

# GWMWater final decision

2018 Water Price Review

19 June 2018

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# Summary

## **In September 2017, GWMWater 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 GWMWater's price submission.<sup>1</sup> The draft decision set out our preliminary views on GWMWater'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 GWMWater, we received four 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 GWMWater.<sup>2</sup> The price determination sets out the maximum prices GWMWater 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 updated the revenue to be collected by GWMWater**

Our final decision approves a revenue requirement of \$317.3 million over the five year period starting 1 July 2018.<sup>3</sup> This is \$0.4 million or 0.1 per cent lower than our draft decision, and mainly reflects our updates to non-controllable costs (see pages 12 to 13).

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<sup>1</sup> Clause 16 of the Water Industry Regulatory Order 2014 requires us to issue a draft decision. GWMWater's price submission and our draft decision are available at [www.esc.vic.gov.au/waterpricereview](http://www.esc.vic.gov.au/waterpricereview).

<sup>2</sup> 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, *GWMWater Determination: 1 July 2018 – 30 June 2023*, June.

<sup>3</sup> 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.

A summary of approved maximum prices for major services delivered by GMMWater is set out on page 26. The estimated typical bills for residential customer groups under our final decision are provided in Table A. In 2018-19 the estimated typical annual bill for a residential owner occupier will fall by around \$30, while remaining steady for a residential tenant (in constant price \$2018-19 terms).

**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)	245	\$1,417	\$1,387	\$1,387
Residential (Tenant)	245	\$439	\$439	\$439

Note: Numbers have been rounded

### **GMMWater will improve services**

Our final decision approves prices that will allow GMMWater 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 GMMWater plans to improve outcomes for customers are by:

- extending digital metering to urban customers
- introducing a town sewer scheme for Goroke
- providing access to drinking water in Kaniva, Moyston, Ultima and Elmhurst.

### **Tariff structures are the same**

Our final decision approves GMMWater’s proposed tariff structures, which reflect a continuation of its current approach. For water services, we have approved GMMWater’s proposal for a fixed service charge and a variable component that depends on water use. For sewerage services, we have approved GMMWater’s proposal for a fixed charge only.

Our final decision also approves GMMWater’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. GMMWater currently uses a revenue cap.

More detail on tariffs and the form of price control is available from page 23.

## GWMWater’s price submission is rated as ‘Advanced’ under PREMO

Our final decision accepts GWMWater’s self-rating of its price submission as ‘Advanced’.

In support of its rating, we note that GWMWater’s engagement started early relative to other corporations and provided customers from all parts of its large service area with an opportunity to participate. It also ran a deliberative customer panel which influenced its proposals.

GWMWater has accepted greater risk through its proposal to change from a revenue cap to a price cap form of price control. It will also introduce a new water quality related guaranteed service level, increasing the revenue risk to the water corporation and increasing accountability for delivering outcomes expected by customers.

Figures A and B summarise our final decision on PREMO. More detail on our assessment of GWMWater’s PREMO rating is provided in Chapter 3. GWMWater is one of nine businesses for which we have approved an ‘Advanced’ 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**

	<b>Overall PREMO rating</b>	<b>Risk</b>	<b>Engagement</b>	<b>Management</b>	<b>Outcomes</b>
GWMWater’s rating	<b>Advanced</b>	Advanced	Leading	Leading	Advanced
Commission’s rating	<b>Advanced</b>	Advanced	Leading	Standard	Advanced

**Figure B Final decision on PREMO – overall rating**

Leading	Advanced	Standard	Basic	Not rated
Goulburn Valley Water	Barwon Water	East Gippsland Water	Wannon Water	South Gippsland Water
	Central Highlands Water	Gippsland Water		Western Water *
	City West Water	Lower Murray Water (urban)		
	Coliban Water	Westernport Water		
	GMMWater			
	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.<sup>4</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.<sup>5</sup>

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 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 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
- the matters specified in our guidance<sup>6</sup>

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<sup>4</sup> 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.

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

- 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 considerations 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 final decision for GMMWater.<sup>7</sup>

In 2016, we issued guidance to GMMWater to inform its price submission. The guidance set out how we will assess GMMWater'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 GMMWater's proposed prices.<sup>8</sup>

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.<sup>9</sup>

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.<sup>10</sup>

## **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.<sup>11</sup>

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

<sup>7</sup> Essential Services Commission 2018, *GMMWater final decision, 2018 Water Price Review – commission's consideration of legal requirements*, 19 June. This is available at [www.esc.vic.gov.au/waterpricereview](http://www.esc.vic.gov.au/waterpricereview).

<sup>8</sup> This is a requirement of the WIRO, clause 14(b).

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

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

<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup>

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.<sup>14</sup> Our guidance explains the building blocks and how we use it to estimate the revenue requirement.<sup>15</sup>

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.<sup>16</sup> 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.

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

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

<sup>14</sup> 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.

<sup>15</sup> Essential Services Commission 2016, *Guidance Paper*, op. cit., pp. 8–9.

<sup>16</sup> 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.<sup>17</sup>

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.<sup>18</sup>

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<sup>17</sup> The Performance element of PREMO will be assessed at the review following the 2018 water price review.

<sup>18</sup> The PREMO process is described in: Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 44–49.

## 2. Our assessment of GWMWater’s price submission

We have made our price determination for GWMWater after considering: GWMWater’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 GWMWater’s price submission are available on our website (to the extent the content is not confidential).

Our guidance included a number of matters water corporations must address in their price submissions. GWMWater’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 GWMWater (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.<sup>19</sup>

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

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

### **Customer engagement**

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

The engagement by GWMWater:

- took place between November 2015 and September 2017, and was informed by its 2013 Community Engagement Strategy

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<sup>19</sup> 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.

