

GOULBURN-MURRAY WATER PRICE REVIEW 2016

Draft decision

February 2016

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Essential Services Commission 2016 *Goulburn-Murray Water Price Review 2016*, Draft decision, February

PREFACE

In September 2015, Goulburn-Murray Water (G-MW) submitted to the Essential Services Commission (the Commission) the prices that it proposed to charge its customers for water services during its four year regulatory period commencing 1 July 2016. The Commission is required to assess the submission and to decide whether to approve G-MW's proposed prices.

This draft decision sets out the Commission's views on G-MW's price submission and seeks comment from interested parties on these views.

Consultation with stakeholders is an important part of the Commission's decision making process. From September to early December 2015, we sought customers' views on the price submission and the assumptions that underpin it. We now seek G-MW's customers' and other interested parties' views on our draft decision.

In making this draft decision, we have considered written submissions that we received on G-MW's price submission and comments made during the public forums that we held in late 2015. I look forward to input from the public in response to our draft decision.

Dr Ron Ben-David
Chairperson

RESPONDING TO THIS DRAFT DECISION

We invite comments from interested parties on this draft decision. The Commission will consider those comments before making its final decision.

Interested parties can provide feedback on this draft decision in two ways:

Come to a public meeting

We will hold public forums in Goulburn-Murray Water's area of operation during April 2016. The forums will provide an opportunity for interested parties to understand and comment on the key features of the draft decision. We will publish details of these forums on our website at esc.vic.gov.au.

Provide written comments or submissions

Written comments in response to this draft decision are due 22 April 2016. We would prefer to receive them by email at water@esc.vic.gov.au.

You may also send comments by mail to:

Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

We usually make all submissions publicly available on our website. If you do not wish some information to be disclosed publicly, please discuss the matter with Commission staff on (03) 9032 1300.

If you cannot access our website, please contact Commission staff to make alternative arrangements to view copies of the submissions.

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SUMMARY

BACKGROUND — THE PRICE REVIEW PROCESS

In September 2015, Goulburn-Murray Water (G-MW) provided its price submission to the Essential Services Commission (the Commission) for the four year regulatory period commencing 1 July 2016. The Commission reviewed the submission according to our guidance for G-MW¹, which aligns with the Australian Competition and Consumer Commission's (ACCC) pricing principles.

In November 2015, we held community forums in Shepparton, Kyabram and Kerang to discuss G-MW's submission with approximately 50 attendees. We also received 17 written public submissions and an additional submission from G-MW.

REVENUE REQUIREMENT

The Commission proposes revenue for G-MW of \$467.7 million for the fourth regulatory period, (table below), which is \$25.6 million (5.2 per cent) lower than G-MW's proposal.

REVENUE — G-MW'S PROPOSED REVENUE COMPARED WITH DRAFT DECISION'S APPROVED REVENUE \$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20	Total
Proposed revenue	120.0	122.7	125.1	125.6	493.3
Draft decision on revenue	115.8	116.9	117.6	117.3	467.7

Note: Numbers have been rounded.

¹ Essential Services Commission 2014, *Goulburn-Murray Water Price Review 2016 – Guideline on price submission*, August 2014.

The lower revenue requirement approved in this draft decision reflects:

- approved operating expenditure of \$374 million for the four years from 2016, which is \$24 million less than G-MW's proposal. The reduction mainly reflects additional reductions in operating expenditure to meet G-MW's cost saving commitments and a change in the forecast of the Murray-Darling Basin Authority contribution required of G-MW
- approved capital expenditure of \$136 million for the fourth regulatory period after an adjustment (\$674 000 over four years) to G-MW's proposed capital expenditure to reflect reduced contingencies on some projects.

TARIFFS

A key issue in our review has been G-MW's proposal to charge common infrastructure access and use fees in its irrigation districts. We consider the differences between the costs of the Shepparton district and the other districts are too large to achieve the principle of "user pays" in respect of a uniform tariff for water storage and delivery in irrigation systems. But we do consider G-MW's cost structures in the districts, as analysed by Indec, would be sufficient to justify common fees for gravity irrigation infrastructure access and use for up to five of G-MW's districts.

The Commission proposes to approve the tariff structures for services such as G-MW's proposed bulk water and storage, pumped irrigation districts, drainage, service points and miscellaneous services. The Commission does not approve G-MW's proposed diversion tariff structures but would approve them if G-MW were to extend the transition period for small diverters from two to four years.

G-MW will need to recalculate and resubmit all its proposed tariffs and prices, to account for our required amendments to operating and capital expenditure.

NON-TARIFF ISSUES

Of the main elements of G-MW's price proposal, the Commission proposes to approve G-MW's proposed service standards, demand forecasts, and form of price control.

1 INTRODUCTION

The Essential Services Commission is Victoria's independent economic regulator. Our role in the water industry includes regulating prices and monitoring the service standards of the 19 Victorian Government owned water businesses. This paper presents the Commission's draft decision on Goulburn-Murray Water's (G-MW) price submission for the fourth regulatory period from 1 July 2016 to 30 June 2020.

G-MW's prices are regulated under two regulatory frameworks:

- G-MW's infrastructure-related services are regulated under the Commonwealth's Water Charge (Infrastructure) Rules (WCIR). These rules cover approximately 95 per cent of G-MW's total regulated costs. In February 2011, the Australian Competition and Consumer Commission (ACCC) accredited the Commission to regulate G-MW. **This accreditation required the Commission to follow the ACCC's pricing principles** (made under the WCIR) when conducting its price review. The accreditation decision and the attached pricing principles are available on our website.
- G-MW's groundwater and some miscellaneous services are not infrastructure related, and are regulated under the Water Industry Regulatory Order (WIRO).

The Commission issued guidance papers to G-MW on the minimum requirements for the information that G-MW should submit to the Commission. These guidance papers are available on our website, www.esc.vic.gov.au.

1.1 OUR APPROACH TO REVIEWING PROPOSED PRICES

The WCIR requires the Commission to adopt a building block approach to review G-MW's proposed prices. This approach has four steps.

The first step is to establish service standards and other outcomes that G-MW proposes to deliver over the regulatory period. These standards and outcomes reflect obligations imposed by the Minister for Water through the Statement of Obligations and government regulatory agencies, and customer preferences.

Next, the Commission determines the revenue that G-MW needs to meet these service obligations and outcomes. To do so, it reviews G-MW's expenditure proposals and calculates an appropriate return on G-MW's assets. The revenue approved by the Commission does not represent amounts that G-MW is required to spend or direct to particular activities or projects. In consultation with customers, G-MW is free to determine its expenditure priorities and to pursue innovation and efficiencies that enable it to outperform cost assumptions.

At the third step, the Commission reviews G-MW's service demand forecasts that are used to forecast prices.

Finally, the Commission reviews G-MW's proposed tariff structures and calculates prices to apply in the first year of the regulatory period.

G-MW should recalculate and resubmit all its proposed tariffs and prices to account for the Commission's required amendments to operating and capital expenditure.

SOURCES OF INFORMATION

The Commission made its draft decision after considering a range of information sources: G-MW's price submission including supplementary information submitted on 10 February 2016 and responses to queries; written submissions from interested parties; comments by attendees at customer forums; and reports prepared by a consultant (Indec) on G-MW's operating and capital costs and the cost reflectivity of proposed irrigation tariff structures.

Indec reviewed G-MW's capital and operating expenditure proposals and its irrigation and diversion tariff proposals. Its final reports are available on our website. G-MW had an opportunity to respond to Indec's review findings before the release of this draft decision. The Commission had regard to Indec's findings in making its draft decision.²

² Figures in tables of the Commission's and Indec's data have been rounded.

1.2 THE STRUCTURE OF THIS DRAFT DECISION

This draft decision contains our review of G-MW's proposals, and summarises the amendments that G-MW needs to make to gain the Commission's approval. It is structured as follows:

- Chapter 2 sets out our view of G-MW's proposed service standards.
- Chapter 3 sets out our review of the revenue that G-MW proposed to raise through prices to meet its proposed service standards.
- Chapter 4 sets out our review of G-MW's proposed operating expenditure.
- Chapter 5 sets out our review of G-MW's proposed capital expenditure program.
- Chapter 6 sets out our review of G-MW's proposed method of financing capital investments in its infrastructure.
- Chapter 7 sets out our review of G-MW's demand forecasts that are used, with the proposed revenue, to forecast future prices for customers.
- Chapter 8 sets out our review of G-MW's proposed form of price control, which determines how prices will change over the regulatory period.
- Chapter 9 sets out our review of G-MW's proposed irrigation and drainage tariff structures.
- Chapter 10 sets out our review of G-MW's proposed bulk water and storage tariff structures.
- Chapter 11 sets out our review of G-MW's proposed diversion tariff structures.
- Chapter 12 sets out our review of G-MW's proposed miscellaneous services tariff structures.
- Appendix A lists the written submissions that we received on G-MW's price proposal.

2 SERVICE STANDARDS

2.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed service standards and targets. G-MW has a set of customer service standards. Each service standard has a target level of service for G-MW to achieve. In its price submission, G-MW proposed a number of changes to its service standards to better align them with customers' preferences and to better specify the services.

2.2 APPROACH TO REVIEWING SERVICE STANDARDS

The Commission regulates service standards under the Water Industry Regulatory Order (WIRO). In our guidance to G-MW, we stated that any new service standards would need to reflect verified obligations on G-MW or the service expectations of its customers. For any proposed changes away from the service levels of the third regulatory period, we stated G-MW should provide evidence of having consulted with customer groups on service and price trade-offs.

2.3 OVERVIEW OF G-MW'S PROPOSED SERVICE STANDARDS

G-MW's pricing submission proposed changes to its service standards and targets to better specify services and link them to customer preferences. The changes include adding new service standards, modifying some existing standards, and removing some standards. Table 2.1 lists the proposed service standards.

G-MW proposed adding new service standards to address gaps in measurement and reporting that it stated were identified by customers and to ensure standards are

comprehensive and consistent. A service standard on the maximum number of supply interruptions for example, exists for gravity irrigation customers and is now proposed for pumped irrigation customers too.

G-MW also proposed removing three service standards:

- ‘processing licence transfers within 10 business days’, because the standard was part of a plan for unbundling groundwater and surface water, which will not occur
- ‘the number of pipeline bursts’, because it is not a direct customer service outcome
- ‘responding to diversion customer access or supply queries within one business day’, because it will be covered by a service standard on customer complaints.

For two standards, ‘the number of complaints’ and ‘calls answered within 30 seconds’, - G-MW proposed to retain a service standard but lower the performance target. It submitted that the proposed standards are at industry standard levels and are offset by new standards that make G-MW’s customer service standards more comprehensive.

Further, G-MW proposed altering seven service standards to better specify the service delivered.

In its submission, G-MW advised the proposed changes in service standards reflect significant consultation with Water Service Committees and at customer forums.

