



# Lower Murray Water draft decision

2023 Water Price Review

30 March 2023



## Acknowledgement

We acknowledge the Traditional Owners of the lands and waterways on which we work and live.

We acknowledge all Aboriginal and Torres Strait Islander communities, and pay our respects to Elders past and present.

As the First Peoples of this land, belonging to the world's oldest living cultures, we recognise and value their knowledge, and ongoing role in shaping and enriching the story of Victoria.

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## Summary

### **Our draft decision considers Lower Murray Water's proposed prices for a 5-year period starting 1 July 2023**

This draft decision sets out our preliminary views on Lower Murray Water's price submission.<sup>1</sup> Our draft decision should be read together with Lower Murray Water's price submission.



We invite interested parties to comment on our preliminary views in this draft decision before we make a final decision and issue a price determination in June 2023. For details of how to provide feedback, see our dedicated Engage Victoria page: <https://engage.vic.gov.au/water-price-review-2023>.

### **Lower Murray Water has committed to delivering outcomes that reflect customer priorities across its urban and rural services**

As a business that provides urban and rural water services, Lower Murray Water engaged on a set of proposed outcomes for each of these major service areas. The outcomes it proposes are similar (with a focus on providing customers value for money and safe, reliable services), but refined to reflect the different nature of services and the customer base.

For its urban services, Lower Murray Water has committed to deliver the following outcomes for customers:

- Services provide customers value for money
- Provide customers reliable and safe drinking water
- Provide customers with reliable sewerage services
- Provide customer service avenues that are responsive to resolve requests or enquiries within agreed key performance indicators
- Service its communities in a socially responsible and environmentally sustainable manner.<sup>2</sup>

For its rural services, Lower Murray Water has committed to the following outcomes for customers:

- Services provide customers value for money
- Provide customers with water when they need it

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<sup>1</sup> Clause 16 of the Water Industry Regulatory Order 2014 requires the Essential Services Commission to issue a draft decision; Lower Murray Water's price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

<sup>2</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 64.

- Provide customer service avenues that are responsive to resolve requests and enquiries
- Service our communities in a socially responsible and environmentally sustainable manner.<sup>3</sup>

Among the key initiatives to deliver on its commitments, it will look to become a more customer-engaged business and focus on securing water reliability which is a key issue for both Lower Murray Water's urban and rural customers. It will invest in systems and infrastructure to ensure the availability of water when required, including by taking into account population growth.

## **Our draft decision adopts a revenue requirement that will enable Lower Murray Water to deliver on its proposed outcomes**

Our draft decision adopts a revenue requirement that will allow Lower Murray Water to deliver on its customer service commitments, government policy, statements of obligations, and obligations monitored by the Environment Protection Authority Victoria and the Department of Health.

Our draft decision presents key benchmarks for each of Lower Murray Water's urban and rural services. This is consistent with how these parts of the business have been treated in our past price reviews, allowing for differentiated pricing based on the nature of the service provided.

For Lower Murray Water's urban services, our draft decision is to adopt a revenue requirement of \$216.7 million for Lower Murray Water over the 5-year period starting 1 July 2023 (Chapter 4).<sup>4</sup> This compares to the \$219.3 million proposed by Lower Murray Water in its price submission. The lower amount adopted in our draft decision mainly reflects a relatively minor adjustment we propose to forecast operating expenditure (Section 4.1.1).

For Lower Murray Water's rural services, our draft decision is to adopt a revenue requirement of \$138.1 million for Lower Murray Water over the 5-year period starting 1 July 2023 (Chapter 7). This compares to the \$139.2 million proposed by Lower Murray Water in its price submission. The lower amount adopted in our draft decision reflects a relatively minor adjustment to its regulatory asset base, arising from adjustments to forecast capital expenditure (Section 7.2.2).

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

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<sup>3</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 107.

<sup>4</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. Along with forecast demand, it is an input to calculating the prices to be charged by a water corporation.

## **In response to our draft decision, Lower Murray Water must consider the inflation environment and the impact on customer prices and bills**

For its urban services and some rural services, Lower Murray Water, unlike some other water businesses, proposes to increase its prices in real terms over the 2023–28 regulatory period. Under its proposal, prices would rise by around 0.3 per cent per year more than inflation, on average. For rural services, price changes will range from 6.4 per cent below inflation to an increase of 1.3 per cent more than inflation by 2028. In its response to our draft decision, Lower Murray Water must provide us with further information illustrating how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.<sup>5</sup>

Since lodgement of its price submission it has become increasingly likely that a relatively high inflation adjustment will be incorporated into 2023-24 prices.

Prices and estimated bills will also change following our draft decision to reflect updates for inflation and the cost of debt. The March Quarter 2023 annual outcome for the consumer price index due for release in late April 2023, will be added to 2023-24 real prices.<sup>6</sup>

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall through 2023 and 2024.<sup>7</sup> For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to opening base costs for the 2023–28 regulatory period. Accordingly, it may be the case that the inflation that is added to prices in 2023-24 provides an uplift in revenue that is well above a business’s actual costs for the year.

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<sup>5</sup> This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission, in considering the manner in which a regulated entity’s prices are to be calculated, determined or otherwise regulated, must have regard to whether prices provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

<sup>6</sup> Published by the Australian Bureau of Statistics (All Groups – Australia).

<sup>7</sup> The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) fall to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

## **Tariff structures will generally remain the same**

For urban services Lower Murray Water proposed to maintain its existing tariff structures. For residential and non-residential water services, it proposed a two-part tariff with a fixed service charge and a variable usage component that depends on water use (this includes a three-tier inclining block structure for residential services). For residential and non-residential sewerage services, Lower Murray Water proposed a fixed service charge only.

For rural services, Lower Murray Water, proposed to maintain its existing tariff structures for pumped irrigation, waterworks, stock, domestic and private diversions across all rural districts. Lower Murray Water proposed to continue recovering the cost incurred by individual districts through the use of location-based pricing.

Our draft decision is to accept Lower Murray Water's proposed tariff structures for both its urban and rural services, on the basis that they are a continuation of Lower Murray Water's current approach, meet the criteria in our guidance, and are generally supported by its customers. Specifically, the tariff structures ensure a sustainable revenue stream and are simple to understand.

## **Our draft decision rates Lower Murray Water's price submission as 'Standard' under the PREMO framework**

Our draft decision is to rate Lower Murray Water's price submission as 'Standard' under the PREMO framework (Table B). This is the same as the business's self-rating of its price submission.

Key factors supporting this PREMO rating include:

- Lower Murray Water has overall, met its outcome commitments for the period to date for its urban services.
- Lower Murray Water has tested its guaranteed service level scheme with customers, and confirmed that the current scheme was appropriate.
- Our proposal for relatively minor adjustments to forecast operating and capital costs, reflects Lower Murray Water's sound justification for its proposed expenditure.
- Lower Murray Water proposing to exclude uncertain projects from its capital expenditure forecasts, helping to ensure customers do not pay more than they need to.
- The inclusive nature of Lower Murray Water's engagement including with local services that work with First Nations people, and with customers experiencing payment difficulty.
- Lower Murray Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by them.



- Our preliminary view is that Lower Murray Water’s proposed targets indicate an overall improvement in service levels for its customers.

Our draft decision proposes to not accept Lower Murray Water’s proposed self-rating of its price submission as ‘Standard’ for the Performance element of PREMO.<sup>8</sup>

In 2021-22 (the last available year of audited results), its expenditure was around 20 per cent higher than the benchmark adopted in 2018. After accounting for changes in corporate cost allocation from its rural business to its urban business, this reduces to around 15.6 per cent. This is higher than the average among businesses in the current price review (around 9 per cent).

While Lower Murray Water generally delivered on its outcome commitments, its 2021-22 operating cost increases relative to the 2018 benchmark were relatively high compared to the average.

While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to manage and reprioritise costs closely having regard to the price review benchmarks. The PREMO framework (and the Water Industry Regulatory Order 2014 itself) is built on a sharp focus on efficiency, and base year costs for 2021-22 are critical to assessing the efficient operating costs to be reflected in benchmarks adopted for pricing in the 2023–28 period.

For the 2018 water price review, we approved an overall PREMO rating of ‘Standard’ for Lower Murray Water’s price submission, which is the same overall rating proposed in this draft decision (note its PREMO rating in 2018 only covered its urban business).

See Section 1.4 and Chapter 9 for an explanation of the PREMO framework.



Our PREMO rating is an assessment of the water business’s price submission and its ambition to deliver outcomes valued by its customers. It is not an assessment of the water business itself.

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<sup>8</sup> While Lower Murray Water’s urban services were covered by PREMO at its 2018 water price review, its rural services were not. Accordingly, at the 2023 review the Performance element of PREMO does not apply in relation to Lower Murray Water’s rural infrastructure services.

**Table B**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Lower Murray Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's rating	Standard	Basic	Standard	Standard	Standard	Standard

Among the 9 draft decisions we have released so far, Lower Murray Water is one of 4 businesses for which we propose to approve a 'Standard' rating (Table C).

**Table C**      **Draft decision on PREMO — overall rating**

Leading	Advanced	Standard	Basic
	Barwon Water Gippsland Water GWMWater South East Water Yarra Valley Water	East Gippsland Water Lower Murray Water South Gippsland Water Westernport Water	

## We invite feedback on our draft decision

We invite feedback from stakeholders on our draft decision before we make a final decision and price determination. We expect to release our final decision and price determination in June 2023.

Stakeholders may comment on any aspect of our draft decision, including:

- the information we have relied upon in our assessment (such as Lower Murray Water's price submission);
- additional matters or issues we should consider before making our final decision
- whether our draft decision on Lower Murray Water's price submission has adequate regard to the matters in clause 11 of the Water Industry Regulatory Order 2014 and our guidance.

### How to provide feedback and stay up to date

You can stay up to date with our review via the dedicated Engage Victoria website:

<https://engage.vic.gov.au/water-price-review-2023>

You can provide feedback by:

- taking part in a public forum
- providing written comments or submissions.

## Taking part in a public forum

We plan to hold a public forum on 20 April 2023. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

## Provide written comments or submissions

Written comments or submissions in response to this draft decision will be due by 9 May 2023.

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

We would prefer to receive comments and submissions via the dedicated [Engage Victoria website](#).

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

2023 Water Price Review  
Essential Services Commission  
Level 8, 570 Bourke Street  
Melbourne VIC 3000

## Submission and privacy statement

We encourage transparency in our review processes. It is our policy to publish all submissions to the 2023 water price review on the Essential Services Commission website unless the submitter has requested confidentiality. When we publish a submission, we will also include some details about the submitter (your name, not your address) unless the submitter has requested anonymity (does not want to be identified).

You can request confidentiality in relation to your submission. Requesting this may affect the weight we can give to your submission. You may also request anonymity.

## Next steps

Activity	Indicative date
Public forum	20 April 2023
Closing date for submissions on our draft decision	9 May 2023
Release date for our final decision and price determination	June 2023

## PART A

# 1. Our role and approach to water pricing

## 1.1 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* (WI Act) and sits within the broader context of the *Essential Services Commission Act 2001* (ESC Act). Our role under the WIRO includes regulating the prices and monitoring service standards of the 18 water businesses operating in Victoria.

## 1.2 We are reviewing the proposed prices of 14 water businesses

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.<sup>9</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.<sup>10</sup>

Lower Murray Water provided a submission to us proposing prices for a 5-year period starting 1 July 2023. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2023. The price determination will specify the maximum prices Lower Murray Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the reasons for our price determination.

## 1.3 We assess prices against the WIRO and other legal requirements

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

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

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<sup>9</sup> The review excludes Melbourne Water, Goulburn-Murray Water, North East Water and Greater Western Water. In 2021 we approved prices for Melbourne Water to 30 June 2026 and in 2020 we approved prices for Goulburn-Murray Water to 30 June 2024. In 2018, we approved prices for North East Water to 30 June 2026. We have approved an extension to the regulatory period for Greater Western Water to 30 June 2024.

<sup>10</sup> The prescribed services are listed at clause 7(b) of the WIRO.

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance<sup>11</sup>
- 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.

Appendix B lists the specific objectives and the various matters we must have regard to when making a price determination and provides a guide to where we have done so in this draft decision. Table 1.1 summarises the matters we must have regard to and groups them into themes.

We issued a variation to our guidance for Lower Murray Water in July 2022. This additional guidance is available on our website and clarifies that the Performance element of PREMO does not apply to Lower Murray Water’s rural infrastructure services.<sup>12</sup>

This is the first time that Lower Murray Water’s rural infrastructure services have been assessed under the PREMO framework. Lower Murray Water’s rural business was not assessed under our PREMO framework in 2018, because at that time it fell under the Commonwealth Government’s Water Charge (Infrastructure) Rules 2010 assessment framework.

Our approach with all water businesses that have been assessed for the first time under the PREMO framework has been to limit the overall rating of that business to the four “REMO” elements, but not Performance. Accordingly, in establishing its rating for the Performance element, Lower Murray Water was only required to consider the performance of its urban business.

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<sup>11</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>12</sup> Essential Services Commission, *Variation to guidance paper issued by the Essential Services Commission in respect of Lower Murray Water’s rural infrastructure services*, 29 July 2022.

**Table 1.1 Matters businesses and the commission must have regard to**

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
<ul style="list-style-type: none"> <li>• promotion of efficient use of prescribed services by customers [cl 8(b)(i), WIRO]</li> <li>• promotion of efficiency in regulated entities as well as efficiency in, and the financial viability of, the regulated water industry [cl 8(b)(ii), WIRO]</li> <li>• provision to regulated entities of incentives to pursue efficiency improvements [cl 8(b)(iii), WIRO]</li> <li>• efficiency in the industry and incentives for long term investment [s. 8A(1)(a), ESC Act]</li> <li>• efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry [s. 33(3)(b), ESC Act]</li> <li>• financial viability of the industry [s. 8A(b)(1), ESC Act]</li> </ul>	<ul style="list-style-type: none"> <li>• particular circumstances of the regulated industry and the prescribed goods and services for which the determination is being made [s. 33(3)(a), ESC Act]</li> <li>• return on assets in the regulated industry [s. 33(3)(c), ESC Act]</li> <li>• ensure that regulatory decision making and regulatory processes have regard to any differences between the operating environments of regulated entities [s. 4C(b), WI Act]</li> </ul>	<ul style="list-style-type: none"> <li>• in performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers [s. 8(1), ESC Act] without derogating from that objective. The Commission must in seeking to achieve the objective have regard to the price, quality and reliability of essential services [s. 8(2), ESC Act]</li> <li>• enable customers or potential customers of the regulated entity to easily understand the prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated [cl 11(d)(i), WIRO]</li> <li>• provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible [cl 11(d)(ii), WIRO]</li> <li>• take into account the interests of customers of the regulated entity, including low income and vulnerable customers [cl 11(d)(iii), WIRO]</li> </ul>

Continued next page

Table 1.1 (continued)

Benchmarking	Health, safety and social obligations	Other
<ul style="list-style-type: none"> <li>any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries [s. 33(3)(d), ESC Act]</li> </ul>	<ul style="list-style-type: none"> <li>the relevant health, safety, environmental and social legislation applying to the industry [s 8A(1)(d), ESC Act]</li> <li>to ensure that regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities [s. 4C(c), WI Act]</li> </ul>	<ul style="list-style-type: none"> <li>the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries [s. 8A(1)(c), ESC Act]</li> <li>consistency in regulation between States and on a national basis [s. 8A(1)(f), ESC Act]</li> <li>the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for—(i) consumers and users of products or services (including low income and vulnerable consumers) (ii) regulated entities [s. 8A(1)(e), ESC Act]</li> <li>wherever possible, to ensure that the costs of regulation do not exceed the benefits [s. 4C(a), WI Act]</li> </ul>

**Note:** References in the table are to the Water Industry Regulatory Order 2014 (WIRO), the Essential Services Commission Act 2001 (ESC Act), and the Water Industry Act 1995 (WI Act).



## 1.4 PREMO

PREMO stands for **P**erformance, **R**isk, **E**ngagement, **M**anagement, and **O**utcomes. Each element of PREMO is summarised in Box 1.1.

### Box 1.1 PREMO

Water businesses must demonstrate their level of ambition in delivering value for money for customers in their price submissions across the five PREMO elements:

- Performance — have the performance outcomes to which the business committed in the previous regulatory period been met or exceeded?
- Risk — has the business sought to allocate risk to the party best positioned to manage that risk? To what extent has the business accepted risk on behalf of its customers?
- Engagement — how effective was the business's customer engagement to inform its price submission?
- Management — is there a strong focus on efficiency? Are controllable costs increasing, staying the same, or decreasing? Is the price submission succinct and free of material errors?
- Outcomes — do proposed service outcomes represent an improvement, the status quo, or a reduction of service standards?

First introduced at our 2018 water price review, the purpose of PREMO is to provide incentives for water businesses to deliver outcomes most valued by customers. PREMO includes reputation incentives, via the rating of price submissions as Leading (the highest available rating), Advanced, Standard or Basic, depending on the level of ambition expressed by a water business in its price submission. Financial incentives are provided by linking the return on equity to the PREMO rating.

A key priority under PREMO is to provide incentives for a water business to engage with customers to understand their priorities and concerns and take these into account in forming its proposals, as outlined in its price submission. These should be evidenced in price submissions by linking the outcomes proposed with findings from a business's engagement.

Our guidance specifies the way in which we expect water businesses to assess themselves by reference to the PREMO elements.

Our 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>13</sup>

For the 2023 water price review, a water business's ambition in terms of delivering customer value is being assessed against all five elements of PREMO — Performance, Risk, Engagement, Management and Outcomes. This is the first water price review where we are assessing the Performance element of the PREMO framework. The Performance element assesses businesses against their Outcomes and proposals from the previous price review (for our 2023 review, this means proposals at the 2018 water price review). We did not assess the Performance element in 2018 because it was the first time that we had applied the PREMO framework and so we did not have a set of approved Outcomes to inform our assessment.

Taking into account all five elements of PREMO, a water business 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 proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>14</sup>

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<sup>13</sup> In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

<sup>14</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.

## 2. Our assessment of Lower Murray Water's price submission

We have made our draft decision on Lower Murray Water's price submission after considering:

- Lower Murray Water's price submission
- Lower Murray Water's responses to our queries
- our consultants' reports
- written submissions from interested parties (a list of submissions is provided in Appendix A).

