ESSENTIAL SERVICES COMMISSION

Coliban Water draft decision

2018 Water Price Review

28 March 2018

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Summary

In September 2017, Coliban Water provided a submission to us proposing prices for a five year period starting 1 July 2018

This draft decision sets out our preliminary views on Coliban Water's price submission.[1] [2]

We invite interested parties to comment on our preliminary views in this draft decision before we make a final decision and issue a price determination in June 2018. Details on how to make a submission on our draft decision are provided in Chapter 4.

Coliban Water has committed to deliver improved outcomes to customers

Our draft decision proposes to approve a revenue requirement that will allow Coliban Water to deliver on the customer service commitments outlined in its price submission, government policy, and obligations monitored by Environment Protection Authority Victoria and Department of Health and Human Services.

Some of the ways Coliban Water plans to improve outcomes for customers are by:

- reducing prices
- increasing its support for customers experiencing bill payment difficulty
- investing in water quality improvements for a number of towns
- increasing the ways customers can communicate and receive information from the business.

Our draft decision proposes to approve a lower revenue requirement than proposed by Coliban Water

Our draft decision proposes to approve a revenue requirement of $597.8 million for Coliban Water over the five year period starting 1 July 2018, for the purpose of approving maximum prices.[3] This is $18.0 million or 2.9 per cent lower than proposed by Coliban Water.

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[1] Clause 16 of the Water Industry Regulatory Order 2014 requires us to issue a draft decision.

[2] Coliban Water's price submission is available on our website at www.esc.vic.gov.au.

[3] The revenue requirement is the forecast amount a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including Environment Protection Authority Victoria and the Department of Health and Human Services. Along with forecast demand, it is an input to calculating the prices to be charged by a water corporation.

Our draft decision on the revenue requirement is based on our views on:

- Coliban Water's PREMO rating and therefore, its return on equity. As noted below, our draft decision proposes a rating of 'Standard', compared to Coliban Water's proposed rating of 'Advanced'. This results in a lower return on assets and a lower revenue requirement.
- Our draft decision not to accept Coliban Water's proposed financial viability adjustment. Forecast improvements in interest cover (and cash flow) from existing sound levels, and an ongoing decline in gearing, indicates Coliban Water is in a position to generate cash flow to meet its service commitments, without any financial viability adjustment (see page 35 for more information).
- We have also proposed relatively minor reductions to forecast controllable operating expenditure, mainly related to electricity (see page 13), and capital expenditure (see page 20).

Based on our draft decision, on average Coliban Water's prices over 2018-19 to 2022-23 will be about 2.9 per cent lower than its original proposal.[4]

Coliban Water must respond to our draft decision and propose individual tariffs that reflect our initial views on the revenue requirement. Its response will determine the price and bill impact of our draft decision on individual tariffs and customer groups.

Our draft decision is not to accept Coliban Water's proposed form of price control

We propose not to accept Coliban Water's proposed 'hybrid revenue cap' form of price control. We consider the proposed form of control is complex, and it potentially allows Coliban Water to retain any revenue collected above the limit included in its hybrid revenue cap until the end of the regulatory period (resulting in prices that don't reflect efficient costs). See from page 27 for more information.

We have accepted most of Coliban Water's proposed tariff structures

Our draft decision accepts Coliban Water's proposal to continue with its existing tariff structures and some of its proposed minor tariffs.

For water services, Coliban Water proposed a fixed service charge and a variable component that depends on water used. For residential sewerage services, Coliban Water proposed a fixed service charge only. For non-residential sewerage services Coliban Water proposed a fixed service charge and a variable component. These reflect a continuation of its existing tariff structures.

Our initial views on Coliban Water's tariff structures are set out in more detail from page 29.

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[4] This is an indicative percentage change on prices based on the percentage change in draft decision revenue requirement compared to the proposed revenue requirement.

Coliban Water's price submission is rated as 'Standard' under PREMO

We consider Coliban Water has produced a good underlying price submission, built on strong customer engagement and robust cost management. It has proposed to deliver improved outcomes for its customers, particularly in areas identified by customers as a service priority, with a proposed price fall of 1 per cent per year from 2018-19.

However, we consider Coliban Water's approach, including its proposed financial viability adjustment and aggressive approach to depreciation, reflects an unjustified and significant transfer of risk between itself and its customers, and between present and future customers. The net effect is that its customers would be charged prices above a level that reflects an efficient cost of providing services. No other water business has proposed this approach.

We acknowledge, however, that the PREMO framework did not specifically address businesses transferring risk between different generations of customers. Coliban Water may therefore respond to this draft decision with additional information regarding its proposed approach to risk management and its original self-rating of 'Advanced' for Risk.

Overall, we have rated Coliban Water's price submission as 'Standard' under PREMO, compared with the 'Advanced' it proposed in its price submission. (Table A).

Our PREMO rating is an assessment of the water corporation's price submission. It is not an assessment of the water corporation itself.

Table A PREMO Rating

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
Coliban Water's rating	**Advanced**	Advanced	Advanced	Advanced	Advanced
Commission's rating	**Standard**	Basic	Advanced	Advanced	Advanced

Among the 15 draft decisions we have released so far, Coliban Water is one of five corporations for which we propose to approve a ‘Standard’ rating (Table B).

Table B Draft decision on PREMO – overall rating

Leading	Advanced	Standard	Basic
Goulburn Valley Water	Barwon Water	Coliban Water	Wannon Water
	Central Highlands Water	East Gippsland Water	
	City West Water	Gippsland Water	
	GWMWater	Lower Murray Water (urban)	
	North East Water	Westernport Water	
	South East Water		
	Southern Rural Water		
	Yarra Valley Water		

1. Our role and approach to water pricing

We are Victoria's independent economic regulator

Our role in the water industry is based on the Water Industry Regulatory Order 2014 (WIRO) which is made under the *Water Industry Act 1994* (Vic) (WI Act) and sits within the broader context of the *Essential Services Commission Act 2001* (Vic) (ESC Act). Our role under the WIRO includes regulating the prices and monitoring service standards of the 19 water corporations operating in Victoria.

We are reviewing the prices 17 water corporations propose to charge customers from 1 July 2018

Our review of the prices proposed by the water corporations covers the prescribed services listed in the WIRO.[5] The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.[6]

In September 2017, Coliban Water provided a submission to us proposing prices for a five year period starting 1 July 2018. Our task is to assess the price submission against the legal framework that governs our role, and make a price determination that takes effect from 1 July 2018. The price determination will specify the maximum prices Coliban Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We also issue a final decision that explains the reasons for our price determination.

We assess prices against the WIRO and other legal requirements

Clause 11 of the WIRO specifies the mandatory factors we must have regard to when making a price determination, including matters set out in the WIRO, the WI Act and the ESC Act. In reaching this draft decision we have had regard to each of the matters required by clause 11 of the WIRO, including:

- the objectives and matters specified in clause 8 of the WIRO, which include economic efficiency and viability matters, industry specific matters, customer matters, health, safety, environmental and social matters, and other matters which are specified in sections 8 and 8A of the ESC Act and section 4C of the WI Act

[5] The review excludes Melbourne Water and Goulburn-Murray Water. In 2016 we approved prices for Melbourne Water to 30 June 2021 and for Goulburn-Murray Water to 30 June 2020.

[6] The prescribed services are listed at clause 7(b) of the WIRO.

- the matters specified in our guidance[7]
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

A separate document lists the specific objectives and the various matters the commission must have regard to when making a price determination and provides a guide to where the commission has done so in this draft decision.[8]

In 2016, we issued guidance to Coliban Water to inform its price submission. The guidance set out how we will assess Coliban Water's submission against the matters we must consider under clause 11 of the WIRO.

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve Coliban Water's proposed prices.[9]

If we consider the submission does not have adequate regard for the matters specified in clause 11 of the WIRO or comply with our guidance, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.[10]

The 2018 price review is the first we've undertaken under our new water pricing approach

In 2014, the Victorian Government reviewed and revised the WIRO. The changes allowed us more flexibility to decide on the pricing approach we use in Victoria's water sector. In April 2015 we released a consultation paper to start reviewing our pricing approach.[11]

Over 2015, we held a series of workshops and hosted a conference (in November) to hear from stakeholders and explore alternative ways to approach water pricing.

In May 2016, we released a position paper setting out our proposed new pricing approach, and invited submissions.[12] We met with each water corporation and other interested parties to help

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[7] Essential Services Commission 2016, *2018 Water Price Review, Guidance paper*, November.

[8] Essential Services Commission 2018, *Coliban Water draft decision, 2018 Water Price Review – commission's consideration of legal requirements*, 28 March. This is located on our website at www.esc.vic.gov.au

[9] This is a requirement of the WIRO, clause 14(b).

[10] This is provided for under the WIRO, clause 14(b)(i).

[11] Essential Services Commission 2015, *Review of Water Pricing Approach, Consultation paper*, April.

[12] Essential Services Commission 2016, *A new model for pricing services in Victoria's water sector*, *Position paper*, May.

inform their submissions. Submissions were supportive of the overall proposal, in particular the greater focus on customer engagement and value.

We finalised our new approach to water pricing in October 2016.[13]

Our new pricing approach builds on many aspects of the previous approach. We continue to use the building blocks to estimate the revenue requirement for a water corporation.[14] Our guidance explains the building blocks and how we use it to estimate the revenue requirement.[15]

Among the key changes, the new approach introduces new incentives to help ensure water corporations deliver the outcomes most valued by customers. Our new PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.[16] The PREMO incentive is described next.

Our consultation on the pricing approach informed the guidance we issued water corporations in November 2016 to inform price submissions for the 2018 water price review.

PREMO

PREMO stands for **P**erformance, **R**isk, **E**ngagement, **M**anagement, and **O**utcomes. The purpose of PREMO is to provide an incentive for water corporations to deliver outcomes most valued by customers. It includes incentives for a water corporation to engage with customers to understand their priorities and concerns, and take these into account.

PREMO links the return on equity allowed in the revenue requirement to the value delivered by a water corporation to its customers. Under PREMO, a higher level of ambition in terms of delivering customer value results in a higher return on equity.

Our PREMO rating is an assessment of the water corporation's price submission. It is not an assessment of the water corporation itself.