TABLE 2.1 SERVICE STANDARDS

Standard		2016-17	2017-18	2018-19	2019-20
GENERAL CUSTOMER SERVICE					
Licensing and administration					
Processing allocation trade applications within 5 business days		90%	90%	90%	90%
Processing water share applications within 10 business days		95%	95%	95%	95%
Processing change of ownership applications within 10 business days	New	90%	90%	90%	90%
Customer service					
Complaints to Energy Water Ombudsman Victoria (per 1000 customers)		0.17	0.17	0.17	0.17
Customer complaints to G-MW (per 1000 customers)	Modified	3	3	3	3
Telephone calls answered within 30 seconds	Modified	80%	80%	80%	80%
Customer complaints responded to within 10 business days	New	100%	100%	100%	100%
First call resolution	New	50%	52%	54%	56%
GRAVITY IRRIGATION					
Water delivery					
Efficiency achieved as a % of delivered		80.5%	82%	83.5%	85%
% of orders delivered on day requested		93%	93%	93%	93%
% of orders within +/- 10% of flow rate for 90% of time		80%	80%	80%	80%
% of orders within +/- 40mm of supply level 90% of time		80%	80%	80%	80%
Maintenance					
Maintenance requests responded within target (% priority 1-2)		90%	90%	90%	90%
Unplanned service interruptions (>12 hours)		5	5	5	5
Drainage irrigation					
Availability of surface drainage		98%	98%	98%	98%
Availability of sub-surface drainage		98%	98%	98%	98%

PUMPED IRRIGATION					
Irrigation water orders delivered on day requested		98%	98%	98%	98%
Number of unplanned supply interruptions greater than 12 hours	New	5	5	5	5
Efficiency achieved as a percentage of delivered		92%	92%	92%	92%
Notification provided to affected customers on system restoration within 2 hours of unplanned outage	New	100%	100%	100%	100%
WATER DISTRICTS					
Number of supply interruptions for continuous periods in excess of 96 hours	Modified	0	0	0	0
Efficiency achieved as a percentage of delivered		85%	85%	85%	85%
DIVERSIONS					
Groundwater resource monitoring data is collected in accordance with management plan requirements and is readily accessible to our customers. Monitoring data made accessible within two weeks of data being submitted by the monitoring contractor	Modified	90%	90%	90%	90%
Customer access to groundwater is managed through seasonal allocations which are announced in accordance with relevant management plans	Modified	100%	100%	100%	100%
Access to unregulated stream flows is managed in accordance with restriction triggers in Local Management Rules. Number of validated concerns per 1000 customers	Modified	2	2	2	2
BULK WATER					
The ability of each regulated system to deliver water to meet customer demand as a percentage of time	Modified	99%	99%	99%	99%
The ability of each regulated system to maximise harvesting opportunities up to 100% of the design storage capacity as a percentage of time	Modified	100%	100%	100%	100%
Minimum flow requirements for regulated waterways as specified in the relevant bulk entitlements are satisfied as a percentage of time	Modified	98%	98%	98%	98%
Seasonal determination announcements for regulated systems to be made within defined timeframes each month	New	100%	100%	100%	100%
Risk of spill announcements for relevant regulated systems to be made within defined timeframes each month	New	100%	100%	100%	100%

2.4 COMMISSION'S REVIEW

The Commission proposes to approve G-MW's proposed service standards because they are consistent with the requirements in our guidance to G-MW:

- G-MW provided evidence that the new service standards were proposed by customers or developed in consultation with customer representative groups
- for most of the standards that will not change, the proposed service targets are equal to or higher than previous years' targets, or consistent with industry averages
- the Commission received positive feedback on G-MW's service standards at the public forums.

To facilitate improved transparency around G-MW's performance, G-MW should report annually on its website and to Water Service Committees on its performance against the service targets approved in the Commission's final decision.

Following the completion of this review, the Commission will revise the Customer Service Code to reflect its final decision regarding the new service standards and targets.

2.5 DRAFT DECISION

The Commission proposes to approve the service standards and targets proposed by G-MW.

3 REVENUE REQUIREMENT

3.1 INTRODUCTION

This chapter presents Goulburn-Murray Water's (G-MW) revenue requirement. The Commission must be satisfied that G-MW's prices are set at a level that generates sufficient revenue for the water business to recover the efficient cost of delivering services over the fourth regulatory period. This revenue does not represent the approval of any particular projects or items of expenditure. Rather, G-MW should allocate its revenue depending on the most efficient spending options available during the regulatory period, which may change over time.

3.2 APPROACH TO REVIEWING THE REVENUE REQUIREMENT

The Australian Competition and Consumer Commission's (ACCC) pricing principles require us to use the 'building block' approach to estimate the revenue that G-MW requires to deliver proposed service standards in the fourth regulatory period. Under this approach, the revenue reflects operating expenditure and a return on the regulatory asset base (RAB) updated annually to reflect additional capital expenditure and regulatory depreciation. We review these elements in separate chapters in this decision.

3.3 G-MW'S PROPOSAL

G-MW proposed a revenue requirement of \$493.3 million for the fourth regulatory period, an average of \$123.3 million per year. This compares to \$387.2 million approved by the Commission for the third regulatory period, an average of \$129.1 million per year.

3.4 COMMISSION'S REVIEW

The Commission reviewed the 'building blocks' in G-MW's price submission and adjusted G-MW's proposed revenue requirement to reflect:

- a downward adjustment to operating expenditure of \$24 million given additional productivity improvements and a difference in the allowance for the forecast Murray-Darling Basin Fee (chapter 4)
- a minor adjustment to new capital expenditure (chapter 5).

Table 3.1 contains the Commission's draft decision on revenue.

TABLE 3.1 G-MW'S REVENUE REQUIREMENT — DRAFT DECISION
\$ million (\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Operating expenditure	105.9	96.2	94.5	92.7	90.7	374.2
Return on assets	13.5	12.4	13.6	14.5	15.1	55.6
Return of assets	12.6	7.2	8.9	10.4	11.5	38.0
Draft decision on total revenue requirement	132.0	115.8	116.9	117.6	117.3	467.7

3.5 DRAFT DECISION

The Commission proposes to specify the total revenue amount set out in table 3.1 of the draft decision.

4 OPERATING EXPENDITURE

4.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed operating expenditure. Operating expenditure is expenditure required to operate G-MW's infrastructure, maintain its assets and provide administrative support. It makes up 80 per cent of G-MW's proposed revenue requirement for the fourth regulatory period.

4.2 APPROACH TO REVIEWING OPERATING EXPENDITURE

The Commission regulates G-MW's operating costs according to the Australian Competition and Consumer Commission's (ACCC) pricing principles (box 4.1) made under the Water Charge (Infrastructure) Rules 2010 (WCIR).

As set out in our guidance to G-MW, we assess G-MW's proposed operating expenditure by:

- establishing a baseline business-as-usual (BAU) operating expenditure using operating expenditure in 2014-15 (the most recent year for which full year data is available), and subtracting any expenditure that is non-recurring and inefficient.³
- for each year from 2016-17 to 2019-20, assessing the prudence and efficiency of G-MW's proposed changes from the BAU estimate for 2014-15. Our guidance noted we would focus on savings (or productivity improvements) arising as a result of infrastructure modernisation.

³ Non-recurring expenditure is any one-off expenditure items that will not continue in future years.

BOX 4.1 ACCC'S PRINCIPLES FOR ASSESSING OPERATING EXPENDITURE

In making an assessment of the prudent and efficient operating expenditure for the fourth regulatory period, the regulator must assess:

- the prudence and efficiency of operating expenditure in the previous regulatory period
- the reasons and evidence supporting changes to service standards in the fourth regulatory period
- the reasons and evidence supporting changes to operating expenditure in the fourth regulatory period
- reasonable productivity improvements in providing services over the fourth regulatory period

Where relevant, a regulator must compare and take into account operating expenditure of similar businesses.

Forecasts must be based on reasonable assumptions of the efficient costs likely to be incurred in this period.

Source: Australian Competition and Consumer Commission, *Application by Essential Services Commission of Victoria for accreditation Final decision*, 17 February 2012.

4.3 OVERVIEW OF G-MW'S PROPOSAL

G-MW proposed operating expenditure of \$398.1 million for the fourth regulatory period (table 4.1), an average of \$99.5 million per year. For the third regulatory period, its average actual operating expenditure per year has been \$98.0 million. But G-MW's price submission noted that operating expenditure in the third regulatory period has been lower than approved in the Commission's 2013 price determination.⁴

⁴ G-MW forecasted operating expenditure for the third regulatory period of \$293.9 million, which is \$24.2 million less than the approved amount of \$318.1 million from its 2013 Price Review: See Essential Services Commission 2013, price review 2013: rural water businesses - final decision, June.

TABLE 4.1 G-MW'S PROPOSED OPERATING EXPENDITURE
\$ million (\$ 2015-16)

Year	Third regulatory period			Fourth regulatory period ^(b)			
	2013-14	2014-15	2015-16 ^(a)	2016-17	2017-18	2018-19	2019-20
Proposed	97.6	93.8	102.5	100.1	99.9	99.8	98.5

^a Forecast.

^b G-MW's price period is four years from 1 July 2016.

The majority of G-MW's proposed operating expenditure is in irrigation and drainage services (table 4.2) followed by spending on bulk water services and Murray-Darling Basin Authority (MDBA) services. G-MW forecast spending levels for all services will not change substantially in real terms over the fourth regulatory period.

TABLE 4.2 G-MW'S PROPOSED OPERATING EXPENDITURE BY SERVICE
\$ million (\$ 2015-16)

Service	Average annual level third regulatory period	2016-17	2017-18	2018-19	2019-20
Irrigation and drainage	60.5	60.2	60.5	60.1	59.1
Diversion	5.4	5.3	5.3	5.2	5.3
Bulk water	14.8	16.0	15.7	16.2	15.9
MDBA assets	13.0	14.2	14.2	14.2	14.2
Customer billing	4.3	4.4	4.3	4.1	4.0
Total	98.0	100.1	100.0	99.8	98.5

Source: G-MW price submission.

Note: The customer billing expense category is included in the fourth regulatory period forecasts following G-MW's centralisation of billing services cost reporting. The Commission estimated the average customer billing expense for the third regulatory period.

G-MW explained that the main influences on the trend in forecast operating expenditure for the fourth regulatory period are:

- savings from staff reductions as a result of an internal restructuring project
- increases in information technology spending - from an average of \$2 million per year in the third regulatory period to \$6 million in the fourth regulatory period, largely as a result of the asset handover for the Connections Project
- savings from competitive procurement processes
- uniform gravity irrigation fees (chapter 9) saving of \$0.85 million per year.

4.4 COMMISSION'S REVIEW

The Commission formed its draft decision on operating expenditure after considering G-MW's pricing submission, additional information provided by G-MW, customer and stakeholder submissions, and the report by an expert consultant, Indec.⁵ G-MW did not present its operating expenditure information in the form required by the Commission's guidance. Consequently, Indec needed to obtain more information from G-MW, and to verify and present data in a manner consistent with our guidance.

4.4.1 ESTABLISHING BAU OPERATING EXPENDITURE FOR 2014-15

Indec used the most recent full year of actual data on G-MW's operating expenditure, (\$93.9 million in 2014-15) to establish an efficient BAU operating expenditure for G-MW. But G-MW submitted the data needed three adjustments to reflect a BAU level:

- Labour costs should be higher because 70 temporarily unfilled positions had lowered labour costs in 2014-15.
- Contributions to the MDBA should be higher, given an abnormally low contribution level in 2014-15 (\$10.6 million compared to \$14.2 million in 2013-14).
- Contracted services costs (including those for irrigation services) should be lower.

With these adjustments, G-MW proposed baseline expenditure of \$102.5 million.

