions sought included errors identified, further information or arguments to support the original forecasts and further adjustments to the businesses' original forecasts.

While many of the issues were business specific, some of the common issues raised by businesses about the Commission's Draft Decision included impacts of new energy contracts on electricity expenditure and finalisation by the Department of Sustainability and the Environment of advice on the environmental contributions from 1 July 2008.

The Commission has considered the businesses' responses to the Draft Decision and has adjusted the relevant benchmarks for each business only where:

- errors have been identified in the assumptions or forecasts adopted by the Commission in its Draft Decision
- businesses have provided further information or arguments to support their original forecasts
- additional obligations have been imposed by other regulators that were not known or could not have reasonably been known at the time the Water Plans were submitted

- material adjustments have been proposed, such that the change in expenditure is so great as to create significant risk that prices may not recover sufficient revenue or may significantly over recover revenue.

The Commission has adjusted the controllable operating expenditure benchmarks for all businesses except East Gippsland Water, South Gippsland Water, Westernport Water, GWMWater and Melbourne Water's drainage and waterways services.

All adjustments to total operating expenditure benchmarks, including the environmental contribution, payroll tax reductions and licence fee adjustments, over the regulatory period constitute a reduction of $13.37 million from the Draft Decision (see table 4.2). This compares to proposals by businesses to increase operating expenditure by $10.87 million over the draft decision level, the key component for all businesses was an overall reduction of $27.94 million in the environmental contribution compared to the draft decision.

The Commission's view is that the operating expenditure forecasts adopted in the Final Decision provide a sufficient level of expenditure for the businesses to operate and deliver their proposed services. The level of benchmarks adopted in the Final Decision:

- Provide, at a regional industry level, $2.76 billion in operating expenditure over the period, with expenditure increasing from $550.13 million in 2008-09 to $558.09 million in 2012-13, to meet demand growth, escalating real costs and new obligations.
- For the urban business, total expenditure of $2.15 billion over the regulatory period, resulting in an increase of 4.36 per cent in 2012-13 over the forecast 2008-09 level. The final decision for rural businesses provides for expenditure of $607.95 million over the period, reflecting a 8.3 per cent decrease in expenditure in 2012-13 compared to 2008-09.
- For Melbourne Water's total drainage and waterways expenditure of $453.7 million over the period, resulting an increase in 2012-13 of 4.6 per cent above 2008-09.
- Reflect adjustments in the benchmarks for each business ranging from an 8.8 percent reduction for Western Water to a 0.8 per cent increase for Goulburn-Valley Water compared with their original Water Plan forecasts.

The Commission does not believe the other proposed adjustments put forward by the businesses but not accepted are material enough to increase the risk that the business will not recover sufficient revenue over the regulatory period. A summary of the adjustments sought by the businesses is set out in Attachment 4A.

Table 4.2 **Commission's revisions for the final decision**
$ million in January 2007 prices

	Proposed by business	*Adopted in final decision*
Urban businesses		
Barwon	-5.76	-11.15
Central Highlands	0.00	-2.34
Coliban	0.78	0.09
East Gippsland	0.00	-0.06
Gippsland	0.76	-1.53
Goulburn Valley	0.60	-0.58
GWMWater	0.00	-0.96
Lower Murray (urban)	2.74	0.92
North East	1.17	0.54
South Gippsland	0.00	-0.72
Wannon	1.40	-0.71
Western	1.81	1.48
Westernport	0.24	-0.35
Total urban	**3.74**	**-15.38**
Rural businesses		
FMIT	0.00	-0.18
Goulburn-Murray	8.67	3.68
Lower Murray (rural)	-1.53	-1.66
Southern Rural	0.00	0.17
Total rural	**7.14**	**2.02**
All regional businesses	**10.87**	**-13.37**
Melbourne Water drainage and waterways	0	0

Note Numbers may not add due to rounding.

Table 4.3 **Final decision — operating expenditure (2008-09 to 2010-11)**
$ million in January 2007 prices

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*
Urban businesses						
Barwon	73.10	77.73	74.50	75.32	77.20	377.85
Central Highlands	46.67	44.83	46.97	45.10	44.91	228.49
Coliban	55.00	50.96	50.81	50.90	52.09	259.75
East Gippsland	11.99	12.06	12.84	13.12	13.07	63.08
Gippsland	49.66	53.17	52.88	53.49	53.86	263.06
Goulburn Valley	31.80	31.93	32.50	32.73	33.06	162.02
GWMWater	25.65	25.87	25.66	25.44	25.23	127.85
Lower Murray (urban)	17.26	16.68	16.40	16.61	17.00	83.95
North East	27.11	26.99	27.21	27.93	28.23	137.47
South Gippsland	12.59	12.15	12.34	12.24	12.36	61.67
Wannon	31.37	30.57	31.85	31.31	30.90	155.99
Western	31.91	34.63	37.39	40.71	44.86	189.50
Westernport	9.23	9.06	9.18	9.10	9.05	45.61
Total urban	**423.33**	**426.62**	**430.54**	**433.98**	**441.81**	**2 156.28**
Rural businesses						
FMIT	5.06	5.01	5.06	5.08	5.11	25.32
Goulburn-Murray	92.27	93.11	87.47	83.08	82.86	438.79
Lower Murray (rural)	11.75	11.96	11.29	11.48	11.64	58.11
Southern Rural	17.71	17.25	17.22	16.86	16.67	85.72
Total rural	**126.79**	**127.33**	**121.04**	**116.50**	**116.27**	**607.95**
All businesses	**550.13**	**553.95**	**551.58**	**550.48**	**558.09**	**2 764.22**
Melbourne Water drainage and waterways	88.7	88.4	91.3	92.5	92.8	453.7

Note Numbers may not add due to rounding.

4.4 Issues raised in response to the draft decision

4.4.1 Errors and omissions in the draft decision

In response to the Draft Decision, a number of businesses proposed adjustments that reflected errors or omission in relation to the operating expenditure adjustments. The Commission also identified further adjustments recommended by its consultants that were not reflected in the Draft Decision. As a result, the Commission has reviewed the information provided and adjusted the benchmarks reflect the following:

- Inclusion of a further $0.17 million reduction in expenditure adjustments for Central Highlands Water set out in SKM's final expenditure report but not reflected the Draft Decision.[14] These adjustments include increases in expenditure for the Superpipe ($0.23 million) and electricity ($0.13 million) and a $0.53 million reduction in labour.
- Reversal of the expenditure adjustment related to a double count of Gippsland Water's licence fees ($2.65 million). Information was provided by Gippsland Water to show that EPA, DHS and ESC licence fees were not double counted. The Final Decision includes a further reduction of $2.39 million for environmental works, consulting fees and native vegetation identified in the consultant's final expenditure report but not reflected in the Draft Decision.
- A new cost for replacing filters at a number of Goulburn Valley Water's treatment plants was proposed during the consultant's expenditure review. Consistent with the consultant's recommendation the cost ($0.6 million) was treated as capital expenditure in the draft decision. Goulburn Valley Water's suggestion that the cost be treated as operating expenditure has been accepted by the Commission.
- An adjustment to expenditure on new obligations identified in the consultant's final expenditure report for North East Water, but not reflected in the Commission's Draft Decision. Expenditure has been reduced by $0.45 million in the Final Decision. Electricity expenditure has also been increased because the 2006-07 base level adopted in the consultant's expenditure report was lower than actual, resulting in a $1.71 million increase for the Final Decision
- In its Draft Decision the Commission incorrectly included a net positive productivity adjustment for Wannon Water, a $0.48 million reduction has been made in the Final Decision.
- The majority of reductions for Western Water's local supply have been reversed in the Final Decision. Additional chemical costs for local treatment have been increased by $1.31 million over the Draft Decision, this is still a reduction over the Water Plan as the Commission has capped expenditure in the last two years at that of the third year. All expenditure removed ($5.99 million) for local supply costs in the Draft Decision has been re-instated, though an adjustment to the last two years has been included in electricity adjustments (section 4.3). Due to significant uncertainties about inflows the Commission considered it prudent that local supply expenditure be kept at the third year level in the last two years of the period. The Commission will allow adjustments to expenditure for Melbourne Water and local supply to be adjusted if materially different to that forecast.
- In its Water Plan, Western Water had incorrectly included some depreciation in operating expenditure. In the Draft Decision, the Commission concluded that depreciation had not been included in operating expenditure and did not make an adjustment. However, Western Water subsequently informed the Commission that it had been included in the forecasts. Therefore, expenditure for the Final Decision has been reduced by a total of $2.61 million.

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[14] SKM 2008, *Expenditure Forecast Review for the Victorian Regional Urban Businesses – Central Highlands Water*.

4.4.2 Additional information in support of Water Plan forecasts

Adjustments have also been adopted that reflect additional information provided to support Water Plan forecasts requested in the Draft Decision. Adjustments accepted by the Commission in the Final Decision are:

- Barwon Water — provided further information on fluoridation expenditure, resulting in a reduction in operating expenditure of $0.57 million over the period.
- Gippsland Water — chemical costs (increase of $2.17 million) were revised based on supporting information demonstrated that bulk oxygen costs were treated separately to chemical costs in the Water Plan.
- Coliban Water — following the release of the Draft Decision, Coliban Water provided the Commission's consultant (SKM) with further information in support of its green offset and recycling expenditure and increased electricity expenditure. SKM recommended that this expenditure be included, with a further $1.17 million for green offset and recycling and $0.28 million for electricity included in the Final Decision.
- Wannon Water — provided further information to support its labour expenditure, including details of positions filled for which expenditure had been removed in the Draft Decision. The Commission has increased expenditure by $1.02 million over the period in the Final Decision
- The Commission accepted the reasoning set out in Goulburn-Murray Water's response to the Draft Decision on reinstating expenditure associated with asset rationalisation. Forecast expenditure has been increased by $5.19 million over the first two years of the regulatory period.

The Commission has not accepted the remaining operating expenditure revisions of $0.1 million put forward by Barwon Water, on the basis that these do not reflect material risks to regulatory obligations or service outcomes proposed in its Water Plan.

4.4.3 New expenditure items

In response to the Draft Decision, a number of businesses proposed further revisions to their original forecasts. Consistent with the approach outlined, the Commission has only adjusted the benchmarks where these revisions reflect:

- additional obligations that have been imposed by other regulators that were not known or could not have reasonably been known at the time the Water Plan was submitted
- material adjustments that have been proposed, such that the change in expenditure is so great as to create significant risks that prices may not recover sufficient revenue or may significantly over recover revenue.

A number of businesses advised the Commission of the outcomes of the tender for electricity supply for the first three years of the regulatory period. Where the pricing outcomes were materially different from the electricity expenditure forecasts in the Draft Decision further adjustments were made by the Commission:

- Following a detailed demand review, Barwon Water advised that their expenditure on electricity could be reduced by $4.96 million over the period from that in the Draft Decision.
- Information supplied by Western Water and the Commission decision to maintain expenditure for local supply at third year levels in the last two years has resulted in an overall reduction of $0.34 million over the period compared to the Draft Decision.

Lower Murray Water and Wannon Water proposed adjustments but these were considered to be immaterial to the expenditure allowed for in the Draft Decision.

The Commission has adjusted the operating expenditure benchmarks for the businesses as follows:

- Barwon Water — following direction from the Department of Human Services to provide fluoridation at its three major water supply facilities, Barwon Water has adjusted operating expenditure benchmarks to reflect a $0.57 million reduction.
- Lower Murray Water — various adjustments including:
  - a reduction in expenditure by relacing ISDN with a microwave link was proposed in the Water Plan. A detailed review of the microwave link found that it is not currently cost effective and Lower Murray Water submitted that expenditure be increased by $0.189 million for urban and $0.021 million for rural.
  - the Final Decision for urban expenditure included allowances for $0.149 million for increased resources to ensure compliance with water restrictions in 2008-09 and an increase of $0.36 million over the period to meet an obligation, arising after the Draft Decision, to fluoridate their supply
  - rural expenditure was reduced by $0.200 million in each of the first two years of the period due to additional efficiency savings in their control room.
- Wannon Water — further review of $CO_2{}^e$ emissions expenditure resulted in the capitalisation of part of the original expenditure resulting in a $0.2 million expenditure reduction. Following the submission of their Water Plan, the Glenelg Hopkins Catchment Management Authority provided comment on expenditure for river and aquifer health which appeared to be overlooked. A $0.25 million increase in expenditure has been included in the Final Decision.
- Western Water — an additional reduction in Melbourne Water bulk supply costs of $0.43 million over the period was proposed by Western Water and has been reflected in the Final Decision. Western Water also accepted a further $0.38 million reduction for a number of miscellaneous expenditure items identified by SKM's final report but not required to meet the its efficiency target.
- The Commission has reduced expenditure to be paid to Southern Rural Water to reflect updated inflation figures in the Final Decision. Southern Rural Water costs are to be held constant in nominal terms across the period.
- The Commission has reduced Goulburn-Murray Water's expenditure by $0.045 million and Southern Rural Water's expenditure by $0.02 million in 2008-09 as regulatory audits will not occur.
- Southern Rural Water — requested that expenditure for labour ($0.61 million) and electricity ($0.04 million) be increased to reflect the Commission's view of a

1.25 per cent real annual wages increase and increases in energy prices. These changes were accepted and are reflected in the Final Decision.

The Commission has not accepted the remaining operating expenditure revisions of $0.63 million put forward by Lower Murray Water and $0.09 million by East Gippsland Water, on the basis that these do not reflect material risks to regulatory obligations or service outcomes proposed in their respective Water Plans. Goulburn-Murray Water's request to increase their expenditure by $21.5 million has not being accepted due to the uncertainty surrounding their future expenditure requirements. Goulburn-Murray Water will be required to provide the Commission with updated an updated revenue requirement for the remaining four years of the regulatory period.

4.5 Other adjustments

4.5.1 Bulk water costs

Apart from for Western Water, the Commission has not made any further adjustments to the bulk water expenditure assumptions adopted in the Draft Decision. Western Water's Melbourne Water expenditure has been reduced by $0.43 million as proposed in their submission to the Draft Decision and a reduction of $0.13 million made to Southern Rural Water's costs to reflect updated inflation figures (see table 4.4).

Consistent with the approach discussed in chapter 16, prices can be adjusted during the period if there are material differences between projected and actual bulk water costs.

Potential sources of material change are:

- impacts on a change from system to basin pricing by Goulburn-Murray Water, impacting on Goulburn Valley Water and North East Water
- variations from Central Highland Water's and Coliban Water's forecast pumped volumes and entitlement purchases for the Goldfield's Superpipe
- impacts on Wannon Water's expenditure following the completion of the Hamilton pipeline and
- change of Western Water's supply balance between Melbourne Water and local sourced water and the outcomes of the 2008-09 water price review for Melbourne Water.

Table 4.4 **Western Water bulk water expenditure adjustments**
1 January 2007 prices

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*
Melbourne Water	-0.09	-0.09	-0.08	-0.08	-0.08	-0.43
Southern Rural	-0.02	-0.02	-0.03	-0.03	-0.03	-0.13

4.5.2 Environmental contribution

While a number of businesses included adjustments to the environmental contribution in their submissions following the Draft Decision, the Commission's Final Decision reflects the final advice received from the Department of Sustainability and the Environment (DSE).

DSE advice provided the contribution as a constant (in nominal terms) requirement for the first four years of the regulatory period. For the purposes of the Final Decision the Commission extended the amount in nominal terms into the fifth year.

This results in an overall decrease to the benchmarks of $27.94 million over the regulatory period. The final environmental contribution and adjustment from the Draft to Final Decision are set out in table 4.5. While a number of businesses provided forecasts of environmental contribution adjustments in their submissions to the Draft Decision, the Commission has made adjustments based on DSE's final advice.

Table 4.5 **Environmental contribution**
$ million

	Environmental contribution	Environmental contribution for period	Adjustment draft to final decision
	Nominal	*1 January 2007 prices*	*1 January 2007 prices*
Urban businesses			
Barwon	4.136	19.54	-5.65
Central Highlands	1.868	8.83	-2.13
Coliban	1.902	8.99	-1.45
East Gippsland	0.771	3.64	-0.10
Gippsland	2.616	12.36	-2.49
Goulburn Valley	1.793	8.48	-1.16
GWMWater[a]	1.242	5.87	-1.06
Lower Murray (urban)	0.925	4.37	0.25
North East	1.480	6.99	-0.79
South Gippsland	0.706	3.34	-0.70
Wannon	1.469	6.94	-0.98
Western	1.512	7.15	-2.01
Westernport	0.512	2.42	-0.38
Total urban	**20.933**	**98.93**	**-18.63**
Rural businesses			0.00
FMIT	0.094	0.44	-0.17
Goulburn-Murray	0.271	6.76	-1.40
Lower Murray (rural)	1.430	1.28	-1.47
Southern Rural	0.263	1.24	-0.51
Total rural	**2.057**	**9.72**	**-3.56**
All businesses	**22.990**	**108.65**	**-22.19**

[a] Includes contribution based on urban and rural revenues.

4.5.3 Further adjustments

Licence fees adjustment for previous regulatory period

In the Final Decision for the last regulatory period the Commission advised that it would allow businesses to recover expenditure due to differences between forecast and actual licence fees.

Only two businesses, Barwon Water and FMIT, proposed adjustments for recovery of licence fees from the first period.

Due to variations in costing methodologies, the Commission has developed an estimate of the licence fees to be recovered for each business.

Adjustments for Melbourne Water licence fees will be undertaken following the broader review of their prices in 2008-09.

Payroll tax and Workcover premium adjustments

Following the announcement of a reduction in payroll tax from 5.05 per cent to 4.95 per cent and reductions in the average Workcover premium, the Commission approached businesses to provide a forecast of the impact on their expenditure.

For the Final Decision the Commission was required to estimate a reduction for Goulburn-Murray Water, Lower-Murray Water and Southern Rural Water. Impacts were considered to be immaterial for a further seven businesses (see table 4.6).

Adjustments for Melbourne Water's land tax, payroll and licence fees will be undertaken following the broader review of their prices in 2008-09.

Table 4.6 **Licence fee, payroll tax and Workcover premium adjustments**
$ million in 1 January 2007 prices

	Licence fee adjustments	*Payroll, land and Workcover adjustments*
Urban businesses		
Barwon	0.225	-0.20
Central Highlands	0.09	-0.69
Coliban	0.09	0a
East Gippsland	0.04	0[a]
Gippsland[b]	0.12	-0.04
Goulburn Valley	0.09	-0.11
GWMWater	0.003	0[a]
Lower Murray (urban)	0.009	-0.03[c]
North East	0.075	-0.02
South Gippsland	0.04	-0.07[a]
Wannon	0.09	-0.24
Western	0.075	0[a]
Westernport	0.025	0[a]
Total urban	**0.972**	**-0.91**
Rural businesses		
FMIT	0.003	0[a]
Goulburn-Murray	0.04	-0.1[c]
Lower Murray (rural)	0.006	-0.03[c]
Southern Rural	0.015	-0.04[c]
Total rural	**0.064**	**-0.18**
All businesses	**1.036**	**-1.09**

[a] Not material [b] Payroll adjustment only. [c] Estimated by Commission based on 2006-07 labour costs.

Attachment 4A Summary of adjustments to operating expenditure for the final decision

	Description	*Proposed*	*Adopted*
Barwon	Did not accept Draft Decision to remove all pandemic expenditure.	0.100	0.000
	Proposed a decrease in electrical expenditure based on a new electrical contract after the Draft Decision.	-4.96	-4.96
	Proposed a reduction to fluoridation expenditure after the Draft Decision.	-0.57	-0.57
Central Highlands	The Commission identified the Draft Decision omitted the consultants final recommendation on electricity expenditure.	0	0.13
	The Commission identified the Draft Decision omitted the consultant's final recommendation on Superpipe.	0	0.22
	The Commission identified the Draft Decision omitted the consultant's final recommendation on labour expenditure.	0	-0.53
	The Commission decreased the forecast expenditure for ESC licence fees.	0	-0.135
Coliban	Accepted increased electricity expenditure identified after the Draft Decision.	0.28	0.28
	Accepted an increase in green offset and recycling expenditure identified after the Draft Decision.	1.17	1.17
East Gippsland	Proposed an increase in expenditure due to increasing fuel costs	0.09	0
FMIT	Proposed to recover expenditure for Water Register costs from the first period. The Commission notes that an allowance greater than the proposed expenditure to be recovered was included in the first regulatory period.	0.014	0
	Proposed to recover expenditure for ESC regulatory audit costs from the first period. The Commission notes that an allowance greater than the proposed expenditure to be recovered was included in the first regulatory period	0.04	0
Goulburn Valley	Did not accept filter replacement as capita expenditure and proposed increase in operating expenditure.	0.6	0.6

	Description	*Proposed*	*Adopted*
Gippsland	Accepted additional reductions in native vegetation, environmental and consultant fees and labour identified in the final expenditure report.	-3.75	-3.75
	Provided further information on additional chemical costs removed in the Draft Decision.	2.17	2.17
	Did not accept Draft Decision on a double count of licence fees and further supporting information.	2.65	2.65
	Accepted a reduction in expenditure for ESC licence fees identified after the Draft Decision.	-0.2	-0.2
Lower Murray (urban)	Proposed additional expenditure for compliance officers for 2008-09.	0.15	0.15
	Proposed an increase in IT staffing levels.	0.23	0
	Proposed an increase in expenditure for communications due to the removal of expenditure for the microwave link.	0.18	0.18
	Proposed and increase in electricity expenditure after entering into a new energy contract.	0.25	0
	Identified new operating expenditure associated with an additional obligations to fluoridate water.	0.36	0.36
Lower Murray (rural)	Proposed an increase in staffing levels for IT.	0.15	0
	Proposed an increase in expenditure for communications due to the removal of expenditure for the microwave link.	0.03	0.03
	Proposed a decrease in control room costs.	-0.20	-0.20
North East	The final expenditure report identified a further reduction to new obligations that was not included in the Draft Decision.	-0.45	-0.45
	Did not accept the electricity expenditure.	1.11	1.71
Wannon	The Commission reversed a positive productivity adjustment included in the Draft Decision.	0	-0.48
	The Commission reduced forecasted ESC licence fees.	0	-0.17
	Did not accept the adjustment for labour.	1.02	1.02

	Description	*Proposed*	*Adopted*
Wannon (continued)	Provided information on a new obligation to provide money for river and aquifer health to the CMA.	0.25	0.25
	Proposed a reduction in greenhouse energy reduction expenditure.	-0.20	-0.20
	Proposed and increase in electricity expenditure after entering into a new energy contract.	0.22	0
Western	Did not accept reductions in additional chemicals for local supply.	6.88	7.30
	Proposed an increase in electricity expenditure after entering into a new energy contract.	0.36	-0.34
	Proposed a decrease in bulk water purchases from Melbourne Water.	-0.43	-0.43
	Proposed a decrease in miscellaneous expenditure based on expenditure consultant recommendations.	-0.38	-0.38
Goulburn-Murray	Did not accept removal of asset rationalisation expenditure.	5.19	5.19
	Did not accept change to Lake Mokoan expenditure from 2009-10 to 2010-11 and proposed to increase expenditure for that not spent in 2007-08.	7.4	0
	As regulatory audit will not occur in 2008-09 for rural business the Commission removed the remaining expenditure.	0	-0.05
	Proposed adjustments to Advanced Maintenance Program Expenditure and new miscellaneous expenditure.	14.1	0
Southern Rural	Proposed that labour expenditure reflects 1.25 per cent real wages growth.	0.60	0.60
	Proposed that electricity expenditure reflect assumptions for urban businesses.	0.04	0.04
	Did not accept the Commission's view of productivity improvements.	0.82	0
	As regulatory audit will not occur in 2008-09 for rural business the Commission removed the remaining expenditure.	0	-0.05

5 CAPITAL EXPENDITURE

5.1 Introduction

Capital expenditure is a key component of the revenue requirement. Net capital expenditure is recovered by being added to the regulatory asset base (RAB) and is reflected in prices through a return on the RAB (that is the weighted average cost of capital (WACC) multiplied by the RAB) and a return of the RAB (through regulatory depreciation).

The WIRO requires the Commission to ensure the prices levied by the businesses provide them with a sustainable revenue stream that does not reflect monopoly rents or inefficient expenditure and allows the business to recover expenditure on renewing and rehabilitating existing assets. 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. The WIRO further requires the approved prices, or the manner in which they are determined, to provide incentives for the businesses to pursue efficiency improvements over the regulatory period.

For the Draft Decision, the Commission sought to identify and assess the major projects that comprise a significant proportion of the total capital expenditure forecast, rather than assessing each of the business's entire forecast capital expenditure. Cardno–Atkins (Cardno), Sinclair Knight Merz (SKM) and Halcrow Pacific (Halcrow) provided an independent assessment of the businesses' proposed expenditure.

In response to the Draft Decision a number of businesses accepted the Commission's adjustments, while some provided further information in relation to issues raised in the Draft Decision, or in relation to further issues that were identified. The Commission has assessed this information in making its Final Decision and has adjusted the relevant benchmarks for each business where:

- errors have been identified in the assumptions or forecasts adopted by the Commission in its Draft Decision
- businesses have provided further information or arguments to support their original or revised forecasts
- additional obligations have been imposed by other regulators that were not known or could not have reasonably been known at the time the Water Plan was submitted
- material adjustments have been proposed, such that the change in expenditure is so great as to create significant risk that prices may not recover sufficient revenue or may significantly over recover revenue.

5.2 Overview of draft decision

In its Draft Decision, the Commission adopted the expenditure forecasts set out in table 5.1 for urban businesses and table 5.2 for rural businesses.

In making its Draft Decision, the Commission generally accepted the recommendations of SKM and Cardno regarding the required level of capital expenditure for each water business. As shown in tables 5.1 and 5.2 overall the Commission's Draft Decision forecast capital expenditure was 1.1 per cent more than that proposed by urban businesses and 2.9 per cent (net) less than that proposed by rural businesses. The increase for urban businesses was largely due to the deferral of 2007-08 expenditure into the second regulatory period, identified during the Commission's review process.

Generally, the main reasons for adjustments to forecast capital expenditure programs related to:

- revisions of capital works programs following consultation between the businesses, the consultants and other regulatory agencies
- lack of justification for projects to be undertaken in the forthcoming regulatory period and
- adjustments due to expected slippage and/or potential for prudent deferral due to proposed works being non-urgent.

The Commission also identified a number of projects that could be subject to a within period adjustment because of uncertainty around the scope and/or timing of expenditure.

In relation to specific businesses, the Commission accepted the proposed expenditure forecasts for GWMWater while it adjusted expenditure for all other businesses. There was a significant increase for FMIT (119 per cent) which used forecasts from its 2005 Master Plan without inflating expenditure to January 2007 prices and made no provision for other cost increases. South Gippsland Water's proposed expenditure was increased by 12.7 per cent due to the increased costs forecast for the Poowong/Loch/Nyora Sewerage Scheme from the costs originally proposed in its Water Plan.

Overall, aside from capital expenditure in 2007-08 and 2008-09, which include a small number of large projects such as the Goldfields Superpipe, the Wimmera Mallee Pipeline and the Gippsland Water Factory, the Draft Decision provided for a level of capital expenditure comparable with historical levels. The detailed adjustments for each business were set out in Volume II of the Draft Decision.

Table 5.1 **Draft decision — urban businesses capital expenditure 2008-09 to 2012-13**

$million in January 2007 prices

	Proposed						Draft decision						
	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*Change per cent*
Barwon	97.50	81.70	162.84	154.03	67.03	563.10	114.45	83.57	159.90	142.37	62.70	562.99	0.0
Central Highlands	53.55	25.46	22.16	20.88	18.27	140.32	52.81	27.13	28.36	25.29	25.19	158.77	13.2
Coliban	51.52	44.49	45.74	43.92	28.43	214.10	76.04	42.29	32.94	14.64	25.52	191.43	-10.6
East Gippsland	29.61	15.36	4.45	3.32	3.43	56.17	24.77	20.16	4.49	3.32	3.43	56.17	0.0
Gippsland	56.93	32.26	42.45	56.89	62.74	251.27	53.64	30.58	40.52	53.19	62.27	240.20	-4.4
Goulburn Valley	24.84	31.87	24.90	17.62	13.66	112.90	39.50	25.84	18.25	17.07	13.06	113.71	0.7
GWMWater[a]	251.14	45.04	11.78	15.68	17.83	341.47	251.14	45.04	11.78	15.68	17.83	341.47	0.0
Lower Murray (urban)	27.14	7.47	8.05	6.36	8.38	57.40	26.98	13.64	8.54	6.84	8.86	64.86	13.0
North East	16.44	23.42	22.36	20.19	17.15	99.55	18.87	21.94	25.04	17.28	19.55	102.68	3.1
South Gippsland	12.07	10.24	9.86	8.55	7.18	47.90	10.36	6.24	9.36	14.55	13.48	53.99	12.7
Wannon	25.16	43.80	12.82	16.77	11.54	110.09	35.99	35.00	15.36	15.95	14.46	116.76	6.1
Western	38.15	33.38	24.25	16.92	15.88	128.59	38.15	33.38	25.15	16.92	15.88	129.49	0.7
Westernport	2.80	3.95	16.32	4.19	2.38	29.65	2.85	4.00	3.02	10.69	8.88	29.45	-0.7
Total Urban	**686.87**	**398.44**	**407.98**	**385.32**	**273.90**	**2,152.40**	**745.55**	**388.81**	**382.71**	**353.79**	**291.11**	**2,161.97**	**0.4%**

[a] GWMWater's capital expenditure includes a government contribution of $124.5 million for the Wimmera Mallee Pipeline in 2008-09.

Table 5.2 **Draft decision — rural businesses capital expenditure 2008-09 to 2012-13**
$million in January 2007 prices

		Proposed						Draft decision						
		2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*Change per cent*
FMIT	Gross	0.06	0.86	1.49	0.06	0.06	2.53	0.05	1.72	3.67	0.05	0.05	5.54	119.1
	Net	0.06	0.86	1.49	0.06	0.06	2.53	0.05	1.72	3.67	0.05	0.05	5.54	119.1
Goulburn-Murray Water	Gross	56.75	39.11	33.12	38.06	37.45	204.49	45.12	44.38	34.54	36.24	35.75	196.03	-4.1
	Net	27.06	27.26	25.64	29.49	30.02	139.46	22.06	29.26	28.64	29.49	30.02	139.46	0.0
Lower Murray (rural)	Gross	22.76	2.97	13.73	20.00	1.81	61.26	21.13	4.52	4.51	4.50	4.52	39.17	-36.1
	Net	16.16	2.97	10.73	11.99	1.81	43.65	14.53	4.52	4.51	4.50	4.52	32.57	-25.4
Southern Rural	Gross	12.09	11.87	15.12	32.21	45.79	117.09	11.97	11.75	15.00	32.09	45.67	116.49	-0.5
	Net	7.80	8.03	14.99	32.09	45.67	108.59	7.68	7.91	14.87	31.97	45.55	107.99	-0.6
Total Rural	**Gross**	**91.65**	**54.81**	**63.46**	**90.34**	**85.11**	**385.36**	**78.27**	**62.37**	**57.72**	**72.89**	**85.99**	**357.22**	**-7.3**
	Net	**51.09**	**39.12**	**52.84**	**73.63**	**77.55**	**294.23**	**44.33**	**43.41**	**51.68**	**66.01**	**80.13**	**285.56**	**-2.9**

5.3 Response to draft decision

5.3.1 Overview of responses and Commission assessment

In response to the Draft Decision, nine businesses (Barwon Water, East Gippsland Water, GWMWater, Gippsland Water, South Gippsland Water, Western Water, Westernport Water, FMIT and Southern Rural Water) accepted the Commission's Draft Decision capital expenditure forecasts. However, a number of issues were raised by the remaining businesses including where; they did not agree to Draft Decision adjustments, further adjustments were proposed and/or additional expenditure items were proposed. The following outlines some of the major issues identified by the Commission in making its Final Decision.

