



Wannon Water draft decision

2023 Water Price Review

6 April 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 Wannon Water’s proposed prices for a 5-year period starting 1 July 2023

This draft decision sets out our preliminary views on Wannon Water’s price submission.¹ Our draft decision should be read together with Wannon Water’s price submission.



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

Wannon Water has committed to delivering outcomes that reflect customer priorities

Wannon Water plans to deliver the following outcomes for customers:

- Ongoing reliability of water and sewerage services
- Ongoing protection of the environment through action and education, prioritising Country and our communities
- Fair and reasonable bills for all
- Improved water quality in identified communities
- Improved customer experience of our products and services
- Active partnerships for healthy and resilient communities.²

Among the key initiatives to deliver on its commitments, Wannon Water will improve access to its financial support programs and build capability to ensure it has proactive hardship identification, communication and outreach. A number of major projects seek to protect the environment and respond to the business’s compliance obligations, and it is on track to be carbon neutral by 2030.

¹ Clause 16 of the Water Industry Regulatory Order 2014 requires the Essential Services Commission to issue a draft decision; Wannon Water’s price submission is available on our website at www.esc.vic.gov.au.

² Wannon Water, 2023 water price submission, September 2022, pp. 26–32.

Our draft decision approves a revenue requirement that is lower than proposed by Wannon Water

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

Wannon Water proposed a revenue requirement of \$384.9 million over a 5-year period starting 1 July 2023.³ Our draft decision adopts a revenue requirement of \$370.8 million, which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure. The main adjustments proposed in our draft decision reflect our preliminary views on Wannon Water’s operating expenditure forecasts (Section 4.1).

Under Wannon Water’s proposal, generally prices (excluding inflation) will be higher.

Based on Wannon Water’s price submission, before inflation, the typical annual water and sewerage bill for a residential owner-occupier rises from \$1,106 currently, to \$1,115 in 2023-24 and \$1,154 in 2027-28. Bills for household tenants rise from \$207 in 2022-23 to \$212 in 2023-24 and \$229 by 2027-28 (Table A). These estimates exclude inflation (they are in \$2022-23 terms).

Table A Estimated typical water and sewerage bills (\$2022-23)

	Average consumption (kL p.a.)	2022-23 (current)	2023-24	2027-28
Residential – owner occupier	142	\$1,106	\$1,115	\$1,154
Residential – tenant	142	\$207	\$212	\$229
Non-residential (small)	100	\$1,122	\$1,132	\$1,172
Non-residential (medium)	1,000	\$4,192	\$4,229	\$4,389
Non-residential (large)	5,000	\$15,983	\$16,165	\$16,945

To address customer affordability, Wannon Water proposed to charge prices that are lower (on average) than the amount it could charge under the revenue requirement proposed in its price submission; that is, it would under-recover its forecast costs.

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

Wannon Water must respond to our draft decision on its revenue requirement. There are some areas (noted below) that may impact Wannon Water’s revenue requirement and prices approved in our final decision and determination, which could impact estimated customer bills.

In response to our draft decision, Wannon Water must consider the inflation environment and the impact on customer prices and bills

Wannon Water, unlike some other water businesses, proposes to increase prices in real terms over the 2023–28 regulatory period. Under its proposal, annual water and sewerage bills for a typical household would increase by 0.8 per cent on average in the period to 2027-28 (excluding inflation). Non-residential water and sewerage prices are proposed to follow a similar path.

Given this and given that since lodgement of its price submission it has become increasingly likely that a relatively high inflation adjustment will be incorporated into 2023-24 prices, Wannon Water must provide us with further information illustrating how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills.⁴ Wannon Water has proposed to charge lower prices than it could under its proposed revenue requirement in order to address affordability.

Prices and estimated bills will change following our draft decision to reflect updates for inflation and the cost of debt. The March Quarter 2023 annual outcome for the consumer price index due for release in late April 2023, will be added to 2023-24 real prices.⁵

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall through 2023 and 2024.⁶ For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.⁷

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to businesses’ opening base costs for the 2023–28

⁴ This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission, in considering the manner in which a regulated entity’s prices are to be calculated, determined or otherwise regulated, must have regard to whether prices provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

⁵ Published by the Australian Bureau of Statistics (All Groups – Australia).

⁶ The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

⁷ The pricing model issued by the commission includes a forecast for inflation for the full 2023–28 regulatory period (currently 3 per cent). This assumption is used by businesses to enter expenditure values and prices in our pricing model in real terms.

regulatory period. Accordingly, it may be the case that the inflation that is added to prices in 2023-24 provides an uplift in revenue that is well above a business's actual costs for the year.

Tariff structures will generally remain the same, but with some increases in variable water charges to provide customers with more bill control

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

Wannon Water proposed to increase its variable water charge and reduce its fixed water service charge. Its engagement identified that customers supported an adjustment to the balance of these charges to provide them with greater bill control.

Our draft decision is to approve Wannon Water's proposed tariff structures, on the basis that they are generally a continuation of Wannon Water's current approach and meet the criteria in our guidance. Specifically, the tariff structures ensure a sustainable revenue stream and are simple to understand. Our review of Wannon Water's proposed tariff structures is set out in Section 5.3.1.

Our draft decision is to accept Wannon Water's proposed price cap form of price control (Section 5.2) on the basis that it is a continuation of its existing form of price control. This means its maximum prices are fixed subject to updates for inflation, and any other price adjustments we approve in our price determination.

Our draft decision rates Wannon Water's price submission as 'Standard' under the PREMO framework

Our draft decision is to rate Wannon Water's price submission as 'Standard' under the PREMO framework (Table B). This is the same as the business's self-rating of its price submission. Wannon Water's 2018 price submission received an overall PREMO rating of 'Basic' in the 2018 price review.

Our preliminary view is that we agree with Wannon Water's self-rating of 'Leading' for its price submission Engagement. Wannon Water provided participants with a high level of influence on its proposals. It used a deliberative forum to explore proposed price changes and its tariffs, providing information that enabled panel members to make informed decisions about the impacts of price increases on low income customers and customers experiencing vulnerability.

While our draft decision is to agree with Wannon Water's self-rating of its price submission as 'Standard' for the Risk and Outcomes elements of PREMO (the latter supported by an

improvement in some service targets), our preliminary view is that we disagree with its self-rating of 'Standard' for the Performance and Management elements.

In terms of the Performance element of PREMO, while Wannon Water generally delivered on its outcome commitments, Wannon Water's 2021-22 controllable operating costs were well above the benchmark established in the 2018 price review, and by a percentage amount well above the industry average. While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to reprioritise and manage costs closely having regard to the price review benchmarks. Wannon Water's controllable operating costs in 2021-22 were 16 per cent above the benchmark adopted in the 2018 review, compared to the average among businesses in the current review of around 9 per cent.

Delivery of Wannon Water's key major project for the current regulatory period – the Warrnambool Sewage Treatment Plant – was delayed. The capital and operating costs associated with financing the Plant were reflected in customer prices from 2021-22. However, due to Wannon Water's difficulty obtaining pre-construction approvals, work did not commence until late 2022 and it is now not expected to be completed until 2024-25.

While we acknowledge that project delays can be outside a business's control, customers have contributed to the costs of the project despite not receiving the underlying service. We raised issues related to Wannon Water's capital forecasting during our 2018 price review, including that we considered its approach would potentially result in customers paying more than they needed to.⁸

In terms of the Management element of PREMO, we consider Wannon Water has not sufficiently justified the reasons for the increase in its controllable operating costs for 2021-22 relative to the benchmark adopted at the 2018 price review. Justification of amounts above the benchmark is important as it sets the baseline for assessment of future operating expenditure. Further, we have proposed adjustments to Wannon Water's proposed operating and capital expenditure forecasts.

The Water Industry Regulatory Order requires that the commission, in seeking to achieve the objectives specified in section 8 of the Essential Services Commission Act 2001 and the Water Industry Act 1994, must have regard to and place particular emphasis on a range of matters related to efficiency.⁹ Further, our guidance requires a water business to justify that its forecast costs reflect prudent and efficient expenditure.

⁸ Essential Services Commission, *Wannon Water draft decision: 2018 Water Price Review*, 28 March 2018, p. 34.


⁹ Clause 8(b) of the Water Industry Regulatory Order 2014.

We expect Wannon Water in its response to our draft decision, to provide sufficient justification to demonstrate its forecast expenditure is prudent and efficient, and will deliver the outcomes expected by its customers and to meet regulatory and policy obligations.

Despite disagreeing with Wannon Water’s self-rating of two elements of its price submission (Performance and Management), our draft decision is to agree with Wannon Water’s overall self-rating of its price submission as ‘Standard’ for PREMO. This is influenced by our preliminary view that we agree with Wannon Water’s self-rating of ‘Leading’ for Engagement and, as noted in the commission’s guidance, all PREMO elements are taken into account in considering the overall weighting.

Wannon Water’s response to the matters raised in our draft decision, and our ongoing consultation and review, will inform our final view on its price submission PREMO rating.

See Section 1.4 and Chapter 7 for an explanation of the PREMO framework.



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

Table B **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Wannon Water’s self-rating	Standard	Standard	Standard	Leading	Standard	Standard
Commission’s rating	Standard	Basic	Standard	Leading	Basic	Standard

Among the 11 draft decisions we have released so far, Wannon Water is one of 6 businesses for which we propose to approve a ‘Standard’ rating (Table C).

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

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

We invite feedback on our draft decision

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

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

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

Table C lists specific issues we are seeking feedback on to inform our final decision and price determination for Wannon Water.

Table C Specific topics we are particularly interested in stakeholder feedback on

Topic	Specific issue	Draft decision reference
New customer contributions	Feedback from developers and other customers about Wannon Water’s proposed new customer contributions charges.	Section 5.4

How to provide feedback and stay up to date

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

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

You can provide feedback by:

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

Taking part in a public forum

We plan to hold a public forum on 27 April 2023. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

Provide written comments or submissions

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

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

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

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

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

Submission and privacy statement

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

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

Next steps

Activity	Indicative date
Public forum	27 April 2023
Closing date for submissions on our draft decision	9 May 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 businesses operating in Victoria.

1.2 We are reviewing the proposed prices of 14 water businesses

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.¹⁰ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.¹¹

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

1.3 We assess prices against the WIRO and other legal requirements

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

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

¹⁰ 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.

¹¹ The prescribed services are listed at clause 7(b) of the WIRO.

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance¹²
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

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

In October 2021, we issued guidance to Wannon Water to inform its price submission. The guidance set out how we would assess Wannon Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Wannon Water would comply with certain requirements and specified information that Wannon Water 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 Wannon Water's proposed prices.¹³

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.¹⁴

¹² Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

¹³ This is a requirement of the WIRO, clause 14(b).

¹⁴ 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"> • promotion of efficient use of prescribed services by customers [cl 8(b)(i), WIRO] • 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] • provision to regulated entities of incentives to pursue efficiency improvements [cl 8(b)(iii), WIRO] • efficiency in the industry and incentives for long term investment [s. 8A(1)(a), ESC Act] • 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] • financial viability of the industry [s. 8A(b)(1), ESC Act] 	<ul style="list-style-type: none"> • 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] • return on assets in the regulated industry [s. 33(3)(c), ESC Act] • 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] 	<ul style="list-style-type: none"> • 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] • 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] • 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] • take into account the interests of customers of the regulated entity, including low income and vulnerable customers [cl 11(d)(iii), WIRO]

Continued next page

Table 1.1 (continued)

Benchmarking	Health, safety and social obligations	Other
<ul style="list-style-type: none"> any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries [s. 33(3)(d), ESC Act] 	<ul style="list-style-type: none"> the relevant health, safety, environmental and social legislation applying to the industry [s 8A(1)(d), ESC Act] 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] 	<ul style="list-style-type: none"> the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries [s. 8A(1)(c), ESC Act] consistency in regulation between States and on a national basis [s. 8A(1)(f), ESC Act] 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] wherever possible, to ensure that the costs of regulation do not exceed the benefits [s. 4C(a), WI Act]

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

1.4 PREMO

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

Box 1.1 PREMO

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

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

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

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

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

Our PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.¹⁵

¹⁵ In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

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

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.¹⁶

¹⁶ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.