In response, Indec:

- found G-MW had filled most of, and was likely to fill all, the 70 vacancies it reported, but did not accept G-MW's assertion that the positions would cost \$7.5 million annually. Indec used a position analysis provided by G-MW (which it considered to be a reliable cost estimation tool) to forecast an on-going cost of \$7.1 million to fill all vacancies
- accepted G-MW's proposed increase in MDBA contributions
- accepted G-MW's proposed decreases in baseline expenditure resulting from savings in legal services, materials and plant hire

⁵ Indec's report is available on the Commission's website.

- did not receive further information from G-MW on its forecast for lower contracted services costs. It is unclear what services are included in this item.

Based on these revisions, Indec recommended an efficient BAU operating expenditure of \$102.1 million (table 4.3). The Commission considers \$102.1 million is an efficient baseline level of operating expenditure from which to assess G-MW's proposed changes to expenditure in the fourth regulatory period.

TABLE 4.3 ESTABLISHING G-MW'S BASELINE EXPENDITURE
\$ million (\$ 2015-16)

Expenditure Item	G-MW's proposal	Indec's assessment
Actual operating expenditure (2014-15) ^(a)	93.9	93.9
Increases in operating expenditure		
Increase in Murray-Darling Basin Authority contributions	3.7	3.7
Vacancies (70 positions)	7.5	7.1
Decreases in operating expenditure		
Legal costs	0.5	0.5
Materials costs	0.7	0.7
Plant hire costs	1.4	1.4
Baseline operating expenditure	102.5	102.1

^a This amount includes MDBA contributions of \$10.6 million.

Source: Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals*, January.

CONTROLLABLE OPERATING EXPENDITURE

To review G-MW's proposals for productivity improvements, Indec removed all items from G-MW's operating expenditure over which G-MW does not have control and thus cannot reduce through efficiency savings. These items are the MDBA contribution; the Essential Services Commission (ESC) licence fee; and an environmental contribution collected by the Department of Environment, Land, Water and Planning (DELWP). Indec's proposed BAU controllable operating expenditure is \$86.1 million (table 4.4).

TABLE 4.4 G-MW'S CONTROLLABLE OPERATING EXPENDITURE 2014-15
\$ million (\$ 2015-16)

Description	\$ millions
Indec's proposed baseline	102.1
Exclusion of non-controllable costs	
Murray-Darling Basin Authority contributions	14.2
ESC licence fees	0.1
Environmental contributions	1.7
Controllable baseline operating expenditure (2014-15)	86.1

Source: Indec, 2016, 2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals, January.

4.4.2 FORECASTING OPERATING EXPENDITURE

After assessing the BAU expenditure for 2014-15, the Commission's review focused on G-MW's expected cost and productivity changes over the fourth regulatory period.

PRODUCTIVITY IMPROVEMENTS

Under the ACCC's pricing principles, the Commission must assess whether G-MW's forecast costs include reasonable productivity improvements. We instructed Indec to review G-MW's expected productivity changes, particularly gains expected from changes to its infrastructure network.

G-MW's proposed productivity

G-MW forecasts a \$4 million fall in its baseline controllable operating expenditure - down from the baseline of \$86.1 million to \$82.1 million in 2019-20 - as a result of productivity improvements from two sources (table 4.5):

- an average decrease in labour costs of \$600 000 per year over four years
- an average decrease in costs from unspecified sources of \$400 000 per year over four years.

TABLE 4.5 G-MW'S PROPOSED PRODUCTIVITY IMPROVEMENTS
\$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20
Indec recommended baseline controllable operating expenditure	86.1	83.7	83.5	83.4
G-MW's proposed efficiency saving	-2.4	-0.2	-0.1	-1.3
G-MW proposed controllable operating expenditure	83.7	83.5	83.4	82.1

Note: Numbers have been rounded.

G-MW proposed a reform of its gravity irrigation fees, which it expected to lead to an annual operating expenditure saving of \$850 000 in administration in 2019-20. It has included this amount in its productivity savings.

Indec examined G-MW's changes and confirmed they were feasible. It then assessed whether further productivity improvements are possible.

Indec's recommended productivity adjustment

Indec's starting point for analysing possible productivity improvements was G-MW's proposed \$20 million cost reduction program, as outlined in G-MW's 2013 Blueprint.⁶ In the Blueprint and reconfirmed in its price submission, G-MW described its new business model which includes modernising irrigation infrastructure, redesigning tariffs, and reducing operating expenditure by \$20 million per year by 2018, through a business transformation program. The Blueprint itemises the areas in which G-MW forecast savings can be made.⁷ The Commission supports the realisation of the savings outlined in the Blueprint.

Indec subtracted from G-MW's \$20 million cost reduction program those savings that do not relate to regulated services (\$3 million), savings that had been achieved in the third regulatory period (\$6.6 million) and savings that G-MW had already included in its price submission (\$4 million). Indec estimated the remaining savings to be made by the last year of the fourth regulatory period are \$6.4 million (table 4.6).⁸

⁶ Indec, 2016, 2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals, p 20.

⁷ Goulburn-Murray Water, 2013 Blueprint, p 18 at <http://www.youblisher.com/p/599430-G-MW-Blueprint-April-2013/>

⁸ Indec, 2016, 2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals, p 20.

TABLE 4.6 INDEC'S RECOMMENDED PRODUCTIVITY IMPROVEMENTS
\$ million (\$ 2015-16)

Description	\$ million
Savings in 2013 Blueprint initiative	20.0
Savings from prescribed services ^(a)	17.0
Savings achieved by end of third regulatory period	6.6
<i>Potential savings over fourth regulatory period</i>	<i>10.4</i>
Savings included in 2016 price submission	4.0
Remaining productivity improvements	6.4

Source: Indec, 2016, 2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals, January.

^a G-MW advised that 85 per cent of the \$20 million savings target relates to prescribed services

Indec acknowledged that G-MW faced risk regarding the amount and timing of Indec's recommended productivity savings. Indec recommended the risks from delivering the savings could be mitigated by extending G-MW's delivery timeframe from 2018 to 2020.⁹ It also considered the \$6.4 million in productivity improvements should be factored into prices and allocated equally in each year of the fourth regulatory period - that is, forecast operating expenditure should include an assumed cumulative productivity saving of \$1.6 million per year, in addition to G-MW's productivity assumptions (table 4.5).

Irrigation tariff reform saving

As noted, G-MW stated that its operating expenditure proposal includes a saving of \$850 000 per year, commencing in the final year of the regulatory period, from simplifying its gravity irrigation infrastructure access and use fees. Given this draft decision does not approve this proposal (chapter 9), the proposed \$850 000 annual saving from this reform will be added back to operating expenditure in the final year of the fourth regulatory period, when the saving was scheduled to be realised. We adjusted Indec's recommended controllable operating expenditure for this amount (table 4.7). If G-MW resubmits an amended irrigation proposal, it should include a revised savings forecast.

⁹ Indec, 2016, 2016-20 Review of water prices for Goulburn-Murray Water productivity and capex proposals, p 21.

TABLE 4.7 COMMISSION DRAFT DECISION ON PROPOSED PRODUCTIVITY IMPROVEMENTS
\$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20
G-MW proposed controllable operating expenditure	83.7	83.5	83.4	82.1
Indec proposed productivity improvement	-1.6	-3.2	-4.8	-6.4
Indec's proposed controllable operating expenditure	82.1	80.4	78.6	75.8
Return of saving from irrigation fee reform	-	-	-	0.85
Commission's draft decision on controllable operating expenditure	82.1	80.4	78.6	76.6

Note: Numbers have been rounded.

Commission's view on productivity savings

Based on Indec's analysis of productivity savings, the Commission decided:

- additional productivity savings (\$6.4 million) are reasonable and should be included in operating expenditure forecasts to meet the total savings amount in the Blueprint
- the proposed \$0.85 million annual saving from G-MW's irrigation reform will be added back to operating expenditure in the year 2019-20
- spreading the achievement of G-MW's Blueprint savings over the fourth regulatory period balances the risks to G-MW and customer interests.

The Commission received written submissions and heard in public forums that some customers were concerned that savings from proposed productivity improvements in the fourth regulatory period were not forecast to be passed on to customers:

GMW committed to reducing costs within the organisation by a minimum of \$20 million, (Blueprint pg.17) however there has been no commensurate reduction in prices being paid by the majority of customers.

*The forecast operating expenditure for each year of the Final Water plan is approximately \$100 million for each year ... There are no savings that are identified here.*¹⁰

The Newgate Research report submitted by G-MW showed that customers were concerned about the value for money and wanted cost reductions from G-MW.

The Commission considers that returning the savings from G-MW's 2013 Blueprint to customers through lower prices is a sound method of deriving productivity improvements for the fourth regulatory period. By outperforming its approved operating expenditure in the third regulatory period, G-MW demonstrated productivity savings from its Blueprint exist and G-MW is capable of realising them.

G-MW considers savings are possible beyond the ones that it proposed. It proposed in its price submission to discuss with customers whether additional savings, once realised, should be used to pay down debt or be put to other uses.¹¹ But the Commission already allows revenue for G-MW to pay down debt via the return of capital and submissions to the Commission have made clear that customers seek lower prices for G-MW's services.

Based on the Commission's existing allowance for paying down debt, customer submissions and the requirements of the ACCC's pricing principles, the Commission's view is that any savings made should be returned to customers in the form of lower prices.

NON-CONTROLLABLE OPERATING EXPENDITURE

G-MW has three items of non-controllable operating expenditure: the MDBA contribution, the ESC licence fee, and an environmental contribution collected by the DELWP.

MDBA contribution

G-MW proposed an MDBA contribution of \$14.2 million per year. We observed the level of the annual MDBA contribution has varied significantly between 2010-11 and 2014-15 at an average of approximately \$12 million per year for the last two years. For

¹⁰ D Mongan, 2015, *Submission*, November.

¹¹ Goulburn-Murray Water, 2015, *Goulburn-Murray Water Corporation, Submission to Price review 2016*, p 42.

the draft decision, therefore, the Commission proposes to adopt \$12 million per year as G-MW's MDBA contribution, to reflect the longer term average contribution. We will address any material variation between this amount and the actual MDBA contribution at the time of the annual tariff approval as a pass through. For the final decision we will update the MDBA contribution in line with the long term average once we receive confirmation from DELWP about the expected MDBA contributions for 2015-16.

ESC licence fee

We used G-MW's proposed \$80 000 for its ESC licence fee for the draft decision. We will update this amount for the final decision.

Environmental contribution

We used G-MW's proposed \$1.71 million of environmental contributions for the draft decision. We will update this amount for the final decision.

4.4.3 DRAFT DECISION

To derive G-MW's approved operating expenditure for this draft decision we took Indec's recommended controllable operating expenditure, adjusted it for the Commission's decision on reduced savings from irrigation fee reform (table 4.7) and added in the current estimates of G-MW's non-controllable operating expenditure (table 4.8).

TABLE 4.8 G-MW'S DRAFT DECISION TOTAL OPERATING EXPENDITURE – DRAFT DECISION ADJUSTMENTS
\$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20
Controllable operating expenditure (from table 4.7)	82.1	80.4	78.6	76.6
<i>Adjustments</i>				
MDBA contributions	12.0	12.0	12.0	12.0
ESC licence fees	0.1	0.1	0.1	0.1
Environmental contribution	1.7	1.7	1.7	1.7
Draft decision on total operating expenditure	95.9	94.2	92.4	90.4

Note: Numbers have been rounded.

The Commission's approved operating expenditure for G-MW is \$372.9 million, which is 6.4 per cent lower than the \$398.3 million proposed by G-MW (table 4.9).

