



# GWMWater draft decision

2023 Water Price Review

2 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 GMMWater’s proposed prices for a 5-year period starting 1 July 2023**

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

### **GMMWater has committed to progress projects to improve water quality and reduce carbon emissions over the next 5 years**

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

GMMWater plans to deliver the following outcomes for customers:

- Safe drinking water
- Clean non-drinking water – urban
- Clean non-drinking water – rural
- Reliable and affordable services
- Healthy and Liveable Region

GMMWater’s proposed targets for its proposed outcomes are generally similar to those in the current 2018-23 regulatory period (Section 3.2). Improvements are focused in areas such as investing in urban and rural water quality, and further reducing carbon emissions. It will also continue to plan for long-term water security. As noted below, key outcomes for customers will be delivered alongside falling (real) prices.

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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; GMMWater’s price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

## Prices for GWMWater’s urban and rural water services will generally fall in real terms

Based on GWMWater’s price submission, before inflation the typical annual water and sewerage bill for a residential owner-occupier (with access to potable water) will fall from \$1,403 currently to \$1,292 in 2023-24, then increase to \$1,307 by 2027-28 (Table A). These estimates exclude inflation (they are in \$2022-23 terms).

Excluding inflation, bills for household tenants (with access to potable supply) will fall from \$422 in 2022-23 to \$388 in 2023-24 before rising to \$391 in 2027-28. Estimated annual water and sewerage bills for non-residential urban customers (with a 20mm connection point) are also shown below.

In real terms, prices for other services will also generally fall, including for rural pipeline, groundwater, environmental water, and bulk water services.

In response to our draft decision, GWMWater must update its proposed prices to reflect a small correction to its revenue requirement (noted below). This adjustment should not have a material impact on the bill estimates provided by GWMWater in its price submission. In response to our draft decision, GWMWater will also need to update its prices for our updates for inflation and the cost of debt (expected in April 2023).

**Table A** Estimated typical annual water and sewerage bills, urban services (\$2022-23)

	Average consumption (kL p.a.)	2022-23 (current)	2023-24	2027-28
Residential – owner occupier	240	\$1,404	\$1,292	\$1,307
Residential – tenant	240	\$422	\$388	\$391
Non-residential (Medium)	390	\$1,649	\$1,517	\$1,533

## Our draft decision is to adopt a slightly lower revenue requirement than proposed by GWMWater

Our draft decision is to adopt a revenue requirement of \$323.8 million for GWMWater over the 5-year period starting 1 July 2023 (Chapter 4). This is around \$3.7 million (1.1 per cent) lower than the revenue requirement proposed by GWMWater in its price submission.

This mainly reflects adjustments to benchmarks used to calculate its regulatory asset base, to align with the 2021-22 regulatory accounts we approved for GWMWater (which occurred after we received GWMWater’s price submission).

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

For its existing tariffs, GWMWater proposed no changes to tariff structures. It proposed to introduce a new industrial fire service tariff for non-residential customers in industrial zones.

Our draft decision is to approve GWMWater's proposed tariff structures, because GWMWater's engagement found they are generally supported by its customers and generally reflect a continuation of current arrangements.

Our draft decision is to approve GWMWater's proposal for a new industrial fire service tariff because the tariff reflects the efficient incremental costs of providing the improved service and is generally supported customers. Our review of GWMWater's tariffs is set out in Section 5.3.1.

Our draft decision is to accept GWMWater's proposed price cap form of price control (Section 5.2) because this is the same as its current approach, provides customers with price certainty, and means that demand risk is managed by the businesses and not its customers. This means maximum prices are fixed subject to updates for inflation and cost of debt, and any other adjustments we approve in our price determination.

## **Our draft decision rates GWMWater's price submission as 'Advanced' under the PREMO framework**

Our draft decision is to rate GWMWater's price submission as 'Advanced' under the PREMO framework (Table B). The is the same as the business's self-rating of its price submission.


Key factors supporting this PREMO rating include:

- a strong engagement program which gives confidence that its proposals are informed by deep insights into customer priorities and concerns
- a reduction in its prices in the current regulatory period in response to it not meeting some performance targets, demonstrating accountability
- demonstrated operating cost control, with its operating costs in the current period relatively close to benchmarks (noting most other businesses' operating costs are above these benchmarks)
- a relatively high efficiency target and a forecast reduction in controllable operating expenditure (compared with outcomes for the current 2018–23 regulatory period)
- recognition of the possible impacts of a high inflation outlook on prices in the near term, and proposing a price path that helps to manage these impacts for its customers
- the introduction of two new guaranteed service levels, focusing on supply interruptions, which are supported by customers.

While our draft decision accepts GWMWater’s proposed rating of ‘Advanced’ for the Management element of PREMO, we note that its price submission did not include material we consider substantive to our assessment of its proposals. This includes information describing its capital expenditure program in the current regulatory period (to inform the commission’s assessment of Performance and proposed capital expenditure) which can be key drivers of customer prices. This lack of information required us to issue several requests for information to clarify its proposals.

However, we have put greater weight on the improvement in customer value that will be delivered by GWMWater, including through reduced (real) prices and (relevant to its Management rating) relatively high efficiency targets and operating cost control. Accordingly, our draft decision accepts GWMWater’s proposed rating of ‘Advanced’ for Management.

See Section 1.4 and Chapter 7 for more detail, including an explanation of the PREMO framework.



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

**Table B** PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
GWMWater’s self-rating	Advanced	Advanced	Advanced	Leading	Advanced	Advanced
Commission’s rating	Advanced	Advanced	Advanced	Leading	Advanced	Advanced

Among the four draft decisions we have released so far, GWMWater is one of three corporations for which we propose to approve an ‘Advanced’ rating (Table C).

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

Leading	Advanced	Standard	Basic
	Yarra Valley Water Gippsland Water GWMWater	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 GWMWater’s price submission)
- additional matters or issues we should consider before making our final decision
- whether our draft decision on GWMWater’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 in early 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 are due by 28 April 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 and/or anonymity in relation to your submission. Requesting this may affect the weight we can give to your submission.

## Next steps

Activity	Indicative date
Public forum	Early April 2023
Closing date for submissions on our draft decision	28 April 2023
Release date for our final decision and price determination	June 2023

# 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 corporations 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 corporations propose to charge customers for prescribed services from 1 July 2023.<sup>2</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.<sup>3</sup>

GWMWater 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 GWMWater 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>2</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>3</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 Essential Services Commission considers relevant
- the matters specified in our guidance<sup>4</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.

Attachment 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.

In October 2021, we issued guidance to GWMWater to inform its price submission. The guidance set out how we would assess GWMWater's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that GWMWater would comply with certain requirements and specified information that GWMWater must provide to us when submitting its price submission.

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve GWMWater's proposed prices.<sup>5</sup>

If we consider the submission does not have adequate regard for the matters specified in clause 11 of the WIRO or does not comply with our guidance, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.<sup>6</sup>

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<sup>4</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>5</sup> This is a requirement of the WIRO, clause 14(b).

<sup>6</sup> This is provided for under the WIRO, clause 14(b)(i).

**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 1994 (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 corporations 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 corporations 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>7</sup>

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

For the 2023 water price review, a water corporation'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 corporation'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>8</sup>

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<sup>7</sup> In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

<sup>8</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.

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

We have made our draft decision on GWMWater's price submission after considering:

- GWMWater's price submission
- GWMWater'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 GWMWater's price submission are available on our website (to the extent the material is not confidential).

Our guidance included matters water corporations must address in their price submissions. Our preliminary assessment of these matters is provided in this draft decision.

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



GWMWater must submit a response to our draft decision and provide an updated financial model by 21 April 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 GWMWater 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 GWMWater has committed to over the regulatory period (Chapter 3)
- establish GWMWater's revenue requirement using a building block methodology (Chapter 4)
- use demand forecasts and the form of price control to convert the revenue requirement to tariffs and prices (Chapter 5).



Chapter 6 outlines our consideration of GWMWater’s financial position, which we have also had regard to.

Chapter 7 outlines our assessment of GWMWater’s price submission under the PREMO framework.

## 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>9</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>10</sup>

GWMWater 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.

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

<sup>10</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.

## 3. Customer outcomes

The customer outcomes and value GMMWater 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:

- examines GMMWater’s engagement with its customers in preparing its price submission
- reviews whether GMMWater has delivered on the outcomes it committed to for the current regulatory period (2018–23) and examines the customer outcomes GMMWater is committing to for the next regulatory period
- outlines GMMWater’s proposed guaranteed service levels.

### 3.1 Customer engagement

Our guidance required GMMWater to engage with customers to inform its price submission. Our guidance also identified principles to guide GMMWater’s engagement.<sup>11</sup>

We consider GMMWater’s engagement aligned with these principles in a number of ways:

- GMMWater engaged early in its planning noting its submission was informed by insights from the committees and forums it ran throughout the current regulatory period.
- It engaged using a range of methods such as surveys, workshops, participation at regional events, an online hub, and an independently chaired community panel.
- It engaged on matters that are material to liveability in its communities such as access to quality drinking water, the reliability of water services, and service standards.
- GMMWater engaged deeply using a community panel – a method well suited to the complex price and service trade-offs that participants were asked to consider, and which had a demonstrated and high level of influence on the final set of proposals.
- GMMWater’s engagement was tailored to the diversity of its customers, including those who are experiencing vulnerability and First Nations people. For example, it engaged hard-to-reach customers through the involvement of community workers in workshops.

More detail on GMMWater’s engagement is available in its price submission.<sup>12</sup>

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<sup>11</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

<sup>12</sup> GMMWater’s price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

GWMWater's response to the community panel's preferences provide evidence that its engagement influenced its proposals. For example, informed by the panel, GWMWater proposed:

- drinking-quality water-supply upgrades (initially in Berriwillock and Culgoa with further towns planned once costs are better understood)<sup>13</sup>
- clearer arrangements on when and how it will move towns from non-drinking water quality to a rural supply, including when it will consider upgrades to drinking-quality water instead
- extending the Northern Mallee Pipeline to Nyah and Piangil systems so the towns of Speed, Tempy, Underbool and Walpeup will be less reliant on supply from the Murray River<sup>14</sup>

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

In terms of our assessment of GWMWater's proposed rating of 'Leading' for its Engagement element of PREMO, our preliminary view is that GWMWater designed and delivered a quality engagement program and achieved strong customer and stakeholder influence on the proposals in its submission.

