



# Westernport Water draft decision

2023 Water Price Review

20 December 2022



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## Summary

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

This draft decision sets out our preliminary views on Westernport Water’s price submission.<sup>1</sup> Our draft decision should be read together with Westernport 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 May 2023. For details of how to provide feedback, see our dedicated Engage Victoria page: <https://engage.vic.gov.au/water-price-review-2023>.

### **We have released an early draft decision for Westernport Water**

Westernport Water’s price submission provided clear and comprehensive information supporting its proposals. It also provided evidence that its engagement revealed the main priorities and concerns of customers, and that it has taken this feedback into account. This enabled us to quickly assess its price submission against the legal framework.

While we intend to explore some (confined) areas further in the lead up to our final decision, we consider these do not involve matters that materially impact on customer prices or outcomes.

For these reasons, we are releasing this draft decision earlier than for most other water businesses. We have also released an early draft decision for Yarra Valley Water. We will release draft decisions for the remaining water businesses by the end of March 2023.

### **Westernport Water has committed to improving customer outcomes, with a focus on water quality and the environment**

Westernport Water plans to deliver the following outcomes for customers:

- Provide high-quality drinking water
- Reduce its environmental impact and adapt to climate change
- Resolve sewer blockages quickly

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

- Keep water interruptions to a minimum
- Be there when needed
- Keep essential services affordable.<sup>2</sup>

Our assessment of Westernport Water’s proposed targets for these outcomes suggests the business will improve its customer service levels (Section 3.2). Consistent with the findings from its engagement, a key focus of service improvements will be investing in water quality improvements, reducing its carbon emissions, and generally responding to growth in its region.

A customer panel will be appointed by Westernport Water each year to provide commentary on its performance against its outcome commitments. If outcome targets are missed over consecutive years, Westernport Water has committed to providing a corrective action plan to explain to its customers how performance will improve. Additionally, it has committed to returning funds to the community if targets are not met.

### **Westernport Water’s proposal means annual water and sewerage bills will rise slightly in 2023-24 (excluding inflation)**

Subject to any changes impacting the revenue requirement following our draft decision, based on Westernport Water’s price submission, the typical annual water and sewerage bill for a residential owner-occupier will rise from \$1,227 currently, to \$1,230 in 2023-24, and then remain steady to 2027-28 (Table A). These estimates exclude inflation (they are in \$2022-23 terms). Bills for household tenants will rise from \$186 in 2022-23 to \$193 in 2023-24, remaining steady to 2027-28.

Estimated annual water and sewerage bills for non-residential customers are also shown below.

Estimated bills are likely to change following our draft decision, to reflect our updates for inflation and the cost of debt. There are some confined areas (noted below) for further exploration that may also impact Westernport Water’s revenue requirement and prices approved in our final decision and determination, which could impact estimated customer bills.

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<sup>2</sup> Westernport Water, 2023–28 Water Price Submission, September 2022, p. 5.

**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	88	\$1,227	\$1,230	\$1,230
Residential – tenant	88	\$186	\$193	\$193
Non-residential (small)	500	\$2,096	\$2,134	\$2,134
Non-residential (medium)	651	\$2,415	\$2,465	\$2,465
Non-residential (large)	1,200	\$3,574	\$3,668	\$3,668

## **Our draft decision approves a revenue requirement that will enable Westernport Water to deliver on its proposed outcomes**

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

Our draft decision is to approve a revenue requirement of \$137.7 million for Westernport Water over the 5-year period starting 1 July 2023 (Chapter 4).<sup>3</sup> This reflects our view of efficient costs.

We note that in response to our draft decision, Westernport Water must update its regulatory asset base to be consistent with the outcomes of our regulatory accounts review for 2021-22, which verifies key historical revenue and expenditure items. This may impact its revenue requirement (noting any impact is likely to be small, in the order of \$0.2 million over the regulatory period).

As well, we note our draft decision is to accept Westernport Water’s proposed new customer contributions, subject to the findings of our complete review of all the businesses proposing to use the average incremental cost model to calculate charges (Section 5.4). For the purpose of our draft decision however, we have adopted Westernport Water’s proposed forecast for revenue from customer contributions (Section 4.3.2.1).

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

For water services, Westernport Water proposed a fixed service charge and a variable component that depends on water use. For residential sewerage services, Westernport Water proposed a

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

fixed charge only. For non-residential sewerage services, Westernport Water proposed a two-part tariff with a fixed service charge and a variable usage component.

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

Our draft decision is to approve these tariff structures, on the basis that they are generally a continuation of Westernport Water's current approach and meet the criteria in our guidance. Our review of Westernport Water's proposed tariff structures is set out in Section 5.3.1.

Our draft decision is to accept Westernport Water's proposed price cap form of price control. This means its maximum prices for the regulatory period are fixed subject to updates for inflation and cost of debt, and any other price adjustments we approve in our price determination. Westernport Water currently uses a price cap.

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

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

Key factors supporting this PREMO rating include:

- a relatively high operating cost efficiency target
- relatively strong outcomes on the commission's customer perception survey
- alignment of customer views on service priorities and improvements, with its proposed outcomes commitments and targets
- its commitment to return funds to the community where service targets are not met
- the introduction of an independent process to review its performance against outcome commitments
- the overall strength of the justification for the prudence and efficiency of its forecast expenditure.
- a relatively good track record of delivering its major projects in the current regulatory period compared to other businesses.

It also provided a price submission and supporting model that were generally of a high quality.

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. It is not an assessment of the water business itself.

**Table B**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Westernport Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's rating	Standard	Standard	Standard	Standard	Standard	Standard

## 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 May 2023.

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

- the information we have relied upon in our assessment (such as Westernport Water's price submission)
- additional matters or issues we should consider before making our final decision
- whether our draft decision on Westernport 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 to inform our final decision and price determination for Westernport Water.

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

Topic	Specific issue	Draft report reference
Guaranteed service levels	Westernport Water's proposed guaranteed service levels and rebates.	Section 3.3
New customer contributions	Westernport Water's proposed new customer contributions tariffs.	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 in late February 2023. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

### Provide written comments or submissions

Written comments or submissions in response to this draft decision are due by 10 March 2023.

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

We would prefer to receive comments and submissions via the dedicated Engage Victoria website.

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

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

### Submission and privacy statement

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

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

## Next steps

Activity	Indicative date
Public forum	Late February 2023
Closing date for submissions on our draft decision	10 March 2023
Release date for our final decision and price determination	Late May 2023

# 1. Our role and approach to water pricing

## 1.1 We are Victoria's independent economic regulator

Our role in the water industry is based on the Water Industry Regulatory Order 2014 (WIRO), which is made under the *Water Industry Act 1994* (WI Act) and sits within the broader context of the *Essential Services Commission Act 2001* (ESC Act). Our role under the WIRO includes regulating the prices and monitoring service standards of the 18 water corporations operating in Victoria.

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

Our review is of the prices that the 14 water corporations propose to charge customers for prescribed services from 1 July 2023.<sup>4</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.<sup>5</sup>

Westernport 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 Westernport Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the reasons for our price determination.

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

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

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

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<sup>4</sup> The review excludes Melbourne Water, Goulburn-Murray Water, North East Water and Greater Western Water. In 2021 we approved prices for Melbourne Water to 30 June 2026 and in 2020 we approved prices for Goulburn-Murray Water to 30 June 2024. In 2018, we approved prices for North East Water to 30 June 2026. We have approved an extension to the regulatory period for Greater Western Water to 30 June 2024.

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

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the Essential Services Commission considers relevant
- the matters specified in our guidance<sup>6</sup>
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

Attachment B lists the specific objectives and the various matters we must have regard to when making a price determination and provides a guide to where we have done so in this draft decision.<sup>7</sup> Table 1.1 summarises the matters we must have regard to and groups them into themes.