- Melbourne Interconnector (Barwon Water) — The expenditure associated with the Melbourne Interconnector pipeline has been excluded from the capital expenditure forecasts. When the project is completed and comes into service the asset base, and in turn prices, will be adjusted to reflect the project costs as well as the capitalised interest cost (based on the WACC) incurred during construction less any government contributions.
- Small town water and sewerage schemes (Central Highlands Water) — Central Highlands Water refined its budget estimate for its small town water and sewerage projects resulting in a net reduction of $3.5 million. It also proposed a change in the timing (expenditure brought forward to 2008-09) of the projects with the agreement of its customers. Support for bringing these projects forward was also provided by a number of stakeholders including the Moorabool Shire Council, the Municipal Association of Victoria, and the Golden Plains Shire who did not find the Draft Decision timeline for the Smythesdale sewer project acceptable, due to the urgent need for sewerage in the township.[15] Central Highlands Water has also included government contributions it will receive for these projects. The Commission has accepted the revised expenditure profile for the small town sewerage scheme which is outlined in table 5.3, with all projects forecast to be completed by 2010-11.

[15] Golden Plains Shire, *Submission to the 2008 Water Price Review in the relation to Central Highland Water*, 5 May 2008.

Table 5.3 **Timeline for Central Highlands Water's country towns**
$million in January 2007 prices

	2007-08	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Blackwood sewerage scheme	0.25	0.24	1.5	4.3		
Gordon sewerage scheme	0.12	0.21	0.9	2.2		
Smythesdale sewerage scheme	0.11	0.54	2.7	1		
Waubra sewerage scheme	0.13	0.49	0.8	0.2		
Landsborough/Navarre water supply upgrade	0.39	1	1.63			
Total	0.9	2.48	7.53	7.7		

Note $729 000 was spent in 2005-06 and 2006-07.

Source: Central Highlands Water, Additional Information for Final Decision provided to the ESC, 29 May 2008.

- Rural channel system reconfiguration (Coliban Water) — Between the Draft and Final Decisions, Coliban Water indicated to the Commission that it was undertaking planning for two rural reconfiguration projects with an estimated cost of $25 million, providing $5000 per ML of water savings. The Commission accepts this increase in cost of $5 million, as the cost per ML has improved compared with the original proposal which was closer to $10 000 per ML. The increased cost for this project has been included in the final two years of the regulatory period.
- Loch Sport sewerage scheme (Gippsland Water) — The Commission notes that in response to the Draft Decision there has been considerable concern raised by Gippsland Water customers, particularly over having to pay for the project without receiving any apparent benefits.[16] The Commission recognises the concerns raised by customers regarding this project and has decided to adopt an approach proposed by North East Water for a number of its country town sewerage schemes. Under this approach the Commission has removed the construction costs and customer contributions from the expenditure forecasts for the last two years of the period. When the project is complete these costs less any contributions plus the capitalised interest cost incurred during construction will be reflected in prices.
- also notes that there is significant uncertainty around the project cost and timing, as well as other issues surrounding who should be funding this project. Given these uncertainties, the Commission in its Final Decision has omitted the main construction costs for this project, but has retained some expenditure for planning and design investigations. These costs will be rolled in at the end of the regulatory period when the sewerage scheme comes into service.

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[16] Gippsland Resources Group, Response to the 2008 Water Price Review, Draft Decision, Volume 2 Gippsland Water – March 2008, p.5.

- Gippsland Water Factory (Gippsland Water) — The Commission notes there has been significant concern over the funding for the Gippsland Water Factory (GWF), where customers have claimed that its only function is to treat and recycle water for the Australian Paper Maryville mill.[17] The Commission notes that recycling is only one component of the plant, and that the GWF will treat residential and commercial wastewater from more than 15 000 households and businesses across the Gippsland area. The Commission has therefore not made any adjustment to this project in the Final Decision.
- Nichols Point sewerage scheme (Lower Murray Water (Urban)) **—** Lower Murray Water noted that following the Minister's approval to proceed with the Nichols Point sewerage scheme, it intends to complete this project in 2008-09. However, the Commission considers that based on expenditure in the current year being delayed from 2007-08, it is reasonable to expect some expenditure for this project will be deferred into 2009-10. This is consistent with the Commission's decision on a number of small town sewerage schemes for other businesses. The Commission has therefore made no change to the Draft Decision adjustment for this project.
- Mount Beauty and Myrtleford water upgrades (North East Water) — North East Water in its response to the Draft Decision stated that although its Board passed a resolution to bring forward the Mount Beauty upgrade, it did not propose to adjust its forecast expenditure. The Commission notes that the Department of Human Services has expressed concern over the timelines for water quality upgrades at Mount Beauty and Myrtleford due to ongoing public health risks. Consequently, North East Water made some further adjustments to its capital expenditure forecasts to give greater priority to these projects[18]. For the Final Decision, the Commission has also brought forward the expenditure for these projects to reflect their completion by 2010-11 at the latest.
- Cost of capital for small town sewerage schemes (North East Water) — North East Water stated that the while the weighted average cost of capital (WACC) should provide the basis for future price setting, retrospective adjustments for outlays outside the current price determination should be made on an actual cost basis. North East Water further claimed that as these projects will be 100 per cent debt funded, it is inappropriate to apply the 60/40 debt to equity assumptions embedded in the WACC. However, the Commission maintains the view that regardless of the timing difference between projects being completed and when they are rolled into the asset base, or the debt component of funding for individual projects, businesses will receive the WACC for the life of the asset. The Commission also notes that North East Water will receive some government contributions for these small town water and sewerage schemes in the next regulatory period.
- Lake Mokoan — Return to Wetlands (Goulburn-Murray Water) — In its response to the Draft Decision, Goulburn-Murray Water stated that the estimate for this project was based on information that Cardno had at the time of its review in December 2007. Subsequent to the review, the Minister announced that decommissioning will proceed. DSE therefore expect the delivery of water

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[17] Gippsland Water Resource Group, *Response to draft decision*, p.3.

[18] Email from Daniel Mongan from North East Water to the ESC, 5 June 2008.

savings from this project by 30 June 2009. Goulburn-Murray Water argued that the bulk of reliability offsets can be completed by 30 June 2009, and therefore argued that the original timeline of the project be reinstated. However, the Commission notes that a significant amount of Goulburn-Murray Water's 2007-08 expenditure is being deferred into 2008-09. Given this and the already large capital program forecast for 2008-09, the timeline adopted in the Draft Decision appears more realistic. The Commission has not made any change to the timeline for this project (completion by 2009-10) as set out in the Draft Decision.

- Renewals annuity (Lower Murray Water (rural)) — Lower Murray Water proposed that due to the continuation of renewals pricing in the Merbein district in the first two years of the regulatory period, it would deduct $0.3 million of capital expenditure in 2008-09 and $0.74 million in 2009-10. The Commission has accepted this adjustment to capital expenditure, however, it does not accept the collection of a renewals annuity over the regulatory period. It expects any positive balances to be used on projects during the period (see chapter 6).
- Merbein pipeline (Lower Murray Water (rural)) — Lower Murray Water initially did not accept the Commission's Draft Decision to exclude this project, claiming that if funding does not occur, a project of $11 million will be constructed to deliver some of the same benefits of the larger $22 million project. However, further to its response to the Draft Decision, Lower Murray Water has accepted the Commission's Draft Decision, and has been assured by the Commission that when the details of this project, either due to confirmation of government funding or revised costs for the project become more certain, prices can be adjusted during the period (see chapter 16).[19] The Commission will also allow $1 million for feasibility and planning to be undertaken during the period.
- Smoothing of capital program (Lower Murray Water (rural)) — Lower Murray Water did not accept the adjustment made to smooth the capital expenditure forecast based on historical expenditure. Lower Murray Water considered this adjustment to be a crude way of planning a capital works program and ignores the needs of customers. Lower Murray Water stated that its program is derived from a risk based prioritisation and this approach puts Lower Murray Water's assets and services at risk. The Commission considers that it is reasonable to expect some slippage in the forecast capital expenditure, particularly as the level of expenditure is significantly greater than it has been historically. The Commission therefore maintains the view that smoothing Lower Murray Water's rural capital expenditure is reasonable.

All proposed adjustments to the Draft Decision capital expenditure forecasts including those discussed above, and the Commission's assessment for the Final Decision are summarised in Attachment 5A.

5.3.2 Adjustments to 2007-08 expenditure

Between the Draft and Final Decisions, actual expenditure for 2007-08 has become more certain for a number of businesses which has required some further adjustments to the 2007-08 expenditure that is rolled into the asset base. These adjustments include:

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[19] Email from John Bergin of Lower Murray Water to the ESC, 3 June 2008.

- Gippsland Water stated that the forecast had increased to $137.4 million from $128.7 million approved in the Draft Decision, though it had only spent $79 million to date, largely due to delays in the GWF. The Commission considers that based on its expenditure to date, it is unlikely that Gippsland Water will spend the full $137.4 million in 2007-08. For the Final Decision the Commission considers that based on the expenditure to date and that the original forecast for 2007-08 was approximately $130 million, that Gippsland Water's 2007-08 expenditure be reduced to $100 million, with $30 million being deferred into the 2008-09 capital expenditure forecast. The Commission notes that Gippsland Water's 2008-09 opening asset base has been adjusted downwards by $30 million due to reasons discussed in chapter 3.
- Lower Murray Water (Urban) has shifted expenditure on permanent water rights from 2007-08 (assumed by the Commission) to 2005-06 and 2006-07 (to reflect actual timing of purchases). Lower Murray Water also proposed the deferral of a number of projects from 2007-08 to 2008-09, and included expenditure for rehabilitation of sewers, resulting in a net increase of $0.78 million. This adjustment to the 2007-08 expenditure has been accepted by the Commission in its Final Decision.
- North East Water confirmed that its 2007-08 expenditure will be $17 million, resulting in $7.2 million of expenditure being deferred to 2008-09.
- Wannon Water proposed the deferral of expenditure for a number of projects and some additional costs associated with them. The Commission has accepted this in its Final Decision, deferring $2.64 million from 2007-08 and including $3.47 million in 2008-09.
- Western Water proposed to retain its original forecast for 2007-08 of $34.5m, which the Commission has reflected in its Final Decision.
- Goulburn-Murray Water proposed a revised figure for 2007-08 of $38.6 million due to the deferral of a number of projects into the next regulatory period. Goulburn-Murray Water has stated that it is likely that the program will require further adjustment within the period.
- Coliban Water's opening asset base has been adjusted upwards by $19.9 million due to a reduction in government contributions that had been included in the Draft Decision for 2006-07 and 2007-08.

5.3.3 Adjustment provisions during the regulatory period

A number of businesses identified projects that may be undertaken during the period. As discussed in the Draft Decision, the Commission will consider adjusting the regulatory asset base for projects that become more certain during the regulatory period. However, the Commission notes that it will only consider adjusting prices for major projects that would impact on a business' ability to recover an efficient level of capital expenditure needed to deliver service expectations of customers over the period. The Commission will not consider making adjustments for minor changes to the businesses' capital programs that occur throughout the period, as all variations to the approved capital expenditure forecast will be adjusted for at the end of the regulatory period (see chapter 16).

5.3.4 Melbourne Water drainage and waterways

The Commission's Draft Decision on Melbourne Water's drainage and waterways services accepted the proposed capital expenditure forecast. In between the Draft and Final Decisions, Melbourne Water provided further information to the Commission regarding the issues raised in the Draft Decision, which the Commission was satisfied with. The Commission has therefore made no further adjustment to its Final Decision for Melbourne Water's drainage and waterways forecast capital expenditure (see table 5.4).

Table 5.4 **Final decision — capital expenditure**
$ million in January 2007 prices

	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*
Capital expenditure	105.7	132.6	118.0	121.4	111.8

5.4 Final decision — capital expenditure

The Commission believes that the capital expenditure benchmarks adopted in this Final Decision will allow each business to deliver its proposed services and meet known regulatory obligations. It does not consider that where proposed adjustments put forward by the businesses have not been accepted they will restrict businesses' ability to recover sufficient revenue or meet their required levels of service delivery.

The key issue for capital expenditure for the forthcoming regulatory period remains whether the businesses have the resources to deliver these major programs within the proposed timeframe, noting that major projects often require detailed planning and approvals before they can proceed. Additionally, the completion of major projects in the period will impact on the delivery of some of the smaller projects forecast. This has already been reflected by the significant number of projects being carried over from the current year into 2008-09 for a number of businesses. The Commission also notes that deliverability is an issue across the State and nationally in terms of overall capacity of the sector to obtain resources given some of the major projects being undertaken, such as the desalination plant and the Sugarloaf pipeline. This suggests that businesses will be competing against each other for resources, materials and contractors. It is these constraints rather than a lack of available capital that may compromise the delivery of capital programs approved in this Final Decision.

The Commission's Final Decision compared with its Draft Decision is outlined in tables 5.5 for the urban businesses and 5.6 for the rural businesses.

Table 5.5 **Final decision — urban businesses capital expenditure 2008-09 to 2012-13**
$million in January 2007 prices

	Draft decision						Final decision						
	2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*Change per cent*
Barwon	114.45	83.57	159.90	142.37	62.70	562.99	114.45	75.90	101.49	82.83	62.70	437.38[a]	-22.3%
Central Highlands	52.81	27.13	28.36	25.29	25.19	158.77	56.02	37.92	39.81	18.96	17.15	169.86	7.0%
Coliban	76.04	42.29	32.94	14.64	25.52	191.43	76.04	42.29	32.94	17.14	28.02	196.43	2.6%
East Gippsland	24.77	20.16	4.49	3.32	3.43	56.17	24.77	20.16	4.49	3.32	3.43	56.17	0.0%
Gippsland	53.64	30.58	40.52	53.19	62.27	240.20	83.64	30.58	41.57	34.04	43.12	232.95	-3.0%
Goulburn Valley	39.50	25.84	18.25	17.07	13.06	113.71	38.90	25.84	18.25	17.07	13.06	113.11	-0.5%
GWMWater[b]	251.14	45.04	11.78	15.68	17.83	341.47	251.14	45.04	11.78	15.68	17.83	341.47	0.0%
Lower Murray (urban)	26.98	13.64	8.54	6.84	8.86	64.86	25.64	18.29	8.60	6.92	9.23	68.68	5.9%
North East	18.87	21.94	25.04	17.28	19.55	102.68	24.22	22.81	29.22	19.91	13.68	109.84	7.0%
South Gippsland	10.36	6.24	9.36	14.55	13.48	53.99	10.36	6.24	9.36	14.55	13.48	53.99	0.0%
Wannon	35.99	35.00	15.36	15.95	14.46	116.76	44.38	35.03	15.46	16.02	14.54	125.45	7.4%
Western	38.15	33.38	25.15	16.92	15.88	129.49	38.15	33.38	25.15	16.92	15.88	129.49	0.0%
Westernport	2.85	4.00	3.02	10.69	8.88	29.45	2.85	4.00	3.02	10.69	8.88	29.45	0.0%
Total Urban	**745.55**	**388.81**	**382.71**	**353.79**	**291.11**	**2,161.97**	790.57	397.49	341.14	274.05	261.01	2064.26	**-4.5%**

[a] The cost of the Melbourne Interconnector is not reflected in this number, these costs will be rolled into the asset base and reflected in prices towards the end of the period. [b]GWMWater's capital expenditure includes a government contribution of $124.5 million for the Wimmera Mallee Pipeline in 2008-09.

Table 5.6 **Final decision — rural businesses capital expenditure 2008-09 to 2012-13**
$million in January 2007 prices

		Draft decision						Final decision						
		2008-09	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*2008-09*	*2009-10*	*2010-11*	*2011-12*	*2012-13*	*Total*	*Change per cent*
FMIT	Gross	0.05	1.72	3.67	0.05	0.05	5.54	0.05	1.72	3.67	0.05	0.05	5.54	0.0
	Net	0.05	1.72	3.67	0.05	0.05	5.54	0.05	1.72	3.67	0.05	0.05	5.54	0.0
Goulburn-Murray Water	Gross	45.12	44.38	34.54	36.24	35.75	196.03	73.65	46.92	35.36	33.39	33.05	222.38	13.4
	Net	22.06	29.26	28.64	29.49	30.02	139.46	30.23	27.43	26.40	23.96	24.34	132.36	-5.1
Lower Murray (rural)	Gross	21.13	4.52	4.51	4.50	4.52	39.17	26.04	4.69	5.17	4.46	5.98	46.32	18.3
	Net	14.53	4.52	4.51	4.50	4.52	32.57	19.44	4.69	5.17	4.46	5.98	39.73	22.0
Southern Rural	Gross	11.97	11.75	15.00	32.09	45.67	116.49	11.97	11.75	15.00	32.09	45.67	116.49	0.0
	Net	7.68	7.91	14.87	31.97	45.55	107.99	7.68	7.49	14.87	31.97	45.55	107.56	-0.4
Total Rural	**Gross**	**78.27**	**62.37**	**57.72**	**72.89**	**85.99**	**357.22**	**111.71**	**65.08**	**59.19**	**70.00**	**84.75**	**390.73**	9.4
	Net	**44.33**	**43.41**	**51.68**	**66.01**	**80.13**	**285.56**	**57.40**	**41.33**	**50.11**	**60.43**	**75.92**	**285.18**	**-0.1**

Attachment 5A Summary of adjustments to capital expenditure for the final decision

	Proposed adjustment	*Final decision*
Barwon Water	The Commission has determined that the Melbourne Interconnector be removed from the forecast and prices will be adjusted when it comes into service.	Accepted.
Central Highlands	Proposed a net reduction of $3.5 million for the small town water and sewerage projects. Also proposed a change in timing, shifting expenditure forward into 2008-09.	Accepted.
	Increased expenditure for the Goldfields Superpipe in the areas of water purchases, land compensation and reverse flow.	Accepted.
	Other minor adjustments across a number of projects due to revisions in timing and scope.	Accepted.
	Adjusted for Federal Government $90 million grant for the Goldfields Superpipe, to be received in 2007-08.	Accepted.
	Adjusted for government contributions for the small town sewerage schemes of $4.6 million in 2008-09.	Accepted.
Coliban	Revised rural configuration project — to undertake two rural reconfiguration projects with water savings at about $5000 per ML, with an estimated cost of $25 million.	Accepted. Included additional $5 million over the final two years of the period.
Gippsland	The Commission has omitted the construction costs for the Loch Sport project from Gippsland Water's capital expenditure forecast for the next regulatory period, but has retained some expenditure for further planning and design investigations.	Accepted.
Goulburn Valley	Proposed that expenditure for the repair to filters of $630k is an operating cost, and will not extend their original useful life.	Accepted.

	Proposed adjustment	*Final decision*
Lower Murray (Urban)	Stated that the value of permanent water rights to be transferred from operating expenditure to capital expenditure should be $553,000 not $530,000.	Accepted.
	Did not accept Draft Decision to defer some expenditure for Nichols Point as it intends to complete this project in 2008-09.	Not accepted.
	Did not accept the Draft Decision adjustment for PCs and laptops as they are difficult to sell after 3 to 4 years and are often used within the business.	Accepted.
	Due to escalation in costs proposed an increase in forecast expenditure for rehabilitation of sewers $0.2 million and the Kerang Wastewater treatment plant $0.7 million, with expenditure for this project being deferred until 2009-10.	Accepted.
	Identified two additional projects, (1) fluoridation of water treatment plants $2 million, to be completed in 2008-09 and 2009-10 to be funded by DHS and (2) Swan Hill sewerage catchment development $0.3 million in 20012-13.	Accepted.
North East	Reprioritisation of projects due to public health issues related to water quality, specifically the Bright off-stream storage, Mount Beauty WTP and Myrtleford WTP.	Accepted. Made further adjustments to bring forward timing of these projects.
Wannon	Adjustment for double counting for a component of the Warrnambool WRP upgrade.	Accepted.
	Did not accept the general adjustments made to the Draft Decision as being inconsistent with SKM's final report.	Accepted.
	Proposed a greenhouse offset capital investment of $71,000 per annum over the five year period.	Accepted.

	Proposed adjustment	*Commission's assessment*
Goulburn-Murray	Proposed revised expenditure forecast for its drainage renewal program.	Accepted.
	Proposed that the original timeline for the Lake Mokoan Return to Wetlands project be reinstated.	Not accepted.
	Proposed a number of variations to timing and cost for the dam safety program.	Accepted.
	Proposed a number of other variations to its overall capital program	Accepted.
Lower Murray (rural)	Renewals expenditure has been transferred from capital expenditure of $0.3 million in 2008-09 and $0.74 million in 2009-10.	Accepted.
	Accepted the Commission Draft Decision to exclude Merbein pipeline project, with assurance for reopening during the period.	Accepted.
	Did not accept the adjustment made to smooth the capital expenditure forecast based on historical expenditure.	Not accepted.
	Domestic stock and metering program — program has increased over the period $0.38 million.	Accepted
	Shifted $0.5 million for the Millewa Treatment Plant from 2008-09 to 2009-10.	Accepted
	Proposed increased costs for Robinvale High Pressure System of $5 million in the first year of the regulatory period.	Accepted
	Proposed additional projects including $1.5 million in 2012-13 to widen the channel and upgrade the river pump station at Lake Cullulleraine to allow for further development by private diverters.	Accepted.
Southern Rural	Annual forecast customer contribution of $420k for dairy use metering had only appeared in 2008-09. This has been corrected to appear in each year of the 2008-12 regulatory period.	Accepted.

6 FINANCING CAPITAL INVESTMENTS

In submitting their Water Plans, the businesses were required to propose a return on and of existing and new investments that satisfied the regulatory principles of the WIRO.

The WIRO requires the Commission to ensure that the prices proposed in the businesses' Water Plans provide a return on all investments made after 1 July 2004 to augment existing assets or construct new assets. This implies that businesses' revenue should provide:

- a return on the value of the regulatory asset base (RAB) (that is, the weighted average cost of capital multiplied by the RAB) and
- a return of the initial investment over time through an allowance for regulatory depreciation.

The following section provides a summary of the both the Commission's Draft Decision and the submissions received in response to this decision. Following this, the Commission will then outline its Final Decision regarding the rolling forward of the RAB, the rate of return on capital investments, the businesses' regulatory depreciation, renewals annuity programs and any requests by urban businesses for foregone revenue or additional expenditure from the current regulatory period.

6.1 Overview of draft decision

The following provides a brief summary of the Commission's Draft Decision with regard to the financing of capital investments.

6.1.1 Rolling forward the RAB

The Commission's Draft Decision with regard to the rolling forward of the businesses' RAB reflected an updated estimate for 2007-08 based on the businesses' actual capital expenditure for July to December 2007 (see chapter 5).

6.1.2 Rate of return

The Commission's Draft Decision was to adopt a rate of return that reflects an estimate of the opportunity cost of capital on the basis of a weighted average cost of capital (WACC) that reflects the weighted average of its different sources of finance —namely debt and equity. This estimate involved the use of the capital asset pricing model (CAPM) to derive a required return on equity. The outcome of the Draft Decision is shown in table 6.1.

Table 6.1 **Draft decision - real post tax WACC**

Real risk-free rate	*Equity beta*	*Market risk premium*	*Debt margin*	*Financing structure*	*Franking credit value*	*WACC*
(per cent)	*(β)*	*(per cent)*	*(per cent)*	*(per cent)*	*(ÿ)*	*(per cent)*
3.41	0.65	6.00	1.95	60	0.5	6.1

In determining the WACC, the Commission used a 20-day trading period up to 19 March 2008 to establish a nominal risk-free rate. Then, using the new approach to forming the real risk-free rate that the Commission has adopted, it deflated the nominal risk-free rate using an independent forecast of inflation. This resulted in a real risk-free rate of 3.41 per cent.

With regard to the equity beta, the Draft Decision noted that recent regulatory decisions in other industries and the relatively lower non-diversifiable risk experienced by the water businesses in comparison to the energy businesses. The Commission was therefore of the view that the equity beta should be updated to reflect the latest empirical observations. Therefore the Draft Decision was to apply an equity beta of 0.65 for the upcoming regulatory period.

The Commission sought information from Treasury Corporation Victoria (TCV) regarding the actual debt margin facing the water businesses. The Commission received confidential advice from TCV that outlined a range for the debt margins that it charges to clients based on a ten-year term to maturity. This range was due to the Financial Accommodation Levy (FAL) that is charged depending on the credit ratings of the individual businesses. Based on this range, the Commission formed a view that the debt margin should be set at 1.95 per cent. This margin was based on debt with a ten-year term to maturity and a credit rating of BBB+ and included an adjustment for any establishment fee.

The Draft Decision on the market risk premium, financing structure and franking credits resulted in the same numbers for the parameters to be used as in the previous price review.

6.1.3 Regulatory depreciation

In the Draft Decision, the Commission was of the view that the businesses' depreciation profiles were slightly on the aggressive side and suggested that businesses consider extending the estimated useful lives of their capital expenditure. It noted that this approach would also help to ease pricing pressures on current customers within their region in the near term.

Specifically, the Commission suggested that Barwon Water consider adjusting its depreciation profile for its Interconnector capital project to at least 100 years. It noted that this may help to alleviate pricing concerns that Barwon Water's customers may have, and ensure that all beneficiaries of the project pay for the service that the project provides.

6.1.4 Renewals annuities

In the Draft Decision the Commission acknowledged that both Lower Murray Water and FMIT had proposed to adopt the RAB approach for the next regulatory period rather than continuing with the renewals annuity approach. This left Southern Rural Water as the only rural water business operating with the renewals annuity approach.

The Commission accepted the proposals put forward by the businesses, however it requested Lower Murray Water to provide more detail on how it proposed to transition to the RAB approach.

6.1.5 Foregone revenue for urban water businesses

A number of urban water businesses outlined in their Water Plans that as a consequence of the continued drought and the impact of water restrictions, they had incurred higher than expected operating costs and collected less revenue than expected. The affected businesses requested that these amounts be recovered in the next regulatory period.

Following the review of these proposals the Commission's Draft Decision was that only Coliban Water could recover its proposed amount in the forthcoming regulatory period. Coliban Water was allowed to recover the proposed amount due to potential financial viability concerns.

The Commission based this concern of financial viability on the businesses' forecast interest cover over the forthcoming regulatory period.

6.2 Issues from submissions to the draft decision

The Commission received a limited number of submissions in response to issues with the financing of capital investments. The following provides an outline of the comments and issues that were submitted.

6.2.1 Rate of return

In response to the Draft Decision, none of the business questioned the methodology in calculating the weighted average cost of capital (WACC), and furthermore most of the businesses acknowledged that the WACC would be updated for the Final Decision to reflect more recent market conditions.

With regard to the overall rate of return proposed in the Draft Decision, there was customer concern regarding the significant costs that the rate of return is placing on customers, especially those on fixed income. Customers questioned the imposition of such a high rate of return during the present economic climate.

Gippsland Water investigated the possibility of adopting an individual, business-specific WACC rather than the industry-wide approach proposed by the Commission in the Draft Decision. During this investigation, Gippsland Water established that although it would gain some relief from the FAL perspective, it believed it would receive a higher WACC due to the difference in Gippsland Water's financing structure.

6.2.2 Foregone revenue

Lower Murray Water has responded to the Draft Decision by stating that the amount that was requested to be recovered in the Water Plan, has subsequently changed and now stands at $3 million. Lower Murray Water agrees with the Commission's statement that it benefited financially in the current regulatory period from the deferral of a major capital project. It is therefore requesting that it recover the difference between the revenue foregone and the benefits received from the capital expenditure underspend. This difference is $0.9 million, Lower Murray Water states that this extra recovery would mean an increase of 0.31 per cent in prices.

In its response to the Draft Decision, Barwon Water stated that the $0.2 million that it was seeking to recover in the forthcoming regulatory period, was for adjustments made due to increased licence fees during the current regulatory period. It noted that it was of the understanding that any adjustment for licence fees will be included in the following Water Plan.

6.2.3 Renewals annuities

Lower Murray Water noted that since the submission of its Water Plan it has decided, in consultation with its Merbein customers, to continue with renewals annuity for two years of the regulatory period, then transition to the RAB approach in the third year. It states that this is due to the Merbein pipelining of the channel project being moved out until later in the regulatory period.

Lower Murray Water advised that it intends to return the positive renewals balances in the first year as a lump sum contribution, except for Merbein which will be returned in year three of the regulatory period.

6.3 Final decision

Further to the issues raised in submissions, the Commission has identified other issues since the Draft Decision, the following will address these issues along with the issues raised in submissions.

6.3.1 Rolling forward the RAB

Following the release of the Draft Decision, some businesses have provided the Commission with further information relating to their 2007-08 capital expenditure. In some cases, this information has altered the amounts that were approved to be rolled into the RAB. These changes from the Draft Decision are discussed in more detail in chapter 5.

In the Draft Decision, the Commission stated that it intended to use regulatory accounting information to update the regulatory asset base. Instead it has relied on the information provided by the businesses in their financial templates. This is due to inconsistencies between the businesses' regulatory accounts and the fact that some businesses' regulatory accounts are yet to be signed-off by Directors. Furthermore, the Commission is to conduct a review of the Regulatory Accounting

Code following the price review, which will attempt to remove these inconsistencies and provide more reliable regulatory accounts for future use.

The Commission has noted that at the present time there are many significant capital projects that are being planned and constructed. Some capital projects require years to reach full completion, currently this capital expenditure is included in the RAB as it is incurred and receives both a return on and of capital expenditure. For this price review, North East Water has delayed the incorporation of capital costs with regard to some small town projects due to customer concerns. The Commission has adopted a similar approach for the incorporation of capital costs for both Gippsland Water, with regard to its Loch Sport project due to customer concerns regarding the price impact of this project, and Barwon Water with regard to its Interconnector pipeline. These projects are discussed in more detail in chapter 5.

The Commission will continue to assess the possibility of deferring the roll in of capital costs for specific projects on a case-by-case basis. This will depend on various issues such as the type of the capital project and the level of customer concerns regarding the impact of the capital costs, the ability of the business to finance the project and the timing of revenue to be received from the project.

6.3.2 Rate of return

In regard to concerns about the imposition of a high rate of return, the Commission notes that under s14(1)(a) of the Water Industry Regulatory Order (WIRO), the Commission must allow the businesses to recover a rate of return on investments made for existing and new assets. This rate of return is calculated based on the market conditions at the time of the price review.

The Commission notes that the forthcoming regulatory period is being set during an uncertain time for financial markets, it also notes that it is adopting a ‘within period’ adjustment mechanism to deal with uncertainty and events that are outside the control of the business. This mechanism is discussed in more detail in chapter 16.

The Commission’s Final Decision with regard to the WACC to apply to the water businesses is 5.8 per cent. The following table provides the parameters used to determine the WACC, this is followed by an outline of any differences in the parameters between the Draft Decision and the Final Decision.