<sup>20</sup> Consumer Action Law Centre 2018, *Submission on standard draft decisions: 2018 Water Price Review*, 8 May, p. 10.

- used a range of methods such as a deliberative panel that met over four days, workshops, information booths at community events, online and paper surveys and social media
- included councils, farmers, urban property owners and tenants, agricultural operators, manufacturers, welfare agencies and committees for recreational and irrigation water use
- led to recommendations by its deliberative panel on pricing and guaranteed service levels which were fully adopted in the price submission
- covered topics such as water quality, affordability, tariff structures, recreational water and rural pipeline tariff.

More detail on GMMWater’s engagement is available in its price submission.<sup>21</sup>

Evidence that GMMWater’s engagement influenced its proposals includes its agreement to propose a number of recommendations made by its deliberative panel, including:

- committing to improve water quality in Kaniva, Moyston and Ultima
- agreeing to pay \$100 to affected customers when it issues a boil water notice
- extending recreational water discounts to schools and adjusting the recreation contribution charge in line with the panel’s recommendations.

The influence of GMMWater’s engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of consumers.<sup>22</sup>

In a submission responding to our draft decision, CALC suggested we could play a greater role to promote best practice customer engagement and identify areas for improvement.<sup>23</sup> We note that following our price review, we will continue to work with water corporations to promote best practice customer engagement.

## Outcomes

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

- safe and clean water
- reliable and affordable services
- to support a healthy and liveable region.

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<sup>21</sup> GMMWater’s price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au). See pages 30 to 37.

<sup>22</sup> 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).

<sup>23</sup> Consumer Action Law Centre, *op. cit.*, p. 4.

Some of the specific ways GMMWater plans to improve outcomes for customers are by:

- extending digital metering from rural to urban customers, contributing to efficiency savings and lower costs and customer prices
- introducing a town sewer scheme for Goroke
- providing access to drinking water in Kaniva, Moyston, Ultima and Elmhurst.

GMMWater's proposed measures and targets for reporting against outcomes are listed on pages 37 to 41 of its price submission. In early 2018-19, we will engage with GMMWater to finalise measures and targets and how it will report to customers. Its performance will inform our assessment of the Performance element of PREMO in future price reviews.

In a submission in response to our draft decision, 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.<sup>24</sup> 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.<sup>25</sup> Further, water corporations already allocate funds to programs aimed to deliver payment options and hardship support required by our customer service codes. GMMWater has responded to customer views on affordability by proposing price reductions for most towns, and maintaining programs to support customers in financial hardship.

## Service Standards

GMMWater 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 GMMWater's targets until 2023 are set out in Appendix B.

In its submission 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'.<sup>26</sup> We note that for its urban services, GMMWater proposed reducing targets

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<sup>24</sup> Consumer Action Law Centre, op. cit., p. 3.

<sup>25</sup> 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.

<sup>26</sup> Consumer Action Law Centre, op. cit., p. 6.

for reliability and attending faults to align with current performance. For rural services, GMMWater will maintain targets at current performance levels.

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.

We note that many of GMMWater's proposed standards for reliability and attending faults were informed by feedback from customers, which aligns with our expectation that water corporations consider customer preferences when forming 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 GMMWater'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.

GMMWater's proposed GSLs are set out on pages 42 to 44 of its price submission and in appendix A1. It has proposed to maintain existing GSLs, and introduce a GSL relating to water quality. Our draft decision provides an overview of GMMWater's proposed GSLs.

In its submission CALC supported GSL payments increasing over time.<sup>27</sup> We note GMMWater has proposed to maintain payment amounts for its existing GSLs.

GMMWater's proposed GSLs were informed by feedback from its biannual workshop, outreach to rural customers and recommendations from its deliberative panel. We consider the proposed GSLs therefore reflect the aspects of service delivery most important to customers. For this reason, our final decision approves GMMWater's proposed GSLs.

GMMWater's GSLs are set out in Appendix C.

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

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<sup>27</sup> Consumer Action Law Centre, op. cit., p. 1.

## 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.<sup>28</sup> Along with forecast demand, it is an input to calculating prices.

Our draft decision accepted GWMWater's proposed revenue requirement of \$317.7 million over a five year period starting 1 July 2018. Our final decision approves a slightly lower revenue requirement of \$317.3 million. This reflects our final decision on each element of the revenue requirement, as set out in Table 2.1.

The reduction for our final decision is mainly due to updates we made to updates to the cost of debt (impacting the return on assets) and forecast operating expenditure. These reductions offset an increase in depreciation. Adjustments to the revenue requirement since our draft decision are set out at Table 2.2. The following sections set out the reasons for the changes in more detail.

**Table 2.1** Final decision – Revenue requirement  
\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Operating expenditure	33.7	33.6	33.3	33.2	32.9	166.6
Return on assets	16.6	16.7	16.9	17.0	17.0	84.2
Regulatory depreciation	12.2	12.8	13.4	13.8	14.3	66.5
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
<b>Revenue requirement</b>	<b>62.5</b>	<b>63.1</b>	<b>63.5</b>	<b>64.0</b>	<b>64.2</b>	<b>317.3</b>

Note: Numbers have been rounded

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<sup>28</sup> 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 GWMWater in the regulatory period from 1 July 2018. We had regard to their views in our draft decision.