In October 2021, we issued guidance to Westernport Water to inform its price submission. The guidance set out how we would assess Westernport Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Westernport Water would comply with certain requirements and specified information that Westernport 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 Westernport Water's proposed prices.<sup>8</sup>

If we consider the submission does not have adequate regard for the matters specified in clause 11 of the WIRO or does not comply with our guidance, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.<sup>9</sup>

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<sup>6</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>7</sup> Essential Services Commission 2022, *Westernport Water draft decision, 2023 Water Price Review – commission's consideration of legal requirements*, 20 December 2022. This is located on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au)

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

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

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

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

Continued next page

Table 1.1 (continued)

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

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

## 1.4 PREMO

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

### Box 1.1 PREMO

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

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

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

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

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

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

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

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water corporation's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>10</sup>

## 1.5 Early draft decisions

We may fast-track a price submission to an early draft and final decision if it provides comprehensive and clear information in support of its proposals. We anticipate that final decisions for fast-tracked price submissions will be made in May 2023 rather than June 2023.

We may release a fast-tracked draft decision in response to a price submission if:

- the price submission is sufficiently clear and comprehensive to facilitate our timely assessment against the legal framework
- the price submission demonstrates that customer priorities and concerns have been identified and taken into account
- any changes required to allow us to accept prices are relatively minor
- we accept the overall PREMO self-rating proposed by the water corporation.

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<sup>10</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.



## 2. Our assessment of Westernport Water's price submission

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

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

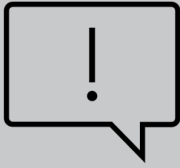
Our guidance included matters water corporations must address in their price submissions. Westernport Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this draft decision.

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

For these reasons, we were able to form an early view that we accept most of Westernport Water's proposals for our draft decision. We intend to explore some areas further in the lead up to our final decision. However, we consider these do not involve matters that materially impact on customer prices, or the outcomes proposed by Westernport Water.

If consultation on our draft decision does not result in significant further review being required, we intend to make a price determination for Westernport Water in May 2023. If consultation or our ongoing assessment causes us to form a view that significant further review is required, we may defer our price determination for Westernport Water until June 2023.

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



Westernport Water must submit a response to our draft decision and provide an updated financial model by 10 March 2023 (via email to [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au)). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for Westernport Water in May 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 Westernport Water has committed to over the regulatory period (Chapter 3)
- establish Westernport 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 Westernport Water's financial position, which we have also had regard to.

Chapter 7 outlines our assessment of Westernport 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.<sup>11</sup> Our guidance proposed that we set a 5-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.<sup>12</sup>

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<sup>11</sup> This is a requirement of the Water Industry Regulatory Order 2014, clause 9.

<sup>12</sup> For detail on the reasons for using five years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, p. 18.

Westernport 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.

## 3. Customer outcomes

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

### 3.1 Customer engagement

Our guidance required Westernport Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Westernport Water’s engagement.<sup>13</sup>

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

- engaged early on its planning and received feedback from over 2000 customers
- used a range of methods including surveys, interviews, focus groups and deliberative forums to engage with stakeholders across its towns and communities
- tailored its engagement to suit customer circumstances, including through meetings with local service providers to understand the needs of customers experiencing vulnerability, and by designing deliberative processes with community members to support deeper discussion and exploration of issues
- engaged on local issues of importance to the community, which influenced proposals for matters such as the quality and reliability of services, the mix of fixed and variable charges in bills, and the business’s role in preserving the natural environment
- engaged in a way that was inclusive of the experience of First Nations people and Traditional Owners, through the Bunurong Land Council Aboriginal Corporation and its reconciliation action plan working group.

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<sup>13</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

More detail on Westernport Water's engagement is available in its price submission.<sup>14</sup>

Actions proposed to be undertaken by Westernport Water provide evidence that its engagement influenced its proposals. In response to feedback from stakeholders, Westernport Water proposed:

- improving the consistency of water quality and taste<sup>15</sup>
- investing in wetlands to reduce release of wastewater into the ocean<sup>16</sup>
- establishing a working relationship with the Bunurong Land Council Aboriginal Corporation to strengthen cultural water value<sup>17</sup>
- minor adjustments in the mix of variable and fixed water and sewerage charges, while maintaining support for customers having difficulty affording bills<sup>18</sup>
- improving response times to sewer blockages, in recognition of the significant impact delays in repairs have on customers.<sup>19</sup>

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

Overall, our preliminary view is that Westernport Water has designed and delivered an engagement program well suited to its operating environment and the context of its community.

Westernport Water engaged on a clear set of issues that stakeholders could influence, which led to a series of proposals relating to its investment in services and environmental preservation.

Westernport Water's engagement methods including meetings with its local community organisations, service providers and a financial counsellor, as well as its deliberative processes, allowed it to tailor its materials to the audience it was engaging with.

In terms of its deliberative panel, it was able to explore topics where there was not full agreement among customers. Its engagement with the Bunurong Land Council Aboriginal Corporation to identify partnership opportunities and engagement expectations will improve planning on activities that affect First Nations people.

A submission from the Consumer Action Law Centre questioned the quality of some aspects of Westernport Water's engagement, specifically in developing its proposal for rebalancing its fixed and variable usage charges (See Section 5.3.2 for more detail). We considered this feedback in

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<sup>14</sup> Westernport Water's 2023–28 price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

<sup>15</sup> Westernport Water, 2023–28 Water Price Submission, September 2022, p. 37.

<sup>16</sup> Westernport Water, 2023–28 Water Price Submission, p. 39.

<sup>17</sup> Westernport Water, 2023–28 Water Price Submission, p. 30.

<sup>18</sup> Westernport Water, 2023–28 Water Price Submission, p. 45.

<sup>19</sup> Westernport Water, 2023–28 Water Price Submission, p. 41.

the context of Westernport Water's overall engagement and the level of influence the engagement had on the proposals in the submission.

Our preliminary view is that we agree with its self-rating of 'Standard' for its Engagement element of PREMO. See Chapter 7 for more detail on our PREMO assessment of Westernport Water's price submission.

## **3.2 Outcomes**

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

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

A business's price submission should account for its actual performance against its outcome commitments for the current period, from 1 July 2018 to 30 June 2023.<sup>20</sup>

We consider Westernport Water accounted for its annual performance for each measure in its price submission. We note, like many other water businesses, Westernport Water's price submission was missing its overall rating against each outcome for the period to date. In the absence of this information, we have drawn on Westernport Water's 2021-22 Outcomes report for its period to date rating.<sup>21</sup>

Table 3.1 lists Westernport Water's outcome commitments and includes its annual performance results as reported in its price submission and in our 2021-22 Outcomes report.<sup>22</sup> The information in this table informs our assessment under the Performance element of PREMO, which is discussed in Chapter 7.

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<sup>20</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

<sup>21</sup> Essential Services Commission, Westernport Water's outcomes performance 2021-22, October 2022.

<sup>22</sup> Westernport Water, 2023 water price submission, September 2022, p. 14–17.

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

Outcome	2018-19	2019-20	2020-21	2021-22	Period to date <sup>a</sup>
Reliable water and wastewater services	Amber	Green	Amber	Red	Red
Better tasting water	Amber	Amber	Amber	Red	Red
Affordable and responsive services	Amber	Green	Green	Amber	Amber
A more sustainable community	Amber	Amber	Amber	Amber	Amber

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

Westernport Water assessed its period to date performance for each outcome based on its lowest rating for that outcome across the 4 years, in the same way that it rates its performance for each outcome based on its lowest rated measure for that outcome. This is presented in Table 3.1 above.

Notably, Westernport Water failed to meet its sewer main blockage targets and drinking water customer satisfaction rating for 3 out of the first 4 years of the current regulatory period. However, Westernport Water reported that it achieved 8 of its 14 measures in the first 4 years of the current regulatory period and has already achieved its net greenhouse gas emissions target for 2022-23. It reported no Safe Drinking Water Act non-compliances during this period, and it performed particularly well against outcome 3 for affordable and responsive services, falling short on only two targets over five measures in the current period.<sup>23</sup>

In its price submission, Westernport Water outlined how it addressed shortfalls in performance and acknowledged that failure to meet output targets represents a reduction in customer value. In consultation with its customers during the 2018 price review, Westernport Water established a performance rebate scheme to incentivise performance. The performance rebate scheme will credit customers \$5 for every failed target up to a cap of \$20. The rebate is payable in 2023-24 and is based on its end-of-period performance.<sup>24</sup>

In the current regulatory period, Westernport Water’s self-reporting has been commendable. It reported its performance results to its customers through its Annual Watermark, which is published on its website and distributed to customers as a bill insert.<sup>25</sup> It also has one of the highest benchmarks for self-assessing its performance and assesses its overall performance for each

<sup>23</sup> Essential Services Commission, Westernport Water’s outcomes performance 2021-22, October 2022; Westernport Water, 2023 water price submission, September 2022, pp. 14–17.