2. Our assessment of Wannon Water's price submission

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

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

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

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

We found Wannon Water's price submission provided evidence that its engagement sought to capture the main priorities and concerns of customers, and that it has taken this feedback into account (see Section 3.1 on customer engagement).

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



Wannon Water must submit a response to our draft decision and provide an updated financial model by 9 May 2023 (via email to water@esc.vic.gov.au). 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 Wannon Water in June 2023.

2.1 Draft decision paper outline

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

- Determine the regulatory period (Section 2.2).
- Confirm the customer outcomes and service levels that Wannon Water has committed to over the regulatory period (Chapter 3).

- Establish Wannon Water’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 Wannon Water’s financial position, which we have also had regard to.

Chapter 7 outlines our assessment of Wannon Water’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.¹⁷ 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.¹⁸

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

¹⁷ This is a requirement of the WIRO, clause 9.

¹⁸ 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 Wannon Water plans to deliver over the regulatory period are a key component of its price submission – confirming its commitments to customers, underpinning its revenue requirement, and feeding in to its PREMO assessment.

This chapter:

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

3.1 Customer engagement

Our guidance required Wannon Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Wannon Water’s engagement.¹⁹

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

Wannon Water’s engagement on its price submission:

- was informed by ongoing engagement activities since 2018, with targeted, and deeper deliberative processes throughout 2022
- achieved more than 7,700 instances of engagement using a wide range of methods including surveys, focus groups, interviews, attendance at regional events, pop-up information sessions, a deliberative panel, and a regional advisory forum
- used inclusive engagement methods that were well-tailored to the circumstances of its customers, including holding interviews and focus groups with 40 community organisations, interest groups and key stakeholders at times and locations designed to make participation as easy as possible
- established its regional advisory forum, which met twice a year between 2018 and 2022 and provided stewardship over Wannon Water’s engagement program and ensured customer influence at each stage of the engagement process

¹⁹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

- expanded on its ongoing partnership and engagement with indigenous leaders and communities, by engaging both Registered Aboriginal Parties — Eastern Maar and Gunditj Mirring — through a relationships-based approach to developing the price submission
- engaged on matters that were influential on service and prices including affordability, tariff structures, water quality, service levels, customer experience and customer engagement.

More detail on Wannon Water’s engagement is available in its price submission.²⁰

Actions proposed to be taken by Wannon Water in response to feedback provide evidence that its engagement influenced its proposals. For example, in its price submission, Wannon Water proposed:

- investing \$500,000 in activities over the regulatory period to identify and communicate with customers experiencing payment difficulty – in response to feedback from customers that more could be done to increase awareness of its financial support programs²¹
- providing an additional \$200,000 in financial support over the regulatory period for customers impacted by price increases and bill structure changes – in response to feedback from its deliberative panel that supporting customers experiencing vulnerability was important to panel members²²
- a price path that involved incremental increases in customer bills – to avoid larger increases at a future time²³
- investing in new water treatment infrastructure – in response to feedback from customers seeking better tasting water across more of its towns²⁴
- a digital transformation to improve customers’ experience – in response to feedback that customers saw room for improvement in this area.²⁵

The influence of Wannon Water’s engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of customers.

Overall, our preliminary view is that Wannon Water has designed and delivered a robust and thorough engagement program and achieved strong customer and stakeholder influence on the proposals in its submission.

²⁰ Wannon Water’s price submission is available on our website at www.esc.vic.gov.au.

²¹ Wannon Water, 2023 water price submission, September 2022, p. 29.

²² Wannon Water, 2023 water price submission, September 2022, p. 29.

²³ Wannon Water, 2023 water price submission, September 2022, p. 23.

²⁴ Wannon Water, 2023 water price submission, September 2022, p. 30.

²⁵ Wannon Water, 2023 water price submission, September 2022, p. 31.

Wannon Water's engagement builds on a series of engagement activities undertaken since 2018. Its regional advisory forum, comprising customers and other stakeholders, co-designed key aspects of its engagement on its pricing submission, and ensured the quality of the consumer input at each stage of the process. The insights gathered from its Great Tasting Water project and the Customer Support Review informed the targeted engagement on its price submission.

We consider that Wannon Water's engagement achieved a high level of participation across its diverse customer base as seen in the high level of customer contact it was able to achieve. We also consider that Wannon Water's engagement was inclusive, in particular for First Nations people and people experiencing vulnerability. We note the ongoing relationships Wannon Water has built with local First Nations groups and Registered Aboriginal Parties, in addition to the engagement undertaken for its price submission. We note the influence this engagement had on the pricing proposals in the form of proposed Outcome 2, under which Wannon Water has committed to maintaining strong partnerships with First Nations communities and organisations, and will deliver its foundation Reconciliation Action Plan.

We note that Wannon Water adopted all the recommendations from its deliberative panel, and members of the regional advisory forum unanimously supported the submission. We also note the level of customer support Wannon Water received when it invited comment on its draft price submission.

In a submission to the commission's price review, the Consumer Action Law Centre was positive about the timing of Wannon Water's engagement, but sought assurance about the extent to which Wannon Water had tailored its engagement to suit the content on which it was seeking to engage, specifically the quality of information about how renters may be affected by any increase in variable charges.

Wannon Water sought customers' views on the proportion of fixed and variable charges via its deliberative panel. Wannon Water provided further information on its engagement for us to review, including the composition of its deliberative panel, the presentation slides and a recording of the deliberative panel discussion on variable charges. This information satisfied us of the high quality of the supporting material, and that the issue had been the subject of detailed and nuanced discussion in more than one forum. In forming our view of the appropriateness of the information given the content it engaged on, we saw evidence that panel members were well informed on the disproportionate impact the rebalancing of tariffs may have on renters when forming their recommendations. We also saw evidence Wannon Water sought to address customers' concerns about the impacts on low income customers and customers experiencing vulnerability through proposals to move incrementally towards a higher variable portion for charges, and introducing overall price increases slowly over the 5 years of the regulatory period. Section 5.3.3 outlines other assistance that will be available to tenants under Wannon Water's proposal.

See Section 5.3.3 for our preliminary assessment of how Wannon Water has taken into account the interests of low income and vulnerable customers, including tenants.

Based on the above, our preliminary view is that we agree with Wannon Water's self-rating of 'Leading' for its price submission engagement. See Chapter 7 for more detail on our PREMO assessment of Wannon Water's price submission.²⁶

3.2 Outcomes

3.2.1 Performance against outcome commitments 2018–23

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

A business's price submission should account for its actual performance against its outcome commitments for the current period, from 1 July 2018 to 30 June 2023.²⁷

We consider Wannon Water accounted for its annual performance for each measure in its price submission. Table 3.1 lists Wannon Water's outcome commitments and includes its annual performance results as reported in its price submission and the period-to-date rating published in our 2021-22 Outcomes report.²⁸ The information in this table informs our assessment under the Performance element of PREMO, which is discussed in Chapter 7.

²⁶ Wannon Water's price submission is available on our website at www.esc.vic.gov.au.

²⁷ Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

²⁸ Wannon Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

Table 3.1 Business self-assessment of performance against Outcome commitments

Outcome	2018-19	2019-20	2020-21	2021-22	Period to date ^a
Provide safe and reliable water supplies	Green	Green	Amber	Green	Green
Provide sewerage services that protect public health and the environment	Green	Green	Green	Green	Green
Ensure the long-term resilience of our services	Green	Green	Green	Green	Green
Be responsive and willing to adapt as customer needs change	Green	Green	Green	Green	Green
Protect and enhance the environment in line with community expectations	Amber	Amber	Green	Green	Green
Partner with customer communities and help our region flourish	Green	Green	Green	Green	Green
Ensure we provide great value	Red	Red	Red	Red	Red

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

Wannon Water considers it has achieved or exceeded its targets for 44 of its 61 reported measures over the first 4 years of the current regulatory period. Of these 61 measures for the 4-year period to date, 7 (11 per cent) have been rated as amber 'close to achieving target' and 10 (16 per cent) as red 'failed to meet target'.²⁹

Wannon Water failed to meet its 'value for money' customer satisfaction targets for the period, subsequently not meeting its 'ensure we provide great value' outcome. It scored an average rating of 79 per cent across the period to date for its 'value for money' customer satisfaction results, compared to its annual target of 84 per cent. In its 2021-22 outcomes report, it noted water quality as a key driver, and that customer perceptions of value for money are unlikely to increase unless it provides significant investment to improve water quality, particularly in its groundwater towns.³⁰

Wannon Water reported that it considers it achieved its remaining outcomes for the period to date. It achieved full compliance with its bulk entitlement and groundwater licences during this period, and it performed well against its targets for customer satisfaction ratings for its 'partnering with

²⁹ Wannon Water, 2023 water price submission, September 2022, p. 4–8.

³⁰ Essential Services Commission, Wannon Water's outcomes performance 2021-22, October 2022.

customer communities' outcome, falling short on only one target over three measures in the current period.³¹

In the current regulatory period, Wannon Water reported on its performance as part of its annual report which it publishes on its website.

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

3.2.2 Outcome commitments for 2023–28

Wannon Water engaged with its customers to refine its outcomes for the period from 1 July 2023 to 30 June 2028. It has established six customer outcomes it proposes to deliver:

- Ongoing reliability of water and sewerage services
- Ongoing protection of the environment through action and education, prioritising Country and our communities
- Fair and reasonable bills for all
- Improved water quality in identified communities
- Improved customer experience of our products and services
- Active partnerships for healthy and resilient communities.³²

Among the key initiatives to deliver on its commitments, it proposes to under-recover its revenue requirement to support affordability and reduce customer bill impacts. It will improve access to its financial support programs by providing an additional \$200,000 to support customers facing payment difficulties and will invest \$500,000 to ensure it has proactive identification, communication and outreach programs.

It will also target projects to protect the environment and be carbon neutral by 2030.

3.2.3 Our assessment of measures and targets

Wannon Water proposed a set of 23 measures and targets that it will use to report on performance across the 6 outcomes. These are set out on pages 26 to 32 of its price submission. Performance against these measures will inform our assessment during future price reviews.

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

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

³¹ Essential Services Commission, Wannon Water's outcomes performance 2021-22, October 2022.

³² Wannon Water, 2023 water price submission, September 2022, pp. 26–32.

- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.³³

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

We will provide Wannon Water with our standard Outcomes Reporting Template, identifying issues we have found during our preliminary review, to complete and submit with its response to this draft decision.

Evidence provided by Wannon Water demonstrates that its measures and targets were developed in consultation with its customers, and that they are supported by its customers. As part of its engagement program for its price submission, its customers provided feedback on six key themes which were used to inform its 2023–28 outcome commitments. As part of its deliberative panel process, in April 2022, it designed and tested its final outcomes and measures, resulting in the panel's endorsement.³⁴

Wannon Water's proposed targets for its outcome measures suggest an overall improvement in customer value. In our preliminary view, of the 23 output targets 15 indicate an increase in customer value, either improving on past performance or improving across the 2023–28 regulatory period.

We also note Wannon Water has proposed to remove its previous measure for full compliance with the Safe Drinking Water Regulations, which we had asked all businesses to include at the 2018 price review.

