

Goulburn Valley Water final decision

2018 Water Price Review

19 June 2018

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Contents

Summary	iv
1. Our role and approach to water pricing	1
2. Our assessment of Goulburn Valley Water's price submission	5
Regulatory period	5
Customer engagement	6
Outcomes	7
Service Standards	7
Guaranteed service levels	8
Revenue requirement	9
Operating expenditure	11
Regulatory asset base	15
Closing regulatory asset base	16
Forecast regulatory asset base	16
Capital expenditure	17
Customer contributions	19
Cost of debt	19
Return on equity – PREMO rating	20
Regulatory depreciation	21
Tax allowance	22
Demand	22
Form of price control	22
Tariff structures and prices	23
Adjusting prices	25
New customer contributions	25
Financial position	27
3. PREMO rating	29
Our review of Goulburn Valley Water's PREMO rating	29
Appendix A – submissions received on draft decision	32
Appendix B – approved service standards	33
Appendix C – approved GSL schemes	34
Appendix D – rate of return	36

Summary

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

In March 2017, we released our draft decision on Goulburn Valley Water's price submission.¹ The draft decision set out our preliminary views on Goulburn Valley Water's proposals, and invited interested parties to make further submissions. We also held a public meeting in April 2018. In addition to a response from Goulburn Valley Water, we received two written submissions on our draft decision, which are available on our website. A list of these submissions is included in Appendix A to this final decision.

After considering feedback, we have made a price determination for Goulburn Valley Water.² The price determination sets out the maximum prices Goulburn Valley Water may charge for prescribed services (or the manner in which its prices are to be calculated, determined, or otherwise regulated) for the five year period from 1 July 2018 (2018-23). This final decision paper sets out our supporting reasons and analysis for the price determination.

Where our final decision on a particular aspect is unchanged from our draft decision, we have not detailed the supporting reasons in our final decision. Rather, we have noted that our final decision accepts the reasons and position we reached in the draft decision.

Where we have reached a different decision to that proposed in our draft decision, or where new information required our consideration, we have set out our reasons in full in this final decision. This final decision should be read in conjunction with our draft decision.

Our final decision has approved the prices proposed by Goulburn Valley Water

Our final decision approves a revenue requirement of \$373.4 million over the five year period starting 1 July 2018, the same amount as our draft decision.³ We have also approved the prices proposed by Goulburn Valley Water. A summary of approved maximum prices for major services is

¹ Clause 16 of the Water Industry Regulatory Order 2014 requires us to issue a draft decision. Goulburn Valley Water's price submission and our draft decision are available at www.esc.vic.gov.au/waterpricereview.

² Before the commencement of a regulatory period, clause 10 of the Water Industry Regulatory Order 2014 requires us to make a price determination which determines the maximum prices a water corporation may charge, or the manner in which its prices are to be calculated, determined or otherwise regulated during the regulatory period. See Essential Services Commission 2018, *Goulburn Valley Water Determination: 1 July 2018 – 30 June 2023*, June.

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 the 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.

set out from page 23. The estimated typical bill for residential customers under Goulburn Valley Water’s proposal and our final decision are provided in Table A. The estimated typical water and sewerage bill for a residential owner occupier will fall by around \$19 in 2018-19 and by a further \$71 in the following four years – a fall of around \$90 over five years (in constant price \$2018-19 terms). The estimated typical bill for a residential tenant will fall by around \$7 in 2018-19 and by a further \$23 in the following four years (a fall of around \$30 over five years).

Table A **Estimated typical water and sewerage bills**
\$ 2018-19

Customer group	Average consumption (kL p.a.)	2017-18 annual bill	2018-19 annual bill	2022-23 annual bill
Residential (Owner occupier)	260	\$938	\$919	\$848
Residential (Tenant)	260	\$312	\$305	\$282

Note: Numbers have been rounded

Goulburn Valley Water will improve services

Our final decision approves prices that will allow Goulburn Valley Water to deliver on its customer service commitments, government policy, and obligations monitored by the Environment Protection Authority Victoria and the Department of Health and Human Services.

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

- reducing prices for all customer groups
- improving services by introducing new ways for customers to receive and provide information
- increasing access to drinking water including in some non-potable towns
- trialling changes to fixed and variable tariffs for customers seeking greater control of their bills.

Tariff structures are the same

Our final decision approves Goulburn Valley Water’s proposed tariff structures, which reflect a continuation of its current approach. For water services, we have approved Goulburn Valley Water’s proposal for a fixed service charge and a variable component that depends on water used. For residential sewerage services, we have approved Goulburn Valley Water’s proposal for a fixed charge only. For non-residential sewerage services, we have approved a fixed service charge and a variable usage component.

Our final decision also approves Goulburn Valley Water’s proposed price cap form of price control. This means its maximum prices are fixed subject to updates for inflation, and any other price

adjustments we approve in our price determination. Goulburn Valley Water currently uses a price cap. For more detail on tariffs and the form of price control, see pages 22 to 24.

Goulburn Valley Water’s price submission is rated as ‘Leading’ under PREMO

Our final decision rates Goulburn Valley Water’s price submission as ‘Leading’, consistent with our draft decision. Goulburn Valley Water’s proposals reflect a significant improvement in the value delivered to customers. It will improve customer services, at the same time reducing prices from 1 July 2018 by two per cent in each of the following five years. Out of all the water corporations included in our 2018 price review, Goulburn Valley Water has the largest price decline.

The price reductions reflect Goulburn Valley Water’s high efficiency improvement rate in relation to controllable operating expenditure and its proposed efficiency dividend to return savings to customers. These outcomes support its overall self-rating as ‘Leading’.

Figures A and B summarise our final decision on PREMO. More detail on our assessment of Goulburn Valley Water’s PREMO rating is provided in Chapter 3. Goulburn Valley Water is the only business for which we have approved a ‘Leading’ PREMO price submission rating.

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

Figure A **PREMO Rating**

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
Goulburn Valley Water’s rating	Leading	Leading	Leading	Leading	Leading
Commission’s rating	Leading	Leading	Leading	Leading	Leading

Figure B Final decision on PREMO – overall rating

Leading	Advanced	Standard	Basic	Not rated
Goulburn Valley Water	Barwon Water Central Highlands Water	East Gippsland Water Gippsland Water	Wannon Water	South Gippsland Water Western Water *
	City West Water Coliban Water GWMWater	Lower Murray Water (urban) Westernport Water		
	North East Water South East Water Southern Rural Water Yarra Valley Water			

* We have not assessed Western Water under PREMO, as prior to lodging its price submission it notified us of its intention to target a short-term pricing outcome rather than the overall value for money outcome expected under PREMO. Western Water adopted this approach to provide time for it to undertake a review to inform longer-term prices.

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.⁴ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.⁵

Our task is to assess price submissions by water corporations against the legal framework that governs our role, and make a price determination that takes effect from 1 July 2018. We make a price determination after issuing a draft decision, and considering feedback from interested parties.

The price determination specifies the maximum prices a water corporation 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 sets out the supporting 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 making a price determination, 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

⁴ 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.

⁵ The prescribed services are listed at clause 7(b) of the WIRO.

- the matters specified in our guidance⁶
- 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.