Table 6.2 **Final decision — real post-tax WACC**

Real risk-free rate	*Equity beta*	*Market risk premium*	*Debt margin*	*Financing structure*	*Franking credit value*	*WACC*
(per cent)	(β)	(per cent)	(per cent)	(per cent)	(ÿ)	(per cent)
3.227	**0.65**	**6.00**	**1.75**	**60**	**0.5**	**5.8**
Draft decision						
3.41	0.65	6.00	1.95	60	0.5	6.1

Real risk-free rate

The Commission's Draft Decision applied a nominal risk-free rate based on a 20-day average of the yield for a 10-year nominal government bond (using information from the RBA). This approach is relatively standard among regulators. However, the Commission determined during the Gas Access Arrangements Revision that there were issues with regards to bias contained within the real Commonwealth Treasury Issued Bonds (TIBs). Therefore the approach was to adopt an average for nominal bonds and deflate the yield by an independent forecast of inflation, resulting in a real risk-free rate.

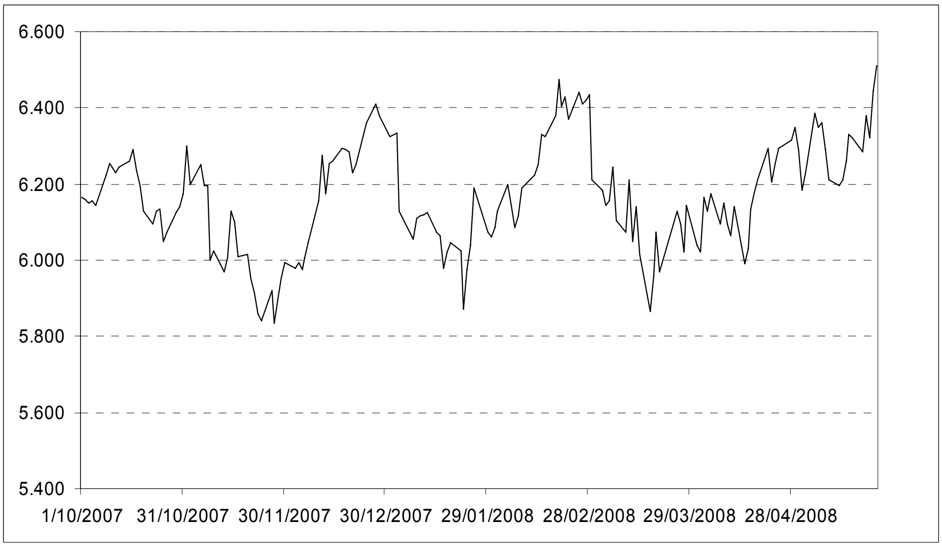
The financial market has encountered volatility in recent months, this being due to both global and domestic factors. The Commission notes that this volatility impacts on the determination of a risk-free rate for establishing prices for the regulatory period. The trading period that is chosen to establish the market conditions can have a significant impact on the five-year regulatory period following.

The Commission notes that in earlier price reviews, both energy and water, discussion was framed around the appropriate time-frame — 20 or 40 days —that should be used to form an average for the risk-free rate. While there was no distinct reasoning for the conclusion, the Commission has continually adopted the 20-day trading period to determine a risk-free rate. The Commission notes that other regulators, such as the Australian Competition and Consumer Commission (ACCC) have used 40-day averages in determining the risk-free rate for some of its regulated entities.[20]

The Commission accepts that the financial markets have experienced a degree of volatility in recent months, with this volatility also impacting on the bond market (see figure 6.1). Therefore, in order to assist in countering some of this volatility, the Commission has decided to adopt a 40-day trading period to determine a nominal risk-free rate of return.

[20] Australian Competition and Consumer Commission, 2008, Revised Access Arrangements – GasNet Australia – Final Decision, p. 65.

Figure 6.1 **Yield on 10-year Government nominal bond**



Note This information is up to 23 May 2008 — the end of the designated trading period for the review.

Data source: http://www.rba.gov.au/Statistics/Bulletin/F02Dhist.xls

The Commission has calculated this nominal risk-free rate of return based on the average of the 40-day trading period until 23 May 2008; which has resulted in a nominal rate of 6.227 per cent.

The Commission's Draft Decision on inflation relied primarily on the analysis undertaken by the Commission in relation to the Gas Access Arrangements Review Final Decision. This analysis incorporated the February increase in interest rates by the RBA, however subsequent to this there was a further interest rate rise in March, largely due to inflationary pressures. Therefore the Commission has incorporated this further increase into its forecast with relation to a Final Decision forecast for inflation.

Since the Draft Decision, the RBA released a Statement on Monetary Policy in May. In this statement the RBA's view is that inflation expectations for the near term remain relatively high, this reflects both stronger than expected consumer price inflation outcome for the March quarter of 2008 and the softer outlook for the economy.

> *A reduction in inflation over time will require a significant slowing in domestic demand … there is now evidence that demand growth has slowed, but it will take time for this to have a substantial impact on inflation.*
>
> *…*
>
> *While domestic sources of inflationary pressure have clearly increased over the past year, the rise in inflation has been partly a*

> *result of global factors, notably a general increase in commodity prices.*[21]

These types of statements suggest that in the medium-term, more weight can be placed on inflation settling at the top of the target range of 2 to 3 per cent. Further to this, the RBA state there has been much stronger demand conditions prevailing in Australia for most of the recent period in comparison to other advanced economies. This stronger demand results in Australia having higher inflation than the average for advanced economies.

While the objective of the RBA is for inflation to be, on average, in the range between 2 and 3 per cent, this does not imply that inflation would not be outside the boundaries of this range at any particular time, or that the average should be expected to fall in the middle of this range.

This further interest rate rise, combined with the RBA statements regarding the outlook for inflation, has caused the Commission to reassess its inflation forecast from the Draft Decision. The Commission's Final Decision is to apply an inflation factor of 2.9 per cent. This factor is still within the target range for the RBA, however it reflects a higher starting point than the Draft Decision and more recent statements from the RBA.

The Commission's Final Decision is that the real risk-free rate for this review will be set at 3.23 per cent. This consists of a nominal risk-free rate of 6.227 per cent, based on a 40-day trading period until 23 May 2008, and then applying an inflation factor of 2.9 per cent. The Commission notes that while this is slightly lower than the Draft Decision (3.41 per cent), it is significantly higher than the indicative real risk-free rate provided in the Guidance Paper (2.6 per cent). It is acknowledged that changes in these rates are largely due to the different market conditions at the time of producing each paper.

Debt margin

The Commission's Draft Decision attempted to provide an allowance for the debt margin that was able to more accurately reflect the actual debt margins faced by the water businesses. This was done through discussions with TCV, Victoria's central financing authority that provides loans and financial services to Victoria's Government Business Enterprises (GBEs).

Following these discussions with TCV, the Commission was able to acquire a better knowledge of the actual debt margins that the water businesses face and was able to therefore provide a more accurate estimate for the debt margin. The Commission noted that by using information acquired from TCV, the Commission was able to tailor the debt margin aspect of the WACC determination to suit the water businesses more specifically.

Changes in the market conditions in recent months required the Commission to seek updated information from TCV regarding the debt margin. The Commission received confidential advice from TCV that outlined an updated range for the debt

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[21] Reserve Bank of Australia (RBA) 2008, Statement of Monetary Policy, May, p. 2.

margins that it charges to clients based on a ten-year term to maturity. As outlined in the Draft Decision, this range in due to the Financial Accommodation Levy (FAL) that is charged, depending on the credit ratings of the individual businesses.

Based on this new information, the Commission's Final Decision is to apply a debt margin of 1.75 per cent for all businesses. This debt margin is slightly lower than that proposed in the Draft Decision (1.95 per cent), but still significantly greater than the estimate provided for by the Commission in its Guidance Paper (1.11 per cent). The estimate from the Guidance Paper was that which the businesses used in constructing their Water Plans for submission to the Commission.

6.3.3 Regulatory depreciation

The purpose of allowing a 'return of' capital expenditure through regulatory depreciation when setting regulated charges is to return to investors the value of the capital that has been invested over the life of the relevant asset.

The Commission noted in its Draft Decision that it was of the view that the businesses' depreciation profiles were slightly on the aggressive side and suggested that businesses consider extending the estimated useful lives of their capital expenditure. It also noted that this approach would help to ease any pricing pressures on current customers within their region in the near term.

Following the release of the Draft Decision, the Commission did not receive any submissions relating to the appropriateness of businesses' depreciation profiles. Furthermore, none of the businesses proposed to change their depreciation profiles, remaining of the view that their depreciation profiles were appropriate.

In its Water Plan, FMIT proposed to adopt a depreciation profile of 12 years for all assets, both existing and new. The Commission is of the view that based on comparisons with other businesses, the estimated asset life used by FMIT is unrealistic. Therefore it has changed FMIT's depreciation profile to reflect a more realistic assumption of 20 years.

6.3.4 Renewals annuities

In the Draft Decision, the Commission accepted proposals to transition from the renewals annuity approach to the RAB approach, however, Lower Murray Water asked to provide more detail regarding the transition.

The Commission notes that Lower Murray Water has since proposed to change its approach to transitioning to a RAB approach with regard to the Merbein area. It states that this change is due to a delay in the Merbein channel project until the third year of the regulatory period, and therefore it is of the view that to reduce the possibility of price volatility, it would continue the renewals annuity approach until the third year of the regulatory period.

The Commission accepts that the capital project needs to be completed, however the Commission does not accept Lower Murray Water's proposal to leave the Merbein area on the renewals annuity approach for the first two years of the regulatory period. The Commission's capital expenditure forecasts have allowed

$1 million for feasibility and planning to be undertaken during the period. In the Commission's view this, as well as the surplus in the Merbein district balance, can be used by Lower Murray Water to offset the initial cost of financing the project.

The Commission's Final Decision is that Lower Murray Water transition the Merbein area to a RAB approach in the same manner it has proposed to transition its other districts. If Lower Murray Water is concerned about price impacts the Commission notes that adjustments can be made through the revenue cap to ensure a more smoothed price path across the regulatory period.

6.3.5 Foregone revenue for urban water businesses

The Commission accepts Barwon Water's request that it recover additional expenditure of $0.2 million incurred due to increased licence fees during the current regulatory period. The Commission acknowledges that this approach was approved in the previous price review, and has therefore made this adjustment for each of the urban businesses.

The Commission's Draft Decision outlined its approach to handling requests from urban businesses with regard to revenue foregone during the current regulatory period. The Draft Decision proposed that an adjustment to the revenue requirement be made for Coliban Water in order to reflect the unique circumstances regarding Coliban Water and its ability to operate effectively for the upcoming period. This adjustment that was made by the Commission to provide Coliban Water with an average interest cover of 1.5 across the forthcoming regulatory period.

With regard to Lower Murray Water's revised request to recover $0.9 million in foregone revenue, the Commission notes that its interest cover for the upcoming period is quite significant compared to what is considered reasonable. The Commission does not consider the request to be material and is not of the view that Lower Murray Water is facing significant financial viability concerns. Furthermore, Lower Murray Water also underspent on its forecast operating expenditure (as well as forecast capital expenditure) for the current regulatory period. Considering all of these factors, the Commission does not accept Lower Murray Water's request to recover $0.9 million of foregone revenue in the forthcoming regulatory period.

Subsequent to the Draft Decision, Coliban Water has informed the Commission that there needed to be an adjustment to its 2007-08 capital expenditure, this caused its opening RAB to increase substantially. This adjustment is discussed in more detail in chapter 5. Due to this increase in the opening RAB, Coliban Water will receive more revenue than that proposed in the Draft Decision. The Commission has therefore altered the adjustment to Coliban Water's revenue requirement to alleviate financial viability concerns that the Commission had when setting the Draft Decision. This revenue requirement adjustment for financial viability purposes has been adjusted downwards to continue to provide an average interest cover of 1.5 given the higher opening RAB.

7 DEMAND FORECASTS

7.1 Introduction

The water businesses' demand forecasts represent a key element of their Water Plans for the regulatory period. Changes in customer numbers and consumption are important determinants of the capability of the water and sewerage infrastructure to provide services and of the need for expenditure on renewal and augmentation. Thus, the demand forecasts have a direct bearing on the prices that customers will pay during the period.

As part of their Water Plans, each of the urban water businesses were required to set out detailed forecasts in relation to a number of key demand variables including water and sewerage customer numbers, water supply volumes and sewerage loads and each of the rural water businesses was required to set out irrigation volumes and customer numbers, volumes supplied to stock and domestic customers and customer numbers, drainage volumes and customer numbers and the volumes of groundwater supplied.

A business's revenue requirement is recovered through the combination of the prices it proposes to charge and the quantities it believes it will sell, hence changes in the demand forecasts result in changes to prices.

7.2 Overview of draft decision

Overall, most of the businesses in their Water Plans forecast improved rainfall levels going forward, although some have based their forecasts on an assumption that drought conditions will continue over the period. Generally, the businesses that forecast dry conditions in the future operate in the western districts of Victoria where drought levels have been the most severe. However, most of the businesses in the western district are forecasting strong growth in water demand as alternative water sources are commissioned. In particular, the businesses are of the view that the Goldfields Pipeline will alleviate supplies in the west of the State and thus demand will increase over the regulatory period.

With increasing supplies from either rainfall or alternative water sources, most of the businesses forecast that water restrictions will lift over the period though restrictions will remain in place for some of the period. Most businesses also forecast that consumption levels will not return to pre-drought levels because of changes in customer behaviour and permanent water savings rules. Some businesses assumed that increased community awareness of the need to conserve water resources and permanent restrictions will permanently reduce average household usage levels in the future.

Many of the businesses are relying on these permanent changes to consumption habits to achieve their water reduction targets as set out in their Water Strategy plans. These targets commit each business to reduce per capita consumption levels by 25 per cent of mid-1990s levels by 2015.

Another factor that businesses are anticipating will assist them to achieve their 2015 targets are water conservation measures. The businesses are proposing to introduce non-price water conservation measures, such as water efficient appliances, over the period. Few of the businesses included elasticity effects in their forecasts but at the same time, indicated that they would place increasing reliance on variable charges.

Growth in the number of connections is a key determinant of total customer numbers. Nearly all of the businesses relied on the Department of Sustainability and Environment's Victoria in Future population and household forecasts to develop their forecasts of customer numbers. In recent years, new dwelling construction in some urban area has been at high levels, particularly on the metropolitan fringe and in coastal areas. However, growth in new dwellings construction and thus customer numbers is variable across the State with many non-metropolitan areas experiencing declining populations. Ageing populations and the increasing number of single occupancy residences is another driver of customer numbers considered in this review. The Commission also placed weight on the businesses' recent connection history when evaluating connections forecasts as well as any proposals for small town water and sewerage systems.

In assessing the businesses' proposed demand forecasts, the Commission sought to ensure that the forecasts:

- recognise and reflect key drivers of demand including weather, economic activity (including activity in the housing market), restrictions on usage, prices and tariff structures, and water conservation and demand management programs and the potential impact of climate change on inflow assumptions
- have been developed on the basis of sound forecasting methods
- reflect the most recent data available, together with historical data that can identify trends in demand and account for current demand and economic conditions, and reasonable prospects for market development and
- have been applied in an unbiased manner that gives due weight to all relevant factors.

Prior to the Draft Decision the Commission engaged consultants PricewaterhouseCoopers (PwC) to assist in the detailed review of the demand forecasts. The Commission generally accepted the adjustments to demand forecasts proposed by PwC. A number of businesses also adjusted their proposed demand forecasts in response to the consultant's review and to take account of continued drought conditions in 2007-08. (In particular North East Water, Westernport Water and Western Water made substantial revisions to their forecasts during the consultant's review).

The Commission considered the consultant's recommendations as well as its own analysis in making its Draft Decision and proposed changes to most of the businesses' demand forecasts.

These adjustments to the Water Plan's demand forecasts reflected assumptions about the impact of:

- population growth and demographic changes (with growth rates revised upwards for a number of businesses)
- future rainfall levels, water inflows and climate change
- restriction levels applying to water consumption
- price and tariff structure changes on water consumption (including applying price elasticity where businesses had not done so) and
- water conservation measures adopted during the regulatory period.

Overall, for urban water businesses these changes were relatively minor in most cases, but were more significant for Gippsland Water, Central Highlands Water (which both had customer growth rates revised upwards), North East Water (where poor rainfalls and lower than expected consumption in 2007-08 lead to downward revision of supply volumes) and Westernport Water (where water supply volumes were revised upwards).

The Commission accepted the demand forecasts proposed by the five rural water businesses, with the exception of Lower Murray Water.

7.3 Responses to the draft decision

This section details responses made by businesses to the Draft Decision and the Commission's assessment of those responses. Detailed tables containing the Commission's Final Decision on demand forecasts for each business are set out in Annexure A to the Determination issued in respect of that business.

In response to the Draft Decision:

- Nine urban water businesses — Barwon Water, Central Highlands Water, Coliban Water, Gippsland Water, East Gippsland, Goulburn Valley Water, GWMWater, Lower Murray Water, and South Gippsland Water — accepted the Commission's Draft Decision.
- Four rural water businesses — Goulburn-Murray Water, GWMWater, Lower Murray Water, Southern Water — accepted the Commission's Draft Decision. FMIT sought to revise its demand forecasts in light of lower supply volumes in 2007-08.

The remaining businesses put forward alternative forecasts. The nature of the businesses' proposed revisions to their demand forecasts are summarised in table 7.1.

Table 7.1 **Responses to the draft decision**

Business	*Response to the draft decision*	*Final decision*
North East	Modelling in the Draft Decision double counted major customer volumes.	Accept
Wannon	Revised down the number of billable customer numbers. Remove addition of 424 ML per annum for leakage reduction as this had not been included in water consumption figures.	Accept Accept
Western	Need to adjust customer numbers to reflect higher population growth rates as identified by the PWC review. Reduce recycled water volumes due to construction delays and lower inflows to sewage treatment plants.	Accept Accept
Westernport	Did not accept that supply volumes would recover back to historic usage levels. Review did not consider demographic of customer base.	Not accepted, issues raised by Westernport Water had been considered in the Draft Decision.
FMIT	Continued drought conditions and below expected seasonal allocations have lead to a reduction in the demand forecast. More conservative supply volume assumptions have been adopted based on 2007-08 volumes.	Accept Accept

7.3.1 Regional Urban Water businesses

Five regional urban businesses sought amendments to the Commission's Draft Decision on demand forecasts.

North East Water

In the Draft Decision, the Commission accepted revised demand forecasts from North East Water further modified by PWC. The revised forecasts were significantly lower than those proposed in the Water Plan due to poor rainfalls, lower than expected consumption in 2007-08, and continued restrictions for the early part of the regulatory period.

After the release of the Draft Decision, North East Water identified a potential error in the Commission's modelling of the revised demand forecasts. It identified that the volumes associated with some major customers were double counted and sought further clarification. The Commission accepts that there was a modelling error associated with the water volumes for North East Water.

The Commission and North East Water agree on the demand volumes set out in North East Water's response to the Draft Decision.

Wannon Water

In the Draft Decision the Commission accepted Wannon Water's connection numbers and revised its water sales volumes upwards. In response Wannon Water proposed two changes to the demand forecasts set out in the Draft Decision.

First, it advised that an error had resulted in the number of billable customers being overstated in the Water Plan. PWC in reviewing Wannon Water's demand forecasts had identified discrepancies between the number of customers and the number of billable services and the absence of a reconciliation between these numbers. Since the Draft Decision, Wannon Water has conducted a review of its billing system which identified the need for a significant reduction in the forecast number of customers.

Second, Wannon Water argued that PWC had erred in recommending an increase of 424 ML per annum in the water demand volumes due to the demand saving from water leakage. Wannon Water has sought to remove this adjustment on the basis that water savings from its leakage reduction program had been included in assessments of reduced per capita consumption but not in forecast water sales volumes, and as such it did not need to be added back into the demand forecasts. Wannon Water believed miscommunication with PWC resulted in the error.

The Commission has accepted both of these adjustments.

Western Water

In the Draft Decision, the Commission accepted Western Water's forecast of customer numbers on the advice of PWC. During the consultant's review Western Water revised its customer numbers from those submitted in the Water Plan to take account of higher population growth. The Commission in its modelling had used the original customer numbers. The Commission has clarified with PWC that the higher numbers had been accepted.

In response to the Draft Decision, Western Water proposed to reduce the Class A recycled water demand to reflect advice from developers on delays in proposed developments. Western Water also proposed additional reductions to recycled water volume due to reduced sewage treatment plant inflows.

The Commission has accepted both of these adjustments.

Westernport Water

In the Draft Decision, the Commission accepted revised demand forecasts from Westernport Water which were modified by PWC to include a gradual rebound in water usage back to historic levels after the lifting of water restrictions.

In January 2008, Westernport Water provided a revised submission for demand forecasts to PwC as part of the demand review. The revised submission was based on updated billing data from March 2007, and more accurately reflected the impacts of increased tank rebates processed over the preceding 12 months for residential properties, and impacts from major water users implementing water saving measures.

Originally, Westernport Water predicted that no water restrictions would be in place, and demand would be strong leading into the start of the second regulatory period. The original Water Plan submission was based on 1800 ML consumption for 2008-09. This figure was revised to 1700 ML based on the:

- impacts of a slower recovery from lifting restrictions (and the possibility of not lifting stage 2 restrictions until 2009-10)
- increase in tank rebates processed
- notification from major water users implementing permanent water saving infrastructure and
- a general downward trend in per property demand for residential customers due to the demographic profile of the customer base (60 per cent of residential properties are non-permanent residences).

Generally, these changes where accepted by PWC in its review and the Commission in the Draft Decision. The PWC review agreed with Westernport Water's revised water usage for 2008-09, the forecast of residential and non residential customer numbers and non residential water demand.

The review differed on residential customer water usage after the lifting of water restrictions. In its review, PWC took the view that household consumption from 2009-10 (in the absence of restrictions) follows a constant growth back to historic levels prior to water restrictions. PWC further commented that it felt this was a conservative assumption given it had phased in a recovery in supply volumes over the full regulatory period. This approach contrasted with Westernport Water's assumption that average household volumes would actually fall once restrictions were lifted. PWC further commented that Westernport Water had not provided substantive information regarding the expected yield from its conservation program and recommended that the impact of conservation programs not be included in the demand assumptions.

In response to the Draft Decision, Westernport Water proposed amending its demand forecasts to reflect a 1 per cent growth in demand each year of the regulatory period. Westernport Water argued that the forecasts assumed by PwC did not consider the demographics of its customers:

- 60 per cent of residential properties are non-permanent residents
- non-permanent properties only use 26 per cent of total consumption (approximately 450 ML per year)
- the rate of change from non-permanent to permanent properties is minimal due to the additional properties being constructed as non-permanent (or holiday) rentals
- Westernport Water has the highest proportion of holiday homes in the State
- likelihood of major sea change is highly unlikely over the plan period
- current financial markets (increasing home loan rates) indicates that the market for properties on the island has slowed and

- water conservation is a high priority for customers, as highlighted in customer consultation for the Water Plan, and feedback from customer consultative panel (CCP) members.

The Commission does not accept the revision proposed by Westernport Water for the following reasons:

- the demographics of Westernport Water's customers were considered in PWC's demand review and by the Commission in making its Draft Decision. Indeed, it was the Westernport Water demographic that lead to the view that a large reduction in household consumption is unlikely to be achieved. Westernport Water with it large non-permanent population already has the lowest average household water consumption in Victoria (and Australia). A key reason for this is the high proportion of non-permanent residents.
- In the information provided in support of its revised forecast, Westernport Water identified that it had used an average household usage of 113 kL for its permanent population and 61 kL for it non-permanent population. However historic water consumption data for Westernport Water indicates average household usage of 112 kL (including both permanent and non-permanent households). Westernport Water appears to have confused its historic average annual household data with average use by permanent households.
- Westernport Water identified minimal rates of change from non-permanent to permanent households. A shift from permanent to non-permanent households would support a reduction in consumption but no such change is occurring.
- Westernport Water has not considered any rebound in residential consumption after the lifting of water restrictions; this is at odds with the assumptions used by other water businesses.
- Westernport Water did not supply information on conservation programs and their impact on demand to either PwC as part of its review or the Commission in response to the Draft Decision. It is the Commission's view that conservation programs are likely to be less successful for Westernport Water than for other water businesses due to the high proportion of holiday homes and the already low use of water by its customers.

The Commission also notes that there is a potential inconsistency between Westernport Water conservative demand assumptions and its expenditure forecasts which contain significant expenditure on water supply augmentation. If the Commission were to accept the conservative household water consumption forecasts it would need to remove or significantly reduce the expenditure associated with water supply augmentation.

On balance, the Commission considers that the demand forecasts adopted in the Draft Decision for Westernport Water are reasonable, reflect the best available information and take account of the issues raised by Westernport Water. The Commission's review of the data provided by Westernport Water in support of the proposed revisions does not support any further adjustment to the demand forecasts adopted in the Draft Decision.

The Commission acknowledges that there may be some uncertainty over future demand levels and has put in place mechanisms to deal with this uncertainty through a within-period review (see chapter 16).

7.3.2 Rural water businesses

One of the five regional businesses sought amendments to the Commission's Draft Decision.

In the Draft Decision, the Commission accepted FMIT's demand forecasts. In response to the Draft Decision FMIT proposed to reduce the demand forecasts due to continued drought conditions and below expected seasonal allocations for 2007-08 with the expectation of further low allocations into the future.

FMIT proposed to adopt more conservative supply volume assumptions based on 2007-08 delivery volumes.

The Commission has accepted FMIT's proposed adjustments.

7.3.3 Melbourne Water's drainage and waterways services

In the Draft Decision, the Commission accepted the demand forecasts proposed by Melbourne Water which were based on information provide by the metropolitan water retailers using growth rates derived from the Department of Sustainability and Environment's 2004 *Victoria in Future* forecasts. These forecasts suggest Victoria's population will increase by around 50 000 persons for each of the next 5 years, with around 38 000 of these in Melbourne (a growth rate of around 1 per cent).

However, the latest data from the ABS indicates that in 2005 and 2006 Victoria's population growth was 75 000 per annum — 50 per cent higher than the *Victoria in Future* with most of this increase in Melbourne (forecasts. ABS 3101.0 Australian Demographic Statistics Table 2.) In its review of regional urban water businesses demand forecasts the Commission has adopted a higher growth rate for Western Water on the basis that the *VIF 2004* figures are understating actual growth rates. The Commission understands that the Victoria in the Future figures are likely to be revised in 2008-09 and will consider whether any future adjustments will need to be made under the approach for dealing with uncertainty. Any subsequent review of the Metropolitan Melbourne Water prices will also require a detailed review of metropolitan growth forecasts.

7.4 Final decision

The Commission has considered the basis put forward by the businesses for adjusting their forecasts and has accepted the revised forecasts provided by FMIT, Wannon Water and Western Water. It has not accepted the proposed adjustment proposed by Westernport Water. The Commission has made no further adjustments to demand forecasts adopted in the Draft Decision for the remaining businesses.

Overall, the Commission considers that the Final Decision demand forecasts are reasonable, reflect the best available information and give appropriate weight to all relevant factors. The Commission acknowledges that there may be uncertainty over future demand levels and is proposing to deal with this uncertainty through a within-period review. This mechanism is discussed in chapter 16.

8 OVERVIEW OF PRICES

The Commission is responsible for regulating prices for certain water and sewerage services provided by the water businesses. The WIRO prescribes the following services for which the Commission has the power to regulate prices:

- retail water services — the supply of water by a water business to a retail customer
- retail sewerage services — the removal, treatment and disposal of sewage and trade waste by a metropolitan retailer or a regional water business
- retail recycled water services — the supply of recycled water by a water business to a retail customer
- storage operator and bulk water services — the supply of bulk water from one water business to another
- bulk sewerage services — the conveyance, treatment and disposal of wastewater by Melbourne Water for another water business
- bulk recycled services — the supply of recycled water by Melbourne Water
- metropolitan drainage services — the supply of drainage services by Melbourne Water
- irrigation drainage services — the removal and disposal of run-off of irrigation by a rural water business
- connection services — the connection of a serviced property to a water supply or sewerage system
- services to which developer charges apply — contributions to the cost of works for connections services
- diversion services — the management, extraction or use of groundwater or surface water by a water business.

The Commission's price regulation role relates explicitly to these and any other services in connection with these prescribed services. It does not extend to other services that water businesses may provide in competition with other service providers, such as plumbing services or the sale of gardening products and water tanks.

As part of their Water Plans each of the water businesses subject to this review has proposed average annual price increases unadjusted for inflation, ranging from 0.3 per cent to 17.2 per cent (see table 8.1). They also set out details about the basis on which they proposed to structure charges for different services, and the extent to which they proposed to significantly change the level and structure of these charges over the regulatory period.

Table 8.1 **Average annual increase in prices over the regulatory period**

	Proposed	*Draft decision*	*Final decision*[a]
	per cent	per cent	per cent
Urban businesses			
Barwon	10.6	11.5	9.5[b]
Central Highlands	11.3[c]	10.9[c]	10.1
Coliban	13.1	12.8	12.8
East Gippsland	5.4	7.3	6.8
Gippsland	17.2[d]	17.4[d]	14.9
Goulburn Valley	5.9	8.3	7.7
GWMWater	5.9	7.3	6.6
Lower Murray (urban)	4.1	4.8	4.3
North East	8.4	8.5	9.4
South Gippsland	4.3	5.9	4.9
Wannon	6.1	5.9	6.6
Western	10.9	10.0	8.8
Westernport	4.7	5.6	4.9
Rural businesses			
FMIT	6.5	7.7	10.7
Goulburn-Murray	2.2	2.5	1.1
Lower Murray (rural)	0.3	1.1	0.9
Southern Rural	**e**	**e**	6.8

Note Average annual price change compared to 2007-08 prices. It represents the amount that current prices need to increase to match the present value of the revenue requirement and implies a smoothed increase in prices over the period. [a] Some businesses have applied non-smoothed price increases across services and tariff components. [b] Does not reflect the impact of the Melbourne Interconnector. The costs associated with the Interconnector will be rolled into the asset base at a later date and will add around 1 per cent to average prices. [c] Proposed a non smoothed increase of 25 per cent in the first year of period followed by 5.5 per cent for each remaining year. [d] Proposed a non smoothed increase of 23 per cent for each of the first and second years of the period followed by 10 per cent for each remaining year. [e] Southern Rural Water did not provide the Commission with sufficient information to enable it to calculate the required average annual price change.

Overall, the average price increases (before adjusting for inflation) implied by the Final Decision for each business range from 1.2 per cent for Lower Murray Water's rural services to 16.2 per cent for Gippsland Water. For most businesses the average price implied by the Final Decision is lower than that implied by the Draft Decision. For a number of businesses the Final Decision is lower or fairly close to what was originally proposed. However, only four businesses have annual price increase of over 10 per cent. The annual price increases reflect the revenue benchmarks and demand forecasts adopted by the Commission.

8.1 Assessing businesses' proposed prices

The WIRO requires the Commission to be satisfied that the proposed prices or the manner in which they are determined:

- provide appropriate incentives for the sustainable use of water resources by presenting water users with appropriate signals about:
  - the costs of providing services, including costs associated with future supplies and periods of peak demands and/or restricted supply
  - choices regarding alternative supplies for different purposes
- provide the businesses with incentives to pursue efficiency improvements and promote the sustainable use of water resources
- enable customers or potential customers to readily understand the prices charged or the manner in which such charges are to be calculated or otherwise determined.
- take into account the interests of their customers — including low income and vulnerable customers.

In its final report for the tariff structure inquiry, the Commission acknowledged that a number of often competing economic and non-economic objectives are advanced as important considerations in the design of water tariff structures.[22] It also recognised that there is no one 'single best tariff' and that a range of different tariff structures will be consistent, or at least not inconsistent, with the WIRO principles.