**Table 2.2 Adjustments to draft decision revenue requirement**  
\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
<b>Draft decision – revenue requirement</b>	<b>62.0</b>	<b>62.9</b>	<b>63.6</b>	<b>64.4</b>	<b>64.8</b>	<b>317.7</b>
Operating expenditure	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9
Return on assets	-0.3	-0.3	-0.4	-0.4	-0.4	-1.8
Regulatory depreciation	1.0	0.7	0.4	0.2	0.0	2.2
<b>Total adjustments</b>	<b>0.5</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.3</b>	<b>-0.5</b>	<b>-0.4</b>
<b>Final decision – revenue requirement</b>	<b>62.5</b>	<b>63.1</b>	<b>63.5</b>	<b>64.0</b>	<b>64.2</b>	<b>317.3</b>

Note: Numbers have been rounded

## Operating expenditure

Operating expenditure is an input to the revenue requirement. Our draft decision proposed to adopt a \$155.2 million benchmark for GWMWater’s forecast controllable operating costs for the 2018–23 period. This was \$5.9 million lower than proposed by GWMWater, and we set out our reasoning for this adjustment in our draft decision (pages 9 to 17). In summary, we found:

- Evidence indicating its baseline controllable operating expenditure reflects an efficient benchmark.<sup>29</sup>
- An efficiency improvement rate of 1.5 per cent per year on its urban controllable operating costs, which is greater than its forecast growth of 0.5 per cent per year, giving a declining annual baseline operating cost.
- \$0.65 million of additional labour costs to cover wage increases above inflation resulting from its enterprise agreement, were not considered to be prudent and efficient.
- \$2.98 million of additional electricity costs and maintenance expenses were not considered to meet the requirements of our guidance.
- GWMWater had included costs for state environmental water in its baseline expenditure, with the forecast totalling \$2.28 million across 2013–18. Since this is not a prescribed service under the WIRO, we have removed the costs from operating expenditure.

<sup>29</sup> 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 \$12.2 million for GMMWater's non-controllable operating costs for the 2018–23 period.<sup>30</sup> 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.

GMMWater's response to our draft decision provided updated forecasts for controllable operating expenditure based on the latest information for payroll tax and electricity, and proposed to accept our other adjustments:

- 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, GMMWater has advised a reduction of \$0.90 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.
- GMMWater proposed to accept our draft decision forecast for electricity, although its revised forecast for 2018–20 identified some potential savings.<sup>31</sup> We acknowledge that GMMWater is one of two corporations that has not included costs for renewable energy generation or emissions reduction projects in its capital expenditure forecast, because it considers the cost savings achieved from such projects should at least cover the cost of the project. Our final decision on electricity costs remains unchanged from our draft decision, because GMMWater's latest electricity price forecasts are consistent with the draft decision, and we consider it prudent for the savings arising from GMMWater's proposed renewable energy projects to fund the capital investments.
- Our draft decision removed \$3.15 million from GMMWater's proposal for additional labour and maintenance costs above the baseline. In its response, GMMWater effectively accepted our draft decision controllable operating expenditure allowance, but re-cut its forecast to show a higher efficiency improvement rate of 2.5 per cent while retaining its original proposed cost increase above the baseline. We do not accept these proposed amendments to the input, because we do not reinstate the costs above the baseline that we removed in our draft decision. However, we note in its original price submission, GMMWater indicated its price submission had been built on an aspirational efficiency improvement rate of 2.5 per cent per year, but it had only 'locked in' 1.5 per cent in its pricing financial model. We recognise GMMWater's response

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<sup>30</sup> Non-controllable costs are those that cannot be directly or indirectly influenced by a water corporation's decisions.

<sup>31</sup> 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 did not recommend any adjustments for our final decision.

to our draft decision reflects its original aspirations to outperform its proposed 1.5 per cent efficiency rate, and we support GMMWater in achieving its higher efficiency target.

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.<sup>32</sup> No other new considerations were presented in submissions received following the draft decision that caused us to change our views on controllable operating expenditure.

Accordingly, our final decision for controllable operating expenditure accepts the \$0.90 million reduction for payroll tax changes from our draft decision.

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.<sup>33</sup>

Based on the latest inflation data, we have revised the forecast 2018-19 environmental contribution from \$2.21 million to \$2.22 million, which results in a total increase of \$0.04 million across the 2018–23 period.

Accordingly, we have increased our draft decision forecast for GMMWater's non-controllable operating expenditure by \$0.04 million to \$12.27 million across the 2018–23 period.

Table 2.3 sets out our adjustments from our draft decision for controllable and non-controllable operating expenditure. Table 2.4 sets out the benchmark operating expenditure we have adopted for our final decision.

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<sup>32</sup> Consumer Action Law Centre, *op. cit.*

<sup>33</sup> 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 2.3 Adjustments to operating expenditure**

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
<b>Draft decision – total operating expenditure</b>	<b>33.8</b>	<b>33.8</b>	<b>33.4</b>	<b>33.3</b>	<b>33.1</b>	<b>167.5</b>
Payroll tax reduction	-0.18	-0.18	-0.18	-0.18	-0.18	-0.90
<b>Total adjustments to controllable costs</b>	<b>-0.18</b>	<b>-0.18</b>	<b>-0.18</b>	<b>-0.18</b>	<b>-0.18</b>	<b>-0.90</b>
Environmental contribution	0.01	0.01	0.01	0.01	0.01	0.04
<b>Total adjustments to non-controllable costs</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.01</b>	<b>0.04</b>
<b>Final decision – total operating expenditure</b>	<b>33.7</b>	<b>33.6</b>	<b>33.3</b>	<b>33.2</b>	<b>32.9</b>	<b>166.6</b>

Note: Numbers have been rounded

We have adopted the benchmark for operating expenditure set out in Table 2.4 for the purpose of making our final decision on GMMWater’s revenue requirement (Table 2.1). We consider our final decision for GMMWater’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.<sup>34</sup>

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<sup>34</sup> Essential Services Commission 2016, *Guidance paper*, op. cit., p. 31.