TABLE 4.9 DRAFT DECISION ON G-MW'S OPERATING EXPENDITURE
\$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20	Total
G-MW proposal	100.1	99.9	99.8	98.5	398
Draft decision adjustment	4	5	7	8	24
Draft decision	96	94	92	90	373

Note: Numbers have been rounded.

The difference between G-MW's proposal and the Commission's draft decision reflects:

- the incorporation of Indec's recommended productivity improvements reflecting the Blueprint savings
- our adjustment to allow for the Commission's decision not to approve G-MW's proposed irrigation fee reforms and their accompanying savings
- our adoption of MDBA contributions consistent with the recent average contribution.

The Commission considers G-MW's proposed operating expenditure does not comply with the ACCC's pricing principles because it does not reflect efficient levels of operating expenditure and does not include reasonable productivity improvements. In contrast, the Commission considers this draft decision complies with the ACCC's pricing principles because we determined prudent and efficient operating expenditure and reasonable productivity improvements for the fourth regulatory period.

4.4.4 DRAFT DECISION

The Commission proposes to specify the adjusted operating expenditure amount in table 4.9 of this draft decision.

5 CAPITAL EXPENDITURE

5.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) capital expenditure. Capital expenditure is expenditure to maintain existing assets and establish new assets that service customers over the longer term. The usual drivers of capital expenditure are customer service standards and compliance with regulatory and government obligations. Funds provided to G-MW by government or other outside sources for its Connections Project are not included in customers' prices, so are not considered capital expenditure for the Commission's review.

In its price submission, G-MW proposed more capital expenditure per year in the fourth regulatory period than in the current (third) regulatory period.

5.2 APPROACH TO REVIEWING CAPITAL EXPENDITURE

The Commission regulates G-MW's infrastructure related capital expenditure according to the Australian Competition and Consumer Commission's (ACCC) pricing principles. These principles focus on the efficiency and prudence of capital expenditure (box 5.1).

BOX 5.1 ACCC'S PRINCIPLES FOR ASSESSING CAPITAL EXPENDITURE

In making an assessment of the prudent and efficient capital expenditure for the fourth regulatory period, the regulator must assess:

- the prudence and efficiency of capital expenditure in the previous regulatory period (where relevant to proposed capital expenditure in the fourth regulatory period)
- the reasons and evidence supporting the commencement of new major capital expenditure projects in the fourth regulatory period, including whether such projects are consistent with efficient long term expenditure on infrastructure services
- the reasons and evidence supporting levels of capital expenditure in the fourth regulatory period
- whether the timeframe for delivering the proposed capital expenditure program is reasonable, having regard to the operator's delivery of major projects in the past
- whether the asset management and planning framework of the operator reflects best practice.

Source: Australian Competition and Consumer Commission, *Application by Essential Services Commission Victoria for Accreditation Final decision*, 17 February 2012.

In our guidance, we stated we would test the prudence, efficiency and deliverability of G-MW's proposed capital expenditure by reviewing a selection of capital projects across G-MW's services. Then, we would apply systemic findings from the review to all capital expenditure forecasts, and possibly a blanket adjustment across all or part of G-MW's capital expenditure forecast.

5.3 G-MW'S PROPOSAL

G-MW proposed capital expenditure of \$136.7 million over the fourth regulatory period. This amount equals an average of \$34.2 million per year, compared with average expenditure of \$21 million per year in the third regulatory period. In particular, G-MW proposed higher capital expenditure in 2016-17 than in later years because several projects will carry over from the previous regulatory period (table 5.1).

TABLE 5.1 G-MW'S CAPITAL EXPENDITURE OVER THIRD AND FOURTH REGULATORY PERIODS
\$ million (\$ 2015-16)

2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
10.8	22.5	29.3 ^a	45.2	32.8	32.5	26.3

Source: Goulburn-Murray Water's pricing model for the fourth regulatory period.

a The Commission approved \$29.3 million for 2015-16.

G-MW proposed to undertake the largest amounts of capital expenditure on its irrigation and drainage, and bulk water projects (table 5.2).

TABLE 5.2 G-MW'S CAPITAL EXPENDITURE BY SERVICE
\$ million (\$ 2015-16)

Service	2015-16	2016-17	2017-18	2018-19	2019-20	Total
Irrigation and drainage	18.0	25.4	20.7	19.3	16.2	81.6
Diversions	1.7	0.9	0.6	0.6	0.6	2.7
Bulk water	5.8	13.6	6.4	7.9	5.9	33.7
Corporate	3.9	5.3	5.0	4.7	3.7	18.7
Total	29.3	45.2	32.8	32.5	26.3	136.7

Source: Goulburn-Murray Water's pricing model for the fourth regulatory period.

5.4 COMMISSION'S REVIEW

The Commission formed its draft decision on capital expenditure after considering G-MW's price submission (including a report by consulting firm UXC), information provided by G-MW to support its forecasts, the expenditure assessment reports prepared by the Commission's expert consultant, Indec, and customer and stakeholder submissions.

The Commission received a submission on G-MW's proposed expenditure which highlighted that G-MW had not delivered the capital expenditure forecast in the third regulatory period:

GMW have been unable to meet historic targets ... The ESC should reduce GMW's capital expenditure budget to a level it has proven it can deliver¹²

In accordance with the Australian Competition and Consumer Commission's (ACCC) pricing principles, we reviewed the efficiency of G-MW's proposed capital expenditure program. In consultation with the Commission, Indec selected then reviewed three larger capital expenditure projects scheduled to commence during the fourth regulatory period to assess G-MW's approval and management processes for capital expenditure. Indec's report is available on our website.¹³

REVIEW OF SAMPLE PROJECTS

From its review of the selected projects, Indec found:

- G-MW's proposed capital expenditure is prudent, efficient and deliverable within the required timeframe
- a contingency allowance of around 10 per cent would be more appropriate for G-MW's information technology projects than 15 per cent, given G-MW's recent experience delivering such projects and its low expectation of needing the contingency.

¹² D Mongan, 2015, *Submission*, November. The Commission's decision not to accept G-MW's proposal to alter its forecast for capital expenditure for the final year of the third regulatory period is addressed in Chapter 6.

¹³ G-MW resubmitted its pricing model at a later date to correct for errors in the treatment of capital expenditure and contributions. For this reason, the capital expenditure amounts differ in Indec's report and the Commission's draft decision. The substance of Indec's findings is not affected by these errors.

Based on Indec's findings and our own assessment of G-MW's price submission, we are satisfied that G-MW's capital expenditure program is supported by adequate processes for planning and forecasting efficient expenditure. We are also satisfied that G-MW's proposed capital expenditure for the fourth regulatory period is supported by sufficient reasons and evidence.

But we consider the contingency amount allowed for G-MW's information technology programs should be reduced from 15 per cent to 10 per cent. For the purposes of this draft decision, the Commission assumed expenditure on information technology projects is \$15.5 million and includes a 15 per cent contingency. A reduction of the contingency to 10 per cent would result in expenditure of \$14.8 million. If some projects have contingencies less than 10 per cent, then G-MW should provide the Commission with details before the Commission makes its final decision.

As required by the ACCC's pricing principles, we instructed Indec to also report on other areas of G-MW's capital expenditure program:

- Regarding G-MW's capacity to deliver its proposed capital expenditure program, Indec found G-MW should be able to resource and deliver the capital expenditure program in the fourth regulatory period. Based on Indec's findings and our own assessment of G-MW's price submission, we are satisfied that the timeframe for delivering the proposed capital expenditure program is reasonable.
- Regarding G-MW's asset management program, G-MW advised Indec that it is aligning its asset management framework with a Victorian Government direction requiring G-MW to achieve an international standard by July 2018. G-MW had finalised its own asset management policy in 2014. Based on Indec's report and our own review of G-MW's submission, we are satisfied G-MW's asset management framework is at an acceptable standard.

Based on Indec's findings and our own assessment of G-MW's submission (including the UXC report), and subject to the adjustment to the contingency amount, we are satisfied that G-MW's proposed capital expenditure program accords with the ACCC's pricing principles.

For these reasons, the Commission proposes to approve the capital expenditure in table 5.3, which includes the adjustment of the contingency from 15 to 10 per cent.

TABLE 5.3 DRAFT DECISION ON G-MW'S CAPITAL EXPENDITURE
\$ million (\$ 2015-16)

	2016-17	2017-18	2018-19	2019-20	Total
G-MW's proposal	45.2	32.8	32.5	26.3	136.7
Adjustment	-0.17	-0.17	-0.17	-0.17	-0.67
Draft decision	45.0	32.6	32.3	26.1	136.0

Note: Numbers have been rounded.

The Mid Term Review of G-MW's Connections Project could have implications for G-MW's capital expenditure program. So, in its response to this draft decision, G-MW must advise the Commission how its capital expenditure program might change over the fourth regulatory period as a result of the Mid Term Review.

5.5 DRAFT DECISION

The Commission proposes to specify the adjusted capital expenditure amount in table 5.3 of this draft decision.

6 FINANCING CAPITAL INVESTMENTS

6.1 INTRODUCTION

This chapter sets out the Commission’s draft decision on Goulburn-Murray Water’s (G-MW) proposed assumptions for rolling forward its regulatory asset base (RAB). The RAB is the value (as assessed by the Commission) of G-MW’s capital investments. It is the value on which G-MW can earn a rate of return, and the value returned to G-MW as regulatory depreciation. Rolling forward the RAB is the process for deciding the opening value of the RAB to be used for the fourth regulatory period.

6.2 APPROACH TO ROLLING FORWARD THE RAB

We set out our approach to rolling forward the RAB in our guidance, which aligns with the requirements of the Australian Competition and Consumer Commission’s (ACCC) pricing principles.¹⁴

¹⁴ Australian Competition and Consumer Commission, *Application by Essential Services Commission Victoria for Accreditation Final decision*, 17 February 2012.

6.3 COMMISSION'S REVIEW

G-MW's proposal for the opening value of the RAB is in table 6.1.

TABLE 6.1 G-MW PROPOSED RAB ROLL FORWARD
\$ million (\$ 2015-16)

Closing RAB as at 1 July 2013	221.6
Plus net capital expenditure 2013-14 to 2014-15	60.6
Less regulatory depreciation 2013-14 to 2014-15	19.4
Less proceeds from disposal of assets 2013-14 to 2014-15	0
RAB as at 1 July 2015	262.8
Plus net capital expenditure (forecasts approved for the fourth regulatory period) 2015-16	29.3
Less regulatory depreciation 2015-16	12.6
Less assumed proceeds from disposal of assets 2015-16	0
Less assumed government/customer contributions 2015-16	0.8
RAB as at 1 July 2016	278.7

G-MW proposed to replace the previously approved 2015-16 capital expenditure (\$29.3 million) with a higher forecast (\$43.7 million), to deliver a more stable price path for customers from over the fourth and fifth regulatory periods. It stated the increase is largely a result of capital expenditure being shifted from earlier in the third regulatory period into 2015-16. This proposal is not included in table 6.1 because the Commission advised G-MW that it should present its RAB based on the approved figures from the 2013 price review and an adjustment would be made if the Commission approved G-MW's proposal for a higher capital expenditure estimate.

In our guidance, we stated we will roll into the RAB the approved 2015-16 capital expenditure, to remove incentives for the water businesses to delay capital works until the last year of the regulatory period (which could provide an undue benefit to the businesses). To address any difference between the forecast and the actual amounts, we will make an adjustment when calculating the opening RAB for the fifth regulatory period.