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

Our guidance included matters water businesses must address in their price submissions. Lower Murray Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this draft decision.

We found Lower Murray Water's price submission generally presented clear and comprehensive information to support its proposals. Lower Murray 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 Section 2.3 on customer engagement).

Unless otherwise noted, all financial values referred to in this draft decision paper are in \$2022-23, which means inflation is excluded.



Lower Murray Water must submit a response to our draft decision and provide an updated financial model by 9 May 2023 (via email to [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au)). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for Lower Murray Water in June 2023.

### 2.1 Draft decision paper outline

This decision paper is structured around the steps we take to arrive at our price determination. In summary, these steps are:

- Determine the regulatory period (Section 2.2).
- Confirm the customer outcomes and service levels that Lower Murray Water has committed to over the regulatory period (Chapter 3 for urban services and Chapter 6 for rural services).

Our assessment of Lower Murray Water's price submission

- Establish Lower Murray Water’s revenue requirement using a building block methodology (Chapter 4 for urban services and Chapter 7 for rural services).
- Use demand forecasts and the form of price control to convert the revenue requirement to tariffs and prices (Chapter 5 for urban services and Chapter 8 for rural services).

Chapter 9 outlines our assessment of Lower Murray Water’s price submission under the PREMO framework.

Below, we address elements of our draft decision that are common to Lower Murray Water’s urban and rural services; namely its regulatory period, engagement, and rate of return.

## 2.2 Regulatory period

Our draft decision is to approve a regulatory period of 5 years from 1 July 2023.

We are required to set the term of the regulatory period over which a water business’s price determination will apply.<sup>15</sup> Our guidance proposed that we set a 5-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.<sup>16</sup>

Lower Murray Water proposed a regulatory period of 5 years. Accordingly, consistent with the reasons outlined in our guidance, our draft decision proposes to set a regulatory period of 5 years.

## 2.3 Customer engagement

Our guidance required Lower Murray Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Lower Murray Water’s engagement.<sup>17</sup>

We consider Lower Murray Water’s engagement aligned with these principles in a number of ways. Lower Murray Water:

- engaged early, building on survey data gathered in mid-2021 and continuing through to September 2022
- used a range of methods including surveys, focus groups, deliberative processes and customer committee meetings, as well as one-on-one approaches such as on-farm and in-field activities – reaching a total of 19,000 urban and rural customers
- tailored its engagement to suit customer circumstances, including through meetings with local service providers to understand the needs of customers experiencing vulnerability, and using

<sup>15</sup> This is a requirement of the WIRO, clause 9.

<sup>16</sup> For detail on the reasons for using five years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, p. 18.

<sup>17</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

deliberative processes with its rural and urban customers to support deeper discussion and exploration of issues

- engaged in a way that was inclusive of the experience of First Nations people and Traditional Owners, including testing and reviewing issues with Mallee District Aboriginal Services, Murray Valley Aboriginal Co-Op and the First People of the Millewa-Mallee Aboriginal Corporation
- engaged on matters that influence services and prices, such as its performance measures and targets, investment priorities, its approach to volumetric pricing for urban customers, allocation of corporate costs between the urban and rural sides of the business, and proposed price paths for rural and urban customers.
- More detail on Lower Murray Water's engagement is available in its price submission.<sup>18</sup>

Actions proposed to be taken by Lower Murray Water in response to customer feedback provides evidence that its engagement influenced its proposals. For example, in its price submission, Lower Murray Water proposed:

- outcomes that reflected the key findings from its engagement
- an extended period of review and evaluation of potential impacts of changes in its three-tiered volumetric charges – in response to feedback from participants in its engagement that sought a thorough exploration of all issues including any impact change might have on customers already experiencing payment difficulty
- prioritising local initiatives when addressing carbon offset requirements – in response to feedback from participants in its urban deliberative forum that this was a valued local investment
- changes in the corporate cost allocation split between its rural and urban services – in response to feedback from rural customers this should be examined, and after acceptance by urban customers of the fairness of the new split continued purchases of additional bulk water entitlements – in response to feedback customers prioritise securing future water supply and reliable services
- continued investment in digital services – in response to feedback from rural customers they valued efficiency measures that improve service delivery such as water ordering as well as accessible communications.

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

Overall, our preliminary view is that Lower Murray Water has designed and delivered an engagement program that is responsive to its operating environment and the context of its community and service mix, which includes both rural and urban water services. We acknowledge the Consumer Action Law Centre's feedback on the relatively short duration of its engagement on

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<sup>18</sup> Lower Murray Water's price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

its pricing submission and have taken that into account in our assessment of its overall engagement program.<sup>19</sup>

We consider that Lower Murray Water engaged widely, gathering insights from across its customer base using a range of methods to support customer participation on issues that had meaningful influence on its investment decisions and service levels.

We consider that Lower Murray Water's engagement was sufficiently inclusive and well suited to the circumstances of its customers. It engaged directly with service providers that work with people experiencing vulnerability and recruited a diverse mix of customers to participate in its deliberative forum. In doing so it achieved an understanding of the issues and concerns of its customers experiencing vulnerability and provided opportunities for these issues to inform the decision-making process.

Our review of its deliberative processes identified that Lower Murray Water achieved strong participation, including during its urban deliberative forum. Lower Murray Water provided good quality information and presentation materials to members to support their deliberation. The forum also provided suitable opportunities for deeper discussion and issue exploration.

Lower Murray Water built on its existing engagement activities with rural customers by involving its advisory committees early in its engagement, and at key stages in its program to test engagement findings and to develop options. Through these forums, members were able to ensure the consideration of past engagement outcomes in future proposals. Lower Murray Water expanded the reach of its engagement on its price submission using technical field staff to engage customers, and individual interviews with major rural stakeholders.

Based on the above, our preliminary view is that we accept its self-rating of 'Standard' for its price submission engagement. See Chapter 9 for more detail on our PREMO assessment of Lower Murray Water's price submission.

## **2.4 Rate of return**

In establishing the return on assets component of Lower Murray Water's revenue requirements, we have applied a rate of return to Lower Murray Water's regulatory asset base calculated for each of its urban and rural services. The rate of return is calculated using a benchmark cost of debt and a benchmark return on equity value.

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<sup>19</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 1 December 2022, 30 November 2022, p. 8.

### 2.4.1 Cost of debt

Our draft decision is to accept the cost of debt proposed by Lower Murray Water.

Our guidance required Lower Murray Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Lower Murray Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, as set out in Table 2.1, our draft decision is to accept the cost of debt proposed by Lower Murray Water, noting that the cost of debt estimates will be updated following the release of the Australian Bureau of Statistics March Quarter 2023 consumer price index.

**Table 2.1** Draft decision – cost of debt

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Cost of debt (nominal)	7.05%	5.36%	5.27%	4.91%	4.53%	4.61%	3.31%	3.05%	3.75%	3.75% <sup>a</sup>

**Note:** Numbers have been rounded. <sup>a</sup> Estimated cost of debt – we will update the 2022-23 figure before the final decision and price determination.

### 2.4.2 Return on equity

Our draft decision is to adopt a return on equity of 4.1 per cent, which reflects Lower Murray Water's PREMO self-rating.

Under our PREMO incentive mechanism, which we have applied since 2018, the return on equity we adopt to calculate the revenue requirement is linked to a business's PREMO rating. See Chapter 9 for an explanation of PREMO and our assessment of Lower Murray Water's PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water business's self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business's self-rating and our rating.<sup>20</sup> We reviewed the return on equity values in the matrix in mid-2022 given the change in market conditions that has occurred since we published our guidance in October 2021. We consider that the values in our matrix reflect the medium-term real rates of return.<sup>21</sup>

<sup>20</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42–43.

<sup>21</sup> We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity

Lower Murray Water rated its price submission as 'Standard'. Based on this PREMO self-rating, Lower Murray Water proposed a return on equity of 4.1 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as 'Standard'.<sup>22</sup>

As outlined in Chapter 9, our draft decision is to agree with Lower Murray Water's PREMO self-rating and adopt its proposed return on equity.

## 2.5 Financial position

We have reviewed key indicators of Lower Murray Water's financial performance and our preliminary view is that Lower Murray Water will generate sufficient cash flow to deliver on its service commitments.

In approving prices, we must have regard to the financial viability of the water industry.<sup>23</sup> We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the *Water Industry Regulatory Order (2014)* to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

Lower Murray Water's price submission and the supporting financial models provided estimates for key indicators of financial performance. These estimates were based on Lower Murray Water's assumptions about its revenue and expenditure. We have reviewed the key indicators of financial performance and our preliminary view is that we consider Lower Murray Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

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adopted by interstate regulators in the following publications: Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW's rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water's water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

<sup>22</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

<sup>23</sup> WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).



## PART B – Urban water and sewerage services

## 3. Customer outcomes

The customer outcomes Lower Murray Water plans to deliver over the regulatory period are a key component of its price submission – confirming its commitments to customers, underpinning its revenue requirement, and feeding in to its PREMO assessment.

This chapter:

- reviews whether Lower Murray Water has delivered on the urban services outcomes it committed to for the current regulatory period (2018–23) and examines the customer outcomes Lower Murray Water is committing to for the next regulatory period
- outlines Lower Murray Water’s proposed urban service standards
- outlines Lower Murray Water’s proposed urban guaranteed service levels.

### 3.1 Outcomes

#### 3.1.1 Performance against outcome commitments 2018–23

As part of our 2018 water price review, Lower Murray Water established ‘outcomes’ it would deliver its urban customers over the following 5 years. These outcomes were reflected in the prices we approved for the period 1 July 2018 to 30 June 2023. Progress against these outcome commitments can indicate whether customers got what they paid for.

A business’s price submission should account for its actual performance against its outcome commitments for the current period, from 1 July 2018 to 30 June 2023.<sup>24</sup>

We consider Lower Murray Water accounted for its annual performance for each measure in its price submission. Table 3.1 lists Lower Murray Water’s outcome commitments for its urban services and includes its annual performance results as reported in its price submission and the period-to-date rating published in our 2021-22 Outcomes report.<sup>25</sup> The information in this table informs our assessment under the Performance element of PREMO, which is discussed in Chapter 9.

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<sup>24</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

<sup>25</sup> Lower Murray Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

**Table 3.1 Business self-assessment of performance against Outcome commitments**

Outcome (urban services)	2018-19	2019-20	2020-21	2021-22	Period to date <sup>a</sup>
1. Keep my costs to a minimum	Amber	Red	Amber	Green	Amber
2. Be easy to contact and quick to respond	Green	Green	Green	Amber	Green
3. Provide me with consistent, safe, clean drinking water	Green	Amber	Green	Amber	Amber
4. Provide me with reliable sewerage services	Green	Green	Green	Green	Green
5. Be present and active in the community	Green	Green	Green	Green	Green
6. Be mindful of our environment	Red	Amber	Amber	Amber	Amber
7. Comply with other government obligations	Green	Green	Green	Green	Green

**Note:** Green = achieved target; Amber = close to achieving target; Red = failed to meet target. <sup>a</sup> This is Lower Murray Water’s self-assessment of its performance across the first 4 years of the current regulatory period. Lower Murray Water’s performance against Outcome commitments in the final year of the current regulatory period (2022-23) will be published in our 2022-23 Outcomes Report.

Source: Lower Murray Water, 2023 water price submission, September 2022, p. XX; Essential Services Commission, Lower Murray Water’s outcomes performance 2021-22, October 2022.

In its price submission, Lower Murray Water reported it had achieved or exceeded its targets for 86 (74 per cent) of its 116 performance targets related to its urban services over the first 4 years of the current regulatory period. Of these 116 targets, 14 (12 per cent) have been rated as amber ‘close to achieving target’ and 16 (14 per cent) as red ‘failed to meet’ in the period to date.<sup>26</sup>

Lower Murray Water considers it was close to achieving its targets for outcome 1, ‘keep my costs to a minimum’ for the period to date. However, its measure to deliver 1 per cent per year efficiency improvement on controllable costs from 2016-17 was not met in the last 3 years of the current regulatory period. It considers the key drivers for not meeting its targets were increases in operating costs required to deliver outcomes and compliance requirements, and the uplift in information and communications technology expenditure.<sup>27</sup>

Lower Murray Water considers it was close to achieving its targets for outcome 6 ‘be mindful of our environment’ for the period to date. It failed to meet its annual targets for each year of the current

<sup>26</sup> Lower Murray Water provided incorrect rating totals and percentages for its targets on page 46 of its price submission. We have drawn on the information reported in Table B1 and provided corrected figures above. Lower Murray Water, 2023 water price submission, September 2022, Table B1, p. 47.

<sup>27</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 48.

regulatory period for its carbon emissions measure. In its price submission, it notes that actions are underway to address the issues preventing it from achieving its targets.<sup>28</sup>

Lower Murray Water considers it performed well for outcome 5, 'be present and active in the community,' despite challenges due to the covid-19 pandemic. It delivered an Aboriginal Reconciliation Action Plan and Diversity and Inclusion Strategy during the period, and in its annual survey customers consistently provided satisfaction ratings above 90 per cent for Lower Murray Water's role in the community, via.<sup>29</sup>

In the current regulatory period, Lower Murray Water published its annual performance report on its website.

Our draft decision is that we agree with Lower Murray Water's self-assessment that it has, overall, met its outcome commitments in relation to its urban services for the period to date.

### **3.1.2 Outcome commitments for 2023–28**

Lower Murray Water engaged with its customers to refine its urban services outcomes for the period from 1 July 2023 to 30 June 2028. It has established five customer outcomes it proposes to deliver for its urban services:

- Maintaining costs to a minimum
- Provide customers reliable and safe drinking water
- Provide customers with reliable sewerage services
- Provide customer service avenues that are responsive to resolve requests and enquiries
- Service its communities in a socially responsible and environmentally sustainable manner.<sup>30</sup>

### **3.1.3 Our assessment of measures and targets**

Lower Murray Water proposed a set of 21 measures and targets that it will use to report on performance across the 5 urban services outcomes. These are set out on page 64 of its price submission. Performance against these measures will inform our assessment during future price reviews.

We have assessed Lower Murray Water's proposed measures against the criteria set out in our guidance which states that proposed output measures for each outcome must:

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable

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<sup>28</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 49-50.

<sup>29</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 47 and p.49.

<sup>30</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 64.

- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.<sup>31</sup>

Evidence provided by Lower Murray Water demonstrates that its urban services measures and targets were developed in consultation with its customers, and that they are supported by its customers. It engaged customers through community advisory committees and panels, community focus groups, and targeted surveys. Agreement was obtained from its urban deliberative panel that its revised outcome commitments, performance measures, and targets captured urban customer priorities and expectations.<sup>32</sup>

Generally, we consider Lower Murray Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each urban services outcome. However, there are some matters that we will follow up with Lower Murray Water to improve the clarity and accountability of its targets.

We will provide Lower Murray Water with our standard Outcomes Reporting Template to complete and submit with its response to this draft decision. We will work with the business to ensure the final set of measures addresses the above matters and complies with our guidance requirements.

For its urban services, our preliminary view is that Lower Murray Water's proposed targets for its outcome measures suggest an overall improvement in customer value.

Lower Murray Water will report annually to its customers on how it has performed against its outcome commitments. It will re-establish its urban customer advisory committee, to review its performance against its outcome commitments and other initiatives.<sup>33</sup>

### **3.2 Service standards related to service reliability and faults**

Service standards are a common set of services applicable to all Victorian consumers required under Clause 18.2 of the *Water Industry Standard – Urban Customer Service* (Urban Water Industry Standard). Each water business must specify its own targets against each of these service standards. Rather than performance measures, these service standards and corresponding service levels are the minimum level of service customers can expect to receive.

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<sup>31</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

<sup>32</sup> Lower Murray Water, 2023 water price submission, September 2022, pp. 9–19.

<sup>33</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 65.

Lower Murray Water’s proposed service standards relating to reliability and faults can be found in its urban service standard 2023–28 document.<sup>34</sup>

Lower Murray Water’s proposed urban service standards are consistent with the current service standards in the Urban Water Industry Standard and its customer charter (with some wording changes to align with the updated Water Industry Standard). It has included three additional service standards related to customer service and maximum time in responding to complaints. Lower Murray Water reviewed the proposed urban service standards with its customers. Lower Murray Water has also specified minimum flow rates as required by the Water Industry Standard.

On the basis of the above, our preliminary assessment is that the service standards relating to reliability and faults proposed by Lower Murray Water comply with the requirements of the Urban Water Industry Standard.

Service standards are approved in our Water Industry Standard. Accordingly, in early 2023-24, we will update the Urban Water Industry Standard to reflect approved service standards.

### **3.3 Guaranteed service levels**

Our draft decision is to accept Lower Murray Water’s proposed guaranteed service levels for its urban services.

Guaranteed service levels define a water business’s commitment to deliver a specified level of service. For each guaranteed service level, typically a water business commits to a payment or a rebate on bills to those who have received a level of service below the guaranteed level.

Lower Murray Water’s proposed guaranteed service levels are set out on pages 65 and 66 of its price submission. It has proposed to maintain its current urban guaranteed service levels and rebate amounts. Its engagement with its customers revealed that customers were happy with the service levels they currently receive. Customers did not think lower thresholds for guaranteed service level rebates were required or that higher rebates were required. Customers reiterated the high level of inconvenience of a sewage spill into a customer’s home.

Our draft decision is to accept Lower Murray Water’s proposed urban guaranteed service levels, on the basis that they have been agreed with customers during its engagement. Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

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<sup>34</sup> Lower Murray Water, proposed urban service standards 2023–28, February 2023.

Guaranteed service levels are approved in our water industry standards. Accordingly, in early 2023-24, we will update the standards to reflect the guaranteed service levels published in our final decision.

## 4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>35</sup> Along with forecast demand, it is an input to calculating prices.

We have used a building block methodology to establish the revenue requirement. This chapter outlines our assessment of Lower Murray Water's revenue requirement for its urban services based on the following steps:

- establish an efficient benchmark level of forecast operating expenditure for the next regulatory period (Section 4.1)
- establish an efficient benchmark level of forecast capital expenditure for the next regulatory period (Section 4.2)
- roll-forward the regulatory asset base (Section 4.3)
- apply a rate of return to the regulatory asset base, calculated using:
  - a benchmark cost of debt estimated using a 10-year trailing average approach (Section 2.1.1)
  - a benchmark return on equity value determined by Lower Murray Water's PREMO rating (Section 2.1.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.4)
- establish a benchmark tax allowance (Section 4.5).

