

# Gippsland Water final decision

2023 Water Price Review

23 June 2023

## Acknowledgement

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

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

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

### An appropriate citation for this paper is:

Essential Services Commission 2023, Gippsland Water final decision: 2023 Water Price Review, 23 June

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# Summary

## We have made our final decision on Gippsland Water's prices for the next 5 years

In March 2023, we released our draft decision on the price submission Gippsland Water submitted to us in September 2022.<sup>1</sup> The draft decision set out our preliminary views on Gippsland Water's proposals and invited interested parties to make further submissions. We also held a public forum in April 2023. In addition to a response by Gippsland Water, we received four written submissions on our draft decision, which are available on our website (see Appendix A of this final decision for details).

After considering that feedback and Gippsland Water's response, we have made a price determination for Gippsland Water.<sup>2</sup> The price determination sets out the maximum prices Gippsland Water may charge for prescribed services (or the manner in which its prices are to be calculated, determined, or otherwise regulated) for the 5-year period from 1 July 2023 (2023–28). This final decision sets out our supporting reasons and analysis for the price determination.



Where our final decision on a particular aspect is unchanged from our draft decision, we have not detailed the supporting reasons in our final decision. Rather, we have noted that our final decision confirms the reasons and position we reached in the draft decision.

Where we have reached a different decision to that proposed in our draft decision, or where new information required our consideration, we have set out our reasons in full in this final decision. This final decision should be read in conjunction with our draft decision.

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<sup>1</sup> Our draft decision for Gippsland Water is available at [www.esc.vic.gov.au/waterpricereview](http://www.esc.vic.gov.au/waterpricereview).

<sup>2</sup> Before the commencement of a regulatory period, clause 10 of the Water Industry Regulatory Order 2014 requires us to make a price determination which determines the maximum prices a water business may charge, or the manner in which its prices are to be calculated, determined or otherwise regulated during the regulatory period. See Essential Services Commission, *Gippsland Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

## **We have approved a revenue requirement of \$703.9 million over 5 years**

Our final decision approves a revenue requirement of \$703.9 million over the 5-year period starting 1 July 2023 (see Chapter 4).<sup>3</sup> This is \$11.4 million or 1.6 per cent higher than our draft decision, which mainly reflects our updates to the cost of debt.

This revenue requirement will allow Gippsland Water to deliver on its customer service commitments, government policy, statements of obligations, and obligations monitored by the Environment Protection Authority Victoria and the Department of Health.

## **Typical water and sewerage bills will rise from 1 July 2023**

A summary of approved maximum prices for major services delivered by Gippsland Water is set out in Section 5.3.2 Table A shows the estimated typical bills for different customer groups under our final decision, for 2022-23 (the current year) and 2023-24. For a typical residential owner occupier, estimated annual water and sewerage bills (including inflation) will rise from around \$1,363 currently to \$1,414 in 2023-24, an increase of around 3.7 per cent. For a typical residential tenant, bills (including inflation) will rise from around \$366 currently to \$380 in 2023-24. The bill paid by each customer will vary depending on water use, prices for fixed and variable tariffs, and other charges.

After 2023-24, water and sewerage prices will generally decrease by around 0.1 per cent per year, excluding inflation.

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<sup>3</sup> Along with forecast demand, the revenue requirement is an input to calculating the prices to be charged by a water business.

**Table A Estimated typical annual water and sewerage bills**

Customer group	Average consumption (kL p.a.)	2022-23 (current)	2023-24
		\$2022-23	\$2023-24
Residential – owner occupier	164	\$1,363	\$1,414
Residential – tenant	164	\$366	\$380
Non-residential (small)	70	\$1,267	\$1,316
Non-residential (medium)	327	\$2,258	\$2,353
Non-residential (large)	600	\$3,311	\$3,455

**Notes:** The table shows the average bills for 2023-24 expressed in \$2023-24 terms (which means 7 per cent inflation has been included). Our draft decision included bill estimates based on our draft decision revenue requirement, expressed in \$2022-23 terms as the inflation figure was not available at this time. Our determination for Gippsland Water sets prices in \$2023-24 terms, with provision for inflation to be added in each of the remaining years of the regulatory period based on the latest inflation data. Dollar amounts have been rounded.