<sup>24</sup> Westernport Water, 2023 water price submission, September 2022, p. 19 and p. 47.

<sup>25</sup> Westernport Water, 2023 water price submission, September 2022, p. 14.

outcome on its lowest rated outcome, and performance for each outcome on its lowest rated measure.

Noting its stringent self-rating process, our draft decision is that we agree with Westernport 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

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

- Provide high-quality drinking water
- Reduce its environmental impact and adapt to climate change
- Resolve sewer blockages quickly
- Keep water interruptions to a minimum
- Be there when needed
- Keep essential services affordable.<sup>26</sup>

Among the key initiatives to deliver on its commitments, Westernport Water proposed to invest around \$5.6 million over the next regulatory period to target improvements to water quality. It also proposed investment of around \$20 million to reduce its environmental impact, including accelerating plans to achieve net zero emissions (by 2030).<sup>27</sup> These investments are in addition to proposed investment in response to relatively strong growth in its region, and asset renewals.

As noted above, building on its engagement for its price submission, it will engage with the Bunurong Land Council Aboriginal Corporation and explore further research into cultural water values within its region. These will improve planning on activities that affect First Nations people.

In terms of affordability, Westernport Water has committed to absorbing a range of possible future cost increases such as higher energy costs. It has committed to achieving an efficiency target of 1.5 per cent per annum on its controllable operating costs and increasing grants (in 2023-24) for customers experiencing financial difficulty. It has also established a new target to focus on the facilitation of Utility Relief Grants for its customers.

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<sup>26</sup> Westernport Water, 2023–28 Water Price Submission, September 2022, p. 5.

<sup>27</sup> Westernport Water has taken into account water conservation and efficiency measures, and a long term horizon for managing the impacts of climate change; matters noted in a submission by the Concerned Waterways Alliance. A number of Westernport Water's key projects support a response to minimise environmental impacts and adaptation to climate change.



### 3.2.3 Our assessment of measures and targets

Westernport Water proposed a set of 20 measures and targets that it will use to report on its performance across the six outcomes. These are set out on pages 36 to 45 of its price submission. Performance against these measures will inform our assessment during future price reviews.

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

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.<sup>28</sup>

Evidence provided by Westernport Water demonstrates that these measures and targets were developed in consultation with its customers, and that they are supported by its customers. Generally, we consider Westernport Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome, once the following matters we identified in our assessment have been addressed:

- 1 of the 20 measures is not relevant to the outcome it represents
- 5 of 20 measures are not measurable
- 18 of 20 measures are considered ambiguous or not clearly defined
- 6 of 20 measures are not easy to understand
- 1 of the 20 measures does not have targets for each year of the regulatory period.

Westernport Water has also removed 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.

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

Westernport Water's proposed targets for its outcome measures suggest an overall improvement in customer value. In our preliminary view, of the 20 output targets:

- 10 indicate an increase in customer value, either improving on past performance or improving across the 2023–28 regulatory period

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<sup>28</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

- 7 suggest current customer value is maintained
- 1 indicates a decrease in customer value
- 2 are unclear in how customer value changes.

Westernport Water's 'customer satisfaction with drinking water' measure indicates a decrease in customer value. Westernport Water notes that a change in demographics and taste comparison has influenced its performance against this measure in 2018–23, and it has lowered its 2023–28 targets to reflect this. However, it notes that it remains committed to improving customer satisfaction above current levels and will target incremental improvements year-on-year back up to its 2018–23 target levels.<sup>29</sup>

For the 2023–28 period, a customer panel will be appointed each year to provide commentary on Westernport Water's performance against its outcome commitments. If outcome targets are missed over two consecutive years, Westernport Water has committed to providing a corrective action plan to explain to its customers how performance will improve. Additionally, Westernport Water has committed to returning \$25,000 (per year in the last 4 years of the regulatory period) to a related community-led proposal that aligns to one of three themes – healthy people, healthy planet, and healthy communities – following an expression of interest process.<sup>30</sup> We consider this level of accountability for shortfalls in performance demonstrates Westernport Water's commitment to delivering value to its customers.

Westernport Water has committed to reporting annually to customers on how it has performed against its outcome commitments. It will continue to communicate performance through its Annual Watermark performance report, which is published on its website and distributed to customers as a bill insert. Following feedback from its customers, a customer panel will now provide commentary on its performance and be included in its Annual Watermark.<sup>31</sup>

Our draft decision is to accept Westernport Water's self-assessment of 'Standard' for the Outcome element of PREMO, which is discussed further in Chapter 7.

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<sup>29</sup> Westernport Water, 2023 water price submission, September 2022, p. 37.

<sup>30</sup> Westernport Water, 2023 water price submission, September 2022, p. 117.

<sup>31</sup> Westernport Water, 2023 water price submission, September 2022, p. 47.

### 3.3 Guaranteed service levels

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

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

Westernport Water's proposed guaranteed service levels are set out on page 49 of its price submission. It has proposed no changes to its current guaranteed service levels based on feedback from its focus groups that customers were satisfied with current arrangements.

Therefore, our draft decision is to accept Westernport Water's proposed guaranteed service levels and rebates, subject to our consideration of any feedback following the release of our draft decision.

Guaranteed service levels are approved in our water industry standards. 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 corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>32</sup> Along with forecast demand, it is an input to calculating prices.

We have used a building block methodology to establish the revenue requirement. This chapter outlines our assessment of Westernport 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 Westernport 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 approve a revenue requirement of \$137.7 million. This is subject to our ongoing review of Westernport Water's proposed new customer contributions, and its response to our draft decisions on the closing and forecast regulatory asset base.

Westernport Water proposed a revenue requirement of \$137.7 over a 5-year period starting 1 July 2023. Our draft decision is to approve a revenue requirement of \$137.7 million (Table 4.1) which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

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<sup>32</sup> We met with officers of the Department of Environment, Land, Water and Planning, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Westernport Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.

We note that our regulatory accounts review process for 2021-22 identified that Westernport Water’s past capital expenditure was higher than it had estimated for its price submission.

As noted in Section 4.3.1, Westernport Water must respond to our draft decision with an updated regulatory asset base matching its approved regulatory accounts (the adjustment could impact the revenue requirement by around \$0.2 million over the next regulatory period).

Westernport Water’s response to our draft decision should also outline its proposed approach to reflecting this update in its revenue requirement and prices (and consider any other changes to its revenue requirement following our draft decision).

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	18.8	19.0	18.9	19.1	19.0	94.8
Return on assets	3.8	3.6	3.5	3.5	3.4	17.8
Regulatory depreciation	4.0	4.2	4.6	5.0	6.0	23.9
Tax allowance	-	-	-	-	-	-
<b>Draft decision – revenue requirement</b>	<b>26.7</b>	<b>27.0</b>	<b>27.2</b>	<b>27.9</b>	<b>28.8</b>	<b>137.7</b>

**Note:** Numbers have been rounded.

There are some areas we will continue to assess in the lead up to our final decision. These are:

- revenue from customer contributions (Section 4.3.2.1)
- new customer contributions (Section 5.4).

Our final decision will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Westernport 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, Westernport 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.

## 4.1 Operating expenditure

Our draft decision is to accept Westernport Water's forecast operating expenditure.

Operating expenditure is a component of the revenue requirement. Westernport Water's price submission provides detail on its forecast operating expenditure from pages 74 to 87.

We assess both:

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

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting's report on its assessment of Westernport Water's expenditure forecast is available on our website.<sup>33</sup>

Table 4.2 sets out our draft decision on Westernport Water's forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

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<sup>33</sup> FTI Consulting, *Westernport Water: Review of Expenditure Forecasts – 2023 Water Price Review, Fast Track Report*, December 2022.