The 2018 water price review is the first time we've applied our PREMO incentive mechanism.

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[13] For more detail on the new water pricing approach see: Essential Services Commission 2016, *Water Pricing Framework and Approach: Implementing PREMO from 2018*, October.

[14] The revenue requirement is the forecast amount that a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including Environment Protection Authority Victoria and the Department of Health and Human Services.

[15] Essential Services Commission 2016, *Guidance Paper*, op. cit., pp. 8-9.

[16] In December 2017 we issued early draft decisions for East Gippsland Water, South East Water, Westernport Water and Yarra Valley Water.

For the 2018 water price review, a water corporation's ambition in terms of delivering customer value is being assessed against four elements of PREMO – Risk, Engagement, Management and Outcomes.[17]

A water corporation must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the justification for the PREMO rating, and also rate the price submission. This process determines the return on equity reflected in the revenue requirement.[18]

[17] The Performance element of PREMO will be assessed at the review following the 2018 water price review.

[18] Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 45–49.

2. Our assessment of Coliban Water's price submission

We have made our draft decision on Coliban Water's price submission after considering: Coliban Water's price submission, its responses to our queries, and written submissions from interested parties (a list of submissions is provided in Appendix A).

Any reports, submissions, or correspondence provided to us which are material to our consideration of Coliban Water's price submission are available on our website (to the extent the material is not confidential).

Our guidance included a number of matters water corporations must address in their price submissions. Coliban Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this chapter.

Generally, we found Coliban Water's price submission presented comprehensive information to support its proposals. Coliban Water also provided evidence that its engagement sought to capture the main priorities and concerns of customers, and that it has taken this feedback into account (see the customer engagement section on page 6).

> Coliban Water must submit a response to our draft decision and provide an updated financial model by 8 May 2018 (via email to water@esc.vic.gov.au). The response will be published on our website. We also invite other interested parties to make a submission.
>
> We intend to make a price determination for Coliban Water in June 2018.

All financial values referred to in this chapter are in $2017-18.

Regulatory period

Coliban Water proposed a five year regulatory period. Our draft decision accepts Coliban Water's proposal as it is consistent with our guidance. Our guidance proposed to approve a five year regulatory period, subject to any alternative and justified proposal.[19]

Coliban Water explored the benefits of a ten year regulatory period with stakeholders. Coliban Water's submission noted residential customers supported a ten year regulatory period on the basis that it provides for long-term price stability. Commercial customers supported a ten year regulatory period as it provides price certainty and assists business planning.[20]

While it proposed a five year regulatory period from 1 July 2018 to 30 June 2023, to incorporate customer views, Coliban Water made a commitment that its prices over the five years from 1 July 2023 would reflect a continued one per cent per annum decline in its revenue. It also noted its intention to seek "fast-tracking" at its next price review, subject to meeting certain criteria.[21]

On Coliban Water's prices from 1 July 2023 and fast-tracking, we note that these are matters that will be considered at Coliban Water's next price review. These matters will be considered having regard to the regulatory framework and the commission's guidance applying at the time.[22]

Customer engagement

Our guidance required Coliban Water to engage with customers to inform its price submission.

The engagement by Coliban Water:

- took place between 2016 and August 2017, drawing on feedback gathered since 2013
- used a range of methods including surveys, face to face interviews, community forums and water taste testing events
- was informed by input from residential and rural customers, indigenous groups, vulnerable customer advocacy groups, developers, trade waste, and large business customers

[19] For detail on the reasons for using five years as the default regulatory period, see: Essential Services Commission 2016, *Guidance paper*, op. cit., p. 21.

[20] Coliban Water, *Pricing Submission 2018*, p. 41.

[21] Our 2018 water price review allowed for a form of fast-tracked price review. In December 2017, we released an early draft decision for four water corporations, as we were able to assess their price submission relatively quickly against the legal matters we must have regard to in making a price decision and determination.

[22] Our current guidance notes that the decision to 'fast-track' a price submission in our 2018 water price review is at the commission's discretion, see: Essential Services Commission 2016, *Guidance paper*, op. cit., p. 14. Further, our future approach to considering price submissions may differ in future price reviews.

- covered matters such as the length of the regulatory period, service outcomes, guaranteed service levels, price and service trade-offs, and price changes.

More detail on Coliban Water's engagement is available in its price submission.[23]

Evidence that Coliban Water's engagement influenced its proposals includes:

- improving customer access to its call centre and its website in response to feedback that customers value ease of access to Coliban Water
- a falling price path in response to feedback that customers value affordable and stable bills
- implementing new customer rebates where the outcomes delivered by Coliban Water don't meet its commitments, in response to feedback from customers about service priorities.

The influence of Coliban Water's engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of consumers.[24]

Outcomes

Coliban Water proposed a number of outcomes it would deliver to customers over the five year period starting 1 July 2018. These are to:

- supply high quality water customers can trust
- provide infrastructure and services to meet customer needs now and in the future
- reduce its environmental footprint and achieve a socially responsible, sustainable business for future generations
- be open and transparent about pricing and service disruptions, and easy to do business with
- support the liveability of the region.

Coliban Water proposed measures it will use to report on progress against achieving each outcome. These are set out at pages 22 to 32 of its price submission. To report on its performance, Coliban Water will develop a reporting framework and test it with customers over 2018.

We will engage with Coliban Water to finalise the measures and targets used to assess performance against its outcomes, and how it will report this publicly. Performance against these measures will inform our assessment during future price reviews.

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[23] Coliban Water's price submission is available on our website at www.esc.vic.gov.au.

[24] See for example, WIRO clauses 8(b)(i), 8(b)(ii), 8(b)(iii), 11(d)(iii), and ESC Act Sections 8(1), 8A(1)(a).

Guaranteed service levels

Guaranteed service levels (GSLs) define a water corporation's commitment to deliver a specified level of service. For each GSL, a water corporation commits to a payment or a rebate on bills to those who have received a level of service below the guaranteed level.

Coliban Water's proposed GSLs are set out on page 7 of supplement B to its price submission. It has made no changes to its hardship GSL, proposed to modify two existing GSLs and introduce fourteen new ones. New GSLs relate to water quality, sewer spills, improved response times to queries and requests, and the timing of planned water supply outages.

The changes to its GSLs were informed by customer engagement. On this basis we propose to accept Coliban Water's proposed GSLs. Final GSLs will be subject to our consideration of any feedback following the release of our draft decision.

Revenue requirement

The revenue requirement is the forecast amount a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including Environment Protection Authority Victoria and the Department of Health and Human Services. Along with forecast demand, it is an input to calculating prices. [25]

Coliban Water proposed a revenue requirement of $615.8 million over a five year period starting 1 July 2018. Our draft decision proposes to reject the revenue requirement in Coliban Water's submission and instead approve a revenue requirement of $597.8 million, 2.9 per cent lower than proposed by Coliban Water. This reflects our assessment of each element that comprises the revenue requirement, including forecast expenditure.

Our draft decision on the revenue requirement is set out at Table 2.1. Our draft decision on the revenue requirement will allow Coliban Water to deliver all commitments it made in its price submission.

[25] We met with officers of the Department of Environment, Land, Water and Planning, Department of Health and Human Services, and Environment Protection Authority Victoria, to discuss their expectations of Coliban Water in the regulatory period from 1 July 2018. We had regard to their views in our draft decision.

Table 2.1 Draft decision – revenue requirement
$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Operating expenditure	67.7	67.4	66.5	66.1	66.1	333.7
Return on assets	19.4	19.3	19.3	19.3	19.3	96.5
Regulatory depreciation	31.5	32.5	33.5	34.4	35.6	167.5
Draft decision – revenue requirement	**118.6**	**119.2**	**119.2**	**119.8**	**121.0**	**597.8**

Note: Numbers have been rounded

Table 2.2 summarises proposed changes to the revenue requirement.

Our final decision will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Coliban Water must update its revenue requirement and prices to reflect our April 2018 updates to estimates for the cost of debt and inflation.

There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination, and impact on the revenue requirement, Coliban Water should update its price submission and also provide us with an updated financial model. Any updates will be publicly available on our website.

Table 2.2 Adjustments to revenue requirement
$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Proposed revenue requirement	**121.4**	**121.8**	**123.1**	**124.1**	**125.3**	**615.8**
Operating expenditure	-0.3	-0.1	-1.2	-1.5	-1.4	-4.4
Return on assets	-1.5	-1.5	-1.5	-1.6	-1.6	-7.7
Regulatory depreciation	-0.02	-0.1	-0.1	-0.2	-0.3	-0.8
Financial viability adjustment	-1.0	-1.0	-1.0	-1.0	-1.0	-5.0
Total adjustments	**-2.8**	**-2.6**	**-3.9**	**-4.3**	**-4.3**	**-18.0**
Draft decision – revenue requirement	**118.6**	**119.2**	**119.2**	**119.8**	**121.0**	**597.8**

Note: Numbers have been rounded

Operating expenditure

Operating expenditure is an input to the revenue requirement. Coliban Water's price submission provides detail on its forecast operating expenditure from pages 33 to 34, with a cost breakdown shown in table C3 on page 13 of its supplement C.

We assess both:

- controllable costs – those that can be directly or indirectly influenced by a water corporation's decisions
- non-controllable costs – those that cannot be directly or indirectly influenced by a water corporation's decisions.

For controllable operating expenditure, our assessment process first confirms an efficient baseline, based on the last year of actual costs prior to our price review (that is, 2016-17). We then consider the forecast costs relative to this baseline, including the proposed efficiency improvement rate and forecast growth, and any proposed cost changes relative to the baseline. We engaged Deloitte Access Economics to provide expert advice to inform our assessment of controllable operating expenditure. Deloitte's report on its assessment of Coliban Water's expenditure forecast is available on our website.[26]

For non-controllable expenditure (including bulk water and sewerage services, government charges and licence fees) we confirm the proposed forecasts, with reference to the relevant regulatory body where appropriate.

Table 2.3 sets out our draft decision on Coliban Water's forecast operating expenditure, for the purpose of establishing the revenue requirement (Table 2.1). Details of our assessment and reasons for our proposed adjustments to Coliban Water's proposal follow, with a summary of our adjustments shown at Table 2.4.