The Commission acknowledged that the water businesses typically serve different customer groups with different needs, willingness to pay and service costs. Thus, different businesses may consider that different tariff structures are better suited to their particular circumstances — it is not a case of 'one size fits all'. The Commission also accepted that some businesses may choose not to propose refinements to their tariff structures especially where they believe current tariff structures already meet the WIRO principles.

The Draft Decision set out the Commission's approach to assessing the businesses' proposed tariff structures. The Commission focused its assessment on those businesses proposing significant changes to price levels for individual tariff components or introducing new structures. It assessed the businesses' proposals in the context of a broad range of factors, including:

- the overall level of, and change in, prices
- the prevailing demand/supply balance

[22] In September 2007, the Commission was asked by the Minister for Finance to conduct an inquiry into tariff structures for the Victorian water industry. The Commission' final report to the Minister and other related material can be found on its website.

- each business' total revenue requirement for the regulatory period
- any other proposed tariff structure reforms
- the combined customer impacts from all proposed tariff structure changes
- the general price changes proposed for the regulatory period and
- feedback from stakeholder consultation.

In the Draft Decision, the Commission generally proposed to approve the tariff structures proposed by businesses. However, it sought further information from a number of businesses on customer impacts and the implementation of tariff structure changes. It also raised some concerns about the allocation of costs between residential and non-residential customers.

8.2 Issues raised in response to the draft decision

In response to the Draft Decision a number of stakeholders (both at public meetings and through submissions) raised concerns about a number of issues relevant to the proposed average price increases and changes in tariff structures. For the most part the Commission has attempted to address these concerns in the following chapters where they relate to specific services. However, a number of issues were raised that are relevant across a number of services and these are discussed in this section.

8.2.1 Affordability

A number of stakeholders raised concerns about the affordability of the proposed average price increases especially with regards to low incomes earners, pensioners and tenants.

The Commission acknowledges that the magnitude of the proposed average price increases approved by the Final Decision may be of concern to some customers. It notes that for most the average price increase set out in the Final Decision are less than those in the Draft Decision.

In determining the proposed price increases the Commission has endeavoured to ensure that they are necessary and reasonable. Having undertaken an extensive review of the businesses' proposed expenditure forecasts, it is the Commission's view that these prices reflect the efficient costs of delivering, what for most businesses is, an ambitious program of works over the next five years. A significant proportion of the capital expenditure program forecast to be completed over the regulatory period relates to improving the security of supply, improve reliability and servicing new towns.

As part of the Draft Decision the Commission sought further information from a number of businesses on their hardship policies and the mechanisms in place to help deal with those customers facing significant price increases. Generally, the Commission is satisfied that the businesses' have in place appropriate policies and mechanisms to deal with those customers. However, the Commission is proposing to undertake an audit of the businesses' hardship policies as part of its next annual audit. The audit will also consider the businesses' application of collection and restriction processes.

It is also worth noting that as part of the 2008-09 budget, the government announced that it would increase the concessions cap by 14.8 per cent to $182 from 1 July 2008.[23]

Overall, the Commission's Final Decision seeks to balance customers' long term interests by ensuring that businesses have sufficient revenue to deliver the required services on a value for money basis, thereby limiting the extent to which prices may need to rise significantly in the future to address any conservatism in this regulatory period.

8.2.2 Customer impacts

Stakeholders have also raised concerns about the customer impacts arising from changes to tariff structures. As part of the Draft Decision the Commission sought further information from a number of businesses on customer impacts and suggested that businesses consider whether the impact on customers could be minimised by phasing in proposed changes over time. Doing so, would provides customers with some time to adjust their behaviour accordingly.

Having considered the information provided by businesses in response to the Draft Decision and taking into account the comments made by stakeholders in submissions and public meetings the Commission has not approved elements of proposed tariff structures for a number of businesses. Although the proposed changes in tariff structures could be justified in terms of sending appropriate signals to customers, the Commission is concerned about impacts for particular customers or customer groups. Therefore it has not approved:

- North East Water's proposed increase in the variable water charge or the corresponding decrease in the fixed sewerage charge (see chapter 9).
- GWMWater's approach to setting its pipeline tariffs (see chapter 13)
- Goulburn-Murray Water's proposed approach for bulk water charges.

Also the Commission's Final Decision to not approve aspects of Wannon Water's proposed total dissolved salt charges for its Hamilton and Warnambool treatment plants effectively addresses potential customer impacts raised by some trade waste customers (see chapter 11).

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[23] The water and sewerage concession provides a 50 per cent discount on water consumption, sewerage disposal and service charges up to a maximum cap.

9 RETAIL WATER AND SEWERAGE SERVICES

9.1 Introduction

Retail water and sewerage services are provided by 11 regional urban water businesses (Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, North East Water, South Gippsland Water, Wannon Water, Western Water and Westernport Water) and two hybrid rural/urban businesses (GWMWater and Lower Murray Water).

The tariffs proposed by businesses for the 2008-13 regulatory period can be broadly classified as either:

- fixed tariffs —single fixed charges with no relation to usage or
- two part tariffs — tariffs comprising a fixed component and a usage component related to metered water use.

Two part tariffs may include a flat usage charge where the price per kL of water is constant for all customers, or alternatively an inclining block structure, where customers are charged a higher price per kL as their consumption increases.

9.2 Overview of draft decision

9.2.1 Retail water tariff proposals

In relation to retail water all businesses proposed two part tariffs comprising a fixed service charge and a usage charge (based on the volume of water used) for residential customers for the 2008-13 regulatory period.

Central Highlands Water, Wannon Water[24] and Westernport Water proposed to introduce three tier inclining block tariff structures.

Barwon Water, Coliban Water, East Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water, North East Water, Wannon Water and Western Water proposed to increase the proportion of revenue recovered from the usage component of their two part tariffs.

Central Highlands Water proposed to increase the proportion of revenue recovered from the fixed component of its two part tariff.

[24] Previously, Wannon Water applied a three tier inclining block tariff in the Portland Coast region and a two tier inclining block tariff in the South West region.

In its Draft Decision the Commission proposed to approve all of the businesses' inclining block tariff proposals, with the exception of Lower Murray Water's seasonal inclining block tariff.

The Commission proposed not to approve Lower Murray Water's seasonal inclining block tariff on the basis that it does not accurately reflect the costs of providing the service, or provide appropriate signals to customers about using water resources in a sustainable manner.

The Commission requested that Lower Murray Water provide further justification for its seasonal inclining block tariff, including conservation objectives and the relationship to price patterns on the temporary market.

In its Draft Decision the Commission proposed to approve the businesses' proposals to increase or alter the proportion of revenue recovered from the usage component of their two part tariffs. The Commission noted that the businesses' proposals to increase the proportion of revenue recovered from the usage component of their two part tariffs are not inconsistent with the WIRO as they provide customers with incentives to conserve water. However, the Commission noted its concerns that there may be adverse impacts on some customers from the restructuring proposals, particularly in the context of the proposed price increases.

The WIRO requires the Commission to be satisfied that prices take into account the interests of customers of the water businesses, including low income and vulnerable customers. The Commission's Customer Service Code requires each business to have a hardship policy that details procedures for assisting residential customers in hardship.

The Commission's December 2006 Review of Water Businesses' Hardship Policies found that each water business had put in place a hardship policy. However, the hardship policies varied in terms of comprehensiveness and effectiveness when assessed against a set of best practice criteria identified by the Commission. As part of the review, the Commission also made improvements to the regulatory and monitoring framework for water hardship policies.[25]

The Commission expects businesses to have appropriate hardship policies for addressing customer impacts, and will be auditing the businesses later this year to ensure they are compliant with the requirements of the Customer Service Code in relation to hardship.

The Commission suggested that Barwon Water, Central Highlands Water, Coliban Water, North East Water, Wannon Water and Western Water provide further information on their hardship policies and proposals for mitigating customer impacts, particularly with regard to non-residential customers and tenants.

The Commission also requested Gippsland Water, North East Water and South Gippsland Water provide further information on why major customers are subject to different prices to the rest of their general customer base.

[25] The Commission's 2006 Review of Water Businesses' Hardship Policies is available on its website at http://www.esc.vic.gov.au/public.

9.2.2 Retail sewerage tariff proposals

For retail sewerage services, most businesses proposed to levy fixed access charges only for residential customers and two part tariffs containing a variable usage component for non-residential customers.

In terms of restructuring proposals put forward by the businesses for the 2008-13 regulatory period:

- Barwon Water is proposing to remove its variable sewerage disposal charge for residential customers.
- North East Water is proposing to reduce fixed sewerage charges in order to recover more revenue from its water customers and remove its variable sewerage charge for all non-residential customers and residential customers in Wangaratta, Bright, Yarrawonga, Benalla, Myrtleford and Porepunkah.
- Wannon Water is grouping customers into five separate groups, each with its own particular price path.
- Central Highlands Water, East Gippsland Water, Goulburn Valley Water are proposing to bring fixed sewerage charges across their districts into line over the regulatory period.

In the Draft Decision, the Commission proposed to approve the businesses' restructuring proposals for retail sewerage charges.

However, the Commission noted that it has concerns about the implementation of some of the businesses' tariff restructuring proposals. Where tariff restructuring is proposed to take place over the course of a single year, or a few years, rather than spread evenly over the period, customers may have difficulties in absorbing price increases and adjusting their behaviour in response to the new tariffs. The Commission also noted that there is no imperative for price increases to fall precisely when capital expenditure is undertaken.

In order to minimise customer impacts of restructuring proposals, the Commission suggested that:

- Central Highlands Water consider amending its price path such that Beaufort customers are subjected to smooth year on year price increases, rather than a small decrease followed by a small increase and then three substantial increases.
- Barwon Water also consider implementing its tariff restructure more gradually over the period rather than making significant changes from 2007-08 to 2008-09.

Lower Murray Water was also requested to amend its tariff schedule to remove its environmental levy and incorporate it into its general tariffs.

9.3 Responses to draft decision

In response to the Draft Decision, where requested to do so, the businesses provided more information on their tariff proposals and programs for mitigating customer impacts. The Commission has reviewed the information provided by the following businesses and is satisfied that they are consistent with the WIRO:

- Lower Murray Water provided further justification for its seasonal inclining block tariff, sewerage tariffs and amended its sewerage tariffs to remove the environmental levy.
- Barwon Water, Central Highlands Water, Coliban Water, Wannon Water and Western Water provided further information on their hardship policies and proposals for mitigating customer impacts.
- Gippsland Water, North East Water and South Gippsland Water provided further information on their charges to major customers.

North East Water also provided information on its hardship policy and proposals for mitigating customer impacts. However, the Commission has not approved North East Water's proposed variable usage charge for water on the grounds that it does not sufficiently take into account the interests of customers.

In response to the Draft Decision, Westernport Water proposed to introduce a fixed water access charge for non-residential customers with 150 mm connections. The proposed price movement was 6.4 per cent per year, while other fixed access charges for non-residential for non-residential customers are increasing by 6.4 per cent in the first two years and then 2.5 per cent for the remaining years of the regulatory period.

In its submission to the Draft Decision, the Consumer Utilities Advocacy Centre (CUAC) noted that it strongly supported the Commission's view that an approach which attempts to minimise large price shocks to customers is most likely to be in customers' interests.[26]

CUAC also expressed the view that the businesses' levels of restriction and legal action (as described in the Commission's 2006-07 Water Performance Report) suggests that many businesses' hardship policies are not effective.

In its submission, the Energy and Water Ombudsman (Victoria) (EWOV) noted that many of the businesses' tariff restructuring proposals would shift costs from landlords to tenants, and suggested that businesses should consult widely on how to provide information to customers about price increases and changes to tariff structures.[27]

9.3.1 Lower Murray Water

Retail water services

In its Draft Decision, the Commission proposed not to approve Lower Murray Water's seasonal inclining block tariff on the basis that it does not accurately reflects the costs of providing the service, or provide appropriate signals to customers about using water resources in a sustainable manner.

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[26] Consumer Utilities Advocacy Centre 2008, Submission to the Draft Decision, 12 May.

[27] Energy and Water Ombudsman (Victoria) 2008, Submission to the Draft Decision, 9 May.

Lower Murray Water was requested to provide further justification for its seasonal inclining block tariff, including conservation objectives and the relationship to price patterns on the temporary market.

In its submission to the Draft Decision, Lower Murray Water stated it believed that its seasonal inclining block tariff does not contravene the WIRO. In particular, Lower Murray Water's tariff structure provides appropriate signals to customers about using resources in a sustainable manner for a number of reasons, including that:

- a consistent signal is being sent to customers over the course of the year, because the price of the tiers does not change and
- in most cases, customers' seasonal consumption patterns mirror the change in thresholds for the inclining block tiers, due to the requirement for evaporative air conditioning and more showers.

In support of this statement, Lower Murray Water provided average household consumption for the first three quarters of 2007-08.

Table 9.1 **Lower Murray Water average residential consumption per quarter 2007-08**

	1st Quarter *July-September*	*2nd Quarter* *October-December*	*3rd Quarter* *January-March*
Average residential consumption per quarter	52 kL	76 kL	113 kL

Note Level 4 restrictions applied from July to 16th January, and level 3 restrictions from 17th January 2008 onwards.

In relation to price patterns on the temporary market, Lower Murray Water stated that price patterns on the temporary market do not bear any relation to, or show any correlation with Lower Murray Water's seasonal inclining block tariffs or demand. Given the volatility shown by prices on the temporary market within a given season, Lower Murray Water does not see this as a reliable tool for planning demand management or pricing proposals.

At the public forum held by the Commission in Mildura on 1 May 2008, Lower Murray Water customers stated that they supported the seasonal inclining block tariff structure as:

- customers use more water in summer due to the dry conditions and greater use of air conditioners and
- Lower Murray Water had consulted with customers and is best placed to decide on the appropriate tariff structure.

The Commission notes that varying the thresholds of the inclining block charge on a seasonal basis in effect changes the price that customers are charged for consuming the same amount of water.

Further, the price of water on the temporary market could be seen as providing a price signal indicating the scarcity value of water at different times of the year. It could therefore be argued that the price signal provided by the seasonal inclining block charge should not contravene the signals provided by the market in relation to the scarcity value of water.

However, the Commission considers that given customer support, and the apparent significant increase in non-discretionary water use over the warmer quarters by Lower Murray Water customers, that Lower Murray Water's seasonal inclining block tariff satisfies the requirements of the WIRO.

Retail sewerage services

In its Draft Decision, the Commission noted that Lower Murray Water's sewerage charges based on cisterns, room or bed numbers, load factors and discharge factors is complex and may not be readily understood by customers, thereby diminishing the effectiveness of any price signals to customers regarding the sustainable use of Victoria's water resources.

The Commission also noted that Lower Murray Water's recovery of the environmental contribution through a customer based charge may not accurately reflect the cost incurred by Lower Murray Water, and may lead to over or under recovery of costs. Lower Murray Water was required to treat the environmental contribution as an overhead cost and incorporate it into its general tariffs.

In relation to its sewerage tariffs, in its submission to the Draft Decision, Lower Murray Water noted that it introduced its tariff structure in 1995 after extensive research and development with its customers and has not changed it since then.

In particular, Lower Murray Water noted that it had consulted with the accommodation and hospital sector for input into the setting of load factors and occupancy rates.

In relation to the environmental contribution, Lower Murray Water will incorporate the environmental into its general tariffs.

Final decision

The Commission has approved Lower Murray Water's retail water and sewerage tariffs.

9.3.2 North East Water

In its Draft Decision, the Commission proposed to approve North East Water's proposed retail water and sewerage tariffs. However, given that North East Water is proposing a significant restructuring of tariffs, the Commission requested that it provide further information on its proposals for mitigating customer impacts especially with regard to tenants and non-residential customers.

The Commission also noted that North East Water is proposing to levy significantly lower variable usage charges for major customers than for residential and other non-residential customers. In relation to contracts entered into between water businesses and customers the Commission is obliged to ensure that businesses comply with the pricing principles and to follow up any reports of potential non-compliance.

North East Water was requested to provide an explanation as to why its major customers are subject to lower variable usage charges than other customers

There were also a number of submissions from customers which raised concerns about the proposed price increase and restructuring of tariffs. In particular, one water only customer noted that they were facing an increase of 54.4 per cent (or $182.71) in their bill from 2007-08 to 2008-09.[28] Another customer advocated adopting an inclining block tariff, and increasing the price charged to non-residential customers.[29]

In response to the Draft Decision, in relation to customer impacts North East Water stated that large industrial and commercial customers were contacted and received either a full version of the Water Plan or the Executive summary, and invited to make comments.

North East Water also provided examples of non-residential customer impacts, noting that additional costs were not a significant proportion of total operating costs.

With regard to tenants, North East Water noted that a tenant with average consumption (166 kL per year) would face an increase of between $98.92 (with the Government rebate) and $110.64 (without the rebate) from 2007-08 to 2008-09.

With regard to customers receiving water only, North East Water noted that an average customer consuming 342 kL per annum would face an increase of $244.16 from 2007-08 to 2008-09.

North East Water has modified its hardship policy to allow a portion of fees to be waived where hardship is established. The hardship policy may also be applied in circumstances where households exceed four permanent occupants. Further, customers having difficulty paying their bill may also be provided with some appliances from North East Water to assist in reducing consumption.

In relation to the variance between prices charged to large non-residential customers and the rest of the customer base, North East Water noted that it has only 2 customers receiving non-scheduled prices. These customers are on a steady path to the standard tariff. However, it was also noted that these customers are receiving a charge that is greater than North East Water’s cost to supply the service. For one customer, due to its scale, there is a risk that the scheduled tariff could exceed the stand alone cost of service provision.

[28] G Yearbury 2008, Submission to Draft Decision, 10 April.

[29] O Lavery 2008, Submission to Draft Decision, 8 May.

The Commission notes that North East Water's proposal to increase the proportion of revenue collected via the variable usage component of its water charges is broadly consistent with the WIRO. It is also apparent from its Water Plan that North East Water has undertaken customer consultation indicating a customer preference for higher variable charges.

However, the Commission remains concerned that the substantial increases in bills from 2007-08 to 2008-09 faced by water only customers and tenants do not sufficiently take into account the interests of customers as required by the WIRO.

The Commission considers that in order to protect customers from large price increases, North East Water should implement its tariff restructure more gradually over the course of the five year regulatory period, rather than substantially from 2007-08 to 2008-09.

The Commission has specified prices for North East Water such that the proposed increase in the variable charge for water is smoothed to take place more evenly over the course of the regulatory period. To achieve this outcome the Commission has specified a slightly greater than proposed increase to fixed charges for water across the period. The variable charge for water will still be the same as proposed by North East Water at the end of the period, reflecting its stated intention to provide customers with more control over their bills and incentives for the sustainable use of water.

Further, as noted in Chapter 16, under the hybrid form of price control adopted by the Commission North East Water may apply during the period to adjust its prices or tariff structures at the time of the annual price review in order to implement its tariff restructure in a different manner to that specified by the Commission.

The Commission will also require North East Water to provide details of its contract prices with non-residential customers to ensure they are consistent with the pricing principles.

Final decision

The Commission has not approved North East Water's proposed variable usage charge for water on the grounds that it does not sufficiently take into account the interests of customers, including low income and vulnerable customers.

The Commission has specified an alternative price path which smooths the proposed increase in the variable usage charge for water over the course of the regulatory period.

To enable this result, the Commission adjusted the proposed prices for North East Water's fixed access charges for water, by applying a slightly greater increase to charges than proposed by North East Water, to ensure that the business earns revenue equal to its revenue requirement.

North East Water is required to provide details of its contract prices to the Commission to ensure they are consistent with the pricing principles.

9.3.3 Gippsland Water

In its Draft Decision, the Commission noted that Gippsland Water levies significantly lower variable usage charges for some major customers than for residential and other non-residential customers. In relation to contracts entered into between water businesses and customers, the Commission is obliged to ensure that businesses comply with the pricing principles and to follow up any reports of potential non-compliance.

Gippsland Water was requested to provide an explanation as to why their major customers are subject to lower variable usage charges than the rest of the customer base.

In their submissions to the Draft Decision and the public forum held in Traralgon on 28 April 2008, customers raised a number of issues about Gippsland Water's proposed tariffs, including:

- concerns about the affordability of price increases
- that usage charges were insignificant in comparison with fixed charges and
- that large non-residential users were being subsidised by the general customer base.[30]

The Consumer Utilities Advocacy Centre also submitted that the Commission should ensure that the level and nature of cost allocation for major projects between residential and non-residential users is equitable and in line with WIRO principles.[31]

In its response to the Draft Decision, Gippsland Water recognised that customers had raised concerns that large non-residential users were being subsidised by the general customer base. However, Gippsland Water stated that this was not the case, and noted that:

- most major clients are supplied with raw water delivered by large gravity fed systems which are low cost to operate in relation to the costs of supplying residential customers
- bulk water and bulk wastewater costs and revenues are segregated from the rest of the business and
- where lower water volumetric charges have been agreed in long term contracts, fixed charges for water and wastewater services have been set at higher levels than for residential and other non-residential customers.

Gippsland Water also agreed to provide details of all major contracts to the Commission. At this stage the final actual costs associated with the Gippsland Water Factory are not known, so it has been difficult, in the time available, for the Commission to fully analyse how costs have been allocated between customers. The Commission is proposing to further review these contracts once the final costs

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[30] For example, see Gippsland Resource Group 2008, Submission to Draft Decision, 9 May.

[31] Consumer Utilities Advocacy Centre 2008, Submission to the Draft Decision, 12 May.

of the Gippsland Water Factory are known and assess how costs have been allocated across customers.

As noted in chapter 3, the Commission has adjusted Gippsland Water's revenue requirement and approved an average annual price increase of 14.9 per cent. Consistent with Gippsland Water's proposal the Commission has increased tariffs in each of the first two years of the regulatory period by 23 per cent and reduced the average increase for the remainder of the period from 10 per cent (as proposed) to 4.3 per cent.

Final decision

The Commission has approved the structure of Gippsland Water's retail water and sewerage tariffs, but has specified an average prince increase of 14.9 per cent. It has increase prices by 23 per cent for each of the first and second years of the regulatory period ad 4.3 per cent for each subsequent year.

9.3.4 South Gippsland Water

In its Draft Decision, the Commission proposed to approve South Gippsland Water's retail water and sewerage tariffs. However, the Commission noted that South Gippsland Water levies a higher usage charge for its major customer, Murray Goulburn, than for the rest of its customer base. South Gippsland Water was requested to provide an explanation as to why Murray Goulburn is subject to higher usage charges than other customers.

In its response to the Draft Decision, South Gippsland Water clarified that Murray Goulburn attracts a higher volumetric rate than other customers, but does not pay fixed charges.

South Gippsland Water stated that Murray Goulburn intends to be fully self-sustainable in water within 10 years, and has forecast significant reductions in demand. The result of this will be that Murray Goulburn will gradually reduce its demand on the Leongatha system.

South Gippsland Water presented the Commission with a report into implementing a uniform volumetric rate for all customers, which would involve a lower volumetric rate for Murray Goulburn and also the levying of fixed charges. Murray Goulburn and South Gippsland Water have argued that establishing a fixed charge and a lower volumetric rate will be a disincentive to Murray Goulburn implementing its planned demand reductions.

The Commission remains of the view that customers receiving the same service should be subject to the same charges, however, is cognisant of the impacts that reducing variable charges to Murray Goulburn may have on the rest of South Gippsland Water's customer base.

Final decision

The Commission has approved South Gippsland Water's retail water and sewerage tariffs.

9.3.5 Barwon Water

In its Draft Decision, the Commission proposed to approve Barwon Water's proposed retail water tariffs. However, in light of the substantial restructure towards collecting more revenue via variable charges, the Commission requested that Barwon Water provide further information on its proposals for mitigating customer impacts, particularly in relation to non-residential customers and tenants.

In relation to sewerage charges, the Commission also suggested that Barwon Water should consider implementing its restructure more gradually over the period rather than from 2007-08 to minimise customer impacts.

At the public forum held in Geelong on 10 April 2008, a number of customers noted their support for the introduction of an inclining block tariff structure to encourage sustainable use of water.

Bartter, a large non-residential customer of Barwon Water, noted in its submission to the Draft Decision that despite reducing its water use over the last decade, its water bill was set to increase by 13 per cent in the next financial year.[32] Bartter also noted that it is taking part in the WaterMap Program, but still believed that the cost increase is at odds with its efforts at reducing water consumption.

In its response to the Draft Decision, Barwon Water recognised that in the first year of the regulatory period some customer segments will see a greater impact on their bill. Barwon Water has not proposed to amend the implementation of its tariff restructure, but has noted that programs have been put in place to assist impacted customer segments.

In order to minimise customer impacts, Barwon Water noted that it has a Hardship Program and Customer Assistance Program to assist customers adversely affected. Barwon Water's Hardship Program conforms to the requirements of the Commission's Customer Service Code, and also includes the provision of site visits. Barwon Water's Customer Assistance Program offers a variety of assistance mechanisms, largely for residential customers.

Barwon Water also has programs to assist residential and non-residential customers save water, reducing the impacts of price increases. Barwon Water's Water Secure Programs include indoor and outdoor programs to assist with water savings for residential customers, and business efficiency programs (including the WaterMap Program) aiming at water reductions among the top non-residential users.

[32] Bartter Enterprises Pty Limited 2008, Submission to Draft Decision, 21 May.

Final decision

The Commission notes Barwon Water's procedures for mitigating customer impacts and has approved Barwon Water's retail water and sewerage tariffs.

9.3.6 Central Highlands Water

Retail water services

In its Draft Decision, the Commission proposed to approve Central Highlands Water's retail water and sewerage tariffs. This included Central Highlands Water's proposal to introduce a three tier inclining block tariff for retail water services. Given that Central Highlands Water is proposing a significant restructuring of tariffs, the Commission requested that it provide further information on its proposals for mitigating customer impacts especially with regard to tenants and non-residential customers.

A number of customers made submissions regarding Central Highlands Water's proposed tariff structure.

Central Highlands Water's customer liaison group and one individual customer submission advocated similar pricing structures to that proposed by Central Highlands Water, but with a fourth block that imposed significant penalties for high water use.[33]

Another customer in their submission noted their support for an inclining block tariff structure, but stated that the price increase was insufficient to curb water wastage, and also noted that the proposed prices put more burden on low consumption users.[34]

In its response to the Draft Decision, Central Highlands Water noted that it has been consulting with its residential and non-residential customers on tariff increases and has an extensive Non-residential and Residential Demand Management Program to assist customers to reduce their variable water costs.

Central Highlands Water is also revising its hardship policy to offer:

- financial counselling
- individual case assessment
- revised payment plan options and
- a streamlined application process.

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[33] Customer Liaison Group CHW 2008, Submission to Draft Decision, April 21 and R de Jong 2008, Submission to Draft Decision, 19 April.

[34] P & B Sansome 2008, Submission to Draft Decision, 3 May.

Retail sewerage services

In its Draft Decision, the Commission suggested that in order to minimise customer impacts for Beaufort customers Central Highlands Water should consider implementing smooth year on year increases to fixed sewerage infrastructure charges.

In its Water Plan, Central Highlands Water proposed to bring fixed sewerage charges across its districts into line over the regulatory period. Central Highlands Water currently applies a uniform fixed access charge for sewerage across all systems apart from Clunes and Beaufort.

Clunes charges are slightly lower than the predominant access fee due to historic reasons. Beaufort charges are significantly lower than those for the main customer base but will be increased after an upgrade to the Beaufort sewerage treatment plant during the period. Fixed access charges for sewerage in Beaufort are proposed to undergo a small decrease from 2007-08 to 2008-09, a small increase from 2008-09 to 2009-10 and then substantive increases (ranging from $69.85 to $104.55) for the final three years of the regulatory period.

In its submission to the Draft Decision, Central Highlands Water stated that it had reviewed the proposed pricing for Beaufort and believes the proposed price path is appropriate and any further adjustment would disadvantage the Beaufort customer base.

Final decision

The Commission notes Central Highlands Water's procedures for mitigating customer impacts and has approved Central Highlands Water's retail water and sewerage tariffs.

9.3.7 Wannon Water

In its Draft Decision, the Commission proposed to approve Wannon Water's retail water and sewerage tariffs. However, it also noted that Wannon Water's proposal involved a substantial restructuring of tariffs. Given this restructure, and the increases proposed for some customer groups, the Commission requested that Wannon Water provide further information on its proposals for mitigating customer impacts especially with regard to tenants and non-residential customers.

At the public forum held in Warrnambool on 22 April 2008, several customers raised concerns about affordability, in particular that the increase in variable charges would shift costs from landlord to tenants.

A number of non-residential customers have raised concerns with the Commission about Wannon Water's proposed prices.

In its submission to the Draft decision, the Warrnambool Cheese and Butter Factory expressed its acceptance of Wannon Water's requirement to increase prices, however noted that it would require time to adjust to the new charges and hence would prefer if they were phased in over a longer period.[35] The Warrnambool Cheese and Butter Factory also noted its concerns that Wannon Water had not made a formal proposal to it for mitigating the impact of the proposed price increases.

In its response to the Draft Decision, Wannon Water noted that it has consulted with all the affected major non-residential customers with respect to tariff changes, including phasing out the industry discount that was previously applied in the former South West Water service area.

In relation to mitigating impacts for large customers, Wannon Water indicated that:

- large customers are generally required to provide a WaterMap savings plan
- it has an education program to assist customers in making savings.
- it provides advice to customers on downsizing the size of service connections or consolidating the number of connections to create savings in bills and
- will also consider phasing in price increases for non-residential customers who can demonstrate the tariff reforms directly threaten the viability of their business.

The removal of cistern charges will also offset impacts on non-residential customers. Other measures not specific to large non-residential customers include:

- structuring the revenue requirement such that it is slightly less in the first year of the new determination than in the last year of the current determination to minimise price impacts
- additional assistance to tenants in the form of directly communicating with all tenants who hold a concession card.

Final decision

The Commission notes Wannon Water's procedures for mitigating customer impacts and has approved Wannon Water's retail water and sewerage tariffs.

9.3.8 Coliban Water and Western Water

In its Draft Decision, the Commission proposed to approve Coliban Water's and Western Water's proposed retail water and sewerage tariffs. However, given that these businesses are proposing a significant restructuring of tariffs towards variable usage charges, the Commission requested that they provide further information on their proposals for mitigating customer impacts especially with regard to tenants and non-residential customers.

In its response to the Draft Decision, Western Water noted the provisions of its Hardship Policy, as required under the Commission's Customer Service Code.

[35] Warrnambool Cheese and Butter Factory Company Holdings Limited 2008, Submission to Draft Decision, 6 May.

Coliban Water has established a hardship team to assist identification of short term (crisis) hardship and long term (chronic) hardship.

Western Water treats hardship cases within non-residential customers on a case-by-case basis using the principles of its existing hardship policy.

In addition, depending on the merits of individual cases, Western Water may use waivers to make allowances for hardship circumstances that arise from time to time based on the customer agreeing to an instalment plan that prevents future indebtedness.

In its response to the Draft Decision, Coliban Water noted the provisions of its Hardship Policy, as required under the Commission's Customer Service Code. This policy is equally available to tenants.

In addition to providing assistance to non-residential customers to develop water management action plans, Coliban Water also noted that non-residential customers would not be excluded from entering into payment arrangements to assist them in paying their bill.

Final decision

The Commission notes Coliban Water's and Western Water's procedures for mitigating customer impacts and has approved Coliban Water's and Western Water's retail water and sewerage tariffs.