**Table 4.2 Draft decision – operating expenditure**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>17.2</b>	<b>17.4</b>	<b>17.3</b>	<b>17.6</b>	<b>17.5</b>	<b>87.0</b>
<b>Non-controllable operating expenditure</b>	<b>1.6</b>	<b>1.6</b>	<b>1.6</b>	<b>1.5</b>	<b>1.5</b>	<b>7.8</b>
Bulk services <sup>a</sup>	0.4	0.4	0.4	0.4	0.4	2.2
Environmental contribution <sup>b</sup>	1.0	1.0	1.0	1.0	0.9	4.9
Licence fees – Essential Services Commission <sup>c</sup>	0.03	0.03	0.03	0.03	0.03	0.14
Licence fees – Department of Health <sup>c</sup>	0.04	0.04	0.04	0.04	0.04	0.18
Licence fees – Environmental Protection Authority <sup>c</sup>	0.03	0.03	0.03	0.03	0.03	0.17
<b>Draft decision – operating expenditure</b>	<b>18.8</b>	<b>19.0</b>	<b>18.9</b>	<b>19.1</b>	<b>19.0</b>	<b>94.8</b>

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

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

Details of our assessment of Westernport Water's proposal are included in Section 4.1.1 (controllable operating costs) and Section 4.1.2 (non-controllable operating costs).

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 Westernport Water's price submission.

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

#### 4.1.1 Controllable operating expenditure

Westernport Water proposed a total forecast controllable operating expenditure of \$87.0 million over a 5-year regulatory period. For the reasons set out below, we propose to accept Westernport Water's forecast operating expenditure for the 2023–28 regulatory period.

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

1. Establish a baseline controllable operating expenditure – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, 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 Westernport Water to be 2.0 per cent per year from 2023-24 to 2025-26 and 1.8 per cent per year from 2026-27 to 2027-28.
3. Apply an annual cost efficiency improvement rate – assumed by Westernport Water to be 1.5 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**

Westernport Water has proposed a controllable operating expenditure baseline of \$16.4 million, after removing \$2.5 million in non-recurring operating expenditure that occurred in 2021-22. Westernport Water's proposed baseline is \$1.6 million (or 10.5 per cent) higher than the benchmark figure of \$14.8 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Our expenditure consultant requested substantiation of Westernport Water's proposed increase to its baseline year operating expenditure benchmark.<sup>34</sup> Westernport Water explained the increase was due to a number of factors including:

- \$0.4 million for additional contractor and consultancy costs, driven by an increase in compliance obligations over the current regulatory period
- \$0.4 million to adapt to changes in its operating environment brought about by the coronavirus pandemic
- \$0.3 million in additional staffing costs to attract and retain skilled employees
- \$0.2 million to meet water consumption that was 10 per cent higher than forecast due to an increase of around 1,200 permanent residents over the period, leading to an increase in treatment costs. Westernport Water noted the 2021 census recorded 60.6 per cent of dwellings in the business area were permanently occupied, up from 53.6 per cent in 2016.
- \$0.2 million to service actual residential connections that were 2.5 per cent higher in the baseline year than what was forecast in its 2018 price submission, and a subsequent increase

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<sup>34</sup> FTI Consulting, *Westernport Water: Review of Expenditure Forecasts – 2023 Water Price Review, Fast Track Report*, December 2022, pp. 19–21.



in customer transactions that required an additional customer service team member and an additional meter reader.

Our expenditure consultant verified these additional costs were recurring and found Westernport Water's substantiation of these costs to be reasonable. Accordingly, it recommended accepting Westernport Water's proposed baseline increase with no adjustments required. We reviewed Westernport Water's proposals and the advice from our expenditure consultant.

Given the above, we consider Westernport Water's proposal reflects an efficient baseline cost to forecast annual operating expenditure for the purpose of our draft decision.

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

Westernport Water proposed an average efficiency improvement rate on its controllable operating costs of 1.5 per cent per annum. This is a lower rate than the rate it proposed in its 2018 price submission (an efficiency rate of 2.7 per cent per annum), but higher than many other businesses in the current price review.

The efficiency improvement rate is also lower than Westernport Water's proposed average cost growth rate of 2.0 per cent per annum for 2023–26 and 1.8 per cent per annum for 2026–28, effectively delivering a net annual increase to its controllable annual baseline operating costs in each year of the regulatory period. Westernport Water has forecast its cost growth rate based on several costs that are linked to increasing connection numbers such as materials and supplies, maintenance, billing and postage. We note that its average cost growth rate is lower than forecast customer growth across the period, leading to reductions in controllable costs per customer.

Westernport Water proposed that through its 1.5 per cent annual efficiency rate, it plans to absorb future cost increases while seeking efficiencies across its business. Among the cost increases it plans to absorb are higher energy costs (noting it forecasts relatively flat energy costs over the next regulatory period), increased support for customers experiencing hardship, and continued paper billing (while customers are migrated to e-billing). The efficiencies it will seek across its business include costs related to labour and insurance, and preventative maintenance as it continues investing in renewal activities.

#### **4.1.1.3 Cost adjustments**

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

- \$3 million for the operational expenditure costs associated with preventative maintenance, compliance programs, and additional initiatives for the development of new capital assets in the next regulatory period, which will in turn deliver efficiencies in electricity and staffing costs

- \$1.4 million for employee costs to account for an above average vacancy rate of 6 per cent in 2021-22 against the usual 3 per cent vacancy rate incorporated into overall employee cost assumptions.

The above costs represent an additional \$4.4 million over the regulatory period, or an average of \$0.9 million per annum.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline, requesting further information to substantiate the proposed increase in employee costs, and was satisfied the additional expenditure to address the higher than usual vacancy rate was reasonable. Our expenditure consultant considered that Westernport Water provided solid reasoning and evidence for both additions and did not recommend adjusting Westernport Water's proposed forecast.<sup>35</sup>

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

#### 4.1.2 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

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

The values we have adopted for our draft decision are set out above in Table 4.2.

Westernport Water has proposed \$7.8 million in non-controllable operating expenditure over the 2023–28 regulatory period. This is a decrease of \$0.6 million compared to the 2018–23 regulatory period, driven by a \$0.3 million decrease in external bulk charges; and a decrease of \$0.3 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

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<sup>35</sup> FTI Consulting, *Westernport Water: Review of Expenditure Forecasts – 2023 Water Price Review, Fast Track Report*, December 2022, pp. 21–24.

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. Westernport Water has followed this approach in its price submission.

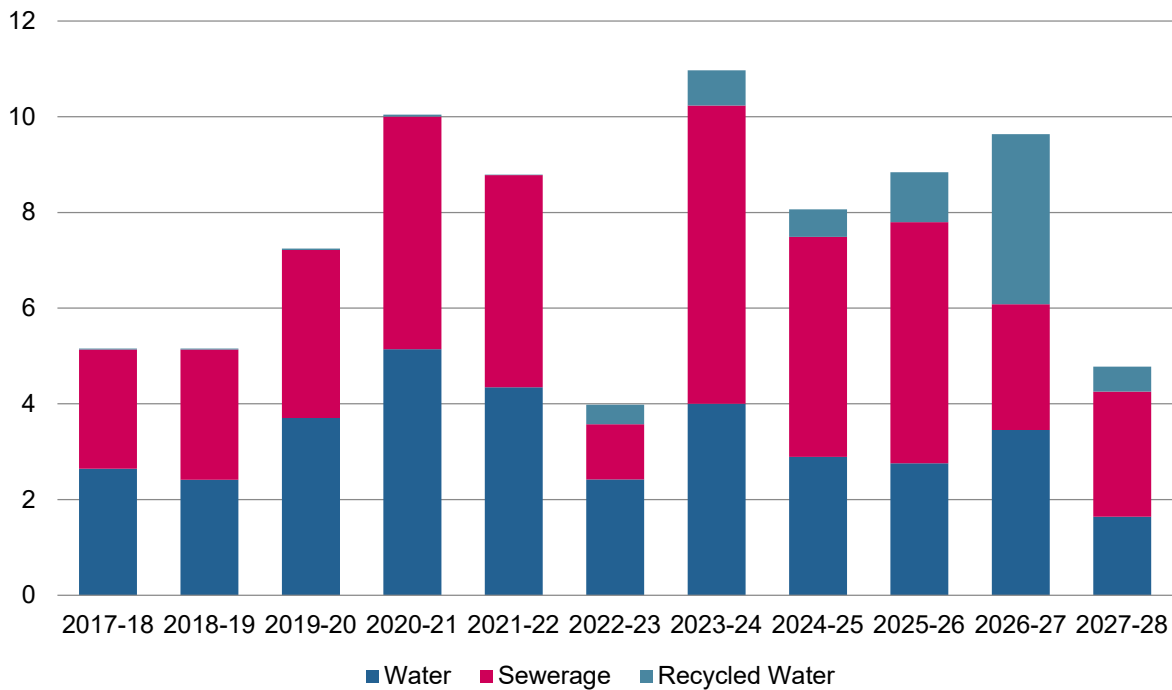
Accordingly, consistent with the reasoning in our guidance paper, our draft decision is to accept Westernport Water’s proposed non-controllable operating expenditure. We have verified that Westernport Water’s forecast bulk charges are consistent with Melbourne Water’s 2021 price determination and prior 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 accept Westernport Water’s proposed forecast capital expenditure of \$42.3 million between 2023-24 and 2027-28.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Westernport Water’s forecast capital expenditure and supporting information is provided at pages 54 to 73 of its price submission. Figure 4.1 shows Westernport 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 4.1 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.