Our consideration of legal requirements 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 we have done so for our price determination for Goulburn Valley Water.⁷

In 2016, we issued guidance to Goulburn Valley Water to inform its price submission. The guidance set out how we will assess Goulburn Valley 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 Goulburn Valley Water's proposed prices.⁸

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.⁹

The power for water corporations to impose fees is set out in the *Water Act 1989 (Vic)* (Water Act). Provisions in the Water Act also govern the manner in which water corporations may impose fees, and it is for each water corporation to ensure that it complies with them.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

⁶ Essential Services Commission 2016, *2018 Water Price Review: Guidance paper*, November.

⁷ Essential Services Commission 2018, *Goulburn Valley Water final decision, 2018 Water Price Review – commission's consideration of legal requirements*, 29 May. This is available at www.esc.vic.gov.au/waterpricereview.

⁸ This is a requirement of the WIRO, clause 14(b).

⁹ This is provided for under the WIRO, clause 14(b)(i).

¹⁰ See Part 13, Division 5 of the *Water Act 1989 (Vic)*.

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

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 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.

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

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.

The 2018 water price review is the first time we've applied our PREMO incentive mechanism. 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 The PREMO process is described in: Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 44–49.

2. Our assessment of Goulburn Valley Water's price submission

We have made our price determination for Goulburn Valley Water after considering: Goulburn Valley Water's price submission, its responses to our queries and our draft decision, and written submissions from interested parties. A list of submissions responding to our draft decision is provided in Appendix A. We also held a public meeting in April on our draft decision to receive feedback.

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

Goulburn Valley Water's price submission and financial model presented clear and comprehensive information to support its proposals. Goulburn Valley 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 customer engagement on page 6).

Our guidance included a number of matters water corporations must address in their price submissions. Goulburn Valley Water's price submission addressed each of these matters, with our preliminary assessment set out in our draft decision. Our final decision is set out below.

Regulatory period

Our draft decision accepted the five year regulatory period proposed by Goulburn Valley Water (1 July 2018 to 30 June 2023) in its price submission. Our guidance proposed to approve a five year regulatory period, subject to any alternative and justified proposal.¹⁹

In response to our draft decision, Consumer Action Law Centre (CALC) recommended the regulatory period should be the same for all water corporations, unless there are special circumstances.²⁰ In support of this, it noted factors such as greater community attention when all price reviews are undertaken at the same time.

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 Consumer Action Law Centre 2018, *Submission on standard draft decisions: 2018 Water Price Review*, 8 May, p. 10.

Our final decision is to approve the five year regulatory period proposed by Goulburn Valley Water. This is the same period we have approved for all but three water corporations in our current price review.

Customer engagement

Our guidance required Goulburn Valley Water to engage with customers to inform its price submission. The engagement by Goulburn Valley Water:

- took place between September 2016 and May 2017, and incorporated past customer research
- included a range of methods such as community forums, pop-up water cafes at community events, online and paper surveys, and a deliberative forum
- involved customers from all 54 of its towns, and sought feedback from a range of customer groups including plumbers, builders, land developers, and major customers
- covered topics such as prices, on-line services, water quality in non-potable towns, the balance of fixed and variable charges, hydration stations, water efficiency and emission reduction.

More detail on Goulburn Valley Water's engagement is available in its price submission.²¹

Evidence that Goulburn Valley Water's engagement influenced its proposals includes:

- reducing prices in response to feedback that customers prioritise affordability
- improving water quality in response to customer support for better tasting drinking water
- introducing digital services in response to feedback that customers value real time notifications
- trialling new approaches to fixed and variable charges in response to feedback that customers would prefer greater control over their bills.

The influence of Goulburn Valley Water's engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of consumers.²²

CALC suggested we could play a greater role to promote best practice customer engagement and identify areas for improvement.²³ We note that following our price review, we will continue to work with water corporations to promote best practice customer engagement.

²¹ Goulburn Valley Water's price submission is available on our website at www.esc.vic.gov.au. See pages 6 to 9.

²² 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).

²³ Consumer Action Law Centre, *op. cit.*, p. 4.

Outcomes

The outcomes Goulburn Valley Water proposes to deliver over the five year period starting 1 July 2018 are:

- the best prices for customers
- a renewed focus on water quality and supply
- modern and thoughtful customer service
- meaningful environmental and recreational outcomes.

Goulburn Valley Water's proposed measures and targets for reporting against these outcomes are set out on pages 11 to 25 of its price submission. Goulburn Valley Water has committed to reporting to customers annually on its performance against each of these measures. It proposed an annual customer forum as well as circulating performance information online and via mail-outs.

In early 2018-19, we will engage with Goulburn Valley Water to finalise measures and targets and how it will report to customers. Its performance will inform our assessment during future price reviews as part of the Performance element of PREMO assessments.

CALC commented on the need for additional funding for regional water corporations to strengthen existing hardship programs or adopt new practices to assist vulnerable customers.²⁴ CALC cited our 2013 price review where we provided an additional allowance for metropolitan water corporations to expend existing hardship programs or introduce new hardship programs.

We have not adopted CALC's recommendation in our final decision. We note that the additional allowance in our 2013 price review was provided in recognition of the large one-off price increases approved for the metropolitan corporations during the review.²⁵ Further, water corporations already allocate funds to programs aimed to deliver payment options and hardship support required by our customer service codes. Goulburn Valley Water has responded to its customers' views on affordability by reducing prices, establishing an affordability fund and developing alternative payment options for customers experiencing financial hardship.

Service Standards

Goulburn Valley Water has also provided a list of service standards relating to reliability and attending faults that it will include in its customer charter. These service standards and Goulburn Valley Water's targets until 2023 are set out in Appendix B.

²⁴ *ibid.*, p. 3.

²⁵ The increase in prices approved in 2013 for metropolitan Melbourne was around 20 to 25 per cent. We note for most water corporations in our 2018 price review, generally prices are remaining relatively steady, or falling.

CALC has noted a range of ambitions by water corporations when it comes to proposed service standards and that water corporations should be encouraged to 'improve service standards over time'.²⁶

We note that Goulburn Valley Water proposed major improvements in some standards for reliability and attending faults, and reduced service levels for others. We accept there are arguments for maintaining or decreasing service levels over time particularly where engagement identifies customers are satisfied with the existing level of service or do not support increasing expenditure to deliver improved service.

Goulburn Valley Water's proposed standards for reliability and attending faults were informed by its engagement program. This approach aligns with our expectation that water corporations to consider customer preferences when forming these service targets.

Approved service standards relating to reliability and attending faults are set out in Appendix B and form part of the manner in which Goulburn Valley Water's services are regulated.

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. We expect water corporations to include GSLs in its customer charter.

Goulburn Valley Water's proposed GSLs are set out on pages 36 and 37 of its price submission. It has committed to introduce seven new GSLs relating to implementation of its tariff trial, improving water pressure, improving water taste, upgrading supply of non-potable water, notification of interruptions to supply, and installation of water hydration stations.²⁷ In our draft decision we provided an overview of Goulburn Valley Water's proposed GSLs.

In a submission responding to our draft decisions, CALC supported GSL payments increasing over time.²⁸

We note Goulburn Valley Water has also expanded its GSL program, increasing the accountability on the business to deliver on customer service targets. Goulburn Valley Water's approach to its GSL scheme was developed in consultation with customers to reflect the most important aspects

²⁶ Consumer Action Law Centre, op. cit., p. 6.