9.3.9 Westernport Water

In its Draft Decision, the Commission proposed to approve Westernport Water's retail water and sewerage charges on the basis that they were consistent with the WIRO.

In its response to the Draft Decision, Westernport Water proposed to introduce a fixed water access charge for non-residential customers with 150 mm connections. The proposed price movement was 6.4 per cent per year, while other fixed access charges for non-residential customers are increasing by 6.4 per cent in the first two years and then 2.5 per cent for the remaining years.

The Commission has approved Westernport Water's proposed non-residential 150 mm access charge for 2008-09, but has specified annual price increases in line with increases for other non-residential access charges for water.

Final decision

The Commission has not approved Westernport Water's proposed increases for the non-residential 150 mm access charge for water. The Commission has specified a prices increase in line with increases for other non-residential charges for water.

10 RECYCLED WATER

10.1 Introduction

A number of factors determine the price that water businesses are able to charge recycled water customers, including the price and availability of alternative water supplies, the scope to use or substitute recycled water for other water supplies in relevant applications, and government policies on recycled water use. Currently, major influences on the market for recycled water are the ongoing drought and limited availability of potable water supplies, concerns about improving environmental impacts and water flows, and the increasing price of alternative water sources (including potable water).

While regional businesses are not subject to explicit recycling targets, there is a general obligation in their Statements of Obligations to optimise the use of recycled water.[36] Businesses are also subject to Environment Protection Authority (EPA) licensing conditions for the discharge of treated wastewater.

10.2 Overview of draft decision

Since the 2005 Urban Water Price Review, the Government has instituted a number of initiatives and policies that directly affect recycled water.[37] In response to these changes, the Commission reviewed the principles outlined in the 2005 Urban Water Price Review. It decided that, since businesses are now able to compel certain customers to take up recycled water services, the principle of allowing businesses to maximise revenue from recycled water services should no longer be applied.

The Commission proposed that businesses adopt pricing principles that ensure that recycled water prices are set so as to:

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

[36] Clause 15.1 of the Statement of Obligations.

[37] These include changes to the Statement of Obligations (including new obligations to develop strategies to balance supply and demand and set conservation targets). From 9 October 2006, clause 56 of the Victoria Planning Provisions gives water businesses the power to mandate third pipe systems for the provision of recycled water for identified areas to assist in balancing supply and demand.

Businesses should apply these principles in setting prices where recycled water services are provided to large non-residential or unique (one-off) customers. For recycled water services provided through third pipe systems to residential customers, the Commission proposed in the Draft Decision that the prices charged for recycled water provided in new developments completed during the regulatory period be determined consistent with the pricing principles set out above and the WIRO principles. These prices would then be added to the tariff schedule and become subject to the annual price approval process.

The Commission set out cost allocation principles relating to the allocation of sewage treatment costs among sewage dischargers and recycled water customers:

- Where water is recycled as a least cost alternative to treating and disposing of effluent or complying with discharge licence standards, the treatment costs should be recovered on a ‘polluter pays’ basis through sewerage and trade waste charges, with any revenue derived from the beneficial reuse of treated effluent used to offset sewerage and trade waste fixed charges.
- Revenue shortfalls from recycled water initiatives undertaken to meet specified obligations, including Government recycling obligations or supply and demand balancing, may be recovered from the general customer base through variable water charges where such recycling confers benefits on all water customers (through improved availability or security of potable water supplies).
- The costs of discretionary projects undertaken for environmental, social or other reasons, not directly related to specified government targets, should generally be recovered from recycled water users. However, to the extent that the broader customer base benefits (from managing supply and demand or from improved environmental values), there may be a case for spreading an appropriate share of treatment costs across the broader customer base.

Businesses would need to consult with affected customers about their willingness to pay for the benefits of increased recycling before any revenue shortfall could be recovered from water tariffs.

10.3 Responses to draft decision

Submissions from customers and businesses supported the proposed amendment to the recycled water pricing principles and the proposed process for approving scheduled prices for recycled water services provided through third pipe systems to residential customers.

Yarra Valley Water argued that recycled water services provided through third pipe systems are a homogeneous product and therefore scheduled prices for these services should be the same for all customers. Uniform prices for recycled water supplied through third pipe systems would be consistent with the pricing principles provided they include a variable charge, are related to the prices charged for the relevant substitute, and cover the full costs of supply.

10.4 Final decision

The Commission has approved Western Water's Class A variable price for recycled water supplied to residential customers through reticulated third pipe systems. Coliban Water proposed, in its response to the Draft Decision, scheduled prices to apply for residential recycled water supplied through two third pipe systems to be completed during the regulatory period. The Commission has approved the proposed prices as they include a variable charge and are related to the prices charged for the relevant substitute.

In the Draft Decision, the Commission sought further information from Wannon Water on its proposal to impose a salt charge on non-residential sewerage and trade waste customers when there is a demand for re-use of the wastewater. The Commission's cost allocation pricing principles require that the costs of treating sewerage and trade waste to a level above that required for safe discharge should be borne by the beneficiaries of the recycled water. The Commission's decision on the proposed salt charge is set out in chapter 11. Wannon Water's recycled water charges must comply with the Commission's recycled water pricing principles and the allocation of costs reflected in recycled charges must be consistent with the cost allocation principles set out above and the Commission's decision on trade waste prices.

Businesses will be required to reflect the Commission's pricing principles in their tariff schedules. Any additional or alternative principles that are not consistent with the Commission's principles, such as Wannon Water's statement on salt load charging included in its Water Plan, must not be applied in determining recycled water prices.

All new, renewed or renegotiated contracts for recycled water supply must be consistent with this decision. Businesses will be required to demonstrate how their recycled water contracts comply with the principles. The Commission will monitor businesses' compliance with the recycled water pricing principles as part of its annual audit processes.

Final decision

The Commission has approved the prices proposed by Coliban Water and Western Water to be charged for recycled water supplied to residential customers through reticulated third pipe systems.

For other new third pipe developments completed during the regulatory period, businesses should apply pricing principles to determine the prices charged and then add these prices to the tariff schedule for approval during the annual price approval process. Prices for recycled water services provided to large non-residential or unique (one-off) customers under contract should be set according to the pricing principles.

Businesses are required to reflect the following principles in their tariff schedule:

Prices should be set so as to:

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

Where a business does not propose to fully recover the costs associated with recycled water, it must demonstrate to the Commission that:

- it has assessed the costs and benefits of pursuing the recycled water project
- it has clearly identified the basis on which any revenue shortfall is to be recovered
- if the revenue shortfall is to be recovered from non-recycled water customers
  - the project is required by 'specified obligations' or
  - there has been consultation with the affected customers about their willingness to pay for the benefits of increased recycling.

11 TRADE WASTE

11.1 Introduction

Each of the regional businesses (except Westernport Water) levies separate trade waste charges on customers who discharge waste other than normal domestic sewage into the sewerage system.

Trade waste charges are generally set as part of a defined schedule of tariffs that identify charges for a range of parameters including fixed charges, volume, and other key cost drivers such as biochemical oxygen demand (BOD) and suspended solids (SS). Where trade waste services are unique in nature (for example, due to discharge strength or volume), prices may be set on a case-by-case basis with reference to pricing principles included in a business's Determination.

The Department of Sustainability and Environment (DSE) commenced a state-wide review of trade waste management in December 2005. The outcome of the review may have implications for the basis on which trade waste charges are set in future.

11.2 Overview of draft decision

The Commission's basic approach to trade waste pricing is that prices must provide appropriate signals to trade waste customers about the relative merits of discharging to the sewerage system compared to alternatives such as waste minimisation and on-site treatment.

In general, 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. However, the Commission recognised the complexity of estimating long run marginal cost (LRMC), the practical difficulties involved in designing and implementing cost-reflective tariff schedules, and potential constraints on customers' capacity to respond appropriately to price signals.

In the Draft Decision, the Commission identified a number of issues and its proposed response:

- cost allocation — For an efficient allocation of treatment and disposal costs among trade waste customers and recycled water customers, the costs of treating trade waste to a level above that required for safe discharge should be borne by the beneficiaries of the treated water to give these users accurate signals about their use of recycled water. The Commission's guidance on allocating the costs of treating trade waste (and other waste water) has been set out in cost allocation principles (see chapter 10). The Commission proposed not to approve Wannon Water's proposed salt charge for trade waste customers —

to recover the cost of treating effluent to a standard suitable for reuse where there is a demand for re-use of that water — without evidence that the allocation of costs complies with the trade waste pricing principles (see below).

- non-scheduled trade waste charges — The Commission proposed a set of pricing principles to be used in determining trade waste charges for major trade waste customers and new and unique customers where scheduled prices do not apply. These principles should be included in businesses' tariff schedules and should provide, at a minimum, that:
  - volumetric and load based prices should, to the extent practicable, reflect the LRMC of trade waste transfer, treatment and disposal
  - the total revenue received from each customer should be greater than the cost that would be avoided from ceasing to serve that customer, and (subject to meeting avoidable cost) less than the stand alone cost of providing the service to the customer in the most efficient manner
  - the methodology used to allocate common and fixed costs to that customer should be clearly articulated and be consistent with any guidance provided by the Commission
  - prices should reflect reasonable assumptions regarding the volume and strength of trade waste produced by that customer
  - depreciation rates and rates of return used to determine prices should be consistent with those adopted by the Commission in this Determination
  - customers should be provided with full details of the manner in which prices have been calculated and
  - where applying these principles results in significant changes to prices or tariff structures, arrangements for phasing in the changes may be considered and any transitional arrangements should be clearly articulated.
- changes in trade waste charging during the regulatory period — The Commission proposed that any significant changes to trade waste charges or their calculation method, to reflect the outcomes of reviews by businesses or DSE, must be approved in the context of each business's form of price control, either the hybrid form of price control proposed for urban businesses for the forthcoming regulatory period or revenue caps for the rural businesses (see chapter 16).

11.3 Responses to draft decision

The Warrnambool Cheese and Butter Factory[38]objected to Wannon Water's proposed salt charge for wastewater currently disposed off through ocean outfall, noting that the charge would result in a significant increase in its total water bill.

The Commission received several submissions expressing concerns about how Gippsland Water has allocated costs between residential and non-residential customers, including suggestions that residential customers may be subsidising large trade waste customers.

[38] Warrnambool Cheese and Butter Factory 2008, Submission to the Draft Decision, 8 May.

11.4 Final decision

The Commission has approved the trade waste tariff schedules proposed by the businesses, except Wannon Water's proposed TDS salt charge. It has also approved South Gippsland Water's proposed new charging system to replace cistern based charging and Wannon Water's proposal to apply the same charging arrangements to customers in the Portland and Warrnambool regions as apply to other customers.

11.4.1 Wannon Water's proposed salt charge

In the Draft Decision, the Commission questioned whether Wannon Water's proposed salt charge to non-residential sewerage and trade waste customers, when there is a demand for re-use of the wastewater, was consistent with the Commission's pricing principles. The Commission proposed not to approve Wannon Water's trade waste charges without evidence that the allocation of costs complies with the pricing principles.

Wannon Water has provided evidence that for inland discharges (from the Hamilton treatment plant), least cost disposal requires the removal of salt down to domestic strength salt discharges. The Commission has therefore approved the proposed TDS salt charge of $0.225 per kg in 2008-09 to trade waste customers for wastewater treated at the Hamilton treatment plant. However, the Commission has not approved the large increase in the TDS charge proposed for 2009-10 because Wannon Water has not provided evidence that the substantially higher charge is consistent with the pricing principles. For the years 2009-10 to 2012-13, the Commission has specified real annual increases in the TDS salt charge equal to the overall average price increase for that year for all services provided by Wannon Water.

For the Warrnambool treatment plant, ocean outfall disposal, which does not require the removal of salt, represents least cost disposal. The Commission has not approved the proposed TDS salt charge for wastewater treated at the Warrnambool treatment plant.

This decision in relation to Wannon Water's proposed salt charge effectively addresses potential customer impacts raised by some trade waste customers.

11.4.2 Trade waste contracts

The Commission requires each business to reflect in its tariff schedule the trade waste pricing principles set out in the Draft Decision to apply to those customers for whom scheduled prices do not apply. The Commission noted in the Draft Decision that any non-scheduled prices contained in contracts that were renegotiated, renewed or entered into during the first regulatory period must be consistent with the pricing principles set out in the Determination. The businesses must also apply these principles in determining non-scheduled prices contained in any future new, renegotiated or renewed trade waste contracts.

Businesses are required to provide details of all new, renegotiated and renewed contracts and to demonstrate how these contracts comply with the pricing principles. During the regulatory period, the Commission will monitor all businesses' compliance with the trade waste pricing principles as part of its annual audit processes.

In response to concerns raised by Gippsland Water customers, the Commission asked the business to provide details of its contracts with trade waste customers and to demonstrate how the terms and prices included in those contracts complied with the pricing principles. Gippsland Water provided some information about its major contracts and stated that contract prices were sufficient to recover costs. As the Commission has not had sufficient time to confirm that contract prices are compliant with the trade waste pricing principles, it will undertake further investigation of these prices and their calculation during the next 12 months.

11.4.3 Reviews of trade waste pricing

As noted in the Draft Decision, any significant changes to trade waste charges or their calculation method resulting from reviews by businesses or reflecting the outcome of the DSE review of trade management must be approved in the context of the form of price control approved for that business (see chapter 16).

Final decision

The Commission has approved the tariff schedules proposed by the businesses, excluding Wannon Water's proposed TDS salt charge.

For wastewater treated at Wannon Water's Hamilton treatment plant, the Commission has approved a salt charge of $0.225 per kg for 2008-09 and annual real price increases for the salt charge for the years 2009-10 to 2012-13 equal to the overall average price increase for that year for all services provided by Wannon Water. The Commission has not approved the proposed TDS salt charge for wastewater treated at the Warrnambool treatment plant.

Each business is required to reflect in its tariff schedule the following trade waste pricing principles to apply to those customers for whom scheduled prices do not apply:

- volumetric and load based prices should, to the extent practicable, reflect the LRMC of trade waste transfer, treatment and disposal
- the total revenue received from each customer should be greater than the cost that would avoided from ceasing to serve that customer, and (subject to meeting avoidable cost) less than the stand alone cost of providing the service to the customer in the most efficient manner
- the methodology used to allocate common and fixed costs to that customer should be clearly articulated and be consistent with any guidance provided by the Commission
- prices should reflect reasonable assumptions regarding the volume and strength of trade waste produced by that customer
- depreciation rates and rates of return used to determine prices should be consistent with those adopted by the Commission in this Determination
- customers should be provided with full details of the manner in which prices have been calculated and
- where applying these principles results in significant changes to prices or tariff structures, arrangements for phasing in the changes may be considered and any transitional arrangements should be clearly articulated.

Any significant changes to trade waste charges or their calculation method during the regulatory period must be consistent with the form of price control approved for that business.

12 NEW CUSTOMER CONTRIBUTIONS

12.1 Introduction

In certain circumstances new customers may be required to make an upfront contribution to the costs of connecting to a water business's water, sewerage and recycled water networks. Existing non-serviced property owners are also required to make upfront contributions for the cost of connection. A water business may also charge a new customer or developer a new customer contribution that will recover the financing costs associated with bringing forward the provision of shared distribution assets. One of the Commission's responsibilities is approving or determining capital contributions or the method by which they are calculated for new and existing customers.

The key aspects of the current arrangements for new customer contributions are:

- new customers are responsible for providing assets that are to be installed specifically to service their property or development (reticulation assets)
- water businesses may charge a per lot charge up to the scheduled charge for each new property connected. The maximum per lot charge was set at $500 for 2005-06 and will remain constant in real terms until the end of the regulatory period
- water businesses are responsible for assets that are generally provided to service more than one development (shared assets) and
- water businesses may apply to the Commission to levy a charge above the scheduled charge where shared assets must be constructed ahead of schedule to service a new property or development. In these cases and subject to approval by the Commission, the water business may recover the capital financing costs that are attributable to bringing forward construction of the shared assets.

The current arrangements were adopted by the Commission as interim arrangements.

12.2 Overview of draft decision

Scheduled charges

In their Water Plans, most of the businesses proposed to adopt the Victorian Water Industry Association's proposal for charging new customer contributions.

This approach entails basing the scheduled charge for new customer contributions on the potential impact on future water demand of the new development, generally by using lot size as a determinant. Essentially there would be three levels of contribution:

1. a minimum $550 per lot per service for water, sewerage and dual pipe recycled water (total $1,650 per lot) for developments which are designed in a manner that will have minimal impact on future water resource demands and can be catered for without additional investment to upgrade the medium-term distribution capacity. These developments are typically a lot with an area no greater than 450 square meters.
2. $1,100 per lot per service for water, sewerage and dual pipe recycled water (total $3,300 per lot) for urban developments which will require further investment in infrastructure.[39] These developments are typically traditional Greenfield urban developments with lot sizes between 450 square meters and 1,350 square meters.
3. $2,200 per lot per service for water, sewerage and dual pipe recycled water (total $6,600 per lot) — for developments designed in such a way that properties will create demand for water resources over and above high-density developments which will require further investment in infrastructure. These developments are typically Greenfield developments with lot sizes exceeding 1,350 square meters, for example, lots with potentially large outside water use which will influence near term investment in infrastructure decisions.

Under the Victorian Water Industry Association approach the current mechanism for levying charges greater than the scheduled charge would remain in place.

In response to the businesses' proposals the Commission proposed to adopt the Victorian Water Industry Association approach for determining the scheduled charge for new customer contributions. The Commission's approval was subject to an adjustment clarifying that contributions in relation to recycled water will not be subject to a scheduled charge, but rather will be regulated via the Commission's proposed pricing principles for recycled water and assessed on a case-by-case basis.

Allocation of costs for reticulation assets

In their Water Plans and submissions to the Commission's December 2007 Issues Paper, most businesses noted that they were satisfied with the Commission's current procedures for the classification of assets and allocation of costs for shared and reticulation infrastructure as set out in the New Customer Contributions Guideline.

Gippsland Water stated that it would strongly oppose any proposal to change the current asset definitions, on the basis that it would:

[39] The original text in the Draft Decision included the specification - "water sensitive urban developments which will require further investment in infrastructure within a six year period to serve those developments. Or, where shared assets must be constructed ahead of schedule to service a new property or development and the calculated 'bring-forward' costs are greater than $1000 per lot for water and sewerage the calculated charge shall apply." This was part of the Victorian Water Industry Association's draft submission, and was included in error by the Commission. The amended submission is set out above.

- significantly increase the number of shared assets that businesses would be responsible for, increasing capital expenditure and jeopardising other capital projects
- add confusion to the industry and
- make the calculation of the brought forward percentage difficult as there are potentially many developments happening at once.

In its Draft Decision, the Commission noted that since the introduction of the interim arrangements, a number of developers had raised the issue of the allocation of costs for reticulation assets with the Commission.

The Commission suggested an approach whereby developers would only be required to provide funding proportional to the amount of capacity created in the new infrastructure attributable to their development. Residual capacity could be funded by the water business up until such time as subsequent development used up that capacity.

The Commission requested that businesses provide their viewpoints on the possible application of this approach, including:

- the incidence of situations where developers pay for a greater capacity in reticulation assets than is required by their development and
- possible mechanisms for allocating costs to developers based on a system capacity requirements.

Allocation of costs for shared assets

As noted above, in their Water Plans and submissions to the Commission's December 2007 Issues Paper, most businesses noted that they were satisfied with the Commission's current procedures for the classification of assets and allocation of costs for shared and reticulation infrastructure as set out in the New Customer Contributions Guideline.

However, given that the estimation of bring forward periods is typically imprecise, the Commission requested the views of businesses and other stakeholders on possible alternatives to the calculation of bring forward charges for shared infrastructure. The Commission considered that there may be merit in creating a scale of bring forward periods with a general application, such as:

- 0-5 years — no bring forward
- 6-10 years — contribution defined as 35 per cent of the as constructed cost of shared assets
- 11-15 years — contribution defined as 50 per cent of the as constructed cost of shared assets
- >15 years — contribution defined as 70 per cent of the as constructed cost of shared assets.

12.3 Responses to draft decision

Scheduled charges

In response to the Draft Decision, most businesses supported the adoption of the Victorian Water Industry Association's proposal to scale contributions according to the water sensitivity of particular developments and the demand for future infrastructure.

Villawood Properties and the Urban Development Institute of Australia (UDIA) expressed their general opposition to the concept of new customer contributions.

The UDIA stated that the cost of new infrastructure should be recovered through general retail prices over the life of the infrastructure. In established areas, infrastructure is maintained and replaced with the use of revenue collected from retail prices, and the residents of new developments should be treated no differently.[40]

Villawood Properties noted that new customers are effectively an expansion of water companies' business, and as such, the costs of new infrastructure to service them should be recovered via retail prices.[41]

Villawood Properties, GEO Property Group and the UDIA questioned the appropriateness of using lot size as a determinant for water use and efficiency. In their submissions, Villawood Properties and the UDIA stated that:

- a number of factors influence water use an efficiency, including landscaping, household design, fitting and appliance selection, and the use of water tanks and grey water systems and
- the best way to send price signals about the efficient use of water is through retail water prices.

In questioning whether lot size provides an accurate guide to servicing costs, GEO Property Group proposed that there should be an assessment of the servicing cost of a range of current urban design scenarios and development of additional explicit criteria to fine-tune application of the prices to specific situations.[42] A number of submissions also requested more clarity around the application of the scale of different charges.[43]

Aside from the general issues raised about the appropriateness of the new customer contributions regime and the proposed approach of scaling charges according to lot size, there were a number of submissions on the charges to apply in relation to recycled water. These submissions generally proposed one of two approaches, being that new customers connecting to recycled water networks should either:

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[40] Urban Development Institute of Australia (Victoria) 2008, Submission to Draft Decision, 15 May.

[41] Villawood Properties 2008, Submission to Draft Decision, 9 May.

[42] GEO Property Group, Submission to Draft Decision, 22 May.

[43] For example, see City of Greater Geelong 2008, Submission to Draft Decision, 9 May.

- be subject to a discounted or zero charge or
- be subject to the same charges as new customers connecting to water and sewerage networks.

The Victorian Water Industry Association proposed that where a development is supplied by recycled water and is able to demonstrate savings in the use of potable water, the scheduled new customer contribution for water would be reduced by half in recognition of the lower volumes of potable water required.

The Urban Development Institute of Australia (UDIA), and property developers Villawood Properties and the GEO Property Group stated in their submissions that they believed that charges for recycled water should be subsidised in whole or in part by the general customer base, due to the benefits accruing to other customers in terms of security of supply.

South East Water, City West Water and Yarra Valley Water all noted in their submissions to the Draft Decision that they believed recycled water should be subject to the same scheduled charges as water and sewerage.[44]

City West Water and South East Water noted that maintaining a scheduled charge would assist in minimising administrative costs and provide certainty for developers.

In support of its position, Yarra Valley Water recognised that the uptake of recycled water provides a benefit to the general customer base via the deferral of the next water supply augmentation, but noted that developers and property owners also benefit:

- developers benefit from marketing advantages and drought proofing their development and
- property owners benefit from drought proofing their properties and the generally lower usage charges associated with recycled water.

Yarra Valley Water stated that given that new customer contributions do not fully recover the costs of servicing new developments, the general customer base bears the cost of funding network extensions for water and sewerage. Recycled water supplied via a third pipe should be treated identically to water and sewerage services. Levying a zero or reduced new customer contribution for recycled water is not consistent with the treatment of water and sewerage services. For example, developers must pay scheduled charges for connection to the sewerage network, even though the provision of sewerage services provides benefits to the wider community in terms of public health and cleaner waterways.

Yarra Valley Water also noted that reductions in the use of potable water due to the uptake of recycled water do not necessarily result in a proportional reduction in the costs of supplying assets required for the provision of potable water.

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[44] Both City West Water and Yarra Valley water included the caveat that when determining contributions for large unique recycled water customers, pricing principles should apply.

Allocation of costs for reticulation infrastructure

Submissions in response to the Commission's Draft Decision generally expressed support for either:

- adopting the Commission's proposed approach of allocating costs to developers based on the proportion of infrastructure required by their development or
- retaining the current methodology for allocating costs related to the provision of reticulation infrastructure.

Stakeholders expressing support for the Commission's proposed approach generally did so on the grounds of fairness or equity between developers. TGM Group,[45] L. Bisinella Developments[46] and the UDIA pointed out the inequity of the developer proceeding first in a catchment being required to fund infrastructure that they may only obtain a small portion of benefit from.

City West Water, South East Water and Yarra Valley Water noted in their submissions that they supported retaining the current approach.

City West Water expressed the view that the Commission's proposal begins to confuse the concept of shared and reticulation assets. If reticulation assets were apportioned between developments, then in essence they should be shared assets and paid for by the water business.

South East Water stated that the Commission should give further consideration to the application of the definition of shared versus reticulation assets in special circumstances.

Yarra Valley Water stated that if developers were only to pay a portion of reticulation costs, future developers would then be required to contribute to sunk costs which would not provide appropriate signals for development.

Allocation of costs for shared infrastructure

A variety of views were expressed by stakeholders in response to the Commission's Draft Decision.

Most submissions noted that the determination of bring forward periods, the main factor in determining the financing costs to be applied when levying a non-scheduled charge, was very difficult in practice and often the subject of disputes.

City West Water and Gippsland Water noted their support for the Commission's current approach for allowing businesses to apply for approval to levy a charge greater than the scheduled charge. These businesses' opposition to the proposed approach is based on the view that more disputes will arise between developers and water businesses due to the significant funding differences between the proposed scale of blocks.

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[45] TGM Engineers, Surveyors & Planners 2008, Submission to Draft Decision, 7 May.

[46] L. Bisinella Developments Pty Ltd 2008, Submission to Draft Decision, 9 May.

Gippsland Water noted that although there is currently room for conjecture about how far out of sequence a development is, the difference in contributions is not marked and allows developers and businesses some room to negotiate. Under the proposed approach, there would be a marked difference in contributions between a development that is five years out of sequence compared with a development that is considered six years out of sequence.

Yarra Valley Water indicated that it supported the Commission's proposal to introduce a scale of bring forward periods with a general application, but cautioned that this does not alleviate the fundamental problem of determining the timing and location of incremental growth. Given the difficulties in forecasting development in one year timeframes is difficult, the concept of grouping incremental development in to five year blocks appears logical. However, the proposal may lead to increased disputes as the financial benefits of moving from one block to another are significant compared to moving between single years under the current approach.

South East Water noted that introducing a scale of brought forward charges may solve some issues, but there would still be scope for disagreement. To ensure that the scale was more closely aligned to the brought forward periods in the Urban Development Program, South East Water recommended the following scale:

- 0-2 years — no bring forward
- 3-5 years — contribution defined as 25 per cent of the as constructed cost of shared assets
- 6-10 years — contribution defined as 35 per cent of the as constructed cost of shared assets
- 11-15 years — contribution defined as 50 per cent of the as constructed cost of shared assets
- >15 years — contribution defined as 70 per cent of the as constructed cost of shared assets.

South East Water also suggested that to reduce administration costs, rather than being required to submit an application to the Commission for every non-scheduled charge, the water businesses should have the ability to issue developers with brought forward charges, with developers having a right of appeal to the Commission.

The UDIA suggested that bring forward costs should be determined based upon the amount of years a development is outside the 0-5 brought forward period (i.e. a 7 year bring forward period under the current approach would become a 2 year bring forward period). The UDIA also suggested that bring forward costs should be reduced by the extent of any benefits derived by water companies in earning retail based revenue earlier than otherwise expected.[47]

Also raised in submissions were the difficulties associated with updating forecasts of network expansion over the course of the regulatory period. Villawood Properties stated in their submission that:

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[47] Urban Development Institute of Australia (Victoria) 2008, Submission to Draft Decision, 15 May.

> *Water companies have shown a convoluted approach to bring-forward costs over recent times and have steadfastly refused to understand how development advances in greenfield areas and plan and implement water and sewer infrastructure in response.*[48]

The UDIA noted that expectations regarding the anticipated timing of development can change significantly from one year to another, and that a rigid approach to estimating bring forward periods may not reflect the true level of demand or land take up.

South East Water, on the other hand, stated in their submission that brought forward charges should apply on the basis of the Urban Development Program in place at the time of the development of the Water Plan. Deviation from this approach would mean that South East Water would need to accelerate planning for asset construction in growth areas, resulting in significant cost increases.

Transitional issues

With regard to transitional issues, some stakeholders proposed that any changes to scheduled charges should be delayed.

The Energy and Water Ombudsman (Victoria) suggested that changes to scheduled charges should not come into effect until 1 January 2009 to allow sufficient time to notify customers of the change.[49]

GEO Property Group suggested that the application of the changes should be deferred, during which time the proposal should be developed further, with any price increases phased in over several years for estates where major investment commitments have been made.[50]

12.3.1 Commission assessment

Scheduled charges

In this and the 2005 Water Price Review, the Commission has taken the view that it is reasonable for businesses to require an upfront contribution to the capital costs of servicing new developments. The Commission believes that this represents an appropriate balance between reflecting the incremental costs associated with connecting new customers and recognising the additional revenue provided to businesses via the connection of new customers.

The Commission maintains the view that using lot size as a determinant to scale contributions according to the water sensitivity of particular developments and the demand for future infrastructure is consistent with the WIRO. While other factors will have an influence on water use, the advantage of using lot size is in its simplicity and also (unlike most water saving measures) that it is known at the planning permit stage for lot developments.

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[48] Villawood Properties 2008, Submission to Draft Decision, 9 May, p.3.

[49] Energy and Water Ombudsman (Victoria) 2008, Submission to Draft Decision, 9 May.

[50] GEO Property Group, Submission to Draft Decision, 22 May.

In relation to charges for developments serviced by recycled water, it should be clarified that new customer contributions represent an upfront contribution by developers to the cost of infrastructure assets, and are in no way intended to recover the full cost of shared infrastructure assets provided to service the development. Under the current regulatory arrangements, water businesses are capable of recovering all capital expenditure associated with providing infrastructure as all capital expenditure is rolled into the regulatory asset base and recovered over time through prices. Therefore the provision of recycled water infrastructure and the fact the new customer contributions do not typically recover the entire costs of such infrastructure upfront should not be viewed as creating a funding shortfall.

The Commission notes Yarra Valley Water's view that all customers benefit from the provision of sewerage and water services. However, these benefits do not take the form of a reduction in capital costs related to the provision of prescribed services. Therefore applying reductions to scheduled charges due to the take up of recycled water is not inconsistent with charges for water and sewerage.

Given that scheduled charges for new customer contributions are not intended to recover the full costs of providing infrastructure upfront, there is no need for the reduction in scheduled charges due to recycled water take up to exactly mirror the reduction in costs to the water business. Additionally, the proposed reduction in costs for scheduled charges represents the value to other customers not only of reduced overall system costs due to reduced potable water use, but also of greater security of supply.

Therefore the Commission considers that the most appropriate way forward is to levy a reduced scheduled charge for water where developments are also supplied by recycled water. This will provide certainty for developers as to the potential costs involved, and is not expected to impose excessive administrative costs upon water businesses. As is the case for water and sewerage charges, businesses will have the option of applying pricing principles to determine charges to apply to large unique recycled water customers.

With regard to providing more clarity around the application of the scale of different charges the Price Determination sets out the approach to be taken in determining the appropriate category of scheduled charge to apply.

Allocation of costs for reticulation infrastructure

With regard to the submissions from the metropolitan water businesses, the Commission agrees that in most cases the current methodology for allocating the costs of reticulation infrastructure is appropriate.