## **Gippsland Water has committed to delivering outcomes that reflect customer priorities, including a focus on pathways for Aboriginal people**

Gippsland Water plans to deliver the following outcomes for customers:

- Be affordable and fair
- Do its job well
- Be easy to deal with
- Be involved in the community
- Be environmentally responsible
- Plan for the future.<sup>4</sup>

Among the key service initiatives to deliver on its commitments, Gippsland Water will introduce SMS messages to customers in the event of a service disruption, and an app that will provide customers the ability to monitor their usage and flexibility in managing their bill payments.

It will establish new initiatives and pathways for Aboriginal people, including more opportunities for Aboriginal employment with the organisation, support for professional education and work, delivering reticulated water and drinking fountains to the culturally significant Knob Reserve, and exploring opportunities to make land it manages available for cultural use.

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<sup>4</sup> Gippsland Water, 2023 water price submission, September 2022, p. 55.

## Tariff structures will remain the same

Consistent with our draft decision, our final decision approves Gippsland Water's proposed tariff structures, on the basis that they reflect a continuation of its current approach. For water services, our final decision approves Gippsland Water's proposal for a fixed service charge and a variable component that depends on water usage. For residential sewerage services, we have approved Gippsland Water's proposal for a fixed charge only. For non-residential sewerage services, we have approved a fixed service charge and a variable usage component.

Consistent with our draft decision, our final decision also approves Gippsland Water's proposed price cap form of price control, because it is a continuation of its current approach. This means its maximum prices are fixed subject to updates for inflation, and any other price adjustments we approve in our price determination. For more detail on tariffs and the form of price control, see Chapter 5.

## Our draft decision rates Gippsland Water's price submission as 'Advanced' under the PREMO framework

Consistent with our draft decision, our final decision is to rate Gippsland Water's price submission as 'Advanced' under the PREMO framework (Table B). This is the same as the business's self-rating. Factors in support of Gippsland Water's PREMO rating include, that it proposed relatively large real price reductions, underpinned by efficiencies and management of risk on behalf of customers – for example, it proposed excluding uncertain projects from its expenditure forecasts. It also provided a price submission and supporting model that were generally of a high quality.

See Section 1.4 for an explanation of the PREMO framework and Chapter 7 for more detail on our assessment of Gippsland Water's price submission.



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

**Table B**    **PREMO rating**

	<b>Overall PREMO rating</b>	<b>Performance</b>	<b>Risk</b>	<b>Engagement</b>	<b>Management</b>	<b>Outcomes</b>
Gippsland Water's self-rating	Advanced	Advanced	Leading	Leading	Advanced	Advanced
Commission's rating	Advanced	Advanced	Leading	Leading	Advanced	Advanced



# 1. Our role and approach to water pricing

## 1.1 We are Victoria's independent economic regulator

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

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

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.<sup>5</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.<sup>6</sup>

Gippsland 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. We make a price determination after issuing a draft decision and considering feedback from interested parties, including any response to the draft decision from the water business.