Wannon Water has committed to reporting annually to its customers on how it has performed against its outcome commitments and will review targets where it proposes an increase in service and value as part of its annual engagement program. It will also establish an annual forum with representatives from its diverse customer groups to discuss new or unexpected issues.³⁵

³³ Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

³⁴ Wannon Water, 2023 water price submission, September 2022, p. 24.

³⁵ Wannon Water, 2023 water price submission, September 2022, pp. 24 and 32.

On the basis of the above, our draft decision is to accept Wannon Water's self-assessment of its price submission as 'Standard' for the Outcomes element of PREMO, which is discussed further in Chapter 7.

3.3 Service Standards related to service reliability and faults

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

Wannon Water's proposed service standards relating to reliability and faults can be found in its proposed urban service standards 2023–28 document.³⁶

The urban service standards proposed by Wannon Water are the same as those for the current 2018–23 regulatory period (with some wording changes required by the updated Water Industry Standard). Wannon Water has also specified a minimum flow rate as required by the Water Industry Standard. In its price submission, despite stating that it proposed to maintain its existing service levels, Wannon Water inadvertently included several additional service standards and service levels which are not part of its service standards for the current regulatory period. It corrected this in the proposed urban service standard 2023–28 document it subsequently provided.

Wannon Water has updated seven of the specified service levels to reflect actual average response time to ensure that this is a more realistic reflection of its current performance. This has been informed by customer preferences.

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

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

³⁶ Wannon Water, proposed service standards 2023–28 document, February 2023.

3.3 Guaranteed service levels

Our draft decision is to accept Wannon Water's proposed guaranteed service levels.

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

Wannon Water's proposed guaranteed service levels are set out on page 34 of its price submission. It is not proposing any changes to its guaranteed service levels or the levels of rebates that apply in the current regulatory period. Its four guaranteed service levels relate to water supply reliability, sewerage service reliability and the mandatory guaranteed service level relating to restriction or legal action. Through its engagement Wannon Water confirmed that the guaranteed service levels align with the areas that customers value most.

We propose to accept Wannon Water's proposed guaranteed service levels, on the basis that they have been reviewed with customers during its engagement. Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

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

4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health. 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 Wannon Water'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 Wannon Water'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 \$370.8 million, which is lower than the \$384.9 million proposed by Wannon Water.

Wannon Water proposed a revenue requirement of \$384.9 million over a 5-year period starting 1 July 2023. Our draft decision approves a revenue requirement of \$370.8 million. The components of the revenue requirement are set out in Table 4.1.

Table 4.2 itemises our proposed adjustments to Wannon Water's proposed revenue requirement, reflecting our review of Wannon Water's proposed operating and capital expenditure (Sections 4.1 and 4.2) including reconciliation with its approved regulatory accounts.

Table 4.1 Draft decision on Wannon Water’s revenue requirement
 \$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure ^a	48.2	50.3	50.8	51.5	51.3	252.1
Return on assets	10.8	10.8	10.5	10.1	9.8	52.1
Regulatory depreciation	11.6	12.4	13.5	14.4	14.8	66.6
Tax allowance	0.0	0.0	0.0	0.0	0.0	0.0
Draft decision – revenue requirement	70.5	73.5	74.8	75.9	76.0	370.8

Note: Numbers have been rounded. ^a Reflects provisional amounts that we will further review in the lead up to our final decision.

Our final decision on Wannon Water’s revenue requirement will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Wannon Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

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

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. Wannon Water’s proposed revenue requirement	72.76	76.59	77.68	78.92	78.96	384.92
B. Operating expenditure ^a	-2.19	-2.96	-2.57	-2.56	-2.56	-12.84
C. Return on assets	-0.05	-0.14	-0.21	-0.26	-0.28	-0.94
D. Regulatory depreciation	0.01	0.01	-0.06	-0.15	-0.17	-0.36
E. Draft decision – revenue requirement (A+B+C+D)	70.54	73.50	74.84	75.95	75.96	370.78

Notes: Our proposed adjustments are the differences between our draft decision and what Wannon Water proposed in its price submission. Row A shows the total revenue requirement proposed by Wannon Water in its price submission. We have arrived at our draft decision (row E) by proposing the relevant adjustments to the components of the revenue requirement shown in rows B to D. Numbers have been rounded. ^a Row B reflects provisional amounts that we will further review in the lead up to our final decision.

4.1 Operating expenditure

Our draft decision is to adopt a provisional forecast operating expenditure of \$252.14 million, which is \$12.84 million or 4.8 per cent lower than proposed by Wannon Water.

Operating expenditure is a component of the revenue requirement. Wannon Water’s price submission provides detail on its forecast operating expenditure from pages 37 to 41.

We assess both:

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

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting’s report on its assessment of Wannon Water’s expenditure forecast is available on our website.³⁷

³⁷ FTI Consulting, *Wannon Water – Expenditure Review for 2023 water price review*, February 2023.

Table 4.3 sets out our draft decision on Wannon Water’s forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Controllable operating expenditure	44.38	46.60	47.18	47.85	47.79	233.81
Non-controllable operating expenditure	3.79	3.73	3.66	3.60	3.54	18.33
Bulk services ^a	0.36	0.36	0.36	0.36	0.36	1.80
Environmental contribution ^b	3.10	3.04	2.98	2.92	2.86	14.89
Licence fees – Essential Services Commission ^c	0.11	0.11	0.11	0.11	0.11	0.54
Licence fees – Department of Health ^c	0.03	0.03	0.03	0.03	0.03	0.14
Licence fees – Environmental Protection Authority ^c	0.19	0.19	0.19	0.19	0.19	0.97
Draft decision – operating expenditure^d	48.17	50.33	50.85	51.45	51.33	252.14

Notes: Numbers have been rounded. ^a Bulk services covers the supply of bulk water and sewerage services.

^b Environmental contributions are funds collected from water businesses under the *Water Industry Act 1994*. ^c 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. ^d This reflects a provisional amount that we will review further in the lead up to our final decision.

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

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

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

The operating expenditure that we propose to adopt for Wannon Water does not represent the amount that Wannon Water is required to spend or allocate to particular operational, maintenance

and administrative activities. Rather, it is a benchmark that represents assumptions about the overall level of operating expenditure (to be recovered through prices) that we consider sufficient to operate the business efficiently and to maintain services over the regulatory period.

Table 4.4 Our proposed adjustments to Wannon Water’s proposed operating expenditure
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. Wannon Water’s proposed total operating expenditure	50.36	53.29	53.42	54.02	53.89	264.97
B. Our total proposed adjustments to controllable operating costs (B1 + B2)	-2.19	-2.96	-2.57	-2.56	-2.56	-12.84
B1 – Total baseline adjustments	-2.19	-2.19	-2.18	-2.17	-2.17	-10.9
B1.1 – One-off operating projects	-1.19	-1.19	-1.19	-1.18	-1.18	-5.93
B1.2 – Additional contractor support	-1.00	-1.00	-0.99	-0.99	-0.99	-4.97
B2 – Total step change adjustments	0.00	-0.77	-0.39	-0.39	-0.39	-1.95
B2.1 – Great tasting water project	0.00	-0.77	-0.39	-0.39	-0.39	-1.95
C. Our total proposed adjustments to non-controllable operating costs	0.00	0.00	0.00	0.00	0.00	0.00
D. Draft decision – total operating expenditure^a (D = A + B + C)	48.17	50.33	50.85	51.45	51.33	252.14

Notes: Our proposed adjustments are the differences between our draft decision and what Wannon Water proposed in its price submission. Row A shows the total operating expenditure proposed by Wannon Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating costs shown in row B (and itemised in rows B1.1, B1.2 and B2.1). Numbers have been rounded. ^a This reflects a provisional amount that we will review further in the lead up to our final decision.

4.1.1 Controllable operating expenditure

Wannon Water proposed a total forecast controllable operating expenditure of \$246.64 million over a 5-year regulatory period. For the reasons set out below, we propose to adopt a provisional forecast controllable operating expenditure of \$233.81 million, which is \$12.84 million or 5.2 per cent lower than proposed by Wannon Water.

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

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, one-off items are removed or normally occurring items are added in.
2. Apply a growth rate for operating expenditure for the regulatory period – assumed by Wannon Water to be 0.74 per cent per year.
3. Apply an annual cost efficiency improvement rate – assumed by Wannon Water to be 1.00 per cent per year.
4. Make adjustments for additional costs or cost saving expected in future years.

4.1.1.1 Baseline controllable operating expenditure

Wannon Water has proposed a controllable operating expenditure baseline of \$47.18 million, after removing \$4.13 million in non-recurring operating expenditure that occurred in 2021-22. Wannon Water's proposed baseline is \$6.38 million (or 16 per cent) higher than the benchmark figure of \$40.80 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

We note that the 2021-22 benchmark figure included \$0.47 million in forecasted additional operating costs for the Warrnambool Sewage Treatment Plant upgrade, which has not been constructed within the current regulatory period. Removing this allowance means Wannon Water's proposed baseline is \$6.85 million (or 17 per cent) higher than the equivalent benchmark figure of \$40.33 million. This is one of the highest baseline increases proposed for the 2023 water price review.

Our expenditure consultant requested substantiation of Wannon Water's proposed increase to its baseline year operating expenditure benchmark.³⁸ Wannon Water explained the increase was due to a number of factors including regulatory obligations, digital transformation, energy prices and insurance.

³⁸ FTI Consulting, *Wannon Water – Expenditure Review for 2023 water price review*, February 2023, pp. 22–31.

Our consultant verified these additional costs were recurring and found Wannon Water's substantiation of these costs to be mostly reasonable.

Wannon Water also sought inclusion of \$2.92 million for 'other costs'. Given the magnitude of these 'other costs' when compared to the remaining expenditure increases flagged by Wannon Water, our consultant requested further information to justify the proposed baseline. Wannon Water explained that the \$2.92 million in 'other costs' comprised:

- \$1.2 million for 'one-off' projects, with most of the cost attributed to delayed works scheduled to occur earlier in the current regulatory period having instead occurred in 2021-22
- \$1.0 million for additional contractor labour support which includes expert advice on cyber security and additional resourcing for vacancies or specialised services
- Other miscellaneous items such as increased cost of supplies (e.g. pipe fittings and chemicals), additional support for customers experiencing vulnerability, response to the coronavirus pandemic, and an expansion of Wannon Water's trainee program.