We consider our proposed operating expenditure in this draft decision better reflects the expenditure that a prudent service provider would incur when acting efficiently to achieve the lowest cost in delivering the outcomes specified in Coliban Water's price submission.

The benchmark operating expenditure that we propose to adopt for Coliban Water does not represent the amount that Coliban Water is required to spend or allocate to particular operational, maintenance and administrative activities. Rather, it represents assumptions about the overall level of operating expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain services over the regulatory period.

[26] Deloitte Access Economics 2018, *Coliban Water – expenditure review for 2018 water price review*, February.

Table 2.3 Draft decision – operating expenditure

$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Controllable costs	**60.1**	**59.9**	**59.1**	**58.8**	**58.9**	**296.7**
Non-controllable costs	**7.6**	**7.5**	**7.4**	**7.3**	**7.2**	**37.0**
Bulk services[a]	2.3	2.3	2.3	2.3	2.3	11.6
Environmental contribution[b]	5.0	4.9	4.8	4.7	4.6	23.9
Licence fees - ESC[c]	0.067	0.067	0.067	0.067	0.100	0.366
Licence fees - DHHS[c]	0.037	0.037	0.037	0.037	0.037	0.186
Licence fees - EPA[c]	0.187	0.187	0.187	0.187	0.187	0.936
Draft decision – operating expenditure	**67.7**	**67.4**	**66.5**	**66.1**	**66.1**	**333.7**

[a] Bulk services covers the supply of bulk water and sewerage services

[b] The Environmental Contribution collects funds from water corporations under the WI Act

[c] License fees are paid to cover costs incurred by Department of Health and Human Services, Environment Protection Authority Victoria, and the Essential Services Commission in their regulatory activities related to the water corporation

Note: Numbers have been rounded

Coliban Water proposed a total forecast controllable operating expenditure of $301.3 million over a five-year regulatory period. For the reasons set out below, we propose to reduce this by $4.6 million to establish a benchmark controllable operating expenditure of $296.7 million.

Baseline controllable operating expenditure:

- Coliban Water has proposed upward adjustments of $0.71 million to its actual 2016-17 baseline year controllable operating expenditure, producing a starting point for forecast annual operating expenditure. The resultant figure of $57.82 million is 9 per cent below the benchmark of $63.397 million allowed for 2016-17 in the previous price determination. Coliban Water advised the upwards adjustments were to account for lower than typical pumping (electricity costs) via the Goldfields Superpipe and contractor payments that were withheld only in 2016-17. Deloitte reviewed the baseline year and recommended no adjustment. We agree with Deloitte's view as we consider this reflects an efficient baseline cost to forecast annual operating expenditure.

Efficiency improvement:

- Coliban Water's proposed efficiency improvement rate on controllable operating costs is 1.5 per cent per year. This is relatively high compared to its past performance (where it met our mandated 1 per cent efficiency rate), however it is at the lower end of those water businesses rating themselves Advanced under the PREMO framework. It is less than Coliban Water's forecast connection growth rate of 1.7 per cent per year, resulting in an increasing annual baseline operating cost.

Proposed cost changes:

- In total, Coliban Water has sought additional operating expenditure of $8.55 million (2.9 per cent) above its growth-adjusted baseline cost. Forecast increases in wages (above inflation) will be managed by Coliban Water within its growth-adjusted baseline and efficiency improvement.
- Coliban Water proposed $5.51 million in additional electricity costs above the baseline due to higher forecast prices. Deloitte compared the forecast electricity costs above the baseline with its latest forecasts for electricity prices, and recommended an indicative reduction of $2.57 million as it did not agree with Coliban Water's forecasted higher electricity prices continuing beyond 2019-20 through to 2022-23.[27] We accept Deloitte's recommendation as we consider it reflects a more accurate forecast of efficient electricity costs during the regulatory period from 2018-23. However we do acknowledge that there is currently uncertainty in forecasting electricity prices and Coliban Water is currently seeking electricity contract tenders with its current contract expiring on 30 June 2018. We request that Coliban Water proposes a revised electricity forecast based on its updated contract prices in response to our draft decision.
- Coliban Water proposed an additional $0.34 million for increased trade waste monitoring. Deloitte considered that Coliban Water did not provide sufficient evidence of the anticipated enhanced environmental outcomes from the additional expenditure, nor the expected results from the new price signals for the relevant customer category. Accordingly, Deloitte recommended a $0.34 million adjustment. We agree with Deloitte's view as Coliban Water has not provided explanations consistent with our guidance.[28]

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[27] Deloitte Access Economics, op. cit., pp.16–20.

[28] Refer to the mid period tariff changes section for our draft decision on Coliban Water's proposed introduction of an intermediate trade waste category between the existing minor and major categories.

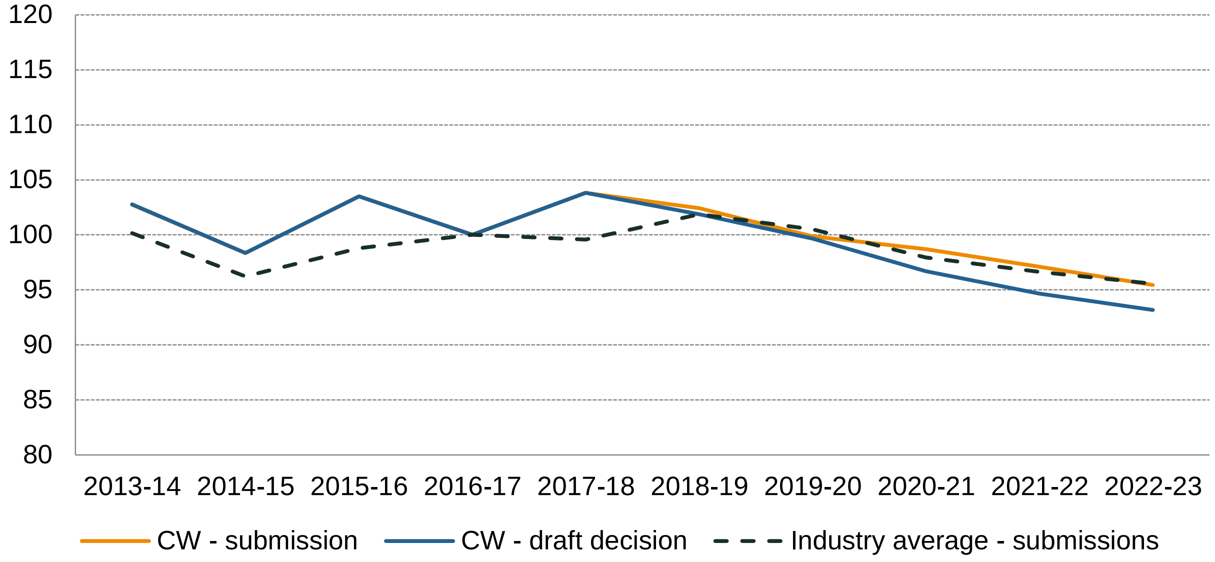
- Coliban Water proposed $0.68 million for improved services for developers, data connections at its water treatment plants and desludging of customer septic tanks. Deloitte initially considered Coliban Water's evidence of customer support for the developer services and desludging, and recommended no adjustments. Coliban Water explained that the data connectivity at its plants would improve its water quality outcomes. Deloitte subsequently agreed that there was a need for Coliban Water to increase its expenditure given its recent series of notifications to the Department of Health and Human Services for known or suspected water contamination. We accept Deloitte's final view as we consider the additional expenditure has been justified consistent with our guidance.
- Coliban Water proposed additional costs of $0.54 million arising from capital expenditure projects that could not be accommodated within existing budgets. Deloitte considered that Coliban Water did not provide sufficient justification for why the costs were above the growth-adjusted baseline or the expected improved outcomes for customers. Accordingly, Deloitte recommended an adjustment of $0.54 million. We agree with Deloitte's recommendation as the expenditure did not reflect prudent expenditure.
- Coliban Water proposed $0.43 million for support to customers in financial hardship. Coliban Water provided further information to Deloitte explaining the additional expenditure was for debt waivers and payment matching for customers. We do not consider this type of direct financial assistance for customers to cover the non-payment of bills to be actual operating costs incurred by Coliban Water – rather, it represents revenue not collected. We have removed the $0.43 million of proposed additional costs from controllable operating expenditure and transferred this amount to revenue not collected in the financial model.
- Coliban Water proposed an additional $1.06 million above the baseline across six different cost items. Deloitte received insufficient supporting information on a number of these activities to justify their costs as being additional to the growth adjusted baseline. As a result, Deloitte recommended an adjustment of $0.50 million. We consider this recommendation is consistent with the requirements of our guidance for costs above the baseline to be justified.
- We also note that Coliban Water's forecast for controllable operating expenditure included costs to fund the discount to some sewerage access fees. As discussed in the tariff changes section, we propose not to accept this cross-subsidy and have removed $0.24 million from controllable operating expenditure, as well as the equivalent subsidy revenue from the tariff schedule.[29]

We consider applying our proposed adjustment of $4.63 million to Coliban Water's total proposed controllable operating expenditure forecast better meets the requirements of the WIRO and the

[29] Refer to the tariff structure section from page 29 for our analysis of Coliban Water's proposed 20 per cent reduction in the annual wastewater access fee for Elmore.

criteria for prudent and efficient expenditure outlined in our guidance.[30] This will bring about a greater decrease (in real terms) in controllable operating expenditure per connection, slightly more than the industry average, as shown in Figure 2.1.

Figure 2.1 Controllable operating expenditure per water connection
Index: 2016-17=100



Submission – based on actual historical and forecast values provided by the water corporation in its price submission. Draft decision – includes any corrections or adjustments to historical and forecast values arising from our assessment. Industry average – drawn from the price submissions for all urban water corporations (excludes rural expenditure).

For non-controllable operating expenditure, we have adjusted Coliban Water's forecasts where required based on the latest information received from the relevant regulatory authorities on their licence fees and the environmental contribution. The values we have adopted for our draft decision are set out in Table 2.3 above.

For the environment contribution, we have used the 2018-19 value provided by the Department of Environment, Land, Water and Planning and assumed that this will remain flat in nominal terms (decline in real terms) across the 2018–23 regulatory period.