The price determination specifies the maximum prices a water business may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We also issue a final decision that sets out our supporting 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 matters we must have regard to when making a price determination, including matters set out in the WIRO, the WI Act and the ESC Act, and clause 8 of the WIRO requires that we place particular emphasis on the promotion of efficiency-related matters. In making a price determination, we have had regard to each of the matters required by clause 11 of the WIRO, including:

- the objectives and matters specified in clause 8 of the WIRO, which include economic efficiency and viability matters, industry specific matters, customer matters, health, safety, environmental

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<sup>5</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>6</sup> The prescribed services are listed at clause 7(b) of the WIRO.

and social matters, and other matters which are specified in sections 8 and 8A of the ESC Act and section 4C of the WI Act

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance<sup>7</sup>
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

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

In October 2021, we issued guidance to water businesses, including Gippsland Water to inform their price submissions. The guidance set out how we would assess Gippsland Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Gippsland Water would comply with certain requirements and specified information that Gippsland Water must provide to us when submitting its price submission.<sup>8</sup>

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 Gippsland Water's maximum proposed prices it can charge for the prescribed services it provides.<sup>9</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>10</sup>



The power for water businesses to charge fees for services they provide is set out in the *Water Act 1989*.<sup>11</sup> These provisions in the Water Act also govern the process for and manner in which water businesses may set and impose fees. Each water business must ensure that it complies with these legislative requirements.

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<sup>7</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>8</sup> Among these expectations are matters that progress our 'Getting to fair' strategy relating to the water industry. See Essential Services Commission, *Getting to fair: Breaking down barriers to essential services*, August 2021.

<sup>9</sup> This is a requirement of the WIRO, clause 14(a).

<sup>10</sup> This is provided for under the WIRO, clause 14(b)(i).

<sup>11</sup> See part 13, Division 5 and 6 of the *Water Act 1989*.

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

**Note:** References in the table are to the Water Industry Regulatory Order 2014 (WIRO), the Essential Services Commission Act 2001 (ESC Act), and the Water Industry Act 1994 (WI Act).

## 1.4 PREMO

PREMO stands for Performance, Risk, Engagement, Management, and Outcomes. Each element of PREMO is summarised in Box 1.1.

### Box 1.1 PREMO

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

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

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

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

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

Our PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.<sup>12</sup>

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<sup>12</sup> In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

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

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>13</sup>

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<sup>13</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 41–46.

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

We have made our final decision on Gippsland Water's price submission after considering:

- Gippsland Water's price submission
- Gippsland Water's presentation made directly to commissioners
- Gippsland Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 6 April 2023<sup>14</sup>
- written submissions from interested parties (a list of submissions responding to our draft decision is provided in Appendix A).

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

Our guidance included matters water businesses must address in their price submissions. Gippsland Water's price submission addressed each of these matters, and our initial assessment of those matters is set out in our draft decision.

We consulted on our draft decision, receiving submissions between 2 March and 28 April 2023 and holding an online public forum on 6 April 2023, during which Gippsland Water was asked by a participant to provide an update on the timing of the customer portal, which was addressed by Gippsland Water at the forum.

Gippsland Water provided a response to our draft decision, including a revised financial model that reflected the updated cost of debt and inflation figures we provided to businesses in May 2023.<sup>15</sup> In arriving at our final decision, we have considered Gippsland Water's responses to our draft decision.

This paper sets out our final decision.

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<sup>14</sup> A recording of this forum is available on our website.

<sup>15</sup> All references to Gippsland Water's price submission in this document refer to Gippsland Water's original price submission that it provided to us in September 2022 rather than its response to our draft decision.

## 2.1 Final decision paper outline

This final decision paper is structured around the steps we have taken to arrive at our price determination. In summary, these steps were:

- Determine the regulatory period (Section 2.2).
- Confirm the customer outcomes and service levels that Gippsland Water has committed to over the regulatory period (Chapter 3).
- Establish Gippsland 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 Gippsland Water's financial position, which we have also had regard to.

Chapter 7 outlines our assessment of Gippsland Water's price submission under the PREMO framework.

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

## 2.2 Regulatory period

Our final 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>16</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>17</sup>

Gippsland Water proposed, and our draft decision approved, a regulatory period of 5 years.