We consider that GWMWater's engagement achieved a high level of collaboration and influence through the appointment of an independent chair of its community panel and the opportunities for the chair to inform the decision making of GWMWater.<sup>15</sup> The methods it used were diverse and robust, allowing for a depth of deliberation well suited to the price and equity trade-offs GWMWater took to customers. Its engagement was representative of the diversity of its customer base, which is notable given the large geographical footprint of GWMWater and the variety of services it provides.

The Consumer Action Law Centre commented positively on GWMWater's transparency regarding the make-up of its community panel. The Consumer Action Law Centre pointed to the high representation of people with the experience of vulnerability as evidence of the strength of GWMWater's engagement.<sup>16</sup> However, it also noted that GWMWater did not identify any community panel members from culturally or linguistically diverse backgrounds.

In forming our preliminary view about the diversity GWMWater was able to achieve, we considered GWMWater's recruitment effort for its community panel, the broad representation of customers

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<sup>13</sup> GWMWater, 2023 water price submission, Appendix 1, Independent Community Panel Report to GWMWater, September 2022, pp. 4 and 33.

<sup>14</sup> GWMWater, 2023 water price submission, Appendix 1, p. 38.

<sup>15</sup> See GWMWater, 2023 water price submission, Appendix 1.

<sup>16</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022.

contributing to the panel, and the overall opportunities for customers to participate in its price review process, which included surveys, workshops, participation at events, and its online hub.

The Consumer Action Law Centre also questioned whether GWMWater had achieved a truly collaborative process, noting some panel members reported insufficient time to review materials prior to community panel meetings. We acknowledge this feedback and agree that providing participants with appropriate information and a reasonable and fair opportunity to participate underpins good engagement.

Aggregated customer feedback provided by GWMWater on its community panel process indicates high satisfaction with the quality of presentation materials and technical support during the community panel process. We also saw evidence of GWMWater's willingness to adjust its schedule for panel discussions when requested, so customers could consider additional material and undertake further deliberation.<sup>17</sup> In our view, these factors indicate that GWMWater supported effective participation, and helped to ensure collaboration in line with the expectations of participants. We also note the independence of the community panel and its chair, and the strong alignment between GWMWater's final set of proposals and the customer preferences identified through engagement.

Based on the above, our preliminary view is that GWMWater improved on its high-quality engagement in the 2018 price review and our draft decision is that we agree with its self-rating of 'Leading' for the Engagement element of PREMO.

## **3.2 Outcomes**

### **3.2.1 Performance against outcome commitments 2018–23**

As part of our 2018 price review, GWMWater established outcomes it would deliver to its customers over the following five 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 in the can indicate whether customers got what they paid for and inform our assessment of the Performance element of PREMO (Chapter 7).

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>18</sup>

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<sup>17</sup> See GWMWater, 2023 water price submission, Appendix 1, pp. 18-19 and pp. 48–51. GWMWater's Community Panel, assisted by an independent consultant, provided a report to GWMWater documenting the processes and outcomes of the panel. This report detailed (among other things) feedback from community panel members on a range of matters to do with the delivery of the community panel. While the report noted some areas for improvement, in general the feedback on the quality of the materials and collaboration with GWMWater was positive.

<sup>18</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

We consider that GMMWater accounted for its annual performance for each measure in its price submission. Like many other water businesses, GMMWater did not include its overall rating against each outcome for the period to date. In the absence of this information, we have drawn on GMMWater’s 2021-22 Outcomes report for its period to date rating.<sup>19</sup>

Table 3.1 lists GMMWater’s outcome commitments and includes its annual performance results as reported in its price submission and in our 2021-22 Outcomes report.<sup>20</sup> The information in this table informs our assessment under the Performance element of PREMO.

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

Outcome	2018-19	2019-20	2020-21	2021-22	Full period <sup>a</sup>
1. Safe Drinking Water <sup>b</sup>	Green	Green	Amber	Amber	Amber
1.a Safe Drinking Water <sup>c</sup>				Green	Green
1.b Clean, Non-Drinking Water – Urban <sup>d</sup>				Red	Red
1.c Clean, Non-Drinking Water – Rural Pipeline <sup>d</sup>				Green	Green
2. Reliable and Affordable Services	Amber	Amber	Amber	Amber	Amber
3. Healthy and Liveable Region	Amber	Green	Green	Green	Green

**Note:** Green = achieved target; Amber = close to achieving target; Red = failed to meet target. <sup>a</sup> This is GMMWater’s self-assessment of its performance across the first four years of the current regulatory period. Its performance against outcome commitments in the final year of the current regulatory period (2022-23) will be published in our 2022-23 Outcomes Report. <sup>b</sup> Outcome 1 replaced by outcomes 1.a., 1.b. and 1.c. in 2021-22. <sup>c</sup> New outcome added in 2021-22, previously combined under outcome 1. ‘Safe and Clean Water’. <sup>d</sup> Essential Services Commission, *GMMWater’s outcomes performance 2021-22, October 2022*.

GMMWater worked with its community panel in the development of its price submission to revise its measures and targets during 2021-22 and has adopted these changes for the last year of the current regulatory period (2022-23). Outcome 1 ‘Safe and clean drinking water’ has been replaced by outcomes 1.a, 1.b and 1.c, which break this outcome down to reflect the different main customer groups serviced by GMMWater. GMMWater has also included its past performance results for each new measure in its 2021-22 Outcomes Report.

<sup>19</sup> Essential Services Commission, *GMMWater’s outcomes performance 2021-22, October 2022*.

<sup>20</sup> GMMWater, 2023 water price submission, September 2022, p. 15.

In its price submission, GWMWater noted that its 2021-22 Outcomes report provides a detailed account of its performance against outcome commitments and measures.<sup>21</sup> We have drawn on GWMWater's 2021-22 Outcomes report for its account on its performance for the period to date.

In its 2021-22 outcomes report, GWMWater acknowledged it failed to meet its Outcome 1.b for clean, non-drinking water (urban) for the period to date. It measured its performance for this outcome based on the percentage of survey responses for customer satisfaction and the number of non-drinking water quality complaints per 1000 customers. It noted that the results demonstrated a higher level of dissatisfaction among customers receiving non-potable water supply. It also noted that existing commitments to drinking water upgrades in Kaniva, Elmhurst, Moyston and Ultima (all delayed and yet to be completed), along with proposals under consideration in its price submission, are focused on improving the value of services to its customers.<sup>22</sup>

In its 2021-22 outcomes report, GWMWater also acknowledged it was close to achieving its targets for its reliable and affordable services outcome for each year in the period to date. This outcome is an aggregate of 15 individual measures, and GWMWater achieved its targets for 11 of these in 2021-22.

In its price submission, GWMWater considered it is performing well in respect to drinking water and rural pipeline services, as reported in its 2021-22 outcomes report. It also noted it had reduced its tariffs during the current regulatory period where there was a variance in performance – customers affected by the delayed delivery of drinking water upgrades, for example.<sup>23 24</sup>

In the current regulatory period, GWMWater reported its performance results to its customers on its website, via its 'our performance' page. It mostly reported its performance on time, and generally provided a reasonable assessment of its performance.

As part of our 2021-22 outcome reporting process, GWMWater reported on the status of its 16 major projects it set as part of its 2018 price determination. It reported that four projects were completed late, six were delayed but expected to be completed in 2022-23, and two were on schedule, with the remaining four delayed and carried over to the 2023–28 period.<sup>25</sup> GWMWater

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<sup>21</sup> GWMWater, 2023 water price submission, September 2022, p.15.

<sup>22</sup> Essential Services Commission, GWMWater's outcomes performance 2021-22, October 2022, p. 6.

<sup>23</sup> GWMWater, 2023 water price submission, September 2022, p.15.

<sup>24</sup> GWMWater, 2023 water price submission, September 2022, p.21.

<sup>25</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 26-33. GWMWater'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.

has initiated an additional five major projects during the 2018–23 period that were not included in its 2018 price determination.<sup>26</sup>

Our draft decision is that we agree with GWMWater’s self-assessment that it has, overall, met its outcome commitments for the period to date. This is consistent with our views set out in our Outcomes reporting during the current regulatory period.<sup>27</sup>

### 3.2.2 Outcome commitments for 2023–28

GWMWater engaged with its customers to refine its outcome commitments for the period from 1 July 2023 to 30 June 2028. It has established five customer outcomes it proposes to deliver:

- Safe drinking water
- Clean non-drinking water – urban
- Clean non-drinking water – rural
- Reliable and affordable services
- Healthy and liveable Region

Among the key initiatives to deliver on its commitments are capital works to improve water supply and water quality. GWMWater will upgrade the towns of Berriwillock and Colgoa to a drinking water supply and complete upgrades currently underway for Kaniva and Moyston. It will also complete the East Grampians Water Supply project, improve the quality of water for the Northern Mallee Pipeline, and invest in mains renewal to maintain the reliability of its supply network. GWMWater will also continue studies to add to security of recreational water.

In terms of adaptation in response to climate change, as well as progressing a number of projects relating to the security and quality of water supply (including ongoing studies related to a number of possible projects), GWMWater has committed to achieving net zero emissions by 2035.

Investments in renewable energy will contribute to operating cost reductions.<sup>28</sup>

Our review below informs our assessment of the Outcomes element of PREMO provided in Chapter 7.

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<sup>26</sup> See section 4.2.1 and 4.2.2 of this draft decision for more information on GWMWater’s capital expenditure program.

<sup>27</sup> These reports are available at <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/water-business-outcomes-reporting#tabs-container2>

<sup>28</sup> GWMWater has taken into account a long-term horizon for managing the impacts of climate change; matters noted in a submission by the Concerned Waterways Alliance (Concerned Waterways Alliance submission to the Essential Services Commission Water Price Review 2023. As well as providing an overview of climate change impacts, its submission noted a number of integrated water cycle initiatives (pp. 12-13).