²⁷ Justification for Goulburn Valley Water's proposed GSLs is set out in its price submission at Appendix 8 – its price submission is available at www.esc.vic.gov.au.

²⁸ Consumer Action Law Centre, op. cit., p. 1.

of service delivery (as identified by customers). For these reasons, our final decision approves Goulburn Valley Water's proposed GSLs.

Goulburn Valley Water's GSLs are set out in Appendix C.

Goulburn Valley Water's commitment to GSL payments should these service levels not be met, forms part of the manner in which Goulburn Valley Water's services are regulated.

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.²⁹ Along with forecast demand, it is an input to calculating prices.

Our draft decision proposed to approve a revenue requirement of \$372.6 million over a five year period starting 1 July 2018, which reflected the demand forecast and prices proposed by Goulburn Valley Water. We note our building block method produced a maximum allowed or 'notional' revenue requirement of \$377.6 million, which was higher than that sought by Goulburn Valley Water.

Goulburn Valley Water advised us of a small increase to its demand forecasts to correct an error in its price submission before we released our draft decision. We inadvertently omitted this correction in our draft decision, and have addressed it in this final decision.

Goulburn Valley Water has committed to hold prices at the levels in its price submission, so the correction to demand increases the forecast revenue requirement slightly to \$373.4 million (Table 2.1). The new revenue requirement is still below our updated notional revenue requirement of \$375.2 million (Table 2.2). Adjustments to the notional revenue requirement from our draft decision are set out in Table 2.3, and described later in this Chapter.

Our final decision approves the revised revenue requirement figure of \$373.4 million over a five year period starting 1 July 2018, consistent with the reasons in our draft decision.

We consider our final decision approves prices that will enable Goulburn Valley Water to remain financially viable (page 26), and enable it to deliver on customer outcomes, government policy, and obligations.

²⁹ 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 Goulburn Valley Water in the regulatory period from 1 July 2018. We had regard to their views in our draft and final decisions.

Table 2.1 Adjustments to draft decision revenue requirement

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Draft decision – revenue requirement	75.8	75.3	74.6	73.8	73.1	372.6
Demand forecast correction	0.0	0.1	0.2	0.3	0.4	0.8
Final decision – revenue requirement	75.8	75.3	74.7	74.1	73.5	373.4

Note: Numbers have been rounded

Table 2.2 Final decision – Revenue requirement

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Operating expenditure	46.4	46.4	46.3	46.2	45.5	230.8
Return on assets	15.4	16.1	16.9	17.4	17.8	83.6
Regulatory depreciation	11.0	11.9	12.9	14.0	13.6	63.4
Non-prescribed revenue offset of revenue requirement	-0.5	-0.5	-0.5	-0.5	-0.5	-2.7
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
Notional revenue requirement	72.3	73.9	75.5	77.1	76.4	375.2
Efficiencies or savings to be found by GVW	3.5	1.4	-0.8	-3.0	-2.9	-1.8
Final decision revenue requirement	75.8	75.3	74.7	74.1	73.5	373.4

Note: Numbers have been rounded

Table 2.3 Adjustments to draft decision notional revenue requirement
\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Draft decision – notional revenue requirement	73.2	74.3	75.8	77.4	76.9	377.6
Operating expenditure	-0.8	-0.4	-0.3	-0.3	-0.5	-2.2
Return on assets	-0.04	-0.04	-0.04	-0.04	-0.04	-0.2
Total adjustments	-0.8	-0.4	-0.3	-0.3	-0.5	-2.4
Final decision – notional revenue requirement	72.3	73.9	75.5	77.1	76.4	375.2

Note: Numbers have been rounded

Operating expenditure

Operating expenditure is an input to the notional revenue requirement. Our draft decision proposed to adopt a \$210.5 million benchmark for Goulburn Valley Water’s forecast controllable operating costs for the 2018-23 period. This was \$9.7 million lower than proposed by Goulburn Valley Water, and we set out our reasoning for this adjustment in our draft decision (pages 10 to 17). In summary, we found:

- Evidence indicating its baseline controllable operating expenditure reflects an efficient benchmark.³⁰
- Goulburn Valley Water proposed an efficiency improvement rate of 3.1 per cent, higher than all other water corporations (at that time). This rate significantly exceeded its forecast customer connection growth rate of 1.3 per cent per year.
- Goulburn Valley Water significantly outperformed the industry average with a proportionally large decrease in controllable operating expenditure per water connection.
- \$5.90 million of proposed additional labour costs, mostly to cover wage increases above inflation resulting from its enterprise agreement, were not considered to be prudent and efficient.
- An additional \$3.79 million to cover costs associated with the asset maintenance program, operating costs from new assets, planning, strategy and environmental consultancies and electricity, was not considered to meet the requirements of our guidance.

³⁰ Controllable costs are those that can be directly or indirectly influenced by a water corporation’s decisions.

Our draft decision also requested an updated forecast for electricity costs based on new contract prices, given the electricity contract was currently under negotiation.

We forecasted \$22.5 million for Goulburn Valley Water's non-controllable operating costs for the 2018-23 period.³¹ We noted in our draft decision that we would update this forecast for our final decision, and also adjust for the latest inflation and external bulk charges data.

Goulburn Valley Water's response to our draft decision accepted the commission's adjustments to its price submission, and provided updated forecasts for controllable operating expenditure based on the latest information for payroll tax and electricity prices:

- The 2018-19 Victorian budget cut the payroll tax from 3.65 per cent to 2.425 per cent for regional corporations from 1 July 2018. As a result, Goulburn Valley Water has advised a reduction of \$1.40 million across the 2018-23 period. This is consistent with our draft decision requirement to be provided with updated forecasts if there is a change in legislation or government policy, and we have reduced the forecast accordingly.
- Goulburn Valley Water initially accepted our draft decision on its electricity costs, but subsequently provided an updated forecast based on the updated VicWater electricity price forecast, as it doesn't have updated contract prices available.³² It has a current electricity contract for its large sites until June 2019 (our draft decision assumed this expired in June 2018).³³ Given the updated VicWater report states that the NEG (medium) scenario is now looking much more likely than the other scenarios, we have used the NEG scenario prices (converted from nominal to 2017-18 real terms) to estimate a revised electricity forecast for Goulburn Valley Water. Accordingly we have produced a revised forecast of \$0.14 million above Goulburn Valley Water's baseline across 2018–23, a decrease of \$0.87 million from our indicative draft decision of \$1.01 million. We consider this better reflects efficient expenditure for our final decision.

CALC's submission to our draft decision supported our approach of adjusting forecast electricity costs and limiting wage increases in operating expenditure above the baseline.³⁴ No other new

³¹ Non-controllable costs are those that cannot be directly or indirectly influenced by a water corporation's decisions.

³² The VicWater Supply Chain Excellence Program 5 Year Electricity Price Forecast May 2018 sets out three scenarios; 'Status Quo', 'National Energy Guarantee' (NEG) and 'Luddite' (broadly corresponding to high, medium and low). The prices in the report are expressed in nominal terms, and must be converted to 2017-18 real terms for use in our financial models.

³³ We requested our expenditure consultant, Deloitte Access Economics, to review the updated electricity price forecasts and compare against the information received for our draft decision. Deloitte recommended an \$0.87 million reduction for our final decision.

³⁴ Consumer Action Law Centre, op. cit.

considerations were presented in submissions received following the draft decision that caused us to change our views on controllable operating expenditure.