We usually consider adjustments to approved capital expenditure only when a business can justify deferrals in capital works, or identify special circumstances.

The Commission has considered G-MW's proposal to alter the capital expenditure forecast for 2015-16, and is not convinced it is justified because:

- it is not consistent with our guidance and usual practice
- the price differences between accepting and rejecting the proposal are small and unlikely to result in any price instability noticeable to customers
- changing the forecast creates an incentive to delay spending on capital expenditure early in the regulatory period to earn interest on revenue raised but not spent.

The Commission considers an adjustment to recognise any higher amounts of capital expenditure should be made in the usual way at the next price review.

The Commission's draft decision on the opening RAB and the capital approved in Chapter 5 results in the RAB set out in table 6.2.

TABLE 6.2 DRAFT DECISION ON G-MW'S RAB
\$ million (\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20
Opening RAB	262.8	278.68	312.87	334.28	353.94
Plus gross capital expenditure	29.3	44.99	32.64	32.30	26.13
Less government contributions	0.4	0.62	0.46	0.22	0.22
Less customer contributions	0.4	0.62	0.46	0.22	0.22
Less proceeds from disposals	0	0.00	0.00	0.00	0.00
Less regulatory depreciation	12.6	7.17	8.86	10.43	11.49
Less fully funded government programs/projects		2.39	1.45	1.77	1.25
Closing RAB	278.68	312.87	334.28	353.94	366.88

6.3.1 DRAFT DECISION ON THE RAB

The Commission proposes not to approve the amended capital expenditure forecast proposed by G-MW for 2015-16 as part of its approach to rolling forward the RAB.

Accordingly, the Commission proposes to specify the RAB from 1 July 2016 as set out in table 6.2.

6.4 APPROACH TO REVIEWING THE RATE OF RETURN

We set out our approach to reviewing the rate of return in our guidance, which aligns with the requirements of the Australian Competition and Consumer Commission's (ACCC) pricing principles.¹⁵ This approach includes the weighted average cost of capital (WACC) parameters required by the pricing principles.

6.4.1 COMMISSION'S REVIEW OF THE RATE OF RETURN

We included a WACC estimate in the financial model that we provided to G-MW to prepare its price submission. We will update this WACC estimate before the final decision, to reflect market conditions. The parameters for the draft decision are in table 6.3.

We estimated the real risk free rate and a debt margin according to the methodology in the ACCC's pricing principles to calculate a rate for return for G-MW:

- we calculated the real risk free rate from the 40 day trading period to 29 January 2016.
- we developed the range for the debt margin from estimates in a report prepared by Incenta for the Commission, which is on our website. This range is consistent with recent guidance and decisions of other Australian regulators.¹⁶ We included an assumed 0.15 per cent debt raising cost in our range for the debt margin based on information from the Treasury Corporation of Victoria.

¹⁵ Australian Competition and Consumer Commission, Application by Essential Services Commission Victoria for Accreditation Final Decision, 17 February 2012.

¹⁶ See for example IPART August 2015 WACC update, August.

TABLE 6.3 DRAFT DECISION – REAL POST TAX WACC

WACC parameter	Source of parameter	Value
Risk free rate of return	ESC estimate	0.60%
Equity beta	ACCC pricing principles	0.70
Equity (market risk) premium	ACCC pricing principles	6.00%
Debt margin (includes debt raising cost)	ESC estimate	2.65 - 3.15%
Financing structure (debt assets)	ACCC pricing principles	60%
Franking credits	ACCC pricing principles	0.50
Forecast inflation	ESC estimate	2.20%
Vanilla post tax (real) WACC range		3.9 to 4.2%
Proposed Vanilla post tax (real) WACC		4.2%

6.4.2 DRAFT DECISION ON THE WACC

G-MW proposed a WACC of 4.2 per cent which falls within the Commission's range, albeit at the top end. For the purposes of the draft decision, we propose a WACC of 4.2 per cent. This figure will be updated in the final decision.

6.4.3 DRAFT DECISION

The Commission proposes to approve G-MW's proposed real post tax weighted average cost of capital of 4.2 per cent subject to any change in market conditions at the time of the final decision.

6.5 APPROACH TO CALCULATING DEPRECIATION

In our guidance, we stated G-MW should estimate regulatory depreciation using reasonable assumptions about asset life and utilisation. Our approach is for G-MW to begin receiving depreciation when an asset comes into service.

6.5.1 COMMISSION'S REVIEW OF DEPRECIATION

G-MW's depreciation proposal is based on a straight line approach, which depreciates an equal amount of an asset each year in real terms based on the expected useful life of the asset. The Commission's view is that the straight line approach is a reasonable approximation of actual asset use.

The Commission found G-MW provided sufficient information to support this approach in accordance with the principles in our guidance.

6.5.2 DRAFT DECISION – DEPRECIATION

The Commission proposes to approve G-MW's proposed depreciation forecasts subject to any amendments which may be required in response to the Commission's draft decision on G-MW's capital expenditure.

7 DEMAND

7.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed demand forecasts. The Commission requires demand forecasts from G-MW to calculate prices based on G-MW's approved revenue. Demand for G-MW's services can include the demand for water and the demand for service points. The demand forecasts will not have a large impact on customer prices because most of G-MW's costs are fixed and are recovered by fixed charges; the variable component of G-MW's water bills, which varies with changes in demand, is small.

G-MW forecasted a decline in demand for its services in the fourth regulatory period.

7.2 APPROACH TO REVIEWING DEMAND

The Commission reviewed G-MW's demand proposals under the Australian Competition and Consumer Commission's (ACCC) pricing principles. In our guidance (which accords with those principles), we noted G-MW's demand forecasts need to:

- be based on an appropriate and unbiased forecasting methodology
- reflect reasonable assumptions about the key drivers of demand
- use the best available information, including historical data to identify demand trends
- account for current demand and economic conditions.

7.3 G-MW'S PROPOSAL

In its price submission, G-MW stated most of its costs are fixed and do not vary with the demand for water. It stated that its revenues are structured to match costs, with only a small percentage of revenue (13 per cent in 2014-15) being variable.

The largest component of G-MW's variable demand is for water¹⁷, which G-MW forecasted will fall from around 1.16 to 1.13 million megalitres over the fourth regulatory period.

7.4 COMMISSION'S REVIEW

The Commission proposes to accept G-MW's proposed demand forecasts because they comply with the ACCC's pricing principles given that they:

- are based on an appropriate and unbiased forecasting methodology as outlined in G-MW's price submission
- reflect reasonable assumptions about the drivers of demand as outlined in G-MW's price submission
- utilise the best available information, including historical data, to identify demand trends. The data identified in G-MW's price submission appears to be comprehensive and appropriate for the task of forecasting demand
- account for current demand and current and forecast economic conditions.

7.5 DRAFT DECISION

The Commission proposes to approve G-MW's proposed demand forecasts.

¹⁷ G-MW's demand forecasting methodology is set out in G-MW's price submission on page 68.

8 FORM OF PRICE CONTROL

8.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed form of price control. The form of price control is an important means of managing risk for water businesses. In its 2013 final decision, the Commission approved G-MW's proposal for a revenue cap form of price control with a rebalancing constraint to limit the extent of price changes in any one year.

In its price submission G-MW proposed to continue with its current form of control.

8.2 APPROACH TO REVIEWING FORMS OF PRICE CONTROL

The Australian Competition and Consumer Commission's (ACCC) pricing principles allow the Commission to apply any form of price control. In our guidance we supported G-MW maintaining its revenue cap.

8.3 G-MW'S PROPOSAL

G-MW proposed to continue to apply a revenue cap to its regulated tariffs (other than miscellaneous services charges which are set according to pricing principles), with a rebalancing constraint of +/-10 per cent to limit changes to tariffs in each year of the regulatory period. G-MW argued that a revenue cap is appropriate because it:

- allocates risks to the party best placed to manage them
- ensures revenue adequacy to match G-MW's high fixed costs
- is simple and transparent.

In its price submission, G-MW noted no opposition to a revenue cap during its consultation with water customers.

8.4 COMMISSION'S REVIEW

The Commission considers G-MW's revenue cap proposal complies with the ACCC's pricing principles because it appropriately balances the requirements of revenue and price stability and includes an appropriate rebalancing constraint on individual tariffs of +/-10 per cent of the approved price path in each year.

8.5 DRAFT DECISION

The Commission proposes to approve G-MW's proposal to maintain a revenue cap form of price control with a rebalancing constraint on individual tariffs of +/-10 per cent of the approved price path in each year.

9 IRRIGATION AND DRAINAGE TARIFFS

9.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed irrigation and drainage tariff structures. G-MW provides infrastructure for irrigation and drainage (including removing water from irrigation and other areas).

9.2 APPROACH TO REVIEWING TARIFFS

The Commission regulates G-MW's tariffs according to the Australian Competition and Consumer Commission's (ACCC) pricing principles (box 9.1).

BOX 9.1 ACCC'S PRINCIPLES FOR ASSESSING TARIFFS

Tariff structures should:

- promote the economically efficient use of water infrastructure assets
- ensure sufficient revenue streams to allow efficient delivery of the required services
- give effect to the principles of user pays in respect of water storage and delivery in irrigation systems
- achieve pricing transparency
- facilitate efficient water use and trade in water entitlements.

Source: Australian Competition and Consumer Commission, *Application by Essential Services Commission Victoria for Accreditation Final Decision*, 17 February 2012.

In our guidance to G-MW, we noted that G-MW would propose a greater commonality of fees for gravity irrigators¹⁸ and supported the principle of common costs being reflected in more common fees. In our guidance the Commission stated:

- locational pricing often reflects a less integrated network with large differences in costs between different water networks
- the substantial alterations to G-MW's infrastructure from the Connections Project will lead to a more inter-connected network, which will mean customers will increasingly have more uniform service levels
- a more inter-connected network is likely to lead to streamlined tariffs and fees. Where differences in costs for different customers remain, we expect G-MW to articulate the basis for any differences in tariffs and fees for its customers.

Our guidance emphasised G-MW must demonstrate any tariff reform proposals are underpinned by evidence on costs, to ensure G-MW's price submission reflects the ACCC's pricing principles' focus on "user pays" principles. Also in our guidance, we highlighted the ACCC's requirement that we have regard to consultation undertaken by G-MW.

9.3 G-MW'S PROPOSED IRRIGATION TARIFFS¹⁹

G-MW proposed to make its Infrastructure Access Fee and Infrastructure Use Fee uniform over four years across its six irrigation districts: Shepparton, Central Goulburn, Rochester, Campaspe, Loddon Valley, and Murray Valley. It submitted that:

- these fees are no longer driven by costs unique to each district, but instead largely reflect G-MW's system-wide operating costs
- uniform fees would reduce annual administration costs by approximately \$850 000

¹⁸ The infrastructure Access Fee is a fixed fee based on customers' delivery shares and the Infrastructure Use Fee is a variable fee based on customers' use of water. Both reflect operations, maintenance and renewals costs in the gravity districts.

¹⁹ G-MW's main fees for gravity irrigation are its: Infrastructure Access Fee, Infrastructure Use Fee, Service Point Fee, Service Fee, and Entitlement Storage Fee.

- uniform fees would spread volatility over a larger customer base and provide customers with more stable and predictable prices.

G-MW stated the proportion of centralised costs, as distinct from district costs, had increased from 48 per cent in 2011-12 to 63 per cent in 2014-15 with the 2015-16 budget forecasts showing a further increase to 67 per cent.