### 3.2.3 Our assessment of measures and targets

GWMWater proposed a set of 35 measures and targets that it will use to report on its performance across the 5 outcomes. These are set out on pages 40 to 42 of its price submission. Performance against these measures will inform our assessment during future price reviews.

We have assessed GWMWater’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
- have performance targets listed for each year of the regulatory period.<sup>29</sup>

Evidence provided by GWMWater demonstrates that these measures and targets were developed in consultation with its customers, and that they are supported by its customers. GWMWater noted that the content of and performance against its 2018–23 outcomes were subject to a continuous feedback loop with customers and stakeholders during the regulatory period. It noted that customers provided regular feedback about the relevance of both measures and outcomes, as well as which outcomes needed to be prioritised, which informed its 2023–28 proposal.<sup>30</sup>

We consider some of GWMWater’s measures will provide a sound basis to track performance and delivery against each outcome, particularly those that are unchanged from the current set of measures. However, all the new measures and those existing measures that have been modified have not been well presented in its submission and will require considerable reworking to meet our requirements.

In particular, GWMWater has listed all of its current service standards as measures for its “reliable and affordable services” outcome – however, these are minimum levels of service all customers should expect to receive, and do not represent performance measures in the form presented by the business. We expect a water business to understand the different roles of a service standard and a performance measure and seek to make this clear to its customers.

We identified the following matters in our assessment that need to be addressed:

- 12 of 35 measures are not measurable
- 14 of 35 measures are considered ambiguous or not clearly defined
- 4 of 35 measures are not easy to understand

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<sup>29</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 23.

<sup>30</sup> GWMWater, *2023 water price submission*, September 2022, p. 39.



- 3 of 35 measures do not have targets for each year of the regulatory period.

We will provide GWMWater 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.

GWMWater's proposed targets for its outcome measures are mostly consistent with its existing targets, even where it has outperformed the existing target in the current period. Also, targets for each measure are held flat across the five years of the 2023–28 period. In our view, of the 35 output targets:

- 1 indicates an improvement on past performance.<sup>31</sup>
- 25 indicate service levels will be maintained.
- 1 indicates a decrease in service levels.
- 8 are unclear how service levels change. Of these, three do not have targets for each year of the regulatory period.

GWMWater's target for average duration of planned water supply interruptions has been raised from 180 minutes to 200 minutes after it did not meet the target in the current period. It noted that this update reflects its water mains renewals program and was endorsed by its community panel.<sup>32</sup> GWMWater has also committed to reporting annually to customers on how it has performed against its outcome commitments.

While most of GWMWater's output targets will be maintained at current levels, its proposed outcomes were informed by engagement with its customers and are generally supported. The outcomes are also being delivered with relatively substantial reductions in (real) prices. On that basis our draft decision is to accept GWMWater's proposed PREMO rating of 'Advanced' for the Outcomes element of PREMO (discussed further in Chapter 7).

### **3.3 Service standards relating to reliability and faults**

Service standards are a common set of services applicable to all Victorian consumers as required by clause 18.2 of the *Water Industry Standard – Urban Customer Service* (Urban Water Industry Standard) and clause 1.5 of the *Water Industry Standard – Rural Customer Service* (Rural Water Industry Standard). Each water business must specify its own targets against each of these service standards. These service standards and corresponding target service levels are the minimum level of service customers can expect to receive.

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<sup>31</sup> This output is measuring carbon emission reduction, with mandatory targets set in the Statement of Obligations (Emissions Reduction) issued by the Minister for Water.

<sup>32</sup> GWMWater, *2023 water price submission*, September 2022, p. 45-46.

GWMWater's target service levels relating to reliability and faults for urban customers can be found on page 46 of its submission, and for rural customers on page 47 of its submission.

In addition, GWMWater has proposed a target service level of 10 business days to respond to complaints and enquiries if a written reply is requested (as required by clause 1.5 (b) of the Rural Water Industry Standard).

The urban target service levels proposed by GWMWater are substantially the same as those for the current 2018–23 regulatory period (with some changes to align with the updated Urban Water Industry Standard). GWMWater has also specified minimum flow rates as required by the updated Urban Water Industry Standard.

As noted in Section 3.2, the target service level for the average duration of planned water supply interruptions has been increased from 180 minutes to 200 minutes. GWMWater has stated that this reflects the water mains renewal program endorsed by its community panel. We further note that the change to the target service level was unanimously supported by its community panel.

The rural target service levels proposed by GWMWater consolidate its previous service levels and reword them as required by the updated Rural Water Industry Standard.

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

The approved service standards for each business will be published in our Water Industry Standards in early 2023-24.

### **3.4 Guaranteed service levels**

Our draft decision is to accept GWMWater's proposed guaranteed service level scheme.

Guaranteed service levels define a water corporation'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.

GWMWater's proposed guaranteed service levels are set out on page 49 of its price submission. It has proposed two new guaranteed services that relate to multiple unplanned urban water interruptions and multiple unplanned sewer blockages. Each will have a rebate value of \$80. Its six other guaranteed service levels and rebate values will remain the same.

Our draft decision is to accept GWMWater’s proposed guaranteed service levels, on the basis that they have been agreed with customers at its community panel and customer and stakeholder workshop.<sup>33</sup> Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

Guaranteed service level schemes 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.

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<sup>33</sup> GWMWater, *2023 water price submission*, Appendix 1, p. 37.

## 4. Revenue requirement

The revenue requirement is the forecast amount a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>34</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 GWMWater's revenue requirement 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 4.4.1)
  - a benchmark return on equity value determined by GWMWater's PREMO rating (Section 4.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.5)
- establish a benchmark tax allowance (Section 4.6).

Our draft decision is to adopt a revenue requirement of \$323.8 million over the 5-year regulatory period starting 1 July 2023, which is \$3.7 million lower than the revenue requirement proposed by GWMWater.

GWMWater proposed a revenue requirement of \$327.6 million over a 5-year period starting 1 July 2023. Our draft decision is to adopt a revenue requirement of \$323.8 million as set out in Table 4.1 (\$3.7 million less than the revenue requirement originally proposed by GWMWater).

The lower amount reflects corrections (shown in Table 4.2) to align with GWMWater's approved regulatory accounts for 2021-22.<sup>35</sup> Amounts for operating expenditure, return on assets and regulatory depreciation have been adjusted.

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<sup>34</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 GWMWater in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.

<sup>35</sup> This review process was not completed until after GWMWater had provided its 2023 water price submission in September 2022. Our draft decision on GWMWater's revenue requirement reflects an updated financial model provided by GWMWater during our review following finalisation and approval of the regulatory accounts.

Our draft decision reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

**Table 4.1 Draft decision on GWMWater’s revenue requirement**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	37.9	38.0	38.1	37.6	37.2	188.8
Return on assets	13.4	13.2	12.9	12.8	12.8	65.1
Regulatory depreciation	12.0	13.2	14.4	15.3	15.0	69.9
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
<b>Draft decision – revenue requirement</b>	<b>63.3</b>	<b>64.5</b>	<b>65.4</b>	<b>65.7</b>	<b>65.0</b>	<b>323.8</b>

Note: Numbers have been rounded.

**Table 4.2 Our proposed adjustments to GWMWater’s proposed revenue requirement**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. GWMWater’s proposed revenue requirement</b>	<b>64.1</b>	<b>65.2</b>	<b>66.2</b>	<b>66.4</b>	<b>65.7</b>	<b>327.6</b>
B. Operating expenditure	-0.4	-0.4	-0.4	-0.4	-0.4	-1.9
C. Return on assets	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9
D. Regulatory depreciation	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9
<b>E. Draft decision – revenue requirement (A + B + C + D)</b>	<b>63.3</b>	<b>64.5</b>	<b>65.4</b>	<b>65.7</b>	<b>65.0</b>	<b>323.8</b>

Notes: This table shows the differences between the amounts approved under our draft decision and what GWMWater proposed in its price submission. Row A shows the total revenue requirement proposed by GWMWater 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.

Our final decision on GWMWater’s revenue requirement will be based on the latest available information. Accordingly, in response to our draft decision GWMWater must update its revenue requirement and provide an updated price schedule 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 the revenue requirement, GWMWater 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.

## 4.1 Operating expenditure

Our draft decision adopts forecast operating expenditure of \$188.8 million over the 5-year period from 1 July 2023, \$1.9 million lower than the amount proposed by GWMWater in its price submission. This reflects corrections arising from our approval of its 2021-22 regulatory accounts.

Operating expenditure is a component of the revenue requirement. GWMWater's price submission provides detail on its forecast operating expenditure from pages 52 to 55.

We assess both:

- controllable operating expenditure – comprising costs that can be directly or indirectly influenced by a water corporation's decisions
- non-controllable operating expenditure – comprising costs that cannot be directly or indirectly influenced by a water corporation'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 GWMWater's expenditure forecast is available on our website.<sup>36</sup>

Since lodging its price submission with us, our 2021-22 review of GWMWater's regulatory accounts identified a correction to the operating expenditure amount proposed in its price submission. This reduces the baseline year controllable operating expenditure by \$0.37 million, resulting in a total decrease of \$1.92 million across the 2023–28 regulatory period and a revised total forecast of \$188.84 million as shown in Table 4.3. Our draft decision is to therefore to adopt a forecast operating expenditure of \$188.84 million over the 5-year regulatory period, because this figure is consistent with the audited regulatory accounts. Our assessment reflects these revised figures.

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<sup>36</sup> FTI Consulting, *GWMWater: Review of Expenditure Forecasts – 2023 Water Price Review, Interim Report*, December 2022.