For its urban services, our draft decision is to not approve the revenue requirement in Lower Murray Water's price submission, and instead approve a revenue requirement of \$216.7 million, which is 1.2 per cent lower than proposed.

Lower Murray Water proposed a revenue requirement for its urban services of \$219.3 million over a 5-year period starting 1 July 2023. Our draft decision approves a revenue requirement of \$216.7 million (Table 4.1).

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<sup>35</sup> We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Lower Murray Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.



**Table 4.1 Draft decision on Lower Murray Water’s urban services revenue requirement**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	29.3	29.4	29.5	29.9	29.3	147.5
Return on assets	5.2	5.0	5.0	4.9	4.9	24.9
Regulatory depreciation	10.4	10.9	9.6	9.6	9.4	49.9
Non prescribed revenue requirement <sup>a</sup>	-1.1	-1.1	-1.1	-1.1	-1.1	-5.5
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
<b>Draft decision – revenue requirement</b>	<b>43.7</b>	<b>44.2</b>	<b>42.9</b>	<b>43.3</b>	<b>42.5</b>	<b>216.7</b>

**Note:** Numbers have been rounded. <sup>a</sup> The offsets relate to revenue earned from non-prescribed water purchases.

Table 4.2 summarises how our draft decision on Lower Murray Water’s urban services revenue requirement (row E) differs to the revenue requirement proposed by Lower Murray Water in its price submission (row A). Where our draft decision differs from Lower Murray Water’s price submission in relation to a component of the revenue requirement, the adjustment we propose is shown in rows B to D of Table 4.2. The adjustments we propose are generally relatively small and are mainly to correct errors in regulatory accounts estimates for 2021-22.

Our final decision on Lower Murray Water’s urban services revenue requirement will be based on the latest available information.

Accordingly, as well as responding to our draft decision and providing an updated price schedule, Lower Murray Water must update its urban services revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination that impact on its forecast costs and the revenue requirement, Lower Murray Water should update its price submission and provide us with an updated financial model. It also should notify us of any material changes that impact its forecast costs, revenue requirement or prices (including demand). Any updates to its submission or pricing model will be made publicly available on our website.

**Table 4.2 Our proposed adjustments to Lower Murray Water’s proposed urban services revenue requirement**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Lower Murray Water’s proposed urban services revenue requirement</b>	<b>44.1</b>	<b>44.7</b>	<b>43.5</b>	<b>43.9</b>	<b>43.1</b>	<b>219.3</b>
B. Operating expenditure	-0.3	-0.3	-0.4	-0.4	-0.4	-1.7
C. Return on assets	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
D. Regulatory depreciation	-0.0	-0.1	-0.1	-0.1	-0.1	-0.4
<b>E. Draft decision – urban services revenue requirement (A+B+C+D)</b>	<b>43.7</b>	<b>44.2</b>	<b>42.9</b>	<b>43.3</b>	<b>42.5</b>	<b>216.7</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Lower Murray Water proposed in its price submission. Row A shows the total urban services revenue requirement proposed by Lower Murray Water in its price submission. We have arrived at our draft decision (row E) by proposing the relevant adjustments to the components of the revenue requirement shown in rows B to D. Numbers have been rounded.

## 4.1 Operating expenditure

For Lower Murray Water’s urban services, our draft decision is to adopt a forecast operating expenditure of \$147.46 million, which is \$1.75 million lower than proposed by Lower Murray Water.

Operating expenditure is a component of the revenue requirement. Lower Murray Water’s price submission provides detail on its forecast operating expenditure for its urban services from pages 73 to 78.

We assess both:

- controllable operating expenditure – comprising all costs that can be directly or indirectly influenced by a water business’s decisions
- non-controllable operating expenditure – comprising all costs that cannot be directly or indirectly influenced by a water business’s decisions.

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting's report on its assessment of Lower Murray Water's expenditure forecast is available on our website.<sup>36</sup>

Table 4.3 sets out our draft decision on Lower Murray Water's forecast urban services operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

**Table 4.3 Draft decision – urban services operating expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>26.76</b>	<b>26.91</b>	<b>27.02</b>	<b>27.49</b>	<b>26.92</b>	<b>135.11</b>
<b>Non-controllable operating expenditure</b>	<b>2.54</b>	<b>2.50</b>	<b>2.47</b>	<b>2.45</b>	<b>2.40</b>	<b>12.35</b>
Bulk services <sup>a</sup>	0.72	0.73	0.75	0.76	0.76	3.73
Environmental contribution <sup>b</sup>	1.73	1.68	1.63	1.59	1.54	8.17
Licence fees – Essential Services Commission <sup>c</sup>	0.02	0.02	0.02	0.04	0.04	0.15
Licence fees – Department of Health <sup>c</sup>	0.02	0.02	0.02	0.02	0.02	0.09
Licence fees – Environmental Protection Authority <sup>c</sup>	0.04	0.04	0.04	0.04	0.04	0.21
<b>Draft decision – operating expenditure</b>	<b>29.30</b>	<b>29.41</b>	<b>29.49</b>	<b>29.93</b>	<b>29.32</b>	<b>147.46</b>

**Notes:** Numbers have been rounded. <sup>a</sup> Bulk services covers the supply of bulk water and sewerage services.

<sup>b</sup> Environmental contributions are funds collected from water businesses under the *Water Industry Act 1994*. <sup>c</sup> Licence fees are paid to cover costs incurred by the Department of Health, the Environment Protection Authority Victoria, and the Essential Services Commission in their regulatory activities related to the water business.

Table 4.4 summarises how our draft decision on Lower Murray Water's urban services operating expenditure (row D) and its two components differ from the operating expenditure proposed by Lower Murray Water in its price submission (row A). Rows B and C of the table summarise our proposed adjustments to Lower Murray Water's proposed controllable and non-controllable operating expenditure for urban services.

<sup>36</sup> FTI Consulting, *Lower Murray Water – Expenditure Review for 2023 water price review*, February 2023.

Details of our assessment and reasons for our proposed adjustments to Lower Murray Water’s proposal are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).

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

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

**Table 4.4 Our proposed adjustments to Lower Murray Water’s proposed urban services operating expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Lower Murray Water’s proposed total operating expenditure</b>	<b>29.55</b>	<b>29.71</b>	<b>29.84</b>	<b>30.33</b>	<b>29.77</b>	<b>149.21</b>
<b>B. Our total proposed adjustments to controllable operating costs (B1)</b>	<b>-0.20</b>	<b>-0.20</b>	<b>-0.20</b>	<b>-0.20</b>	<b>-0.20</b>	<b>-1.00</b>
B1 – Revised water reticulation and distribution costs	-0.20	-0.20	-0.20	-0.20	-0.20	-1.00
<b>C. Our total proposed adjustments to non-controllable operating costs (C1)</b>	<b>-0.05</b>	<b>-0.10</b>	<b>-0.15</b>	<b>-0.20</b>	<b>-0.25</b>	<b>-0.75</b>
C1 – Environmental contribution	-0.05	-0.10	-0.15	-0.20	-0.25	-0.75
<b>D. Draft decision - total operating expenditure (D = A + B + C)</b>	<b>29.30</b>	<b>29.41</b>	<b>29.49</b>	<b>29.93</b>	<b>29.32</b>	<b>147.46</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Lower Murray Water proposed in its price submission. Row A shows the total operating expenditure proposed by Lower Murray Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating costs and non-controllable operating costs shown in rows B and C (itemised in rows B1 and C1). Numbers have been rounded.

### 4.1.1 Controllable operating expenditure

Lower Murray Water proposed a total forecast controllable operating expenditure for urban services of \$136.11 million over a 5-year regulatory period. For the reasons set out below, we propose to adopt a forecast operating expenditure of \$135.11 million for the 2023–28 regulatory period, which is \$1.0 million lower than proposed by Lower Murray Water.

Lower Murray Water's forecast controllable operating expenditure for the period from 1 July 2023 is estimated through a series of steps:

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, one-off items are removed or normally occurring items are added in.
2. Apply a growth rate for operating expenditure for the regulatory period – assumed by Lower Murray Water to be 1.1 per cent per year.
3. Apply an annual cost efficiency improvement rate – assumed by Lower Murray Water to be 1.08 per cent per year.
4. Make adjustments for additional costs or cost saving expected in future years.

#### 4.1.1.1 Baseline controllable operating expenditure

Lower Murray Water has proposed a controllable operating expenditure baseline of \$27.21 million for urban services, after adding \$0.90 million due to a change in corporate cost allocations between its urban and rural services and \$0.09 million to account for recurring operating expenditure that had not been incurred in 2021-22 and removing \$0.75 million in non-recurring costs. Lower Murray Water's proposed baseline is \$4.47 million (or 20 per cent) higher than the benchmark figure of \$22.74 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Our expenditure consultant requested substantiation of Lower Murray Water's proposed increase to its baseline year urban services operating expenditure benchmark. Lower Murray Water explained the increase was due to a number of factors including the reallocation of indirect corporate costs to urban from rural services, and increases labour costs reflecting structural change, chemicals and IT costs.

Our expenditure consultant verified these additional costs were recurring and found Lower Murray Water's substantiation of these costs to be mostly reasonable, but recommended one adjustment, as described below.<sup>37</sup>

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<sup>37</sup> FTI Consulting, *Lower Murray Water – Expenditure Review for 2023 water price review*, February 2023, pp. 26–33.

Our expenditure consultant found that the costs comprising the \$0.4 million for increases in urban water reticulation and distribution costs were recurring and reasonable. However, as Lower Murray Water had forecasted the future annual expenditure for this item to be \$0.2 million lower than what had occurred in 2020-21, our expenditure consultant recommended removing the additional \$0.2 million from the proposed baseline to reflect these forecasted costs.

Accordingly, our expenditure consultant recommended accepting Lower Murray Water's proposed urban services baseline increase with the \$0.2 million adjustment noted above. We reviewed Lower Murray Water's proposal and the advice from our expenditure consultant.

Given the above, our preliminary view is that removing the \$0.2 million for urban water reticulation and distribution costs results in an efficient baseline cost to forecast annual urban services operating expenditure for the purpose of our draft decision.

#### **4.1.1.2 Efficiency improvement and growth rate**

Lower Murray Water proposed an average efficiency improvement rate on its controllable urban services operating costs of 1.08 per cent per annum. This is a slightly higher rate than the rate it proposed in its 2018 price submission (an efficiency rate of 1.00 per cent per annum), but around the median when compared to other businesses in the current price review.

For the average cost growth rate, Lower Murray Water has proposed a rate of 1.1 per cent per annum which is also around the median when compared to other businesses in the current price review. As the efficiency improvement rate is almost the same as Lower Murray Water's proposed average cost growth rate, this effectively delivers minimal net annual changes to its controllable annual baseline operating costs in each year of the next regulatory period.

Lower Murray Water has not proposed any cost savings that would reduce its level of service to its customers but has sought productivity improvements through an organisation restructure to improve service delivery teams across the business.

#### **4.1.1.3 Cost adjustments**

Lower Murray Water has proposed additional forecast operating expenditure adjustments to the annual baseline for urban services, including:

- \$2.8 million for increased ICT expenditure reflecting the rollout of the second phase of its Business Transformation Program and a step-up in Software as a Service (SaaS) licence fees between 2022-23 and 2023-24
- \$0.43 million due to increased purchases of large-scale generation certificates (LGCs) to meet a commitment to source 100 per cent of its energy from renewable sources by 2025
- -\$1.31 million reduction as electricity costs are forecast to decrease due to stabilisation of prices compared to the current regulatory period

- -\$1.14 million savings for forecast efficiencies in Technical Service activities with a reduction in consultant and contractor expenses through increased staff retention and development
- -\$0.8 million in balancing variations.

The above adjustments to the forecast urban services baseline represent an overall reduction of \$0.02 million over the regulatory period.

Our expenditure consultant reviewed each of the proposed forecast variations to the baseline and requested further information from Lower Murray Water, including further information on the \$2.8 million for ICT expenditure and the \$0.43 million for the purchase of LGC carbon offsets. Our consultant considered that Lower Murray Water provided solid reasoning and evidence for both additions and did not recommend adjusting the business's proposed step changes, especially given the net overall minor reduction from step changes to Lower Murray Water's forecast urban services controllable operating expenditure in the next regulatory period.

We have considered the advice from our expenditure consultant, and Lower Murray Water's proposal. We consider Lower Murray Water's approach to forecasting its urban services operating expenditure is consistent with the requirements of our guidance. Our preliminary position is therefore that we are satisfied that its proposed forecast for urban services represents efficient controllable operating expenditure. There is evidence that Lower Murray Water has significantly tested its controllable expenditure requirements, resulting in it forecasting an overall decline (excluding inflation) in controllable operating expenditure per customer connection across the 2023–28 regulatory period.

#### 4.1.2 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

- obtaining the most recent information from the relevant regulatory authorities on their licence fees and the environmental contribution
- adjusting the forecasts proposed by Lower Murray Water where required.

The values we have adopted for our draft decision regarding urban services are set out above in Table 4.3.

Lower Murray Water has proposed \$13.10 million in non-controllable operating expenditure for urban services over the 2023–28 regulatory period. This is a decrease of \$0.33 million compared to the 2018–23 regulatory period, driven by a \$0.14 million increase in external bulk charges and a decrease of \$0.49 million reflecting the decrease in the real value of the environmental contribution across the 2018–23 regulatory period.

Our guidance paper sets out our approach for businesses to forecast their non-controllable operating costs. We consider businesses should forecast licence fees for the Department of

Health, the Environment Protection Authority Victoria and the Essential Services Commission to remain flat in real terms, and for the environmental contribution to remain flat in nominal terms (decline in real terms) across the 2023–28 regulatory period. Lower Murray Water has partially followed this approach in its price submission with a forecasted flat licence fee for the Essential Services Commission for the first 3 years but has included a \$0.01 million increase in 2026-27 and 2027-28 for the next regulatory period. Further, its proposal forecasts the environmental contribution remaining flat in real terms rather than nominal terms. We will review these figures prior to our final decision.

Our draft decision proposes to reduce Lower Murray Water’s forecast non-controllable operating expenditure for urban services by \$0.75 million across the 2023–28 period, resulting from adjustments to the environmental contribution to reflect a flat rate in nominal rather than real terms across the 2023–28 regulatory period, based on the forecast figure from the last year of the current regulatory period (2022-23).

We have reviewed Lower Murray Water’s forecast bulk charges with Goulburn-Murray Water’s 2022-23 approved tariffs and request that Lower Murray Water respond to our draft decision by:

- updating its forecast bulk charges by maintaining the forecast bulk charges at a flat rate in real terms (using a price path of 0 per cent and not applying CPI) during the next regulatory period
- submitting an updated financial model which takes into account these changes.

Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation and external bulk charges data.

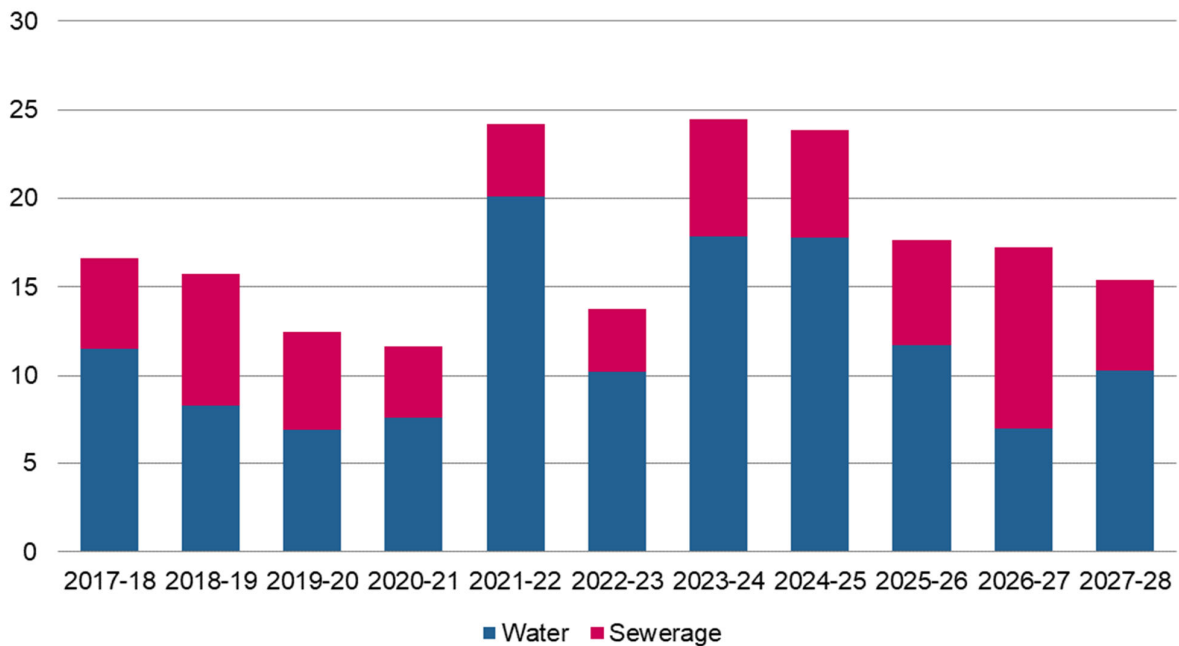
## 4.2 Capital expenditure

For its urban services, our draft decision is to adopt a forecast capital expenditure of \$94.8 million between 2023-24 and 2027-28, which is \$3.8 million or 4 per cent lower than proposed by Lower Murray Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Lower Murray Water’s forecast capital expenditure and supporting information for urban services is provided at pages 78 to 82 of its price submission. Figure 4.1 shows Lower Murray Water’s actual gross capital expenditure for urban services for 2017-18 and the first 4 years of the current regulatory period (2018-19 to 2021-22) and forecast gross capital expenditure for urban services from 2022-23 to 2027-28. The first 5 years of actual expenditure shown in Figure 4.1 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.



**Figure 4.1 Gross capital expenditure for urban services by service category**  
\$ million 2022-23



**Note:** This graph shows actual figures for 2017-18 to 2021-22, and Lower Murray Water's forecasts for 2022-23 to 2027-28.