Wannon Water's description of 'one-off' operating projects is very broad and includes many routine operating costs. For the \$1.2 million in 'one-off' projects above the 2021-22 benchmark, Wannon Water explained to our consultant that this was due to a reduction applied to operating expenditure for the current regulatory period from the 2018 price determination resulting in a lower allowance compared to what it had continued to spend. In particular, it noted it had continued to incur average annual expenditure for one-off operating projects consistent with its historical expenditure, and that the costs in 2021-22 were higher due to a backlog of works and increased costs in recent years. Our consultant considered the explanation provided by Wannon Water for the increase of \$1.2 million above the 2021-22 benchmark was unclear, and it was unable to assess whether this represented a recurring cost and prudent and efficient expenditure. Our consultant therefore recommended removing the additional \$1.2 million from the proposed baseline.³⁹

Likewise, our expenditure consultant was not satisfied with Wannon Water's explanation for the \$1.0 million for additional contractor support, as Wannon Water had not been able to clearly identify the specific drivers for this additional expenditure item (e.g. the cost and activities that relate to cyber security or specialised services and how this is separate to the increased expenditure related to new or increased regulatory obligations and digital transformation). Nor could Wannon Water demonstrate that this will be an ongoing recurring cost. Our expenditure consultant therefore recommended removing the additional \$1.0 million from the proposed baseline.⁴⁰

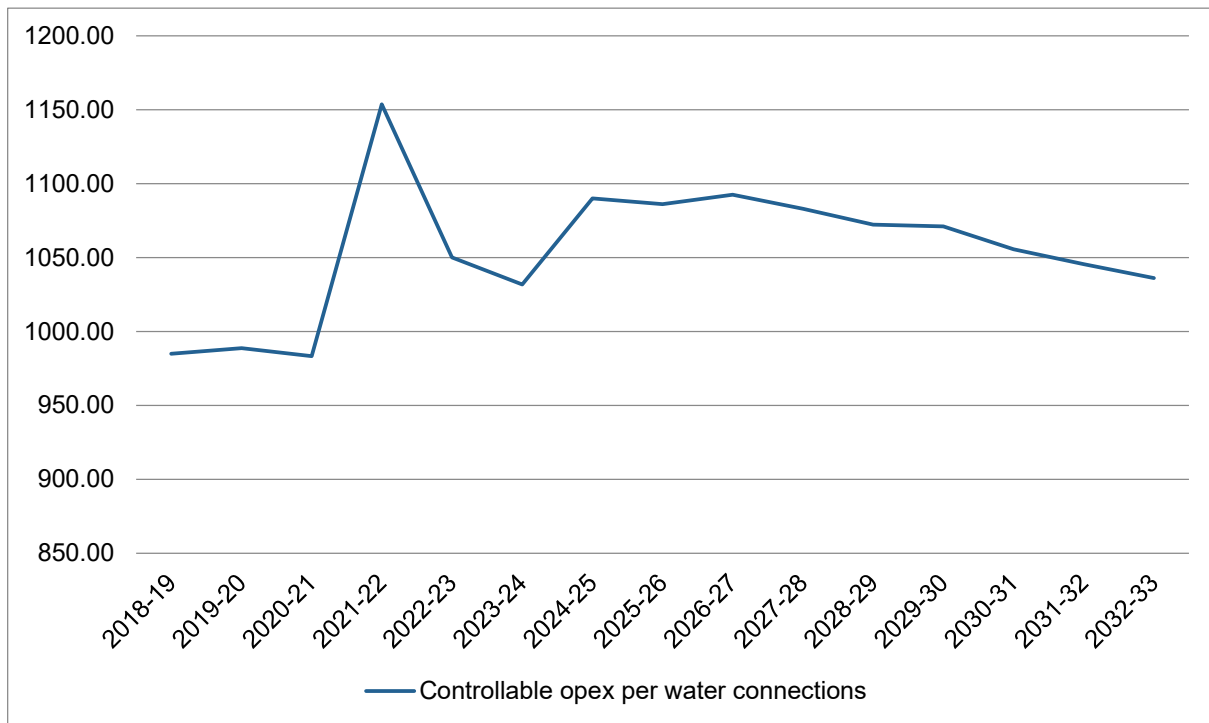
³⁹ FTI Consulting, *Wannon Water – Expenditure Review for 2023 water price review*, February 2023, pp. 26–29.

⁴⁰ FTI Consulting, *Wannon Water – Expenditure Review for 2023 water price review*, February 2023, pp. 29–30.

Accordingly, our consultant recommended accepting Wannon Water’s proposed baseline increase after removing the \$1.2 million for ‘one-off’ projects and \$1.0 million for additional contractor support.

We reviewed Wannon Water’s proposal and the advice from our expenditure consultant. Wannon Water’s controllable operating expenditure profile across the 2018–23 period is very unusual in that total annual expenditure was relatively steady (around \$43 million) for the first 3 years before spiking up by \$8 million (an 18 per cent step change) in the 2021-22 baseline year. The majority of this increase, about \$6 million, is attributed to corporate costs. The spike is evident in Figure 4.1 below, which shows the controllable operating expenditure per water customer connection across the current 2018–23 period, the forecast for the 2023–28 period, and the outlook for the 2028–33 period, as presented in Wannon Water’s price submission financial model.

Figure 4.1 Controllable operating expenditure per water connection
\$2022-23



Note: This graph shows actual figures for 2017-18 to 2021-22, and Wannon Water’s forecasts for 2022-23 to 2032-33.

We recognise our expenditure consultant’s assessment is based on the reasons provided by Wannon Water for the additional expenditure above the baseline in 2021-22.

However, we are not satisfied Wannon Water has adequately explained why its operating expenditure rose so suddenly, and why this occurred in the 2021-22 baseline year which is critical for establishing the efficient forecast for setting prices to apply in the next regulatory period. We require a clearer understanding of this before we can verify the efficiency of the proposed baseline.

Given the above, we do not accept Wannon Water's proposed baseline forecast. For the purposes of establishing a revenue requirement for our draft decision, we have adopted a provisional controllable operating expenditure baseline of \$44.98 million based on our expenditure consultant's advice.

In response to this draft decision, we require Wannon Water to provide a clear account of its controllable operating expenditure and the shifts that occurred in 2021-22, so we can establish an efficient baseline for our final decision and prices for 2023–28.

4.1.1.2 Efficiency improvement and growth rate

Wannon Water proposed an average efficiency improvement rate on its controllable operating costs of 1 per cent per annum. This is the same as the rate it proposed in its 2018 price submission, and is in the lower half when compared to other businesses in the current price review.

As the efficiency improvement rate is also higher than Wannon Water's proposed average cost growth rate of 0.74 per cent per annum, this will effectively deliver a net annual decrease of 0.26 per cent per annum to its controllable annual baseline operating costs in each year of the regulatory period. When compared to other businesses in the current price review, Wannon Water ranks third out of the 13 urban water businesses for lowest net annual changes to controllable operating expenditure.

With Wannon Water having the second lowest customer growth rates for all Victorian water businesses, where the operating cost growth allowance does not reflect what Wannon Water expects to incur during the next regulatory period, Wannon Water has accepted this risk to deliver the net annual decrease on behalf of customers with a commitment to absorb some new expenditure through operational efficiency improvements, reallocating resourcing within the business and advocating to reduce regulatory compliance red tape.

4.1.1.3 Cost adjustments

Wannon Water has proposed additional forecast operating expenditure above the annual baseline, including:

- \$4.96 million for new billing and customer relationship management systems (CX Plus)
- \$3.48 million towards improving customer experience with a software package to optimise system functionality and become a more customer-centric organisation
- \$1.95 million for new operating costs related to the Great Tasting Water project
- \$1.46 million for additional operating costs related to the Warrnambool Sewage Treatment Plant upgrade (including increased electricity demand)
- \$1.0 million for digital projects licencing costs in areas such as cyber and security-related resilience, works management mobility and GIS platform replacement

- \$0.92 million for operating costs related to the proposed Warrnambool Sewage Treatment Plant UV system
- \$0.37 million to meet carbon emissions reduction targets
- \$0.32 million decrease for electricity prices which are forecast to have an overall reduction in costs for the next regulatory period
- \$0.70 million decrease for electricity demand reductions due to the implementation of two large solar generation projects

The above costs represent an additional \$13.18 million over the regulatory period, or an average of \$2.64 million per annum.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline and requested further information from Wannon Water, including a further breakdown by individual cost item where required, along with documentation that supported the prudence and efficiency of each cost item.

Our expenditure consultant assessed each forecast variation against criteria for prudent and efficient operating expenditure and was satisfied each item was appropriately costed and supported by internal documentation, which included evidence of its prudence and efficiency. It therefore considered that Wannon Water's proposed additions to controllable operating expenditure were reasonable, however it did recommend removing the \$1.95 million that relates to the Great Tasting Water project, discussed below.

For the largest step change of \$4.96 million for new billing and customer relationship management systems (CX Plus), our expenditure consultant requested a further breakdown and justification of the costs. Wannon Water explained that the CX Plus step change comprised of:

- \$5.33 million for new CX Plus software licencing
- \$0.78 million for support agreement
- –\$1.14 million avoidance of existing Aquarate licencing

With 87 per cent of the proposed operating expenditure due to unavoidable software licencing and Wannon Water having engaged in a robust process to select a preferred vendor to deliver CX Plus to ensure good cultural fit and an acceptable balance of risk, cost and implementation time, our expenditure consultant was satisfied that this expenditure item is prudent and efficient.⁴¹

For the \$1.95 million towards the operating costs related to the Great Tasting Water project, our expenditure consultant proposed to remove the associated capital expenditure for this project for the next regulatory period due to uncertainty regarding the scope, cost, timing and delivery of this

⁴¹ FTI Consulting, *Wannon Water – Expenditure Review for 2023 water price review*, February 2023, pp. 32–33.

project. Accordingly, our consultant also recommended removing the operating expenditure associated with this project. This is further discussed in Section 4.2.2.

As noted in Section 4.2.2, while we accept the driver of this expenditure and consider the need for the project is well established and supported by customers, the project has not been developed sufficiently by Wannon Water for us to assess the prudence and efficiency of associated expenditure. As also noted in Section 4.2.2, in our draft decision we have instead proposed to include 10 per cent of the capital cost forecast by Wannon Water in relation to this project, to contribute to its development and implementation.

We have considered the advice from our expenditure consultant, and Wannon Water's proposal. We consider Wannon Water's approach to forecasting its additional operating expenditure requirements above the baseline is consistent with the requirements of our guidance. Our preliminary position is that we are mostly satisfied that its proposed additions represent efficient controllable operating expenditure, with the exception of the \$1.95 million towards the Great Tasting Water project. There is evidence that Wannon Water has significantly tested its controllable expenditure requirements, resulting in a forecast overall decline (excluding inflation) in controllable operating expenditure per customer connection from 2024-25 onwards.

4.1.2 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

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

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

Wannon Water has proposed \$18.33 million in non-controllable operating expenditure over the 2023–28 regulatory period. This is a decrease of \$2.06 million compared to the 2018–23 regulatory period, driven by a decrease of \$2.20 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 (decline in real terms) across the 2023–28 regulatory period. Wannon Water has followed this approach in its price submission.

Accordingly, consistent with the reasoning in our guidance paper, our draft decision is to accept Wannon Water's proposed non-controllable operating expenditure. We will verify Wannon Water's

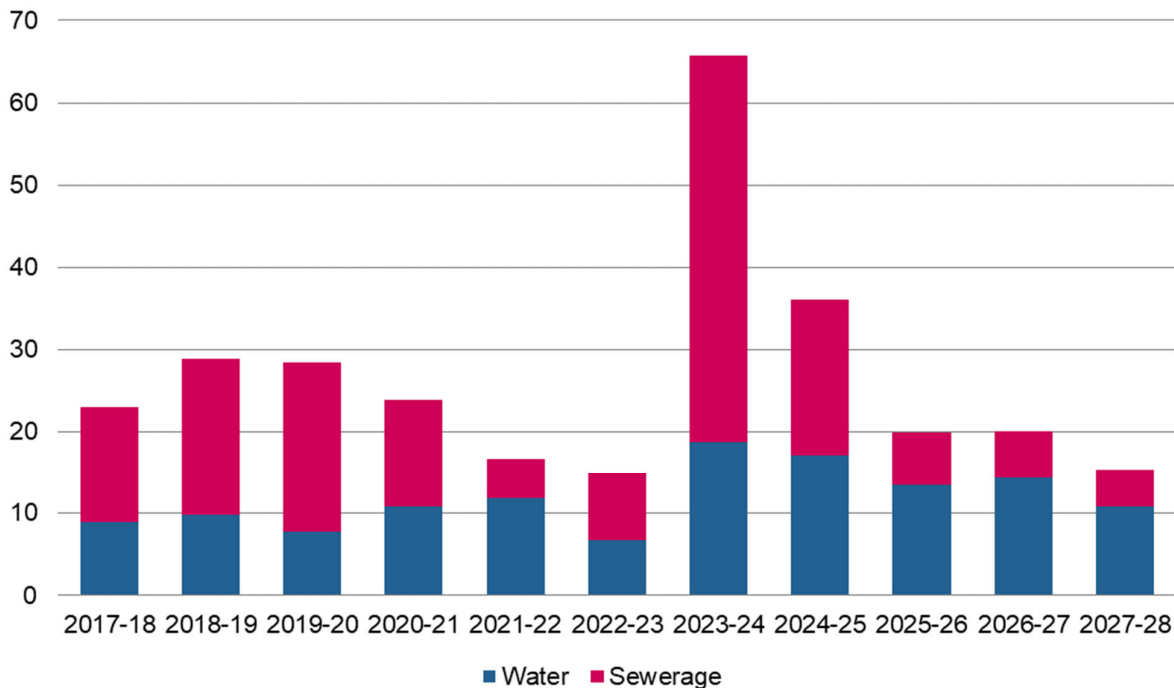
forecast bulk charges with GWMWater’s charges for the next regulatory period once our final decision is made for GWMWater’s 2023 price review. Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation and external bulk charges data.