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



**Note:** This graph shows actual figures for 2017-18 to 2021-22 and Westernport Water 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 Westernport Water’s expenditure forecast is available on our website.<sup>36</sup>

#### 4.2.1 Actual capital expenditure

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

Our review of Westernport Water’s annual regulatory accounts identified that it had not included \$2.3 million in capital expenditure it incurred across 2017-18 to 2021-22. As noted in Section 4.3.1, it will need to respond to our draft decision to confirm its regulatory asset base to correct for this adjustment. We have included these additional amounts for the purpose of comparing its actual expenditure against the forecasts.

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

Westernport Water is forecast to exceed its 2018 price determination benchmark of \$29.7 million by \$5.5 million (or 19 per cent). In net terms (that is, once any contributions or disposals are accounted for), it is forecast to exceed its 2018 determination benchmark of \$26.5 million by \$4.4 million or 17 per cent.

Westernport Water's price submission provided several reasons for its increased expenditure (relative to the benchmark) in the current regulatory period:

- A land purchase brought forward from the next regulatory period to the current period under its Sustainable Water Reuse and Land Management project. This delivered 32.6 hectares of land adjoining the Cowes Wastewater Treatment Plant. The land purchase was due to the opportunistic timing of land becoming available (purchase was originally planned for the 2023-28 regulatory period).
- \$2.7 million in renewals projects related to the additional land purchase. This will assist the business to meet its EPA licence requirements and reuse targets.
- The implementation of its Business Transformation Project which experienced a change in scope during the regulatory period.

Westernport Water also noted it has largely delivered the major projects it proposed in its 2018 price submission, with the exception of its Business Transformation Project and its Zone Metering and Pressure Management Project. The Business Transformation Project was partially delivered but ongoing configuration challenges meant the implementation of a new finance system was no longer considered fit for purpose. Completion of the Zone Metering and Pressure Management Project has been deferred to the period after the next regulatory period following a successful pilot. At the end of June 2022, Westernport Water reported that 7 of its 10 major projects were completed, with the remaining 3 on track for completion in 2022-23.<sup>37</sup>

#### 4.2.2 Forecast Capital Expenditure

For the reasons set out below, our draft decision is to accept the forecast capital expenditure of \$42.3 million proposed by Westernport Water for the purpose of calculating its revenue requirement:

- Westernport Water's price submission provided evidence that its forecasts for capital expenditure are prudent and efficient. Its total proposed capital expenditure is \$7.1 million (20.1 per cent) higher than actual capital expenditure in the current 2018–23 period. This is due to additional expenditure to respond to increase treatment plant capacity to meet growth and minimise environmental impacts.

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<sup>37</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 59–62.

- Our expenditure consultant requested selected documents from Westernport Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program.<sup>38</sup> Based on the sample of documents reviewed and FTI Consulting’s workshop with the business, it found that Westernport Water has a robust approach for developing project scope, the timing of works and cost estimates.
- Our expenditure consultant requested and received information on Westernport Water’s major capital projects referenced in its price submission, as well as information supporting its renewals program for expenditure on yet to be specified projects. Following review of this information, our expenditure consultant completed a workshop with Westernport Water, confirming that some expenditure classified under a growth driver may be reclassified under compliance.
- Our expenditure consultant considered that business cases were supported by robust planning processes, which have resulted from independent reviews, master plans or renewal/growth requirements. To support this, Westernport Water provided the master plan for its King Road Wastewater Treatment Plant project, which showed several detailed options were considered to deliver the relevant Recycled Water Project, and provided information that justified its proposed approach.
- FTI Consulting recommended no adjustments to Westernport Water’s forecast capital expenditure for the next regulatory period.
- FTI Consulting also noted the increase to the capital expenditure program in the next regulatory period is modest, and overall renewals costs are decreasing by 5 per cent from 2018–23 to 2023–28. We agree with FTI Consulting’s view as we consider that, for the purpose of our draft decision, the prudence and efficiency of the expenditure has been justified, consistent with our guidance.
- Our preliminary view is that Westernport Water’s planned capital expenditure program appears to be achievable given its past track record delivering its capital expenditure program. As noted in Section 4.2.1, over the current 2018–23 period, Westernport Water is expected to deliver all of its planned major projects. The exceptions are one component of its Business Transformation Project, and its Zone Metering and Pressure Management Project, which has been deferred to the period after the next regulatory period following a successful pilot.<sup>39</sup>
- Westernport Water has excluded speculative projects from its price submission where there is uncertainty in timing, cost, scope and benefits of capital expenditure. For example, Westernport Water has excluded its San Remo Wastewater Futures project and a data integration and

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<sup>38</sup> FTI Consulting, *Westernport Water: Review of Expenditure Forecasts – 2023 Water Price Review, Fast Track Report*, December 2022, pp. 26–31.

<sup>39</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021-22*, 18 October 2022, pp. 59–62.

analytics project, only including enough funding for related planning costs that will occur in the period. This approach is consistent with our guidance for managing uncertain expenditure. Our draft decision is to accept Westernport Water's proposal for addressing uncertainty, noting the following:

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

We have reviewed Westernport Water's proposals and advice from FTI Consulting. We agree with FTI Consulting's assessment, and we consider Westernport Water's approach to forecasting its capital expenditure is consistent with the requirements of our guidance and principles in the Water Industry Regulatory Order 2014.<sup>40</sup>

Our draft decision for total gross capital expenditure is to accept Westernport Water's proposed benchmark. The benchmark we propose to adopt is set out in Table 4.6.

The benchmark that we propose to adopt for Westernport Water does not represent the amount that Westernport 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 Westernport Water's revenue requirement, we are not requiring the corporation to remove that project. Westernport 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 corporation's regulatory asset base is the value of the corporation's assets for regulatory purposes.<sup>41</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4), and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

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<sup>40</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 32–37.

<sup>41</sup> These values were set initially for the water corporations by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

Our guidance required Westernport Water to propose:

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

#### 4.3.1 Closing regulatory asset base

Our draft decision is to not accept Westernport Water's proposed closing regulatory asset base. Westernport Water must respond to our draft decision to reflect its regulatory accounts review for 2021-22.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.<sup>42</sup> This helps to ensure prices reflect the actual net expenditure of a water corporation.<sup>43</sup>

We compared Westernport 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 benchmark, we consider its justification for the additional amounts before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature.

Westernport Water's net capital expenditure over the period from 2017-18 to 2021-22 was \$31.8 million, \$4.1 million or around 13 per cent higher than forecast.<sup>44</sup>

The higher amount mainly reflects the bringing forward of a land purchase planned for the 2023–28 regulatory period, and a changed scope for its Business Transformation Project. Given the benefits of these projects, we consider these should be reflected in the closing regulatory asset base.

In response to our draft decision, Westernport Water must update its proposed closing regulatory asset base to reflect the outcomes of our review of its regulatory accounts for 2021-22 (see Section 4.2.1). For the purpose of approving a revenue requirement for our draft decision however,

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<sup>42</sup> See Section 4.2 for a discussion of Westernport Water's capital expenditure.

<sup>43</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

<sup>44</sup> This includes the additional \$2.3 million in capital expenditure we noted in Section 4.2.1 which had not been reflected in Westernport Water's proposal.



we have adopted the closing regulatory asset base proposed by Westernport Water in its original submission (Table 4.3).