However, the Commission also recognises that in some instances developers have been required to provide substantial infrastructure from which they obtain only a small portion of the benefit.

With regard to the classification of shared and reticulation assets, the Commission notes that at the time of the development of the New Customer Contributions Guideline, a substantial part of the debate concerned the definition of reticulation assets. The adopted definition, based principally on size, was considered to provide certainty in the majority of circumstances, but with flexibility to suit particular developments.[51]

In light of the businesses' support for the current approach, and the issues raised by developers where the current approach has resulted in an inequitable situation, the Commission considers that the most appropriate way forward is for the current approach to continue to apply in the majority of cases. This being that the developer is responsible for funding all reticulation sized pipes and associated assets required for their development.

In cases where it can be established that the a developer is required to provide reticulation assets that exceed the requirements of their development in a material respect, the developer should only be required to contribute to the costs of the reticulation assets an equitable amount given the requirements of their development. The balance of the costs of the reticulation assets in such a case can be recovered from future developers connecting to the reticulation assets in question.

Allocation of costs for shared infrastructure

The Commission is cognisant of the fact that the number of years brought forward is generally the most contentious issue surrounding the determination of financing or bring-forward charges to be paid by developers concerning the construction of shared assets.

The Commission also recognises concerns raised by City West Water and Gippsland Water that the introduction of a scale of specific brought forward charge blocks may lead to increased disputes given the difference in funding requirements between the blocks. Where there is a significant difference between the non-scheduled charges developments with only one year between them in terms of the years the development is considered to be brought forward, the Commission agrees that the potential for disputes may increase.

Therefore the Commission considers that the most appropriate way forward is to create as simple criteria as possible for determining the brought forward financing costs to apply. The estimation of brought forward periods is imprecise, and as such, the Commission has endeavoured to create a mechanism by which only the most obviously out of sequence developments will be subject to financing costs associated with bringing forward shared assets.

In aid of this, the brought forward financing costs associated with developments requiring the construction of shared network assets are to be calculated on the basis of the extent to which the assets are being constructed form part of a logical extension to water business's existing water and sewerage networks.

Where the shared assets could be reasonably considered to form part of a logically sequenced network expansion and could reasonably be expected to be required by

[51] The Commission's 2005 Explanatory Paper for the Water Industry New Customer Contributions Guideline is available on the Commission's website at http://www.esc.vic.gov.au/public/

the business within a short to medium term planning horizon, no bring forward contribution is to apply (scheduled charge applies).

Where the shared assets do not form part of a logically sequenced network expansion, but could reasonably be expected to have been required by the business in respect of a long term planning horizon, then a non-scheduled contribution equivalent to 40 per cent of the as constructed cost of the shared assets will apply.

Where the shared assets do not form part of a logically sequenced network expansion, and could not reasonably be expected to have been required by the business in respect of a long term planning horizon, then a non-scheduled contribution equivalent to 70 per cent of the as constructed cost of the shared assets will apply.

The Commission also considers that the administrative costs of the process for new customer contributions would be reduced by allowing businesses to issue developers with non-scheduled charges. In doing so, the water business must set out the pricing principles for determining developer charges as contained in the determination, and also notify the developer of their right to appeal any non-scheduled charge to the Commission.

The submissions from Villawood Properties, UDIA and South East Water all raise the issue (albeit from differing angles) of the approach to be taken in the face of changing expectations regarding the timing of development and hence the estimation of bring forward costs.

Under the current regulatory regime, the Commission determines a forward looking revenue requirement for businesses based on assumptions about the expenditure that businesses propose to undertake and the return on and of assets over the regulatory period. It should be noted that the Commission does not approve a capital expenditure budget for businesses that is to be spent on individual projects. Rather, the assumed capital expenditure is a benchmark used by the Commission to assess whether prices will deliver sufficient revenue to the businesses over the period. The businesses are free to determine their own expenditure priorities in light of changing circumstances over the course of the regulatory period.

Transitional issues

The Commission accepts that there are likely to be a range of impacts to developers and water businesses as a result of the changes to new customer contributions. However, it does not consider that the impacts warrant a deferral of the changes, or a phasing in of increases to scheduled charges.

The increase in scheduled charges is not expected to have significant customer impacts. While the increase in costs to developers may be large in some circumstances, as noted by Villawood Properties and the UDIA these costs are typically passed on to home buyers.

Delaying implementation of the changes would provide incentives for developers to either rush development ahead or stall developments in order to avoid paying higher charges or to take advantage of the changes proposed to the allocation of costs for reticulation assets and the calculation of costs where shared assets are constructed ahead of schedule.

With regard to the status of existing agreements, where businesses have entered into written contracts with developers prior to the release of this Final Decision that set out the relevant charges to apply, the Commission is of the view that the terms and conditions of those contracts should be met in their entirety.

Final decision

The Commission has approved scheduled new customer contributions to be levied by each business according to the following categories:

- Category 1: a minimum $550 per lot per service for water, sewerage and dual pipe recycled water (total $1,650 per lot) for developments which are designed in a manner that will have minimal impact on future water resource demands and can be catered for without additional investment to upgrade the medium-term distribution capacity. These developments are typically a lot with an area no greater than 450 square meters.
- Category 2: $1,100 per lot per service for water, sewerage and dual pipe recycled water (total $3,300 per lot) for urban developments which will require further investment in infrastructure. These developments are typically traditional Greenfield urban developments with lot sizes between 450 square meters and 1,350 square meters.
- Category 3: $2,200 per lot per service for water, sewerage and dual pipe recycled water (total $6,600 per lot) — for developments designed in such a way that properties will create demand for water resources over and above high-density developments which will require further investment in infrastructure. These developments are typically Greenfield developments with lot sizes exceeding 1,350 square meters, for example, lots with potentially large outside water use which will influence near term investment in infrastructure decisions.

Developments also connecting to recycled water will be subject to a 50 per cent reduction in the applicable scheduled charge for water.

These charges will be increased each year for inflation and will apply equally to each residential and non-residential customer to be connected.

Allocation of costs for reticulation assets

In light of the businesses' support for the current approach, and the issues raised by developers where the current approach has resulted in an inequitable situation, the Commission considers that the most appropriate way forward is for the current approach to continue to apply in the majority of cases. This being that the developer is responsible for funding all reticulation sized pipes and associated assets required for their development.

In cases where it can be established that the a developer is required to provide reticulation assets that exceed the requirements of their development in a material respect, the developer can only be required to contribute to the costs of the reticulation assets an amount that reflects the requirements of their development. The balance of the costs of the reticulation assets in such a case may be recovered via contributions from subsequent customers connecting to the reticulation assets in question.

Continued next page

Final decision (continued)

Allocation of costs for shared assets

The brought forward financing costs associated with developments requiring the construction of shared network assets are to be calculated on the basis of the extent to which the assets are being constructed form part of a logical extension to water business's existing water and sewerage networks.

Where the shared assets could be reasonably considered to form part of a logically sequenced network expansion and could reasonably be expected to be required by the business within a short to medium term planning horizon, no bring forward contribution is to apply (scheduled charge applies).

Where the shared assets do not form part of a logically sequenced network expansion, but could reasonably be expected to have been required by the business in respect of a long term planning horizon, then a non-scheduled contribution equivalent to 40 per cent of the as constructed cost of the shared assets will apply.

Where the shared assets do not form part of a logically sequenced network expansion, and could not reasonably be expected to have been required by the business in respect of a long term planning horizon, then a non-scheduled contribution equivalent to 70 per cent of the as constructed cost of the shared assets will apply.

The water businesses will also have the ability to issue developers with non-scheduled charges, rather than applying to the Commission in each instance. In doing so, the water business must set out the pricing principles for determining developer charges as contained in the Determination, and also notify the developer of their right to appeal any non-scheduled charge to the Commission.

13 RURAL SERVICES

13.1 Introduction

Rural water services, which include bulk water, irrigation, irrigation drainage, domestic and stock services and groundwater and surface water diversions, are all prescribed services under the WIRO. These services are predominantly supplied in Victoria by the three dedicated rural water businesses (Goulburn-Murray Water, Southern Rural Water and First Mildura Irrigation Trust) and two rural urban water businesses (Lower Murray Water and GWMWater).[52]

In the Draft Decision, the Commission highlighted and discussed a number of issues relating to rural tariffs. In particular, it focussed on cases where:

- a change in tariff structure was proposed
- certain tariffs have been a source of customer concern or may be difficult for customers to understand
- tariffs for a particular service or in a particular district have increased by significantly more than the business average without sufficient explanation in the business's Water Plan
- the Commission was concerned that aspects of a particular tariff were not consistent with the WIRO.

The Commission also indicated that it proposed to approve all other rural tariffs not specifically discussed in the Draft Decision. The Commission confirms the approval of these tariffs. The approved prices and processes for adjusting prices over the regulatory period are set out in the Determination for each businesses.

This chapter sets out the Commission's Final Decision on rural tariffs, including for Southern Rural Water which submitted its proposed tariffs after the Draft Decision was released.

13.2 Bulk water

A storage operator and bulk water service is defined as a service provided by a regulated entity in connection with the provision of water supply to another regulated entity.

[52] Coliban Water and Wannon Water also supply services to a small number of rural customers.

13.2.1 Overview of draft decision

The Commission assessed the proposed bulk water prices for the rural businesses providing this service. Goulburn-Murray Water and GWMWater provided indicative bulk water prices, however Southern Rural Water argued that it did not provide a bulk water service. The Commission requested further information from each of the businesses in order to approve their bulk water prices.

In the Draft Decision the Commission indicated that there would be a pass-through mechanism for bulk water costs for the urban businesses. Urban businesses would be able to apply for a pass-through of any difference between the bulk water prices assumed by the Commission and the actual amounts paid.

13.2.2 Response to draft decision

In response to the Draft Decision, Goulburn-Murray Water provided further detail regarding its proposed pricing structure. The Commission has also had further discussions regarding phasing in Goulburn-Murray's proposals.

North East Water queried the tariff structures that were proposed by Goulburn-Murray Water, questioning why irrigators enjoy the benefits of system pricing while wholesale prices are based on a basin pricing methodology.

Some businesses also questioned the application of and reasoning for Goulburn-Murray Water's Regional Urban Storage Ancillary Fee.

Southern Rural Water did not provide any comments or further information on the bulk water prices it intends to apply for the forthcoming regulatory period.

13.2.3 Final decision

Goulburn-Murray Water

The Commission considers that there is merit in Goulburn-Murray Water moving from a system-based pricing approach to a basin-based pricing approach. It agrees with Goulburn-Murray Water that this change in approach will help to identify the real costs of bulk water services for different water entitlements and will assist in water trading activities. The Commission understands that the proposed prices set out in the Water Plan were estimates, with bulk water prices across the period generally equal to the entitlement storage fee prices for customers without land, except where the basin price was lower than the system price.

The Commission notes that Goulburn-Murray Water is currently consulting on how to transition its with-land customers from system to basin-based pricing, including how to manage individual customer impacts.

The Commission notes that in the previous price review, it was not required to assess the structure of the tariffs for the rural businesses. For this price review however, the Commission is required to assess the proposed rural tariff structures against the WIRO principles.

It is the Commission's view that Goulburn-Murray Water has not consulted sufficiently with its without land customers. Goulburn-Murray Water should be treating both with and without land customers consistently and the without land customers should be included in Goulburn-Murray Water's consultation process for the transitioning from system to basin-based pricing.

Therefore the Commission's Final Decision is to freeze the Entitlement Storage Fee at 2007-08 levels for 2008-09 and remove the without land price, resulting in one fee for customers with land and customers without land. With regard to the bulk water prices that Goulburn-Murray Water has proposed, the Commission has maintained prices at 2007-08 levels for the 2008-09 year.

Any shortfall in revenue in the first year due to this pricing change will be accounted for under the revenue cap. The Commission will reassess these charges next year when Goulburn-Murray Water resubmits its tariff schedule (see chapter 16). By this time Goulburn-Murray Water should have undertaken sufficient consultation with both its with and without land customers on transitional arrangements.

Following the Draft Decision, the Commission sought further information from Goulburn-Murray Water regarding the Regional Urban Storage Ancillary Fee (RUSAF). In response, Goulburn-Murray Water indicated that this fee was related to a nominal rate of return that had previously been derived to cover such costs as the provision of community facilities, such as picnic grounds and boat ramps.

The Government's White Paper (released in 2004), stated that this rate of return would be phased out and that alternative arrangements would be made to support the activities previously funded by the revenue collected. Goulburn-Murray Water has implemented the RUSAF to recover the costs that were previously funded through the nominal rate of return.

The Commission notes that the urban businesses have been paying the RUSAF since it was introduced by Goulburn-Murray Water. In the absence of alternative arrangements being made across the industry, the Commission approves the continued application of the RUSAF. The Commission will consider this fee in more detail as part of the further review of Goulburn-Murray Water's prices in the coming 12 months (see chapter 16).

GWMWater

The Commission has constructed a tariff schedule for the five years of the forthcoming regulatory period based on the information provided to the Commission in GWMWater's templates. The schedule includes the bulk water prices that GWMWater can charge its bulk water customers.

Southern Rural Water

The Commission notes that Southern Rural Water charges its bulk water customers through its Storage Operator Charge which it recovers through its non-tariff revenue. The Commission approves this non-tariff revenue based on the principles regarding non-scheduled prices set out in Southern Rural Water's Determination regarding non-tariff revenue.

Uncertainty of bulk water costs for urban businesses

The Commission has introduced a mechanism for adjusting prices to deal with uncertainty (see chapter 16). The urban businesses may apply under this mechanism for adjustments to reflect the differences between actual and forecast bulk water costs.

13.3 GWMWater rural pipeline tariffs

In its Water Plan, GWMWater proposed a pipeline tariff structure for the Wimmera Mallee Pipeline, to replace GWMWater's channel-based domestic and stock system, and on the Northern Mallee Pipeline.

Currently, channel customers pay an area charge and a charge for each dam fill, while Northern Mallee Pipeline customers pay a meter charge, an area charge and a usage charge based on volume consumed. Under GWMWater's proposed pipeline tariff structure, customers would pay a meter charge, a capacity charge based on each customer's 'allowance' (initially based on property size) and a usage charge (which increases when a customer consumes more than their allowance).[53]

A key element in GWMWater's proposed pipeline tariff structure is the sale of 'growth water', which would allow customers to increase the size of their allowance and avoid incurring the higher usage charge. GWMWater also indicated that the proposed tariff structure would be capable of supporting a system of tradable rights in the pipeline systems, if and when such a system is introduced.

13.3.1 Overview of draft decision

In the Draft Decision, the Commission questioned whether the proposed three-step usage charge was cost reflective. However, it also noted that the proposed tariff structure appeared capable of supporting a system of tradable rights, which customers have indicated a preference for, and that the increasing variable charge was integral to the proposed tariff structure as a whole.

The Commission therefore gave its in-principle support for GWMWater's proposed pipeline tariff structure but sought further information on some important matters regarding the transition to the new tariff structure. The first issue related to growth water, in particular the timing and processes for the sale of growth water to customers, whether a reserve price on growth water should apply and how the proposed tariff structure would operate on the Northern Mallee Pipeline without growth water being available. The second issue related to the timelines and processes associated with introducing trade in the pipeline systems. The third issue related to the potential adverse impacts of the proposed tariff structure on

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[53] Meters that service a household attract a primary meter charge, which is higher than the standard meter charge. Primary meters provide customers with an additional household allowance that does not attract the capacity charge. See Draft Decision section 13.5.1 for a more detailed overview of the proposed tariff structure.

existing supply-by-agreement customers and how these impacts have been addressed.

13.3.2 Response to draft decision

In its response to the Draft Decision, GWMWater provided further information on the original business case for the Wimmera Mallee Pipeline, growth water and costs of water savings, and the possibility of trade in the pipeline systems. With particular relevance to the proposed tariff structure and the concerns raised in the Draft Decision, GWMWater's response is summarised as follows:

- The sale of growth water will occur in each of the six systems in the Wimmera Mallee Pipeline as they are completed. The relevant dates and other details will be communicated broadly by GWMWater.
- Existing customers (including Division 4 customers) will have first opportunity to apply to receive growth water. These customers have the option of purchasing non-tradable allowances at the discounted price of $1000 or tradable allowances for $2500. Purchases at this stage will be made through expressions of interest.
- Remaining peak growth water and all off-peak and ex-headworks growth water will then be made available to existing and new customers through a tender process.
- The reserve price of $2500 per ML of growth water is defensible in the absence of an existing water market in the Wimmera Mallee system and on the basis that it is towards the lower end of similar established benchmarks and below the average cost of $6550 per ML that was incurred to secure the water savings.
- Conservative estimates of the timeframes for the take-up of growth water have been made. GWMWater's response indicates that no growth water will be sold until 2009-10 and that not all growth water will be sold during the regulatory period.[54]
- No allowances or entitlements will be tradable until the growth water sales program is complete.
- The customer impacts from the new tariff structure have been the subject of extensive consultation with supply-by-agreement customers. The off-peak capacity charge has been designed to allow these and other intensive use customers to receive water at lower prices during the winter off-peak period. The level of discount reflects cost savings from reduced pipeline capacity achieved by spreading total consumption over the year.

The Commission received several submissions from customers and other stakeholders on the Wimmera Mallee Pipeline. The proposed pipeline tariffs were also the subject of considerable comment at the Horsham Public meeting (in April). Common themes in the submissions and the public meeting were affordability, uncertainty about the level of government contributions and future pipeline costs, significant and disproportionate cost increases for some customers, especially intensive use customers, and concerns about consultation and transparency of GWMWater.

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[54] GWMWater 2008, Response to Draft Decision, 9 May, p. 6.

A group of customers on Supply System 6 of the Wimmera Mallee Pipeline raised concerns that previously unrated properties will be rated and will incur charges when the pipeline is constructed, even though many customers prefer not to be connected and have made previous investments to be self sufficient.[55] They also raised concerns about the lack of consultation and transparency by GWMWater on the matter.

This issue was noted more generally in the submission by the Northern Grampians Shire Council, which also highlighted affordability and the costs of on-farm works as important issues.[56] The issue was also the subject of concern at the public meeting and in a number of other submissions.

13.3.3 Final decision

The Commission has given further consideration to GWMWater's proposals, the additional information it provided in response to the Draft Decision and the feedback received from other stakeholders on the proposed pipeline tariffs.

The Commission notes that in order to approve prices it must be satisfied that they are cost reflective, are readily understandable by customers and do not create undue customer impacts. After further consideration of the proposals, the Commission is not satisfied that GWMWater's proposed pipeline tariffs are consistent with these principles and hence are not consistent with the WIRO. The reasons for the Commission's decision are discussed below.

Customer impacts

The Commission notes that the impact of the proposed tariff structure will be borne disproportionately by certain customer groups. The replacement of the channel system with the Wimmera Mallee Pipeline will increase the overall cost of providing stock and domestic services in the region, hence increasing the average bill for customers. However, while some customers will not experience major increases in their bills, the increases for other customers will be significant.

GWMWater has provided a number of examples of how the proposed tariff structure will impact on various customer groups in its Pipeline Tariff Products Fact Sheet.[57] Two examples demonstrate the disproportionate impacts of the proposed tariff structure.

The first example relates to a large property (1220 hectares) with a house and annual consumption of 1916 kL (based on 610 hectares of grain and 400 sheep). Such a customer would currently incur an annual bill of $3806 on the channel system (based on 2 dam fills) and $3504 on the Northern Mallee Pipeline system. Under the proposed pipeline tariff structure, this customer would be required to pay $3896, representing increases of around 2 per cent and 10 per cent for the channel system and Northern Mallee customer respectively.

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[55] Supply System 6 Unrated Property Owners, Submission to Draft Decision, 21 April.

[56] Northern Grampians Shire Council 2008, Submission to Draft Decision, 10 April.

[57] The fact sheet is available on GWMWater's website: http://www.gwmwater.org.au/

In the second example, the representative customer has a smaller property (320 hectares) with a house and larger annual consumption of 3200 kL. This customer would currently face an annual bill of $1124 on the channel system (based on 2 dam fills) and $2721 on the Northern Mallee Pipeline respectively. Under the proposed pipeline tariff structure, this customer would face a bill of $5692; a 400 per cent and 100 per cent increase for the channel system and Northern Mallee customer respectively.

The Commission recognises that current channel customers will receive a significantly different level and quality of service when they connect to the Wimmera Mallee Pipeline. However, the Commission considers that the higher costs should be spread across benefiting customers more equally and not be concentrated on particular groups. The GWMWater examples demonstrate that while large land holders will not experience material price increases, the price increases for more intensive users with smaller land holdings will be significant. In the second example, Northern Mallee Pipeline customers will receive the same level of service but will experience a doubling of their water bill.

GWMWater noted that the representative customer in the second example could reduce their bill to $4067 by purchasing one ML of growth water. However, the Commission considers that this is still a significant increase that is disproportionate relative to the increase for the broader customer base.

GWMWater has previously stated that the allowance of 2.5 kL per hectare is sufficient for most customers. However, in cases where it is not sufficient, which appears to be likely for intensive water users with smaller land holdings, the customer impacts are large. The Commission is also aware of similar examples raised by customers at the Horsham public forum and in confidential submissions, where the customer impacts are expected to be significant.

Cost reflectivity

The Wimmera Mallee Pipeline will initially operate with excess capacity. In the absence of any capacity constraints, it can be reasonably expected that the marginal costs of providing water would be relatively constant, meaning that a uniform variable rate would most effectively signal costs to customers. The Commission notes that the difference between the first and third tier variable charge under the proposed tariff structure is significant and does not consider that it is reflective of differences in underlying costs.

Potential for trade in the pipeline systems

GWMWater has not provided any clear timeframes for introducing trade into the pipeline system, although it indicated that no trade in allocations will occur before all growth water is sold. Based on its response to the Draft Decision, it appears that this will not occur during the regulatory period. The Commission is concerned about the lack of clarity regarding the commencement of trade since the proposed tariff structure is designed to accommodate trade and appears to be an important part of GWMWater's longer term strategy for the region.

Further, the specific nature of any legislative amendments required to enable trade to occur (which would involve transferring the property rights for allowances and allocations to customers) has not been clarified. The Commission is concerned about this uncertainty, especially in relation to growth water, as customers are likely to prefer certainty on the legal status of the resource and its ability to be traded in the future.

Process for allocating growth water

The Commission raised concerns in the Draft Decision about whether the reserve price for the sale of pipeline growth water was appropriate. While noting that using a price to allocate a scarce resource (such as growth water) between customers ensures that it is directed to its most efficient use, a reserve price is only appropriate if the seller has an alternative use for the resource. In the cases of growth water, it is not clear what GWMWater will do with unsold growth water.

GWMWater has previously justified the reserve price for growth water on the basis that a market for such a product does not exist in the Wimmera Mallee region. However, a market outcome can be achieved in this situation (where there is a single seller and many customers) by allocating the growth water through an auction or tender process with no reserve price. Setting a reserve price will either result in some growth water not being sold (when the market price is below the reserve price) or the reserve price being redundant (when the market price is above the reserve price).

While the Commission supports using a price to allocate growth water between customers, it does not support setting the price as a means of requiring customers to contribute upfront to the costs of the Wimmera Mallee Pipeline. The Commission recognises that GWMWater has made a significant capital investment in the pipeline. However, the Commission considers that these costs should be recovered over time through prices, as is the typically the case for investments in water infrastructure in Victoria.

The Commission also raised concerns about how the proposed tariff structure would operate for the Northern Mallee Pipeline system, given that it is sourced from the Murray system and growth water would only be available from the Grampians system. GWMWater has not indicated how customers on the Northern Mallee Pipeline can avoid paying the higher variable charge in the absence of growth water.

After considering the above factors, the Commission is not satisfied that the proposed pipeline tariff structure is consistent with the WIRO. GWMWater will be required to resubmit a revised tariff structure to apply from the second year of the regulatory period, which addresses the Commission’s concerns as discussed above. The details of this process are set out in GWMWater’s price determination.

In particular, the revised tariff structure should ensure that any cost increases are spread more equally between customers and not concentrated on particular customer groups. The Commission will consider a revised version of the pipeline tariff structure that was originally proposed, provided that:

- clear timeframes for establishing trade in the pipeline systems are provided, including details on specific legislative changes that are required and
- pipeline growth water products are allocated to customers through an auction or tender process with no reserve price.

For 2008-09, the Commission has approved pricing principles for GWMWater's pipeline services. The principles require that GWMWater seek the Commission's approval where it proposes to levy a charge other than the channel charge on customers connecting to the pipeline.

The Commission notes GWMWater's proposal to phase in price increases for supply-by-agreement customers over a four year period and supports this proposal. GWMWater should incorporate gradual increases for supply-by-agreement customers under the pricing principles for 2008-09 and in its tariff proposals for the remainder of the regulatory period.

Final decision

The Commission has not approved GWMWater's proposed rural pipeline tariffs. For 2008-09, the Commission has approved pricing principles and GWMWater will be required to resubmit a revised tariff structure to apply from the second year of the regulatory period, which addresses the Commission's concerns.

13.4 Wimmera Irrigation Area tariffs

GWMWater supplies irrigation services to about 230 customers in the Wimmera Irrigation Area. Customers in this area have not received any water for several years because of severe drought conditions. GWMWater does not currently apply its standard irrigation tariffs but instead charges a special drought charge of $1000 per year for customers with entitlements of over 50 ML and $600 per year for customers with entitlements of less than 50 ML.

GWMWater proposed a new tariff structure for the Wimmera Irrigation Area, comprised of a fixed service charge that is applied to each service regardless of entitlement, a capacity charge based on the size of entitlement and a sales water charge for all water consumed above entitlement in years where allocations are above 100 per cent.[58]

As noted in the Draft Decision, a key feature of the proposed tariff structure is that the capacity charge varies depending on the size of allocations in each year. Customers will pay more for water in years where they receive higher allocations and are better able to meet the payments. Likewise, customers will pay less in years of low allocation when their income may be adversely affected. GWMWater also proposed to retain the special drought tariff until allocations in the Wimmera Irrigation Area reach 15 per cent, at which time the new tariff structure would be introduced.

[58] See the Draft Decision for a more detailed overview of GWMWater's proposed irrigation tariff structure.

13.4.1 Overview of draft decision

The Commission proposed to approve the proposed tariff structure on the basis that it was cost reflective in the long run and was effective in mitigating adverse customer impacts in years of low allocation. However, it had some concerns about continuing the drought tariff in its current form and about whether irrigation sector debts were expected to accumulate prior to introducing the new tariff structure. It therefore sought further information from GWMWater on the extent to which debts would accumulate due to the continuation of the drought tariff.

13.4.2 Response to draft decision

GWMWater did not provide any specific information on the extent to which revenue shortfalls would be experienced in the Wimmera Irrigation Area under the drought tariff, only that any shortfalls would be identified during the annual tariff approval process. In its response, it noted that there is uncertainty about the extent to which irrigation will be re-established in the Wimmera Irrigation Area when water supply returns, as significant investment will need to be undertaken by irrigators to be able to receive water again.[59]

In its submission to the Draft Decision, the Wimmera Irrigators Association raised concerns about further accumulation of debt, given that irrigation sector debts had previously been waived.[60] It also questioned the costs of running a system that does not operate.

13.4.3 Final decision

The Commission considers that the revised tariff structure proposed by GWMWater is appropriate for when supply is returned to the Wimmera Irrigation Area and confirms its support for its introduction when water becomes available.

In regard to the accumulation of debts in the irrigation area, the Commission recognises that there is significant uncertainty about when supply will be restored, the amount of investment irrigators will be required to undertake to receive water again and the extent to which irrigators would be willing to undertake such investment. It is reasonable to expect that GWMWater would not undertake any operations or maintenance or make any capital investments in the area until sufficient water became available and enough irrigators indicate their intention to receive water again.

GWMWater indicated that operating expenditure on irrigation services has remained constant over the previous four years, with only negligible expenditure being incurred on operations or maintenance. The templates also indicate that operating expenditure on irrigation is only forecast to increase in later years of the regulatory period when water is forecast to be available.

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[59] GWMWater 2008, Response to Draft Decision, 9 May, p. 7

[60] Wimmera Irrigator's Association 2008, Submission to Draft Decision, 9 May.

Due to the long term nature of the current drought and high level of uncertainty about when and to what extent services will be restored in the Wimmera Irrigation Area and the level of expenditure that will be required, the Commission has approved the drought tariffs only. GWMWater's Determination will include a mechanism whereby GWMWater can apply to the Commission to have the revised irrigation tariff structure introduced as part of the annual tariff approval process, should services be restored within the regulatory period (see chapter 16). As part of this process, GWMWater will be required to provide information on expected costs and revenues from the Wimmera Irrigation Area and consult with its customers before making such an application.

Final decision

The Commission has approved the continuation of the drought tariff in the Wimmera Irrigation Area.

The Commission has approved a process for introducing the revised irrigation tariff structure, should supply in the Wimmera Irrigation Area be restored within the regulatory period.

13.5 Termination fees

Termination fees are payments made by irrigation customers who no longer require access to a water business's irrigation network. Upon paying the relevant termination fee, a customer can surrender some or all of their delivery entitlement, including the associated obligation to pay infrastructure access changes.

In 2006, the Australian Government requested the Australian Competition and Consumer Commission (ACCC) to develop a consistent approach for the pricing of irrigation services in the Murray-Darling Basin, including principles for calculating termination fees. The ACCC released its report on 6 November 2006.[61]

13.5.1 Overview of draft decision

The Commission proposed to adopt the principles recommended by the ACCC for calculating termination fees.

Goulburn-Murray Water had proposed to continue its current method for calculating termination fees, which were first introduced on 1 July 2007 and are set at 15 times the relevant infrastructure access charge. The Commission noted that the factor of 15 used by Goulburn-Murray Water exceeds that recommended by the ACCC. It therefore required Goulburn-Murray Water provide further explanation on why it had adopted a method that was not consistent with the ACCC principles.

[61] Australian Competition and Consumer Commission 2006, *A regime for the calculation and implementation of exit, access and termination fees charged by irrigation water delivery businesses in the southern Murray-Darling Basin*, 6 November.

The Commission also sought further information from First Mildura Irrigation Trust, Lower Murray Water, GWMWater and Southern Rural Water, which referred to termination fees in the Water Plans but did not provide explicit proposals.

13.5.2 Response to draft decision

In response to the Draft Decision, Goulburn-Murray Water indicated that while the state governments of New South Wales, South Australia and Victoria agreed to adopt most of the ACCC's recommendations, they did not adopt all of the recommendations on termination fees. Instead, they agreed to allow water businesses to levy termination fees set at 15 times the relevant infrastructure access charge until 30 June 2010, or later date following a forthcoming review by the state governments and ACCC.

This agreement and most of the other ACCC principles were formally adopted through the making of a protocol under the Murray Darling Basin Agreement, which is binding in New South Wales, South Australia and Victoria.

Lower Murray Water indicated that it proposes to continue with its current method for calculating termination fees, which are set at 8 times the relevant shadow infrastructure access charge (equivalent to between 8 and 8.5 times the actual infrastructure access charge).

First Mildura Irrigation Trust indicated that it is still finalising its position on termination fees, but that they would be set at a maximum of between 10 and 15 times the infrastructure access charge. It also indicated that actual termination fees would need to be set on a case-by-case basis.

Southern Rural Water included termination fees in its price schedule, which were set at 15 times the infrastructure access charge. GWMWater did not propose termination fees.