4.2 Capital expenditure

Our draft decision is to adopt a forecast capital expenditure of \$143.0 million, which is \$14.2 million or 9 per cent lower than proposed by Wannon Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Wannon Water’s forecast capital expenditure and supporting information is provided at pages 42 to 51 of its price submission. Figure 4.2 shows Wannon Water’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 4.2 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.

Figure 4.2 Gross capital expenditure by service category
\$ million 2022-23



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

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure. FTI Consulting's report on its assessment of Wannon Water's expenditure forecast is available on our website.⁴²

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.

Wannon Water has incurred \$121.0 million in actual gross capital expenditure over the period from 2017-18 to 2021-22, \$46.6 million or 27.8 per cent lower than the benchmarks adopted at the 2018 price review. In net terms, it has incurred \$104.3 million in capital expenditure over the same period, 35.5 per cent lower than the 2018 price review benchmarks.

For 2022-23, Wannon Water provided an updated gross capital expenditure forecast of \$47 million, well above the benchmark of \$15.0 million approved for 2022-23 in our 2018 price review. This largely reflects delayed spending associated with the Warrnambool Sewage Treatment Plant Upgrade project. However, consistent with the requirements of our guidance, Wannon Water has only sought to include the benchmark allowance of \$15.0 million in its regulatory asset base forecast for 2022-23 (see Section 4.3.2).⁴³

As at September 2022, Wannon Water reported that, of the top 10 major projects proposed for the 2018–23 regulatory period, 3 have been completed, 6 are delayed (with 3 expected to be completed in 2022-23) and the remaining project is deferred to the next regulatory period.⁴⁴ In addition, 2 projects were carried over from the 2013–18 regulatory period and completed during 2018–23. Wannon Water provided explanations for the following delayed or deferred projects:

- Warrnambool Sewage Treatment Plant upgrade project is delayed due to difficulty obtaining the required pre-construction approvals and is now expected to be completed in 2024-25.
- Warrnambool water treatment plant – ultraviolet treatment installation is delayed by late delivery of required equipment caused by the impacts of the coronavirus pandemic, and is now expected to be completed in 2023-24.

⁴² FTI Consulting, *Wannon Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023.

⁴³ Wannon Water may seek to include a higher level of capital expenditure for this year at the end of the 2023–28 regulatory period, consistent with our guidance.

⁴⁴ Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021-22*, 18 October 2022, pp. 56–58. Wannon Water's major projects are reported by the business as part of our annual outcomes reporting process, as part of its commitment to communicate the delivery of its major projects to its customers. The business's comments are not audited by the commission. Wannon Water's price submission also included the status of its top 10 major capital projects, and this was consistent with its earlier reporting.

- Warrnambool–Wollaston Road Tower and water pump station is delayed, but was excluded from the capital expenditure allowance for 2018–23 due to a change in scope of the project, with delivery now expected to be staged over the next two regulatory periods.
- Substitution works to improve summer flows in the Gellibrand River are deferred pending the outcome of an application for external funding to ensure ‘value for money’ outcomes for customers.

Wannon Water has sought to explain the key drivers of the variations in its actual capital expenditure over the current regulatory period relative to its 2018 benchmark, noting in particular the delays relating to the Warrnambool Sewage Treatment Plant Upgrade works that were planned for delivery over 2019–21, and the impact of the coronavirus pandemic on contractor availability.

4.2.2 Forecast Capital Expenditure

Our draft decision is to adopt a forecast capital expenditure of 143.0 million, which is lower than the \$157.2 million forecast proposed by Wannon Water.

We have reviewed Wannon Water’s proposed forecast capital expenditure and our draft decision is to adopt a forecast capital expenditure of \$143.0 million, which is \$14.2 million (or 9 per cent) lower than proposed by Wannon Water (Table 4.5).

Table 4.5 Our proposed adjustments to Wannon Water’s proposed total forecast capital expenditure
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Wannon Water’s proposed total forecast capital expenditure	65.76	36.03	20.01	20.03	15.37	157.20
Adjustment – Great Tasting Water project	-4.28	-4.28	-2.48	-2.48	-0.68	-14.18
Draft decision – total forecast capital expenditure	61.48	31.76	17.54	17.55	14.69	143.02

Wannon Water’s proposed capital expenditure forecast for the 2023–28 period is similar to the benchmark of \$159.7 million approved for the current 2018–23 period (which was itself a significant increase on the previous period due to the Warrnambool Sewage Treatment Plant upgrade project).

The forecast capital expenditure remains impacted by the timing of the Warrnambool Sewage Treatment Plant upgrade project (forecast at \$52.9 million across the 2023–28 regulatory period, \$85.0 million total). This project was originally included in its 2018–23 price determination for

completion by 2021-22 at a forecast total cost of \$42.6 million, but construction commenced in December 2022 and is now expected to be completed in 2024-25.

Our expenditure consultant requested selected documents from Wannon Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, our consultant's workshop with the business, and Wannon Water's responses to further questions, our expenditure consultant found that Wannon Water has a robust approach for developing project scope, the timing of works and cost estimates, with the exception of the business's proposed Great Tasting Water project.⁴⁵

Wannon Water has proposed \$93.3 million of capital expenditure on its top 10 major projects in the next regulatory period. This is 59.3 per cent of proposed capital expenditure for the period, with most of this expenditure connected to the Warrnambool Sewage Treatment Plant upgrade (\$52.9 million) and the Great Tasting Water project (\$15.8 million). Our consultant reviewed information for both these projects, along with the Warrnambool Effluent Management strategy project (\$5.5 million). Our consultant recommended no adjustments to the Warrnambool Sewage Treatment Plant upgrade and the Warrnambool Effluent Management strategy projects, but has recommended the forecast expenditure for the Great Tasting Water project be excluded from total program forecast.⁴⁶

Wannon Water has proposed the Great Tasting Water project to improve the quality and taste of drinking water in the groundwater-supplied towns of Portland, Heywood and Port Fairy. It has stated it will seek government funding to deliver the full suite of work, but has committed to delivering improved water quality in at least one of these towns in the next regulatory period regardless of any external funding it receives. Given this project is only in the early stages of the design and development phase, our consultant considered there is a high level of uncertainty regarding the timing and delivery of the project in the next regulatory period. Our consultant noted:

- a significant amount of planning and development work is still required before the delivery stage of work may begin, including the assessment of land acquisition needs and subsequent purchases, and relevant regulatory assessments and approvals
- Wannon Water is yet to identify which town will be upgraded first, although it plans to have selected a town by mid-2023

⁴⁵ FTI Consulting, *Wannon Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 43-44.

⁴⁶ FTI Consulting, *Wannon Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 45-48.

- the need to secure specialist contractors to undertake this work poses a significant risk of delaying this project against the expenditure profile included in Wannon Water's 2023 price submission.⁴⁷

We accept the driver of this expenditure and consider the need for the project is well established and supported by customers. However, we have also taken into account the findings of our expenditure consultant, noted above. The project has not been developed sufficiently by Wannon Water for us to assess its prudence and efficiency. Further:

- Given the current early stage of development of this project, and the high level of uncertainty identified by our consultant, we do not consider the estimated full project costs should be funded through customer prices at this time. It is more appropriate to exclude this expenditure while the project undergoes further development works, including detailed design and obtaining the necessary approvals, and more certainty is established.
- Wannon Water's experience in the current period with its major project to upgrade the Warrnambool Sewage Treatment Plant highlights the risks in including project costs in prices too soon. Customer prices for the current period reflect completion of this project in 2021, but construction has only just commenced some 3 years behind schedule. We do not consider Wannon Water's customers should be expected to carry the risks of another large project with high uncertainty on the back of this.

Recognising the priority that customers have placed on the project, instead of adopting Wannon Water's forecasts for the project, our draft decision adopts an annual amount of \$1.6 million over the regulatory period (around 10 per cent of the gross capital expenditure forecast by Wannon Water), to enable the project to commence.

In its response to our draft decision, Wannon Water may accept this approach or propose an alternative to ensure the project proceeds in the 2023–28 regulatory period to meet customer expectations. For example, Wannon Water could propose to treat the project as an uncertain event and propose to reopen prices in the 2023–28 regulatory period once the project has been completed and services are provided to its customers, or propose to roll in the costs of the project (if completed in the current period) to its prices in the regulatory period from 2028-29.

Our expenditure consultant also reviewed Wannon Water's approach to forecasting its renewals program and considers it provides a reasonable approach to forecasting the timing and costing of renewals.

⁴⁷ FTI Consulting, *Wannon Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 45-48.

Overall, we agree with FTI Consulting's view, and we consider that for the purposes of our draft decision, the prudence and efficiency of the expenditure forecasts, with the exception of the Great Tasting Water project, has been justified consistent with our guidance.

Our preliminary view is that the planned capital expenditure program is achievable in the regulatory period for the following reasons:

- Wannon Water has a number of mechanisms to manage its capacity to deliver, including an ongoing agreement with engineering consultants for design and contract management services
- the Warrnambool Sewage Treatment Plant upgrade has passed all stages of approval with the construction contract awarded and construction commenced
- Wannon Water has allocated a dedicated project manager to oversee the delivery of the Warrnambool Sewage Treatment Plant upgrade
- there is a smaller total number of projects in the forecast capital program for the 2023–28 regulatory period, compared to the current regulatory period.

However, Wannon Water's delivery of its top 10 major projects in the current period currently includes the delay of 6 projects (including the Warrnambool Sewage Treatment Plant upgrade) and the deferral of 1 project.⁴⁸ While Wannon Water has indicated it will complete 3 of the delayed projects in 2022-23, we expect Wannon Water to manage its remaining major capital projects from the current period to ensure they are delivered alongside the forecast capital program, in line with the costs the business has already recouped from customers in the current regulatory period.

Wannon Water has not specifically identified any project costs it has excluded where there is uncertainty in timing, cost, scope and benefits of capital expenditure. For any additional capital expenditure above the benchmark allowance in the 2023–28 regulatory period that Wannon Water proposes to include in the regulatory asset base at the end of the regulatory period, it should note the following:

- Wannon Water will need to demonstrate the prudence and efficiency of these costs if seeking to include them in the regulatory asset base for the 2028–33 price review.
- Deviations from forecasted capital expenditure during the 2023–28 regulatory period will form a key part of our assessment of the Performance element of PREMO at the next price review.

We have reviewed Wannon Water's proposals and advice from FTI Consulting. We agree with our consultant's assessment and consider Wannon Water's approach to forecasting its capital

⁴⁸ Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021-22*, 18 October 2022, pp. 56–58.

expenditure is largely consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014.⁴⁹

For the reasons outlined above, our draft decision for total gross capital expenditure is to not accept Wannon Water's proposed benchmark. Our draft decision adopts a forecast capital expenditure benchmark of \$143.0 million over the 5-year period (Tables 4.5 and 4.7).