**Table 4.3 Closing regulatory asset base (RAB)**  
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
<b>Opening RAB 1 July</b>	<b>131.3</b>	<b>132.5</b>	<b>133.9</b>	<b>136.0</b>	<b>141.0</b>
Plus gross capital expenditure	5.2	5.2	6.2	8.9	7.4
Less government contributions	-	-	-	-	-
Less customer contributions	1.0	1.1	1.2	0.7	0.6
Less proceeds from disposals	0.1	0.1	0.1	0.1	0.1
Less regulatory depreciation	2.9	2.6	2.8	3.1	3.4
<b>Closing RAB 30 June</b>	<b>132.5</b>	<b>133.9</b>	<b>136.0</b>	<b>141.0</b>	<b>144.3</b>

Note: Numbers have been rounded.

#### 4.3.2 Forecast regulatory asset base

Our draft decision is to not approve Westernport Water’s proposed forecast regulatory asset base. It must respond to our draft decision to update for changes arising from its regulatory accounts review for 2021-22 that affect the closing regulatory asset base.

It must also update its forecast regulatory asset base to account for any updates to its forecasts of revenue from customer contributions, arising from our ongoing review of its new customer contributions.

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

Table 4.4 sets out the estimates we have adopted for our draft decision on Westernport Water’s forecast regulatory asset base from 1 July 2023.<sup>45</sup> Our assessments of the components of the

<sup>45</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the

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 4.4 Forecast regulatory asset base (RAB)**  
\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Opening RAB 1 July</b>	<b>144.3</b>	<b>146.0</b>	<b>152.0</b>	<b>154.8</b>	<b>158.0</b>	<b>161.6</b>
Plus gross capital expenditure	6.1	11.0	8.1	8.8	9.6	4.8
Less government contributions	-	-	-	-	-	-
Less customer contributions	0.7	1.0	1.0	1.0	0.9	0.9
Less proceeds from disposals	0.1	0.1	0.1	0.1	0.1	0.1
Less regulatory depreciation	3.7	4.0	4.2	4.6	5.0	6.0
<b>Closing RAB 30 June</b>	<b>146.0</b>	<b>152.0</b>	<b>154.8</b>	<b>158.0</b>	<b>161.6</b>	<b>159.4</b>

Note: Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our draft decision is to accept Westernport Water's forecasts for customer contributions, subject to our further review of its proposed new customer contributions prior to our final decision.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>46</sup>

New customer contributions are a key input to revenue from customer contributions. For the purposes of calculating the regulatory asset base and revenue requirement in our draft decision,

2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

<sup>46</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

we have adopted Westernport Water’s proposed customer contributions forecasts as they are consistent with past trends and forecast growth rates. However, we note that our final decision is subject to our ongoing review of Westernport Water’s new customer contributions (Section 5.4).

## 4.4 Rate of return

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

Our guidance required Westernport Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement (Table 4.5). Westernport Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, our draft decision is to accept the cost of debt proposed by Westernport Water, noting that estimates will be updated following release of the Australian Bureau of Statistics March Quarter 2023 consumer price index.

**Table 4.5 Draft decision – cost of debt**

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

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

### 4.4.2 Return on equity

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

Under our PREMO incentive mechanism, which we have applied since 2018, the return on equity we adopt to calculate the revenue requirement is linked to a business’s PREMO rating. See Chapter 7 for an explanation of PREMO and our assessment of Westernport Water’s PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water corporation’s self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the corporation's self-rating and our rating.<sup>47</sup> We reviewed the return on equity values in the matrix in mid-2022 given the change in market conditions that has occurred since we published our guidance in October 2021 and we consider that the values in our matrix reflect the medium-term real rates of return.<sup>48</sup>

Westernport Water rated its price submission as 'Standard'. Based on this PREMO self-rating, Westernport Water proposed a return on equity of 4.1 per cent per annum. This reflects the maximum rate allowed in our guidance for a price submission rated as 'Standard'.<sup>49</sup>

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

## 4.5 Regulatory depreciation

Our draft decision is to accept Westernport Water's forecast regulatory depreciation, noting we are seeking further information justifying its approach in response to our draft decision.

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

Westernport Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile. We noted in our guidance that we prefer this approach.<sup>50</sup>

Westernport Water adopted an average asset life of 35 years, which is shorter than the 55 years it proposed, and we accepted, at the 2018 price review. We sought further information on Westernport Water's reasons for proposing a shorter average life after reviewing its price submission and it advised that the updated asset lives were:

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<sup>47</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42–43.

<sup>48</sup> We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity adopted by interstate regulators in the following publications: Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW's rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water's water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

<sup>49</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

<sup>50</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

- the result of a comprehensive review by the business that responded to recommendations from the Valuer-General Victoria regarding deficiencies in the quality and accuracy of asset data
- based on the Valuer-General Victoria's 2020-21 asset revaluation report, which confirmed that the issues identified about the quality and accuracy of asset data no longer exist.

Our preliminary position is that we accept Westernport Water's reasons for adopting a shorter average asset life and its forecast depreciation. We note that an average of 55 years was relatively long compared to most other regional urban water businesses.

However, we request that Westernport Water provide further justification in response to our draft decision, noting that the asset lives adopted for statutory accounting purposes do not necessarily need to be adopted for regulatory pricing purposes. The further justification should address the following questions:

- How has it considered that the depreciation lives it proposes are aligned with the period over which customers are expected to benefit from services associated with its assets, particularly given recent rapid growth in its region and growing capital investment?
- How has it considered its approach to depreciation given the strong focus customers place on affordability (which is also reflected in Westernport Water's outcome commitments)?

Our draft decision on regulatory depreciation is shown in Table 4.4.

## 4.6 Tax allowance

The tax allowance is a component of the revenue requirement. Westernport Water has proposed a tax allowance of \$1.2 million in its revenue requirement for the 2023–28 regulatory period. Our draft decision is to accept the forecast as it was calculated consistently with the method required by our guidance.<sup>51</sup>

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<sup>51</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47-48.

## 5. Demand, tariffs and prices

Once Westernport 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 Westernport Water's demand forecasts.

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

Westernport Water's demand forecasts are set out at pages 88 to 98 of its price submission and are also included in its financial model.

Our draft decision is to accept Westernport 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 Westernport Water's price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses.

In its response to our draft decision, Westernport 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 Westernport Water's proposed price cap form of price control.

Our guidance indicated we would have particular regard to whether a corporation proposed to continue its existing form of price control or introduce a new form of price control.<sup>52</sup>

Westernport Water proposed a price cap form of price control as set out on page 122 of its price submission. This is the same as its current approach. Under the price cap form of price control, maximum prices for each prescribed service for the 2023–28 regulatory period are determined at the start of the regulatory period. Adjustments to account for movements in inflation (measured by

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<sup>52</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

the consumer price index published by the Australian Bureau of Statistics), return on assets and any approved pass-through mechanisms will be made during the regulatory period.

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

- it is the same as its current approach, which we have previously approved
- it provides its customers with price certainty
- demand risk is more efficiently managed by Westernport Water, rather than its customers
- was otherwise consistent with the requirements of our guidance.

### 5.3 Tariff structures and prices

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

Westernport Water's proposed tariffs are set out at pages 124 to 126 of its price submission. Prior to our final decision and price determination.

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

#### 5.3.1 Tariff structures

As outlined in our guidance, we have provided the water corporations with a large degree of discretion to decide on individual tariff structures.<sup>53</sup> This recognises water corporations are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

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

A key change proposed by Westernport Water is to increase the share of variable charges for water in customer bills. It proposed to reduce its fixed service charge by 1.6 per cent and increase its variable usage charge by 3.8 per cent. Westernport Water stated this change was to address an

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<sup>53</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

increase in permanent occupancy and feedback from its customers seeking more control over their bills and greater encouragement of water saving.<sup>54</sup>

In its submission, the Consumer Action Law Centre questioned the quality of Westernport Water's consultation on this issue. It noted that not all customers are able to respond to price signals and implement efficiency changes in their home (in order to offset the impact of price increases), with tenants being most constrained in this area. It questioned the low representation of tenants in the deliberative forum on this issue. It also questioned whether the deliberative forum members were fully informed about the impact the variable price increase would have on renters.