**Table 4.3 Draft decision adjustments – total operating expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>GMMWater price submission – Total prescribed operating expenditure</b>	38.23	38.41	38.50	38.03	37.58	190.76
Adjustments to controllable operating costs – regulatory accounting reconciliation	-0.38	-0.38	-0.38	-0.38	-0.38	-1.92
Adjustments to non-controllable operating costs – regulatory accounting reconciliation	0.0	0.0	0.0	0.0	0.0	0.0
<b>Draft decision – Total prescribed operating expenditure</b>	37.85	38.03	38.12	37.65	37.20	188.84

**Note:** Numbers have been rounded.

Table 4.4 sets out our draft decision on GMMWater’s forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

**Table 4.4 Draft decision – operating expenditure**  
\$ million 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	35.01	35.26	35.43	35.03	34.66	175.39
<b>Non-controllable operating expenditure</b>	2.84	2.76	2.69	2.61	2.54	13.45
Bulk services <sup>a</sup>	0.19	0.19	0.18	0.18	0.17	0.91
Environmental contribution <sup>b</sup>	2.53	2.45	2.38	2.31	2.24	11.91
Licence fees – Essential Services Commission <sup>c</sup>	0.06	0.06	0.06	0.06	0.06	0.29
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>	0.05	0.05	0.05	0.05	0.05	0.24
<b>Draft decision – operating expenditure</b>	<b>37.85</b>	<b>38.03</b>	<b>38.12</b>	<b>37.65</b>	<b>37.20</b>	<b>188.84</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.

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 GWMWater’s price submission.

The operating expenditure that we propose to adopt for GWMWater does not represent the amount that GWMWater 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.

#### 4.1.1 Controllable operating expenditure

GWMWater proposed a total forecast controllable operating expenditure of \$177.31 million over a 5-year regulatory period. Consistent with GWMWater’s regulatory accounts we approved as noted in Section 4.1, and for the reasons set out below, we propose to adopt a forecast controllable operating expenditure of \$175.39 million.



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

1. Establish a baseline controllable operating expenditure – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure and 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 GMMWater to be 0.5 per cent per year.
3. Apply an annual cost efficiency improvement rate – assumed by GMMWater to be an average of 1.4 per cent per year.<sup>37</sup>
4. Make adjustments for additional costs or cost savings expected in future years.

### **Baseline controllable operating expenditure**

GMMWater has proposed a controllable operating expenditure baseline of \$35.3 million, after removing \$0.2 million in non-recurring operating expenditure that occurred in 2021-22 (and correcting for the findings of our 2021-22 regulatory accounts review). The baseline of \$35.3 million is 0.8 million (or 2.4 per cent) higher than the benchmark figure of \$34.5 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Our expenditure consultant requested that GMMWater substantiate the increase compared to its baseline year operating expenditure benchmark. GMMWater explained the increase was due to a number of factors including:

- higher water volumes treated through operating contracts
- increases in chemicals and material costs
- increase in fuel costs
- increase in insurance costs
- more frequent inspection of dams and bridges
- improvements in asset management practices, including a move from reactive to proactive maintenance.

Our expenditure consultant verified these additional costs were recurring and found GMMWater's substantiation of these costs to be reasonable. Accordingly, it recommended accepting GMMWater's proposed baseline increase with no adjustments required.

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<sup>37</sup> GMMWater's proposed cost efficiency improvement rate is different for each year and ranges from 1.0 per cent in 2023-24 (lowest) to 1.8 per cent in 2025-26 (highest).

Based on our own review of GMMWater’s proposals and advice from FTI Consulting we consider GMMWater’s proposal reflects an efficient baseline cost to forecast annual operating expenditure for the purpose of our draft decision.

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

GMMWater’s proposed average efficiency improvement rate on its controllable operating costs was 1.4 per cent per annum (relatively high compared to other water businesses). This is higher than GMMWater’s proposed average cost growth rate of 0.5 per cent per annum for 2023–28, effectively delivering a net annual decrease to its controllable annual baseline operating costs in each year of the regulatory period. GMMWater has based its forecast cost growth rate on the forecast customer growth across the period.

GMMWater proposed its cost efficiency improvement rate will be driven by efficiency initiatives including reduced labour and contractor costs realised from past technology investments, rural pipeline extension projects, energy efficiency (including investment in renewable energy generation), rationalisation of redundant infrastructure and high-risk assets, maximising system performance through improved data quality, and joint procurement opportunities.

#### **4.1.1.3 Cost adjustments**

GMMWater has proposed additional operating expenditure above the annual baseline, including:

- \$1.5 million over 2024–2028 associated with the East Grampians Rural Water Supply Project which will provide new customers in the region access to the reticulated water supply
- \$1.4 million in green energy costs over 2025–2028 to meet the Victorian Government’s requirement to achieve 100 per cent green power from 2025-26
- \$1.8 million in Software as a Service (SaaS) licensing fees over 2024–2028 to enable cloud migration
- \$0.5 million to operate new drinking water treatment plants once delivered for the urban towns of Kaniva, Moyston, Berriwillock and Culgoa.

GMMWater has also proposed a downward adjustment of \$0.9 million associated with the cost efficiencies for the rural component of the business, and a minor downward adjustment associated with its electricity cost forecasting approach over the next regulatory period.

The above cost variations represent an additional \$4.3 million over the regulatory period, or an average of \$0.9 million per annum.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline, requesting further information to substantiate the above increases and was satisfied that GMMWater’s explanations and evidence supported the proposed variations. Our expenditure

consultant considered the basis for the proposed additions appear reasonable and did not recommend adjusting GMMWater’s proposed forecast.

We have considered the advice from our expenditure consultant, and GMMWater’s proposal. We consider GMMWater’s approach to forecasting its operating expenditure is consistent with the requirements of our guidance and there is evidence that GMMWater has significantly tested its controllable expenditure requirements. On that basis, our preliminary position is that we are satisfied that its proposed forecast represents efficient controllable operating expenditure.

GMMWater has proposed to capitalise its wastewater treatment plant and its water storage desludging costs for the next regulatory period, rather than include this as controllable operating expenditure. Our expenditure consultant has reviewed this proposal. We have considered GMMWater’s proposal and the views of our expenditure consultant.

Our preliminary view is that GMMWater’s approach meets the requirements of our guidance for capitalisation of an operating expense – that is, it is a material cost, and it does not occur on a regular basis, with no desludging costs expected in the following 2028–33 regulatory period. GMMWater’s approach to desludging is discussed in further detail in Section 4.2.2. on forecast capital expenditure.

#### **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<sup>38</sup>
- adjusting the forecasts proposed by GMMWater where required.

The values we have adopted for our draft decision are set out above in Table 4.4.

GMMWater has proposed \$13.5 million in non-controllable operating expenditure over the 2023–28 regulatory period. This is a decrease of \$1.2 million compared to the 2018–23 regulatory period, driven by a \$0.1 million decrease in external bulk charges; and a decrease of \$1.1 million due to forecast decreases in the real value of the environmental contribution.

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

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<sup>38</sup> Environmental contributions are funds collected from water businesses under the *Water Industry Act 1994*.

(decline in real terms) across the 2023–28 regulatory period. GMMWater has followed this approach in its price submission.

Accordingly, our draft decision is to accept GMMWater’s proposed non-controllable operating expenditure. 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.

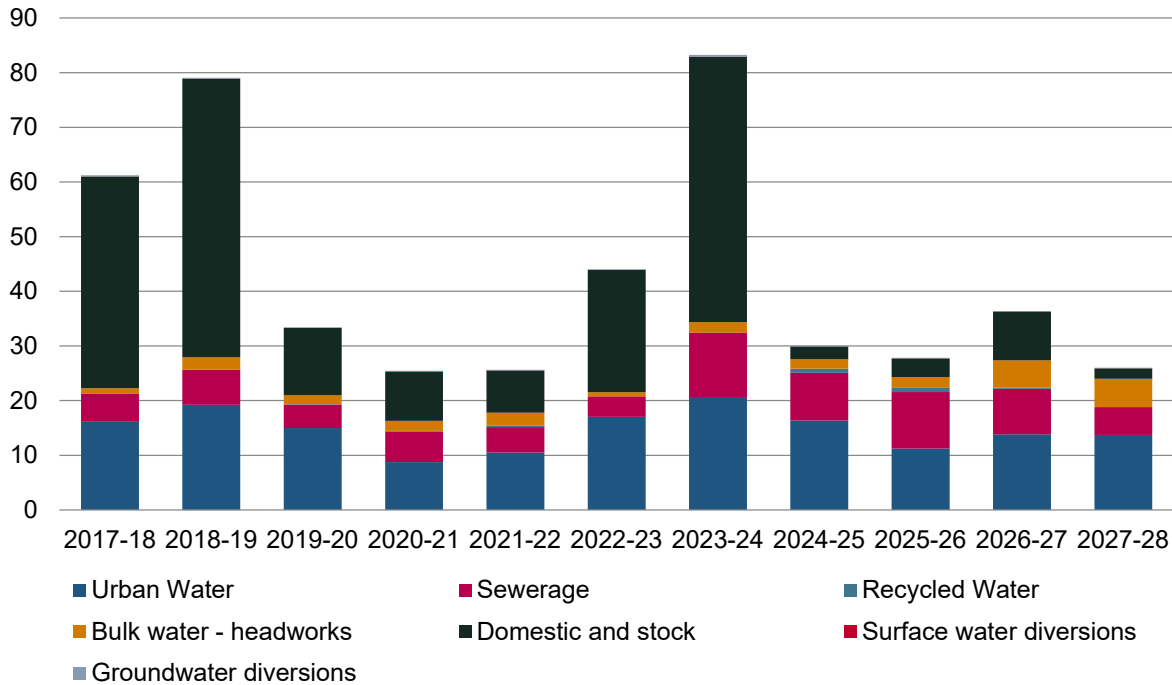
## 4.2 Capital expenditure

Our draft decision is to adopt a benchmark of \$203.6 million for GMMWater’s forecast capital expenditure over the 5-year period from 1 July 2023.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. GMMWater’s forecast capital expenditure and supporting information is provided at pages 56 to 66 of its price submission. Figure 4.1 shows GMMWater’s actual gross capital expenditure for 2017-18 and the first 4 years of the current regulatory period (2018-19 to 2021-22) and forecast gross capital expenditure 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 by service category**

\$ million 2022-23



**Note:** This graph shows actual figures for 2017-18 to 2021-22, and [corporation]'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 GMMWater's expenditure forecast is available on our website.<sup>39</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.