**Table 2.4 Final decision – operating expenditure**

\$ million 2017-18

	2018-19	2019-20	2020-21	2021-22	2022-23	Total
<b>Controllable costs</b>	<b>31.1</b>	<b>31.1</b>	<b>30.8</b>	<b>30.8</b>	<b>30.5</b>	<b>154.3</b>
<b>Non-controllable costs</b>	<b>2.5</b>	<b>2.5</b>	<b>2.4</b>	<b>2.4</b>	<b>2.4</b>	<b>12.3</b>
Bulk services <sup>a</sup>	0.2	0.2	0.2	0.2	0.2	1.2
Environmental contribution <sup>b</sup>	2.2	2.2	2.1	2.1	2.0	10.6
Licence fees – ESC <sup>c</sup>	0.038	0.038	0.038	0.038	0.055	0.206
Licence fees – DHHS <sup>c</sup>	0.017	0.017	0.017	0.017	0.017	0.086
Licence fees – EPA <sup>c</sup>	0.046	0.046	0.046	0.046	0.046	0.231
Other	0.0	0.0	0.0	0.0	0.0	0.0
<b>Final decision – total operating expenditure</b>	<b>33.7</b>	<b>33.6</b>	<b>33.3</b>	<b>33.2</b>	<b>32.9</b>	<b>166.6</b>

<sup>a</sup> Bulk services covers the supply of bulk water and sewerage services

<sup>b</sup> The Environmental Contribution collects funds from water corporations under the Water Industry Act 1994 (Vic)

<sup>c</sup> 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 GWMWater does not represent the amount that GWMWater 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 revenue requirement. Our guidance required GWMWater to propose its:

- closing regulatory asset base at 30 June 2017

Our assessment

- 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 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 proposed to approve a closing regulatory asset base for 30 June 2017 of \$358.9 million. We proposed to approve this amount as GWMWater's actual net capital expenditure was 0.8 per cent lower than the forecast used to approve maximum prices for the period from 1 July 2013.<sup>35 36</sup> GWMWater also calculated its closing regulatory asset base in accordance with the requirements of our guidance.

No other new considerations were raised in submissions on our draft decision that affected our assessment of the closing regulatory asset base. Our final decision approves a closing regulatory asset base at 30 June 2017 of \$358.9 million. The calculations are provided at Table 2.5.

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<sup>35</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure.

<sup>36</sup> We take a risk-based approach to including past capital expenditure in the regulatory asset base. We undertake a prudence and efficiency review where a water corporation has exceeded its net capital expenditure forecasts by more than 10 per cent. We believe this approach is reasonable given capital expenditure can be relatively 'lumpy' in nature.

**Table 2.5 Final decision – Closing regulatory asset base**  
\$ million 2017-18

	2012-13	2013-14	2014-15	2015-16	2016-17
Opening RAB 1 July	319.6	337.2	352.2	357.2	363.2
Plus gross capital expenditure	28.0	30.9	20.4	23.7	22.5
Less government contributions	0.3	3.7	1.2	2.4	12.2
Less customer contributions	1.1	0.3	1.7	0.8	0.7
Less proceeds from disposals	0.9	1.3	1.1	2.2	1.1
Less regulatory depreciation	8.2	10.5	11.5	12.3	12.8
<b>Closing RAB 30 June</b>	<b>337.2</b>	<b>352.2</b>	<b>357.2</b>	<b>363.2</b>	<b>358.9</b>

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 final decision on GWMWater’s forecast regulatory asset base from 1 July 2018.<sup>37</sup> The following sections provide an overview of our assessment of each component of the forecast regulatory asset base.

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<sup>37</sup> 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.

**Table 2.6 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	358.9	402.1	401.7	405.7	411.1	412.8
Plus gross capital expenditure	109.0	16.5	18.6	20.7	17.4	14.9
Less government contributions	48.0	0.0	0.1	0.0	0.0	0.0
Less customer contributions	3.5	3.7	0.9	0.9	0.9	0.9
Less proceeds from disposals	1.0	1.0	0.9	1.0	1.1	1.1
Less regulatory depreciation	13.2	12.2	12.8	13.4	13.8	14.3
<b>Closing RAB 30 June</b>	<b>402.1</b>	<b>401.7</b>	<b>405.7</b>	<b>411.1</b>	<b>412.8</b>	<b>411.5</b>

Note: Numbers have been rounded

### Capital expenditure

Capital expenditure is an input to estimating the regulatory asset base. Our draft decision proposed to adopt an \$88.2 million benchmark for GWMWater’s gross capital expenditure forecast for the 2018–23 period. This was \$9.3 million lower than proposed by GWMWater, and we set out our reasoning for this adjustment in our draft decision (pages 20 to 24). The reasons for this were:

- GWMWater has a robust approach for developing project scope, the timing of works and cost estimates.
- We considered the planned capital expenditure program is achievable, given GWMWater’s past track record delivering its capital expenditure program.
- GWMWater has an appropriate approach for managing expenditure associated with uncertain projects.
- \$9.34 million of forecast renewals expenditure was not fully justified as required by our guidance.

GWMWater’s response to our draft decision accepted our reduction to its renewals expenditure, noting that ‘it is still improving the application of its asset management information to support good long term strategic asset investment decisions.’ In addition, GWMWater highlighted its commitment to maintain customer affordability, and if a greater level of expenditure is required, this will be reconciled and reviewed for its next price submission.

Our assessment

GWMWater’s response also advised the Victorian Government budget has allocated \$32 million for the East Grampians Rural Pipeline project, and its business case anticipates further funding from the Commonwealth Government. GWMWater also stated that its financial commitment for the project will not increase prices to its existing customers. Consequently, GWMWater has not included its \$15 million commitment, expected customer contributions or government funding in its gross capital expenditure forecast for 2018–23, and it has adopted policies for funding consistent with its South West Loddon rural pipeline project (completed in 2013–18). We consider this approach demonstrates that GWMWater is accepting the risk on behalf of customers, consistent with our guidance for managing uncertainty within its capital program. We will review the prudence and efficiency of actual expenditure incurred if GWMWater seeks to include it in the regulatory asset base at the next price review.