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure. FTI Consulting's report on its assessment of Lower Murray Water's expenditure forecast is available on our website.<sup>38</sup>

#### 4.2.1 Actual capital expenditure

The PREMO framework involves reviewing a business's actual performance over the current regulatory period, against its proposals and commitments made to its customers in its previous price submission. This includes a comparison of its actual capital expenditure against the approved expenditure forecasts for the current regulatory period.

Lower Murray Water has indicated it will incur \$85.6 million in actual gross capital expenditure for urban services over the period from 2017-18 to 2021-22. This is around \$7.1 million or 9.1 per cent above the benchmarks adopted at the 2018 price review. In net terms, its expenditure was around \$3.8 million or 5.1 per cent lower than the benchmarks adopted at the 2018 water price review.

Lower Murray Water forecasted \$13.7 million in capital expenditure for urban services for 2022-23 consistent with the benchmark approved for 2022-23 in the 2018 price determination.

<sup>38</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts – 2023 Water Price Review*, February 2023.

However, in its price submission, Lower Murray Water has indicated that it has included 2022-23 costs relating to the Stage 3 UV Works project to its 2023-24 forecast for the purposes of capturing these costs in its regulated asset base. Considering these costs are anticipated to occur in 2022-23, this indicates Lower Murray Water has an updated forecast of \$17.5 million for the year 2022-23.<sup>39</sup> Our draft decision on Lower Murray Water's proposal to include the additional amount of \$3.8 million in its capital forecast is discussed in Section 4.2.2. below.

As at the end of June 2022, Lower Murray Water reported that of the nine major projects included in its 2018 price determination for the 2018–23 period, four were complete with one other project on schedule for completion in 2022-23.<sup>40</sup> Of the remaining four projects:

- The Merbein Wastewater Treatment Plant Diversion project is delayed, with decommission works to occur into the next regulatory period.
- The Koorlong Wastewater Treatment Plant Upgrade project was deferred after the renewal of automation hardware allowed for the extension of the useful life of existing assets.
- Two further major projects were cancelled following the completion of the Swan Hill North Water Treatment Plant Ground Level Storage project, after an options assessment identified the additional storage at this facility would reduce the need for new pump and water main infrastructure.

Based on the above, our preliminary view is that we consider the actual capital expenditure Lower Murray Water has incurred for urban services from 2017-18 to 2022-23 is appropriate for the purpose of calculating its regulatory asset base (see Section 4.3.1).

#### 4.2.2 Forecast Capital Expenditure

Lower Murray Water proposed a total forecast capital expenditure of \$98.6 million for urban services.

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<sup>39</sup> While we consider including the additional \$3.8 million for the Stage 3 UV Works project reflects a more up to date forecast of its expected capital expenditure for 2022-23, Lower Murray Water has only proposed to include the figure of \$13.7 million in its regulatory asset base.

<sup>40</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 34-35. Lower Murray Water's major projects are reported by the business as part of our annual outcomes reporting process, as part of its commitment to communicate the delivery of its major projects to its customers. The business's comments are not audited by the commission.

**Table 4.5 Our proposed adjustments to Lower Murray Water’s proposed total forecast capital expenditure for urban services**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Lower Murray Water’s proposed total forecast capital expenditure – urban services</b>	<b>24.49</b>	<b>23.83</b>	<b>17.64</b>	<b>17.23</b>	<b>15.42</b>	<b>98.61</b>
Adjustments – Stage 3 UV Works project	-3.77	0.00	0.00	0.00	0.00	-3.77
<b>Draft decision – total forecast capital expenditure – urban services</b>	<b>20.72</b>	<b>23.83</b>	<b>17.64</b>	<b>17.23</b>	<b>15.42</b>	<b>94.85</b>

Note: Numbers have been rounded.

For the reasons set out below, our draft decision is to adopt a forecast capital expenditure of \$94.8 million, \$3.8 million (or 4.0 per cent) lower than the \$98.6 million proposed by Lower Murray Water for urban services, for the purpose of calculating its revenue requirement:

- Lower Murray Water's price submission provided evidence that its forecasts for capital expenditure are prudent and efficient. Its total proposed capital expenditure is \$98.6 million, which is \$17.1 million (21.0 per cent) higher than capital expenditure incurred in the current 2018–23 period, but \$19.6 million less than the capital expenditure forecast it provided for the 2023–28 regulatory period in its 2018 price submission. The increase in comparison to the current period is mainly driven by \$9.4 million on the Red Cliffs Improvements to Water Pressure project and \$8 million for Bulk Water Entitlement Purchases. Lower Murray Water’s forecast is mainly composed of \$42 million (42.6 per cent of its total forecast capital program) for renewals expenditure, and \$33.3 million (33.7 per cent) on improvements and compliance.
- However, as described above, Lower Murray Water’s price submission identified that it has allocated \$3.8 million of 2022-23 expenditure connected to the delivery of Stage 3 UV works to the 2023-24 forecast to capture this expenditure in its regulatory asset base. Lower Murray Water explained that this additional expenditure is due to increases in material prices and other market cost escalations, and significant changes in scope to the program. Our expenditure consultant subsequently verified this and confirmed Lower Murray Water’s proposal to include 2022-23 costs in the 2023-24 forecast.<sup>41</sup> We propose to accept the increase in cost for this project, but we do not consider the carry-forward of capital expenditure to the next year is

<sup>41</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 40.

appropriate or consistent with our guidance. Accordingly, our draft decision is to remove the \$3.8 million dollars of expenditure associated with the Stage 3 UV works from its capital expenditure forecast for 2023-24.

- Our expenditure consultant requested additional information from Lower Murray Water as a representative sample of its major projects and programs to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, our consultant considered that Lower Murray Water has a reasonable approach for developing project scope, the timing of works and cost estimates.<sup>42</sup>
- Lower Murray Water has forecast expenditure of \$35.5 million (36 per cent of its total capital expenditure forecast) on the nine projects it has identified as its top major projects. Of these, two projects (New Swan Hill water treatment plant – Stage 1 and Koorlong Sewer Rising Main Duplication) are nominated as uncertain, with Lower Murray Water only including costs for design and approvals in the next regulatory period. Our consultant reviewed the four largest expenditure projects, the Red Cliffs Water Distribution Improvements project (\$9.4 million), the Koorlong Wastewater Treatment Plant Wet Weather Storage project (\$6.1 million), the Mildura Water Mains Upgrade (\$3.8 million), and the purchase of water project (\$8.1 million) as a representative sample of Lower Murray Water's top major projects. Our consultant considered the information reviewed sufficiently justified the proposed projects and established the prudence and efficiency of the related expenditure.<sup>43</sup>
- Lower Murray Water has forecast \$63.1 million in capital expenditure to deliver its remaining capital programs and other capital projects in the 2023–28 period. Our consultant requested further information relating to the business's two largest programs, the Major Program Water and Sewer Main Renewals program (\$12.2 million total) and the Minor Capital Works Water and Sewerage program (\$7.1 million total). Our consultant considered the information provided sufficiently justified the proposed programs and established the prudence and efficiency of the related expenditure.<sup>44</sup>
- Overall, our expenditure consultant considered Lower Murray Water's forecasts were well developed and that its forecast urban capital expenditure has been robustly forecast and is prudent, efficient and deliverable. Based on the information reviewed, our consultant recommended no adjustments to Lower Murray Water's forecast urban capital expenditure.<sup>45</sup>

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<sup>42</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 41–42.

<sup>43</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 42–44.

<sup>44</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 45–46.

<sup>45</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 47.

We agree with our consultant's view because we consider that, for the purposes of our draft decision, the prudence and efficiency of the expenditure has been justified, consistent with our guidance.

- Our preliminary view is that the planned capital program is achievable given Lower Murray Water's past track record delivering its urban capital expenditure program. As noted in Section 4.2.1, over the current 2018–23 regulatory period Lower Murray Water has delivered four major projects, with another on schedule for completion in 2022-23, while one project has been delayed and one has been deferred, two projects have been cancelled following options analyses which confirmed a more effective solution. Our expenditure consultant also reviewed Lower Murray Water's delivery capability and had confidence the forecast urban capital program was deliverable in the next regulatory period.<sup>46</sup>
- Lower Murray Water has identified seven projects where there is uncertainty in timing, cost, scope and benefits of capital expenditure. Costs for four of these projects have been excluded from prices for now, as Lower Murray Water considers they are unlikely to be undertaken in the period, with the business committing to bearing this risk on behalf of customers in the period. For the remaining three projects, Lower Murray Water has only included sufficient costs for design and approval works given uncertainty around future rates of water demand and residential and commercial customer and demand growth. This approach is consistent with our guidance for managing uncertain expenditure. Our draft decision is to accept Lower Murray Water's proposal for addressing uncertainty, noting the following:
  - Lower Murray Water will need to demonstrate the prudence and efficiency of these costs if they are indeed incurred during the 2023–28 regulatory period if seeking to include them in the regulatory asset base for the 2028–33 price review.
  - Deviations from forecasted capital expenditure during the 2023–28 regulatory period will form a key part of our assessment of the Performance element of PREMO at the next price review.

We have reviewed Lower Murray Water's proposals and advice from FTI Consulting and our preliminary view is that Lower Murray Water's approach to forecasting its capital expenditure for urban services is mostly consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014, save for in relation to the Stage 3 UV works, as described above.<sup>47</sup>

Accordingly, our draft decision for total gross capital expenditure for urban services is to not accept Lower Murray Water's proposed benchmark and to instead adopt a benchmark of \$94.8 million for

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<sup>46</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 42.

<sup>47</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 32–37.

the purpose of setting a revenue requirement for urban services. This benchmark is \$3.8 million lower than Lower Murray Water's proposed benchmark due to the \$3.8 million adjustment in relation to the Stage 3 UV works. The benchmark we propose to adopt is set out in Table 4.7.

The benchmark that we propose to adopt for Lower Murray Water does not represent the amount that Lower Murray Water 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. Where we have made an adjustment to exclude a project's capital expenditure from Lower Murray Water's revenue requirement, we are not requiring the business to remove that project. Lower Murray Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

### 4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>48</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 2.4), and regulatory depreciation (discussed in Section 4.4). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Lower Murray Water to propose:

- the closing value of its regulatory asset base at 30 June 2022 (using actual data)
- the opening value of its regulatory asset base at 1 July 2023 (calculated according to the criteria outlined in the guidance)
- the forecast value of its regulatory asset base for each year of the regulatory period (2023-24 to 2027-28), in accordance with the prudence criteria outlined in the guidance.

#### 4.3.1 Closing regulatory asset base

For its urban services, our draft decision is to adopt a closing regulatory asset base of \$196.6 million at 30 June 2022, which is lower than the 197.0 million proposed by Lower Murray Water.

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<sup>48</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.<sup>49</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>50</sup>

Lower Murray Water's proposed closing asset base at 30 June 2022 for urban services is provided at page 82 to 83 of its price submission.<sup>51</sup> Our draft decision proposes to correct for Lower Murray Water's approved regulatory accounts resulting in some relatively minor adjustments to its closing asset base.

We compared Lower Murray Water's actual net capital expenditure for 2017-18 to 2021-22 (taking into account the corrections noted above) with the forecast used to approve maximum prices for the period from 1 July 2018. Typically, if a water business's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature.

Lower Murray Water's net capital expenditure for urban services over the period from 2017-18 to 2021-22 was \$70.4 million. This is \$3.8 million or 5.1 per cent lower than the forecast used to approve maximum prices for the period from 1 July 2018. This is well below the 10 per cent threshold noted above so our draft decision proposes to reflect the \$70.4 million in the closing regulatory asset base for urban services.

Table 4.6 sets out our draft decision on Lower Murray Water's closing regulatory asset base at 30 June 2022 for urban services.

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<sup>49</sup> See Section 4.2 for a discussion of Lower Murray Water's capital expenditure.

<sup>50</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

<sup>51</sup> Available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

**Table 4.6 Draft decision – closing regulatory asset base (RAB) for urban services**  
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
<b>Opening RAB 1 July</b>	<b>173.8</b>	<b>179.2</b>	<b>184.4</b>	<b>186.2</b>	<b>184.3</b>
Plus gross capital expenditure	17.9	17.7	13.8	11.9	24.4
Less government contributions	0.0	0.0	0.0	0.0	0.0
Less customer contributions	3.6	3.2	2.4	4.1	2.0
Less proceeds from disposals	0.5	0.2	0.2	0.1	0.2
Less regulatory depreciation	8.4	9.1	9.5	9.6	9.8
<b>Closing RAB 30 June</b>	<b>179.2</b>	<b>184.4</b>	<b>186.2</b>	<b>184.3</b>	<b>196.6</b>

Note: Numbers have been rounded.

#### 4.3.2 Forecast regulatory asset base

For its urban services, our draft decision is to not accept Lower Murray Water’s proposed forecast regulatory asset base.

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

Consistent with the requirements of our guidance, Lower Murray Water has proposed capital expenditure for 2022-23 the same as the 2018 benchmark adopted at the 2018 price review.

Because our draft decision is to not accept Lower Murray Water’s proposed closing regulatory asset base for urban services, our draft decision is to not accept Lower Murray Water’s proposed forecast regulatory asset base for urban services.



Table 4.7 sets out our draft decision on Lower Murray Water’s forecast regulatory asset base for urban services from 1 July 2023.<sup>52</sup> Our assessments of the other components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

- Section 4.2 (capital expenditure)
- Section 4.3.2.1 (customer contributions)
- Section 4.4 (regulatory depreciation).

**Table 4.7 Draft decision – forecast regulatory asset base (RAB) for urban services**  
\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Opening RAB 1 July</b>	<b>196.6</b>	<b>198.3</b>	<b>206.4</b>	<b>217.2</b>	<b>223.2</b>	<b>228.9</b>
Plus gross capital expenditure	13.7	20.7	23.8	17.6	17.2	15.4
Less government contributions	0.0	0.0	0.0	0.0	0.0	0.0
Less customer contributions	1.7	1.7	1.7	1.7	1.7	1.7
Less proceeds from disposals	0.3	0.5	0.4	0.4	0.2	0.3
Less regulatory depreciation	10.1	10.4	10.9	9.6	9.6	9.4
<b>Closing RAB 30 June</b>	<b>198.3</b>	<b>206.4</b>	<b>217.2</b>	<b>223.2</b>	<b>228.9</b>	<b>233.0</b>

**Note:** Numbers have been rounded.

#### 4.3.2.1 Customer contributions

For its urban services, our draft decision is to not accept Lower Murray Water’s forecasts for revenue from customer contributions.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>53</sup>

<sup>52</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022–23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022 23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

<sup>53</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water corporation’s water, sewerage or recycled water networks.

New customer contributions are a key input to revenue from customer contributions. Since our draft decision is to not accept Lower Murray Water's new customer contributions, our draft decision is to not accept Lower Murray Water's forecasts for customer contributions.

Lower Murray Water must update its customer contribution forecasts in response to our draft decision.

#### 4.4 Regulatory depreciation

For its urban services, our draft decision is to not accept Lower Murray Water's forecast regulatory depreciation.

Regulatory depreciation is a component of Lower Murray Water's revenue requirement and is also an input to calculating the regulatory asset base. Lower Murray Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile.<sup>54</sup> We noted in our guidance that we prefer this approach.<sup>55</sup>

In terms of asset life, Lower Murray Water has assumed around 30 years. We note this is below the average across businesses in the current review of around 47 years. In its response to our draft decision, Lower Murray Water must provide further information to justify its assumed asset life.

Further, because our draft decision is to not accept Lower Murray Water's forecast regulatory asset base for urban services, our draft decision is to not accept Lower Murray Water's forecast regulatory depreciation for urban services.

For the purposes of this draft decision, for urban services we have adopted the regulatory depreciation shown in Table 4.7 in Section 4.3.2. This uses Lower Murray Water's assumed asset lives but recalculates depreciation based on our proposed changes to the regulatory asset base. In response to our draft decision Lower Murray Water must update its forecast for regulatory depreciation.

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<sup>54</sup> For the period from 2022-23 to 2027-28, Lower Murray Water proposed a regulatory depreciation of \$60.31 million.

<sup>55</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

## 4.5 Tax allowance

For its urban services, our draft decision is to accept Lower Murray Water’s proposed forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Lower Murray Water has proposed no tax allowance in its revenue requirement for the 2023–28 regulatory period. Our draft decision is to accept the forecast as it was calculated consistently with the method required by our guidance.<sup>56</sup>

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<sup>56</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47–48.

## 5. Demand, tariffs and prices

Once Lower Murray Water's revenue requirement is established, demand forecasts and the form of price control are used to translate the revenue requirement into tariffs and prices.

### 5.1 Demand

For its urban services, our draft decision is to accept Lower Murray Water's demand forecasts.

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

Lower Murray Water's demand forecasts are set out at pages 67 to 72 of its price submission and are also included in its financial model.

Our draft decision is to accept Lower Murray Water's demand forecasts for urban services for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance.<sup>57</sup> However, since lodgement of Lower Murray Water's price submissions, updated Victorian Government population and dwelling growth estimates have made available to water businesses.

In its response to our draft decision, Lower Murray Water must demonstrate how it has considered these updated estimates and, if required, identify and justify any changes to its demand forecasts (any updates must also be included in its pricing model submitted in response to our draft decision).

### 5.2 Form of price control

For its urban services, our draft decision is to accept Lower Murray Water's proposed tariff basket form of price control.

Our guidance indicated we would have particular regard to whether a business proposed to continue its existing form of price control or introduce a new form of price control.<sup>58</sup>

Lower Murray Water proposed a tariff basket form of price control for urban services, with a rebalancing constraint of  $\pm 10$  per cent on any individual tariff, as set out on page 84 of its price submission. This is the same as its current approach over the past regulatory period. The price

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<sup>57</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 49.

<sup>58</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

control is typically applied equally across all components of the tariff basket, including water and sewerage, residential and non-residential, and between fixed and volumetric charges.

Our draft decision is to accept Lower Murray Water's proposed tariff basket form of price control for its urban business because:

- it is the same as its current approach, which we have previously approved
- it provides its customers with price certainty
- demand risk is more efficiently managed by Lower Murray Water, as it takes the risk that the demand for water will be less than forecast,
- it is otherwise consistent with the requirements of our guidance.