We have assumed the licence fees for the Department of Health and Human Services, the Environment Protection Authority Victoria and the Essential Services Commission remain flat in

[30] Essential Services Commission 2016, *Guidance paper,* op. cit., p. 31.

real terms across the period, but with a 50 per cent increase for our commission fee in 2022-23 to align with our regulatory review cycle.[31]

We have verified Coliban Water's forecast external bulk water charges against the current price determination for Goulburn-Murray Water and GWMWater's price submission.

We have increased Coliban Water's forecast non-controllable operating expenditure by $0.19 million across the 2018–23 period, resulting from our adjustments to:

- increase the Environment Protection Authority licence fee by an average of $0.03 million per year (a total increase of $0.14 million)
- set our commission licence fee at $0.07 million per year and at $0.10 million in 2022-23 (a total increase of $0.04 million).

Overall, non-controllable operating expenditure will increase by $2.00 million from 2017-18 to 2018-19, due primarily to the increase in the environment contribution from $3.27 million to $5.00 million and the increase in external bulk charges from $1.99 million to $2.33 million.

Prior to making our final decision, we will adjust Coliban Water's forecast non-controllable operating expenditure for the latest inflation and external bulk charges data, including any concurrent changes we make to GWMWater's bulk charges in our final decision and price determination.

Table 2.4 sets out our proposed adjustments to both controllable and non-controllable operating expenditure.

[31] The Department of Health and Human Services and the EPA Victoria provided their latest 2016-17 licence fees for making our draft decision. We have also based our forecast on our 2016-17 commission licence fee.

Table 2.4 Adjustments to operating expenditure
$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Proposed total operating expenditure	**68.0**	**67.4**	**67.6**	**67.6**	**67.5**	**338.2**
Removal of sewerage cross-subsidy	-0.05	-0.05	-0.05	-0.05	-0.05	-0.2
Electricity	0.0	0.0	-0.9	-0.8	-0.9	-2.6
Trade waste monitoring	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
Hardship	-0.03	-0.1	-0.1	-0.1	-0.1	-0.4
Consequential opex from capex	-0.01	-0.1	-0.1	-0.1	-0.2	-0.5
Other adjustments	-0.2	0.1	-0.01	-0.3	-0.1	-0.5
Total adjustments to controllable costs	**-0.3**	**-0.1**	**-1.2**	**-1.5**	**-1.4**	**-4.6**
- Licence fees	0.009	0.048	0.047	0.026	0.056	0.187
Total adjustments to non-controllable costs	**0.009**	**0.048**	**0.047**	**0.026**	**0.056**	**0.187**
Draft decision – total operating expenditure	**67.7**	**67.4**	**66.5**	**66.1**	**66.1**	**333.7**

Note: Numbers have been rounded

Regulatory asset base

The regulatory asset base is used to estimate the return on assets and regulatory depreciation in the revenue requirement. Our guidance required Coliban Water to propose its:

- closing regulatory asset base at 30 June 2017
- forecast regulatory asset base for each year of the regulatory period from 1 July 2018.

Closing regulatory asset base

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period to 30 June 2017. This helps to ensure prices reflect the actual net expenditure of a water corporation.[32]

Table 2.5 sets out our draft decision on Coliban Water's closing regulatory asset base at 1 July 2018.

We compared Coliban Water's actual net capital expenditure for 2012-13 to 2016-17 with the forecast used to approve maximum prices for the period from 1 July 2013.[33] We undertake a prudency and efficiency review where a water corporation's net capital expenditure is more than 10 per cent above the forecast used to approve maximum prices for the period from 1 July 2013. We believe this approach is reasonable given capital expenditure can be 'lumpy' in nature.

In its price submission, Coliban Water assumed $234.70 million in net capital expenditure over the period from 2012-13 to 2016-17. We identified some very minor corrections required, which increased this to $234.71 million. This figure is 5.2 per cent higher than the forecast used to approve maximum prices for the period from 1 July 2013. Coliban Water also calculated its closing regulatory asset base in accordance with the requirements of our guidance. For these reasons, our draft decision accepts Coliban Water's proposed closing regulatory asset base for 30 June 2017 of $481.4 million.

[32] Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflects revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

[33] Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure.

Table 2.5 Closing regulatory asset base
$ million 2017-18

	2012-13	2013-14	2014-15	2015-16	2016-17
Opening RAB 1 July	329.0	358.6	396.2	419.9	466.6
Plus gross capital expenditure	45.9	57.7	47.3	65.4	36.7
Less government contributions	0.0	0.0	0.0	0.0	0.0
Less customer contributions	4.0	3.0	4.1	3.5	3.8
Less proceeds from disposals	1.2	4.7	5.8	0.1	1.8
Less regulatory depreciation	11.2	12.4	13.7	15.1	16.2
Closing RAB 30 June	**358.6**	**396.2**	**419.9**	**466.6**	**481.4**

Note: Numbers have been rounded

Forecast regulatory asset base

The forecast regulatory asset base is calculated having regard to the closing asset base, and forecasts for capital expenditure, government and customer contributions, and asset disposals.

Table 2.6 sets out our draft decision on Coliban Water's proposed forecast regulatory asset base from 1 July 2018.[34] Our assessment of the components of the forecast regulatory asset base is set out below.

[34] Our guidance required water corporations to provide an estimate of the components of its regulatory asset base for 2017-18. This is so we can assess the opening asset base for 1 July 2018. Our guidance noted that where the 2017-18 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2013 price determination, the lower amount must be used (otherwise the 2013 determination forecast applies). The estimates for 2017-18 will be confirmed at the price review following the 2018 water price review.

Table 2.6 Forecast regulatory asset base
$ million 2017-18

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Opening RAB 1 July	481.4	496.3	496.1	494.7	493.6	495.3
Plus gross capital expenditure	38.0	36.4	36.6	37.5	41.5	41.1
Less government contributions	0.0	0.0	0.0	0.0	0.0	0.0
Less customer contributions	4.4	3.6	3.9	3.7	3.8	3.9
Less proceeds from disposals	1.5	1.5	1.5	1.5	1.5	1.5
Less regulatory depreciation	17.2	31.5	32.5	33.5	34.4	35.6
Closing RAB 30 June	**496.3**	**496.1**	**494.7**	**493.6**	**495.3**	**495.4**

Note: Numbers have been rounded

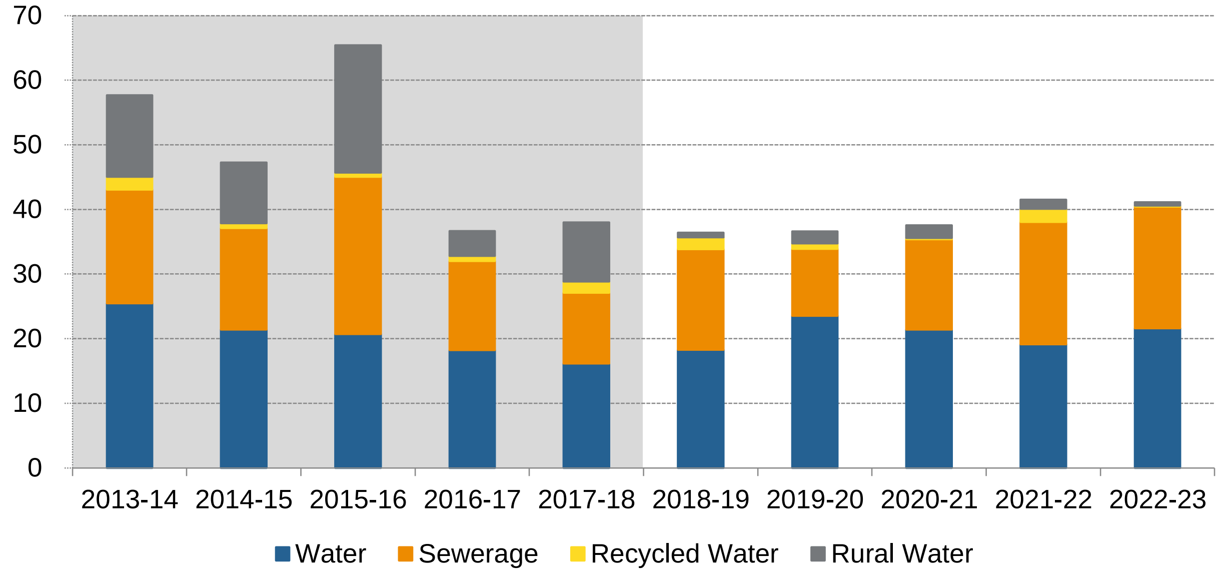
Capital expenditure

Capital expenditure is an input to estimating the regulatory asset base. Coliban Water's forecast capital expenditure and supporting information is provided at pages 34 to 36 of its price submission. This is summarised in Figure 2.2, for the current 2013–18 period, and as proposed by the water corporation for the 2018–23 period.

We engaged Deloitte Access Economics to provide expert advice to inform our assessment of capital expenditure. Deloitte's report on its assessment of Coliban Water's expenditure forecast is available on our website.[35]

[35] Deloitte Access Economics 2018, op. cit.