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

4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.⁵⁰ 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 Wannon Water to propose:

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

⁴⁹ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 32–37.

⁵⁰ These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

4.3.1 Closing regulatory asset base

Our draft decision is to adopt a closing regulatory asset base of \$400.4 million at 30 June 2022, which is \$0.3 million higher than proposed by Wannon Water.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.⁵¹ This helps to ensure prices reflect the actual net expenditure of a water business.⁵²

Wannon Water's proposed closing regulatory asset base at 30 June 2022 is provided at page 52 of its price submission.⁵³ We propose to make minor adjustments to Wannon Water's proposed closing regulatory asset base to reflect its approved regulatory accounts for 2021-22.⁵⁴ Our draft decision is to adopt a closing regulatory asset base for 30 June 2022 of \$400.4 million (Table 4.6).

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

As noted in Section 4.2.1, Wannon Water's net capital expenditure over the period from 2017-18 to 2021-22 was \$104.3 million. This is \$57.4 million or 35.5 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 is to accept this amount for the purpose of calculating Wannon Water's closing regulatory asset base at 30 June 2022 (Table 4.6).

⁵¹ See Section 4.2 for a discussion of Wannon Water's capital expenditure.

⁵² 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 business's water, sewerage or recycled water networks.

⁵³ Available at www.esc.vic.gov.au.

⁵⁴ Since Wannon Water lodged its price submission with us, we identified that its government contributions did not align with its approved regulatory accounts. Our draft decision proposes an adjustment to government contributions to reconcile with the regulatory accounts. This flows into the calculation of the closing regulatory asset base.

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	359.0	370.5	386.0	392.6	399.7
Plus gross capital expenditure	23.1	28.9	28.4	23.9	16.7
Less government contributions	0.0	0.9	6.6	2.5	0.1
Less customer contributions	0.4	0.8	2.5	1.2	1.6
Less proceeds from disposals	0.5	0.7	0.9	0.6	0.5
Less regulatory depreciation	10.6	11.1	11.7	12.5	13.8
Closing RAB 30 June	370.5	386.0	392.6	399.7	400.4

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

Our draft decision is to not accept Wannon Water’s proposed forecast regulatory asset base.

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

Reflecting our preliminary view on Wannon Water’s closing regulatory asset base (Section 4.3.1) and forecast capital expenditure (4.2.2), our draft decision is to not accept Wannon Water’s forecast regulatory asset base.

Consistent with the requirements of our guidance, Wannon Water proposed that the 2022-23 benchmark for capital expenditure adopted at the 2018 price review, be used to calculate its forecast regulatory asset base.

Table 4.7 sets out our draft decision on Wannon Water’s forecast regulatory asset base from 1 July 2023.⁵⁵ Our assessments of the other components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

- Section 4.2 (capital expenditure)
- Section 4.3.2.1 (customer contributions)
- Section 4.5 (regulatory depreciation).

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	400.4	399.6	447.4	464.7	466.7	467.8
Plus gross capital expenditure	14.9	61.5	31.8	17.5	17.6	14.7
Less government contributions	0.0	0.0	0.0	0.0	0.0	0.0
Less customer contributions	1.0	1.5	1.5	1.5	1.5	1.5
Less proceeds from disposals	0.6	0.6	0.6	0.6	0.6	0.6
Less regulatory depreciation	14.3	11.6	12.4	13.5	14.4	14.8
Closing RAB 30 June	399.6	447.4	464.7	466.7	467.8	465.6

Note: Numbers have been rounded.

4.3.2.1 Customer contributions

Our draft decision is to not accept Wannon Water’s forecasts for revenue from customer contributions.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.⁵⁶

⁵⁵ Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022–23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022 23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

⁵⁶ Revenue from new customer contributions reflects revenue earned from new connections made to the water business’s water, sewerage or recycled water networks.

New customer contributions are a key input to revenue from customer contributions. As our draft decision is to not accept Wannon Water’s new customer contributions, our draft decision is to also not accept Wannon Water’s forecasts for customer contributions.

Further, Wannon Water’s forecasts for customer contributions in the financial model and the new customer contributions model do not match (Section 5.4).

For the purposes of calculating the regulatory asset base and revenue requirement in our draft decision, we have used Wannon Water’s proposed customer contributions forecast based on its financial model.

Wannon Water must update its customer contribution forecasts in response to our draft decision and ensure that the forecast customer contributions in the financial model and new customer contributions model can be reconciled.

4.4 Rate of return

In establishing the return on assets component of Wannon Water’s revenue requirement, we have applied a rate of return to Wannon Water’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).

4.4.1 Cost of debt

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

Our guidance required Wannon Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Wannon Water 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 Wannon Water, noting that the cost of debt estimates will be updated following the release of the Australian Bureau of Statistics March Quarter 2023 consumer price index.

Table 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)	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75%	3.75% ^a

Note: Numbers have been rounded. ^a 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 accept Wannon Water’s proposed return on equity of 4.1 per cent.

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 Wannon Water’s PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water business’s self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business’s self-rating and our rating.⁵⁷ 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.⁵⁸

Wannon Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Wannon Water proposed a return on equity of 4.1 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.⁵⁹

As outlined in Chapter 7, our draft decision is to accept Wannon Water’s PREMO self-rating and adopt its proposed return on equity.

4.5 Regulatory depreciation

Our draft decision is to not accept Wannon Water’s forecast regulatory depreciation.

Regulatory depreciation is a component of Wannon Water’s revenue requirement and is also an input to calculating the regulatory asset base. Wannon Water’s forecast regulatory depreciation

⁵⁷ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42–43.

⁵⁸ 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 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.

⁵⁹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

was calculated using a straight-line depreciation profile.⁶⁰ Our guidance stated this is our preferred approach.⁶¹

While it calculated depreciation consistent with the requirements of our guidance, our draft decision is to not accept Wannon Water's forecast for regulatory depreciation, because our draft decision is to not accept its forecast regulatory asset base (Section 4.2.2).

Our draft decision on forecast regulatory depreciation is shown in Table 4.7 in Section 4.3.2.

4.6 Tax allowance

Our draft decision is to accept Wannon Water's proposed forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Wannon Water has proposed no tax allowance in its revenue requirement for the 2023–28 regulatory period. Wannon Water is not in a tax paying position over the forecast regulatory period.

Our draft decision is to accept Wannon Water's forecast as it was calculated consistently with the method required by our guidance.⁶²

⁶⁰ For the period from 2022-23 to 2027-28, Wannon Water proposed a regulatory depreciation of \$81.2 million.

⁶¹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

⁶² Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47–48.

5. Demand, tariffs and prices

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

5.1 Demand

Our draft decision is to accept Wannon Water's demand forecasts.

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

Wannon Water's demand forecasts are set out at pages 55 to 56 of its price submission and are also included in its financial model.

Our draft decision is to accept Wannon Water's demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance. However, since lodgement of its price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses.

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

5.2 Form of price control

Our draft decision is to accept Wannon Water's proposed price cap form of price control.

Our guidance indicated we would have particular regard to whether a business proposed to continue its existing form of price control or introduce a new form of price control.⁶³

Wannon Water proposed a price cap form of price control. 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.

⁶³ Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

Our draft decision is to accept Wannon Water's proposed form of price control because:

- it is the same as its current approach, which we have previously approved
- it provides sufficient revenue to cover the forecast efficient costs of providing services and for Wannon Water to deliver on any health, safety and environmental obligations
- it provides Wannon Water's customers with price certainty
- it is easy to explain to customers
- it is easy to verify that proposed prices comply with the determination requirements
- demand risk is more efficiently managed by Wannon Water than by its customers
- it is otherwise consistent with the requirements of our guidance.

5.3 Tariff structures and prices

Our draft decision is to accept Wannon Water's proposed tariff structures.

Wannon Water's proposed tariffs are set out at pages 59 to 61 of its price submission.

Our draft decision does not approve prices for each tariff. Prices will need to be updated by Wannon Water 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 businesses with a large degree of discretion to decide on individual tariff structures.⁶⁴ This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Wannon Water generally proposed to maintain its existing tariff structures, with a change to the mix of fixed and variable charges for its residential water service. For residential and non-residential water services, it proposed a two-part tariff with a fixed service charge and a variable usage component that depends on water use. For residential sewerage services, Wannon Water proposed a fixed service charge only. For non-residential sewerage services, Wannon Water proposed a two-part tariff with a fixed service charge and a variable usage component.

Wannon Water proposed to increase the variable charge and reduce the fixed charge of its residential water charge. In its submission, the Consumer Action Law Centre raised concerns that

⁶⁴ Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

the proposal will disproportionately affect renters.⁶⁵ The Consumer Action Law Centre noted that renters are less able to respond to pricing signals associated with variable charges, which can lead to payment difficulty. However, the Concerned Waterways Alliance considered increasing the variable charge will encourage water conservation and demand-reduction.⁶⁶ We received an anonymous submission (covering all businesses in our review) that recommended changing the proportion of fixed to variable charges to give customers more power to influence their bills.⁶⁷

During our review of its engagement materials, we saw evidence that Wannon Water had a strong understanding of the impact its rebalancing of tariffs may have on renters. It has sought to address the impact by proposing moving incrementally towards a higher variable portion of charges, and introducing overall price increases slowly over the 5 years of the regulatory period. Section 5.3.3 outlines other assistance that will be available to tenants under Wannon Water's proposal.

We reviewed the composition of Wannon Water's deliberative forum and the materials provided to it and found that Wannon Water's proposal aligns with customer preferences and takes into account the interests of affected customers. Its engagement on this issue is outlined in Section 3.1.

We also note that even though Wannon Water has proposed to increase the variable charge, bills for Wannon Water's residential customers will continue to have a relatively high proportion of fixed charges compared to variable charges, reflecting a large non-permanent population.

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

Our preliminary view is that the two-part tariff structure proposed by Wannon Water 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.⁶⁸ We also consider two-part tariff structures are easy to understand.

For sewerage services, we consider Wannon Water's proposed fixed charge for residential customers is easy to understand. A two-part tariff for non-residential customers sends these customers signals about efficient costs.⁶⁹

⁶⁵ Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 5

⁶⁶ Concerned Waterways Alliance, Initial Feedback: 2023-28 Water Price Review, 1 December 2022, p. 5

⁶⁷ Anonymous, Initial Feedback: 2023-28 Water Price Review, 7 October 2022, p. 1

⁶⁸ 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.

⁶⁹ Our reasons are outlined in our 2013 draft decisions on price review 2013-14 to 2017-18.

For recycled water, we consider Wannon Water's proposal is in accordance with the pricing principles in our guidance and promotes cost reflectivity of tariffs.

5.3.2 Prices

The prices proposed by Wannon Water for water and sewerage services are set out on pages 59 to 61 and 72 to 75 of its price submission.

Under Wannon Water's proposal, generally prices (excluding inflation) will be higher:

- Residential water and sewerage bills for a typical owner-occupier household will increase by 0.8 per cent more than inflation in each of the first 2 years and then by 0.9 per cent more than inflation each year in the remaining 3 years of the 2023–28 regulatory period.
- Prices for water services will decrease by 1.2 per cent each year (before inflation), while water usage charges will increase by 2.1 per cent more than inflation each year.
- Prices for sewerage services will increase by 1 per cent more than inflation each year of the 2023–28 regulatory period. Major trade waste volume charges will increase by 2 per cent more than inflation each year while minor trade waste volume charges will remain stable (before inflation).
- Prices for recycled water charges, fire services and miscellaneous charges will remain stable (before inflation) over the 2023–28 regulatory period.