In assessing Westernport Water's proposed adjustment in fixed and variable service charge we reviewed:

- the materials supplied to participants in its deliberative process relating to the context and bill impact of changes<sup>55</sup>
- the composition of participants in the deliberative forum, who made recommendations for the future approach (two people identified as renters)<sup>56</sup>
- the comments and quotes of participants who took part in the deliberations as evidence of the discussion that took place.<sup>57</sup>

Based on our review of Westernport Water's engagement, our preliminary position is that we are satisfied that Westernport Water's proposed change in the share of fixed and variable water charges takes into account the interests of affected customers and is in line with customer preferences. We also note that household bills in its region have a relatively high proportion of fixed charges compared to variable charges, reflecting a large non-permanent population. Accordingly, our draft decision is to accept this change.

A submission by the Concerned Waterways Alliance noted it fails to understand why inclining block tariffs are not adopted by all water corporations.<sup>58</sup> We note that changes to these structures can impact customers in different ways – for example, they can impact on affordability for larger households. And as noted above, Westernport Water has proposed an increase in its variable charge in part to provide for water saving.

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<sup>54</sup> Westernport Water, 2023 water price submission, September 2022, p. 125.

<sup>55</sup> Westernport Water, 2023 water price submission, September 2022, Appendix 2, pp. 57 to 69.

<sup>56</sup> Westernport Water, 2023 water price submission, September 2022, Appendix 5, p. 10.

<sup>57</sup> Westernport Water, 2023 water price submission, September 2022, Appendix 5, pp. 22 to 24.

<sup>58</sup> Concerned Waterways Alliance submission to the Essential Services Commission Water Price Review 2023, 1 December 2022.



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

Our preliminary view is that the two-part tariff structures proposed by Westernport Water for its water services, and for non-residential sewerage services, will promote the efficient use of these services. The two-part structure for residential and recycled water services sends these customers a signal about the costs of their water use and is an approach that is commonly applied in other states and territories.<sup>59</sup> We also consider two-part tariff structures are easy to understand.

### 5.3.2 Prices

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

In response to our draft decision, Westernport Water will also need to propose updated prices to reflect any updates to its revenue requirement. This includes any changes to its depreciation forecasts, any changes arising from our review of new customer contributions, and its update to the regulatory asset base.

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

In making our price determination, we must have regard to whether Westernport Water took into account the interests of customers, including low income and vulnerable customers.<sup>60</sup>

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

- maintaining an efficiency improvement rate greater than the industry average, helping to minimise prices and bills
- increasing the target number of hardship grants in the first year of the regulatory period
- introducing a target for the number of utility relief grants it facilitates each year.

### 5.3.4 Unique services

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

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<sup>59</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>60</sup> Water Industry Regulatory Order 2014, clause 11(d)(iii).

## 5.4 New customer contributions

Our draft decision is to accept Westernport Water's proposed new customer contributions. This acceptance is subject to the findings of our complete review of all the businesses proposing to use an average incremental cost model for new customer contributions, which may require our draft decision to be reviewed.<sup>61</sup>

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

Westernport Water's proposed new customer contributions are set out at pages 99 to 105 of its price submission. Westernport Water proposed using a model based on average incremental cost to estimate its new customer contributions, rather than the net cash flow approach adopted by the commission.<sup>62</sup> Westernport Water proposed a new customer contribution for water services of \$1,133.21 in 2023-24 compared to \$1,133.57 in 2022-23, and a new customer contribution for wastewater services of \$1,422.82 in 2023-24 compared to \$799.45 in 2022-23.

Westernport Water put forward several reasons for using the alternative incremental cost approach, namely, that it will address:

- the risks associated with the recent development boom in the Bass Coast region
- the issue of cost reflectivity
- the lack of transparency in the rationale and calculation of existing new customer contributions.

We consider the net cash flow approach outlined in our guidance also enables water businesses to address the risks associated with changes in development, allows for cost reflectivity and is transparent, and that these issues can be flexibly dealt with by applying that approach.<sup>63</sup>

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<sup>61</sup> A number of water businesses' price submissions that were not fast-tracked also proposed using the average incremental cost approach to estimate new customer contributions. We will complete our review of all businesses using this approach by March 2023 and will then decide whether this approach meets the new customer contribution pricing principles in our guidance.

<sup>62</sup> The average incremental cost approach calculates the new customer contribution charge by dividing the capital and operating cost of a growth area by the number of connections in that area. The net cash flow approach applies the incremental revenue less incremental cost to estimate the new customer contribution charge.

<sup>63</sup> The inclusion of sunk capital expenditure is not a requirement of our existing net cash flow framework to calculate new customer contribution charges. The inclusion of sunk costs has been cited by Westernport Water as a reason for moving away from the net cash flow approach as it may send incorrect pricing signals to developers on the true cost of development. We note that, since 2013 when we commenced using our net cash flow framework, very few

However, we have reviewed Westernport Water's proposed new customer contributions and consider they are consistent with the new customer contribution pricing principles outlined in our guidance.<sup>64</sup> This is because:

- incremental costs have been included in the new customer contribution calculations
- incremental revenues have been accounted for in the financial model for the relevant service
- average incremental costs can be expected to be above avoidable cost and below standalone cost.

For the above reasons, our draft decision is to accept Westernport Water's proposed new customer contributions subject to any further information on the average incremental cost model that the commission receives in response to this draft decision, or through our 2023 water price review. To the extent that any such feedback is not provided directly in response to Westernport Water's draft decision, we will provide such feedback to Westernport Water if we consider it relevant to this aspect of Westernport Water's price submission.

We are interested in feedback from developers and customers regarding the proposed new customer contributions tariffs.

Westernport Water has provided its negotiating framework for negotiated new customer contribution contracts. This framework is in accordance with the requirement of our new customer contribution pricing principles.

## 5.5 Adjusting prices

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

Westernport Water's proposed price adjustment mechanisms are set out at pages 128 to 130 of its price submission. Its price submission states that it is not proposing any changes to its current pass-through adjustment mechanisms from its 2018 price determination.<sup>65</sup> However, the adjustment formulas it proposed in its submission were not those approved in our 2018 price determination (rather, they appear to replicate those included in its 2018 price submission).

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businesses have included sunk costs in their calculation of new customer contributions. Our 2013 explanatory note explained that these costs should only be included where they were built in anticipation of connections growth and needed to be justified as such. We stated: 'Incremental cost can include an allocation of costs of assets that the business had prudently built in expectation of future growth. If such costs are included, they should be explicitly revealed. Essential Services Commission, New Customer Contributions Explanatory Note, December 2013, p. 5.

<sup>64</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 59.

<sup>65</sup> Westernport Water, *2023-28 Price Submission*, September 2022, p. 128.

We sought clarification from Westernport Water, and it confirmed that the formulas in its submission were included in error, and that it proposed to continue using the approved price adjustment mechanisms in the 2018 price determination.<sup>66</sup>

Our draft decision is to accept Westernport Water's proposal to continue to use these same price adjustment mechanisms, noting we have approved them in the past.

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<sup>66</sup> Response to request for information, 9 November 2022.

## 6. Financial position

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

In approving prices, we must have regard to the financial viability of the water industry.<sup>67</sup> We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the *Water Industry Regulatory Order (2014)* to mean that the prices we approve should provide a high level of certainty that each water corporation can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

Westernport Water's price submission and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on Westernport 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 Westernport Water will generate sufficient cash flow to deliver on service commitments, including financing costs arising from investments to meet service expectations.

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<sup>67</sup> 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 corporation's revenue requirement to that corporation's level of ambition expressed in its price submission. Our guidance required Westernport Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.<sup>68</sup> We required Westernport 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 Westernport 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 Westernport Water's price submission. As outlined in Section 4.4.2, the combination of Westernport Water's self-rating and our rating has determined the return on equity we have adopted to calculate Westernport Water's revenue requirement in our draft decision.

### 7.1 Our PREMO assessment of Westernport Water's price submission

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

Westernport 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 Westernport Water's price submission.

**Table 7.1** PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Westernport Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's rating	Standard	Standard	Standard	Standard	Standard	Standard

<sup>68</sup> This is the first price review we have done where the rating has been based on all five elements of PREMO. In our 2018 price review, our PREMO assessment was against only four of the elements — Risk, Engagement, Management and Outcomes.