Since lodging its price submission with us, our review of GMMWater's annual regulatory accounts identified some necessary changes to GMMWater's reported capital expenditure. We have made corresponding adjustments to GMMWater's prescribed capital expenditure because to make it consistent with the approved regulatory accounts (see Section 4.3.1). As a result of these adjustments, GMMWater's actual capital expenditure across 2017-18 to 2021-22 is \$2.5 million

<sup>39</sup> FTI Consulting, *GMMWater: Review of Expenditure Forecasts – 2023 Water Price Review*, February 2023.

lower than GMMWater included in its price submission (Table 4.5). Our preliminary assessment below reflects these revised figures.

**Table 4.5 Draft decision adjustments – total prescribed capital expenditure**  
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Total
<b>GMMWater price submission – Total prescribed capital expenditure</b>	61.24	79.54	33.43	25.47	27.60	44.03	271.31
Adjustments – regulatory accounting reconciliation	0.00	-0.50	0.00	0.00	-1.95	0.00	-2.46
<b>Draft decision – Total Prescribed capital expenditure</b>	61.24	79.04	33.43	25.47	25.65	44.03	268.85

Note: Actual total prescribed capital expenditure from 2017-18 to 2021-22, forecast in 2022-23.

Over the period from 2017-18 to 2021-22, GMMWater’s gross capital expenditure was \$224.8million, which is \$20.5 million or 10.1 per cent higher than the benchmarks adopted at the 2018 water price review. Its forecast for 2022-23 is \$44 million, higher than the \$16.8 million benchmark adopted at the 2018 water price review.

GMMWater’s price submission did not provide information that enabled us to understand the projects driving the increase in capital expenditure relative to the 2018 price review benchmarks. We requested further information from GMMWater on the drivers of its higher than forecast actual capital expenditure, and referred to GMMWater’s most recent major capital projects report to inform our assessment of the Performance element of PREMO.

GMMWater’s response to our requests for further information identified several projects driving the higher than benchmark capital expenditure in the current regulatory period:

- The South West Loddon Rural Water Supply Project (gross capital expenditure of \$58.1 million) carried over from 2016-17, and completed in 2019-20 after delays in planning and environmental approvals, and a blue-green algae bloom event experienced during its commissioning.
- The Mallee Towns Treated Water Project (gross capital expenditure of \$11.9 million) carried over from 2017-18 and completed in 2019-20 after delays in obtaining planning permits and pipe manufacturing constraints.
- The East Grampians Rural Pipeline Extension Project (gross capital expenditure of \$38.7 million) which started in the current period, noting GMMWater had excluded funding for this project from the 2018 price submission due to uncertainty around government funding.

Since commencing, project delivery has been delayed due to a change in scope and the coronavirus pandemic restrictions disrupting logistics and supply chains. Works will carry over to the next regulatory period and are expected to be completed in 2023-24.

The drivers of the additional expenditure against the benchmark for 2022-23 are:

- the East Grampians Rural Water Supply Project which was commenced during the current regulatory period, and as noted above was excluded from its forecasts in 2018 due to uncertainty about government funding
- the Kaniva water quality upgrade project which was delayed in the current regulatory period, affected by reduced availability of contractors.

Once contributions are accounted for, over the period from 2017-18 to 2021-22, net capital expenditure was \$17.2 million or 12.3 per cent lower than the benchmarks adopted at the 2018 water price review. GWMWater's forecast for 2022-23 is \$44.0 million, which is \$28.2 million higher than the benchmark adopted at the 2018 water price review.

After considering its price submission and the additional information provided by GWMWater, our expenditure consultant found strong supporting information justifying GWMWater's increased capital expenditure over the current regulatory period in relation to new projects and the underlying processes for developing the current capital program adopted for the 2023–28 regulatory period.<sup>40</sup> We considered their views in our assessment.

At the end of June 2022, GWMWater reported that of the 16 major projects proposed for the 2018-23 regulatory period, 4 were completed late, and 6 were delayed (with 4 carried over to 2023–28 (see Section 4.2.2).<sup>41</sup> GWMWater has started 5 additional major projects during the current period, that were not included in its 2018 price determination (totalling \$6.4 million over 2018–23 excluding the East Grampians Rural Pipeline Extension Project). The new initiatives are:

- The East Grampians Rural Pipeline Extension Project, discussed above
- Urban Pressure Improvement Works project, the need for which was identified to resolve flow reductions detected at the customer meter following the delivery of the urban remote metering project

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<sup>40</sup> FTI Consulting, *GWMWater: Review of Expenditure Forecasts – 2023 Water Price Review, Interim Report*, December 2022, pp. 21-24.

<sup>41</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 26-33. GWMWater'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.

- ‘Clean Water’ Pilot – Northern Mallee Pipeline project, which was initiated in response to the increased frequency of adverse water quality events detected in the Murray River due to climate change
- Horsham Agriculture SmartWater and Integrated Water Management project, which is a part of the National Water Grid construction program
- Behind the Meter Solar electricity project.

#### 4.2.2 Forecast Capital Expenditure

GMMWater has proposed forecast gross capital expenditure of \$203.6 million over the 2023–28 regulatory period, or an average of \$40.7 million per annum. This is \$4.0 million (2 per cent) lower than actual capital expenditure in the current period, and \$104.0 million (or 104 per cent) higher than the forecast of \$99.6 million provided for 2023–28 in its 2018 price submission.

The increase is largely due to the inclusion of:

- \$46.5 million for the East Grampians Rural Water Supply Project which was not included in its 2018 forecast and has carried over from the 2018–23 regulatory period. This project has been co-funded from government contributions and will be offset by \$24.7 million dollars in government contributions in 2023-24.
- \$13.3 million for the drinking water quality upgrade projects in Kaniva and Moyston, which are carried over from the 2018–23 regulatory period
- \$11.8 million for two new projects, a treated water supply project in Berrillock and Culgoa and a Headworks Structure Renewal project.
- \$9.2 million for the Northern Mallee Pipeline Clean Water Stage 2 project following on from the expected completion of the Clean Water Pilot project in 2022-23.
- \$4 million in expenditure for both the Horsham SmartWater Integrated Water Management project, and Behind the Meter Solar electricity project, both of which were new projects that were initiated during the 2018–23 regulatory period.
- \$3.5 million for the Water treatment plant upgrades – health based treatment targets project, a continuation of a project begun during the 2018–23 regulatory period
- \$2.8 million for urban water storage desludging and wastewater treatment plant desludging (expenditure previously classified as operating expenditure) proposed to be classified as major maintenance expenditure.
- \$2.6 million for the Donald Wastewater Treatment Plant and Reuse System upgrade carried over from the 2018–23 regulatory period
- An approximate \$12 million dollar increase across its remaining capital programs and projects when compared to its 2018 forecast for the 2023–28 regulatory period.



For the reasons set out below, our draft decision is to accept the forecast capital expenditure of \$203.6 million proposed by GMMWater for the purpose of calculating its revenue requirement:

- GMMWater’s price submission and the additional information requested and received by our expenditure consultant provided evidence that GMMWater’s forecasts for capital expenditure are prudent and efficient. While its total proposed capital expenditure is \$4.0 million (2 per cent) lower than actual capital expenditure in the current 2018–23 period, the sustained level of forecast capital expenditure in 2023–28 is materially higher when compared to previously observed levels of expenditure and its 2018 forecast for the 2023–28 period. In response to a request for further information, GMMWater provided information that identified the main drivers of this increase is \$50.4 million dollars of expenditure to complete new projects the business began in the current regulatory period (including the \$46.5 million to complete the East Grampians Rural Water Supply Project in 2023-24), and \$29.8 million to complete projects that were approved in its 2018 price determination, but did not go ahead due to the prioritisation of the new projects mentioned above (also discussed in section 4.2.1 on actual capital expenditure).
- Our expenditure consultant requested selected documents from GMMWater as a representative sample to demonstrate its asset management processes and justification for its top ten major projects and the remainder of its capital expenditure program. Based on the sample of documents reviewed and GMMWater’s responses to questions, our expenditure consultant found that GMMWater has a robust approach for developing project scope, the timing of works and cost estimates.<sup>42</sup>
- GMMW has forecast \$101.4 million in capital expenditure in the regulatory period to deliver its top ten major projects. Our expenditure consultant considered the information provided by GMMWater in its price submission appropriately linked each of the business’s top ten major project to regulatory obligations and customer outcomes, and found each project was supported by an appropriate business case. Our consultant requested further information on GMMWater’s Industrial Fire Flow project. The additional information provided confidence its costs for this project were fairly and reasonably allocated.
- GMMWater has forecast \$102.2 million to deliver major capital programs in the next regulatory period. Our expenditure consultant reviewed the two largest programs, urban water main renewals (\$18.1 million) and sewer main renewals (\$9.4 million). Our consultant found GMMWater’s approach to developing the cost forecasts for each program was well developed and robust, and did not include additional contingencies. Our consultant also reviewed the programs which included the Horsham Smartwater Integrated Water Management project,

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<sup>42</sup> FTI Consulting, *GMMWater: Review of Expenditure Forecasts – 2023 Water Price Review*, February 2023, pp 24-26.

Computer Hardware project and Behind the Meter Solar project and found no cause for adjustments to the associated expenditure.