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’.<sup>38</sup> It stated that new technology must deliver tangible benefits for water customers and be backed by a comprehensive business case. In our draft decision, we noted GWMWater already has operating digital metering infrastructure for its rural digital network, and it proposes to expand this to its urban customer network. It has already demonstrated customer support and identified that this project has a positive net present value.

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.<sup>39</sup> 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

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 GWMWater’s forecast regulatory asset base (Table 2.6) and its revenue requirement (Table 2.1). We consider this benchmark is consistent with our guidance and WIRO principles.<sup>40</sup>

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<sup>38</sup> Consumer Action Law Centre 2018, op. cit.

<sup>39</sup> *ibid.*

<sup>40</sup> Essential Services Commission 2016, *Guidance Paper*, op. cit., p. 35; WIRO clause 8(b)

The benchmark that we adopt for GMMWater 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 consider sufficient to operate the business and to maintain or improve services over the regulatory period. GMMWater 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 GMMWater's approach for addressing uncertain capital expenditure. We reiterate that GMMWater 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 GMMWater's forecast revenue from customer contributions was reasonable, having regard to past trends and its growth forecasts. We proposed to accept GMMWater's forecast. 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 on revenue from customer contributions is the same as our draft decision. Our final decision adopts the benchmarks set out at Table 2.5.

### **Cost of debt**

In our draft decision we proposed to approve the cost of debt proposed by GMMWater 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 our cost of debt estimate for 2017-18 with our calculation of the actual cost, applying the method outlined in our guidance.<sup>41</sup>

In its submission 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).<sup>42</sup> 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

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<sup>41</sup> 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.

<sup>42</sup> Consumer Action Law Centre 2018, op. cit., p. 8.

lowered compared with the rates allowed in our draft decision. These recommendations are based on a report prepared by CME for CALC.<sup>43</sup>

A submission by the Water Services Association of Australia (WSAA) addressed CALC’s submission.<sup>44</sup> 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.<sup>45</sup>

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 2.7.

**Table 2.7 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

GWMWater rated its price submission as ‘Advanced’. Based on its PREMO self-rating, GWMWater proposed a rate of return on equity of 4.9 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Advanced’.<sup>46</sup>

<sup>43</sup>Consumer Action Law Centre 2018, Appendix A.

<sup>44</sup> Water Services Association of Australia 2018, *Submission*, 15 May.

<sup>45</sup> 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).

<sup>46</sup> Essential Services Commission 2016, *Guidance paper*, op. cit., p. 49.

Our draft decision accepted GWMWater’s proposed return on equity. This reflected our preliminary review of its PREMO self-rating.

In its submission CALC recommended a one per cent reduction to each return on equity value in the PREMO matrix.<sup>47</sup> 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. 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.<sup>48</sup>

Consistent with our draft decision, our final decision accepts GWMWater’s proposed return on equity of 4.9 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 on regulatory depreciation differed from GWMWater’s proposal in its price submission. After lodging its price submission, GWMWater sought to increase regulatory depreciation to correct for an error. We proposed to cap the increase resulting from the correction to an amount that resulted in our draft decision revenue requirement matching the revenue requirement proposed by GWMWater in its price submission. We required GWMWater to provide more information on its forecast for regulatory depreciation in its response to our draft decision.

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<sup>47</sup> Consumer Action Law Centre 2018, *op. cit.*, p. 8.

<sup>48</sup> 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.

In its response to our draft decision, GWMWater revised its forecast regulatory depreciation to reflect current depreciation rates for existing assets. The revision results in a \$2.2 million increase to GWMWater's forecast regulatory depreciation for the 2018-23 period, compared to the amount allowed in our draft decision. We consider GWMWater's updated forecast for regulatory depreciation is consistent with the requirements of our guidance.<sup>49</sup>

No other new considerations for depreciation were raised in submissions on our draft decision.

For the reasons set out above, our final decision adopts GWMWater's revised forecast for regulatory depreciation, as set out in Table 2.1.

## **Tax allowance**

The tax allowance is an input into the revenue requirement. Our draft decision accepted GWMWater's forecasts for zero tax in its revenue requirement, as it was calculated consistently with the method required by our guidance.<sup>50</sup> No new considerations on tax were raised in submissions responding to our draft decision.

For the reasons set out above, our final decision adopts GWMWater's tax forecasts, as set out in Table 2.1.

## **Demand**

In our draft decision, we proposed to approve GWMWater's demand forecasts as we considered they were estimated in a manner consistently with the requirements of our guidance. No new considerations were presented in submissions received following the draft decision which caused us to change our views on demand.

For the reasons set out above, our final decision confirms our draft decision on demand.

GWMWater's price determination includes the benchmark demand forecasts adopted for our final decision.

## **Form of price control**

Our draft decision accepted GWMWater's proposed price cap form of price control. It currently uses a revenue cap. 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

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<sup>49</sup> Essential Services Commission 2016, *Guidance paper*, op. cit., p. 42.

<sup>50</sup> Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 50-51.

we consider demand risk is more efficiently managed by a water corporation, rather than its customers.

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

For these reasons, our final decision confirms our draft decision and approves GWMWater's proposed price cap form of price control.<sup>51</sup>

## **Tariff structures and prices**

Our draft decision accepted GWMWater's proposal to maintain its existing tariff structures comprising:

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

We consider the two-part structure proposed by GWMWater for its urban water tariffs will promote the efficient use of services. The two-part structure for urban water tariffs sends customers a signal about the costs of their water use, and is an approach that is commonly applied in other states and territories.<sup>52</sup> We also considered two-part tariff structures are easy to understand.