13.5.3 Final decision

The Commission recognises the importance of having a consistent framework for the pricing of irrigation services in the Murray-Darling Basin, including termination fees.

Under the principles agreed to by the state governments, the costs that would be directly avoidable through the termination of a delivery entitlement should be taken into account when calculating termination fees, meaning that they should be set on a case-by-case basis. Further, the factor of 15 used to calculate termination fees is a temporary arrangement and may expire within the regulatory period. As such, the Commission has approved pricing principles for the calculation of termination fees instead of scheduled prices.

The Commission has assessed the termination fees proposed by Goulburn-Murray Water, Lower Murray Water and First Mildura Irrigation Trust against the agreements entered into between New South Wales, South Australia and Victoria and considers them to be consistent. The Commission has therefore approved the termination fees proposed by these businesses.

Southern Rural Water is not part of the Murray Darling System and is not covered by the interstate agreements. However, in order to achieve consistency in approach between businesses, the Commission has also approved the same principles for Southern Rural Water.

Final decision

The Commission has approved pricing principles for Goulburn-Murray Water, Lower Murray Water, First Mildura Irrigation Trust and Southern Rural Water for the calculation of termination fees.

13.5.4 Goulburn-Murray Water price changes

In its Water Plan, Goulburn-Murray Water proposed average annual prices of 2.2 per cent across all services. However, it generally proposed different price increases for different services and different districts, rather than uniform price increases across all services. The Commission sought further information on the following matters:

- differences in proposed price changes over the regulatory period for the pumped irrigation districts of Nyah, Tresco and Woorinen, despite the apparent similarities in service
- differences in price changes for 2008-09 between the gravity irrigation districts, especially for Pyramid-Boort, Campaspe and Torrumbarry
- large price increases in 2008-09 for subsurface drainage in a number of districts
- disproportionately large price increases for surface water and groundwater diversions.

In the Draft Decision, the Commission included Goulburn-Murray Water's initial response to the above matters. In summary:

- Differences in pricing adjustments between pumped irrigation districts are predominantly due to changes in Advanced Maintenance Program (AMP) expenditure between districts and issues regarding recovery of revenue from previous periods. Prices that applied in 2006-07 and 2007-08 in Tresco were set to recover deficits from previous years. The recovery of this revenue in the first regulatory period and the reduction of AMP expenditure to zero in the second regulatory period have resulted in price decreases for Tresco. AMP expenditure in Nyah has also been reduced to zero, but started at a lower level compared to Tresco, resulting in smaller price decreases. No AMP expenditure was incurred in Woorinen during the first regulatory period. This, combined with the recovery of a small revenue shortfall from the first regulatory period, has resulted in price increases in the second regulatory period.
- Relatively large price increases for surface water and groundwater diversions are mainly due to expected metering maintenance costs as meters are commissioned across the various districts. Some small differences in price changes between regulated and unregulated systems are due to returns of bank surpluses.

- Price increases for Torrumbarry and Pyramid-Boort in 2008-09 reflect the recovery of revenue shortfalls from the first regulatory period and lower 2007-08 prices (due to smooth annual price decreases in the first regulatory period). Price decreases for Campaspe in 2008-09 are due to the completion of AMP activities in the area during the first regulatory period.
- Relatively large price increases for subsurface drainage mainly reflect recovery of revenue shortfalls from the first regulatory period. These revenue shortfalls resulted from lower than expected water consumption, on which subsurface drainage charges are largely based. The price changes required to recover the shortfall are magnified by the small amount of revenue received through subsurface drainage and by applying the increase in 2008-09 only, with prices remaining constant over the final four years of the regulatory period.

The Commission noted that the information provided by Goulburn-Murray Water appeared reasonable and helped to explain the drivers of the relatively larger price increases and disproportionate price changes between districts for gravity and pumped irrigation.

However, the Commission indicated in the Draft Decision that it would like to better understand how Goulburn-Murray Water determined its prices for difference services and districts, including how it calculated individual ‘revenue requirements’ for each service and district, cost drivers for individual services and districts and how these impacted on prices. As such, the Commission sought further and more detailed financial information from Goulburn-Murray Water on the above matters.

In response to the Draft Decision, Goulburn-Murray Water provided extracts from its internal pricing models to demonstrate how it determined the revenue required from each service or district, the major cost drivers and the different impacts they have on prices between services and districts. After considering this information and Goulburn-Murray Water’s initial response, the Commission is satisfied that the proposed price changes over the regulatory period are driven by changes in costs and hence are consistent with the WIRO. The Commission has therefore approved Goulburn-Murray Water’s proposed prices.

Final decision

The Commission has approved Goulburn-Murray Water’s proposed prices.

13.6 Lower Murray Water

In the Draft Decision, the Commission noted that Lower Murray Water’s proposed rural tariffs displayed significant volatility over the regulatory period, including a number of cases where an individual tariff component increased significantly in one year and decreased significantly the next. The Commission had previously indicated that customer impacts of price changes can be managed effectively through gradual or smooth price changes over the regulatory period. The Commission suggested in the Draft Decision that Lower Murray Water should amend its price paths to smooth out significant fluctuations.

In its response to the Draft Decision, Lower Murray Water submitted a revised set of proposed tariffs for each year of the regulatory period. The revised tariffs included a range of price changes in the first year of the regulatory period, with some individual tariff components increasing and some decreasing. In the remaining four years of the regulatory period, Lower Murray Water has now applied uniform annual average price increases of around 0.5 per cent. On balance, the Commission considers that the smoothed price changes proposed by Lower Murray Water are reasonable and have reduced the potential for adverse customer impacts.

With the exception of the environmental contribution charges, the Commission has approved Lower Murray Water's revised rural tariffs for 2008-09. The prices will be adjusted over the regulatory period through a revenue cap. While Lower Murray Water will have flexibility under the revenue cap, the Commission suggests that it would be appropriate to implement smooth price increases like those included in its revised submission.

The Commission indicated in the Draft Decision that the environmental contribution is not a direct charge on customers and should not be included as a separately itemised price. As such, it proposed not to approve the environment contribution charges.

While Lower Murray Water combined these fees into general tariffs for its urban services, its revised tariffs still included the separate charges for rural services. As such, the Commission has removed the environment levy charge on rural services from Lower Murray Water's tariff schedule. The prices of other rural services have been adjusted accordingly to ensure that the change is revenue neutral.

Final decision

The Commission has not approved Lower Murray Water's environmental contribution charges for rural services. These charges have been removed from Lower Murray Water's prices schedule and other rural charges have been adjusted accordingly to ensure the change is revenue neutral.

The Commission has approved Lower Murray Water's other proposed rural tariffs for 2008-09.

13.7 Southern Rural Water

Southern Rural Water submitted tariffs on 26 May 2008 following consultation with its customer committees on unbundled tariffs. Given the timeframes involved in Southern Rural Water's pricing reforms and submission of tariffs, the Commission has been unable to undertake a thorough assessment of the proposed tariffs.

Based on its review of the proposed tariffs for 2008-09, the Commission notes that irrigation tariffs are consistent with unbundled water and delivery entitlements and that existing tariff structures for other services have been retained. It is also noted that the price increases between 2007-08 and 2008-09 are not uniform between services, with some customer groups bearing greater price increases than others. The Commission has not been able to assess the extent to which the differences in price changes are driven by different cost changes. However, it notes that they are generally consistent with price changes for similar services provided by other rural water businesses. Further, the proposed prices have been developed in consultation with customer committees. The Commission has therefore approved Southern Rural Water's prices for 2008-09.

However, there is considerable uncertainty regarding Southern Rural Water's funding requirements for the remainder of the regulatory period. First, the source of funding and likely timing of the Macalister Irrigation District 2030 implementation has not been clarified. Second, the current agreements for providing recycled water to the Werribee Irrigation District will expire in 2009, after which pricing arrangements have not yet been determined. Third, the consultants undertaking the review of Southern Rural Water's expenditure forecasts identified inconsistencies between the Water Plan, information templates and supplementary information, and recommended that further analysis be undertaken to ensure that the expenditure forecasts are efficient.

Consequently, the Commission has decides that Southern Rural Water will be required to resubmit its proposed revenue requirement for the remaining four years of the regulatory period. The details of this process are set out in Southern Rural Water's Determination.

Final decision

The Commission has approved prices for 2008-09. Southern Rural Water is required to resubmit an amended revenue requirement for the remaining four years of the regulatory period.

13.8 Reporting information at a district level

At a meeting of the chairs of Goulburn-Murray Water's water service committees, it was suggested that the rural businesses should be required to provide information on expenditure and outcomes at a district level.

The businesses are already required to report some information, but on a whole of businesses level. The Commission agrees that there would be merit in reporting this information at a district level. The Commission will consult with the rural businesses and water services water committees on developing these reporting arrangements.

14 MISCELLANEOUS CHARGES

14.1 Introduction

In addition to ‘core’ water, sewerage and rural services, water businesses also provide miscellaneous services, which are supplied in connection with these core services. New connections and tappings, special meter reads, property information statements and applications to build over easements are examples of urban miscellaneous services, while rural miscellaneous services include items such a licence application and licence transfer fees. Like core services, miscellaneous services are prescribed services under the WIRO and are subject to price regulation by the Commission.

Over the previous three years, miscellaneous services have generally been regulated through individual price caps. In some cases, where the price for a service varies on a case-by-case basis or where the price represents a transfer of a third party cost to a customer (such as bank dishonour fees or debt recovery fees), miscellaneous charges are set on an ‘actual cost’ basis. Under the current arrangements, businesses are unable to charge for miscellaneous services that were not approved in their determinations, but may introduce charges for new services with approval by the Commission.

The Commission has previously highlighted a number of issues regarding the pricing and regulation of miscellaneous services, in particular:

- Large price differences exist between businesses for a number of seemingly similar services. Further, it is difficult to assess whether differences in price are due to differences in cost or differences in terminology between businesses.
- It is not always clear from a business’s price schedule the nature of the miscellaneous service being provided or the circumstances when the charge will apply.
- The range of miscellaneous services differ significantly between businesses, with some businesses having as little as 20 scheduled miscellaneous charges and other businesses having several hundred.
- Miscellaneous services only generate a small percentage of total revenue. Given their relative immateriality, the costs of subjecting them to individual price caps and an annual tariff approval process may outweigh the benefits.

To address these issues, the Commission proposed an alternative approach to regulating miscellaneous services. In summary, the alternative approach involves the following features:

- Each business would identify a ‘core’ set of miscellaneous services, which would consist of the business’s most important miscellaneous services and would generate a significant proportion of miscellaneous revenue (over 75 per cent).

- Prices for core miscellaneous services would be approved in a business's Determination and would be subject to individual price caps.
- Core miscellaneous services would be clearly defined to provide further clarity to the Commission and to customers about the nature of the service being provided and the cases when the charge applies.
- Businesses would charge for non-core miscellaneous services in accordance with pricing principles that are related to actual cost.

14.2 Overview of draft decision

In the Draft Decision, the Commission assessed the proposals that businesses provided in their Water Plans and in response to an information request sent in February 2008. Specifically, the Commission assessed the proposals in terms of the miscellaneous services to be included in the businesses' core sets, definitions of core miscellaneous services, method for adjusting prices for core services over the regulatory period and principles for calculating actual cost.

The Commission generally proposed to approve the businesses' proposals regarding miscellaneous services. The cases where the Commission proposed not to approve part of a business's proposal or sought further information are summarised below.

- A number of miscellaneous charges identified by Coliban Water (debt collection), East Gippsland Water (debt collection and contract management fees) and South Gippsland Water (administration developer fees) were not approved as core miscellaneous services as they are set on a case-by-case basis and do not require scheduled charges.
- Wannon Water's tapping and water meter dirt box charges for larger connections were not approved as a core miscellaneous service as they were not expected to be applied over the regulatory period.
- Coliban Water's rental and grazing licence charges were not approved as core miscellaneous services as they are not prescribed services.
- Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water and South Gippsland Water were requested to provide confirmation that at least 75 per cent of their total miscellaneous services revenue is expected to be generated by their core sets, and to identify additional services if required.
- Wannon Water was requested to provide further information on its proposed method for adjusting miscellaneous charges over the regulatory period, or to adopt price increases that were no more than the average increase.
- Western Water and Westernport Water were requested to further simplify their core sets and provide definitions for core miscellaneous services. East Gippsland Water was requested to refine some definitions.
- Barwon Water and Lower Murray Water indicated they would make revised proposals on miscellaneous services in response to the Draft Decision.

The Commission also proposed that a uniform method for calculating actual cost be adopted by all businesses. The proposed method was that actual cost should be based on direct third party or contractor invoice cost, plus direct marginal internal costs (including labour, materials and transport) plus a 25 per cent contribution to overheads.[62]

14.3 Responses to draft decision

The businesses provided the following responses to the Draft Decision in regards to core miscellaneous services and proposed price paths.

- Barwon Water identified a core set of miscellaneous services based generally on a selection of miscellaneous services from its current price schedule, which is expected to generate 65 per cent of miscellaneous revenue. Some rationalisation of water connection related fees was undertaken, including the removal of administration fees and corresponding increases in tapping and meter connection charges. Small real price increases in special and tenant meter reads were also proposed following further analysis of actual cost. Barwon Water proposed to maintain core miscellaneous charges constant in real terms over the regulatory period.
- Coliban Water identified additional services from its current schedule for inclusion in its core set (treated wastewater fees — contract agreements, developer works administration fee and water and sewer plan amendment fees).
- East Gippsland Water identified additional services for inclusion in its core set (special meter reading, information statement with meter reading, private fire service resealing fire hose traps, standpipe tokens, septic waste disposal, desludging fees). It also provided revised and more detailed definitions.
- Gippsland Water provided revised and more detailed definitions of its core miscellaneous services.
- Goulburn Valley Water identified additional miscellaneous services for inclusion in its core set (septic tank waste receival and grease trap waste receival) and proposed that prices for these services be adjusted at the same rate as sewerage and trade waste tariffs.
- GWMWater identified a core set of miscellaneous charges based on a selection of miscellaneous services from its current price schedule, including definitions.
- Lower Murray Water identified a core set of miscellaneous charges based on a selection of miscellaneous services from its current price schedule, including definitions.
- North East Water identified a core set of miscellaneous services based on a selection of miscellaneous services from its current price schedule. It also proposed definitions for each core miscellaneous service and proposed to adjust core miscellaneous charges at the same rate as inflation over the regulatory period.

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[62] The Commission also proposed that in the case of bank dishonour, debt collection and legal fees, the third party costs should be charged directly to the customers without a contribution to internal costs or overheads.

- Wannon Water proposed to adopt the Commission's suggestion that core miscellaneous charges be adjusted at the same rate as the average increase over the regulatory period.
- Western Water identified a core set of miscellaneous services (relating to water and sewerage connections, information statements, fire services, developer works and septic waste disposal), including definitions. It also revised its proposal for adjusting miscellaneous charges over the regulatory period, to apply real annual price increases of 3.3 per cent instead of 4 per cent.
- Westernport Water identified a core set of miscellaneous services (relating to water and sewerage connections and information statements), including definitions.

In regards to the principles for calculating actual cost, the regional urban businesses generally proposed to adopt the principles suggested by the Commission in the Draft Decision, or did not propose alternative methodologies. Yarra Valley Water sought clarity on whether the contribution to overheads should be applied to all direct costs (third party and internal).[63] City West Water noted that it applies different overhead contribution rates depending on the service and only applies this to the labour component. It noted that it uses this method to ensure consistency in price regardless of whether the service is provided internally or by an external party.[64] South East Water indicated its support for the new approach, but indicated that it would be difficult to identify a core set of miscellaneous services that would be expected to generate 75 per cent of miscellaneous revenue without including charges based on actual cost.[65]

14.4 Final decision

The Commission has reviewed the businesses' revised proposals on miscellaneous services. With the exception of the cases listed below, the Commission has approved the proposals on the basis that:

- the core services are expected to generate a significant proportion of miscellaneous revenue
- prices for core services are based on existing price schedules, which were approved as part of the 2005 water price review, and
- prices for core services were generally proposed to increase in line with inflation and by no more than the average increase for any business.

With regards to Barwon Water's core set, the Commission notes that it previously suggested that core services should generate at least 75 per cent of miscellaneous revenue. Even though Barwon Water's core set does not recover this percentage, the Commission has approved them on the basis that they include the most frequently provided miscellaneous services.

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[63] Yarra Valley Water 2008, Submission to Draft Decision, 9 May p. 8.

[64] City West Water 2008, Submission to Draft Decision, 9 May p. 4.

[65] South East Water 2008, Submission to Draft Decision, 9 May p. 2.

The Commission has not approved the following proposals regarding core miscellaneous charges:

- Coliban Water's treated wastewater/contract agreement fees have not been included in its core set as it is calculated on a case-by-case basis and does not require a scheduled charge.
- Western Water's urgent water tapping, urgent sewer connection, urgent information statement, fire service cut ins, meter sales, developer financed works and recycled water inspection fees have not been included in its core set because they are calculated with reference to actual cost and do not have scheduled charges.
- A number of core miscellaneous services proposed by Lower Murray Water have not been approved. Specifically,
  - prices for a number of services are proposed to be set on a case-by-case basis and do not require scheduled charges (various design, supervision and administration fees)
  - the Commission has not been able to assess whether a number of significant price increases between 2007-08 and 2008-09 are reflective of cost increases or whether these services have previously been priced below cost (various design, supervision and administration lodgement fees). The Commission therefore considers that pricing principles should be used in calculating these charges
  - charges for large diameter connections have been removed to reduce the number of scheduled miscellaneous charges.

The Commission notes that even though the above miscellaneous services have not been approved as core services, the businesses may still charge for them as non-core services.

The Commission has also reviewed the proposals submitted by the metropolitan retailers. Where these businesses proposed to increase core miscellaneous charges by more than 14.8 per cent, the Commission has capped the increase at 14.8 per cent.

With regards to non-core miscellaneous services, the Commission has approved a more general method for calculating actual cost than it proposed in the Draft Decision. This is to provide further flexibility to businesses in regards to applying contributions for overheads. Businesses may apply overhead contribution rates as appropriate to ensure that the services are cost reflective. This could include applying different rates depending on the service being provided, or applying the rate to all direct costs or only certain cost components (labour, third party costs, etc). The Commission has approved the following method for calculating actual cost in each business's determination:

> The business will determine actual cost of the service bases on:
>
> > direct third party or contractor invoice cost
> >
> > *plus*

direct marginal internal costs (including labour, materials and transport)

plus

a fair contribution to overheads

In the case of bank dishonour, debt collection and legal fees, the third party costs shall be charged directly to the customer without a contribution for internal costs or overheads.

In regards to rural services, the Commission notes that due to the differences in the range and scope of services provided between businesses, it has been difficult to identify opportunities to rationalise rural miscellaneous services. As such, the Commission has approved the above pricing principles for the setting of rural miscellaneous charges instead of schedules prices.

Final decision

The Commission has not approved a number of services proposed by Coliban Water, Western Water and Lower Murray Water for inclusion as core miscellaneous services.

The Commission has approved standard principles for calculating actual cost for all businesses.

14.5 Implementing the new approach to miscellaneous charges

As discussed previously, only core miscellaneous services will be regulated through individual price caps and be subject to the annual tariff approval process. For all other miscellaneous services, businesses will still be able to charge for them even though they are not listed explicitly in the determination, as long as prices are set in accordance with the approved principles for calculating actual cost.

Businesses will have flexibility to apply actual costs as they consider appropriate. This may include setting a standard price based on actual cost for a particular non-core miscellaneous service. For example, this may be appropriate for services like meter accuracy test or special meter read. Alternatively, it may be appropriate for a business to apply actual costs on a case-by-case basis. Examples of this may include developer administration fees, where the costs incurred by the business are likely to vary with the size of the development. Businesses may also continue levying the miscellaneous charges that were approved over the previous regulatory period provided that they are consistent with the principles of actual cost.

15 MELBOURNE WATER'S DRAINAGE AND WATERWAYS CHARGES

15.1 Introduction

Melbourne Water provides drainage, waterways and floodplain management services in the greater Melbourne metropolitan area. In providing these services, it undertakes programs to improve the health of rivers and creeks, improve stormwater quality, provide drainage infrastructure to service urban growth and provide sufficient levels of flood protection.

The Commission was required to assess Melbourne Water’s Water Plan on the prices it proposed to charge for drainage and waterways services over the next five years. In its Water Plan, Melbourne Water proposed to reform its drainage and waterways prices, moving away from the current method of basing its charges on 1990 property values and a uniform minimum price for all customers. Specifically, it proposed to phase out the property value approach and introduce fixed charges for residential customers over the regulatory period, and to introduce a lower fixed rural charge from 2008-09 for customers that only receive waterways services. For non-residential customers, it proposed to introduce a higher minimum charge in 2008-09, and to continue basing charges on the property values while further reforms are developed and consulted on. In its extended areas, Melbourne Water proposed to levy the residential, non-residential and rural minimum charges. The Water Plan also included pricing proposals for diversion services, developer charges, special drainage area customers, and miscellaneous charges.

The Commission released a Draft Decision on the pricing proposals in May 2008.[66] This chapter sets out the Commission’s Final Decision on Melbourne Water’s proposed drainage and waterways tariff structures and other related pricing matters. The Final Decisions on other matters relating to Melbourne Water’s proposals are included in chapters 2 (key outcomes and service levels), 4 and 5 (operating and capital expenditure), 6 (financing capital investments) and 7 (demand forecasts).

15.2 Extended drainage and waterways areas

One of the major issues raised during the price review related to the extension of Melbourne Water’s drainage and waterways boundary. This boundary was formally extended in 2005 through a government order-in-council to include all of the

[66] Melbourne Water submitted its Water Plan on 19 December 2007. The Water Plan and the Draft Decision can be accessed through the Commission’s website: http://www.esc.vic.gov.au/.

Mornington Peninsula, Phillip Island, parts of the Westernport region and parts of the Werribee and Maribyrnong catchments. Customers in the extended areas will receive regional drainage and waterways services and will be required to pay charges for the first time from 1 July 2008.

The extension of the boundary followed an extensive consultation by the State Government, which identified the lack of a regional drainage and waterways authority in these areas as an issue in the Securing Our Water Future Green Paper in 2003. The Government received submissions and considered options in response to this issue and announced in the 2004 White Paper that Melbourne Water would be given responsibility for providing the drainage and waterways services (which had not previously been provided) in the new areas.

The White Paper indicated that properties within the extended areas will not immediately be liable for the drainage and waterways charge, and that flexible charging arrangements would be developed to reflect levels of service and differences between rural and urban customers.[67] Melbourne Water began undertaking initial consultation on and development of its works programs in the extended areas in mid-2005, including consultation on its Water Plan for the forthcoming regulatory period. Melbourne Water has already incurred expenditure in these areas over the previous three years.

A number of written submissions and comments raised in public forums suggested that the charge should not be introduced in the extended areas, and that the works should be funded through other means. In their submission, the Interface Councils suggested that the proposed rural tariff be removed to ensure a consistent approach with regional Victoria, where waterways improvements are undertaken by catchment management authorities.[68]

While acknowledging this feedback, the role of the Commission in reviewing the proposed drainage and waterways charges under the regulatory framework is not to assess whether the charges should or should not apply. Further, it is not able to review any institutional differences that exist between Melbourne and regional Victoria regarding the provision of waterways services. Instead, the Commission is responsible for assessing whether the *level* of the charges are cost reflective and do not reflect monopoly profits.

The Commission has reviewed the level Melbourne Water's proposed tariffs, including those to apply in the extended areas. The Final Decision on tariffs to apply from 1 July 2008 is discussed in section 15.5.

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[67] Victorian Government 2004, *White Paper: Securing our Water Future Together*, June, p.148.

[68] Interface councils, Submission to Melbourne Water Drainage and Waterways Draft Decision. The Interface Councils comprise the municipalities of Cardinia, Hume, Melton, Mornington Peninsula, Nillumbik, Whittlesea, Wyndham and Yarra Ranges.

15.3 Overview of draft decision

In the Draft Decision, the Commission indicated its in-principle support for Melbourne Water's proposal to phase out the use of property values in calculating drainage and waterways charges.

With regards to charges for residential customers, the Commission noted that continuing to use property values in its existing drainage and waterways area and fixed charges in the extended areas may result in different charges applying to similar properties. It also noted that adverse customer impacts associated with changes to tariff structures can be minimised by introducing them gradually. In order to assess whether fixed charges should be introduced earlier to avoid inconsistency in approach between existing and extended areas, the Commission sought further information from Melbourne Water on the customer impacts of introducing the fixed charges from 2008-09.

The inconsistency of approach between the existing and extended areas with regards to non-residential drainage and waterways charges was also highlighted. The Commission further noted that the inconsistency was likely to be larger for non-residential customers due to the larger range in non-residential property values and that there were no explicit timeframes for removing this inconsistency. As such, the Commission sought further information from Melbourne Water on its broader long-term strategies for non-residential tariff reform. It also sought comments on potential options for addressing the inconsistency between existing and extended areas, including moving all non-residential customers to a fixed charge within the regulatory period or using property values for non-residential customers in the extended areas as further reforms are undertaken.

With regards to diversions charges, the Commission noted that the proposed prices were above the annual average increase. In order to ensure that the price increases were cost reflective, the Commission sought further information from Melbourne Water on how it calculated the proposed prices for diversion services and the cost drivers behind the price increases.

The Commission proposed to approve Melbourne Water's proposed rural drainage and waterways tariff and process for approving special drainage area charges on an annual basis following consultation with the relevant customer representatives. It also proposed to approve Melbourne Water's current method for calculating drainage developer charges (subject to confirmation from Melbourne Water on its pricing principles) and proposals on miscellaneous charges.

15.4 Response to draft decision

In response to the Draft Decision, Melbourne Water provided further information on its pricing proposals.[69]

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[69] Melbourne Water, Submission to Melbourne Water Drainage and Waterways Draft Decision, 3 June 2008. Melbourne Water's submission can be viewed on the Commission's website: http://www.esc.vic.gov.au/.

With regards to residential customers, Melbourne Water confirmed its preference for fixed charges, based on the benefits that are broadly available to all residential customers. However, it also noted that due to the large range in residential property values in Melbourne and surrounding areas, the impacts of moving to a fixed charge in one year would be material, with some customers experiencing significant increases. Melbourne Water also indicated that during consultation on its proposed prices with customers and other stakeholder groups, it received feedback that while there was support for fixed charges for residential customers, the change should be introduced gradually to minimise any one-off impacts on customer's bills. Due to these factors, Melbourne Water confirmed its proposals to introduce fixed residential charges gradually over the regulatory period.

With regards to non-residential customers, Melbourne Water noted a number of principles behind its longer term strategy for tariff reform. These principles are that the tariff structure for non-residential customers more effectively:

- reflects the extent to which different customer sectors impact on, or benefit from waterways and drainage services
- achieve a higher level of transparency and customer understanding
- takes account of customer impacts relative to some other options
- provides an adequate and stable level of revenue to maintain services at an agreed standard and
- delivers significant implementation and administration cost savings.

However, Melbourne Water also noted the difficulties associated with reforming non-residential drainage and waterways tariffs. While noting that maintaining property values is not consistent with its longer term strategy, it also noted the shortcomings of a number of other alternatives.

In particular, it indicated that it did not support fixed charges for non-residential customers in the longer term. This is due to significant differences in the extent to which non-residential customers contribute to the costs of drainage and waterways services (through volumes and quality of stormwater runoff) and receive the benefits (in terms of benefits from flood protection). Further, Melbourne Water noted it did not consider using updated property values was appropriate, as it would lead to price increases for over two-thirds of customers, some of which would be significant. Continually updating property values for pricing purposes would also be costly to administer and would result in price fluctuations on an annual basis.

Melbourne Water indicated that it investigated an alternative charging structure for non-residential customers that it considers more cost reflective and equitable, based on property size and extent of impervious surfaces (such as concreted areas and roofing) as a proxy for quantity and quality of stormwater runoff. However, it indicated that introducing such a tariff structure quickly would result in significant price impacts due to the large distribution of current prices.

In regards to options for addressing the inconsistency in approach between existing and extended areas, Melbourne Water noted that using property values in the extended area was not desirable as there would be a large distribution in prices among customers that have not previously paid the charge.

Due to these factors and the need to consult further with customers on managing price impacts of further reform, Melbourne Water confirmed its original proposal of increasing the non-residential minimum charge in 2008-09 and using property values while further investigations are undertaken.

Melbourne Water also provided further detailed information on how it calculated proposed prices for diversion services and the cost that it expects to incur over the regulatory period in providing these services.

Melbourne Water also confirmed its proposal to adopt the pricing principles currently in place for calculating drainage developer charges.

In response to the Draft Decision, the Commission received a number of comments in written submissions and at three public forums held in the extended areas.[70] This feedback generally related to the introduction of the charge into the extended drainage and waterways areas. In their submission, the Interface Councils suggested that a concession rate should apply within the proposed pricing structures as is the case for other utility services.[71] The potential for a concession rate was also raised in an anonymous submission. The Interface Councils also indicated their support for a consistent approach to calculating charges between the existing and extend areas and the request for further information from Melbourne Water. In particular it noted that the inconsistency in approach for non-residential customers should be addressed before 1 July 2008.

In public forums in the extended areas (Sunbury and Phillip Island), customers indicated that they would like to see information on the works that Melbourne Water undertakes in their local areas, including how much expenditure it incurs in undertaking these works.

15.5 Final decision

The Commission has reviewed the further information provided by Melbourne Water in support of its proposals.

As discussed previously, the Commission has accepted Melbourne Water’s expenditure and demand forecasts, and has adopted a lower cost of capital than in the Draft Decision (the WACC is higher than that adopted by Melbourne Water in its Water Plan). As such, the Commission has approved higher prices than those originally proposed by Melbourne Water. Minimum prices of $81, $62 and $39 for non-residential, residential and rural customers respectively will apply in 2008-09.

In response to concerns raised about customers in the extended areas the Commission also considers that it would be beneficial to develop and implement monitoring and reporting arrangements for Melbourne Water’s works program in the extended areas. The Commission will consult with Melbourne Water and

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[70] Public forums were conducted in Mornington on 3 June, Phillip Island on 4 June and Sunbury on 5 June.

[71] Interface Councils, *Op. Cit.*

relevant customer and stakeholder groups over the next six to twelve months on developing these reporting arrangements.

In regards to the proposed tariff structure reforms over the regulatory period, the Commission notes that there is a trade-off between implementing the reforms quickly to minimise inconsistency in approach between the existing and extended drainage and waterways areas and minimising the adverse customer impacts of large price changes.

Residential customers

In regards to the gradual phasing in of fixed charges for residential customers, the Commission notes that Melbourne Water has consulted on the reforms with customers, who have indicated a preference for gradual price changes rather than large once-off price changes. The Commission has also had regard to more detailed information provided by Melbourne Water on the impact of introducing the fixed charge in 2008-09 and considers that the price impact on over half of all residential customers could be significant. Further, the Commission notes that Melbourne Water proposes to complete its reforms of residential charges within the regulatory period, meaning that any inconsistency in approach will be temporary.

After further consideration of Melbourne Water's proposals and analysis of the alternatives, the Commission considers that the gradual introduction of fixed residential charges strikes the right balance between minimising any inconsistency and minimising adverse customer impacts. The Commission has therefore approved Melbourne Water's residential drainage and waterways prices for the regulatory period.

Non-residential customers

In regards to the pricing reforms for non-residential customers, the Commission acknowledges the difficulties in designing a tariff structure that is cost reflective and equitable. It also notes the large distribution in current charges for non-residential customers and the potential for significant customer impacts with any change in tariff structures.