### 5.3 Tariff structures and prices

For its urban services, our draft decision is to accept Lower Murray Water's proposed tariff structures.

Lower Murray Water's proposed tariffs for urban services are set out at pages 84 to 86 of its price submission.

Our draft decision does not approve prices for each tariff. Prices will need to be updated by Lower Murray Water to reflect our updates to inflation and cost of debt estimates prior to our final decision. They may also need to be updated depending on our further review of its new customer contributions and depreciation, and its response to our draft decision on its regulatory asset base. Our draft decision considers proposals related to tariff structures, the price path proposed, and any submissions on the level of prices or bills.

#### 5.3.1 Tariff structures

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>59</sup> This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Lower Murray Water proposed to maintain its existing tariff structures for urban services. For residential and non-residential water services, it proposed a two-part tariff with a fixed service charge and a variable usage component that depends on water use (this includes a three-tier inclining block structure for residential services). For residential and non-residential sewerage services, Lower Murray Water proposed a fixed service charge only.

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<sup>59</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

Our draft decision is to accept Lower Murray Water’s proposed tariff structures for urban services on the basis that they are generally a continuation of Lower Murray Water’s current approach and otherwise meet the criteria in our guidance and are generally supported by its customers.

Our preliminary view is that the two-part tariff structure proposed by Lower Murray Water for its urban water services will promote the efficient use of services. It also 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>60</sup> We also consider two-part tariff structures are easy to understand.

For sewerage services, we consider Lower Murray Water’s proposed fixed charge for residential and non-residential urban customers is easy to understand and consistent with its engagement findings.

### 5.3.2 Prices

The prices proposed by Lower Murray Water for urban water and sewerage services are set out on pages 84 to 86 of its price submission.

Under Lower Murray Water’s proposal, generally prices (excluding inflation) will be slightly higher. It proposed an increase in prices for its urban services of 0.3 per cent more than inflation over the period 2023-24 to 2027-28.

The Consumer Action Law Centre noted in its submission to us that Lower Murray Water was proposing a modestly increasing price path but had not indicated any investment in hardship assistance or in water efficiency programs.<sup>61</sup> We consider Lower Murray Water has sought to address the interests of low income customers and customers experiencing vulnerability in other ways (see our discussion Section 5.3.3).

In May 2023, we intend to determine prices for Lower Murray Water in \$2023-24 terms. This means we will add the annual change in the March Quarter 2023 consumer price index (published by the Australian Bureau of Statistics) to its 2023-24 prices, which will also flow through to customer bills.

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high.<sup>62</sup> For the 2023–28 regulatory

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<sup>60</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>61</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 4.

<sup>62</sup> The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) fall to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to their opening base costs for the 2023–28 regulatory period. Accordingly, it may be the case that the inflation that is added to prices in 2023-24 provides an uplift in revenue that is well above a business's actual costs for the year. Considering this, and Lower Murray Water's proposal for increasing urban prices in real terms over the 2023–28 regulatory period, we are seeking further information from Lower Murray Water in response to our draft decision on how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.<sup>63</sup>

As part of its response to our draft decision, Lower Murray Water must demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and whether these are reasonable taking into account that some of its key costs (such as labour) are unlikely to increase as much as near-term inflation.

Lower Murray Water's urban water and sewerage prices will also be affected by our draft decision on the revenue requirement for urban services, which is outlined in Chapter 4. In response to our draft decision, Lower Murray Water will need to propose updated prices that reflect our draft decision and any updates to its revenue requirement.

### 5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether Lower Murray Water's prices take into account the interests of customers, including low income and vulnerable customers.<sup>64</sup>

There is evidence that Lower Murray Water has sought to address the interests of low income and vulnerable customers because Lower Murray Water proposed:

- retaining the mix of its fixed and variable charges, noting it aims for a ratio of 40 per cent fixed to 60 per cent variable to provide households with control over water bills.
- a price path that was smoothed, to ensure consistent changes in prices over the regulatory period.

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<sup>63</sup> This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission must have regard to principles that the manner in which a regulated entity's prices are to be calculated, determined or otherwise regulated, should provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

<sup>64</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

- maintaining and enhancing its hardship programs for customer’s experiencing vulnerability.

As noted in Section 2.3, Lower Murray Water’s price submission was informed by engagement that was inclusive of the experiences of customers facing vulnerability, including customers who are unemployed. Engagement with service providers who work closely with customers experiencing payment difficulty revealed the further disadvantage these customers can experience as a result of any changes in variable charging. These insights contributed to Lower Murray Water’s decision to undertake further engagement to inform any proposed change in its tariff structure.

#### 5.3.4 Unique services

Lower Murray Water has confirmed that its proposed tariffs for trade waste and miscellaneous services are calculated in accordance with the pricing principles referenced in our guidance.

### 5.4 New customer contributions

Our draft decision is to not accept Lower Murray Water’s proposed new customer contributions for urban services as we need to review its proposal to include sunk costs (back to 2007 and 2011) in its calculation of new customer contributions.

Our draft decision is to accept Lower Murray Water’s proposed negotiated new customer contributions framework for urban services.

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

Lower Murray Water’s proposed new customer contributions for urban services are set out at page 87 of its price submission. It proposed to:

- increase its new customer contributions for water services by 19.5 per cent and for sewer services by 0.6 per cent from 2022-23 to 2023-24
- maintain the nominal value of its customer contributions over 2024-25 to 2027-28 of the regulatory period.

Lower Murray Water noted it engaged with landholders and developers and that they have broadly supported Lower Murray Water’s proposed new customer contributions.<sup>65</sup> However, we invite

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<sup>65</sup> Lower Murray Water response to our request for information, 20 January 2023.



developers and customers to provide any further comments on Lower Murray Water's proposal and our draft decision.

We are presently not satisfied with Lower Murray Water's proposed new customer contributions and are reviewing the information it has provided to verify that the forecast costs are reasonable and appropriately attributed to developers.

We need to verify that the costs are not being paid for twice, first through water and sewerage charges and then again through developer charges. We also need to verify that the customers who are benefitting from the services are being charged the costs. Accordingly, our draft decision is to not accept Lower Murray Water's proposed new customer contributions for urban services.

Lower Murray Water has provided its negotiating framework for negotiated new customer contribution contracts. This framework is in accordance with the requirements of our new customer contribution pricing principles.<sup>66</sup> For that reason, our draft decision is to accept Lower Murray Water's proposed framework for negotiated new customer contributions in relation to urban services.

## 5.5 Adjusting prices

For its urban services, our draft decision is to accept Lower Murray Water's proposed price adjustment mechanisms.

Lower Murray Water's proposed price adjustment mechanisms are set out at page 88 of its price submission. It proposed the following price adjustment mechanisms, which are similar to those in the current regulatory period:

- to continue with the current uncertain and unforeseen events mechanism
- trailing average cost of debt.

Our draft decision is to accept Lower Murray Water's proposal to continue to use these same price adjustment mechanisms for its urban services, on the basis that we have approved them in the past.

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<sup>66</sup> Essential Services Commission, 2023 water price review: Guidance paper, p. 59.

## PART C – Rural services

## 6. Customer outcomes

The customer outcomes Lower Murray Water plans to deliver over the regulatory period are a key component of its price submission – confirming its commitments to customers, underpinning its revenue requirement, and feeding in to its PREMO assessment.

This chapter:

- reviews whether Lower Murray Water has delivered on the rural services outcomes it committed to for the current regulatory period (2018–23) and examines the customer outcomes Lower Murray Water is committing to for the next regulatory period
- outlines Lower Murray Water’s proposed rural service standards
- outlines Lower Murray Water’s proposed guaranteed service levels for rural services.

### 6.1 Outcomes

#### 6.1.1 Performance against outcome commitments 2018–23

Lower Murray Water’s rural business was not assessed under our PREMO framework in 2018, because at that time it fell under the Commonwealth Government’s Water Charge (Infrastructure) Rules 2010 assessment framework. However, Lower Murray Water elected to establish a set of rural customer outcomes for the 2018–23 regulatory period, and to report on these consistent with and alongside its urban water business.

While Lower Murray Water’s performance against its rural outcomes targets will not contribute to its overall PREMO Performance element rating in this price review, we have still provided an assessment consistent with its urban services business, and to establish a base for its outcome commitments for the 2023–28 regulatory period which is being assessed under the PREMO framework.

We consider Lower Murray Water accounted for its annual performance for each measure in its price submission. Like many of the other water businesses in our current price review, Lower Murray Water’s price submission was missing an overall rating against each outcome for the period to date. In the absence of this information, we have drawn on Lower Murray Water’s 2021-22 Outcomes report for its period to date rating.<sup>67</sup>

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<sup>67</sup> Lower Murray Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

Table 6.1 lists Lower Murray Water’s outcome commitments and includes its annual performance results as reported in its price submission and the period-to-date rating published in our 2021-22 Outcomes report.<sup>68</sup>

**Table 6.1 Business self-assessment of performance against Outcome commitments**

Outcome (rural services)	2018-19	2019-20	2020-21	2021-22	Period to date <sup>a</sup>
Supply me with water when I need it	Green	Green	Green	Green	Green
Keep my costs to a minimum	Green	Green	Green	Green	Green
Be easy to contact and quick to respond	Amber	Green	Green	Green	Green
Comply with other government obligations	Green	Green	Green	Green	Green

**Note:** Green = achieved target; Amber = close to achieving target; Red = failed to meet target. <sup>a</sup> This is Lower Murray Water’s self-assessment of its performance across the first 4 years of the current regulatory period. Lower Murray Water’s performance against Outcome commitments in the final year of the current regulatory period (2022-23) will be published in our 2022-23 Outcomes Report.

Source: Lower Murray Water, 2023 water price submission, September 2022, p. 95; Essential Services Commission, Lower Murray Water’s outcomes performance 2021-22, October 2022.

In its price submission, Lower Murray Water reported it had achieved or exceeded its targets for 36 (82 per cent) of its 44 performance targets related to its rural services over the first 4 years of the current regulatory period. Of these 44 targets, 7 (16 per cent) have been rated as amber ‘close to achieving target’ and 1 (2 per cent) as red ‘failed to meet’ in the period to date.<sup>69</sup>

Lower Murray Water considers it is performing well for the period to date, particularly for outcome 1, ‘supply me with water when I need it’. It consistently delivered water orders on time, meeting its targets for each year in the period, and saw a downward trend of pipe bursts and leaks within its irrigation networks.<sup>70</sup>

Lower Murray Water met most targets for outcome 3, ‘be easy to contact and quick to respond’, but failed to meet its targets in some years for complaints lodged by rural customers to the Energy and Water Ombudsman Victoria. It said that the complaints were mainly due to raw

<sup>68</sup> Lower Murray Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

<sup>69</sup> Lower Murray Water, 2023 water price submission, September 2022, Table C1, p. 95.

<sup>70</sup> Essential Services Commission, Lower Murray Water’s outcomes performance 2021-22, October 2022; Lower Murray Water, 2023 water price submission, September 2022, p. 95-96.

water quality issues arising from blue-green algae in the Murray River and plumatella growth in pipelines, and indicated that it has taken action to resolve these issues.<sup>71</sup>

Lower Murray Water's annual performance reports provided clear explanation of shortfalls in performance. It also published its annual performance on its website.

Based on the above, our draft decision is that we agree with Lower Murray Water's self-assessment that it has, overall, met its outcome commitments in relation to its rural services for the period to date.

### **6.1.2 Outcome commitments for 2023–28**

Lower Murray Water engaged with its customers to refine its rural services outcomes for the period from 1 July 2023 to 30 June 2028. It has established four customer outcomes it proposes to deliver for its rural services:

- Services provide customers value for money
- Provide customers with water when they need it
- Provide customer service avenues that are responsive to resolve requests and enquiries
- Service its communities in a socially responsible and environmentally sustainable manner.<sup>72</sup>

Its performance against these outcomes will inform its Performance rating under PREMO for Lower Murray Water's next price review.

### **6.1.3 Our assessment of measures and targets**

Lower Murray Water proposed a set of 13 measures and targets that it will use to report on performance across the 4 rural service outcomes. These are set out on page 107 of its price submission. Performance against these measures will inform our assessment during future price reviews.

We have assessed Lower Murray Water's proposed measures against the criteria set out in our guidance which states that proposed output measures for each outcome must:

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand

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<sup>71</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 96.

<sup>72</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 107.

- have performance targets listed for each year of the regulatory period.<sup>73</sup>

Evidence provided by Lower Murray Water demonstrates that its rural services measures and targets were developed in consultation with its customers, and that they are supported by its customers. It engaged via its community advisory committee and strategic advisory committee, as well as targeted rural consultation, such as pump station tours, interviews with key rural stakeholders, and events held in each rural district which were open to all rural customers.<sup>74</sup>

Generally, we consider Lower Murray Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome. There are some matters that we will follow up with Lower Murray Water to improve the clarity and accountability of its targets.

We will provide Lower Murray Water with our standard Outcomes Reporting Template to complete and submit with its response to this draft decision. We will work with the business to ensure the final set of measures addresses the above matters and complies with our guidance requirements.

For its rural services, our preliminary view is that Lower Murray Water's proposed targets for its outcome measures suggest an overall improvement in customer value.

Lower Murray Water will report annually to its customers on how it has performed against its outcome commitments. It will publish its performance on its website, as well as review its performance with its strategic advisory and customer advisory committees. It will also implement a digital customer portal which will provide customers with a platform to provide feedback on how it is performing.<sup>75</sup>

## **6.2 Service standards related to service reliability and faults**

Service standards are a common set of services applicable to all Victorian consumers required under clause 1.5 of the *Water Industry Standard – Rural Customer Service* (Rural Water Industry Standard). Each water business must specify its own service levels against each of these service standards. Rather than performance measures, these service standards and corresponding service levels are the minimum level of service customers can expect to receive.

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<sup>73</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

<sup>74</sup> Lower Murray Water worked with its rural customers to achieve alignment between the urban and rural businesses with three out of four customer outcomes (including many of the performance measures and targets) crafted, tested, and validated across both urban and rural cohorts. Lower Murray Water, 2023 water price submission, September 2022, p 101 and pp. 9–19.

<sup>75</sup> Lower Murray Water, 2023 water price submission, September 2022, p. 107-108.

Lower Murray Water's proposed rural service standards relating to reliability and faults can be found on page 106 of its price submission.

At the time of the 2018–23 price review, Lower Murray Water's rural infrastructure-related services and prices were regulated under the Commonwealth Government's Water Charge (Infrastructure) Rules 2010, however its service standards were regulated under Victoria's legal framework. As described above, consistent with its 2018 price submission covering its urban water and related services, Lower Murray Water proposed, and the commission accepted, a set of outcomes and measures covering its rural water and related services despite this area not being regulated under the Water Industry Regulatory Order 2014 at the time. Lower Murray Water included its outcomes and associated targets for the current regulatory period with its service standards for reliability and faults, published in schedule 1 of the Rural Water Industry Standard. Due to legislative changes, Lower Murray Water's infrastructure services are now assessed under the Water Industry Regulatory Order 2014 and the commission's PREMO framework and guidance.

Lower Murray Water reviewed its rural service standards and levels related to reliability and faults with its customers, who confirmed they were satisfied with the service standards and levels that Lower Murray Water is providing. Lower Murray Water's proposed service standards consolidate the service standards related to reliability and faults, removing the list of outcomes and targets that were also included for the current regulatory period. The service standards and service levels proposed by Lower Murray Water are customer-centric and allow customers to understand both the service standards and the level of service they can expect.

Our preliminary assessment is that the service standards relating to reliability and faults proposed by Lower Murray Water comply with the requirements of the Rural Water Industry Standard.

Service standards are approved in our Rural Water Industry Standard. Accordingly, in early 2023-24, we will update the Rural Water Industry Standard to reflect approved service standards.

### **6.3 Guaranteed services levels**

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

Lower Murray Water did not propose any guaranteed service levels for its rural services, as set out on page 108 of its price submission. Lower Murray Water said that it engaged with its customers in relation to rural guaranteed service levels and that the engagement identified that customers consider compensation that effectively adds additional costs to the rural customer

base is not productive. Customers indicated that they preferred that Lower Murray Water be responsive and quickly communicate service delivery issues and focus available resources on improving the performance of the asset base.

We propose to accept that Lower Murray Water has not proposed any rural guaranteed service levels for its rural services on the basis that this has been agreed with customers during its engagement.



## 7. Revenue requirement

The revenue requirement is the forecast amount a water business 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.<sup>76</sup> Along with forecast demand, it is an input to calculating prices.

We have used a building block methodology to establish the revenue requirement for Lower Murray Water's rural services. This chapter outlines our assessment of Lower Murray Water's revenue requirement based on the following steps:

- establish an efficient benchmark level of forecast operating expenditure for the next regulatory period (Section 7.1)
- establish an efficient benchmark level of forecast capital expenditure for the next regulatory period (Section 7.2)
- roll-forward the regulatory asset base (Section 7.3)
- apply a rate of return to the regulatory asset base, calculated using:
  - a benchmark cost of debt estimated using a 10-year trailing average approach (Section 2.4.1)
  - a benchmark return on equity value determined by Lower Murray Water's PREMO rating (Section 2.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 7.4)
- establish a benchmark tax allowance (Section 7.5).

For its rural services, our draft decision is to not approve the revenue requirement in Lower Murray Water's submission, and instead approve a revenue requirement of \$138.1 million, which is 0.8 per cent lower than proposed.

Lower Murray Water proposed a revenue requirement for its rural services of \$139.2 million over a 5-year period starting 1 July 2023. Our draft decision approves a revenue requirement of \$138.1 million (Table 7.1).

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<sup>76</sup> We met with officers of the Department of Environment, Land, Water and Planning, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Lower Murray Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.

**Table 7.1 Draft decision on Lower Murray Water’s rural services revenue requirement**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	20.7	20.8	21.4	21.8	21.3	106.0
Return on assets	2.8	2.7	2.7	2.7	2.7	13.5
Regulatory depreciation	3.3	3.5	3.7	3.9	4.0	18.5
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
<b>Draft decision – revenue requirement</b>	<b>26.8</b>	<b>27.0</b>	<b>27.8</b>	<b>28.3</b>	<b>28.0</b>	<b>138.1</b>

**Note:** Numbers have been rounded.

Table 7.2 summarises how our draft decision on Lower Murray Water’s rural services revenue requirement (row E) differs to the revenue requirement proposed by Lower Murray Water in its price submission (row A). Where our draft decision differs from Lower Murray Water’s price submission in relation to a component of the revenue requirement, the adjustment we propose is shown in rows B to D of Table 4.2. The adjustments we propose are generally relatively small and are mainly to correct for errors in regulatory accounts estimates for 2021-22.