For non-controllable operating expenditure, we have revised our draft decision forecasts where required based on the latest March 2018 inflation and external bulk charges information. We have revised our forecast environmental contribution from our draft decision, and made no changes to forecast licence fees or external bulk charges.³⁵

Based on the latest inflation data, we have revised the forecast 2018-19 environmental contribution from \$3.40 million to \$3.41 million, which results in a total increase of \$0.06 million across the 2018–23 period.

Accordingly, we have increased our draft decision forecast for Goulburn Valley Water’s non-controllable operating expenditure by \$0.06 million to \$22.60 million across the 2018–23 period.

Table 2.4 sets out our adjustments from our draft decision for controllable and non-controllable operating expenditure. Table 2.5 sets out the benchmark operating expenditure we have adopted for our final decision.

³⁵ For the environmental 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.

Table 2.4 Adjustments to operating expenditure

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Draft decision – total operating expenditure	47.2	46.8	46.6	46.5	45.9	233.0
Payroll tax reduction	-0.28	-0.28	-0.28	-0.28	-0.29	-1.40
Electricity	-0.54	-0.14	0.00	0.00	-0.19	-0.87
Total adjustments to controllable costs	-0.82	-0.42	-0.28	-0.28	-0.48	-2.27
Environmental contribution	0.013	0.013	0.013	0.012	0.012	0.064
Total adjustments to non-controllable costs	0.013	0.013	0.013	0.012	0.012	0.064
Final decision – total operating expenditure	46.4	46.4	46.3	46.2	45.5	230.8

Note: Numbers have been rounded

We have adopted the benchmark for operating expenditure set out in Table 2.5 for the purpose of making our final decision on Goulburn Valley Water’s notional revenue requirement. We consider our final decision for Goulburn Valley Water’s forecast operating expenditure is consistent with the requirements of the Water Industry Regulatory Order 2014 (WIRO) and the criteria for prudent and efficient expenditure outlined in our guidance.³⁶

³⁶ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 31.

Table 2.5 Final decision – operating expenditure

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Controllable costs	41.8	41.9	41.8	41.7	41.1	208.2
Non-controllable costs	4.6	4.6	4.5	4.5	4.4	22.6
Bulk services ^a	1.1	1.1	1.1	1.1	1.1	5.5
Environmental contribution ^b	3.4	3.3	3.3	3.2	3.1	16.3
Licence fees – ESC ^c	0.042	0.042	0.042	0.042	0.063	0.232
Licence fees – DHHS ^c	0.029	0.030	0.030	0.030	0.030	0.149
Licence fees – EPA ^c	0.086	0.086	0.086	0.086	0.086	0.429
Final decision – total operating expenditure	46.4	46.4	46.3	46.2	45.5	230.8

^a Bulk services covers the supply of bulk water and sewerage services

^b The Environmental Contribution collects funds from water corporations under the *Water Industry Act 1994* (Vic)

^c Licence 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

The benchmark operating expenditure that we have adopted for Goulburn Valley Water does not represent the amount that Goulburn Valley 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 provide services over the regulatory period.

Regulatory asset base

The regulatory asset base is used to estimate the return on assets and regulatory depreciation in the notional revenue requirement. Our guidance required Goulburn Valley 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.

Our assessment

Closing regulatory asset base

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

Our draft decision accepted Goulburn Valley Water's proposed closing regulatory asset base for 30 June 2017 of \$337.9 million, as it was calculated in accordance with the requirements of our guidance. No new considerations were raised in submissions on our draft decision that affected our assessment of the closing regulatory asset base.

For the reasons set out above, our final decision approves a closing regulatory asset base at 30 June 2017 of \$337.9 million. The calculations are provided at Table 2.6.

Table 2.6 Final decision – Closing regulatory asset base
\$ million 2017-18

	2012-13	2013-14	2014-15	2015-16	2016-17
Opening RAB 1 July	271.2	277.8	289.8	307.9	320.2
Plus gross capital expenditure	20.1	24.0	32.0	26.8	34.2
Less government contributions	1.4	0.0	0.6	0.6	1.6
Less customer contributions	1.2	1.7	2.0	1.7	2.1
Less proceeds from disposals	0.6	0.8	1.1	1.0	0.7
Less regulatory depreciation	10.3	9.5	10.2	11.1	12.0
Closing RAB 30 June	277.8	289.8	307.9	320.2	337.9

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.

Our assessment

Table 2.7 sets out our final decision on Goulburn Valley Water’s forecast regulatory asset base from 1 July 2018.³⁷ Since our draft decision we have updated the closing asset base (noted previously). We have not adjusted any other element of the forecast regulatory asset base for our final decision.

Table 2.7 Final decision – Forecast regulatory asset base
\$ million 2017-18

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Opening RAB 1 July	337.9	351.4	367.3	384.9	401.0	409.4
Plus gross capital expenditure	29.0	29.1	32.2	31.3	24.6	27.7
Less government contributions	0.5	0.0	0.0	0.0	0.0	0.0
Less customer contributions	1.4	1.5	1.5	1.5	1.6	1.6
Less proceeds from disposals	0.7	0.7	1.2	0.8	0.8	0.8
Less regulatory depreciation	12.8	11.0	11.9	12.9	14.0	13.6
Closing RAB 30 June	351.4	367.3	384.9	401.0	409.4	421.1

Note: Numbers have been rounded

Capital expenditure

Capital expenditure is an input to estimating the regulatory asset base. In our draft decision (pages 20 to 23), we proposed to accept Goulburn Valley Water’s gross capital expenditure forecast of \$145.0 million for the 2018–23 period. The reasons for this were:

- Goulburn Valley Water’s price submission and business cases provided evidence that its forecasts for capital expenditure are efficient.
- We considered the planned capital expenditure program is achievable, given Goulburn Valley Water’s past track record delivering its capital expenditure program.

³⁷ 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. The estimates for 2017-18 will be confirmed at the price review following the 2018 water price review.

- Goulburn Valley Water has an appropriate approach for managing expenditure associated with uncertain projects.
- We considered Goulburn Valley Water’s approach to forecasting its capital expenditure is consistent with the requirements of our guidance.

Goulburn Valley Water’s response to our draft decision did not provide any new information on our draft decision for gross capital expenditure.

CALC’s submission reminded the commission and corporations that ‘smart energy meters were touted as a game changer...but have so far failed to deliver on this promise’.³⁸ It stated that new technology must deliver tangible benefits for water customers and be backed by a comprehensive business case. Goulburn Valley Water proposed an ‘intelligent metering’ trial for customers in towns with capacity constraints to see if water use patterns could be changed, potentially allowing it to defer or avoid over \$10 million of capital expenditure to augment water supply to those towns. We consider that Goulburn Valley Water’s costs reflected in our draft and final decision are consistent with our guidance and also align with CALC’s view.

In its submission, CALC also recommended the commission sets industry-wide principles to ensure the rollout of smart meters is in the long-term interest of consumers, including support mechanisms for vulnerable customers. However, our regulatory role does not extend to overseeing the design and delivery of capital projects. We agree with CALC that strong customer engagement and collaboration across the industry is important for achieving an efficient outcome for customers, including vulnerable customers. We also agree water corporations should take into account lessons learnt from the energy smart meter rollout, and from other water corporations further advanced with their digital metering programs.