Our draft decision also accepted GWMWater's introduction of a tariff for the supply of fully treated drinking water to the towns of Elmhurst, Kaniva, Moyston and Ultima, and the introduction of sewerage tariff for the provision of a common effluent drainage system for the town of Goroke. We accepted the introduction of these tariffs as they are supported by customers and reflect the cost of supplying the services.

### **Irrigation water pricing – Commonwealth Environmental Water Holder**

Our draft decision did not accept GWMWater's tariff proposal relating to the Commonwealth Environmental Water Holder (CEWH). It originally proposed 19.2 per cent increase in the fixed charge, and a 19.3 per cent increase in the variable charge over the two years from 1 July 2018. We considered the proposed increases were not justified having regard to our guidance and the WIRO, and because GWMWater linked the CEWH charge to environmental water, not the irrigation entitlement that the CEWH had purchased.

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<sup>51</sup> 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.

<sup>52</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Gosford City Council, Wyong Shire Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

In response to our draft decision, GMMWater proposed a 3.1 per cent increase each year for fixed charges and variable charges to CEWH. It calculated the proposed tariff based on costs associated with servicing an equivalent irrigation entitlement holder, thereby addressing our concern with its original approach. Further, GMMWater’s price path is also within our usual bounds that would trigger concern about a price shock (around 10 per cent per annum). Our final decision approves GMMWater’s proposed tariff, as set out in its response to our draft decision.

### Recreation lake water supply charge

GMMWater proposed to increase the recreation lake water supply charge from \$20 per megalitre to \$25 per megalitre over for the first three years of the 2018-23 period.<sup>53</sup> It claimed that the current price does not reflect the cost of providing the service. Our draft decision agreed that an increase was warranted on cost reflectivity grounds. However, we required GMMWater to consider a transition period for increasing the charge. In response to our draft decision, GMMWater proposed to transition the price increase over five years (rather than three) as set out in table 2.8.

**Table 2.8 Revised recreation lake water prices and tariffs**  
(\$2017-18)

Usage charge	Unit	2017-18 price	% change in 2018-19	% change in 2019-20	% change in 2020-21	% change in 2021-22	% change in 2022-23	2022-23 Price
Price submission	1 ML	\$20	10%	10%	3%	0%	0%	\$25.00
Revised submission	1 ML	\$20	4.1%	4.1%	4.1%	4.1%	4.1%	\$24.50

Note: Numbers have been rounded

We received a submission on the proposed increase in the recreation lake water supply charge from the Wimmera Mallee Recreational Lakes Alliance Incorporated (WMRLA).<sup>54</sup> The WMRLA proposed that yearly increases to the price of recreation lake water should be limited to inflation, suggesting that communities benefitting from recreation lake water have a reduced ability to pay.

We consider that the recreation lake water charge is a unique service not provided by any other water corporation in Victoria. As such, customers enjoy a unique benefit from GMMWater providing the service. Also, the recreation lake water charge is cross subsidised via the recreation water contribution charge (paid by all customers of GMMWater).

<sup>53</sup> The recreation water supply charge is a charge for providing water to recreation lakes and sporting clubs in the region.

<sup>54</sup> Wimmera Mallee Recreational Lakes Alliance Incorporated 2018, *Submission*, 10 May.

In adjusting the price path (set out in Table 2.8) GMMWater has sought to address the impact of the price rise on customers. By adopting a phased increase, we consider GMMWater's revised proposal meets the requirements of the guidance and the WIRO. For these reasons, we have approved GMMWater's proposed recreation lake prices.

### Final decision summary

In its response to our draft decision, GMMWater proposed tariffs reflecting our draft decision on its revenue requirement. We consider these proposed tariffs take into account customers' interests, including low income and vulnerable customers, because:

- the proposed tariffs reflect the forecast efficient costs of delivering services
- the proposed two-part structure for water services tariffs will promote efficient water use, and provide customers a signal about the costs of their water use
- the proposed tariffs were informed by an extensive customer engagement program
- the proposed tariffs would allow the corporation to recover revenue sufficient to cover forecast efficient costs
- GMMWater has payment options and assistance for customers experiencing difficulty paying bills.

No other new considerations were presented in submissions received following the draft decision which caused us to change our views on GMMWater's tariffs.<sup>55</sup>

For the reasons set out above, our final decision approves GMMWater's proposed tariffs.

Our price determination for GMMWater 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 (in \$2018-19 terms).

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<sup>55</sup> On 23 May 2018 (after our consultation period had closed on our draft decision for GMMWater), 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 price determination for GMMWater. Our response to the submission is set out in our final decision paper for Western Water.

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

	2018-19	2019-20	2020-21	2021-22	2022-23
<b>Residential</b>					
Variable (\$/kL)	1.7907	1.7907	1.7907	1.7907	1.7907
Fixed (\$/year)	457.93	457.93	457.93	457.93	457.93
<b>Non-residential</b>					
Variable (\$/kL)	1.7907	1.7907	1.7907	1.7907	1.7907
Fixed (\$/year)	439.59	439.59	439.59	439.59	439.59

Note: Numbers have been rounded down

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

	2018-19	2019-20	2020-21	2021-22	2022-23
<b>Residential and Non-residential</b>					
Fixed (\$/year)	490.38	490.38	490.38	490.38	490.38

Note: Numbers have been rounded down

## Adjusting prices

Our draft decision accepted GWMWater’s proposal to continue its existing price adjustment mechanisms (including the uncertain and unforeseen events mechanism) on the basis that they are consistent with efficiency objectives, and reflect a continuation of current arrangements.<sup>56</sup>

In its response to our draft decision, GWMWater proposed a price adjustment mechanism should the environmental water service become a prescribed service during the 2018-23 period. We have not accepted GWMWater’s proposal as the uncertain and unforeseen mechanism approved in our draft decision can accommodate impacts from changes to the definition of a prescribed service.