In a submission on our draft decisions, the Consumer Action Law Centre supported our proposed 5-year regulatory period. It noted that a 5-year period provided customers with predictability around billing and services and that having a uniform period across all businesses included in our current review meant it would be easier to generate public awareness and engagement.<sup>18</sup>

Accordingly, consistent with the reasons outlined in our guidance, and as proposed in our draft decision, our final decision is to set a regulatory period of 5 years.

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<sup>16</sup> This is a requirement of the WIRO, clause 9.

<sup>17</sup> For detail on the reasons for using 5 years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 18.

<sup>18</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 4.



## 3. Customer outcomes

The customer outcomes Gippsland Water plans to deliver over the regulatory period is 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 outlines our views on:

- Gippsland Water’s engagement with its customers in preparing its price submission (Section 3.1)
- whether Gippsland Water has delivered on the outcomes it committed to for the current regulatory period (2018–23) and the customer outcomes Gippsland Water is committing to for the next regulatory period (Section 3.2)
- Gippsland Water’s service standards for the regulatory period (Section 3.3)
- Gippsland Water’s proposed guaranteed service level scheme for the regulatory period (Section 3.4).

### 3.1 Customer and community engagement

Our guidance required Gippsland Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Gippsland Water’s engagement.<sup>19</sup>

As outlined in our draft decision, we consider Gippsland Water’s engagement with customers and community aligned with these principles in a number of ways. Gippsland Water’s engagement:

- began early, was developed in consultation with stakeholders, and involved feedback from over 3,500 customers and community
- used a range of engagement methods including a deliberative Customer Summit, and an independent Customer Reference Group for deliberations on the customer outcomes, measures and guaranteed service levels
- was tailored to the circumstances of its customer and community, including inclusive engagement activities to hear from people more likely to experience vulnerability
- was inclusive of First Nations people and Traditional Owners with ongoing and new targeted engagement with different local entities.

Our draft decision outlined several ways in which Gippsland Water demonstrated that its engagement influenced its proposals. These included:

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<sup>19</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 20. This guidance includes a focus on engagement by businesses with First Nations people and people experiencing vulnerability which are actions identified in our ‘Getting to fair’ strategy. See Essential Services Commission, *Getting to fair: Breaking down barriers to essential services*, August 2021.

- adopting all recommendations of the Customer Summit
- additional resources to its customer care team to improve early outreach
- opportunities and support for Aboriginal employment and collaborating to raise awareness and sense of pride in local Aboriginal culture
- decreasing the time to rectify a sewer blockage from 95 minutes to 80 minutes.

Our draft decision was to accept Gippsland Water's 'Leading' self-rating for the Engagement element of PREMO on the basis it had designed and delivered a robust and thorough engagement program and achieved strong customer and stakeholder influence on the proposals in its submission. Examples outlined in our draft decision included:

- the level of influence of its Customer Reference Group that helped develop the engagement program and functioned as an independent voice on Gippsland Water's engagement process
- the extent to which its engagement methods support effective participation in its engagement process, particularly by people experiencing vulnerability and its Traditional Owners
- the complexity of the issues it was willing to engage on particularly with its large customers, and the suitability of the methods used in undertaking this engagement
- its willingness to adopt all recommendations of its Customer Summit.

We have considered all submissions received in response to our draft decision. Our final decision is the same as our draft decision, which is to accept Gippsland Water's self-rating of 'Leading' for its price submission engagement.

See Chapter 7 for more detail on our PREMO assessment of Gippsland Water's price submission.

## **3.2 Outcomes**

Gippsland Water's proposed set of outcomes indicates the value its customers can expect to receive during the next regulatory period. Actual performance against output measures and targets is monitored during the regulatory period to demonstrate whether customers are receiving the value they paid for. It also informs the rating for the 'Performance' element of PREMO at the next price review.

Gippsland Water proposed to deliver the following outcomes over the regulatory period starting 1 July 2023:

- Be affordable and fair
- Do your job well
- Be easy to deal with
- Be involved in the community
- Be environmentally responsible
- Plan for the future.