No other new considerations were presented in submissions received following the draft decision that caused us to change our views on gross capital expenditure.

Accordingly, we have adopted the gross capital expenditure benchmark proposed in our draft decision for the purpose of making our final decision on Goulburn Valley Water’s forecast regulatory asset base (Table 2.7) and its notional revenue requirement. We consider this benchmark is consistent with our guidance and WIRO principles.³⁹

The benchmark that we adopt for Goulburn Valley Water does not represent the amount that the water corporation is required to spend or allocate to particular projects. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we

³⁸ Consumer Action Law Centre, *op. cit.*

³⁹ Essential Services Commission 2016, *Guidance Paper*, *op. cit.*, p. 35; WIRO clause 8(b)

consider sufficient to operate the business and to maintain or improve services over the regulatory period. Goulburn Valley Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

In our draft decision, we accepted Goulburn Valley Water's approach for addressing uncertain capital expenditure. We reiterate that Goulburn Valley Water will need to demonstrate the prudence and efficiency of additional costs incurred during the 2018–23 period if seeking to include them in the regulatory asset base.

Customer contributions

Customer contributions are deducted from gross capital expenditure so they are not included in the regulatory asset base.

Our draft decision considered Goulburn Valley Water's forecast revenue from customer contributions was reasonable, having regard to past trends and its growth forecasts. We proposed to accept Goulburn Valley Water's forecast, subject to Goulburn Valley Water responding to our draft decision on its new customer contribution charges (outlined later).

No other new considerations were presented in submissions received following the draft decision which caused us to change our views on revenue from customer contributions.

For the reasons set out above, our final decision confirms our draft decision. The benchmark revenue from customer contributions approved in our final decision is set out at Table 2.7.

Cost of debt

In our draft decision we proposed to approve the cost of debt proposed by Goulburn Valley Water as it used the cost of debt values we specified in our guidance to calculate its revenue requirement. We also noted that we will update the value of the estimated cost of debt for 2017-18 with our calculation of the actual cost, applying the method outlined in our guidance.⁴⁰

CALC recommends that we set the benchmark cost of debt at five per cent or around one per cent lower than the amount allowed in our draft decision (6.05 per cent per annum in nominal terms).⁴¹ CALC submits that government owned water corporations carry less risk than private corporations and as such, the allowed cost of debt and the return on equity should be lowered compared with

⁴⁰ We received data on the actual trailing average cost of debt for 2017-18 from Treasury Corporation Victoria in April 2018 and we updated the 2017-18 estimates for our final decision.

⁴¹ Consumer Action Law Centre, op. cit. p. 8.

the rates allowed in our draft decision. These recommendations are based on a report prepared by CME for CALC.⁴²

A submission by the Water Services Association of Australia (WSAA) addressed CALC’s submission.⁴³ Among other things, WSAA’s submission noted that competitive neutrality principles have been embedded in government policy, including in Victoria via the Financial Accommodation Levy. As a result, water corporations face a cost of debt that reflects the commercial cost of debt.

In keeping with government policy, the approach we take to the cost of debt is to adopt a benchmark rate that applies to all water corporations. The benchmark reflects our estimate of the efficient financing costs for a privately owned business facing a similar degree of economic risk to a regulated water corporation. We consider this is consistent with the requirements of the WIRO.⁴⁴

In our view, adopting the approach recommended by CALC would mean a benchmark efficient water corporation may not have a reasonable opportunity to recover their debt costs.

A more detailed response to the issues raised by CALC is set out at Appendix D.

Our final decision adopts the benchmark cost of debt as set out in Table 2.8.

Table 2.8 Final decision – 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%	4.5%

Note: Numbers have been rounded

Return on equity – PREMO rating

Goulburn Valley Water rated its price submission as ‘Leading’. Based on its PREMO self-rating, Goulburn Valley Water proposed a rate of return on equity of 5.3 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Leading’.⁴⁵

⁴² *ibid.*

⁴³ Water Services Association of Australia 2018, *Submission*, May.

⁴⁴ Including, in particular, the requirements that our decision have regard to: the promotion of efficiency in regulated industries and the financial viability of the regulated water industry (cl 8(b)(ii) WIRO); efficiency in the industry and incentives for long term investment (s 8A(1)(a) ESC Act); and consistency in regulation between States and on a national basis (s 8A(1)(f) ESC Act).

⁴⁵ Essential Services Commission 2016, *Guidance paper*, *op. cit.*, p. 49.

Our draft decision proposed to accept Goulburn Valley Water's proposed return on equity. This reflected our preliminary review of its PREMO self-rating.

CALC recommended a one per cent reduction to each return on equity value in the PREMO matrix.⁴⁶ CALC's recommendation is based on the findings of a report prepared by CME. The main reason CME proposed the reduction is due to comparisons with returns allowed for UK water entities, and that government owned water corporations carry less risk than private corporations.

The most relevant comparisons for the return on equity are other economic regulators in Australia. The rate for the return on equity (and the regulatory rate of return, comprising the cost of debt and the return on equity) approved in our draft decision are similar to rates recently estimated by other Australian-based regulators of the water sector.⁴⁷ We also consider the allowed return on equity should not be adjusted to reflect government ownership, as the exposure of a water corporation to market risk will not be materially affected by government ownership.

A more detailed response to the issues raised by CALC is set out at Appendix D.

We consider our approach to the return on equity is consistent with our requirements under the WIRO, and in particular, that our estimate provides water corporations with an incentive to invest efficiently, and that our approach has regard to the financial viability of 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.⁴⁸

Consistent with our draft decision, our final decision accepts Goulburn Valley Water's proposed return on equity of 5.3 per cent per annum, reflecting our views above, and our final decision on its PREMO rating (see Chapter 3).

Regulatory depreciation

Regulatory depreciation is an input to calculating the regulatory asset base. Our draft decision proposed to accept Goulburn Valley Water's forecast regulatory depreciation, as it was calculated in a manner consistent with the requirements of our guidance.⁴⁹ No other new considerations were presented in submissions received following the draft decision which caused us to change our views on the depreciation.

⁴⁶ Consumer Action Law Centre 2018, *op. cit.*, p. 8.

⁴⁷ Essential Services Commission of South Australia 2016, *SA Water regulatory determination 2016*, Final Determination, June; Independent Pricing and Regulatory Tribunal 2017, *WACC biannual update*, February.

⁴⁸ Essential Services Commission of South Australia, *op. cit.*; Independent Pricing and Regulatory Tribunal 2017, *WACC biannual update*, August.

⁴⁹ Essential Services Commission 2016, *Guidance paper*, *op. cit.*, p. 42.

For the reasons set out above, our final decision accepts Goulburn Valley Water's forecasts for regulatory depreciation, as set out in Table 2.2.

Tax allowance

The tax allowance is an input into the notional revenue requirement. Our draft decision accepted Goulburn Valley Water's forecasts for zero tax payments, as it was calculated consistently with the method required by our guidance.⁵⁰ No other new considerations were presented in submissions received following the draft decision which caused us to change our views on tax.

For the reasons set out above, our final decision adopts Goulburn Valley Water's tax forecasts, as set out in Table 2.2.

Demand

In our draft decision, we proposed to approve Goulburn Valley Water's demand forecasts as we considered they were estimated in a manner consistent with the requirements of our guidance.