Figure 2.2 Gross capital expenditure by service category
$ million 2017-18



Note: actuals for 2013-14 to 2016-17 and water corporation forecasts for 2017-18 to 2022-23

Coliban Water proposed a total gross capital expenditure of $197.1 million over the five-year regulatory period. For the reasons set out below, we propose to reduce this by $3.9 million to establish a benchmark gross capital expenditure of $193.2 million:

- Coliban Water's price submission provided forecasts for gross capital expenditure that are 19.6 per cent or $48.03 million lower than the $245.12 million spent in the current regulatory period. We note over the first half of the current 2013–18 regulatory period, Coliban Water delivered its Harcourt rural modernisation project, and rural water capital expenditure for 2018–23 reduces from an average of $10.97 million per year to an average of $1.31 million. Coliban Water's forecast for 2018–23 is equally driven by renewals and growth.
- Deloitte requested selected documents from Coliban Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, these demonstrate that Coliban Water has a reasonable approach for developing project scope, the timing of works and cost estimates.
- Deloitte reviewed information for the water programs, the Western Bendigo region water network augmentation project, the Strathfieldsaye region water network augmentation project, the Bendigo water reclamation plant and the digital customer metering project. We agree with

Deloitte's view that the information provided by Coliban Water supported the prudency and efficiency of the proposed capital expenditure for all but one of these programs.[36]

- For the digital customer metering project, Deloitte considered Coliban Water has not provided sufficient information to demonstrate the prudency of the capital expenditure. Deloitte was concerned that Coliban Water did not demonstrate an appropriate options analysis nor appeared to consider a number of additional costs required to fully realise the theoretical savings from the project. This concern was echoed in two submissions we received regarding Coliban Water's price submission.[37] Rather than the full $5.00 million proposed by Coliban Water, Deloitte recommended an allowance of $1.10 million to cover the first three phases of the proposed roll-out. We agree with Deloitte's view as the full amount has not been justified as prudent and efficient capital expenditure, and we have removed $3.90 million from the forecast.
  - We would expect Coliban Water define the success criteria for the phases of the digital customer metering roll-out before the following phase could proceed. At a minimum, we expect this would include the requirement that expenditure for a full roll-out would deliver a positive net present value for the water corporation. We request Coliban Water develop some measures and customer reporting protocols to communicate the success or otherwise of each phase of this project.
  - Any expenditure incurred by Coliban Water for this project above the $1.1 million allowance may be subject to a prudency and efficiency assessment before it can be included in the regulatory asset base.
  - We also expect Coliban Water to manage customer concerns and expectations with digital metering. We received several submissions that were concerned about the health impacts for some customers due to the electromagnetic fields emitted by digital meters and the related infrastructure, and one noted that customers could not opt-out of Coliban Water's installation.[38]
  - Two submissions did not support the possible introduction of Time of Use (ToU) tariffs alongside the digital meter program. Stop Smart Meters Australia (SSMA) was concerned that ToU tariffs for electricity had a very small take-up by Victorians and considered this scenario would be likely for water services. Janobai Smith raised concerns about Coliban Water's engagement on ToU tariffs, specifically she did not see pricing mentioned in the

[36] Deloitte Access Economics, op. cit., pp.28–35.

[37] Stop Smart Meters Australia Inc. 2018, *Submission*, 12 March; Janobai Smith 2018, *Submission*, 12 March. Both submissions raised concerns about potential cost blow-outs for smart metering, as seen for the Victorian electricity sector and more general IT roll-outs.

[38] Alice Black 2018, *Submission,* 7 March; Christine Crawford 2018, *Submission*, 9 March; Stop Smart Meters Australia Inc. 2018, op. cit.; Janobai Smith 2018, op. cit.; Frederica Lamech 2018, *Submission*, 8 March.

Pricing Submission 2018 Community Draft, but ToU tariffs did appear in the final price submission submitted to the commission. Ms Smith considered the question posed to customers during consultation did not suggest that ToU tariffs were being considered.[39]

- We consider the remaining planned capital expenditure program is achievable, given Coliban Water's past track record delivering its capital expenditure program. Over the current 2013–18 regulatory period, Coliban Water has delivered four of its planned major projects, and while three major projects are delayed, these are expected to be delivered by the end of 2018-19.[40]
- Coliban Water has excluded uncertain projects such as the construction of the Castlemaine Link Interconnector Pipeline, augmentation of the Goldfields Superpipe and any prescribed future groundwater expenditure beyond the current transitional solution for Bendigo from the capital expenditure forecast due to uncertainty in timing, cost, scope or benefits. It did not identify the potential costs associated with these projects, and the prudency of these projects will be further investigated during the period. This approach is consistent with our guidance for managing uncertain expenditure. For our draft decision, we accept Coliban Water's proposal for addressing uncertainty, noting the following:
  - Coliban Water will need to demonstrate the prudency and efficiency of these costs if they are indeed incurred during the 2018–23 period if seeking to include them in the regulatory asset base.
  - Variations in capital expenditure from forecast during the 2018–23 period will form a key part of our assessment of the Performance element of PREMO at the next price review.

Table 2.7 below sets out our proposed adjustments to Coliban Water's forecast to establish our draft decision benchmark for gross capital expenditure, consistent with our guidance and WIRO principles.[41] This benchmark is used to calculate the forecast regulatory asset base (Table 2.6) and the revenue requirement (Table 2.1).

[39] Stop Smart Meters Australia Inc. 2018, op. cit.; Janobai Smith 2018, op. cit.

[40] Essential Services Commission 2018, *Status of major projects supplement: Water performance report 2016-17*, 1 March, p. 15.

[41] Essential Services Commission 2016, *Guidance paper,* op. cit., p. 35.

Table 2.7 Draft decision – gross capital expenditure
$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Proposed gross capital expenditure	**36.8**	**37.2**	**38.5**	**42.5**	**42.1**	**197.1**
Digital metering strategy	-0.4	-0.6	-1.0	-1.0	-1.0	-3.9
Draft decision – gross capital expenditure	**36.4**	**36.6**	**37.5**	**41.5**	**41.1**	**193.2**

Note: Numbers have been rounded

The benchmark that we adopt for Coliban Water does not represent the amount that the water corporation is required to spend or allocate to particular projects. Where we have made an adjustment to exclude a project's capital expenditure from Coliban Water's revenue requirement, we are not requiring the corporation to remove that project. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain or improve services over the regulatory period. Coliban Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

Revenue from customer contributions

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.

Our draft decision proposes not to accept Coliban Water's forecasts for revenue from customer contributions, as we propose not to accept all of Coliban Water's proposed new customer contribution charges (discussed on page 34). We require Coliban Water to update its forecast revenue from customer contributions in response to our draft decision.

Cost of debt

Our guidance required Coliban Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Coliban Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, our draft decision accepts the cost of debt proposed by Coliban Water, as set out in Table 2.8.

Table 2.8 Trailing average cost of debt

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Cost of debt (nominal)	6.9%	7.4%	7.0%	6.3%	5.3%	7.1%	5.4%	5.3%	4.9%	4.9%*

* Estimated cost of debt – we will update the 2017-18 figure before the final decision and price determination.

Note: Numbers have been rounded

From 2016, we accepted a ten-year trailing average approach to estimating the benchmark cost of debt, changing from an on-the-day approach. The trailing average approach better aligns the actual cost of debt for an efficient business to the regulated benchmark, compared with an on-the-day approach.[42] We consider the ten year trailing average approach helps to minimise risk to water corporations and provides better incentives for long-term investment.

Return on equity – PREMO rating

Coliban Water rated its price submission as ‘Advanced’. Based on its PREMO self-rating, Coliban Water proposed a rate of return on equity of 4.9 per cent per annum.

Our draft decision proposes not to accept Coliban Water’s PREMO self-rating and the corresponding return on equity of 4.9 per cent per annum. Our draft decision proposes to adopt a rating of ‘Standard’. Our assessment of Coliban Water’s proposed PREMO rating is set out in Chapter 3.

Our draft decision approves a return on equity of 4.3 per cent. This reflects the return rate allowed in our guidance for a price submission self-rated by a water corporation as ‘Advanced’, and which we have rated in our draft decision as ‘Standard’.[43]

The return on equity is similar to rates we have approved in past reviews for the water industry. We have also had regard to the return on equity allowed or estimated by regulators in other Australian jurisdictions recently for the water industry.[44]

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[42] For more detail on the trailing average and on the day approaches to the cost of debt, see Essential Services Commission 2016, *Water pricing framework*, op. cit., p. 27.

[43] Essential Services Commission 2016, *Guidance paper*, op. cit., p. 45.

[44] Essential Services Commission of South Australia 2016, *SA Water regulatory determination 2016*, *Final determination*, June; Independent Pricing and Regulatory Tribunal 2017, *WACC biannual update*, August.

Regulatory depreciation

Regulatory depreciation is an input to calculating the regulatory asset base. Regulatory depreciation allows a water corporation to recover the cost of investing in assets.

In the past, most water corporations have adopted a straight line depreciation profile. For a particular asset, this means the amount for regulatory depreciation will be the same each year, over the assumed asset life. We noted in our guidance that we prefer straight line depreciation.[45]

Coliban Water estimated its forecast regulatory depreciation based on a straight line method. However, it proposed to shorten its assumptions for asset life (halving from around 32 to 16 years), which contributes to the doubling (approximately) of the amount reflected in its revenue requirement for regulatory depreciation, compared to the five years from 1 July 2013.[46] Its forecast depreciation includes amounts it had deferred in previous periods.

We typically allow a water corporation the flexibility to either defer or bring forward the recovery of regulatory depreciation to better reflect asset utilisation, or to manage prices over the long term. However, as stated in our guidance, we expect the calculation of straight line depreciation will reflect a reasonable assumption about average asset life.[47] Coliban Water has not provided sufficient justification for halving its asset life assumption for the purpose of calculating regulatory depreciation using a straight line approach.

Our draft decision proposes to accept Coliban Water's proposed depreciation amount, given we typically allow flexibility in the calculation of depreciation, and because the proposed allowance includes deferred depreciation from previous periods. However we do not accept its assumptions about asset life as a basis for calculating regulatory depreciation under the straight line method.

Coliban Water must provide more information to justify its approach to regulatory depreciation using the straight line method and assumptions about asset life, or propose and justify an alternative approach that is consistent with our guidance. Our final decision will confirm the regulatory depreciation to be reflected in the forecast regulatory asset base. The regulatory depreciation estimates we have adopted for our draft decision are shown in Table 2.6.

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[45] Essential Services Commission 2016, *Guidance Paper*, op. cit., p. 42.

[46] This is almost half the average asset life assumed in the 2013 determination. For the period from 1 July 2018 to 30 June 2023 Coliban Water proposed a regulatory depreciation forecast of $168.3 million.

[47] Essential Services Commission 2016, *Guidance Paper*, op. cit., p. 43.

Tax allowance

The tax allowance is an input into the revenue requirement. Coliban Water has proposed no allowance for tax in its revenue requirement. Our draft decision is to accept the forecast as it was calculated consistent with the method required by our guidance.[48]

Demand

Along with the revenue requirement, demand forecasts are an input to calculating prices.

Coliban Water's demand forecasts are set out at pages 38 to 46 of its price submission (supplement C), and are also included in its financial model. Our draft decision proposes to accept Coliban Water's demand forecasts for the purpose of approving maximum prices as we consider they were estimated in a manner that is consistent with the requirements of our guidance. This includes basing demand forecasts on the latest *Victoria In Future* population growth forecasts issued by the Victorian Government.