G-MW argued its proposal aligns with the ACCC's pricing principles (table 9.1).

TABLE 9.1 G-MW'S EXPLANATION OF HOW ITS PROPOSAL COMPLIES WITH THE ACCC'S PRICING PRINCIPLES

ACCC pricing principles	How the principle is achieved
Promote the economically efficient use of water infrastructure assets	A move to a uniform price will not reduce the signals for efficient water infrastructure use. This is further supported with the Connections Project providing a standardisation of service levels and increasing the extent of common operating costs
Ensure sufficient revenue for the efficient delivery of the services required	A uniform price would allow G-MW to more easily monitor its revenue recovery and balance the risk of declining delivery shares across more customers
Give effect to the principles of user pays for water storage and delivery in irrigation systems	At an aggregate level, there will be no change in the level of cost recovery from users in respect of water storage and delivery in irrigation systems
Achieve pricing transparency	A uniform price will be simpler to explain and implement, and G-MW's reporting will maintain the current transparency of costs and revenues
Facilitate water use and trade in water entitlements	The transition will not materially affect water use or water markets.

Source: G-MW price submission.

In its submission, G-MW advised it had undertaken significant consultation with gravity irrigation customers in 2013 when developing its tariff proposals. In 2015, it consulted on its draft price submission, reporting "mixed responses" for the proposed changes to the Infrastructure Access and Infrastructure Use fees.

In addition, G-MW sought advice from Deloitte Access Economics, which wrote a report that G-MW attached to its price submission. G-MW also submitted information its Annual Customer Survey and a report by Newgate Research.

G-MW proposed that by 2020 all districts would have the same Infrastructure Access Fee (table 9.2). All districts would see a decline (in real terms) over the four year

regulatory period. The Shepparton gravity irrigation district currently has the highest fee so its customers would have the largest fee reduction.

TABLE 9.2 G-MW'S PROPOSED INFRASTRUCTURE ACCESS FEE
\$/ML/Day of delivery share held (\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20
Central Goulburn	3 290	3 178	3 070	2 965	2 863
Torrumbarry	3 131	3 062	2 994	2 928	2 863
Loddon Valley	3 332	3 205	3 085	2 970	2 863
Rochester	2 933	2 917	2 900	2 882	2 863
Murray Valley	3 069	3 016	2 962	2 911	2 863
Shepparton	4 454	3 556	3 316	3 085	2 863

Source: G-MW price submission. Shaded column is the final year of the third regulatory period.

G-MW proposed a uniform Infrastructure Use Fee in all districts in 2016-17, which would remain at this level in real terms until 2019-20 (table 9.3).

TABLE 9.3 G-MW'S PROPOSED INFRASTRUCTURE USE FEE
\$/ML (\$ 2015-16)

	2015-16	2016-17
Central Goulburn	6.50	6.34
Torrumbarry	7.11	6.34
Loddon Valley	7.63	6.34
Rochester	6.50	6.34
Murray Valley	6.08	6.34
Shepparton	9.34	6.34

Source: G-MW price submission. Shaded column is the final year of the third regulatory period.

9.3.1 IMPACT OF PROPOSED CHANGES ON CUSTOMER BILLS

G-MW sought to minimise the impacts on customers by transitioning the changes to the access and use fees over the four years of the regulatory period. Tables 9.4 and

9.5 set out the bills for average small and large gravity irrigation customers.²⁰ The average bills include other proposed tariff changes such as increases in Service Point Fees (section 9.6.1).

TABLE 9.4 TYPICAL BILLS FOR SMALL GRAVITY IRRIGATION CUSTOMERS
(\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20
Central Goulburn	330	343	353	364	375
Torrumbarry	334	344	358	369	380
Loddon Valley	335	342	352	363	373
Rochester	319	335	348	362	373
Murray Valley	329	342	356	367	378
Shepparton	373	354	361	369	376

Source: G-MW price submission. Shaded column is the final year of the third regulatory period.

For average large gravity irrigation customers in Rochester and Murray Valley, the proposed increase in the Service Point Fee offsets the proposed reduction in the Infrastructure Access Fee.

TABLE 9.5 TYPICAL BILLS FOR LARGE GRAVITY IRRIGATION CUSTOMERS
(\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20
Central Goulburn	25 476	25 221	24 969	24 719	24 472
Torrumbarry	25 549	25 294	25 294	25 294	25 294
Loddon Valley	25 866	25 090	24 839	24 591	24 345
Rochester	24 035	24 275	24 518	24 763	25 011
Murray Valley	25 747	26 004	26 004	26 004	26 004
Shepparton	33 895	28 811	27 946	27 108	26 295

Source: G-MW price submission.

²⁰ G-MW's definition of a small and large customer is on page 91 of its price submission.

9.4 COMMISSION'S REVIEW OF IRRIGATION TARIFFS

The Commission formed its draft decision after considering G-MW's price submission (including a report by Deloitte Access Economics and Newgate Research), customer submissions and public forums, and reports by an expert consultant, Indec (engaged by the Commission). When reviewing G-MW's proposed irrigation tariffs, we focussed on their cost-reflectivity given the ACCC's pricing principles' requirement of the application of "user pays" principles.

9.4.1 SUBMISSIONS ON PROPOSED COMMON FEES

We noted strong concern in written submissions to the Commission and among attendees at our public forums that:

- common fees for the irrigation districts not be cost reflective
- under common fees, lower cost districts would subsidise customers in higher cost districts, which does not align with the ACCC's "user pays" principle
- the Shepparton district would benefit disproportionately from the uniform fees
- common fees would reduce the control of local Water Service Committees over their district and reduce incentives to control costs
- the Connections Project aims to provide more common service levels to the districts, but the mid term review of the project raised substantial questions about the project's direction and results. For example, one submission stated:

I do not totally discount the concept or advent of uniform pricing, but with so much uncertainty in front of us, now is not a good time to make the biggest change to the way our tariff has been collected in the past twenty-five years.²¹

Customers were uncertain about the transparency of the current method for calculating charges, with the Victorian Farmer's Federation (VFF) noting "as it is not clear what

²¹ P Hacon, 2015 *Submission*, November.

components are included in the infrastructure it is difficult to assess whether these are in fact common across districts”.²²

Both the VFF and Dan Mongan²³ highlighted the distinct cost drivers that influence expenditure in each district:

- The VFF submitted “each district has a unique infrastructure footprint” that will contribute to “higher or lower maintenance and renewal cost”
- Dan Mongan outlined district cost drivers of “soil type, density of customers, access to industry [and] asset condition” and stated that G-MW’s irrigation districts lack the “physical connectivity” that justifies other uniform distribution charges.

A minority of submissions to the Commission supported the proposal for common fees. The Greater Shepparton City Council²⁴ and participants at the Shepparton public forum considered that uniform pricing contributes to predictable and stable prices that encourage investment across the whole region. They also considered the Shepparton district had received low levels of government investment compared to other districts, but incurred greater costs due to low levels of asset rationalisation.

G-MW also provided a report by Newgate Research which reported customers’ views on a variety of topics including whether customers receiving the same service levels should pay the same, whether customers who cost more should be charged more and the acceptability of the common irrigation fee proposal.

9.4.2 INDEC’S REVIEW

Indec’s analysis considered whether the proposed reforms of G-MW’s gravity irrigation fees are underpinned by changing cost structures. To do this, Indec examined the split between district and central costs, and variations in district costs among the districts.

²² Victorian Farmers Federation, 2015, *Submission*, November.

²³ D Mongan, 2015, *Submission*, November.

²⁴ The Greater Shepparton City Council, 2015, *Submission*, November.

DISTRICT AND CENTRALISED COSTS

Indec does not support G-MW's definitions of district and centralised labour costs.²⁵

The difference in view leads to differences in G-MW's and Indec's analyses of cost allocations. G-MW's view is that only labour costs allocated entirely to one district should be classified as district costs. Thus if a G-MW officer works in two districts, that person's time would be classified as a central cost. Indec's definitions are based on two factors, where the work is undertaken (centrally or in a district) and whether labour costs are recorded as district or central costs by G-MW when the labour is used (as opposed to defining labour as centralised or district for the price submission). Indec's approach leads to a larger proportion of costs being defined as district costs (table 9.6).

Indec analysed G-MW's 2015-16 district labour costs and found that when these are combined with non-labour costs that total district based operating costs are a higher proportion than estimated by G-MW²⁶ (table 9.6).

TABLE 9.6 DISTRICT AND CENTRALISED OPERATING COSTS

Operating cost	G-MW's analysis	Indec's analysis
District	33%	56%
Centralised	67%	44%
Total	100%	100%

Source: Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, January.

Indec had insufficient historical data to verify G-MW's claim that operating costs were becoming more centralised over time.

DISTRICT COSTS

Indec derived the operating costs in each of the six districts to assess whether they were similar in all districts.²⁷ To ensure comparability across districts' costs, Indec:

²⁵ Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, p 9.

²⁶ Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, p 11.

²⁷ Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, p 13.

- recorded district-based costs against the relevant district, and allocated centralised costs to each district based on each district's proportion of customer operations labour costs
- included gravity irrigation operating costs only and excluded operating costs associated with non-gravity irrigation activities (which are not part of the common fee proposal)
- divided total operating costs for each district by the delivery shares for that district to derive an operating cost per delivery share. This calculation controlled for some districts having customers with more delivery shares and thus having higher total costs despite their operating costs to serve each customer possibly being lower.

Indec compared operating costs in the districts using two cost analyses:

- Indec's first analysis showed reasonable uniformity across districts except for Shepparton and, to a lesser extent, Murray Valley²⁸ (see first column in table 9.7 which is ordered from the lowest cost to the highest)
- Indec's second analysis excluded the costs of customer account administration and site compliance (meter maintenance and meter reading). This removes costs that vary substantially with the number of district customers, to leave a clearer indication of districts' operating costs.²⁹ The results (see second column in table 9.7) show the relative differences between the costs of the districts remain largely unchanged.

Indec emphasised its analysis should not be interpreted as a fee calculation because it did not include all costs faced by customers (such as fixed costs).

²⁸ Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, p 14.

²⁹ Indec, 2016, *2016-20 Review of water prices for Goulburn-Murray Water tariff structure proposals*, p 18.

TABLE 9.7 IRRIGATION DISTRICT OPERATING COST ANALYSIS
(\$ 2015-16)

Gravity irrigation district	Indec calculation of total operating costs	Indec calculation of total operating costs excluding account administration and site compliance costs
Central Goulburn	3 145	2 627
Torrumbarry	3 151	2 771
Loddon Valley	3 185	2 857
Rochester	3 245	2 759
Murray Valley	3 522	3 113
Shepparton	4 143	3 534

Source: Indec, 2016, 2016-20 *Review of water prices for Goulburn-Murray Water tariff structure proposals*, January.

Given the uncertainty surrounding the completion of the Connections Project, which could have a significant impact on Indec's costs, Indec was unable to analyse whether G-MW's district irrigation operating cost structures will change in the future.

9.4.3 DRAFT DECISION ON IRRIGATION TARIFFS

For the Commission to approve G-MW's proposal of a common Infrastructure Access Fee and a common Infrastructure Use Fee, G-MW needs to establish that its proposed fees better reflect the ACCC's pricing principles than the existing arrangements. In this case, the most relevant principle is that of giving effect to the principle of "user pays" in respect of water storage and delivery in irrigation systems. To meet this principle, G-MW needs to demonstrate that district charges are sufficiently similar to be covered by common fees.