After lodging its price submission, Goulburn Valley Water advised us of a correction to their sewerage connection forecasts for vacant land. The correction was inadvertently not included in our draft decision. We have updated the connections forecasts for our final decision to reflect the correction, which we consider has been estimated in a manner consistent with the requirements of our guidance. This is the reason for the slight increase in the revenue requirement approved in our final decision (see pages 9 and 10), compared with our draft decision.

No other new considerations were presented in submissions received following the draft decision which caused us to change our views on the demand.

For these reasons, our final decision adopts Goulburn Valley Water's demand forecasts.

Goulburn Valley Water's price determination includes the benchmark demand forecasts adopted for our final decision.

Form of price control

Our draft decision accepted Goulburn Valley Water's proposal to retain a price cap form of price control. We considered that a price cap provides customers with price certainty, and means a water corporation is managing demand risk on behalf of its customers. We also noted that we consider demand risk is more efficiently managed by a water corporation, rather than customers.

⁵⁰ *ibid.*, pp. 50-51.

No other new considerations were presented in submissions received following the draft decision which caused us to change views on the form of price control.

For the reasons set out above, our final decision confirms our draft decision. Our final decision approves Goulburn Valley Water's proposed price cap form of price control.⁵¹

Tariff structures and prices

Our draft decision accepted Goulburn Valley Water's proposal to maintain its existing tariff structures, comprising:

- For residential and non-residential water services, a two-part tariff with a fixed service charge and a variable usage component that depends on water use.
- For residential and non-residential sewerage services, a fixed service charge only.

Our draft decision considered the two-part structure proposed by Goulburn Valley Water for its residential and non-residential water service tariffs will promote efficient use of services. We considered 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 considered two-part tariff structures are easy to understand. For sewerage tariffs, we considered a fixed charge only for residential customers and a two-part tariff for non-residential customers sends customers signals about the efficient costs.⁵²

Our draft decision also accepted Goulburn Valley Water's proposal for a trial tariff structure from 1 July 2019 for three years, for the townships of Cobram and Kilmore. We noted customers in these towns were supportive of a trial to reduce their water fixed charge and increase the variable component to allow greater control over their bills.

We noted Goulburn Valley Water proposed a two per cent per annum price decrease, and they already have amongst the lowest bills in the state (and nationally). We also note that Goulburn Valley Water is committed to its customer hardship fund and alternative payment options to support customers and provide assistance to those in financial distress.

No other new considerations were presented in submissions received following the draft decision which caused us to change views on Goulburn Valley Water's proposed tariff structures.⁵³

⁵¹ We note our determinations 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.

⁵² Our reasons are outlined in our 2013 draft decisions on price review 2012-13 to 2017-18.

⁵³ On 23 May 2018 (after our consultation period had closed on our draft decision for Goulburn Valley Water), we received a submission from Kingspan Environmental and Urban Water Cycle Solutions under our consultation process for Western Water's draft decision. We have considered the views raised in the submission for our final decision and

In relation to Goulburn Valley Water’s proposed tariffs, we consider it appropriate to maintain the views we expressed in our draft decision. Our final decision approves Goulburn Valley Water’s proposed tariffs.

Our price determination for Goulburn Valley Water sets out the maximum prices it may charge for the five year period from 1 July 2018 (or the manner in which its prices are to be calculated, determined, or otherwise regulated). Approved maximum prices for water and sewerage services applying to most residential and non-residential customers are set out at Tables 2.9 and 2.10.

Table 2.9 Final decision – water prices
\$ 2018-19

	2018-19	2019-20	2020-21	2021-22	2022-23
Residential					
Variable	1.1744	1.1509	1.1279	1.1054	1.0833
Fixed	170.63	167.22	163.87	160.60	157.38
Non-residential					
Variable	1.1744	1.1509	1.1279	1.1054	1.0833
Fixed	170.63	167.22	163.87	160.60	157.38

Note: Numbers have been rounded

price determination for Goulburn Valley Water. Our response to the submission is set out in our final decision paper for Western Water.

Our assessment

Table 2.10 Final decision – sewerage charges
\$ 2018-19

	2018-19	2019-20	2020-21	2021-22	2022-23
Residential					
Fixed	443.15	434.29	425.61	417.09	408.75
Non-residential					
Variable	1.6009	1.5689	1.5375	1.5068	1.4767
Fixed	443.15	434.29	425.61	417.09	408.75

Note: Numbers have been rounded

Adjusting prices

In our draft decision we:

- proposed to approve Goulburn Valley Water’s proposal to continue the existing uncertain and unforeseen events mechanism
- noted that Goulburn Valley Water will work with the commission on price adjustment formulas that allow prices to adjust to changes in the cost of debt.

We proposed to approve its existing uncertain and unforeseen events mechanisms on the basis that it is consistent with efficiency objectives, and reflect a continuation of current arrangements.⁵⁴ No other new considerations were presented in submissions received following the draft decision which caused us to change our views on the uncertain and unforeseen events mechanism. Our final decision approves Goulburn Valley Water’s uncertain and unforeseen events mechanism.

Following our draft decision, we have developed price adjustment formulas that allow Goulburn Valley Water’s prices to adjust for changes in the cost of debt, in a manner consistent with the requirements of our guidance. The adjustment formulas are set out in Goulburn Valley Water’s price determination.

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

⁵⁴ WIRO clauses 8(b)(i)(ii) and (iii).

infrastructure requirements and growth rates are relatively well known, while negotiated charges allow water corporations and developers to negotiate a site-specific arrangement.

Our draft decision proposed not to accept Goulburn Valley Water's proposed one-off small increase to the standard water new customer contribution charge, as the supporting model provided to us included some assumptions that were not in line with the business's price submission (financial template). We proposed to accept the continuation of Goulburn Valley Water's existing standard water new customer contribution charge if Goulburn Valley Water did not respond to our draft decision with an updated model that supported the small increase.

In response to our draft decision, Goulburn Valley Water proposed to continue the standard water new customer contribution charge at its existing level (plus annual adjustments for inflation).

For negotiated new customer contributions, we proposed to approve Goulburn Valley Water's proposed method of calculating a charge in accordance with the requirements of our new customer contribution pricing principles.⁵⁵

No other new considerations were presented in submissions received following the draft decision which caused us to change our views on new customer contributions charges.

Our final decision accepts Goulburn Valley Water's proposal to continue applying its standard water new customer contribution charge at its existing level (plus inflation), as it is calculated in accordance with our new customer contribution pricing principles.

For Goulburn Valley Water's negotiated new customer contribution charges, our final decision maintains our position in our draft decision for the same reasons, and accepts Goulburn Valley Water's method of calculating negotiated contribution charges.

Our price determination for Goulburn Valley Water sets out the approved new customer contribution charges for the five year period from 1 July 2018 (or the manner in which its prices are to be calculated, determined, or otherwise regulated).

Goulburn Valley Water should update and publish any development servicing plans and negotiation protocols to assist developers understand the underlying assumptions of its new customer contribution charges.⁵⁶

⁵⁵ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 62.

⁵⁶ Essential Services Commission 2013, *New Customer Contributions: Explanatory Note*, December, pp. 9-11.

Financial position

In approving prices, we must have regard to the financial viability of the water industry.⁵⁷ We interpret the financial viability requirements under the *Essential Services Commission Act 2001* (Vic) and the WIRO to mean that the prices we approve should provide a 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.