Our final decision on Lower Murray Water’s rural services revenue requirement will be based on the latest available information.

Accordingly, as well as responding to our draft decision and providing an updated price schedule, Lower Murray Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination that impact on its forecast costs and the revenue requirement, Lower Murray Water should update its price submission and provide us with an updated financial model. It also should notify us of any material changes that impact its forecast costs, revenue requirement or prices (including demand). Any updates to its submission or pricing model will be made publicly available on our website.

**Table 7.2 Our proposed adjustments to Lower Murray Water’s proposed rural services revenue requirement**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Lower Murray Water’s proposed rural services revenue requirement</b>	<b>26.99</b>	<b>27.26</b>	<b>28.06</b>	<b>28.57</b>	<b>28.29</b>	<b>139.18</b>
B. Operating expenditure	-0.01	-0.03	-0.04	-0.05	-0.06	-0.20
C. Return on assets	-0.10	-0.16	-0.15	-0.14	-0.14	-0.69
D. Regulatory depreciation	-0.02	-0.05	-0.05	-0.05	-0.05	-0.21
<b>E. Draft decision– revenue requirement (A+B+C+D)</b>	<b>26.85</b>	<b>27.03</b>	<b>27.82</b>	<b>28.33</b>	<b>28.05</b>	<b>138.08</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Lower Murray Water proposed in its price submission. Row A shows the total rural services revenue requirement proposed by Lower Murray Water in its price submission. We have arrived at our draft decision (row E) by proposing the relevant adjustments to the components of the revenue requirement shown in rows B to D. Numbers have been rounded.

## 7.1 Operating expenditure

For its rural services, our draft decision is to adopt a forecast operating expenditure of \$106.0 million, which is \$0.2 million lower than proposed by Lower Murray Water.

Operating expenditure is a component of the revenue requirement. Lower Murray Water’s price submission provides detail on its forecast operating expenditure for its rural services from pages 113 to 117.

We assess both:

- controllable operating expenditure – comprising all costs that can be directly or indirectly influenced by a water business’s decisions
- non-controllable operating expenditure – comprising all costs that cannot be directly or indirectly influenced by a water business’s decisions.

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting’s report on its assessment of Lower Murray Water’s expenditure forecast is available on our website.<sup>77</sup>

Table 7.3 sets out our draft decision on Lower Murray Water’s forecast rural services operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 7.1.

**Table 7.3 Draft decision – rural services operating expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>16.91</b>	<b>16.86</b>	<b>17.34</b>	<b>17.53</b>	<b>17.12</b>	<b>85.76</b>
<b>Non-controllable operating expenditure</b>	<b>3.80</b>	<b>3.94</b>	<b>4.08</b>	<b>4.22</b>	<b>4.21</b>	<b>20.25</b>
Bulk services <sup>a</sup>	3.33	3.48	3.64	3.79	3.79	18.03
Environmental contribution <sup>b</sup>	0.45	0.44	0.43	0.41	0.40	2.13
Licence fees – Essential Services Commission <sup>c</sup>	0.02	0.02	0.02	0.02	0.02	0.09
Licence fees – Department of Health <sup>c</sup>	0.00	0.00	0.00	0.00	0.00	0.00
Licence fees – Environmental Protection Authority <sup>c</sup>	0.00	0.00	0.00	0.00	0.00	0.00
<b>Draft decision – operating expenditure</b>	<b>20.71</b>	<b>20.79</b>	<b>21.42</b>	<b>21.76</b>	<b>21.33</b>	<b>106.01</b>

**Notes:** Numbers have been rounded. <sup>a</sup> Bulk services covers the supply of bulk water and sewerage services.

<sup>b</sup> Environmental contributions are funds collected from water businesses under the *Water Industry Act 1994*.

<sup>c</sup> Licence fees are paid to cover costs incurred by the Department of Health, the Environment Protection Authority Victoria, and the Essential Services Commission in their regulatory activities related to the water business.

Table 7.4 summarises how our draft decision on Lower Murray Water’s rural services operating expenditure (row D) and its two components differ from the operating expenditure proposed by Lower Murray Water in its price submission (row A). Rows B and C of the table summarise our

<sup>77</sup> FTI Consulting, *Lower Murray Water – Expenditure Review for 2023 water price review*, February 2023.

proposed adjustments to Lower Murray Water’s proposed controllable and non-controllable operating expenditure for rural services.

Details of our assessment and reasons for our proposed adjustments to Lower Murray Water’s proposal are included in Section 7.1.1 (controllable operating expenditure) and Section 7.1.2 (non-controllable operating expenditure).

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

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

**Table 7.4 Our proposed adjustments to Lower Murray Water’s proposed rural services operating expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Lower Murray Water’s proposed total operating expenditure</b>	<b>20.72</b>	<b>20.82</b>	<b>21.46</b>	<b>21.81</b>	<b>21.39</b>	<b>106.2</b>
<b>B. Our total proposed adjustments to controllable operating costs</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
<b>C. Our total proposed adjustments to non-controllable operating costs (C1)</b>	<b>-0.01</b>	<b>-0.03</b>	<b>-0.04</b>	<b>-0.05</b>	<b>-0.06</b>	<b>-0.20</b>
C1 – Environmental contribution	-0.01	-0.03	-0.04	-0.05	-0.06	-0.20
<b>D. Draft decision – total operating expenditure (D = A + B + C)</b>	<b>20.71</b>	<b>20.79</b>	<b>21.42</b>	<b>21.76</b>	<b>21.33</b>	<b>106.01</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Lower Murray Water proposed in its price submission. Row A shows the total operating expenditure proposed by Lower Murray Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to non-controllable operating costs shown in row C (and itemised in row C1). Numbers have been rounded.

### 7.1.1 Controllable operating expenditure

Lower Murray Water proposed a total forecast controllable operating expenditure for rural services of \$85.8 million over a 5-year regulatory period. For the reasons set out below, we propose to accept Lower Murray Water's forecast rural services operating expenditure for the 2023–28 regulatory period.

Lower Murray Water's forecast controllable operating expenditure for the period from 1 July 2023 is estimated through the following steps:

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, one-off items are removed or normally occurring items are added in.
2. Make adjustments for additional costs or cost saving expected in future years.

#### 7.1.1.1 Baseline controllable operating expenditure

Lower Murray Water has proposed a controllable operating expenditure baseline of \$17.51 million for rural services, after removing \$1.53 million in non-recurring operating expenditure that occurred in 2021-22. Lower Murray Water's proposed baseline is \$0.14 million (or 1 per cent) lower than the benchmark figure of \$17.65 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Lower Murray Water added adjustments to its baseline for two items, and our expenditure consultant requested substantiation of these additional items.<sup>78</sup> Lower Murray Water explained these adjustments were for:

- \$0.08 million for training and travel costs which were impacted by the Covid-19 pandemic in 2021-22
- \$0.29 million for electricity costs to account for decreased volumetric demand in 2021-22 due to higher rainfall (compared to prior year averages).

Our expenditure consultant verified these proposed adjustments to the baseline and found Lower Murray Water's substantiation of these adjustments to be reasonable. As Lower Murray Water's proposed baseline is also below the benchmark established in the 2018 price determination, our expenditure consultant recommended accepting Lower Murray Water's proposed baseline with no adjustments required. We reviewed Lower Murray Water's proposal and the advice from our expenditure consultant.

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<sup>78</sup> FTI Consulting, *Lower Murray Water – Expenditure Review for 2023 water price review*, February 2023, pp. 52-53.

Given the above, our preliminary view is that we consider Lower Murray Water's proposal reflects an efficient baseline cost to forecast annual rural services operating expenditure for the purpose of our draft decision.

#### **7.1.1.2 Cost adjustments**

Lower Murray Water has proposed additional forecast operating expenditure adjustments to the annual baseline for rural services, including:

- \$1.6 million reduction in electricity costs which are forecast to decrease due to stabilisation of prices compared to the current regulatory period
- \$0.9 million for Large-scale Generation Certificates to meet the commitment for Victorian water businesses to source 100 per cent of their energy from renewable sources by 2025
- \$0.2 million in consulting costs to prepare for the 2028 water price review.

In aggregate, the above adjustments to the forecast rural services baseline represent a reduction of \$1.78 million over the regulatory period, or an average of \$0.36 million per annum.

Our expenditure consultant reviewed each of the proposed forecast variations to the baseline and was satisfied that the step changes appeared reasonable and that the proposed items resulting in increased expenditure are more than offset by forecast savings and other adjustments.

We have considered the advice from our expenditure consultant, and Lower Murray Water's proposal. We consider Lower Murray Water's approach to forecasting its operating expenditure for rural services is consistent with the requirements of our guidance. Our preliminary position is therefore, that we are satisfied that its proposed forecast for rural services represents efficient controllable operating expenditure. There is evidence that Lower Murray Water has significantly tested its controllable expenditure requirements.

#### **7.1.2 Non-controllable operating expenditure**

Our process for establishing non-controllable operating expenditure involves:

- obtaining the most recent information from the relevant regulatory authorities on their licence fees and the environmental contribution
- adjusting the forecasts proposed by Lower Murray Water where required.

The values we have adopted for our draft decision for rural services are set out above in Table 7.3.

Lower Murray Water has proposed \$20.45 million in non-controllable operating expenditure for rural services over the 2023–28 regulatory period. This is an increase of \$1.22 million compared to the 2018–23 regulatory period, driven by a \$1.47 million increase in external bulk charges

and a decrease of \$0.24 million reflecting the decrease in the real value of the environmental contribution across the 2018–23 regulatory period.

Our guidance paper sets out our approach for businesses to forecast their non-controllable operating costs. We consider businesses should forecast licence fees for the Department of Health, the Environment Protection Authority Victoria and the Essential Services Commission to remain flat in real terms, and for the environmental contribution to remain flat in nominal terms (decline in real terms) across the 2023–28 regulatory period. Lower Murray Water has partially followed this approach in its price submission with a forecasted flat licence fee for the first 3 years but has included a \$0.01 million increase in 2026-27 and 2027-28 for the next regulatory period. Further, its proposal forecasts the environmental contribution to remain flat in real terms rather than nominal terms. We will review these figures prior to our final decision.

Our draft decision proposes to reduce Lower Murray Water’s forecast non-controllable operating expenditure for rural services by \$0.20 million across the 2023–28 period, resulting from our adjustments to the environmental contribution to reflect a flat rate in nominal rather than real terms across the 2023–28 regulatory period, based on the forecast figure from the last year of the current regulatory period (2022-23).

We have reviewed Lower Murray Water’s forecast bulk charges with Goulburn-Murray Water’s 2022-23 approved tariffs and request that Lower Murray Water respond to our draft decision by:

- updating its forecast bulk charges by maintaining the forecast bulk charges at a flat rate in real terms (using a price path of 0 per cent and not applying CPI) during the next regulatory period
- submitting an updated financial model which takes into account these changes.

Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation and external bulk charges data.

## 7.2 Capital expenditure

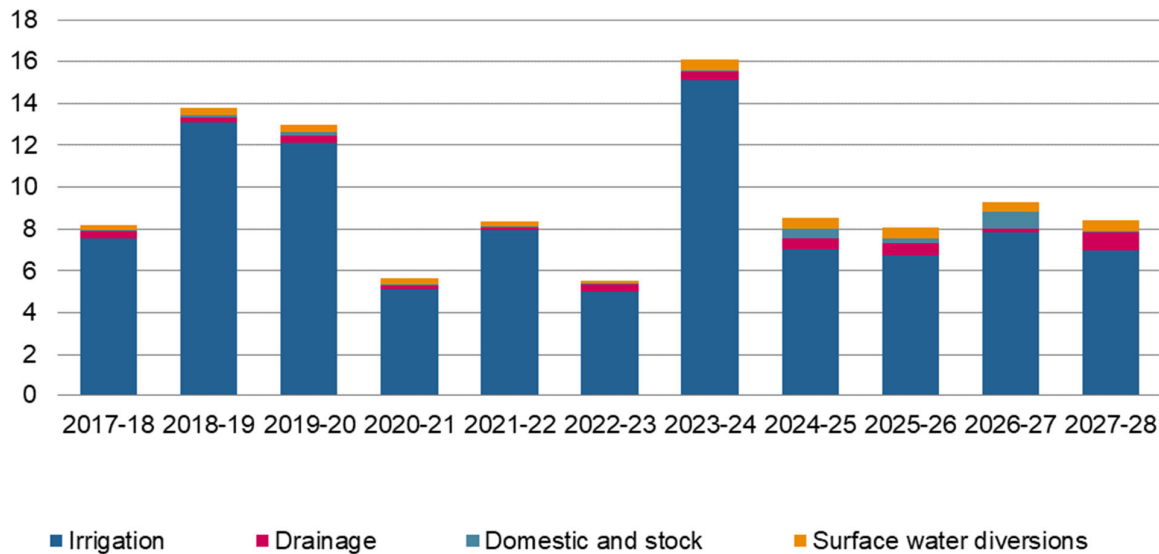
For its rural services, our draft decision is to adopt a forecast capital expenditure of \$43.4 million between 2023-24 and 2027-28, which is \$7.0 million or 16.1 per cent lower than proposed by Lower Murray Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Lower Murray Water’s forecast capital expenditure and supporting information for rural services is provided at pages 117 to 120 of its price submission. Figure 7.1 shows Lower Murray Water’s actual gross capital expenditure for rural services for 2017-18 and the first 4 years of the current regulatory period (2018-19 to 2021-22) and forecast gross capital



expenditure for rural services from 2022-23 to 2027-28. The first 5 years of actual expenditure shown in Figure 7.1 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 7.3.1.

**Figure 7.1** Gross capital expenditure for rural services by service category  
\$ million 2022-23



**Note:** This graph shows actual figures for 2017-18 to 2021-22, and Lower Murray Water's forecasts for 2022-23 to 2027-28.

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure. FTI Consulting's report on its assessment of Lower Murray Water's expenditure forecast is available on our website.<sup>79</sup>

### 7.2.1 Actual capital expenditure

The PREMO framework involves reviewing a business's actual performance over the current regulatory period, against its proposals and commitments made to its customers in its previous price submission. This includes a comparison of its actual capital expenditure against the approved expenditure forecasts for the current regulatory period.

Lower Murray Water will incur \$48.5 million in gross capital expenditure for rural services over the period from 2017-18 to 2021-22, compared to the benchmark of \$35.9 million established in the 2018 price review. Lower Murray Water's submission notes the actual capital expenditure

<sup>79</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts – 2023 Water Price Review*, February 2023.

for rural services for 2022-23 is anticipated to be \$6.8 million more than the approved benchmark that it has proposed to include within the capital expenditure forecast for 2023-24.<sup>80</sup>

In net terms, its rural services expenditure was \$33.8 million compared to the 2018 price determination benchmark of \$26.1 million, an increase of 29.8 per cent.

Lower Murray Water's price submission explained the drivers of increased capital expenditure over the current regulatory period relative to the 2018 benchmark as follows:

- Lower Murray Water has completed the Sunraysia Modernisation Project Stage 2 which had been nominated as an uncertain project and excluded from the 2018 price submission at a cost of \$8.4 million. This project was primarily funded by investor and government contributions.
- Bushfire prevention measures has also required Lower Murray Water to undertake additional unforeseen asset upgrades at the Merbein and Mildura 17th Street pump stations which were largely delivered within existing budgets.
- The cost for the Millewa river pump station replacement project is anticipated to be \$6.8 million higher than the original capital allowance due to market cost escalation and an increase in scope to address New South Wales Government regulatory requirements. Lower Murray Water has proposed to roll the additional expenditure, including external funding, into the 2023-24 regulatory asset base.

We consider these projects largely reflect Lower Murray Water's response to uncertain or unplanned circumstances. Accordingly, our preliminary view is that these costs should be reflected in Lower Murray Water's rural services closing regulatory asset base at 30 June 2022 (Section 7.3.1).

As at the end of June 2022, Lower Murray Water reported that, of the two major projects proposed for the 2018–23 period, one was completed and one was on track to be completed in 2022-23. Based on the above, we consider the actual capital expenditure Lower Murray Water has incurred for rural services from 2017-18 to 2022-23 is appropriate for the purpose of calculating its regulatory asset base (see Section 7.3).

Based on the above, our preliminary view is that we consider the actual capital expenditure Lower Murray Water has incurred for rural services from 2017-18 to 2022-23 is appropriate for the purpose of calculating its regulatory asset base for rural services (see Section 7.3.1).

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<sup>80</sup> If this additional expenditure associated with the Millewa river pump station replacement project is to be included within the regulatory asset base for 2022-23, Lower Murray Water would exceed its 2018 price determination benchmark of \$38.5 million by \$14.6 million (or 38 per cent).

## 7.2.2 Forecast Capital Expenditure

Lower Murray Water proposed a total forecast capital expenditure of \$50.4 million for rural services.