We agree with Westernport Water's proposed overall PREMO self-rating of 'Standard'. This is reflected in the return on equity we propose to approve for Westernport Water (see Section 4.4.2). We have formed this view after reviewing Westernport Water's proposed self-rating for each of the five PREMO elements, and a summary of our assessment against each is 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.<sup>69</sup>

As noted in Section 3.2, we agree with Westernport Water's self-assessment that it has, overall, met its outcome commitments for the period to date. It also transparently reported its results to customers, sending a brochure to every customer with bills and publishing its performance prominently on its website (via its Annual Watermark). Its performance rebate scheme will return funds to customers in 2023-24, in recognition of performance shortfalls.

Supporting its 'Standard' self-assessment, Westernport Water generally achieved higher results than most other urban water businesses in the commission's survey of customer sentiment, covering measures of overall satisfaction, value for money, trust, and reputation in the community (this is summarised at pages 12 and 13 of its price submission).<sup>70</sup>

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

In 2021-22 (the last available year of audited results), its expenditure was \$18.9 million compared to a benchmark of \$14.8 million. The higher than benchmark outcome reflected a range of factors, which we summarised in Section 4.1.1. For the current regulatory period, Westernport Water's capital expenditure (in net terms) is forecast to be around \$4.4 million or 17 per cent higher than the benchmark established at the 2018 water price review.

On both operating and capital costs in the current regulatory period, as noted in Sections 4.1 and 4.2, our preliminary view is that the higher than benchmark expenditure by Westernport Water has been appropriately justified. Its delivery of major projects in the current regulatory period (Section 4.2.1) also compared favourably to other businesses.

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<sup>69</sup> As set out in Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, pp. 74-75. Guiding questions are set out on page 45.

<sup>70</sup> The commission's customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

Our draft decision is to accept Westernport Water’s self-rating of ‘Standard’ for the Performance element of PREMO, on the basis that we consider it met expectations for delivery against outcome commitments, and achieved an overall rating of ‘Standard’ for PREMO in 2018.

### 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).<sup>71</sup>

In support of its self-rating of ‘Standard’ for the Risk element of PREMO, Westernport Water’s price submission provided an overview of key strategic risks and implications for its price submission, and areas where it had chosen to accept risk to deliver lower prices. These areas include demand forecasts, approach to capital planning, and increasing the variable charge component in bills.

As outlined in Section 3.3, Westernport Water proposed no changes to its current guaranteed service level scheme, informed by its engagement finding that customers are generally satisfied with the current framework.

Westernport Water has refined its approach to performance management. It will establish a customer panel each year to assess performance against Outcomes. If targets are missed in two consecutive years, it has committed to return up to \$100,000 over the 2023–28 regulatory period to its community. Placing revenue at risk is one way a water business may support its Risk rating and help to ensure it has sufficient incentives to deliver outcomes that matter most to customers.

We considered Westernport Water’s approach to depreciation, outlined at Section 4.5. We have sought more information to inform our final decision, to seek further justification for how it has considered the customer impacts of its proposal.

However, taking into account other factors supporting its Risk self-rating noted above, we have accepted Westernport Water’s self-rating of ‘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.<sup>72</sup>

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<sup>71</sup> Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, p. 45.

<sup>72</sup> Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, p. 45.



Our review of Westernport Water’s engagement is provided in Section 3.1. In support of its self-rating of ‘Standard’ for the Engagement element of PREMO, Westernport Water delivered an engagement program that provided customers a fair opportunity to participate and to provide feedback on the prices and services that affect them. In our view, that feedback appears to have been influential on the proposals in Westernport Water’s submission.

On its engagement with First Nations people, we note its engagement with the Bunurong Land Council Aboriginal Corporation is a positive next step in building a relationship with the Traditional Owners of the land it is operating on. Westernport Water also received positive feedback from participants who took part in its engagement activities.<sup>73</sup>

Accordingly, our draft decision is to accept Westernport Water’s self-rating of ‘Standard’ for Engagement.

#### **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.<sup>74</sup>

In support of its self-rating of ‘Standard’ for the Management element of PREMO, as noted in Section 4.1.1, Westernport Water proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (1.5 per cent). This contributes to an ongoing reduction in controllable operating expenditure per water connection. Based on advice from FTI Consulting, we have also tested Westernport Water’s assumptions for forecast operating and capital costs, and our preliminary view is that they reflect efficient expenditure.

Westernport Water’s price submission provided clear justification for its proposals, and its financial model contained no substantial errors and was consistent with its written submission. The Westernport Water Board has also attested to the accuracy of the information contained in its submission, as required by our guidance.

Accordingly, our draft decision is to accept Westernport Water’s self-rating of ‘Standard’ for Management.

#### **7.1.5 Outcomes**

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

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<sup>73</sup> Westernport Water, 2023 water price submission, September 2022, p. 34.

<sup>74</sup> Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, p. 45.

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.<sup>75</sup>

As noted in Section 3.2, our preliminary view is that Westernport 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. Further, Westernport Water's proposed targets for its outcome measures suggest an overall improvement in customer value, supporting its Outcomes rating.

We also consider its proposed customer panel – to provide commentary that will be published in its Annual Watermark provided to customers – promotes transparency and accountability. This is also supported by its commitment to return funds to the community if performance targets are not met. We consider this level of accountability for shortfalls in performance demonstrates Westernport Water's commitment to delivering value to its customers.

Section 3.1 provides a list of actions where we consider Westernport Water has demonstrated the influence of customers on its proposed Outcomes and other initiatives. This includes committing expenditure to improve the consistency of water quality and taste, improving response times to sewer blockages, and adjusting the mix of fixed and variable tariffs for water services in response to customer feedback.

Accordingly, our draft decision is to accept Westernport Water's self-rating of 'Standard' for Outcomes.

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<sup>75</sup> Essential Services Commission 2021, 2023 Water Price Review: Guidance Paper, 26 October, p. 45.

# Appendix A — Submissions received

Name or organisation	Date received
Anonymous	7 October 2022
Consumer Action Law Centre	30 November 2022
Concerned Waterways Alliance	1 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 Westernport Water.<sup>76</sup> This paper should be read in conjunction with our draft decision, which is available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission's guidance.<sup>77</sup> We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Westernport 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 Westernport 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).

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<sup>76</sup> Essential Services Commission 2022, *Westernport Water draft decision, 2023 water price review*, 20 December.

<sup>77</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

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

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost promotes efficiency in regulated entities and the water industry. Our draft decision has therefore had regard to the extent that Westernport 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 corporation to retain the benefits of any cost efficiencies it generates until the end of its regulatory period. In other words, a water corporation has an incentive to outperform the operating and capital expenditure benchmarks we accept for the purpose of estimating its revenue requirement and prices. This is consistent with providing incentives for water corporations to pursue efficiency improvements.

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

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

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

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

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

- A ten-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 Westernport Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>78</sup>

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

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

We have had regard to this matter in Chapter 6.

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

In preparing our draft decision, we have had regard to the extent Westernport 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).

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<sup>78</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.

- Our assessment of tariffs (Section 5.3).

## **Industry specific matters**

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

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

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

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

We have had regard to the prescribed services listed in the WIRO in making our decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Westernport 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 Westernport 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 Australia<sup>79</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>80</sup>
- tariff structures applied by water corporations throughout Australia<sup>81</sup>
- the regulatory rate of return set by other regulators.<sup>82</sup>

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

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

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

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

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

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

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<sup>79</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022

<sup>80</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>81</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>82</sup> Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW’s rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.



## Customer matters

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

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

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

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

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

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

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

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

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

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

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

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

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

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

In considering the above factor, we had regard to the customer engagement by Westernport Water and that it proposed:

- maintaining an efficiency improvement rate greater than the industry average, helping to minimise prices and bills
- increasing the target number of hardship grants in the first year of the regulatory period
- introducing a target for the number of utility relief grants it facilitates each year.

Commission’s consideration of legal requirements

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

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

- Our assessment of engagement (Section 3.1)
- Our assessment of outcomes (Section 3.2)

Commission’s consideration of legal requirements

- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).

We consider that our pricing approach helps to address market power and information asymmetries relating to the water corporations. Our PREMO water pricing approach provides incentives for a water corporation to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>83</sup>

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

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

- Implementing a price review process so that water corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>84</sup>

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

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

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

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<sup>83</sup> Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

<sup>84</sup> Essential Services Commission, 2023 water price review: Guidance paper, p. 2.

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

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

- Implementing a price review process so that water corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>85</sup>

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<sup>85</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.