Form of price control

Our guidance noted we would have particular regard to whether a corporation proposes to continue its existing approach, or introduce a new form of price control.[49] Coliban Water proposed a complex hybrid revenue cap form of price control as set out at pages 7 to 10 of its price submission (supplement C). It currently uses a price cap.

We sought further information from Coliban Water on its proposal.[50] We understand that the key elements of Coliban Water's proposed hybrid revenue cap are:[51]

- a revenue cap for the entire five year regulatory period (rather than a revenue cap for each year)
- annual revenue forecasts that are used as a benchmark to estimate the five year revenue cap[52]
- annual customer consultation on the extent of any annual price adjustments to account for over (under) recovery from each year's benchmark revenue forecast

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[48] Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 50-51.

[49] Essential Services Commission 2016, *Guidance paper*, op. cit., p. 53.

[50] We note that there were inconsistences in Coliban Water's explanation of its proposed hybrid revenue cap within its price submission and when compared to the additional information provided to the commission.

[51] Coliban Water's proposed hybrid form of price control included further elements as detailed in its price submission.

[52] Coliban Water proposed that its annual revenue requirement forecasts would not be binding within the period, rather used as a benchmark to estimate compliance with the five year revenue cap.

- Coliban Water will consider customer feedback and decide on the level of annual price adjustments or whether to hold over adjustments until the following regulatory period, with the aim of smoothing prices over the regulatory period[53]
- a 3.5 per cent (nominal) cap on annual price increases if demand (and revenue) is lower than forecast
- to carry-over up to 50 per cent of any revenue variations from forecast by the end of the regulatory period. The 50 per cent adjustment is Coliban Water's estimate of the additional costs of providing water.

Our guidance paper stated that as part of the transition to a trailing average approach to estimating the cost of debt, each water corporation must also propose a price adjustment mechanism (including price control formulas) that allows for prices to adjust on an annual basis to reflect movements in the cost of debt.[54] This ensures prices reflect efficient costs. Coliban Water's proposed hybrid revenue cap formula did not include annual price adjustments to account for movements in the cost of debt. This would mean that price adjustments for cost of debt changes may take place at the end of the regulatory period, which is contrary to our guidance.[55]

As Coliban Water will have flexibility not to adjust prices on an annual basis, we consider its proposed approach could lead to Coliban Water's annual prices not reflecting efficient costs, and may lead to outcomes that are not in customers' best interests.

In addition to proposing a specific price adjustment mechanism to manage demand risk, Coliban Water is also proposing other adjustment mechanisms related to its hybrid revenue cap that impact customers (discussed further on page 34). We are concerned that this leads to a complex form of price control which is difficult for customers to understand and not transparent. We consider this may lead to outcomes that are not in customers' best interests.

We sought information on Coliban Water's reasons for a 50 per cent adjustment offsetting revenue variations from forecast. In response to our request, Coliban Water stated that 50 per cent is indicative of the short run marginal cost of sourcing, treating and transporting water. But Coliban Water also noted that it will need to undertake analysis to support this assumption and the marginal cost could be lower.

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[53] Coliban Water, 2017, *Pricing Submission 2018: Supplement C Financing the Plan*, p. 8.

[54] Essential Services Commission 2016, *Guidance paper*, op. cit., p. 60.

[55] In response to requests for information, Coliban Water provided details on its price adjustment mechanism formula, which was based on one that applies to SA Water. It did not include an annual cost of debt adjustment.

Our draft decision is not to accept Coliban Water's proposed form of price control because:

- Coliban Water could retain any revenue collected above the annual amount included in its hybrid revenue cap until the end of the regulatory period. This could result in prices that don't reflect our assessment of efficient costs.[56]
- Currently, estimates for the cost of debt in the early years of our ten year rolling average calculation for the cost of debt are well above the current estimate for the cost of debt calculated on an 'on-the-day' basis (indicating the ten-year average cost of debt will fall in future years). As stated in our guidance paper, a water corporation must propose an annual adjustment to allow for prices to reflect changes in the cost of debt, as this better aligns prices with efficient costs.[57]
- The proposed hybrid revenue cap is complex and not easy to understand or transparent, which we consider would make it difficult for customers to understand the way in which prices would be calculated.[58]
- Coliban Water has not provided sufficient information in support of its proposal that net revenue should equal 50 per cent of the over (under) recovered revenue. Our guidance paper stated that any proposal for a new form of control must include data and supporting information that describes how it is consistent with providing signals about the efficient cost of delivering services and how it is likely to impact on price stability.[59]
- Coliban Water has not demonstrated that its proposed form of price control better satisfies the requirements of the WIRO than the existing structure. [60]

We consider price stability can be achieved by a simpler and more transparent form of price control. Coliban Water must respond to our draft decision and propose a form of price control which is consistent with our guidance and the WIRO.[61]

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[56] WIRO clause 11(d)(ii).

[57] WIRO clause 11(d)(ii).

[58] WIRO clause 11(d)(i)

[59] Essential Services Commission 2016, *Guidance paper*, op. cit., p. 54.

[60] In considering whether to approve a proposed form of price control, our guidance outlined at p. 53 that we would have particular regard to whether the proposal involves a continuation of an existing structure or the introduction of a new price control. When a change is proposed, businesses will need to provide evidence to demonstrate that the new price control better satisfies the requirements in clause 11 of the WIRO than the existing structure.

[61] We note our determinations will allow water corporations flexibility to apply to change from a price cap to a weighted average price cap or tariff basket within a regulatory period.

Tariff structures

Coliban Water's proposed tariffs are set out at pages 32 and 38 of its price submission (supplement C). Coliban Water proposed an annual decrease in prices of 1 per cent for most customers from 2018-19 to 2022-23. It proposed some changes to minor tariffs.

Our draft decision revenue requirement is 2.9 per cent lower than Coliban Water's proposed revenue requirement. On average this may result in a further reduction in prices from 2018-19 to 2022-23 by approximately the same amount, compared with Coliban Water's original proposal.

Our draft decision does not approve maximum prices for each tariff. Coliban Water must respond to our draft decision with updated prices, which will reflect its response to our draft decision revenue requirement. Our final decision will set out Coliban Water's maximum prices. Our draft decision considers Coliban Water's proposals relating to changes in tariff structures, and any submissions relating to the level of prices or bills.[62]

As outlined in our guidance, we have provided the water corporations with a large degree of discretion to decide on individual tariff structures.[63] This recognises water corporations are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Coliban Water proposed to continue its existing tariff structures, with some exceptions.

Existing tariff structures

Coliban Water proposed to:

- maintain a two-part tariff with a fixed service charge and a variable usage component that depends on water use for residential and non-residential water services
- maintain a fixed service charge only for residential sewerage services. For non-residential sewerage services, it proposed to maintain a two-part tariff
- finalise the harmonisation of prices between the central and northern pricing zones, which began in the third regulatory period, by 2019-20.

We consider the two-part structure proposed by Coliban Water for its water service tariffs will promote efficient use of services. The two-part structure for water tariffs sends customers a signal about costs of their water use, and is an approach that is commonly applied in other states and territories. We also consider two-part tariff structures are easy to understand.

[62] Tariff structure refers to the way in which prices are grouped and the manner of charging, for example, water and sewerage charges, fixed and variable charges.

[63] Essential Services Commission 2016, *Guidance paper*, op. cit., p. 55.

For sewerage tariffs, we consider a fixed charge only for residential customers and a two-part tariff for non-residential tariffs sends customers signals about the efficient costs.[64]

We consider Coliban Water's proposal to continue the simplification of its pricing zones will promote ease of understanding and provides signals about the efficient costs of providing services to customers. It is also supported by customers.

Tariff changes

Coliban Water proposed to:

- abolish the residential recycled water access charge as the charge was higher than the costs of the service provided
- change its irrigation outlet fees tariff from two levels (depending on number of outlets) to a single price per additional outlet
- implement a 'fast track' option for developers seeking faster processing time. The fast track tariff will initially be set at a 50 per cent premium to the standard fees
- introduce two new re-work fees charged on revisions developers make to initial plans or when they require a site re-inspection.

Coliban Water also proposed to provide customers in Elmore with a 20 per cent reduction in their annual wastewater access fee in recognition that the town will receive a lower level of service than other towns.

We consider that:

- removing the residential recycled water access charge will provide signals about the efficient costs of providing services to customers
- simplified outlet fees will promote ease of understanding and is supported by customers
- a fast track option fee is an optional charge for customers seeking faster assessments of applications and is supported by customers
- the two new re-work fees will provide signals to customers on the costs of plan revisions and site re-inspections.

While Coliban Water's proposed 20 per cent discount to Elmore's annual wastewater access fee reflects the town's lower level of service and is supported by customers, its financial model indicates that the discount is funded through a cross subsidy between customer classes. We consider that cross subsidies reduce the signals to customers about the efficient costs of providing a service. We also consider that a reduction in service should result in lower expenditure for that

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[64] Our reasons are outlined in our 2013 draft decisions on price review 2012-13 to 2017-18.

service. For this reason, in our draft decision we have removed the subsidy to Elmore in the tariff schedule and reduced expenditure by the same amount.

Mid-period tariff changes

Coliban Water proposes to apply to the commission during the 2018–23 regulatory period to:

- introduce a new recreational water tariff for council-owned and managed facilities for the purposes of greening open spaces
- restructure trade waste tariffs by introducing an intermediate trade waste category between the existing minor and major categories. Coliban Water proposed to recover an additional $150,000 per annum from intermediate trade waste customers from 2019-20.

We note that Coliban Water has not finalised its proposed recreational water tariff. Coliban Water will consult with customers during the 2018–23 regulatory period to determine the priorities and costs that should apply in developing the proposed tariff.

In principle, we support the change to a more cost reflective trade waste tariff structure that reflects user-pays principles. We note Coliban Water's trade waste customers are supportive of the proposed change. We requested further information from Coliban Water on its proposed additional revenue of $150,000 per annum from 2019-20. Coliban Water noted that it may require less than $150,000 per annum and that it has not finalised its proposed reforms. For this reason, our draft decision proposes not to accept the additional revenue of $150,000 per annum from 2019-20 from new intermediate trade waste customers.