**Table 7.5 Our proposed adjustments to Lower Murray Water’s proposed total forecast capital expenditure for rural services**  
\$ million 2022-23

	2023-24	2024--25	2025-26	2026-27	2027-28	Total
<b>Lower Murray Water’s proposed total forecast capital expenditure – rural services</b>	<b>16.08</b>	<b>8.51</b>	<b>8.06</b>	<b>9.30</b>	<b>8.41</b>	<b>50.35</b>
Adjustments – Millewa River Pump Station project 2022-23 expenditure	-7.00	0.00	0.00	0.00	0.00	-7.00
<b>Draft decision – total forecast capital expenditure – rural services</b>	<b>9.08</b>	<b>8.51</b>	<b>8.06</b>	<b>9.30</b>	<b>8.41</b>	<b>43.35</b>

For the reasons set out below, our draft decision is to adopt a forecast capital expenditure of \$43.4 million, \$7 million (or 13.9 per cent) lower than proposed by Lower Murray Water for rural services, for the purpose of calculating its revenue requirement:

- Lower Murray Water’s price submission provided evidence that its forecasts for capital expenditure are prudent and efficient. It’s total proposed capital expenditure is \$50.4 million, which is (8.8 per cent) higher than capital expenditure in the current 2018–23 period, and \$22.2 million (or 78.8 per cent) higher than the forecast for the 2023–28 regulatory period provided in its 2018 price submission. Lower Murray Water’s increased forecast is driven by higher levels of improvements and compliance related expenditure (\$8.2 million) in the next regulatory period. Lower Murray Water’s rural capital expenditure continues to be largely driven by expenditure on renewals, accounting for \$30.6 million (or 60.7 per cent) of its total forecast capital program.
- However, Lower Murray Water’s price submission identified, and our expenditure consultant confirmed, that it has allocated \$7 million of expenditure connected to the delivery of the Millewa River Pump Station project in 2022-23 to the year 2023-24 to capture this expenditure in its regulatory asset base. Lower Murray Water explained that this expenditure has been delayed due to additional regulatory and environmental requirements. We do not consider the carry-forward of capital expenditure to the next year is appropriate or consistent with our guidance. For our draft decision we therefore propose to remove the \$7 million of

expenditure associated with Millewa River Pump Station project from its forecast capital expenditure benchmark for 2023-24.

- Our expenditure consultant requested additional information from Lower Murray Water as a representative sample of its major projects and capital programs to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, our consultant considered that Lower Murray Water has a reasonable approach for developing project scope, the timing of works and cost estimates.<sup>81</sup>
- Lower Murray Water has forecast \$3.4 million in expenditure over the period on its major projects (7 per cent of its total capital expenditure forecast). Our consultant reviewed the information provided in Lower Murray Water's price submission and considered that there was sufficient justification for the proposed expenditure.
- Lower Murray water has forecast \$46.9 million in expenditure to deliver its remaining capital programs and other capital projects in the 2023–28 period. Our consultant requested information on the three largest programs, the Irrigation Meter Replacement program (\$5.8 million), the Irrigation Minor capital works program (\$5.3 million) and the Irrigation Mains replacement program (\$4 million). Our consultant considered the information provided sufficiently justified the proposed programs and established the prudence and efficiency of the related expenditure.
- Overall, our expenditure consultant considered Lower Murray Water's forecasts were well developed and that its forecast rural capital expenditure has been robustly forecast and is prudent, efficient and deliverable. Based on the information reviewed, our consultant recommended no adjustments to Lower Murray Water's forecast rural capital expenditure.<sup>82</sup> We agree with our consultant's view because we consider that, for the purposes of our draft decision, the prudence and efficiency of the expenditure, with the exception of the carried-over \$7.0 million for the Millewa River Pump Station project, has been justified consistent with our guidance.
- Our preliminary view is that the planned capital program for rural services is achievable given Lower Murray Water's track record delivering its rural capital expenditure program. As discussed in Section 7.2.1, over the current regulatory period Lower Murray Water has completed three of its five major projects and anticipates it will complete the remaining two projects in 2022-23.<sup>83</sup> Our expenditure consultant also reviewed Lower Murray Water's delivery capability and had confidence the forecast capital program was deliverable in the

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<sup>81</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 56-58.

<sup>82</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 59.

<sup>83</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021-22*, 18 October 2022, pp. 33-34.

next regulatory period.<sup>84</sup> The forecast rural capital program is similar in size and cost to previous capital programs delivered by Lower Murray Water.

- Lower Murray Water’s price submission notes two rural projects it has excluded from its pricing proposal. The Red Cliffs Irrigation Suctions project has been deferred to the next regulatory period, while the scope and party responsible for the cost of the King’s Billabong Pumping station project has not yet been determined. Lower Murray Water has not identified where it has excluded any other rural capital project where there is uncertainty in timing, cost, scope and benefits of the capital expenditure. For any additional capital expenditure in the 2023–28 regulatory period that Lower Murray Water proposes to include in the regulatory asset base at the end of the regulatory period, it should note the following:
  - Lower Murray Water will need to demonstrate the prudence and efficiency of these costs if they are incurred during the 2023–28 regulatory period if seeking to include them in the regulatory asset base for the 2028–33 price review.
  - Deviations from forecasted capital expenditure during the 2023–28 regulatory period will form a key part of our assessment of the Performance element of PREMO at the next price review.

We have reviewed Lower Murray Water’s proposals and advice from FTI Consulting and our preliminary view is that Lower Murray Water’s approach to forecasting its capital expenditure for rural services is mostly consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014, save for in relation to the Millewa River Pump Station project, as described above.<sup>85</sup>

Accordingly, our draft decision for total gross capital expenditure for rural services is to not accept Lower Murray Water’s proposed benchmark and to instead adopt a benchmark of \$43.4 million for the purpose of setting a revenue requirement, which incorporates the \$7 million adjustment in relation to the Millewa River Pump Station project described above. The benchmark we propose to adopt is set out in Table 7.7.

The benchmark that we propose to adopt for Lower Murray Water does not represent the amount that Lower Murray Water 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. Where we have made an adjustment to exclude a project’s capital expenditure from Lower Murray Water’s revenue requirement, we are not requiring the business

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<sup>84</sup> FTI Consulting, *Lower Murray Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 57.

<sup>85</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 32–37.

to remove that project. Lower Murray Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

### 7.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>86</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 2.4), and regulatory depreciation (discussed in Section 7.4). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Lower Murray Water to propose:

- the closing value of its regulatory asset base at 30 June 2022 (using actual data)
- the opening value of its regulatory asset base at 1 July 2023 (calculated according to the criteria outlined in the guidance)
- the forecast value of its regulatory asset base for each year of the regulatory period (2023-24 to 2027-28), in accordance with the prudence criteria outlined in the guidance.

#### 7.3.1 Closing regulatory asset base

For its rural services, our draft decision is to adopt a closing regulatory asset base of \$108.7 million at 30 June 2022, which is \$1.5 million lower than the \$110.2 million proposed by Lower Murray Water.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.<sup>87</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>88</sup>

Lower Murray Water's proposed closing asset base at 30 June 2022 for rural services is provided at page 122 of its price submission. Lower Murray Water's proposed closing regulatory asset base does not match its approved regulatory accounts information over the period 2017-18 to 2021-22. We propose to correct for this in our draft decision.

We compared Lower Murray Water's actual net capital expenditure for rural services 2017-18 to 2021-22 (taking into account the corrections noted above) with the forecast used to approve

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<sup>86</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

<sup>87</sup> See Section 4.2 for a discussion of Lower Murray Water's capital expenditure.

<sup>88</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

maximum prices for the period from 1 July 2018. Typically, if a water business's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature.

Lower Murray Water (Rural)'s net capital expenditure for rural services over the period from 2017-18 to 2021-22 was \$33.8 million. This is \$7.8 million or 29.8 per cent higher than the forecast used to approve maximum prices for the period from 1 July 2018.

As noted in Section 7.2.1, our preliminary view is that Lower Murray Water has justified including the higher amounts in its closing regulatory asset base at 30 June 2022. Accordingly, our preliminary view is to include the \$33.8 million in net capital expenditure in the closing regulatory asset base.

Table 7.6 sets out our draft decision on Lower Murray Water (Rural)'s closing regulatory asset base for rural services at 30 June 2022.

**Table 7.6 Draft decision – closing regulatory asset base (RAB) for rural services**  
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
<b>Opening RAB 1 July</b>	<b>94.8</b>	<b>96.4</b>	<b>101.9</b>	<b>103.1</b>	<b>105.2</b>
Plus gross capital expenditure	7.9	13.8	12.9	5.5	8.3
Less government contributions	2.4	0.9	3.4	0.0	0.0
Less customer contributions	0.3	0.3	5.1	0.5	1.8
Less proceeds from disposals	0.4	4.6	0.5	0.1	0.2
Less regulatory depreciation	3.2	2.5	2.7	2.8	2.9
<b>Closing RAB 30 June</b>	<b>96.4</b>	<b>101.9</b>	<b>103.1</b>	<b>105.2</b>	<b>108.7</b>

**Note:** Numbers have been rounded.

### 7.3.2 Forecast regulatory asset base

For its rural services, our draft decision is to not accept Lower Murray Water's proposed forecast regulatory asset base.

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

Because our draft decision is to not accept Lower Murray Water's proposed closing regulatory asset base for rural services, our draft decision is to not accept Lower Murray Water's forecast regulatory asset base for urban services. Consistent with the requirements of our guidance, Lower Murray Water has proposed capital expenditure for 2022-23 the same as the 2018 benchmark adopted at the 2018 price review.

Table 7.7 sets out our draft decision on Lower Murray Water's forecast regulatory asset base for rural services from 1 July 2023.<sup>89</sup> Our assessments of the other components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

- Section 7.2 (capital expenditure)
- Section 7.3.2.1 (customer contributions)
- Section 7.4 (regulatory depreciation).

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<sup>89</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.



**Table 7.7 Draft decision – forecast regulatory asset base (RAB) for rural services**  
\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Opening RAB 1 July</b>	<b>108.7</b>	<b>110.7</b>	<b>111.9</b>	<b>116.3</b>	<b>120.2</b>	<b>125.2</b>
Plus gross capital expenditure	5.5	9.1	8.5	8.1	9.3	8.4
Less government contributions	0.0	0.0	0.0	0.0	0.0	0.0
Less customer contributions	0.2	2.1	0.2	0.2	0.2	0.2
Less proceeds from disposals	0.4	2.4	0.4	0.3	0.2	0.2
Less regulatory depreciation	3.1	3.3	3.5	3.7	3.9	4.0
<b>Closing RAB 30 June</b>	<b>110.7</b>	<b>111.9</b>	<b>116.3</b>	<b>120.2</b>	<b>125.2</b>	<b>129.2</b>

**Note:** Numbers have been rounded.

### 7.3.2.1 Customer contributions

For its rural services, our draft decision is to accept Lower Murray Water’s forecasts for revenue from customer contributions.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>90</sup>

For Lower Murray Water (Rural), the customer contributions shown for 2023-24 are for New South Wales Government contributions to the Millewa Pump Station upgrade, while the customer contributions from years 2 to 5 of the regulatory period reflect typical customer connection and metering contributions.

We compared Lower Murray Water’s forecast for rural services customer contributions with past outcomes. Our preliminary view is that Lower Murray Water’s forecast contributions are reasonable, having regard to past trends and its growth forecasts.

Our draft decision is therefore to accept Lower Murray Water’s forecasts for customer contributions for rural services.

<sup>90</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water corporation’s water, sewerage or recycled water networks.

## 7.4 Regulatory depreciation

For its rural services, our draft decision is to not accept Lower Murray Water's forecast regulatory depreciation.

Regulatory depreciation is a component of Lower Murray Water's revenue requirement and is also an input to calculating the regulatory asset base. Lower Murray Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile.<sup>91</sup> We noted in our guidance that we prefer this approach.<sup>92</sup> Lower Murray Water also calculated regulatory depreciation in a manner consistent with our guidance.

In terms of asset life, Lower Murray Water has assumed around 30 years. We note this is below the average across businesses in the current review of around 47 years. In its response to our draft decision, Lower Murray Water must provide further information to justify its assumed asset life.

Further, given our draft decision on its forecast regulatory asset base, our draft decision is to not accept Lower Murray Water's forecast regulatory depreciation for rural services.

For the purposes of this draft decision for rural services, we have adopted the regulatory depreciation as shown in Table 7.7 in Section 7.3.2. This uses Lower Murray Water's assumed asset lives but recalculates depreciation based on our proposed changes to the regulatory asset base. In response to our draft decision Lower Murray Water must update its forecast for regulatory depreciation.

## 7.5 Tax allowance

For its rural services, our draft decision is to accept Lower Murray Water's proposed forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Lower Murray Water has proposed no tax allowance in its revenue requirement for the 2023–28 regulatory period. Our draft decision is to accept the forecast as it was calculated consistently with the method required by our guidance.<sup>93</sup>

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<sup>91</sup> For the period from 2022-23 to 2027-28, Lower Murray Water proposed a regulatory depreciation of \$21.8 million.

<sup>92</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

<sup>93</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47–48.

## 8. Demand, tariffs and prices

Once Lower Murray Water's revenue requirement is established, demand forecasts and the form of price control are used to translate the revenue requirement into tariffs and prices.

### 8.1 Demand

For its rural services, our draft decision is to accept Lower Murray Water's demand forecasts.

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

Lower Murray Water's demand forecasts for rural services are set out at pages 110 to 113 of its price submission and are also included in its financial model.

Our draft decision is to accept Lower Murray Water's demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance.<sup>94</sup>

### 8.2 Form of price control

For its rural services, our draft decision is to accept Lower Murray Water's proposed revenue cap form of price control.

Our guidance indicated we would have particular regard to whether a business proposed to continue its existing form of price control or introduce a new form of price control.<sup>95</sup>

Lower Murray Water proposed a revenue cap form of price control for rural services as set out on page 124 of its price submission. This is the same as its current approach.

Our draft decision is to accept Lower Murray Water's proposed revenue cap form of price control because:

- it is the same as its current approach, which we have previously approved
- it provides sufficient revenue to cover the forecast efficient costs of providing services and for Lower Murray Water to deliver on any health, safety and environmental obligations
- the annual limit on price increases helps to minimise the impact of price changes on customers that can arise from deviations from forecast demand under a revenue cap.

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<sup>94</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 49.

<sup>95</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

- it is otherwise consistent with the requirements of our guidance.

## 8.3 Tariff structures and prices

For its rural services, our draft decision is to accept Lower Murray Water's proposed tariff structures.

Lower Murray Water's proposed tariffs are set out at pages 124 to 128 of its price submission.

Our draft decision does not approve prices for each tariff. Prices will need to be updated by Lower Murray Water to reflect our updates to its expenditure forecast, inflation and cost of debt estimates prior to our final decision. Our draft decision considers proposals related to tariff structures, the price path proposed, and any submissions on the level of prices or bills.

### 8.3.1 Tariff structures

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>96</sup> This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Lower Murray Water, proposed to maintain its existing tariff structures for pumped irrigation, waterworks, stock, domestic and private diversions across all rural districts. Lower Murray Water proposed to continue recovering the cost incurred by individual districts through the use of location-based pricing.

Our draft decision is to accept Lower Murray Water's proposed tariff structures for rural services, on the basis that they are generally a continuation of Lower Murray Water's current approach and otherwise meet the criteria in our guidance and are generally supported by its customers.

### 8.3.2 Prices

The prices proposed by Lower Murray Water for rural water services are set out on pages 124 to 128 of its price submission.

Under Lower Murray Water's proposal, generally prices (excluding inflation) for rural services will be lower for most districts.

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<sup>96</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

For irrigation and drainage customers (based on 100 ML of annual usage) Lower Murray Water outlined the following average annual customer bill impacts (excluding inflation) for the period:

- Mildura, 1.2 per cent annual decrease
- Red Cliffs, 0.61 per cent decrease
- Robinvale 5.54 per cent decrease
- Mildura HP 6.42 per cent decrease
- Merbein, 1.27 per cent increase.

For domestic and stock customers, Lower Murray Water proposed an average annual decrease of 1.9 per cent (excluding inflation).

For diversion customers, Lower Murray Water proposed an average annual increase of 0.75 per cent (excluding inflation).

As outlined in our guidance, we have provided Lower Murray Water with a large degree of discretion to decide on individual tariff structures.<sup>97</sup> This recognises that Lower Murray Water, in consultation with its customer consultative committees and customers, is best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

In May 2023, we intend to determine prices for Lower Murray Water in \$2023-24 terms. This means we will add the annual change in the March Quarter 2023 consumer price index (published by the Australian Bureau of Statistics) to its 2023-24 prices, which will also flow through to customer bills.

Lower Murray Water's prices for its rural services will also be affected by our draft decision on the revenue requirement, which is outlined in Chapter 7. In response to our draft decision, Lower Murray Water will need to propose updated prices that reflect our draft decision and any updates to its revenue requirement.

### **8.3.3 Addressing the interest of low income and vulnerable customers**

In making our price determination, we must have regard to whether Lower Murray Water's prices take into account the interests of their customers, including low income and vulnerable customers.<sup>98</sup>

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<sup>97</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

<sup>98</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

Our consideration of Lower Murray Water's rural pricing is informed by the nature of its services and customer mix that includes high volume commercial water users. We note that Lower Murray Water proposed:

- a price path that was falling in most districts
- smooth price paths where price increases were well justified, to meet customer preferences for consistency in their costs
- maintaining and enhancing its hardship programs for small business customers experiencing payment difficulty.

Section 2.3 reviews how Lower Murray Water's price submission was informed by engagement that was inclusive of Lower Murray Water's diverse rural customer base.

### 8.3.4 Unique services

Lower Murray Water has confirmed that its proposed tariffs for trade waste and miscellaneous services are calculated in accordance with the pricing principles referenced in our guidance. However, we note that its pricing model did not list its top 10 miscellaneous tariffs. In response to our draft decision, Lower Murray Water must include these top 10 miscellaneous tariffs in its pricing model.<sup>99</sup>

## 8.4 Adjusting prices

For its rural services, our draft decision is to accept Lower Murray Water's proposed price adjustment mechanisms.

Lower Murray Water's proposed price adjustment mechanisms for rural services are set out at page 124 of its price submission. It proposed the following price adjustment mechanisms, which are similar to those in the current regulatory period:

- to continue with its existing uncertain and unforeseen events mechanism
- to continue a direct pass through of Goulburn-Murray Water entitlement storage fees
- to not apply a mechanism for electricity costs that was introduced in 2018.

Our draft decision is to accept Lower Murray Water's proposal to continue the existing price adjustment mechanism for rural services because they are a continuation of existing arrangements. Our preliminary view is to also accept Lower Murray Water's proposal to not apply

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<sup>99</sup> In response to our queries, Lower Murray Water provided us with updated prices in its pricing model in early March 2023. We could not review and query the updated prices, which included some increases to existing price levels in its pricing model, in time for our draft decision.

an electricity cost adjustment because this approach is agreed by stakeholders as the uncertainty in energy prices is lower for the forecast years compared to the current regulatory period.

PART D – PREMO assessment of Lower Murray  
Water's price submission (urban and rural)



## 9. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water business's revenue requirement to that business's level of ambition expressed in its price submission. Our guidance required Lower Murray Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.<sup>100</sup> We required Lower Murray Water to self-rate its price submission as either 'Leading', 'Advanced', 'Standard' or 'Basic', with 'Leading' being the most ambitious and 'Basic' the least.