- GWMWater has proposed to include its urban water storage desludging and wastewater treatment plant desludging expenditure (\$2.8 million), classified as operating expenditure in previous regulatory periods, as major maintenance capital expenditure in its regulatory asset base, to be depreciated over a 10-year period. Our expenditure consultant has sought additional information on GWMWater’s proposal to capitalise this expenditure, to confirm it is appropriate to do so. GWMWater explained these works routinely occur over a five-year period in a ten-year cycle, and that the variation in the cost and timing of these works can have material impacts on the business’s revenue requirement. Given the scheduling of these works over what amounts to two regulatory periods, and the impact the associated costs can have on its revenue requirement, GWMWater considered it appropriate to capitalise these costs, and provided evidence that this produces favourable pricing impacts for customers when compared to treating these costs as an operating expense over the next regulatory period. Given the above, we consider GWMWater’s proposal is appropriate and meets our requirements for capitalisation of a ‘one-off’ operating expense.
- Overall, our expenditure consultant considered GWMWater’s proposals were well developed and that its forecast capital expenditure program is prudent, efficient and deliverable. Our consultant recommended no adjustments to GWMWater’s forecast capital expenditure for the next regulatory period.
- Our preliminary view is that the planned capital expenditure program is ambitious but appears to be achievable given GWMWater’s performance in delivering a larger program than initially proposed in the current regulatory period. But as noted above and in Section 4.2.1, we acknowledge GWMWater’s delivery of its approved major capital projects over the current period has been significantly impacted by the new ‘pushed in’ projects it began over 2018–23. While we acknowledge the drivers of the new projects GWMWater initiated, we expect GWMWater to proactively manage its capital program over the next regulatory period to deliver its major capital projects and programs, including its carried over major projects from the current regulatory period, and effectively communicate their progress to its customers. Where GWMWater does not consider it will be able to deliver on its major projects, we expect GWMWater to consider how this impacts customer value.

GWMWater has not specifically identified any projects it has excluded from its price submission where there is uncertainty in timing, cost, scope and benefits of capital expenditure. GWMWater has however flagged the risk of potential additional demand from mining operations, likely to commence in the short to medium term, which can trigger water supply augmentation to be brought forward. GWMWater has noted it will reflect any changes to the forecast capital expenditure that will materialise during the next regulatory period in subsequent regulatory periods.

Our draft decision is to accept GWMWater’s proposal for addressing uncertain capital expenditure, noting the following:

- GWMWater 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.

Our preliminary position is that we accept FTI Consulting’s recommendations, and we consider that, for the purposes of our draft decision, the prudence and efficiency of the expenditure has been justified, consistent with our guidance and consider that GWMWater’s approach to forecasting its capital expenditure is consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014.<sup>43</sup>

The benchmark that we propose to adopt for GWMWater does not represent the amount that the water corporation is required to spend or allocate to particular projects. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain or improve services over the regulatory period. GWMWater 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 corporation’s regulatory asset base is the value of the corporation’s assets for regulatory purposes.<sup>44</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4), and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required GWMWater 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

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<sup>43</sup> Essential Services Commission, 2023 water price review: Guidance paper, pp. 32–37.

<sup>44</sup> These values were set initially for the water corporations by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

### 4.3.1 Closing regulatory asset base

Our draft decision is to adopt a closing regulatory asset base of \$446.2 million at 30 June 2022, which is \$7.7 million less than the closing regulatory asset base proposed by GWMWater in its price submission.

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>45</sup> This helps to ensure prices reflect the actual net capital expenditure of a water business.<sup>46</sup>

Our draft decision proposes to adopt a closing regulatory asset base of \$446.2 million at 30 June 2022. This is less than the \$453.8 million proposed by GWMWater in its price submission.<sup>47</sup> The change reflects GWMWater's approved regulatory accounts which relates to estimates for customer and government contributions and capital expenditure. The main adjustment relates to a \$6 million increase in customer contributions.

We compared GWMWater's actual net capital expenditure for 2017-18 to 2021-22 with the benchmark used to approve maximum prices for the period from 1 July 2018.

Typically, if a water corporation's net capital expenditure was more than 10 per cent above the benchmark, 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.

As noted in Section 4.2.1, GWMWater's net capital expenditure over the period from 2017-18 to 2021-22 was \$122.1 million. This is \$17.2 million or 12.3 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 identified above, so our draft decision adopts this amount for the purpose of calculating GWMWater's closing regulatory asset base at 30 June 2022 (Table 4.6).

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<sup>45</sup> See Section 4.2 for a discussion of GWMWater's capital expenditure.

<sup>46</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>47</sup> Available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

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

	2017-18	2018-19	2019-20	2020-21	2021-22
Opening RAB 1 July	402.4	409.6	440.5	434.2	437.7
Plus gross capital expenditure	61.2	79.0	33.4	25.5	25.6
Less government contributions	34.7	32.4	19.9	5.6	0.4
Less customer contributions	3.5	0.7	4.6	0.5	0.3
Less proceeds from disposals	1.1	1.2	1.0	0.9	0.9
Less regulatory depreciation	14.8	13.7	14.3	15.0	15.5
<b>Closing RAB 30 June</b>	<b>409.6</b>	<b>440.5</b>	<b>434.2</b>	<b>437.7</b>	<b>446.2</b>

Note: Numbers have been rounded.

### 4.3.2 Forecast regulatory asset base

Our draft decision is to adopt a forecast regulatory asset base as set out in Table 4.7, lower than the amounts proposed by GMMWater in its price submission mainly due to our proposed adjustments to its closing 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.

Table 4.7 sets out our draft decision on GMMWater’s forecast regulatory asset base from 1 July 2023. Our draft decision is to adopt a forecast regulatory asset base that is less than the amount proposed by GMMWater in its price submission, mainly due to corrections to GMMWater’s closing regulatory asset base (Section 4.3.1)

Our guidance specifies that the amount reflected for 2022-23 in the forecast regulatory asset base is to be calculated based on the forecast for gross capital expenditure adopted in the 2018 price determination less any contributions (net capital expenditure).<sup>48</sup>

<sup>48</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

This is intended to provide an incentive for businesses not to defer capital expenditure, noting they recover financing costs on projects included in capital expenditure benchmarks in earlier years.

GWMWater proposed that a net capital expenditure figure of \$44.0 million be adopted for 2022-23, higher than the \$15.8 million benchmark adopted for the 2018 price determination.

As noted in Section 4.2.1, the drivers of the additional expenditure against the benchmark for 2022-23 are the East Grampians Rural Water Supply Project, which was commenced during the current regulatory period and excluded from its forecasts in 2018 due to uncertainty about government funding, and the Kaniva water quality upgrade project which was delayed in the current regulatory period, affected by reduced availability of contractors.

Our preliminary position is that the capital expenditure associated with these projects for 2022-23 should be reflected in the forecast regulatory asset base.

The main reason for the higher 2022-23 capital expenditure figure is the East Gippsland Rural Pipeline extension. We consider GWMWater's approach to exclude this from expenditure benchmarks in 2018 was reasonable given uncertainty about government funding, helping to ensure customer prices in the current regulatory period did not reflect costs for an uncertain project. GWMWater also reduced its customer prices in the current regulatory period to reflect delays to water quality upgrade projects, such as the Kaniva upgrade. For these reasons, we propose to include amounts above the 2018 benchmarks in GWMWater's forecast regulatory asset base.

We note however, that in response to our draft decision GWMWater must provide updated forecasts for these projects to inform our final decision and price determination.

Our assessments of 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 4.5 (regulatory depreciation).

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

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Opening RAB 1 July	446.2	473.1	518.3	528.9	540.3	558.4
Plus gross capital expenditure	44.0	83.2	30.1	27.8	36.4	26.0
Less government contributions	0.0	24.7	2.5	0.7	1.2	1.0
Less customer contributions	0.0	0.1	2.8	0.7	0.6	0.5
Less proceeds from disposals	1.1	1.3	0.9	0.7	1.2	1.2
Less regulatory depreciation	16.1	12.0	13.2	14.4	15.3	15.0
<b>Closing RAB 30 June</b>	<b>473.1</b>	<b>518.3</b>	<b>528.9</b>	<b>540.3</b>	<b>558.4</b>	<b>566.7</b>

Note: Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our draft decision is to accept GWMWater’s forecasts for customer contributions.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>49</sup>

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

On that basis, our draft decision is to accept GWMWater’s forecasts for customer contributions.

## 4.4 Rate of return

In establishing the return on assets component of GWMWater’s revenue requirement, we have applied a rate of return to GWMWater’s regulatory asset base. The rate of return is calculated using a benchmark cost of debt (discussed in Section 4.4.1) and a benchmark return on equity value (discussed in Section 4.4.2).

<sup>49</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water corporation’s water, sewerage or recycled water networks.

#### 4.4.1 Cost of debt

Our draft decision is to accept the cost of debt proposed by GWMWater.

Our guidance required GWMWater to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. GWMWater used the cost of debt values we specified to calculate its revenue requirement. For this reason, as set out in Table 4.8, our draft decision is to accept the cost of debt proposed by GWMWater, 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 4.8** 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.

#### 4.4.2 Return on equity

Our draft decision is to adopt a rate of return on equity of 4.5 per cent, which reflects GWMWater’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 7 for an explanation of PREMO and our assessment of GWMWater’s PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water corporation’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 corporation’s self-rating and our rating.<sup>50</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>51</sup>

<sup>50</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

<sup>51</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



GMMWater rated its price submission as 'Advanced'. Based on this PREMO self-rating, GMMWater proposed a return on equity of 4.5 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as 'Advanced'.<sup>52</sup>

As outlined in Chapter 7, our draft decision is to agree with GMMWater's overall PREMO self-rating and adopt its proposed return on equity.

## 4.5 Regulatory depreciation

Our draft decision is to adopt a forecast regulatory depreciation that is slightly lower than that proposed by GMMWater in its price submission.

Regulatory depreciation is a component of GMMWater's revenue requirement and is also an input to calculating the regulatory asset base. GMMWater's forecast regulatory depreciation was calculated using a straight-line depreciation profile.<sup>53</sup> We noted in our guidance that we prefer this approach.<sup>54</sup> Our draft decision is to adopt a slightly lower forecast for depreciation compared with the forecast proposed in GMMWater's price submission, reflecting the updates to its closing regulatory asset base to reflect its approved regulatory accounts (see Section 4.3.1).

## 4.6 Tax allowance

The tax allowance is a component of the revenue requirement. GMMWater has proposed no allowance for tax in its revenue requirement. Our draft decision is to accept the forecast as it was calculated consistently with the method required by our guidance.<sup>55</sup>

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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>52</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

<sup>53</sup> For the period from 2022-23 to 2027-28, GMMWater proposed regulatory depreciation of \$86.8 million.