We request Coliban Water provide the following information when applying to implement the new tariffs during the 2018–23 regulatory period:

- how the new tariffs meet our pricing principles and the WIRO requirements
- how it consulted with customers on the proposed new tariffs, and how any customer impacts have been adequately addressed.

Unique services

Coliban Water has confirmed its proposed tariffs for trade waste, recycled water and miscellaneous services are calculated in accordance with the pricing principles referenced in our guidance.

Price and bill levels

Submissions by Grace McCaughey, Susan Mayfair, Gerald Mallon and the Consumer Action Law Centre highlighted the impact price changes may have on some customers, particularly those with low or fixed incomes.[65]

We note Coliban Water proposed an annual decrease in prices of 1 per cent for most customers from 2018-19 to 2022-23. Coliban Water has also committed to expand its support for low income and vulnerable customers by proposing an additional $430,000 in expenditure over the 2018–23 regulatory period relating to financial hardship payments to customers.

Our draft decision on Coliban Water's proposed tariffs takes into account customers' interests, including low income and vulnerable customers, because:

- our decision on the revenue requirement, will ensure tariffs only reflect forecast efficient costs
- our decision to not approve Coliban Water's proposed hybrid revenue cap is based on our concern that it may result in outcomes that don't reflect customers' best interests
- Coliban Water has payment options and assistance for customers experiencing difficulty paying bills.

Coliban Water also proposed a 10 per cent increase in project management fees, to enable the fees to better reflect the costs to provide developer services.[66] While a significant increase, this is supported by customers.

Coliban Water proposed to provide a discount on the infrastructure charge for rural customers if it does not make seasonal allocations of 100 per cent. We note that Coliban Water's proposal to discount infrastructure charges for rural customers ensures customers pay for the water received, and is therefore cost reflective. Our draft decision is to accept this proposal.

Other issues

A submission by the Victorian Environmental Water Holder (VEWH) noted inconsistencies in charging arrangements for environmental water between water corporations.[67] It also noted inconsistent approaches to how water corporations charged for environmental water services (mainly differences in whether corporations treated environmental water services as a prescribed or a non-prescribed service).

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[65] Grace McCaughey 2017, *Submission,* 23 October.; Susan Mayfair 2017, *Submission,* 9 October.; Gerald Mallon 2017, *Submission,* 7 November.; Consumer Action Law Centre 2017, *Initial Feedback: 2018 Water Price Review*, 15 November.

[66] Coliban Water 2017, *Supplement C,* op. cit., p. 38.

[67] Victorian Environment Water Holder 2017, *Submission on water corporation water pricing proposals*, 9 November.

We do not have a role in setting the maximum price for environmental water as the services provided to VEWH are not defined as a prescribed service in the WIRO.[68]

Draft decision

For the reasons set out above, our draft decision proposes to accept Coliban Water's proposal on its existing tariff structures and the new tariffs we have assessed during this price review.

Our draft decision proposes not to accept:

- Coliban Water's cross-subsidy to fund the discount to Elmore's annual wastewater access fee – we consider the lower level of service should result in lower expenditure
- the additional $150,000 per annum from 2019-20 from new intermediate trade waste customers.

Prior to our final decision and price determination, Coliban Water must submit a form of price control that is easy to understand and consistent with our guidance, and updated tariff structures in response to our draft decision on tariffs. It also must submit updated prices to reflect our draft decision on the revenue requirement and our updates to cost of debt and inflation estimates, which we will provide in late April 2018

Adjusting prices

Coliban Water's proposed price adjustment mechanisms are set out at pages 10 to 12 of its price submission (supplement C). It proposed:

- to continue with its existing uncertain and unforeseen events mechanism
- to nominate the Castlemaine Link Interconnector Pipeline and the Goldfield Superpipe projects for specific inclusion into the uncertain and unforeseen events mechanism
- the following price adjustments that Coliban Water states are related to its proposed form of price control or which Coliban Water noted may not pass through annually:
  - price adjustment mechanism specific to the hybrid revenue cap
  - improvements in Coliban Water's credit rating
  - pass-through of costs from changes in taxes and legislative obligations when revenue requirement varies by more than 2.5 per cent
  - pass-through for movements in the trailing average cost of debt.

[68] The commission has never regulated Victorian environmental water charges. The charge was implemented by businesses during 2012-13 to 2017-18 as a ministerial directive.

Our draft decision accepts Coliban Water's proposal to:

- continue the existing uncertain and unforeseen events mechanism. We noted in our guidance that we propose that the mechanism continue in its current form[69]
- nominate the Castlemaine Link Interconnector Pipeline and the Goldfield Superpipe projects for specific inclusion into the uncertain and unforeseen event mechanism. This approach is consistent with our guidance for managing uncertain expenditure.

Our draft decision proposes not to accept adjustments that Coliban Water states are linked to its proposed form of price control, because we are not approving Coliban Water's proposed form of price control and we consider cost adjustments should be undertaken annually as this better aligns prices with efficient costs.

We invite Coliban Water to submit revised price adjustment mechanisms that are consistent with our draft decision and guidance.

New customer contributions

New customer contributions (or developer charges) are levied by water corporations when a new connection is made to its water, sewerage or recycled water networks. New customer contributions can be either standard or negotiated. Standard charges apply to new connections in areas where infrastructure requirements and growth rates are relatively well known, while negotiated charges allow water businesses and developers to negotiate a site-specific arrangement.

Coliban Water's proposed new customer contributions charges are set out at pages 42 to 43 of its price submission and pages 36 to 37 of supplement C to its price submission.[70] Coliban Water proposed its standard recycled water contribution charge should increase annually by inflation. It also proposed changes to its standard water and sewerage charges.

On its standard water and sewerage charges, Coliban Water proposed:

- to split its existing standard water and sewerage customer contribution charges into 'growth' and 'non-growth' categories, and:[71]
  - to maintain the 'growth area' water charge at the same level as the 2017-18 standard water charge but with annual adjustments for inflation

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[69] Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 59-60.

[70] In response to a request for information, Coliban Water provided supporting modelling showing its regard for incremental costs and incremental revenue.

[71] Coliban Water confirmed that its proposed charges are reflective of the NCC principles in response to a request for information from the commission.

– that areas regarded as ‘non-growth’ will be charged at 80 per cent of the ‘growth’ charge, reflecting the lower levels of growth infrastructure required in these areas.

- a pass-through to the standard sewerage contribution charge for the costs associated with Coliban Water undertaking the construction of sewer pump stations.

We propose to accept Coliban Water’s proposed standard recycled water contribution charge and standard water charges.

But we propose not to accept Coliban Water’s proposed sewer pump station pass-through to standard sewerage contribution charges because:

- it would be complex to administer
- it leads to uncertainty about the level of standard sewerage contribution charges, which is contrary to the purpose of a standard charge.

A submission received from the Urban Development Institute of Australia (Victoria) raised concerns about Coliban Water’s proposed treatment of costs associated with the construction of sewer pump stations, and how the costs imposed on developers may be inequitable. To ensure a developer is only required to pay for its fair share, the commission has provided businesses with options for allocating costs associated with construction of assets that provide increased capacity beyond what is required for a single development.[72]

As we are proposing not to accept Coliban Water’s proposed approach for a sewer station pump pass-through, we propose not to accept its proposed standard sewerage charges. Coliban Water must respond to this draft decision with updated standard sewerage contribution charges.

For negotiated new customer contributions, Coliban Water proposes to continue to calculate a charge in accordance with the requirements of our NCC pricing principles.[73]

Financial position

In approving prices, we must have regard to the financial viability of the water industry.[74] We interpret the financial viability requirements under the *Essential Services Commission Act 2001* (Vic) and the Water Industry Regulatory Order (2014) to mean that the prices we approve should

[72] The commission has outlined options for dealing with assets that provide increased capacity at page 12 of Essential Services Commission 2013, *New Customer Contributions: Explanatory Note, December*, and in greater detail at page 185 of Essential Services Commission 2013, *Price Review 2013: Regional Urban Water Businesses — final decision,* June.

[73] Essential Services Commission 2016, *Guidance paper,* op. cit., p. 62.

[74] WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

provide a high level of certainty that each water corporation can generate sufficient cash flow to deliver on service commitments, including financing costs arising from investments to meet service expectations.

We use a financial viability test, which primarily considers a water corporation's performance against four key indicators, to assess whether prices will allow a water corporation to generate sufficient cash flow to meet service commitments.[75]

Coliban Water is seeking an adjustment to its revenue requirement of $1 million each year from 2018-19 to 2022-23 to improve its regulatory gearing.[76] Coliban Water's estimated gearing is around 93 per cent (2017-18 financial year), above the 70 per cent benchmark we use as a guide to inform our financial viability assessments.

We have reviewed estimated outcomes for the four key indicators we use to assess financial viability (Table 2.9). The estimates we have used include the revenue and cost assumptions under our draft decision, not including any adjustment for financial viability.

Under this scenario, we note that:

- Forecast gearing declines each year from 2017-18, and will fall below the 70 per cent benchmark in 2026-27.
- Forecast interest cover is well above the bottom of our benchmark range in 2017-18, and continues to improve.
- Forecast funds from operations / net debt is below the lower bound of our benchmark range in 2017-18, but rises above this by 2023-24.
- Forecast internal financing ratio is well above the benchmark range (averaging near to 100 per cent), indicating the corporation can invest in new assets without increasing gearing.

We consider that the forecast improvements in interest cover (and cash flow) from existing sound levels, and the constant decline in gearing, indicates Coliban Water is in a position to generate cash flow to meet its service commitments, without any financial viability adjustment.

Our draft decision proposes a revenue requirement that will allow Coliban Water sufficient revenue to deliver on all outcomes in its price submission.

Allowing a financial viability adjustment would mean customer prices are higher than they need to be to cover the efficient costs of delivering these outcomes. The proposed financial viability

[75] Essential Services Commission 2016, *Guidance paper,* op. cit., p.64.