Although Indec could not verify G-MW's data that showed an increasing proportion of common costs for G-MW's districts, the Commission's view is that such an increase is likely given increased spending on information technology and the reduction in labour costs related to servicing individual districts. However, our review focusses on the level of cost reflectivity of tariffs for the fourth regulatory period (2016-17 to 2019-20), rather than likely trends. The Commission's view is that Indec's analysis of costs is a reasonable estimate of the balance between G-MW's district and central costs over the fourth regulatory period.

For this draft decision, we considered G-MW's submission (including the Deloitte Access Economics report), customer submissions and Indec's report. We also considered:

- the ACCC's pricing principles
- the costs in the different districts, including the strong influence of administrative decisions (such as cost allocation policies) on costs in each district
- the strong concern of customers who made written submissions and attended public forums about possible cross subsidies among districts and a possible loss of district autonomy. Newgate Research's findings were varied but customer attitudes to the common irrigation fee proposal appeared to be mixed rather than strongly supportive
- the savings offered by G-MW and the administrative simplicity that the reforms would deliver
- in the past, GMW customers have called for the Commission to counter price volatility in districts.

While the Commission has no prior expectation about how similar costs ought to be before a common tariff structure can be justified, the analysis by Indec is revealing. Based on Indec's estimates of total operating costs (table 9.7, first column), five of the six districts are within 7.5 per cent of the average cost across all districts which is \$3 399.³⁰ By contrast, costs in the Shepparton district are almost 22 per cent above the average. While five districts are fairly tightly bunched around an average common cost, one district (Shepparton) appears to have significantly different costs, according to this analysis.

³⁰ Using total operating costs excluding account administration and site compliance costs (second column in table 9.7) all districts are within 10 per cent of the average except the Shepparton district which is over 20 per cent above the average.

On balance, we are not satisfied that G-MW's proposed Infrastructure Access Fee and Infrastructure Use Fee meet the ACCC's pricing principles. We consider the differences between the costs of the Shepparton district and the other districts are too large to achieve the principle of "user pays" in respect of water storage and delivery in irrigation systems. But we do consider G-MW's cost structures in the districts, as analysed by Indec, would be sufficient to justify common fees for gravity irrigation infrastructure access and use for up to five of G-MW's districts.

G-MW may wish to reformulate its fee reform proposal in response to this draft decision or provide additional information to support its proposal. If the Commission receives no additional information or no alternative proposal, it proposes to approve the continuing use of G-MW's existing fee structure.

9.5 G-MW'S PROPOSED NYAH AND TRESKO PUMPED IRRIGATION DISTRICT TARIFF INCREASES

G-MW proposed to continue its tariff structure in the Nyah and Tresko pumped irrigation districts but with a rebalancing of its tariffs to cover the costs of capital works in these districts.

For the Nyah district in the fourth regulatory period G-MW proposed:

- to increase the Infrastructure Access Fee by CPI+4 per cent each year
- to increase the Infrastructure Use Fee by CPI+2 per cent each year.

For the Tresko district G-MW proposed:

- to increase the Infrastructure Access Fee by CPI+3 per cent each year
- to increase the Infrastructure Use Fee by CPI+2 per cent each year.

9.5.1 COMMISSION'S REVIEW

The Commission received no submissions on the proposed tariff structure in the Nyah and Tresko districts. We considered G-MW's proposal and formed a view that a price rebalancing for these two districts to reflect costs incurred in the districts would accord with the ACCC's principle of giving effect to "user pays" principles.

9.5.2 DRAFT DECISION ON NYAH AND TRESKO TARIFF PROPOSAL

The Commission proposes to approve G-MW's proposed tariff structure in the Nyah and Tresco districts.

9.6 G-MW'S PROPOSED SERVICE POINT FEES

G-MW proposed to make service point fees fully cost reflective (table 9.8) by 2019-20. Its customers pay different service point charges depending on their meter type.

TABLE 9.8 G-MW PROPOSED SERVICE POINT FEES
(\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20
Domestic and stock	80	88	95	102	109
Local read	300	312	314	316	317
Remote read	350	463	571	696	797
Remote read and operate	400	561	714	859	997

Source: Goulburn-Murray Water's pricing model for the fourth regulatory period.

G-MW submitted:

- for small customers the service point fees make up a substantial proportion of a typical bill, but the proposed increase is about \$12 in the first year of the regulatory period. Small customers do not receive Remote Read or Remote Read and Operate services.
- for large customers that are charged for modernised meters that can be read and operated remotely, the fee will rise from \$400 to \$997 (over five years in the context of a typical large customer bill of approximately \$25 000).

9.6.1 COMMISSION'S REVIEW OF SERVICE POINT FEES

Irrigator submissions to the Commission included mixed views on the proposed change to the service point fees. They noted concerns that:

- costs appear high and are not transparent. David Kerr submitted irrigators were not aware the cost of new outlets would be so significant.³¹ Peter and Mary Fenton³² submitted some customers “have no capacity to reduce their number of outlets”
- customers should not be financially responsible for the cost of meters that are determined by geographic or network constraints, such as service points at properties bisected by roads and G-MW channels and drains.³³

Regarding G-MW’s proposed change to service point fees, we consider:

- that although the percentage increase in service point fees for large customers is substantial and has led to customer concern, shifting the tariffs to cost reflectivity accords with the ACCC pricing principles of promoting the efficient use of water infrastructure assets and giving effect to the principle of “user pays”
- transitioning the fee increases over four years addresses price volatility issues
- that how geographic or network constraints are incorporated into the service point fee structure is a matter for G-MW to decide in consultation with its customers.

9.6.2 DRAFT DECISION ON SERVICE POINT FEES

The Commission proposes to approve G-MW’s proposed service point fee structure because it would lead to greater cost reflectivity, which aligns with the ACCC’s pricing principle of promoting “user pays” principles.

9.7 G-MW’S PROPOSED DRAINAGE TARIFFS

G-MW did not propose to change the structure of its drainage fees.

³¹ D Kerr, 2015, *Submission*, November.

³² P and M Fenton, 2015, *Submission*, November.

³³ D Kerr, 2015, *Submission*, November.

9.7.1 COMMISSION'S REVIEW OF DRAINAGE FEES

The Commission received no submissions on the proposed drainage fees.

9.7.2 DRAFT DECISION ON DRAINAGE FEES

The Commission proposes to approve G-MW's proposed drainage fee structure on the basis that it is continuing with the existing arrangements.

9.8 DRAFT DECISION

The Commission proposes not to approve G-MW's proposed common gravity irrigation Infrastructure Access and Infrastructure Use fee structure.

The Commission proposes to approve G-MW's other proposed irrigation fee structures including those for pumped irrigation, service points and drainage.

10 DIVERSION SERVICES

10.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) proposed diversion services' tariff structures. G-MW provides diversion services to customers who access water from waterways such as rivers, and groundwater. Its diversion services include the management of water sources, compliance monitoring and administration of accounts. In its price submission, G-MW proposed substantial reform of its diversion tariffs.

10.2 APPROACH TO REVIEWING DIVERSION SERVICES

G-MW's diversion proposals are covered by two sets of regulatory criteria:

- We reviewed groundwater services, and surface water diversion services, which do not use G-MW's infrastructure-related services, against the Water Industry Regulatory Order (WIRO).
- We reviewed surface water diversion customers' storage charges, which use G-MW's storage infrastructure services, against the Australian Competition and Consumer Commission's (ACCC) pricing principles.

G-MW's diversion proposals contain tariffs for services covered by both the WIRO and the Water Charge (Infrastructure) Rules (WCIR). For this reason, we reviewed the diversion proposals against the requirements of both regulations.

Our guidance to G-MW required it to consult with customers affected by its proposals.

10.3 OVERVIEW OF G-MW'S PROPOSAL

The tariff structure for diversion services comprise:

- a service fee which covers the cost of managing customer accounts
- a service point fee which covers the costs of diversion meters
- an access fee which covers the cost of ensuring customers access water according to management rules, including the cost of managing allocations, restrictions and water ordering
- a resource management fee which covers the cost of developing resource management plans, and monitoring water use.

G-MW proposes a tariff structure it submits better reflects how costs are incurred:

- The access fee will be levied per service point, rather than on the size of a customer's water entitlement because the number of service points is the main cost driver. G-MW submitted this approach would incentivise customers to rationalise their service points, thereby promoting the efficient use of infrastructure.
- The single service point fee will be replaced by a small and a large service point fee to reflect the level and cost of service to unmetered and metered sites.
- The number of diversion service customer groups will be cut from ten to four, to reflect similar costs in the merged groups.

The four proposed customer groups are:

- unregulated surface water diverters who take water from water systems with no G-MW or Murray-Darling Basin Authority (MDBA) storages, weirs or dams on the river system. These services were previously divided into four categories: Murray; Murray (fish farming); Goulburn; and Goulburn (fish farming)
- regulated surface water diverters who receive water from a system where water is released from a G-MW or MDBA-operated storage. These services were previously divided into the same four categories as unregulated surface water diverters
- groundwater licensees who obtain water using a bore. These were previously divided into three geographic categories, of which two merged
- Shepparton Irrigation Region (SIR) groundwater diverters.

10.3.1 PROPOSED TRANSITION

G-MW proposed the following transition to the new tariff structure for diversions:

- Access fees will shift from being based on the size of a water entitlement to being based on the number of service points by 2017-18.
- A Small Service Point Fee will initially be equal to the stock and domestic service point fee and increased incrementally to reflect costs. The Large Service Point Fee will be \$300 in 2016-17 and then move consistent with the Local Read Meter Fee in gravity irrigation districts.
- The number of diversion customer groups has already been reduced.

G-MW's estimated bill changes for diversion services customers (table 10.1) show that the proposal would increase the costs borne by smaller diversion water customers.

TABLE 10.1 G-MW ESTIMATES OF PROPOSED DIVERSION BILL CHANGES
(\$ 2015-16)

	Typical bill 2015-16	2016-17	2017-18	2018-19	2019-20	Typical bill 2019-20
	Annual percentage change					
Small customer^a						
Regulated surface water diverter	285	21%	21%	3%	3%	443
Unregulated surface water diverter	282	18%	20%	3%	3%	424
Groundwater diverters (intensive)	380	10%	11%	3%	3%	492
Groundwater diverters (other)	339	18%	16%	3%	3%	492
SIR Groundwater diverters	251	-4%	-6%	2%	1%	233
Large customer^a						
Regulated surface water diverter	4 049	1%	-1%	1%	1%	4 130
Unregulated surface water diverter	2 145	-33%	-31%	0%	0%	992
Groundwater diverters (intensive)	3 505	-13%	-11%	0%	0%	2 714
Groundwater diverters (other)	2 485	7%	2%	0%	0%	2 712
SIR groundwater diverters	1 365	-29%	-46%	-2%	-2%	503

^a G-MW has defined large and small customers on page 100 of its submission.

In its price submission G-MW stated the new tariff structure would better meet the ACCC's pricing principles because it better reflects how costs are incurred and thus is more efficient.

10.3.2 CUSTOMER CONSULTATION

In its price submission, G-MW reported it had undertaken significant consultation with customers when developing its strategy for diverter tariffs and found small customers were dissatisfied with paying the same access fees as large customers. As part of its response to these concerns, G-MW proposed:

- to implement the new tariff structure over two years to reduce the impact on small customers
- to make the new tariffs more cost reflective (with costs being driven primarily by the number of service points) and thus promote efficiency.