<sup>54</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

<sup>55</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47–48.

## 5. Demand, tariffs and prices

Once GMMWater'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

Our draft decision is to accept GMMWater's demand forecasts.

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

GMMWater's demand forecasts are set out at pages 69 to 70 of its price submission and are also included in its financial model.

We received a submission from the Commonwealth Environmental Water Holder, querying whether demand forecasting by GMMWater was based on a post 1997 drier scenario, noting the submission from the Commonwealth Environmental Water Holder indicated it considered this would be a better reflection of the service it received.<sup>56</sup>

We confirmed with GMMWater that its proposed bulk water prices including environmental water charges are based on the relative reliability of allocations received by each Wimmera Mallee Pipeline Project entitlement holder, taking into account the post-1997 weather conditions.

Our draft decision is to accept GMMWater's demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance, including by using Victoria in Future 2019 estimates as the basis for its demand forecasts for relevant services.<sup>57</sup>

Since lodgement of GMMWater's price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses. In its response to our draft decision, GMMWater 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).

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<sup>56</sup> Commonwealth Environmental Water Holder, *Submission to the 2023 water price review*, 1 December 2022.

<sup>57</sup> *Victoria in Future* (VIF) is the official state government projection of population and households across Victoria. It is produced by the Department of Environment, Land, Water and Planning.

## 5.2 Form of price control

Our draft decision is to accept GMMWater’s proposed price cap form of price control.

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

GMMWater proposed a price cap form of price control as set out on pages 70 to 71 of its price submission. This is the same as its current approach. Under the price cap form of price control, maximum prices for each prescribed service for the 2023–28 regulatory period are determined at the start of the regulatory period. Adjustments to account for movements in inflation (measured by the consumer price index published by the Australian Bureau of Statistics), return on assets and any approved pass-through mechanisms will be made during the regulatory period.

Our draft decision is to accept GMMWater’s proposed form of price control because:

- it is the same as its current approach
- it provides its customers with price certainty
- demand risk is more efficiently managed by GMMWater, rather than its customers.

## 5.3 Tariff structures and prices

Our draft decision is to accept GMMWater’s proposed tariff structures.

GMMWater’s proposed tariffs are set out at pages 74 to 76 of its price submission.

Our draft decision does not approve maximum prices for each tariff, because as indicated above, prices will need to be updated by GMMWater to reflect our updates to 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.

### 5.3.1 Tariff structures

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

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

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

GWMWater generally proposed to maintain its existing tariff structures, but also proposed introducing an industrial fire service tariff for non-residential customers in industrial zones. For residential and non-residential water services, it proposed a two-part tariff with a fixed service charge and a variable charge depending on water use. For residential and non-residential sewerage services, it proposed a fixed service charge only.

The new industrial fire service tariff proposed by GWMWater will fund fire service connection upgrades that will help medium-sized commercial developments in proposed industrial zones to comply with minimum firefighting infrastructure requirements of the National Construction Code.<sup>60</sup> GWMWater has confirmed the new fixed tariff (which is 10 per cent higher than the current fire service charge) is reflective of the efficient incremental costs of providing the improved service and supported by most of its customers.<sup>61</sup> We consider the fire service tariff meets our pricing principles.

A submission by the Concerned Waterways Alliance noted it fails to understand why inclining block tariffs are not adopted by all water corporations. We note that changes to these structures can impact customers in different ways – for example, they can impact on affordability for larger households.<sup>62</sup>

Our draft decision is to accept GWMWater’s proposed tariff structures, on the basis that they are generally a continuation of its current approach and otherwise meet the criteria in our guidance.

Our preliminary view is that the two-part tariff structure proposed by GWMWater for its 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>63</sup> We also consider two-part tariff structures are easy to understand.

For sewerage services, we consider GWMWater’s proposed fixed charge for residential and non-residential customers is easy to understand.<sup>64</sup>

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<sup>60</sup> Non-residential customers in Horsham, Ararat, Stawell, St Arnaud, Warracknabeal, Nhill, Dimboola, Charlton, Murtoa, Sea Lake and Wycheproof will transition from the standard fire service tariff to the industrial fire service tariff upon completion of fire service connection upgrades on a town-by-town basis.

<sup>61</sup> Response to request for information 17 November 2022. Bartley Consulting, Fire Flows Industrial Customer Research 2022, September 2022, pp. 13-19.

<sup>62</sup> Concerned Waterways Alliance submission to the Essential Services Commission Water Price Review 2023, 1 December 2022.

<sup>63</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>64</sup> Our reasons are outlined in our 2013 draft decisions on price review 2013-14 to 2017-18.

### 5.3.2 Prices

GMMWater's proposed prices are set out in Chapter 18 of its price submission (from page 105).

Under GMMWater's proposal, generally prices (excluding inflation) would be lower.<sup>65</sup> Based on GMMWater's proposed prices, residential water and sewerage bills for a typical household would fall by 7.9 per cent in 2023-24 and remain steady to 2027-28. Non-residential water and sewerage bills for a medium size business would fall by 8 per cent in 2023-24 and generally remain steady until 2027-28. We received a submission supporting the proposed reduction to prices.<sup>66</sup> The Consumer Action Law Centre's submission supported GMMWater's proposed price decrease in year 1 and despite the marginal increases in subsequent years, considered this price path to be a reasonable approach in the context of the current cost of living pressures.<sup>67</sup>

Prices for environmental water holders are proposed to fall by 10 per cent in both 2023-24 and 2024-25, then remain steady to 2027-28.

A submission by the Commonwealth Environmental Water Holder noted that GMMWater's price submission was informative and noted "with gratitude that GMMWater are proposing to reduce the cost to all entitlement holders by achieving system efficiencies". The submission also sought clarification of some issues in relation to GMMWater's approach to setting environmental water charges for the Commonwealth Environmental Water Holder, including demand assumptions and compliance with the National Water Initiative principles.<sup>68</sup>

As noted earlier, we confirmed with GMMWater that its proposed bulk water prices including environmental water charges are based on the relative reliability of allocations received by each Wimmera Mallee Pipeline Project entitlement holder, taking into account the post-1997 weather conditions.

We also note that our role is to assess the price submissions of Victorian water corporations against the requirements in the Water Industry Regulatory Order (2014).

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<sup>65</sup> We note that in response to one of our queries, GMMWater corrected some minor tariff calculation errors and discrepancies, and re-added a tariff that was inadvertently omitted from the model. These tariffs are now included in the draft decision model.

<sup>66</sup> Jo-Anne Kelder, Submission to the 2023 water price review, 29 November 2022.

<sup>67</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, Essential Services Commission, 30 November 2022.

<sup>68</sup> Commonwealth Environmental Water Holder, Submission to the 2023 water price review, 1 December 2022.

Based on the information provided in GMMWater’s bulk water pricing review report, our preliminary view is that we consider the basis of GMMWater’s proposed bulk water prices are transparent, reasonable and consistent with the cost reflective pricing principles of the Water Industry Regulatory Order as outlined in our guidance.

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

In making our price determination, we must have regard to whether GMMWater took into account the interests of customers, including low income and vulnerable customers.<sup>69</sup>

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

- an efficiency improvement rate greater than the industry average
- a real price reduction in the first year, which will assist customers manage the impacts of a high near-term inflation outlook
- formalising the target number of customers provided with hardship assistance and adding a measure for the dollar value of hardship assistance provided
- offering more proactive communication and support for customers needing assistance to access GMMWater’s hardship program.

As noted earlier, we also consider GMMWater’s engagement was tailored to the diversity of its customers, including those who are experiencing vulnerability.

### 5.3.4 Unique services

GMMWater confirmed that its proposed tariffs for major trade waste, non-residential recycled water 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 accept GMMWater’s proposed new customer contributions.

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

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<sup>69</sup> Water Industry Regulatory Order 2014, clause 11(d)(iii).

GMMWater (at page 77 of its price submission) proposed to continue applying the negotiating framework that was approved in our 2013 and 2018 determinations.<sup>70</sup> It has a zero standard charge but responds to any new customer contributions through its negotiating framework.

We have reviewed GMMWater's proposed negotiating framework and consider it is consistent with the new customer contribution pricing principles outlined in our guidance.<sup>71</sup> For this reason, our draft decision is to accept GMMWater's proposed new customer contributions.

## 5.5 Adjusting prices

Our draft decision is to accept GMMWater's proposed price adjustment mechanisms.

GMMWater's proposed price adjustment mechanisms are set out on page 77 of its price submission. It proposed to retain the existing price adjustment mechanisms in relation to uncertain and unforeseen events. It also proposed to apply annual changes to benchmark cost of debt adjustments for tariff categories that have been added since the 2018 determination. These additional tariffs reflect services that are largely funded through capital expenditure, so it is appropriate for cost of debt to be applied to the tariffs.<sup>72</sup>

Our draft decision is to accept GMMWater's proposed price adjustment mechanisms because we consider GMMWater's approach provides cost-reflective price signals in line with the requirements outlined in clause 11 of the Water Industry Regulatory Order (2014).<sup>73</sup>

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<sup>70</sup> In response to a request for information, GMMWater provided a fact sheet of its negotiating framework on its website, including an indicative timeline for a typical negotiation process. Accessed 15 November 2022 <https://www.gmmwater.org.au/billing/tariffs-and-charges>.

<sup>71</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 58.

<sup>72</sup> Cost of debt should be applied to tariffs on services of a capital nature. This is because such services would likely be at least partially debt funded.

<sup>73</sup> WIRO clause 11(d)(ii).

## 6. Financial position

We have reviewed key indicators of GMMWater's financial performance and our preliminary view is that GMMWater 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>74</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 corporation can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

GMMWater's price submission and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on GMMWater's assumptions about its revenue and expenditure. We have reviewed the key indicators of financial performance and our preliminary view is that we consider GMMWater 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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<sup>74</sup> WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).