[76] Gearing is a measure of financial leverage for a water corporation. For price regulation purposes, it is calculated by dividing the water corporation's net debt by its average regulatory asset base. The target range for gearing, used by the commission in our financial viability assessments, is less than 70 per cent.

adjustment is also at odds with a decision by Coliban Water in the 2013–18 regulatory period to charge lower prices than the maximum allowed in its price determination. This was a business decision and should, presumably, only have been made if the business considered itself in a financially viable position. It would have been inappropriate for Coliban Water to charge lower prices than it was entitled to, only to charge higher prices in the 2018–23 regulatory period.

We have assessed Coliban Water's financial viability without the additional $5 million adjustment that it is seeking. We consider Coliban Water is currently in a stable and improving financial position. Our assessment of Coliban Water's future financial position does not indicate that any financial viability adjustment is warranted. For these reasons, our draft decision proposes not to accept Coliban Water's proposed financial viability adjustment.

Table 2.9 Estimates for key financial indicators

Indictor	Benchmark range	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Interest cover (times)	> 1.5	1.68	1.85	1.98	2.10	2.34	2.42	2.64	2.76	2.85	2.99
Gearing (net debt / regulatory asset base (%)	< 70	93.3	89.7	87.5	85.1	82.5	79.8	77.0	73.8	70.5	67.2
Funds from operations / net debt (%)	> 10	4.8	5.3	6.1	6.9	8.4	8.9	10.4	11.2	11.9	12.9
Internal financing ratio (%)	> 35	91.1	79.1	84.8	87.4	90.8	94.1	102.8	106.3	105.1	109.3

Note: Numbers have been rounded

3. PREMO rating

PREMO is an incentive mechanism that links the return on equity to a water corporation's level of ambition in delivering value to its customers.

For the 2018 price review, a water corporation must rate its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. The rating is based on an assessment against the Risk, Engagement, Management and Outcomes elements of PREMO. A 'Leading' price submission is allowed the highest return on equity, and a 'Basic' the lowest.

The assessment tool included in our guidance directs a water corporation to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control, and tariffs.

In Chapter 2, we noted our draft decision is not to accept Coliban Water's proposed return on equity of 4.9 per cent which was based on its proposed PREMO self-rating. Below, we set out our preliminary assessment of Coliban Water's proposed PREMO rating.

Our review of Coliban Water's PREMO self-rating

Coliban Water's proposed PREMO rating, and our draft decision is summarised below.

Table 3.1 PREMO Rating

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
Coliban Water's rating	**Advanced**	Advanced	Advanced	Advanced	Advanced
Commission's rating	**Standard**	Basic	Advanced	Advanced	Advanced

Our draft decision proposes not to accept Coliban Water's overall PREMO self-rating of 'Advanced'. We propose to rate Coliban Water's price submission as 'Standard'. This is reflected in the lower return on equity (4.3 per cent) we propose to approve for Coliban Water at page 25.

We consider Coliban Water has produced a good underlying price submission, built on strong customer engagement and robust cost management. It has proposed to deliver improved outcomes for its customers, particularly in areas identified by customers as a service priority, with a proposed price fall of 1 per cent per year from 2018-19.

However, Coliban Water's proposed prices include an additional $5 million to improve its financial viability (specifically, Coliban was concerned about its gearing ratio – see page 36), comprising an additional $1 million each year above the calculated revenue requirement.[77]

This proposed financial viability adjustment is at odds with a decision by Coliban Water in the 2013–18 regulatory period to collect less revenue from customers by charging lower prices than the maximum allowed in its price determination. This was a business decision and should, presumably, only have been made if the business considered itself in a financially viable position. It would have been inappropriate for Coliban Water to charge lower prices than it was entitled, only to charge higher prices in the 2018–23 regulatory period.

We have assessed Coliban Water's financial viability without the additional $5 million adjustment that it is seeking. We consider Coliban Water is currently in a stable and improving financial position. Our assessment of Coliban Water's future financial position does not indicate that any financial viability adjustment is warranted (as discussed at pages 36 to 38).

In addition to its proposed financial viability adjustment, Coliban Water has adopted a relatively aggressive approach to regulatory depreciation (page 26). This has the effect of raising customer prices in the 2018–23 regulatory period), and lowering prices at some later time. This draft decision seeks more information from Coliban Water to justify its proposed approach to depreciation.

Coliban Water has also proposed a form of price control that we consider is unnecessarily complex (page 27). Although Coliban Water proposes to seek customer views each year about whether (and if so, when) to return any amounts it collects above its revenue forecasts, we consider customers will find it difficult to understand and engage with the overly elaborate mechanism proposed by Coliban Water.

While Coliban Water has proposed this form of price control on the basis that it will provide for price stability, there are other simpler mechanisms that can be used to achieve stable prices.

The net effect of the revenue adjustment and pricing mechanisms proposed by Coliban Water is that its customers would be charged prices above a level that reflects an efficient cost of providing services. Coliban Water appears to argue that customers should pay more now, to reduce potential pricing volatility for future customers and to enhance its financial position. Coliban Water justified this by citing feedback from customers indicating their preference for price stability.

No other water business has proposed this approach. Indeed, some water businesses have sought revenues below their forecast expenditures as part of their commitment to maximising efficiency in

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[77] Coliban Water has previously sought and received financial viability adjustments, including a mid-period reopening of its price determination in 2010 to raise prices, and additional revenue in our 2013 price review.

their delivery of services to customers. These businesses have taken this risk upon themselves, recognising that if they fail to meet their commitments, the business, rather than its customers, will incur the financial consequences.

Overall, we consider Coliban Water's approach reflects an unjustified and significant transfer of risk between itself and its customers, and between present and future customers. This leads to prices above those that would be justified by the WIRO's focus on matters related to efficiency, including that prices should reflect the efficient cost of delivering services.

Accordingly, our draft decision proposes to approve a rating of 'Basic' for the Risk element of PREMO.

We acknowledge, however, that the PREMO framework did not specifically address businesses transferring risk between different generations of customers, particularly when that transfer occurs against the backdrop of improving financial performance.[78] Coliban Water may therefore respond to this draft decision with additional information regarding its proposed approach to risk management and its original self-rating of 'Advanced' for Risk. This will also need to address how the corporation considered the impact of its proposed price path on prices in future regulatory periods.

While we are concerned about its approach to Risk, in other areas of its proposal Coliban Water has demonstrated a strong commitment to delivering better outcomes for its customers. This is evidenced by:

- Improved services in areas such as the taste and odour of water, and providing more timely notifications to customers of service disruptions. Coliban Water has also proposed a strong alignment between customer priorities and the focus of its expanded guaranteed service level (GSL) scheme that was heavily influenced by feedback from its engagement. The GSLs will provide greater accountability to deliver outcomes most valued by customers.
- The influence Coliban Water's engagement had on its proposals. As well as influencing its approach to GSLs, Coliban Water considered customer views on matters such as whether to proceed with capital works (including sewerage projects in Elmore and Lockington), how it provides information to customers on service interruptions and bills, and tariffs.
- Its forecasts for operating expenditure, which incorporate expectations for efficiency improvements above the average of other regional urban water corporations (measured on the basis of controllable costs per connection). It has also proposed price declines. Along with improved service outcomes, this indicates Coliban Water is delivering better value to customers.

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[78] We did not see this as necessary given the WIRO principle mentioned above.

These factors support Coliban Water's self-ratings for the Management and Outcomes elements of PREMO.

Generally, we found Coliban Water's customer engagement to be 'Advanced'. Coliban Water's price submission demonstrated its engagement was inclusive and well planned. Coliban Water used a range of approaches that were well suited to the content of its engagement, including interviews, surveys and customer forums. It engaged broadly with its customer groups (including residential, trade waste and rural customers), tailoring its content accordingly. It also allowed time to re-test its proposals with customers before finalising its submission.

However in discussions on pricing, we consider that the supporting information given to customers did not accurately reflect Coliban Water's financial position or a realistic price path for customers. In our view this is inconsistent with the principle in our guidance of providing appropriate information to customers. Whilst we are concerned about this approach in its discussions on pricing, we note other engagement materials were generally good, and other aspects of its engagement program were strong. Overall, we considered the engagement program was sufficiently robust that we accepted it's self-rating of 'Advanced'.

4. We invite feedback on our draft decision

We invite feedback from stakeholders on our draft decision before we make a final decision and price determination. Our final decision and price determination will be made in June 2018.

Stakeholders may comment on any aspect of our draft decision, including the information we have relied upon in our assessment (such as Coliban Water's price submission). Feedback may also cover:

- additional matters or issues we should consider before making our final decision
- whether our draft decision on Coliban Water's price submission has adequate regard to the matters in clause 11 of the WIRO and our guidance.

How to provide feedback:

Attend a public forum

We will hold a public forum in April or May 2018. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. We will publish details of public forums at www.esc.vic.gov.au/waterpricereview.

Provide written comments or submissions

Written comments or submissions in response to this draft decision will be due in early May 2018.

We require submissions by this date so we have time to fully consider submissions for our final decision. Comments or submissions received after this date may not be afforded the same weight as submissions received by the due date.

We would prefer to receive comments and submissions via our website at www.esc.vic.gov.au/waterpricereview.

Alternatively, you may send comments and submissions by mail to:

2018 Water Price Review
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

We usually make all comments and submissions publicly available in the interests of transparency. If you wish part or all of your submission to be private, please discuss with commission staff.

If you cannot access documents related to our price review, please contact us to make alternative arrangements (phone (03) 9032 1300).

Next steps

Indicative dates are provided below. To keep up-to-date, visit our website at www.esc.vic.gov.au/waterpricereview.

- April or May 2018 – public forum.
- 8 May 2018 – closing date for submissions on our draft decision.
- June 2018 – release date for final decision and price determination.

APPENDIX A – submissions received

Name or organisation	Date received
Stop Smart Meters Australia Inc.	12 March 2018
Mr J Smith	12 March 2018
Ms C Crawford	9 March 2018
Dr F Lamech	8 March 2018
Ms A Black	7 March 2018
Environment Protection Authority Victoria	12 December 2017
Urban Development Institute of Australia	27 November 2017
Consumer Action Law Centre	15 November 2017
Victorian Environmental Water Holder	9 November 2017
Mr G Mallon	7 November 2017
Mrs G McCaughey	23 October 2017
Mrs S Mayfair	9 October 2017