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<sup>56</sup> WIRO clauses 8(b)(i)(ii) and (iii).

No other new considerations were presented in submissions received following the draft decision which caused us to change our views on its existing price adjustment mechanisms. Our final decision confirms our draft decision and approves GMMWater's existing adjustment mechanisms.

As noted in our draft decision, we have also developed price adjustment formula that allows GMMWater's prices to adjust for changes in the cost of debt. This mechanism is set out in GMMWater'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 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 to accept GMMWater's proposal to continue applying a baseline assumption that new customer contributions will attract a zero charge. Where a development is of a scale that it requires an increase in capacity, GMMWater proposed to assess the NCC on a 'case by case' basis in line with our NCC pricing principles, as approved in our 2013 determination.<sup>57</sup>

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.

For the reasons set out above, we consider it appropriate to maintain the views expressed in our draft decision. Our final decision accepts the position in our draft decision for the same reasons, and accepts GMMWater's proposed method of assessing new customer contribution charges on a 'case by case' basis in line with our principles, as it is consistent with the requirements of our guidance.<sup>58</sup>

Our price determination for GMMWater 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)

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<sup>57</sup> Essential Services Commission 2016, *Guidance paper*, op. cit., p. 62.

<sup>58</sup> *ibid.*, pp. 62-63.

GWMWater should update and publish any development servicing plans and negotiation protocols to assist developers understand the underlying assumptions of its new customer contribution charges.<sup>59</sup>

## Financial position

In approving prices, we must have regard to the financial viability of the water industry.<sup>60</sup> 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 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 GWMWater's prices. We have assessed that, under our final decision, GWMWater will generate sufficient cash flow to deliver on service commitments, including financing costs arising from investments to meet service expectations.

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<sup>59</sup> Essential Services Commission 2013, *New Customer Contributions: Explanatory Note, December*, pp. 9-11.

<sup>60</sup> 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, 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 final decision is to accept GWMWater’s proposed return on equity of 4.9 per cent. Below, we set out our assessment of GWMWater’s proposed PREMO rating.

#### Our review of GWMWater’s PREMO rating

GWMWater’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
GWMWater’s rating	<b>Advanced</b>	Advanced	Leading	Leading	Advanced
Commission’s draft decision rating	<b>Advanced</b>	Advanced	Leading	Standard	Advanced
Commission’s final decision rating	<b>Advanced</b>	Advanced	Leading	Standard	Advanced

Our final decision approves a PREMO rating of ‘Advanced’ for GWMWater’s price submission. Factors supporting its PREMO rating include:

- GWMWater’s engagement started early relative to other corporations and provided customers from all parts of its extensive service area with an opportunity to participate. GWMWater also provided customers with a high degree influence on its proposals through a deliberative panel

which it authorised to make recommendations to GWMWater's board. The board gave an undertaking to consider all recommendations made by the panel and ultimately accepted most recommendations. Areas of influence included its approach to GSLs, recreation water, and prioritising investments to improve water quality for a number of towns. Recommendations not accepted by GWMWater were addressed in GWMWater's price submission.

- GWMWater's proposed change from a revenue cap to price cap form of price control, which means the corporation has accepted demand risk on behalf of customers. It also proposed to introduce a new water quality related guaranteed service level, increasing the revenue risk to the corporation and increasing accountability for delivering outcomes expected by customers.

Consistent with our draft decision, our final decision adopts a rating of 'Standard' for the Management element of PREMO, rather than the 'Leading' rating proposed by GWMWater.

GWMWater's proposed operating expenditure incorporated less ambitious assumptions (relative to others) for the improvement in controllable operating costs per customer connection, a measure of efficiency (Figure 3.1). Our draft decision noted that its proposed self-rating for Management may have been better supported if it decided to incorporate its aspirational efficiency target (of 2.5 per cent, compared with the assumption included in its forecasts of 1.5 per cent) into its price submission forecasts. We acknowledge that GWMWater's response to our draft decision commits to the 2.5 per cent efficiency target, but this does not provide grounds for a reassessment of its PREMO rating. The PREMO framework seeks to ensure a water corporation puts its best offer forward in its price submission. Our pricing framework states that businesses cannot seek to improve their rating with an alternative proposal.<sup>61</sup> GWMWater also made corrections to its forecast for regulatory depreciation, and expenditure after lodging its price submission. For these reasons, we consider a rating of 'Standard' is appropriate for Management.

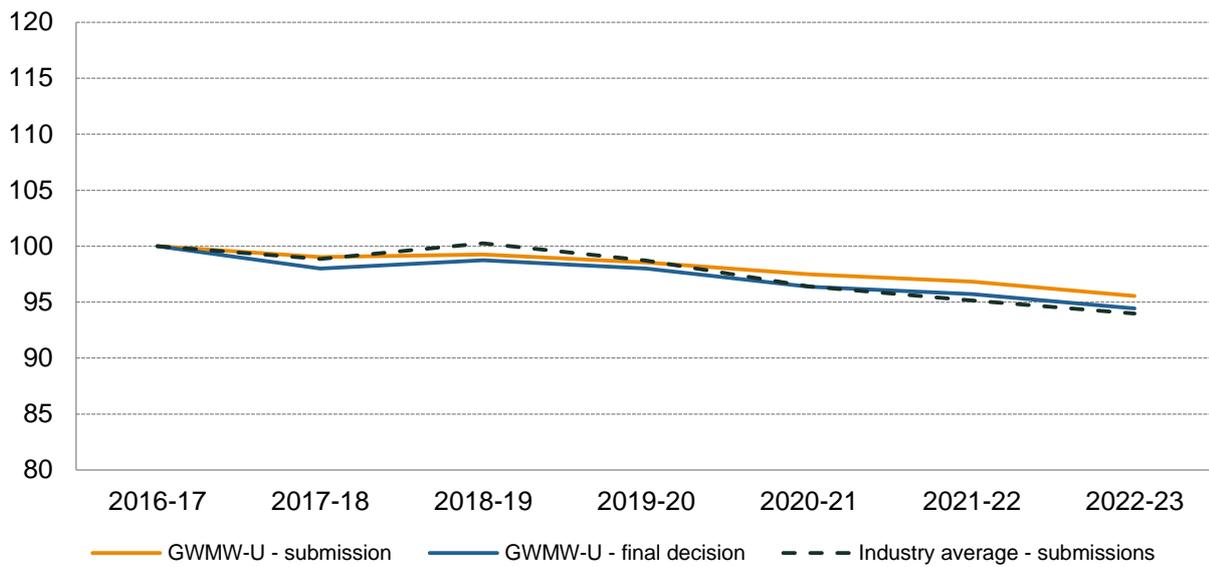
Our final decision to rate GWMWater's price submission as 'Advanced' is reflected in the return on equity we have approved at page 21.