## 7. PREMO rating

Our guidance required GWMWater 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>75</sup> We required GWMWater 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 GWMWater 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 GWMWater's price submission. As outlined in Section 4.4.2, the combination of GWMWater's self-rating and our rating has determined the return on equity we have adopted to calculate GWMWater's revenue requirement in our draft decision.

### 7.1 Our PREMO assessment of GWMWater's price submission

Our draft decision is to rate GWMWater's price submission as 'Advanced' under PREMO, which is the same as GWMWater's self-rating.

GWMWater's self-rating for each of the PREMO elements and its overall self-rating are shown in Table 7.1. This table also includes our proposed ratings following our assessment of GWMWater's price submission.

**Table 7.1** PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
GWMWater's self-rating	Advanced	Advanced	Advanced	Leading	Advanced	Advanced
Commission's rating	Advanced	Advanced	Advanced	Leading	Advanced	Advanced

<sup>75</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.

We agree with GWMWater’s proposed overall PREMO self-rating of ‘Advanced’. This is reflected in the return on equity we propose to approve for GWMWater (see Section 4.4.2). We have formed this view after reviewing GWMWater’s proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

## 7.1 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>76</sup>

For performance against Outcomes, GWMWater has mostly met its commitments to customers (see Section 3.2), noting it is not meeting customer expectations in relation to urban non-drinking water towns. It has demonstrated accountability for not meeting targets by lowering its tariffs for affected customers in 2020-21 and 2021-22.

Compared to other water businesses, GWMWater generally recorded lower scores in the commission’s survey of customer sentiment over the current regulatory period – covering measures of overall satisfaction, value for money, trust, and reputation in the community.

Based on its own research, GWMWater considers this may be attributable to customer dissatisfaction about water quality, particularly where customers receive a non-potable supply (noting that projects to improve rural and urban water quality is a focus of its proposed capital program for 2023-28).

GWMWater presented information supporting customer satisfaction with its performance, such as a high net promoter score, the level and trend of complaints, and improvements in customer service performance identified in the commissions annual water performance reports.

GWMWater’s controllable operating costs during the current regulatory period are forecast to be similar to the benchmarks established at the 2018 price review. It stands out as a relatively strong performer in terms of achieving good controllable operating cost control in the current period.

In terms of capital expenditure, we note that net capital expenditure is lower than the benchmarks adopted at the 2018 water price review for the period from 2017-18 to 2021-22. Based on current forecasts, it will exceed the benchmark adopted for 2022-23.

As noted in Section 4.3.2, this is mainly due to the East Grampians Rural Water Supply Project which was commenced during the current regulatory period, but excluded from its forecasts in

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<sup>76</sup> As set out in Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, pp. 74-75. Guiding questions are set out on page 45.

2018 due to uncertainty about government funding. We consider this approach is reasonable and helped to ensure that in the current regulatory period, customers did not pay for a project that was uncertain.

In terms of major projects in the current regulatory period, our most recent outcomes report noted GWMWater had ten of 16 major projects delayed at the end of 2021-22. We note it has transparently reported delays and delivered a number of initiatives that were unplanned.

Overall, our preliminary view is that GWMWater has justified its Performance self-rating of 'Advanced' and, on that basis, our draft decision is to accept GWMWater's self-rating of 'Advanced' for the Performance element of PREMO.

## 7.2 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>77</sup>

In support of its self-rating of 'Advanced' for the Risk element of PREMO, GWMWater's price submission (pages 24 to 25) highlighted a range of factors including:

- implementation of a new approach that reduces prices through better risk management, driven by proactive approach to maintenance and renewals
- compliance with risk standards specified in the Statement of Obligations (such as ISO55000)
- thorough evaluations of feasibility and milestones for major projects, and using unit rates that reflect recent trends or independently verified market forecasts
- prices that reflect demand projections that are higher than the latest available estimates from the Victorian Government
- its form of price control (price cap) and tariffs proposed that balance risk between the business and its customers
- the introduction of two new guaranteed service levels related to service interruptions.

Our preliminary position is that we agree that these factors support GWMWater's proposed Risk rating of 'Advanced' and on that basis, our draft decision is to accept GWMWater's self-rating of 'Advanced' for risk.

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<sup>77</sup> Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, 26 October, p. 45.

### 7.3 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>78</sup>

Our draft decision is to accept GWMWater's 'Leading' self-rating for the Engagement element of PREMO on the basis of the overall suitability of the engagement methods it used to address complex and sensitive price and equity trade-offs. We also note GWMWater's elevation of diverse and hard to reach voices across in its engagement and its willingness to modify process when requested by customers. See Section 3.1 for more detail.

### 7.4 Management

Management 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>79</sup>

In support of its self-rating of 'Advanced' for the Management element of PREMO, as noted in Section 4.1, GWMWater proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (1.4 per cent). This contributes to reductions in controllable operating expenditure per water connection. We also note it is one of the few businesses in the current price review to propose a lower operating cost forecast for the 2023-28 regulatory period, compared to the current 2018-23 period.

Based on advice from our expert expenditure consultant, we have also tested GWMWater's assumptions for forecast operating and capital costs, and our preliminary view is that they reflect efficient expenditure, and that these features demonstrate the business's commitment to delivering value to its customers, resulting in relatively significant reductions in (real) prices.

We consider GWMWater's price submission did not include material we consider substantive to our assessment of its proposals. This includes information describing its capital expenditure program in the current regulatory period (to inform the commission's assessment of Performance and proposed capital expenditure), which can be key drivers of customer prices. This lack of information required several requests for information to clarify its proposals.

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<sup>78</sup> Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, 26 October, p. 45.

<sup>79</sup> Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, 26 October, p. 45.

In considering its 'Management' rating, we have put greater weight on the improvement in customer value that will be delivered, including through reduced (real) prices and relatively high efficiency targets and operating cost control. Accordingly, our draft decision accepts GWMWater's proposed rating of 'Advanced' for Management.

GWMWater's financial model contained some inconsistencies relative to its written submission and regulatory accounts, but these were not material to customer prices.

## 7.5 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>80</sup>

As noted in Section 3.2, our preliminary view is that GWMWater has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by customers.

Section 3.1 provides a list of actions where we consider GWMWater has demonstrated the influence of customers on its proposed Outcomes and other initiatives. This includes progressing work on drinking water supply upgrades, clarifying arrangements for deciding on water quality upgrades, and extending the Northern Mallee Pipeline to towns to reduce reliance on supply from the Murray River.

As noted in Section 3.2, most of GWMWater's output targets will be maintained at current levels. However, its proposed outcomes were informed by engagement with its customers and are generally supported. The outcomes are also being delivered with relatively substantial reductions in (real) prices. On that basis our draft decision is to accept GWMWater's proposed PREMO rating of 'Advanced' for the Outcomes element of PREMO (discussed further in Chapter 7).

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<sup>80</sup> Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, 26 October, p. 45.

# Appendix A — Submissions received

Name or organisation	Date received
Anonymous	7 October 2022
Jo-Anne Kelder	29 November 2022
Consumer Action Law Centre	30 November 2022
Commonwealth Environmental Water Holder	1 December 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 GWMWater.

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>81</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 GWMWater's compliance with our guidance, in reaching our preliminary view.

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

### **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 3.1).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

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<sup>81</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 GWMWater 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 3.1).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).
- Our assessment of financial viability (Chapter 6).

**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 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

Additionally, our pricing approach allows a water corporation to retain the benefits of any cost efficiencies it generates until the end of its regulatory period. In other words, a water corporation 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 corporations 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 corporation 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 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable GWMWater to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>82</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 corporation can maintain an investment grade credit rating. Further, prices should enable each corporation to generate cash flow to service financing costs arising from investments to meet service expectations.

We have had regard to this matter in Chapter 6.

**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 GWMWater 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 3.1).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).

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<sup>82</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).

## **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 corporation to propose outcomes, tariff structures and expenditure that reflect its particular circumstances. We consider that taking into account the particular circumstances of each water corporation 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 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

We have had regard to the prescribed services listed in the WIRO in making our decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow GWMWater 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 GWMWater to generate a return on assets through:

- Our consideration of the regulatory asset base (Section 4.3).
- Our consideration of the cost of debt (Section 4.4.1).
- Our consideration of the return on equity (Section 4.4.2).

**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>83</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>84</sup>
- tariff structures applied by water corporations throughout Australia<sup>85</sup>
- the regulatory rate of return set by other regulators.<sup>86</sup>

We are not aware of any international benchmarks that are relevant to our 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 corporation 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 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

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

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<sup>83</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022

<sup>84</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>85</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>86</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 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

**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).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our consideration of demand (Section 5.1).
- Our consideration of tariffs (Section 5.3).

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 3.1).
- Our consideration of outcomes (Section 3.2).

**WIRO Clause 11(d)(i) requires us to have regard to whether GMMWater’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 GMMWater’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 corporation’s engagement
- the structure of individual tariffs
- the proposed form of price control
- any changes to tariffs and how water corporations 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 (Section 5.2 and Section 5.3).

**WIRO Clause 11(d)(ii) requires us to have regard to whether GMMWater’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 3.1).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

**WIRO Clause 11(d)(iii) requires us to have regard to whether GMMWater’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 3.1)

- Our consideration of outcomes (Section 3.2)
- Our consideration of guaranteed service levels (Section 3.4)
- Our consideration of tariff structures and prices (Chapter 5)

## **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 GWMWater 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).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of the form of price control (Section 5.2).

**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 GWMWater 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).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

## **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, GWMWater 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 3.1)
- Our assessment of outcomes (Section 3.2)
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).

We consider that our pricing approach helps to address market power and information asymmetries relating to the water corporations. Our PREMO water pricing approach provides incentives for a water corporation 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>87</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 corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations 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 corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>88</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 corporation’s revenue requirement
- allows water corporations to implement various forms of price control, including price caps and revenue caps

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<sup>87</sup> Essential Services Commission 2016, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October, pp. 11–13.

<sup>88</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 2.

- 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 corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations 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 corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>89</sup>

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<sup>89</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 2.