The assessment tool included in our guidance directed Lower Murray Water 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.

We also assessed and rated Lower Murray Water's price submission. As outlined in our guidance, the combination of Lower Murray Water's self-rating and our rating has determined the return on equity we have adopted to calculate Lower Murray Water's revenue requirement in our draft decision. While Lower Murray Water's urban services were covered by PREMO at its 2018 water price review, its rural services were not. Accordingly, at the 2023 review the Performance element of PREMO does not apply in relation to Lower Murray Water's rural services. This is consistent with the variation to our guidance that we published on our website in July 2022.<sup>101</sup>

### 9.1 Our PREMO assessment of Lower Murray Water's price submission

Our draft decision is to rate Lower Murray Water's price submission as 'Standard' under PREMO, which is the same as Lower Murray Water's self-rating.

Lower Murray Water's self-rating for each of the PREMO elements and its overall self-rating are shown in Table 9.1. This table also includes our proposed ratings following our assessment of Lower Murray Water's price submission.

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<sup>100</sup> This is the first price review we have done where the rating has been based on all five elements of PREMO. In our 2018 price review, our PREMO assessment was against only four of the elements — Risk, Engagement, Management and Outcomes.

<sup>101</sup> Essential Services Commission 2022, Variation to guidance paper in respect of Lower Murray Water's rural infrastructure services, July.

**Table 9.1**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Lower Murray Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's rating	Standard	Basic	Standard	Standard	Standard	Standard

Our preliminary view is that we agree with Lower Murray Water's proposed overall PREMO self-rating of 'Standard'. This is reflected in the return on equity we propose to approve for Lower Murray Water (see Section 2.4.2). We have formed this view after reviewing Lower Murray Water's proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

### 9.1.1 Performance

For the 2023 price review, a business's rating for the Performance element of PREMO is based on a combination of its overall PREMO rating at its most recent price review, and its level of performance based on achievement of outcomes (related to service targets and performance against expenditure benchmarks set at the previous price review) and customer sentiment.<sup>102</sup>

As noted above, for the 2023 review, the Performance element of PREMO only covers Lower Murray Water's urban services.

For the reasons set out below, our draft decision is to not accept Lower Murray Water's self-rating of 'Standard' for the Performance element of PREMO, and instead propose a rating of 'Basic'.

As noted in Section 3.1, our preliminary view is that we agree with Lower Murray Water's self-assessment that it has, overall, met its outcome commitments for the period to date for its urban services. Lower Murray Water reported it had achieved or exceeded its targets for 86 (74 per cent) of its 116 performance targets over the first 4 years of the current regulatory period.

In terms of customer perceptions, Lower Murray Water generally scored around the middle group of businesses on the commission's survey of customer sentiment – covering measures of overall satisfaction, value for money, trust, and reputation in the community.<sup>103</sup>

<sup>102</sup> As set out in Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 74-75. Guiding questions are set out on page 45.

<sup>103</sup> The commission's customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

In 2021-22 (the last available year of audited results), its expenditure was around 20 per cent higher than the benchmark adopted in 2018. After accounting for changes in corporate cost allocation from its rural business to its urban business, this reduces to around 15.6 per cent. This is higher than the average among businesses in the current price review (around 9 per cent).

Over the period from 2017-18 to 2021-22, in gross terms, Lower Murray Water's capital expenditure (urban) was around 9 per cent higher than forecast, and in net terms around 5.1 per cent lower than forecast. We consider this outcome is reasonable given the lumpiness of capital expenditure.

Additionally, at the end of June 2022, Lower Murray Water reported that, of the nine major projects proposed for the 2018–23 period, five were completed.

However, Lower Murray Water's controllable operating costs for urban services during the current regulatory period are forecast to be higher than the benchmark established at the 2018 water price review. After accounting for corporate cost reallocations, its operating expenditure in 2021-22 was around 16 per cent higher than the benchmarks used for our 2018 price determination. This is well above the industry average of around 9 per cent.

While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to manage and reprioritise costs closely having regard to the price review benchmarks. The PREMO framework (and the Water Industry Regulatory Order 2014 itself) is built on a sharp focus on efficiency, and base year costs for 2021-22 are critical to assessing the efficient operating costs to be reflected in benchmarks adopted for pricing in the 2023–28 period.

Based on the above, our draft decision is to not accept Lower Murray Water's self-rating of 'Standard' for the Performance element of PREMO, and instead propose a rating of 'Basic'. While Lower Murray Water generally delivered on its outcome commitments, its 2021-22 operating cost increases for urban services relative to the 2018 benchmark were relatively high compared to the average of water businesses in the current review.

### 9.1.2 Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don't pay more than they need to), and the business's proposed guaranteed service level scheme (including that it provides incentives for the business to deliver valued services efficiently).<sup>104</sup>

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<sup>104</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

In support of its self-rating of 'Standard' for the Risk element of PREMO, Lower Murray Water's price submission set out its approach to risk management and allocation (provided from page 35 of its price submission). Factors supporting Lower Murray Water's self-rating include:

- its risk management framework is aligned with ISO 31000
- continued use of a price cap for urban services, which means the business manages demand risk on behalf of its customers
- removal of the electricity price adjustment mechanism that applied in the current regulatory period (in part reflecting Lower Murray Water entering into Victorian Government Purchasing Board energy contracts for large and small sites)
- excluding uncertain projects from its capital expenditure forecasts
- it tested its guaranteed service level scheme with customers, and confirmed that the current scheme was appropriate.

On the basis of the above, our draft decision is to accept Lower Murray Water's self-rating of 'Standard' for the Risk element of PREMO.

### 9.1.3 Engagement

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations peoples and those experiencing vulnerability.<sup>105</sup>

Our draft decision is to accept Lower Murray Water's self-rating of 'Standard' for the Engagement element of PREMO.

Overall, our preliminary view is that Lower Murray Water has designed and delivered an engagement program that was responsive to its operating environment and the context of its community and service mix. Lower Murray Water used a range of methods to provide both its urban and rural customers the opportunity for deeper discussion and issue exploration, including issues that had meaningful influence on its investment decisions and service levels.

We consider that Lower Murray Water's engagement was sufficiently inclusive, noting its heavy reliance on local services for insight on the experiences of customers facing vulnerability and of First Nations customers. See Section 2.3 for more detail.

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<sup>105</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

### 9.1.4 Management

The Management element of PREMO is assessed against guiding questions that cover matters such as the efficiency of proposed expenditure and prices, the quality of the business's submission and supporting information to justify proposals, and evidence that there is senior-level ownership and commitment to the proposals contained in the submission.<sup>106</sup>

Lower Murray Water proposed an annual efficiency improvement rate of around 1 per cent for the 2023–28 regulatory period for its urban services, below the average of around 1.3 per cent for businesses in the current price review. Our draft decision proposes some relatively minor adjustments to Lower Murray Water's forecast operating and capital expenditure, the latter impacted by our preliminary view that Lower Murray Water did not propose an appropriate treatment for the Millewa River Pump Station project in 2022-23.

Generally, we consider Lower Murray Water's price submission provided clear justification for its proposals, and its financial model contained no substantive errors (noting there were some corrections to reflect its approved regulatory accounts for 2021-22) and was consistent with its written submission. Its price submission was well presented and clearly linked the outcomes of its engagement to planned outcomes and expenditure. The Lower Murray Water Board has also attested to the accuracy of the information contained in its submission, as required by our guidance.

Based on the above, our draft decision is to accept Lower Murray Water's self-rating of 'Standard' for the Management element of PREMO.

### 9.1.5 Outcomes

The Outcomes element of PREMO is assessed against guiding questions focused on:

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.<sup>107</sup>

As noted in Section 3.1 and Section 6.1, our preliminary view is that Lower Murray Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by customers.

It engaged customers through community advisory committees and panels, community focus groups, and targeted surveys. Agreement was obtained from its urban deliberative panel that its

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<sup>106</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

<sup>107</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

revised outcome commitments, performance measures, and targets captured urban customer priorities and expectations. It also undertook targeted rural consultation, such as pump station tours, interviews with key rural stakeholders, and events held in each rural district.

Generally, we consider Lower Murray Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome. There are some matters that we will follow up with Lower Murray Water to improve the clarity and accountability of its targets.

We also consider Lower Murray Water's proposed targets indicate an overall improvement in service levels for its customers.

Accordingly, our draft decision is to accept Lower Murray Water's self-rating of 'Standard' for the Outcomes element of PREMO.

# Appendix A — Submissions received

Name or organisation	Date received
Anonymous	7 October 2022
Consumer Action Law Centre	30 November 2022
Concerned Waterways Alliance	1 December 2022
Concerned Waterways Alliance	21 December 2022

## Appendix B — Commission’s consideration of legal requirements

Clause 11 of the Water Industry Regulatory Order 2014 (WIRO) specifies the mandatory factors we must have regard to when making a price determination. The WIRO covers matters that are included in the *Water Industry Act 1994* (WI Act) and the *Essential Services Commission Act 2001* (ESC Act).

Below, we describe how we apply the mandatory factors and where we have done so in our draft decision for Lower Murray Water.

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.<sup>108</sup> We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Lower Murray Water’s compliance with our guidance, in reaching our preliminary view.

Note: all chapter and section numbers referenced below refer to our draft decision for Lower Murray Water.

### **Economic efficiency and viability matters**

**WIRO clause 8(b)(i) requires us to have regard to the ‘promotion of efficient use of prescribed services by customers’.**

We consider that the efficient use of prescribed services by customers is promoted when a tariff is applied to customers benefiting from the service covered by the tariff, and tariffs send appropriate signals about efficient costs.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

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<sup>108</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.



**WIRO clause 8(b)(ii) requires us to have regard to the ‘promotion of efficiency in regulated entities as well as efficiency in, and financial viability of, the regulated water industry’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost promotes efficiency in regulated entities and the water industry. Our draft decision has therefore had regard to the extent that Lower Murray Water has demonstrated its proposed outcomes reflect customer service priorities, and whether its tariffs and forecast costs reflect efficient levels of expenditure.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).
- Our assessment of financial viability (Section 2.5).

**WIRO clause 8(b)(iii) requires us to have regard to the ‘provision to regulated entities of incentives to pursue efficiency improvements’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost provides regulated entities incentives to pursue efficiency improvements. The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

Additionally, our pricing approach allows a water business to retain the benefits of any cost efficiencies it generates until the end of its regulatory period. In other words, a water business has an incentive to outperform the operating and capital expenditure benchmarks we accept for the purpose of estimating its revenue requirement and prices. This is consistent with providing incentives for water businesses to pursue efficiency improvements.

**ESC Act section 8A(1)(a) requires us to have regard to ‘efficiency in the industry and incentives for long term investment’.**

We consider that adopting forecasts of efficient expenditure that reflect the service priorities of the customers of each water business promotes efficiency in the water industry.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

We have had regard to incentives for long term investment by adopting:

- A 10year trailing average approach to estimating the benchmark cost of debt (see Section 2.4.1).
- A regulatory rate of return that we consider will enable Lower Murray Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>109</sup>

**ESC Act section 8A(1)(b) requires us to have regard to the ‘financial viability of the industry’.**

We consider that the financial viability of the industry is secured by approving prices that provide a high degree of certainty that each water business can maintain an investment grade credit rating. Further, prices should enable each business to generate cash flow to service financing costs arising from investments to meet service expectations.

We have had regard to this matter in Section 2.5.

**ESC Act section 33(3)(b) requires us to have regard to the ‘efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry’.**

In preparing our draft decision, we have had regard to the extent Lower Murray Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).

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<sup>109</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.

- Our assessment of tariffs (Section 5.3 and Section 8.3).

## **Industry specific matters**

**ESC Act section 33(3)(a) requires us to have regard to the ‘particular circumstances of the regulated industry and the prescribed goods and services for which the determination is being made’.**

Our pricing approach allows each water business to propose outcomes, tariff structures and expenditure that reflect its particular circumstances. We consider that taking into account the particular circumstances of each water business is consistent with taking into account the particular circumstances of the water industry.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

We have had regard to the prescribed services listed in the WIRO in making our draft decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Lower Murray Water to deliver services that are covered by the prescribed services listed in the WIRO.

**ESC Act section 33(3)(c) requires us to have regard to the ‘return on assets in the regulated industry’.**

Our draft decision provides for Lower Murray Water to generate a return on assets through:

- Our consideration of the regulatory asset base (Section 4.3 and Section 7.3).
- Our consideration of the cost of debt (Section 2.4.1).
- Our consideration of the return on equity (Section 2.4.2).

**ESC Act Section 33(3)(d) requires us to have regard to ‘any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries’.**

In assessing costs, prices and return on assets we have had regard to relevant interstate benchmarks:

- indicative bills paid by customers in other jurisdictions in Australia<sup>110</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>111</sup>
- tariff structures applied by water businesses throughout Australia<sup>112</sup>
- the regulatory rate of return set by other regulators.<sup>113</sup>

We are not aware of any international benchmarks that are relevant to our draft decision.

**WI Act section 4C(b) requires us to ‘ensure that regulatory decision making and regulatory processes have regard to any differences between the operating environments of regulated entities’.**

Our pricing approach allows each water business to propose outcomes, a revenue requirement, expenditure and tariffs that reflect its particular circumstances and operating environment.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

Our price review also considers the views of stakeholders affected by Lower Murray Water’s proposals, including through submissions and public meetings.

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<sup>110</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

<sup>111</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>112</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>113</sup> Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW’s rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

## Customer matters

**ESC Act section 8(1) requires us to have regard to the fact that the ‘objective of the Commission is to promote the long term interests of Victorian consumers’.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers is consistent with promoting the long term interests of Victorian consumers.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

**ESC Act Section 8(2) requires us to ‘have regard to the price, quality and reliability of essential services’ in seeking to achieve the objective in section 8(1) of the ESC Act.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers, and allowing businesses to meet regulatory and policy obligations is consistent with this objective.

In terms of prices, the following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our consideration of demand (Section 5.1).
- Our consideration of tariffs (Section 5.3 and Section 8.3).

In terms of the quality and reliability of services, the following sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our consideration of outcomes (Chapter 3 and Chapter 6).

**WIRO Clause 11(d)(i) requires us to have regard to whether Lower Murray Water’s prices ‘enable customers or potential customers of the regulated entity to easily understand prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated’.**

We consider that the following matters are relevant when considering whether Lower Murray Water’s prices enable customers or potential customers to easily understand prices, or the manner in which prices are calculated, determined or otherwise regulated:

- feedback from customers during a water business’s engagement
- the structure of individual tariffs
- the proposed form of price control
- any changes to tariffs and how water businesses explain them to customers.

The following sections of our draft decision involved consideration of this factor:

- Our consideration of tariffs and the form of price control (Sections 5.2 and 5.3 and Sections 8.2 and 8.3).

**WIRO Clause 11(d)(ii) requires us to have regard to whether Lower Murray Water’s prices ‘provide signals about the efficient costs of providing prescribed services to customers while avoiding price shocks where possible’.**

We consider prices can provide signals about efficient costs when a tariff is applied to customers benefiting from the service covered by the tariff, and tariffs send appropriate signals about efficient costs.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3).
- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

**WIRO Clause 11(d)(iii) requires us to have regard to whether Lower Murray Water’s prices ‘take into account the interests of customers of the regulated entity, including low income and vulnerable customers’.**

We consider that customer value established through prices and customer outcomes, as well as tariff structures, and assistance available to customers having difficulty paying bills is relevant to this objective.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 2.3)
- Our consideration of outcomes (Chapter 3 and Chapter 6)
- Our consideration of guaranteed service levels (Section 3.3)
- Our consideration of tariff structures and prices (Chapter 5 and Chapter 8)

## **Health, safety, environmental and social obligations**

**ESC Act Section 8A(1)(d) requires us to have regard to ‘the relevant health, safety, environmental and social legislation applying to the industry’.**

Our draft decision proposes to approve a revenue requirement that will enable Lower Murray Water to deliver the outcomes valued by customers, and on its legal and regulatory obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of the form of price control (Section 5.2 and Section 8.2).

**WI Act section 4C(c) requires us to ‘ensure that regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities’.**

Our draft decision proposes to approve a revenue requirement that will enable Lower Murray Water to deliver the outcomes valued by customers, and on its health, safety, environmental sustainability and social obligations.

The following chapters and sections of our draft decision involved consideration of this factor:

- Our assessment of the revenue requirement (Chapter 4 and Chapter 7).
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).
- Our assessment of tariffs (Section 5.3 and Section 8.3).

## Other matters

**ESC Act section 8A(1)(c) requires us to have regard to ‘the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries’.**

In relation to the above, Lower Murray Water does not face any competition in the delivery of its prescribed services within its region. Our draft decision takes this into account through our consideration of forecast efficient costs, and considering the service priorities of customers as revealed through a business’s customer engagement.

The following sections of our draft decision involved consideration of this factor:

- Our assessment of engagement (Section 2.3)
- Our assessment of outcomes (Chapter 3 and Chapter 6)
- Our assessment of efficient operating expenditure (Section 4.1 and Section 7.1) and capital expenditure (Section 4.2 and Section 7.2).

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>114</sup>

**ESC Act section 8A(1)(e) requires us to have regard to the ‘benefits and costs of regulation (including externalities and gains from competition and efficiency) for: (i) consumers and users of products or services (including low income and vulnerable consumers); and (ii) regulated entities’.**

We have had regard to benefits and costs of regulation by:

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily

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<sup>114</sup> Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.



available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>115</sup>

**ESC Act section 8A(1)(f) requires us to have regard to ‘consistency in regulation between States and on a national basis’.**

Similar to other state and national regulators, our economic regulatory approach:

- uses the building block method to estimate a water business’s revenue requirement
- allows water businesses to implement various forms of price control, including price caps and revenue caps
- allows for consultation with key stakeholders during a price review, including through the release of a draft decision.

**WI Act section 4C(a) requires us to ‘ensure that the costs of regulation do not exceed the benefits’.**

We have sought to ensure that the costs of regulation do not exceed the benefits by:

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>116</sup>

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<sup>115</sup> Essential Services Commission, 2023 water price review: Guidance paper, p. 2.

<sup>116</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.