The Commission has considered the further information provided by Melbourne Water on the impacts of introducing fixed charges for non-residential customers within the regulatory period and of using property values in the extended areas. In both cases, the Commission has considered the customer impacts to be significant and outweigh any benefits of adopting a strictly consistent approach. The Commission also considers that the costs of using updated property values will be costly to administer and is not consistent with Melbourne Water's longer term pricing strategies.

Due to these factors, the Commission agrees with Melbourne Water that more time is needed to further investigate and consult on reforms for non-residential customers. It has therefore approved Melbourne Water's non-residential drainage and waterways prices for the regulatory period.

However, the Commission has also approve a flexible form of price control for all businesses, including Melbourne Water, which allows tariff reforms to be introduced within the regulatory period. Melbourne Water is therefore encouraged to proceed with developing its non-residential pricing reforms with a view to possibly starting to introduce them within the period. The Commission will liaise with Melbourne Water over the regulatory period on further investigations and consultations on further tariff reform.

Other services

In regards to diversion services, the Commission previously noted that the prices have been consulted on with customers and are generally consistent with price increases for similar services in regional Victoria. After considering these factors and the additional information provided on how the proposed prices were calculated and the cost drives behind the price increase, the Commission has approved Melbourne Water's diversion prices for the regulatory period.

In the Draft Decision, the Commission proposed to approve the current method for setting special drainage area charges, whereby Melbourne Water submits its prices for approval by the Commission on an annual basis after consulting with the relevant customer committees. Melbourne Water made its submission on the 2008-09 special drainage area charges shortly before the release of the Draft Decision. The Commission has completed its review of these charges and is satisfied that they are cost reflective and have been adequately consulted on. The Commission has approved these prices for 2008-09 and have adopted the pricing principles that are currently in place for the remainder of the regulatory period.

The Commission also confirms its approval of Melbourne Water's rural waterways charges, principles for calculating drainage developer charges and proposals on miscellaneous services.

Final decision

The Commission has approved Melbourne Water's drainage and waterways charges for residential customers.

The Commission has approved Melbourne Water's drainage and waterways charges for non-residential customers. The Commission will work closely with Melbourne Water on further reforms to non-residential charges, including the possibility of introducing these reforms within the regulatory period.

The Commission has approved prices for Melbourne Water's special drainage areas for 2008-09 and current process for adjusting these charges over the regulatory period.

The Commission confirms its approval of Melbourne Water's rural waterways charges, principles for calculating drainage developer changes and proposals on miscellaneous charges.

The Commission will work with Melbourne Water and other stakeholders on developing reporting arrangements on programs in the extended areas.

16 ADJUSTING PRICES

16.1 Introduction

The pricing principles in clause 14(1) of the Water Industry Regulatory Order (WIRO) require water businesses and the Commission to ensure that prices are set to:

- provide a sustainable revenue stream that covers operating and capital expenditure and provides a reasonable rate of return on assets
- give businesses incentives to operate efficiently and to promote sustainable water use
- signal to customers the costs of using water and give them incentives to use water sustainably
- take into account the interests of customers
- allow customers to understand prices being charged or how they have been calculated.

In setting prices for the coming five year regulatory period, businesses and the Commission have had to make assumptions about demand and supply levels, operating and capital expenditures, and capital financing costs (these are discussed in earlier chapters). Once prices have been set, the Commission does not normally adjust approved prices for prescribed services during the regulatory period to reflect differences between actual and forecast costs of service provision or divergences between actual and forecast demand levels.

This approach provides businesses with an incentive to manage their costs efficiently during the regulatory period (as required by the WIRO pricing principles). Businesses can re-prioritise, in consultation with customers, their capital projects or programs to manage changes in circumstances over the regulatory period.

In determining the form of price control adopted for each business and other mechanisms to assist businesses to manage the impacts of uncertainty, businesses and the Commission have to weigh up a number of factors relating to the WIRO pricing principles. These include:

- the nature and magnitude of relevant uncertainties affecting costs, revenues and outcomes
- potential impacts of uncertain and unforeseen events on the businesses' financial viability and
- customer preferences and potential customer impacts.

16.2 Overview of draft decision

Significant uncertainty about expected conditions during the forthcoming regulatory period means that the assumptions for demand levels and business costs (such as the timing and cost of major capital projects) are subject to a higher than normal level of uncertainty. The Commission proposed three main mechanisms for dealing with this uncertainty:

- a hybrid form of price control for the urban businesses, that combines individual price caps with opportunities for businesses to adjust their tariff strategies (and/or rebalance prices) at the time of the annual price review, and revenue caps for the rural businesses
- end of period adjustments during the subsequent price review process for unforeseen changes in legislative and other Government-imposed obligations during the period
- within-period adjustments, including pass throughs for uncertain capital projects (identified at the time of the Final Decision), licence fees and catastrophic events (such as fire, earthquake or act of terrorism), and within-period review of differences between actual and forecast demand levels.

The Commission proposed to approve individual price caps for all of the urban businesses, Lower Murray Water's urban services and GWMWater (which, with the completion of the Wimmera Mallee Pipeline, will take on more of the characteristics of an urban business). The Commission also proposed to approve individual price caps for Southern Rural Water's recycled water services and fee-based (diversions) applications. Businesses subject to individual price caps would be able to apply during the regulatory period to adjust their tariff structure under the hybrid form of price control.

The Commission proposed to approve revenue caps for FMIT, Goulburn-Murray Water, Lower Murray Water's rural services and Southern Rural Water's services excluding recycled water and fee-based (diversions) applications.

Due to very high levels of uncertainty about major projects proposed by Goulburn-Murray Water and Southern Rural Water, the Commission proposed not to approve prices for all services provided by these businesses for the full five year regulatory period until the scope and funding arrangements for the Foodbowl Modernisation Project, projects in the Macalister Irrigation District and the Werribee Irrigation District Recycled Water Scheme have been clarified.

16.3 Responses to draft decision

Most businesses accepted the Commission's Draft Decision on the form of price control to apply and welcomed the proposed mechanisms to address specified sources of uncertainty.

The Consumer Utilities Advocacy Centre (CUAC) also supported the Commission's proposed mechanisms for adjusting prices during the period because they will assist in avoiding price shocks in the next regulatory period and ensure that prices would be reduced if circumstances were more favourable than expected.[72] CUAC emphasised that the process for reviewing prices during the period must include ‘robust’ public consultation and take into account consumer views, particularly in relation to affordability.

Coliban Water stated that a tariff basket would allow it to hold some prices constant over the regulatory period and adjust some other prices.[73] However, any planned rebalancing of prices that is known at the start of the period can be accommodated within individual price caps – Coliban Water has set out the appropriate price movements for inclusion in a Schedule to the Final Determination.

GWMWater questioned whether individual price caps would allow it sufficient flexibility to balance prices across different service segments and to manage uncertainty.[74] A number of submissions were received from GWMWater customers, and comments were made at the public forum in Horsham, expressing concerns about GWMWater’s proposed tariff structure and prices, particularly the proposed pipeline tariffs.

A number of businesses sought clarification of the magnitude of the changes in costs or demand levels that would be classified as ‘significant’ or ‘material’ for the purpose of making within-period adjustments to the Final Determination. Some businesses were also concerned that a number of individual changes, each one falling under the threshold for materiality, could amount to a material impact when taken together.

Central Highlands Water and Gippsland Water identified additional uncertain capital projects.[75]

Some businesses, including City West Water and South East Water, suggested that, rather than excluding uncertain capital projects from the capital expenditure forecasts, allowances for such projects’ ‘most likely cost and timing’ should be included as the base case against which adjustments are made.[76] The businesses considered that this approach would minimise the magnitude of any price adjustments to customers.

16.4 Final decision

In response to submissions and further information from the businesses, the Commission has modified its approach to dealing with uncertainty. In doing so, the Commission has recognised that the nature and magnitude of uncertainty

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[72] Consumer Utilities Advocacy Centre 2008, Submission to the Draft Decision, 12 May.

[73] Coliban Water 2008, Response to Draft Decision, 16 May.

[74] GWMWater 2008, Response to Draft Decision, 9 May.

[75] Central Highlands Water 2008, Response to Draft Decision, 12 May. Gippsland Water 2008, Response to Draft Decision 9 May.

[76] City West Water 2008, Submission to Draft Decision, 9 May. South East Water 2008, Response to Draft Decision, 9 May.

surrounding required outcomes, costs and demand levels varies across businesses. The revised approach better balances the WIRO pricing principles by ensuring businesses' revenues will be sufficient to cover efficient costs (for ongoing financial viability) while addressing customer interests and customer impacts.

16.4.1 Form of price control

The Commission has approved individual price caps for all of the urban businesses, Lower Murray Water's urban services and GWMWater. Individual price caps are also approved for Southern Rural Water's recycled water services and fee-based (diversions) applications. The Commission has approved revenue caps for FMIT, Goulburn-Murray Water, Lower Murray Water's rural services and Southern Rural Water's services excluding recycled water and fee-based (diversions) applications.

For businesses subject to individual price caps, the Commission has approved a hybrid form of price control to assist these businesses manage uncertainty by implementing any reasonable rebalancing of tariffs that can be justified during the regulatory period. (Businesses subject to revenue caps are already able to rebalance tariffs provided total revenue remains within the revenue cap.)

Under the 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 proposing to adjust their tariff strategies will have to demonstrate to the Commission that they have clearly articulated their new tariff strategy (or explained how the proposed price changes are consistent with their existing tariff strategy), undertaken appropriate customer consultation and addressed customer impacts. The Commission may then approve amended individual price caps consistent with the new tariff strategy for the remainder of the regulatory period.

A simple numerical example of the process for adjusting prices under the hybrid form is set out in the attachment to this chapter.

Generally, a decision on whether and when to make an application under the hybrid form of price control will be determined according to an individual business's judgement as to whether circumstances have changed sufficiently to justify adjustment of its tariff schedule and/or tariff strategy.

However, for GWMWater, the uncertainties associated with the Wimmera Mallee Pipeline, and proposed tradability of 'growth water', are so large that the Commission is not satisfied that GWMWater's proposed tariff strategy complies with the WIRO pricing principles. In particular, GWMWater has yet to resolve a number of implementation issues and to effectively address substantial customer impacts for some customer groups from its proposed pipeline tariffs (see chapter 13). The Commission has approved pricing principles for 2008-09 prices. GWMWater will be required during 2008-09 to submit to the Commission a revised tariff strategy and tariff schedule to apply from 2009-10. The submission will have to comply with the requirements under the hybrid form of price control.

Higher than average uncertainties were identified for two other businesses — Goulburn-Murray Water and Southern Rural Water. Until the scope and funding arrangements for the Foodbowl Modernisation Project, the Macalister Irrigation District projects and the Werribee Irrigation District Recycled Water Scheme have been clarified, the forecasts for operating and capital expenditure for these businesses are so uncertain that their revenue requirements for the regulatory period cannot be calculated with sufficient confidence. Therefore, the Commission has introduced a mechanism similar to the hybrid form of price control to permit adjustment of these businesses' approved revenue requirements. Goulburn-Murray Water and Southern Rural Water will be required during 2008-09 to submit to the Commission amended revenue requirements for the years 2009-10 to 2012-13, accompanied by a detailed explanation of their calculation and evidence that they have consulted customers (including, any relevant consultative committee established under the Water Act 1989).

For Southern Rural Water, the amended revenue requirements will relate to its services that are subject to a revenue cap. Southern Rural Water will also be required during 2008-09 to submit to the Commission a revised tariff schedule to apply from 2009-10 for its recycled water services and fee-based (diversions) applications (that are subject to individual price caps). The business's submission will have to comply with the requirements under the hybrid form of price control.

Final decision

The Commission has approved individual price caps for Barwon Water, Central Highlands Water, Coliban Water, East Gippsland, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water's urban services, North East Water, South Gippsland Water, Wannon Water, Western Water, Westernport Water, and Southern Rural Water's recycled water services and fee-based (diversions) applications.

These businesses may apply during the period to adjust their prices or tariff structures at the time of the annual price review. The Commission may approve amended individual price caps for the remainder of the regulatory period where businesses have provided to the Commission:

- a clearly articulated new tariff strategy or explanation of how the proposed price changes are consistent with the existing tariff strategy
- evidence of adequate customer consultation and steps to address customer impacts and
- a statement showing that the amended price changes are consistent with a tariff basket approach.

During 2008-09, GWMWater and Southern Rural Water (in relation to its recycled water services and fee-based (diversions) applications) will be required to submit to the Commission a revised tariff schedule to apply from 2009-10. Their submissions must provide the information listed above.

The Commission has approved revenue caps for FMIT, Goulburn-Murray Water, Lower Murray Water's rural services and Southern Rural Water's services excluding recycled water and fee-based (diversions) applications.

During 2008-09, Goulburn-Murray Water and Southern Rural Water (in relation to its services other than recycled water services and fee-based (diversions) applications) will be required to submit to the Commission amended revenue requirements for the years 2009-10 to 2012-13, accompanied by a detailed explanation of their calculation and evidence that they have consulted customers and effectively addressed customer impacts.

16.4.2 Dealing with uncertainty

The Commission has modified the mechanism proposed in its Draft Decision to increase businesses' flexibility to apply for adjustments to deal with the impact of uncertain or unforeseen events as well as the Commission's flexibility to make appropriate adjustments.

The Commission recognises that a number of aspects of the businesses' activities are subject to a relatively high degree of uncertainty during this regulatory period. It considers that variations from the assumptions used in determining prices should be considered in totality, rather than taking account of each change separately. In some cases, positive and negative changes may offset each other, resulting in little impact on businesses' costs or revenues overall and requiring no price adjustment. In other cases, a number of small changes may add up to a significant impact, either in one year or taken together over a series of years during the regulatory period.

The Commission considers that defining materiality thresholds would reduce businesses' and the Commission's flexibility to make appropriate adjustments for uncertain and unforeseen events.

In some cases, the Commission may approve a within-period price adjustment, either to increase prices for higher than expected costs and/or weaker than expected demand or to reduce prices for lower than expected costs and/or stronger than expected demand. In other cases, adjustments may be deferred until the third regulatory period particularly when there is a possibility that variations in later years' costs and/or demand levels may offset differences from assumed levels in the particular year in question. The Commission will take into account impacts on the businesses' financial viability and customer interests in making its decision. The process to be followed in seeking to adjust prices is set out in the Determination for each business.

Due to the high level of uncertainty regarding capital expenditure, the Commission will allow businesses to apply for adjustments in respect of projects that are currently included in the capital expenditure assumptions, where costs differ significantly from those included for the purposes of this Decision, as well as projects that have been identified by businesses as uncertain and other projects that were not identified at the time of this Decision.

The businesses and the Commission have already identified a number of capital projects that are likely to be subject to this mechanism. These include:

- The Melbourne Interconnector (Barwon Water) — the capital expenditure associated with this project has been excluded from the forecasts used to determine prices for this regulatory period. When the project is complete and comes into service prices, will be adjusted to reflect the project costs as well as the capitalised interest cost (based on the WACC) incurred during construction less any government contributions.
- The Merbein pipeline (Lower Murray Water) — the main construction costs for this project have been excluded from the forecasts used to determine prices for this regulatory period. Some expenditure has been allowed for feasibility and planning to be undertaken during the period.

This mechanism will not be available in 2008-09 for Goulburn-Murray Water and Southern Rural Water (except for its recycled water services and fee-based applications) since the impact of uncertain and unforseen events will be taken into account in their proposals to amend their revenue requirements.

Final decision

The Commission will assess whether price adjustments are required either within the period or in the third regulatory period proposes to take account of:

- differences between actual and estimated licence fees levied by the Environment Protection Authority, the Department of Human Services and the Commission
- catastrophic events, such as fire, earthquake or act of terrorism
- costs associated with uncertain or unforeseen capital projects
- additional net operating costs associated with meeting unforeseen changes in legislative and other Government-imposed obligations during the period
- significant variations between actual demand levels and the demand forecasts made for the purposes of the price determination
- any other events that the Commission considers require an adjustment.

Attachment 16A Example of a tariff structure adjustment under the hybrid form of price control

The following example demonstrates the method for calculating an amended tariff structure consistent with the hybrid form of price control. In this simple example, the business provides water and sewerage services, with tariffs subject to individual price caps.

In the first year of the regulatory period, water services are charged according to a simple two part tariff with an access fee of $100 a year and a volumetric charge of $1.00 per kL. Sewerage is subject to a $100 a year fixed access fee. Charges are the same for residential and non-residential customers and a uniform real increase of 10 per cent a year has been approved for all tariffs (CPI adjustments are excluded for simplicity).

During the first year, the business applies to alter its tariff strategy from the commencement of the second regulatory year by phasing in over two years the introduction of an inclining block tariff (IBT) structure for the volumetric component of water services. The new tariff strategy will apply for the remainder of the regulatory period.

For the Commission to approve the new tariff strategy, the business must explain:

- the reasons for introducing an IBT structure
- the steps taken to ensure that customers were informed about, and consulted on, the proposed new tariff strategy (if the strategy in the Water Plan has been revised), the proposed new tariff structure and the real prices for water and sewerage services
- the feedback obtained from customers on the proposal
- expected customer impacts (including for different customer groups)
- proposed actions to address any adverse customer impacts.

In addition, the business must demonstrate that the weighted average price increases for the second to fifth years (inclusive) of the regulatory period will be no greater under the new tariff structure than they would have been under the original tariff structure approved by the Commission for the regulatory period. The average price change for the first year in which the amended tariff structure is proposed must satisfy the following formula:

$$\frac{\sum_{i=1}^{n}\sum_{j=1}^{m} p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}} \geq \frac{\sum_{i=1}^{n}\sum_{j=1}^{m} a p_t^{ij} q_{t-2}^{ij}}{\sum_{i=1}^{n}\sum_{j=1}^{m} p_{t-1}^{ij} q_{t-2}^{ij}}, i = 1,...n; j = 1...m$$

where the business has *n* tariff categories, which each have up to *m* tariff components, and where:

p_{t-1}^{ij}	is the tariff charged in regulatory year t-1 for component j of tariff i
p_t^{ij}	is the proposed tariff for component j of tariff i determined in accordance with the approved price movement
ap_t^{ij}	is the proposed tariff for component j of tariff i determined in accordance with the amended prescribed price movements submitted by the business
q_{t-2}^{ij}	is the quantity of component j of tariff i that was sold in regulatory year t-2, or, if an actual quantity is not available, either an estimate of the quantity of component j of tariff i that would have been sold in regulatory year t-2 or a forecast of the quantity of component j of tariff i that is expected to be sold in regulatory year t-2

The proposed prices and forecast quantities for each year of the regulatory period are shown in the table.

In the example, the business has two tariff categories – water, which has two tariff components (fixed and variable charges), and sewerage which has one tariff component. With the introduction of an IBT, there will be four components to the water tariff category (one fixed and three variable charges).

The weighted average price increase for each year of the regulatory period is 10 per cent under the original tariff structure since each tariff component increases by 10 per cent each year. Therefore the weighted average price increase for the second to fifth years of the regulatory period must not exceed 10 per cent.

Note that the prescribed price movement is a maximum and the business may choose to phase in any restructuring of tariffs by applying a lesser increase under their amended tariff structure than the average price increase approved by the Commission. Given the Commission approves a five year revenue requirement, in future years the business may make up any difference by applying a higher average price increase than originally approved to ensure that they recover their approved revenue requirement for the regulatory period.

The business applies the formula to calculate the weighted average price increases for each remaining year of the regulatory period when it prepares its application in 2008-09. For the second regulatory year (2009-10), the weighted average price increase for the proposed amended tariff structure is 10 per cent, the same as under the original proposed prices and forecast quantities. (The same amount of revenue is raised under the old and new tariff structures.) In the third, fourth and fifth years, the weighted average price increase is also 10 per cent, the same as the increase under the original tariff structure.

For 2009-10, the business decides to apply a three tier inclining block tariff, with the first tier price being set at slightly below the previously approved rate, the second tier price the same as the previously approved rate and the third tier price at slightly above the previously approved rate.

p_t^{ij} equals $110.00 for the fixed water fee, $1.10 for the variable water charge and $110.00 for the fixed sewerage fee and p_{t-1}^{ij} equals $100.00 for the fixed water fee, $1.00 for the variable water charge and $100.00 for the fixed sewerage fee under the original tariff structure. Under the new tariff structure, ap_t^{ij} equals $108.00 for the fixed water fee, $1.00 for the first tier variable water charge, $1.30 for the second tier charge and $1.90 for the third tier, and $105.00 for the fixed sewerage fee.

The prices are weighted by the relevant quantities in 2007-08. For the water and sewerage fixed charges, q_{t-2}^{ij} is actual 2007-08 customer numbers, that is, 97. Actual total water consumption in 2007-08 was 485 kL. Since 2007-08 tariff structure included a simple two-part water tariff, the business has to estimate how much would have been consumed within each block if its proposed IBT had been in place then. The business estimates that consumption within each block would have been one-third of total consumption, that is, 161.67 kL per block.

For 2010-11, the business decides to increase the differential between the tiers of its inclining block tariff structure, by applying a greater than average increase to the third tier price, and a lesser than average increase to the first tier price.

p_t^{ij} is the prices that were approved under the original tariff structure – that is, $121.00 for the fixed water fee, $1.21 for the variable water charge and $121.00 for the fixed sewerage fee and p_{t-1}^{ij} equals the prices for 2009-10 under the original tariff structure ($110.00 for the fixed water fee, $1.10 for the variable water charge and $110.00 for the fixed sewerage fee).

Under the new tariff structure, ap_t^{ij} equals $118.80 for the fixed water fee, $1.05 for the first tier variable water charge, $1.40 for the second tier charge and $2.17 for the third tier, and $115.50 for the fixed sewerage fee. ap_{t-1}^{ij} equals $121.00 for the fixed water fee, $0.90, $1.10 and $1.30 respectively for the first, second and third tiers of the inclining block, and $110.00 for the fixed sewerage fee.

The prices are weighted by the business's estimates for the relevant 2008-09 quantities since the actual quantities are not available at the time the application is prepared. For the water and sewerage fixed charges, q_{t-2}^{ij} is estimated 2008-09 customer numbers, that is, 100. The business also estimates total 2008-09 water consumption and how much would have been consumed within each block if its proposed IBT had been in place then. The business estimates that consumption within each block would have been one-third of total consumption, that is, 166.67 kL per block.

For 2011-12, and **2012-13**, the business reverts to a price increase of 10 per cent to each tariff and tariff component, ensuring that the originally approved average price movement approved by the Commission is not exceeded.

Table 16A.1 **Numerical example**

Regulatory Year	*2008-09*		*2009-10*			*2010-11*			*2011-12*			*2012-13*		
Tariff and Price Component	*Price 1/7/08 $*	*Quantity 1/7/08*	*PPM %*	*Price 1/7/09 $*	*Quantity 1/7/09*	*PPM %*	*Price 1/7/10 $*	*Quantity 1/7/10*	*PPM %*	*Price 1/7/11 $*	*Quantity 1/7/11*	*PPM %*	*Price 1/7/12 $*	*Quantity 1/7/12*
ORIGINAL TARIFF STRUCTURE: TWO PART TARIFF FOR WATER														
Water access fee, per annum	100.00	100	10.0	110.00	103	10.0	121.00	106.09	10.0	133.10	109.27	10.0	146.41	112.55
Water usage fee, per kL	1.0000	500	10.0	1.1000	515	10.0	1.2100	530.45	10.0	1.3310	546.36	10.0	1.4641	562.75
Sewerage fee, per annum	100.00	100	10.0	110.00	103	10.0	121.00	106.09	10.0	133.10	109.27	10.0	146.41	112.55
PROPOSED NEW TARIFF STRUCTURE: INCLINING BLOCK TARIFFS FOR WATER														
Water access fee, per annum		100		110.00	103	10.0	121.00	106.09	10.0	133.10	109.27	10.0	146.41	112.55
Water usage 1st tier fee, per kL		166.67		0.9000	171.67	7.5	0.9675	176.82	10.0	1.0642	182.12	10.0	1.1706	184.25
2nd tier fee, per kL		166.67		1.1000	171.67	10.0	1.2100	176.82	10.0	1.3310	182.12	10.0	1.4641	184.25
3rd tier fee, per kL		166.67		1.3000	171.67	11.5	1.4495	176.82	10.0	1.5944	182.12	10.0	1.7538	184.25
Sewerage fee, per annum		100		110.00	103	10.0	121.00	106.09	10.0	133.10	109.27	10.0	146.41	112.55

Note Assumes customer numbers grow by 3 per cent each year. Actual 2007-08 quantities are 97 water/sewerage customers and 485 kL of water consumed.

APPENDIX A SUBMISSIONS AND PUBLIC MEETINGS

A1 List of submissions

Table A.1 **Submissions received to issues paper**

No.	*Name*	*Date received*
1.	Paul McGowan	27/07/2007
2.	Morwell CERC	20/08/2007
3.	Terry Green	12/09/2007
4.	GWMWater Customer (Confidential)	12/09/2007
5.	Tanya Clark	12/09/2007
6.	Thomas Binns	28/09/2007
7.	J.L. Chivell	01/10/2007
8.	Cr Tim Hayes, Hepburn Shire Council	17/10/2007
9.	Brintons Pty Ltd	06/11/2007
10.	E.P. Robinson Pty Ltd	09/11/2007
11.	North West Municipalities Association	27/11/2007
12.	Gippsland Water Customer Petition	02/12/2007
13.	Pauline and Bill Sansome	31/12/2007
14.	Northern Grampians Shire Council	08/01/2008
15.	EWOV	16/01/2008
16.	Goulburn Valley Water	21/01/2008
17.	Plains Water Ltd	25/01/2008
18.	Gippsland Water	25/01/2008
19.	Wannon Water	25/01/2008
20.	Western Water	26/01/2008
21.	Traralgon City & Rural Community Development Association Inc	28/01/2008
22.	Lisa Proctor	28/01/2008
23.	GWMWater	29/01/2008
24.	Southern Rural Water	29/01/2008
25.	Barwon Water	29/01/2008

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Table A.1 (continued)

No.	*Name*	*Date received*
26.	Gippsland Resource Group Inc.	29/01/2008
27.	De Cicco Industries Pty Ltd	01/02/2008
28.	Patricia Liffman	04/02/2008
29.	Grampians Wool Industries Pty Ltd	05/02/2008
30.	Wilma and Peter Western	05/02/2008
31.	Barwon Water	05/02/2008
32.	Russell Northe MLA, Member for Morwell	05/02/2008
33.	Advance Morwell	05/02/2008
34.	Consumer Utilities Advocacy Centre	08/02/2008
35.	Lake Glenmaggie Community Representative Group	20/02/2008
36.	Harry Kilminster	24/02/2008
37.	Hugh Delahunty, Member for Lowan	28/02/2008
38.	Horsham Rural City Council	06/03/2008

Table A.2 **Submissions received to draft decision**

No.	*Name*	*Date received*
1.	Wellington Shire	02/04/2008
2.	Brett Alston	02/04/2008
3.	Golden Plains Shire	04/04/2008
4.	Lawrence Alexander	08/04/2008
5.	Anonymous	08/04/2008
6.	Northern Grampians Shire Council	10/04/2008
7.	Graham Yearbury	10/04/2008
8.	Supply System 6 unrated property owners	21/04/2008
9.	Murphy’s Country Pub	22/04/2008
10.	Customer Liason Group (CHW)	23/04/2008
11.	Rene de Jong (Buninyong)	23/04/2008
12.	Don Laity	24/04/2008
13.	Bartter	01/05/2008
14.	Minyip Progress Association	02/05/2008
15.	R.G Thorne	02/05/2008
16.	Pauline and Bill Sansome	03/05/2008
17.	Horsham South VFF (Confidential)	05/05/2008
18.	Oliver Guthrie	06/05/2008

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Table A.2 (continued)

No.	*Name*	*Date received*
19.	Avoca Business and Tourism Inc.	07/05/2008
20.	Michael O'Sullivan	07/05/2008
21.	Bob Collins	07/05/2008
22.	Michael Davies	07/05/2008
23.	Community Implementation Committee, Smythesdale	07/05/2008
24.	Anonymous	07/05/2008
25.	Warrnambool Cheese and Butter Factory	08/05/2008
26.	Plains Water Ltd	08/05/2008
27.	South Gippsland Water	08/05/2008
28.	Moorabool Shire Council	08/05/2008
29.	Olive Lavery	08/05/2008
30.	George Powell	08/05/2008
31.	City West Water	09/05/2008
32.	Elizabeth Hall	09/05/2008
33.	TGM Group	09/05/2008
34.	Wimmera Irrigators Association	09/05/2008
35.	Lake Glen Maggie Community Representative Group	09/05/2008
36.	Gippsland Resource Group	09/05/2008
37.	Villawood Properties	09/05/2008
38.	Western Water	09/05/2008
39.	United Dairy Farmers of Victoria, District Council 3	09/05/2008
40.	City of Greater Geelong	09/05/2008
41.	Westernport Water	09/05/2008
42.	EWOV	09/05/2008
43.	Goulburn Valley Water	09/05/2008
44.	Barwon Water	09/05/2008
45.	GEO Property Group	09/05/2008
46.	L. Bisinella Developments	09/05/2008
47.	South East Water	09/05/2008
48.	Gippsland Water	09/05/2008
49.	GWMWater	09/05/2008
50.	Ron Seath	09/05/2008
51.	Yarra Valley Water	09/05/2008
52.	Southern Rural Water	09/05/2008
53.	Central Highlands Water	12/05/2008

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Table A.2 (continued)

No.	*Name*	*Date received*
54.	Consumer Utilities Advocacy Centre	12/05/2008
55.	Municipal Association of Victoria	12/05/2008
56.	Latrobe City	13/05/2008
57.	Wannon Water	13/05/2008
58.	VicWater	14/05/2008
59.	Jan Pavich	14/05/2008
60.	North East Water	15/05/2008
61.	Committee for Ballarat	15/05/2008
62.	Coliban Water	16/05/2008
63.	Yarra Valley Water (NCC's)	16/05/2008
64.	Central Gippsland Older Adults Recreation Network Inc.	16/05/2008
65.	Urban Development Institute of Australia (Victoria)	19/05/2008
66.	Keith Murdoch	19/05/2008
67.	Victoria Police	19/05/2008
68.	Goulburn-Murray Water	20/05/2008
69.	Lower Murray Water	23/05/2008
70.	FMIT	23/05/2008
71.	GEO Property Group	27/05/2008

Table A.3 **Submissions received to drainage and waterways draft decision**

No.	*Name*	*Date received*
1.	Melbourne Water	03/06/2008
2.	Anonymous	03/06/2008
3.	Maurice Schinkel	05/06/2008
4.	Interface Councils	05/06/2008
5.	Kevin Spencer	17/06/2008

A2 Details of public meetings

Table A.4 **Water price review 2008 public meetings**

Town	*Date*
Ballarat	8 April 2008
Bendigo	8 April 2008
Geelong	10 April 2008
Wodonga	14 April 2008
Shepparton	15 April 2008
New Haven	18 April 2008
Leongatha	18 April 2008
Horsham	21 April 2008
Warrnambool	22 April 2008
Sunbury	28 April 2008
Traralgon	28 April 2008
Bairnsdale	29 April 2008
Mildura	1 May 2008

Table A.5 **Melbourne Water drainage and waterways charges**

Town	*Date*
Mornington	3 June 2008
Phillip Island	4 June 2008
Sunbury	5 June 2008