Our guidance set out key indicators of forecast financial performance. We have reviewed forecasts for these key indicators based on our final decision on Goulburn Valley Water's prices. We have assessed that, under our final decision, Goulburn Valley Water will generate sufficient cash flow to deliver on service commitments, including financing costs arising from investments to meet service expectations.

⁵⁷ WIRO clause 8(b)(ii) and ESC Act section 8A(1)(b).

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, each water corporation was required to 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 final decision is to accept Goulburn Valley Water's proposed return on equity of 5.3 per cent, based on our PREMO assessment.

Our review of Goulburn Valley Water's PREMO rating

Goulburn Valley Water's proposed PREMO rating, and our draft and final decision are summarised below (Table 3.1).

Table 3.1 PREMO Rating

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
Goulburn Valley Water's rating	Leading	Leading	Leading	Leading	Leading
Commission's draft decision rating	Leading	Leading	Leading	Leading	Leading
Commission's final decision rating	Leading	Leading	Leading	Leading	Leading

Our final decision rates Goulburn Valley Water's price submission as 'Leading'.

Goulburn Valley Water's proposals reflect a significant improvement in the value delivered to customers. Goulburn Valley Water will improve customer services, at the same time reducing its prices from 1 July 2018 by two per cent per annum over the following five years. Out of all of the

water corporations included in our 2018 price review, Goulburn Valley Water has the largest price decline. This means Goulburn Valley Water will have the lowest residential bills in the state before the end of the five year period.

The price reductions are mainly a result of Goulburn Valley Water's very high efficiency improvement rate in relation to controllable operating expenditure (of around 3.1 per cent per annum, see Figure 3.1), and its proposal to deliver further efficiency savings to customers.

These outcomes put Goulburn Valley Water ahead of the rest of the sector in terms of customer value, supporting its overall self-rating as 'Leading' (in particular, supporting its 'Leading' self-rating for the Management and Outcomes elements of PREMO).

Other factors supporting its PREMO ratings include:

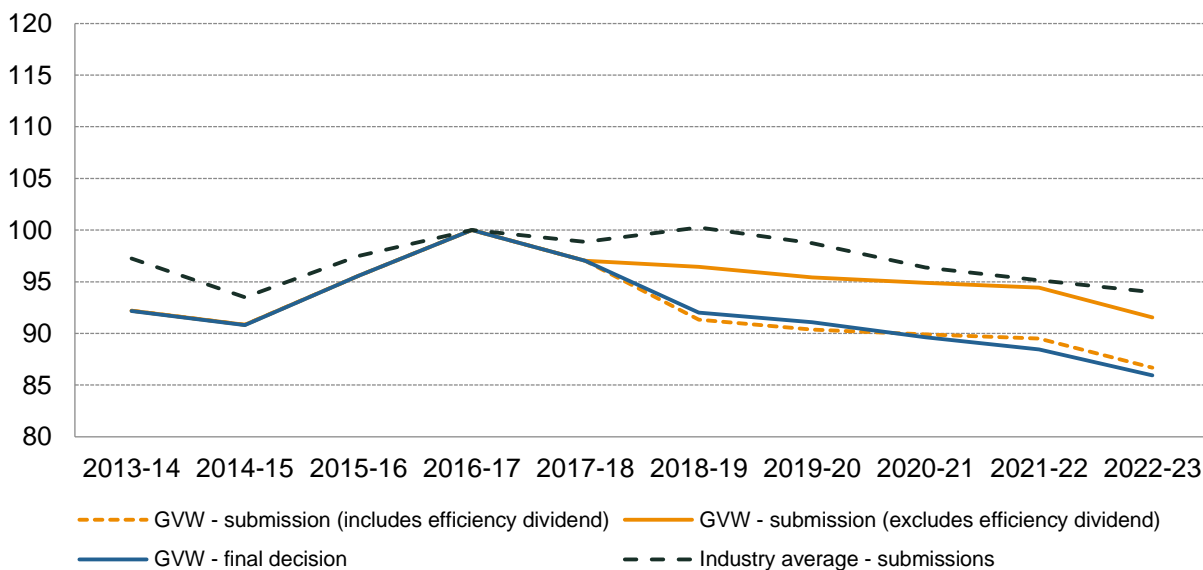
- Goulburn Valley Water's engagement, which was inclusive and tailored to suit its circumstances. Goulburn Valley Water engaged across all 54 towns within its service area, involving one quarter of its staff. It held discussions with customers at water cafes at each town and surveys. It tested engagement results at 'Mini-Public', a deliberative forum whose members were representative of its customer base. In our view the range of methods used were effective in providing customers an opportunity to participate, and well suited to the issues discussed.
- The results of Goulburn Valley Water's engagement had an influence on its proposals. For example, it has initiated a trial tariff (involving a higher variable water tariff) in some towns in response to customer feedback that they would like more control over bills. The results of the trial will be used to inform any future broader rollout of the tariff. (Goulburn Valley Water has proposed to credit the bill of each customer if it fails to initiate the trial by its target date.)
- The influence of engagement is also evident in the corporation's commitments to improve water quality in some towns, and introduce new forms of electronic communication with its customers.
- Goulburn Valley Water's acceptance of greater risk is demonstrated by the introduction of a number of new guaranteed service levels (GSLs). The new GSLs increase the corporation's revenue at risk, providing an incentive and financial consequence should it not deliver on outcomes identified as priority areas by customers. In addition, Goulburn Valley Water's adoption of a P40 cost estimate for major capital projects will result in the corporation bearing greater risk from cost overruns when compared to the P50 approach outlined in our guidance paper.
- Goulburn Valley Water has committed to improving a number of service targets, including in relation to the reliability of supply, and time taken to rectify service interruptions.

Our review of Goulburn Valley Water's proposed PREMO ratings took into account the correction made by the corporation prior to our draft decision to its treatment of non-regulated revenue in our financial model. While the impact of the incorrect entries could have resulted in higher prices, Goulburn Valley Water decided to absorb the revenue shortfall arising from the error.

This, in effect, added to the efficiency targets adopted by Goulburn Valley Water. It also demonstrates the acceptance of risk by Goulburn Valley Water, with the corporation unsure of how it will find the additional efficiencies to offset the impact of the correction.

Our final decision to rate Goulburn Valley Water’s price submission as ‘Leading’ is reflected in the return on equity we have approved at page 20.

Figure 3.1 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.
 Final 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).

Appendix A – submissions received on draft decision

Name or organisation	Date received
Kingspan Environmental and Urban Water Cycle Solutions	23 May 2018
Water Services Association of Australia	22 May 2018
Consumer Action Law Centre	8 May 2018

Appendix B – approved service standards

We have approved the following standards and conditions of service and supply and associated targets for Goulburn Valley Water.