The Consumer Action Law Centre raised concerns in relation to Wannon Water's increasing price path.⁷⁰ As noted below, Wannon Water will need to update its prices in response to our draft decision on its revenue requirement.

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

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall through 2023 and 2024.⁷¹ For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.

⁷⁰ Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, Essential Services Commission, 30 November 2022.

⁷¹ The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) to around 4.8 per cent by December 2023 and to 3.2 per cent by December 2024.

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to the opening base costs for water businesses in the 2023–28 regulatory period. Accordingly, it may be the case that the inflation that is added to prices in 2023-24 provides an uplift in revenue that is well above a business’s actual costs for the year. Considering this, Wannon Water’s proposal for increasing prices in real terms over the 2023–28 regulatory period, and the priority placed by customers on affordability, we are seeking further information from Wannon Water in response to our draft decision on how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.⁷²

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

Wannon Water’s prices will also be affected by our draft decision on the revenue requirement, which is outlined in Chapter 4. In response to our draft decision, Wannon Water will need to propose updated prices that reflect our draft decision and any updates to its revenue requirement.

Wannon Water must also update its proposal to exclude costs in relation to the Warrnambool Sewage Treatment Plant, until the upgrade works are completed and operational. Wannon Water’s prices across 2018–23 included revenue to recover costs associated with completion of this major upgrade project by 2021, namely the financing costs for \$42.6 million of capital investment, and \$1.0 million of additional operating costs from 2021-22. However, given construction of this project only commenced in late 2022, customers have effectively been paying for the project ahead of its delivery.

Given this, our preliminary view is that Wannon Water’s customers should not pay any more towards this project until construction is completed. Accordingly, in its response to our draft decision, Wannon Water’s proposed updated price path should exclude all costs associated with this project until it is operational, currently anticipated in 2025.

Wannon Water’s prices will also be affected by our draft decision on the revenue requirement, which is outlined in Chapter 4. In response to our draft decision, Wannon Water will need to propose updated prices that reflect our draft decision and any updates to its revenue requirement.

⁷² This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission must have regard to specified pricing principles, including that the manner in which a regulated entity’s prices are to be calculated, determined or otherwise regulated, should provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether Wannon Water's prices take into account the interests of customers, including low income and vulnerable customers.⁷³

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

- giving price certainty to customers over the regulatory period through a price cap
- under-recovering its revenue requirement by \$23 million and increasing its debt to minimise the anticipated cost of living pressures during the 2023–28 regulatory period
- improving access to its financial support programs by investing \$500,000 over the 5 years of the regulatory period to ensure proactive identification of vulnerable customers and improved communication and outreach programs
- providing an additional \$200,000 in financial support over the regulatory period for customers finding it difficult to pay their bills.

As noted in Section 3.1, Wannon Water's price submission was informed by engagement that was inclusive of customers experiencing vulnerability. Wannon Water was also the only water business to conduct a gender impact assessment as part of its price submission.

5.3.4 Unique services

For trade waste and miscellaneous services, our draft decision is that we consider Wannon Water's proposal is in accordance with the pricing principles in our guidance and promotes cost reflectivity of tariffs.

5.4 New customer contributions

Our draft decision is to not accept Wannon Water's proposed standard new customer contributions.

Our draft decision is to accept Wannon Water's proposed negotiated new customer contribution framework.

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

⁷³ Water Industry Regulatory Order 2014 clause 11(d)(iii).

allow water businesses and developers to negotiate a site-specific arrangement and manage unforeseen connection demands.

Wannon Water's proposed new customer contributions are set out at page 61 of its price submission. Wannon Water has proposed to keep its new customer contributions flat in real terms from 2022-23 to 2027-28.⁷⁴

We have reviewed Wannon Water's proposed standard new customer contributions for the Warrnambool growth areas and compared them to the charges calculated in its new customer contribution pricing model. Wannon Water did not use the modelled new customer contributions to set the proposed new customer contributions. Instead, it proposed to adopt its 2022-23 new customer contributions across the 2023–28 regulatory period in real terms. We do not consider the proposed charges are cost reflective (our reasons are outlined further below).

Wannon Water's proposal is based on developers' feedback in 2017-18, which supported stability in new customer contributions.⁷⁵ Wannon Water has indicated that it has not undertaken any specific engagement with developers on its proposed new customer contributions, or with water and sewerage customers about the cross-subsidy to new developments, as the total of its water and sewerage new customer contributions is similar to current levels.⁷⁶ Wannon Water noted that its systems are varied and spread over a large geographic area. It considers customers should receive a similar level of service for a similar price regardless of their location. Wannon Water did not estimate the impact on other customers of the cross-subsidy to new developments but considered it to be minor given low customer growth in its service area.⁷⁷ The submission we received from the Consumer Action Law Centre advocated for the commission to more closely scrutinise those price submissions that did not address decreasing cross subsidies. The Consumer Action Law Centre wants to see all users, particularly builders and developers, paying the full costs of their water use.⁷⁸

The commission considers that the broader customer base should not contribute to shortfalls in revenue arising from a proposal to set new customer contributions below estimated costs.

For the following reasons, we consider that Wannon Water's modelled standard new customer contributions should be updated:

⁷⁴ Wannon Water, Response to request for information, 1 February 2023.

⁷⁵ Wannon Water, Response to request for information, 12 December 2022.

⁷⁶ Wannon Water, Response to request for information, 12 December 2022 and 1 February 2023.

⁷⁷ Wannon Water, Response to request for information, 1 February 2023.

⁷⁸ Consumer Action Law Centre, Initial Feedback: 2023–28 Water Price Review, 30 November 2022, p. 5.

- It has indicated it has evidence from developers that the estimated costs in the model are materially lower than current costs.⁷⁹
- The new customer contributions model submitted for the 2023 price review was completed ahead of the finalisation of Wannon Water’s financial model. This resulted in discrepancies on the parameters used between the two models, including growth capital expenditure, customer contributions and assumptions on inflation, tax and the discount rate.
- The Warrnambool roof water harvesting area new contribution charge introduced in 2013 is based on the Warrnambool growth area new customer contribution less a discount of \$2,200. This amount was calculated to reflect the benefit of the Warrnambool roof water harvesting area when this new customer contribution was introduced on 1 July 2013. It is not clear whether that level of discount is still appropriate or required for the 2023–28 regulatory period.⁸⁰
- The new customer contributions for ‘All other areas’ are a continuation of the initial \$800 set in 2013 and have been escalated by the consumer price index since then and not re-tested.

In addition, in the Warrnambool growth area, developers paying only the wastewater new customer contribution are cross subsidising developers paying only the water new customer contribution.⁸¹

In response to our draft decision, Wannon Water must:

- update its modelled new customer contributions for each area and ensure the parameters used are consistent with the financial model (including inflation, tax and regulatory rate of return) and must include all the formulae used
- demonstrate that the growth capital expenditure and new customer contributions revenue included in the new customer contributions model and the regulatory asset base can be reconciled
- provide its cost modelling for the Warrnambool roof water harvesting area to demonstrate that the \$2,200 discount is still appropriate or required
- provide an updated new customer contributions model for ‘All other areas’ to demonstrate that the \$800 new customer contribution is still cost reflective
- submit its transition plan towards the application of cost reflective new customer contributions

⁷⁹ Wannon Water, Response to request for information, 12 December 2022 and 1 February 2023.

⁸⁰ Wannon Water, Response to request for information, 12 December 2022 and 1 February 2023.

⁸¹ The modelled new customer contributions for wastewater services show a negative new customer contribution. This is due to revenue received from new customers being greater than the average cost associated with servicing new customers. Despite the negative modelled new customer contributions, Wannon Water proposed wastewater new customer contributions of \$990 for the 2023–28 regulatory period. This approach has been in place since 2013. This cross subsidy may be immaterial if all developers are choosing to connect to both water and wastewater services.

- set out how it proposes to fund any shortfall in revenue from new customer contributions, compared to the estimated costs of providing the service.

We would like feedback from developers and customers on the proposed new customer contributions charges.

We consider Wannon Water's proposed negotiated new customer contribution contracts comply with the requirements of our new customer contribution pricing principles.⁸² Therefore, our draft decision is to accept Wannon Water's proposed negotiated new customer contribution framework.

5.5 Adjusting prices

Our draft decision is to accept Wannon Water's proposed continuation of its uncertain and unforeseen events mechanism.

Our draft decision is to not accept Wannon Water's proposed adjustment mechanism relating to the cost of debt.

Wannon Water's proposed price adjustment mechanisms are set out on pages 57 and 58 of its price submission. It proposed a continuation of its existing uncertain and unforeseen events mechanism. Our draft decision is to accept Wannon Water's proposal to continue the existing uncertain and unforeseen events mechanism as it reflects a continuation of current arrangements.

Wannon Water currently adjusts its prices annually based on changes in the annual benchmark cost of debt, but it proposes not to apply this mechanism over the 2023–28 period to avoid revenue loss.⁸³ This reflects its proposal to charge below its estimated revenue requirement.

Our preliminary view is that we agree with the intent of Wannon Water's proposal to ensure an adjustment factor does not apply where it is already charging below its revenue requirement.

However, the future path of the cost of debt is uncertain. Accordingly, in response to our draft decision, we require Wannon Water to propose an adjustment mechanism that will enable its prices to adjust downward where they would otherwise exceed the revenue requirement in a particular year. This adjustment should limit downward movements to match the revenue requirement.

⁸² Essential Services Commission, 2023 water price review: Guidance paper, p. 59.

⁸³ Essential Services Commission 2018, Wannon Water Determination: 1 July 2018 – 30 June 2023, 19 June 2018, p. 32

6. Financial position

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

In approving prices, we must have regard to the financial viability of the water industry.⁸⁴ We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the *Water Industry Regulatory Order (2014)* to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

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

⁸⁴ WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

7. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water business’s revenue requirement to that business’s level of ambition expressed in its price submission. Our guidance required Wannon Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.⁸⁵ We required Wannon Water to self-rate its price submission as either ‘Leading’, ‘Advanced’, ‘Standard’ or ‘Basic’, with ‘Leading’ being the most ambitious and ‘Basic’ the least.

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

We also assessed and rated Wannon Water’s price submission. As outlined in our guidance, the combination of Wannon Water’s self-rating and our rating has determined the return on equity we have adopted to calculate Wannon Water’s revenue requirement in our draft decision.

7.1 Our PREMO assessment of Wannon Water’s price submission

Our draft decision is to rate Wannon Water’s price submission as ‘Standard’ under PREMO, which is the same as Wannon Water’s self-rating.

Wannon Water’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 Wannon Water’s price submission.

Table 7.1 PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Wannon Water’s self-rating	Standard	Standard	Standard	Leading	Standard	Standard
Commission’s rating	Standard	Basic	Standard	Leading	Basic	Standard

⁸⁵ 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.

Our preliminary view is that Wannon Water's price submission should be rated as 'Standard', which is the same as its self-rating. This is reflected in the return on equity we propose to approve for Wannon Water (see Section 4.4.2).

We have formed this view after reviewing Wannon Water's proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

7.1.1 Performance

For the 2023 price review, a business's rating for the Performance element of PREMO is based on a combination of its overall PREMO rating at its most recent price review, and its level of performance based on achievement of outcomes (related to service targets and performance against expenditure benchmarks set at the previous price review) and customer sentiment.⁸⁶

As noted in Section 3.2.1, we consider Wannon Water has, overall, met its outcome commitments for the period to date. But, as also noted in Section 3.2.1, it failed to meet its 'value for money' customer satisfaction targets for the period.