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<sup>61</sup> See Essential Services Commission 2016, *Water Pricing Framework and Approach: Implementing PREMO from 2018*, October, p. 49.

**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	15 May 2018
Consumer Action Law Centre	8 May 2018
Wimmera Mallee Recreational Lakes Alliance	7 May 2018

## Appendix B – approved service standards

We have approved the following standards and conditions of service and supply and associated targets for GWMWater’s urban and rural customers.

### GWMWater’s approved service standards for urban customers

Service Standard	2018-19	2019-20	2020-21	2021-22	2022-23
<b>Water</b>					
Number of customers experiencing more than 5 unplanned water supply interruptions in the year (number)	200	200	200	200	200
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)	40	40	40	40	40
Average time taken to attend bursts and leaks (priority 3) (minutes)	40	40	40	40	40
Average duration of unplanned water supply interruptions (minutes)	100	100	100	100	100
Average duration of planned water supply interruptions (minutes)	180	180	180	180	180
<b>Sewerage</b>					
Customers receiving more than 3 sewer blockages in the year (number)	4	4	4	4	4
Average time to attend sewer spills and blockages (minutes)	22	22	22	22	22
Average time to rectify a sewer blockage (minutes)	113	113	113	113	113
Spills contained within 5 hours (per cent)	98	98	98	98	98

Note: Numbers have been rounded

## GMMWater's approved service standards for rural customers

Service Standard	2018-19	2019-20	2020-21	2021-22	2022-23
<b>Rural Pipeline Supply (By District/Supply System)</b>					
Unavailability of supply systems for continuous periods in excess of 72 hours (%) <sup>62</sup>	3	3	3	3	3
Number of Pipeline bursts and leaks (per 100km of pipeline)	1	1	1	1	1
Unaccounted for water (%)	10	10	10	10	10
<b>Bulk Water</b>					
Annual compliance with storage operator obligations (%)	100	100	100	100	100
<b>Licensing/Administration</b>					
New applications for groundwater & supply-by-agreement licenses determined within days 60 (%)	100	100	100	100	100
Applications for renewal of groundwater licenses determined within 40 days (%)	100	100	100	100	100
New applications for surface diversion determined within 22 days (%)	100	100	100	100	100
Application for renewal of surface diversion & supply-by-agreement licenses determined within 60 days (%)	100	100	100	100	100
Processing of permanent transfer/Surface Diversion/Groundwater licenses within 60 days (%)	100	100	100	100	100
Processing of temporary transfer of water entitlement volumes within 15 days (%)	100	100	100	100	100
Processing of permanent transfer of water entitlements volumes within 60 days (%)	100	100	100	100	100
Number of diversion licenses metered or assessed for metering at 30 June (%)	100	100	100	100	100
Volume of total surface water and groundwater entitlements metered at 30 June (%)	90	90	90	90	90

Note: Numbers have been rounded

<sup>62</sup> GMMWater will cart non-potable water to the homestead for interruptions that exceed 72 hours, at no cost to the customer.

## 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 GMMWater.

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

GMMWater 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 GMMWater.

### GMMWater's approved GSL scheme for urban customers

Approved service level obligation	Approved payment (\$)
Notification to customer advising drinking water not suitable for drinking	100
Unplanned water interruptions not restored within five hours of notification	50
Planned interruption longer than notification	50
Sewer interruption not restored within five hours of notification	50
Sewer spill within a house caused by failure of system not contained within one hour	1,000
Restricting the water supply of, or taking legal action against, a residential customer prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying.	300

## Appendix D – rate of return

A submission from the Consumer Action Law Centre (CALC) recommended 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.<sup>63</sup> These recommendations are based on a report prepared by CME for CALC.<sup>64</sup>

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.<sup>65</sup> 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 corporation's borrowing costs do not reflect this. Rather, the water corporations borrow from the state treasury corporation 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 reflects our estimate of the efficient financing costs for a privately owned business facing a similar degree of economic risk to

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<sup>63</sup> Consumer Action Law Centre 2018, *Cost of debt*, op. cit.

<sup>64</sup> Consumer Action Law Centre 2018, *Cost of debt*, op cit., Appendix A.

<sup>65</sup> 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.

a regulated water corporation. We consider this is consistent with the requirements of the Water Industry Regulatory Order 2014 (WIRO).<sup>66</sup>

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.<sup>67</sup> 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.<sup>68</sup>

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.<sup>69</sup>

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<sup>66</sup> 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).

<sup>67</sup> Consumer Action Law Centre 2018, op. cit.

<sup>68</sup> Essential Services Commission of South Australia. op. cit; Independent Pricing and Regulatory Tribunal, op. cit.

<sup>69</sup> 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.