10.4 COMMISSION'S REVIEW

The Commission formed its draft decision after considering G-MW's price submission, stakeholder feedback and reports by an expert consultant, Indec (engaged by the Commission).

TARIFF STRUCTURE

Indec reviewed G-MW's costs of providing services to diversion customers to assess whether the proposed tariff structure reflects how costs are incurred:

- Regarding G-MW's proposal to transition to a fixed cost access fee, Indec's analysis confirmed that the cost drivers for access compliance relate to the number of service points (which are a fixed cost) rather than water entitlement volume.
- Regarding G-MW's proposal to reduce the number of customer groups from ten to four, Indec reported that G-MW could not provide cost data and analysis to support the key cost drivers. However, Indec's analysis did not identify any problems with the move to the four groups' charges.

- Regarding G-MW's proposal for separate Service Point Fees for large and small customers, Indec accepted G-MW analysis of the distinct compliance costs for sites with and without a meter.

We consider G-MW's proposed fixed access fees and restructuring of customer categories more closely align tariffs with costs, leading to greater cost reflectivity and greater efficiency. For this reason we consider the proposal accords with the ACCC's pricing principles and the WIRO.

We reviewed several issues raised in written submissions:

- Regarding a concern that diversion fees exceeded the costs of the service, we confirm fees do not exceed the service costs.
- Regarding a concern that the proposed price signals would not reflect water scarcity, we advise that water availability is managed through G-MW's resource management function.

CONSULTATION AND TRANSITION

The Commission received several submissions on diversion tariff changes and the impact of bills:

- Peter Zlabek³⁴ and Nick Legg³⁵ stated that G-MW did not consult with small diverters on the impact on their bills during the formulation of the Diverters Tariff Strategy or during the consultation period.
- Small diverters Russell Roberts³⁶, Roger Hall³⁷ and Ann Jelinek³⁸ were concerned about the amount and rate of the proposed increase of unregulated surface water prices by 18 per cent in 2016-17 and 20 per cent in 2017-18.

We reviewed G-MW's consultation and consider that many of G-MW's communications did not sufficiently highlight information about the proportionally large price increase for

³⁴ P Zlabek, 2015, *Submission*, November.

³⁵ N Legg, 2015, *Submission*, November.

³⁶ R Roberts, 2015, *Submission*, November.

³⁷ R Hall, 2015, *Submission*, November.

³⁸ A Jelinek, 2015, *Submission*, November.

small diversion customers in the first two years of the regulatory period. Because G-MW's consultation with small diversion customers might not have been sufficient, small diverters' views on the increases in tariffs over two years may not be reflected in the proposal. For this reason, we consider the large price increases in the first two years should be spread evenly over the four years of the regulatory period rather than the two years proposed by G-MW. This longer transition would reduce price volatility and lessen the impact on smaller diverters, in accordance with the ACCC's pricing principles and the WIRO.

10.5 DRAFT DECISION

The Commission proposes to approve G-MW's proposed diversion services tariff structure subject to the transition to the service point based access fee being extended to four years.

11 BULK STORAGE CHARGES

11.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) bulk storage charge structure. G-MW owns and manages storage facilities and assets that store water for wholesale customers (such as rural and urban water corporations and environmental water holders) and retail customers (such as regulated surface water diverters and customers in G-MW's irrigation districts). In its price submission, G-MW proposed to increase charges in some districts over the fourth regulatory period.

11.2 APPROACH TO REVIEWING BULK STORAGE SERVICES

The Commission reviewed G-MW's proposed bulk storage tariff structure against the Australian Competition and Consumer Commission's (ACCC) pricing principles for tariffs (see box 9.1). In our guidance to G-MW, we emphasised that G-MW, in consultation with its customers, is best placed to design tariff structures that meet its customers' needs while promoting the efficient use of its infrastructure.

11.3 G-MW'S PROPOSAL

G-MW proposed to retain its existing tariff structure for storage services which includes:

- a wholesale charge that recovers storage costs from the urban water businesses that use the storages, and from the environmental water holders. These charges are based on the size of the bulk entitlement held in a basin. G-MW submitted that revenues generated from wholesale charges in smaller basins do not recover the

costs incurred. For some smaller basins, it proposed to increase prices by CPI+10 per cent each year until 2024 to ensure cost recovery

- a retail charge paid by irrigators. This charge is based on the size of the water share held by a customer. G-MW proposed no change to its retail tariff structures.

Each of these charges has two prices, which distinguish between high and low reliability water shares.

11.3.1 COMMISSION'S REVIEW

WHOLESALE CHARGES

In its submission on G-MW's proposal, Central Highlands Water raised concerns about the prices it pays for storage in the Bullarook Basin. No other water businesses made a submission on wholesale charges. In response to questions from the Commission, G-MW provided the following details about proposed capital expenditure in the Bullarook Basin in the fourth regulatory period:

- \$30 000 in 2016-17 for the upgrade of the embankment toe drain to address dam safety risk
- \$375 000 in 2018-19 for a bridge to the outlet tower (currently accessed by boat) to address Occupational Health and Safety risk
- \$425 000 and \$1.4 million in 2018-19 and 2019-20 respectively for strengthening the spillway and replacing filters in the embankment to address dam safety risk.

G-MW also advised it allocated overhead operating costs for all basins based on the level of capital expenditure in a basin. As a result, capital spending in the Bullarook Basin has increased the overhead operational costs of the basin.

The Commission's view is that, for wholesale prices, allocating a component of operational overhead costs based on capital expenditure is unlikely to best reflect how operational overhead costs are incurred. This is particularly the case given that G-MW's operating costs are becoming more centralised and constant rather than increasing with capital expenditure in particular districts. The Commission's view is that cost allocation matters are best addressed by water businesses and their customers and that G-MW's could evaluate and change its cost allocation methodology, if needed, via consultation between G-MW and its wholesale customers.

The Commission's view is that G-MW's proposal for wholesale charges is in accordance with the ACCC's pricing principles.

The Commission proposes to approve G-MW's proposed wholesale bulk storage charges (table 11.1)

TABLE 11.1 G-MW'S BULK ENTITLEMENT CHARGES
High reliability water shares \$/ML (\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20	Annual increase (%)
Broken	38.43	42.27	46.50	51.15	56.27	10%
Goulburn	8.16	8.16	8.16	8.16	8.16	0%
Campaspe	24.86	24.86	24.86	24.86	24.86	0%
Loddon	40.96	42.60	44.30	46.07	47.92	4%
Bullarook	329.61	362.57	398.83	438.71	482.58	10%
Murray	11.8	11.62	11.45	11.28	11.11	-1.5%
Ovens	48.45	53.30	58.62	64.49	70.94	10%

Source: Goulburn-Murray Water's pricing model for the fourth regulatory period.

RETAIL CHARGES - COMMISSION'S REVIEW

G-MW proposed to maintain its current structure for its Entitlement Storage Fees. The Commission proposes to approve the fee structure as shown in table 11.2.

TABLE 11.2 ENTITLEMENT STORAGE FEE
High reliability water shares \$/ML (\$ 2015-16)

	2015-16	2016-17	2017-18	2018-19	2019-20	Annual increase (%)
Goulburn	10.57	10.67	10.78	10.89	11.00	1%
Murray	13.04	13.04	13.04	13.04	13.04	0%

Source: Goulburn-Murray Water's pricing model for the fourth regulatory period.

11.4 ENVIRONMENTAL WATER HOLDER TARIFFS

In its submission to the Commission, the Victorian Farmers Federation raised concerns that the Commonwealth Environmental Water Holder pays less for water storage than irrigators. We can confirm environmental water holders are subject to the same tariffs as other G-MW bulk storage customers:

- The Victorian Environmental Water Holder is charged the wholesale price for bulk entitlements held in its own name and in trust for the Murray-Darling Basin Authority.
- The Commonwealth Environmental Water Holder is charged the storage price for non-water users (whose water share is not linked to land).
- By arrangement, the Victorian Environmental Water Holder pays an Infrastructure Access Fee based on an equivalent delivery share.

G-MW proposed to retain its existing charging arrangements for environmental water holders in the 2016 price review period.

The Commission proposes to approve G-MW's proposed tariffs and charges for environmental water holders.

11.4.1 REVIEW SUMMARY

The Commission considers G-MW's proposed wholesale and retail bulk storage charge structures comply with the ACCC's pricing principles because they promote cost reflectivity that improves efficiency and promotes 'user pays' principles. For this reason, the Commission proposes to approve G-MW's proposed bulk storage charge structures.

11.5 DRAFT DECISION

The Commission proposes to approve G-MW's proposed bulk storage charge structure.

12 MISCELLANEOUS SERVICES CHARGES

12.1 INTRODUCTION

This chapter reviews Goulburn-Murray Water's (G-MW) principles for setting miscellaneous service charges. G-MW provides customers with miscellaneous services often related to the major services that it provides. Many of these services are not used frequently. They include granting and transferring licences for customers.

12.2 APPROACH TO REVIEWING MISCELLANEOUS SERVICES CHARGES

Miscellaneous services that relate to G-MW's infrastructure services are regulated under the Water Charge (Infrastructure) Rules 2010 (WCIR). The remainder are regulated under the Water Industry Regulatory Order (WIRO). We reviewed miscellaneous services charges against both the WCIR and the WIRO, to avoid doubt about the regime under which specific services should be assessed.

12.3 G-MW'S PROPOSAL

G-MW submitted a list of all proposed prescribed miscellaneous services with charges for each service. It indicated the charges were calculated using the pricing principles the Commission approved in its 2013 determination.

12.3.1 COMMISSION'S REVIEW

We are satisfied G-MW's proposed prescribed miscellaneous services charges are calculated in a way that meets the requirements of the WCIR and the WIRO because all proposed charges are based on the costs of delivering the service. The pricing principles are in box 12.1.

BOX 12.1 PRICING PRINCIPLES FOR MISCELLANEOUS SERVICES

Prices for miscellaneous services must be set according to actual cost calculated on the basis of the aggregate of:

- direct third party or contractor invoice cost;
- direct marginal internal costs, including labour, materials and transport costs; and
- a fair contribution to overheads.

For bank dishonour, debt collection and legal fees, the third party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

No submissions were made to the Commission about the proposed principles.

The Commission proposes to approve G-MW's proposal given the principles promote cost reflectivity and therefore meet the ACCC's pricing principles and the WIRO.

12.4 DRAFT DECISION

The Commission proposes to approve G-MW's proposed miscellaneous services charges and pricing principles.

APPENDIX A – SUBMISSIONS

The Commission held forums in Kyabram, Shepparton and Kerang. Each forum was attended by 12 to 20 members of the public.

The written submissions in table A.1 are available on our website.

TABLE A.1 SUBMISSIONS RECEIVED ON G-MW'S PRICE SUBMISSION

Name	Date received
Peter Zlabek	7 August 2015
Colin and Mary Fenton	14 August 2015
City of Greater Shepparton	16 August 2015
Central Highlands Water	25 August 2015
Roger Hall	5 September 2015
Russell Roberts	11 November 2015
Zoltan Galambos	17 November 2015
Ann Jelinek	23 November 2015
Daniel Mongan	30 November 2015
Peter Hacon	30 November 2015
Victorian Farmers Federation	30 November 2015
David Kerr	30 November 2015
Loretta Warren	30 November 2015
Colin Fenton	30 November 2015
Murray Haw	30 November 2015
Patrick Connolly	29 January 2016