In terms of customer perceptions, Wannon Water's results on the commission's survey of customer sentiment – covering measures of overall satisfaction, value for money, trust, and reputation in the community – generally improved over the regulatory period. Comparing its scores across the four measures, it tended to rate highest for overall satisfaction, and lowest for value for money. In the commission's most recent survey (January 2023), it generally ranked within the middle group of urban water businesses across the four measures.⁸⁷

Wannon Water's controllable operating costs during the current regulatory period are forecast to be higher than the benchmark established at the 2018 price review.

For 2021-22, its controllable operating expenditure was around 17 per cent higher than the benchmark adopted at the 2018 price review, after accounting for the inclusion of operating costs for the Warrnambool Sewage Treatment Plant upgrade in the 2018 benchmark (noting the upgrade was delayed). This spend above the benchmark is higher than the average across all water businesses (around 9 per cent). While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to closely manage and reprioritise costs having regard to the price review benchmarks.

⁸⁶ As set out in Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, pp. 74-75. Guiding questions are set out on page 45.

⁸⁷ The commission's customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

Wannon Water's gross capital expenditure over the period from 2017-18 to 2021-22 was around \$46.6 million (27.8 per cent) lower than the benchmarks adopted at the 2018 water price review (and \$57.4 million or 35.5 per cent lower in net terms).

The key contributor to the lower than forecast capital expenditure was a delay in the delivery of Wannon Water's key capital project for the current regulatory period – the Warrnambool Sewage Treatment Plant upgrade. The costs (associated with financing the capital investment) were reflected in customer prices from 2021-22. However, due to difficulty obtaining pre-construction approvals, it is now expected to be completed in 2024-25.

While Wannon Water generally delivered on its outcome commitments, as noted above its 2021-22 controllable operating costs were well above the benchmark established at the 2018 price review. Further, the delays to its key capital project – the Warrnambool Sewage Treatment Plant – were not reflected by Wannon Water in customer prices in the current regulatory period (essentially customers paid more than they needed to).

Other businesses made adjustments to their prices in the current regulatory period where projects were not delivered according to schedule (for example, GWMWater) or returned (or committed to return) funds to customers for not meeting service targets (for example, Yarra Valley Water and Barwon Water).

We consider these factors outweighed its performance on delivering on its outcome commitments and customer perception survey results. As a result, our preliminary view is that Wannon Water did not meet its overall performance expectations during the 2018–23 regulatory period and our draft decision proposes a rating of 'Basic' for the Performance element of PREMO.

7.1.2 Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don't pay more than they need to), and the business's proposed guaranteed service level scheme (including that it provides incentives for the business to deliver valued services efficiently).⁸⁸

In support of its self-rating of 'Standard' for the Risk element of PREMO, Wannon Water's price submission provided an overview of key risks and how it proposed they would be managed and allocated during the 2023–28 regulatory period. Key factors supporting its self-rating of 'Standard' for the Risk element of PREMO include:

- its proposal to continue to use a price cap form of price control, providing price certainty for customers and accepting demand risk on behalf of customers

⁸⁸ Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, p. 45.

- proposing to increase the variable proportion of customer bills, adding to the demand risk accepted by the business
- charging prices below its proposed revenue requirement
- the alignment of its risk framework with ISO 55000
- adopting a ‘mid-point’ forecast for energy costs.

Our draft decision is to accept Wannon Water’s self-rating of its price submission as ‘Standard’ for Risk.

7.1.3 Engagement

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations peoples and those experiencing vulnerability.⁸⁹

Our draft decision is to accept Wannon Water’s self-rating of ‘Leading’ for the Engagement element of PREMO on the basis of the overall quality of its engagement program and the level of influence it afforded its stakeholders.

Wannon Water showed strong commitment to a high level of collaboration, including through its regional advisory forum, which exercised a high level of influence through its role in defining the scope and purpose of engagement in Wannon Water’s annual engagement cycles. The level of influence of the deliberative panel on the final set of outcomes, and the strong endorsement by both groups of the final set of proposals in the price submission demonstrates high quality engagement.

Wannon Water engaged widely and deeply on the issues affecting customers experiencing vulnerability, as evidenced through the number of contacts it had with community support organisations, as well as its deeper exploration on the issues of price increases and tariff adjustment in its deliberative forum. We particularly note the quality of the information presented to members of its deliberative panel to support them in their decision making on issues that can have greater impact on low income customers and customers experiencing vulnerability. The result of the engagement was a set of proposals that demonstrate it clearly understood and addressed the impact of the tariff and price increases on its customers experiencing vulnerability.

⁸⁹ Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, p. 45.

7.1.4 Management

The Management element of PREMO is assessed against guiding questions that cover matters such as the efficiency of proposed expenditure and prices, the quality of the business's submission and supporting information to justify proposals, and evidence that there is senior-level ownership and commitment to the proposals contained in the submission.⁹⁰

We consider Wannon Water's price submission was generally well presented, and its financial model contained no substantive errors and was consistent with its written submission. The Wannon Water Board has also attested to the accuracy of the information contained in its submission, as required by our guidance.

In terms of expenditure, Wannon Water proposed an efficiency improvement rate for controllable operating expenditure over the next regulatory period of 1 per cent per annum. This compared to the average of all businesses in the current price review of around 1.3 per cent, and the 1.4 per cent identified in our guidance as an example of a 'Standard' price submission. However, given Wannon Water's forecast operating expenditure growth rate is only 0.7 per cent per year, we consider an efficiency improvement rate of 1.0 per cent is reasonable.

As noted in Section 4.1.1, our preliminary view is that Wannon Water has not sufficiently justified the reasons for the increase in its controllable operating costs for 2021-22 relative to the benchmark adopted at the 2018 price review. Justification of the additional amounts above the benchmark is important as it sets the baseline for assessment of future operating expenditure.

Further, and consistent with our draft decision on its forecast operating and capital expenditure, our preliminary view is that Wannon Water, in its price submission, did not sufficiently justify elements of its forecasts for prudent and efficient expenditure, as required by our guidance.

Given these factors noted above, our draft decision is to not accept Wannon Water's self-rating of its price submission as 'Standard' for Management, and instead adopt a rating of 'Basic'.

7.1.5 Outcomes

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

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.⁹¹

⁹⁰ Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, p. 45.

⁹¹ Essential Services Commission 2021, *2023 Water Price Review: Guidance Paper*, p. 45.

As noted in Section 3.2, our preliminary view is that Wannon Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by customers. As part of its engagement program for its price submission, its customers provided feedback on six key themes which were used to inform its 2023–28 outcome commitments. As part of its deliberative panel process in April 2022, it designed and tested its final outcomes and measures, resulting in the panel’s endorsement.⁹²

Further, Wannon Water’s proposed targets for its outcome measures suggest an overall improvement in customer value.

Wannon Water has also committed to reporting annually to its customers on how it has performed against its outcome commitments and will review targets where it proposes an increase in service and value as part of its annual engagement program. It will also establish an annual forum with representatives from its diverse customer groups to discuss new or unexpected issues.⁹³ We consider this provides a good level of accountability for performance.

Accordingly, our draft decision is to accept Wannon Water’s self-rating of its price submission as ‘Standard’ for the Outcomes element of PREMO.

7.1.6 Summary

Our draft decision agrees with Wannon Water’s overall self-rating of ‘Standard’ for PREMO. Our draft decision is influenced by our preliminary view that we agree with Wannon Water’s self-rating of ‘Leading’ for Engagement and, as noted in the commission’s guidance, all PREMO elements are to be taken into account in considering the overall rating.

Although we consider Wannon Water’s Engagement was strong, and Wannon Water proposed a number of elements that seek to support customer value (such as proposing to charge below its forecast revenue requirement), the PREMO framework is built on a sharp focus on efficiency, sound justification by water businesses for proposed forecast expenditure and prices, and accountability for performance.

The Water Industry Regulatory Order requires that the commission, in seeking to achieve the objectives specified in section 8 of the Essential Services Commission Act 2001 and the Water Industry Act 1994, must have regard to and place particular emphasis on a range of matters related to efficiency.⁹⁴ Further, our guidance requires a water business to justify that its forecast costs reflect prudent and efficient expenditure.

⁹² Wannon Water, 2023 water price submission, September 2022, p. 24

⁹³ Wannon Water, 2023 water price submission, September 2022, pp. 24 and 32.

⁹⁴ Clause 8(b) of the Water Industry Regulatory Order 2014.

As noted above, our preliminary review is that Wannon Water has not sufficiently justified the reasons for the increase in its controllable operating costs for 2021-22 relative to the benchmark adopted at the 2018 price review, and because of that we have not been able to establish an efficient baseline.

Our preliminary review of Wannon Water's forecast expenditure proposes a number of adjustments to its forecast expenditure, as noted above, in part due to lack of justification by Wannon Water.

We expect Wannon Water in its response to our draft decision, to provide sufficient justification to demonstrate its forecast expenditure is prudent and efficient, and will deliver the outcomes expected by its customers and to meet regulatory and policy obligations.

Wannon Water's response to the matters raised in our draft decision will inform our final view on its PREMO price submission rating.

Appendix A — Submissions received

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

Appendix B — Commission’s consideration of legal requirements

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

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.⁹⁵ 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 Wannon Water’s compliance with our guidance, in reaching our preliminary view.

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

Economic efficiency and viability matters

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

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

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

- Our consideration of customer engagement (Section 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).

⁹⁵ 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 Wannon Water has demonstrated its proposed outcomes reflect customer service priorities, and whether its tariffs and forecast costs reflect efficient levels of expenditure.

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

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

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

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

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

- Our consideration of customer engagement (Section 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 Wannon Water to recover borrowing costs associated with its investment in services, and generate a return on assets.⁹⁶

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

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

We have had regard to this matter in 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 Wannon Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

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

- Our consideration of customer engagement (Section 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).

⁹⁶ 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 business to propose outcomes, tariff structures and expenditure that reflect its particular circumstances. We consider that taking into account the particular circumstances of each water business is consistent with taking into account the particular circumstances of the water industry.

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

- Our consideration of customer engagement (Section 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 draft decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Wannon Water to deliver services that are covered by the prescribed services listed in the WIRO.

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

Our draft decision provides for Wannon Water 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 Australia⁹⁷
- operating and capital expenditure costs per connection throughout Australia⁹⁸
- tariff structures applied by water businesses throughout Australia⁹⁹
- the regulatory rate of return set by other regulators.¹⁰⁰

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

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

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

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

- Our consideration of customer engagement (Section 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 Wannon Water’s proposals, including through submissions and public meetings.

⁹⁷ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

⁹⁸ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

⁹⁹ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

¹⁰⁰ 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 Wannon Water's prices 'enable customers or potential customers of the regulated entity to easily understand prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated'.

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

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

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

- Our consideration of tariffs and the form of price control (Section 5.2 and Section 5.3).

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

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

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

- Our consideration of customer engagement (Section 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 Wannon Water's prices 'take into account the interests of customers of the regulated entity, including low income and vulnerable customers'.

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

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

- Our consideration of customer engagement (Section 3.1).

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- 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 Wannon Water to deliver the outcomes valued by customers, and on its legal and regulatory obligations.

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

- Our assessment of the revenue requirement (Chapter 4).
- 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 Wannon Water to deliver the outcomes valued by customers, and on its health, safety, environmental sustainability and social obligations.

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

- Our assessment of the revenue requirement (Chapter 4).
- 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, Wannon Water does not face any competition in the delivery of its prescribed services within its region. Our draft decision takes this into account through our consideration of forecast efficient costs, and considering the service priorities of customers as revealed through a business’s customer engagement.

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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 businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.¹⁰¹

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.¹⁰²

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

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

- uses the building block method to estimate a water business’s revenue requirement
- allows water businesses to implement various forms of price control, including price caps and revenue caps

¹⁰¹ Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

¹⁰² 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 businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.¹⁰³

¹⁰³ Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.