Goulburn Valley Water’s approved service standards

Service Standard	2018-19	2019-20	2020-21	2021-22	2022-23
Water					
Number of customers experiencing more than 5 unplanned water supply interruptions in the year (number)	40	40	40	40	40
Average time taken to attend bursts and leaks (priority 1) (minutes)	30	30	30	30	30
Average time taken to attend bursts and leaks (priority 2) (minutes)	35	35	35	35	35
Average time taken to attend bursts and leaks (priority 3) (minutes)	100	100	100	100	100
Average duration of unplanned water supply interruptions (minutes)	120	120	120	120	120
Average duration of planned water supply interruptions (minutes)	120	120	120	120	120
Sewerage					
Customers receiving more than 3 sewer blockages in the year (number)	40	40	40	40	40
Average time to attend sewer spills and blockages (minutes)	100	100	100	100	100
Average time to rectify a sewer blockage (minutes)	100	100	100	100	100
Spills contained within 5 hours (per cent)	100	100	100	100	100

Note: Numbers have been rounded

Appendix C – approved GSL schemes

We have approved the following service level obligations and corresponding amounts of payment for failure to attain the stated obligation as the guaranteed service level (GSL) scheme for Goulburn Valley Water.

In accordance with clause 13 of our Customer Service Code: Urban Water Businesses, Goulburn Valley Water must ensure that any payment is made to a customer as soon as practical after a customer becomes entitled to the GSL payment.

Goulburn Valley Water is not required to make a payment where the failure to meet the service level is due to the action or inaction of the customer or a third party. For the avoidance of doubt, third party does not include any person or firm acting on behalf of Goulburn Valley Water.

Goulburn Valley Water's approved GSL scheme

Approved service level obligation	Approved payment (\$)
No more than 3 sewage interruptions to a property within a year	50
Containment of a sewage spill in a building within an hour of notification	1000
Water interruption restored within 5 hours of notification	50
No more than 3 sewage interruptions to a property within a year	50
Legal action against, or restriction of water supply to, a residential customer will not be undertaken unless the requirements of the commission's customer service code have been satisfied	300
Tariff-structure trial: A tariff-structure trial will be underway from 1 July 2019. In the event of this deadline not being achieved all residential customers will receive a GSL credit.	5
Tariff-structure trial: A decision will be made by 30 June 2022 as to whether to extend or vary the trial or to adopt a new tariff structure.	5
Water pressure: In the event of water pressure still not being up to standard set out in our customer charter after the implementation of the pressure improvement program, affected customers will receive an annual credit until such time as the pressure is deemed satisfactory.	25
Water taste: Once the program is established, any towns with systemic taste issues will be informed of the timing for improvements. In the event of the timing not being achieved affected customers will receive a credit for each year of delay.	25
Real-time notification of supply events: In the event of an SMS notification not being sent when a prescribed event occurs after 1 July 2019, a credit will be due to all affected customers.	25

Approved service level obligation	Approved payment (\$)
Hydration stations: In the event of a hydration station not being delivered within the indicated timeframe, each customer in that town will receive a GSL credit for each year of delay.	20

Appendix D – rate of return

A submission from the Consumer Action Law Centre (CALC) recommended that we set the benchmark cost of debt at five per cent or around one per cent lower than the amount allowed in our draft decision (6.05 per cent per annum in nominal terms). It also recommended that we reduce each of the equity values in the PREMO matrix by one per cent. CALC submits that government owned water corporations carry less risk than private corporations, and as such, the allowed cost of debt and the return on equity should be lowered, compared with the rates allowed in our draft decision.⁵⁸ These recommendations are based on a report prepared by CME for CALC.⁵⁹

Victoria's water corporations are subject to the competitive neutrality measures the Victorian government agreed to implement as part of the national competition policy agreement and related reforms.⁶⁰ This includes ensuring that borrowing costs reflect an estimate of a water corporation's standalone risk profile and credit rating. We note that:

- Victoria's water corporations do not access debt capital markets directly, but rather, their debt is managed by the state government treasury corporation, through the issuance of government bonds. While the treasury corporation may have access to lower debt funding costs due to government's higher credit rating, the water corporations' borrowing costs do not reflect this. Rather, the water corporations borrow from state treasuries at rates consistent with the risk inherent in the businesses as reflected in their stand-alone credit rating.
- The difference between the government's borrowing costs and the costs faced by water corporations represents consideration for state taxpayers accepting the corporations' credit risk. This is achieved via the Financial Accommodation Levy (FAL), which seeks to ensure the borrowing cost faced by each water corporation reflects the nature of their businesses, not the tax powers of government. If state-owned service providers accessed debt markets directly, then they would face debt financing interest rates that reflected their stand-alone credit ratings.

In keeping with these policy parameters, the approach we take to the cost of debt is to adopt a benchmark rate that applies to all water corporations. The benchmark rate reflects our estimate of the efficient financing costs for a privately owned business facing a similar degree of economic risk

⁵⁸ Consumer Action Law Centre, op. cit.

⁵⁹ *ibid.*, Appendix A.

⁶⁰ We note the Water Services Association of Australia supports application of competitive neutrality principles, see Water Services Association of Australia 2016, *Submission to the Essential Services Commission: A new model for pricing services in Victoria's water sector*, July, p. 11.

to a regulated water corporation. We consider this is consistent with the requirements of the Water Industry Regulatory Order 2014 (WIRO).⁶¹

Adopting the approach recommended by CALC would mean the allowed rate for the cost of debt may be lower than the rate faced by a benchmark efficient water corporation. As well as being inconsistent with government policy that water corporations pay an estimate of a commercial equivalent borrowing rate, it would also be inconsistent with the WIRO's viability and efficiency objectives. Our approach is also similar to that adopted by other Australian economic regulators.

CALC's submission also recommended a one per cent reduction to each return on equity value in the PREMO matrix.⁶² CME proposed the reduction mainly based on comparisons with the return allowed for UK water entities, and its view that government-owned water corporations carry less risk than comparable privately owned businesses.

We believe the most relevant comparisons for the return on equity are other economic regulators in Australia. We note the rate for the return on equity (and the overall regulatory rate of return, comprising the cost of debt and the return on equity) approved in our draft decision are within the range of rates estimated by other Australian-based regulators.⁶³

Also, our current view is that the allowed return on equity should not be adjusted to reflect government ownership. In deriving the values for the return on equity in the PREMO matrix, we had regard to the return on equity we had allowed in the past, and the incentives for water corporations to provide high quality price submissions in the interests of their customers.

CME also argues for a reduction in return on equity to reflect the prevailing revenue cap form of price control. This reflects that a revenue cap provides a water corporation with greater revenue certainty than other forms of price control, such as a price cap. We note however, that only one urban water corporation in Victoria (Yarra Valley Water) has a revenue cap form of price control. As well, a revenue cap does not necessarily change the level of systematic risk faced by a water corporation. For example, it is possible that a water corporation operating under a revenue cap is more exposed to cost risks than corporation operating under a price cap.⁶⁴

⁶¹ Including, in particular, the requirements that our decision have regard to: the promotion of efficiency in regulated industries and the financial viability of the regulated water industry (cl 8(b)(ii) WIRO); efficiency in the industry and incentives for long term investment (s 8A(1)(a) ESC Act); and consistency in regulation between States and on a national basis (s 8A(1)(f) ESC Act).

⁶² Consumer Action Law Centre, *op. cit.*

⁶³ Essential Services Commission of South Australia, *op. cit.*; Independent Pricing and Regulatory Tribunal 2017, August, *op. cit.*

⁶⁴ For example, increases in water demand can lead to increased costs for a water corporation, which would not be matched by an increase in revenue, under a revenue cap. By contrast, under a price cap increases in water demand would also lead to an increase in revenue.

While our final decision has not agreed with CALC’s recommendations, we will re-consider its arguments as part of any future review of the PREMO framework.