Gippsland Water's proposed measures and targets that it will use to report on its performance for each outcome are detailed on pages 61 to 66 of its price submission.

In our draft decision, we agreed with Gippsland Water's self-assessment that it has, overall, met its outcome commitments for the 2018–23 period to date, and that its reporting to customers during this period met our requirements.

We considered its proposed set of outcomes for 2023–28 demonstrated an overall improvement in customer value and was consistent with the requirements of an 'Advanced' rating for the Outcomes element of PREMO. After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Gippsland Water's outcomes.<sup>20</sup>

In our draft decision, we noted that some of the proposed outcome measures and targets were not presented in a manner consistent with our guidance requirements.

In response to our draft decision, Gippsland Water amended its outcome measures and targets. We have worked with Gippsland Water to ensure its final set of measures and targets meets the requirements set out in our guidance.

Following the release of this final decision, we will publish the 2023–28 outcome reporting template for all water businesses participating in this price review, and we expect water businesses to publish them prominently on their own websites.

Our assessment of Gippsland Water's outcomes, measures and targets has informed our final decision rating of its price submission for the Outcomes element of PREMO, which is discussed in Chapter 7.

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

Gippsland Water provided a list of service standards relating to reliability and attending faults that it will include in its customer charter. Service standards are a common set of services applicable to all Victorian consumers as required by clause 18.2 of the Water Industry Standard – Urban Customer Service (Urban Water Industry Standard). Each water business must specify its own targets against each of these service standards. These service standards and corresponding target service levels are the minimum level of service customers can expect to receive.

Our draft decision summarised Gippsland Water's proposed changes in its service standards and the reasons that we considered that they comply with the requirements of the Urban Water Industry Standard.

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<sup>20</sup> A submission from the Consumer Action Law Centre (CALC) commended all businesses for working closely with customers to develop their proposed outcomes set. Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2023.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Gippsland Water's service standards.

Our final assessment is that the service standards relating to reliability and faults proposed by Gippsland Water comply with the requirements of the Urban Water Industry Standard.

These service standards and Gippsland Water's targets until 2028 are set out in Appendix C.

Service standards are set out in the Urban Water Industry Standard. Accordingly, in early 2023-24, we will update the Urban Water Industry Standard to reflect targets set by the water business.

### **3.4 Guaranteed service levels**

Our final decision is to accept Gippsland Water's proposed guaranteed service levels as set out in Appendix D.

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

Gippsland Water's proposed guaranteed service levels are set out on pages 75 to 80 of its price submission. As summarised in our draft decision, Gippsland Water proposed to maintain five of its seven guaranteed service levels (with an increase in the amount payable for one of them) and proposed to remove two guaranteed service levels, which will be replaced by community and environmental commitments that are similar to the current arrangements.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. Our final decision is to accept the guaranteed service levels proposed by Gippsland Water on the basis that Gippsland Water is maintaining or strengthening its overall customer commitments, including but not limited to guaranteed service levels, and the changes have been agreed with customers during its engagement.

Guaranteed service levels are approved in our water industry standards. Accordingly, in early 2023-24, we will update the standards to reflect the guaranteed service levels set out in Appendix D.

## 4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>21</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 Gippsland 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 Gippsland 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 final decision is to approve a revenue requirement of \$703.9 million.

Gippsland Water proposed a revenue requirement of \$694.6 million over a 5-year period starting 1 July 2023. Our draft decision adopted a lower revenue requirement of \$692.5 million, reflecting our draft decision relating to the treatment of capital expenditure in 2022-23. Our final decision approves a revenue requirement of \$703.9 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>21</sup> We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Gippsland Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our final decision.

**Table 4.1 Final decision on Gippsland Water’s revenue requirement**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	89.4	90.2	91.4	92.3	91.6	454.9
Return on assets	23.6	24.1	25.5	27.0	28.3	128.6
Regulatory depreciation	21.7	22.9	24.0	25.2	26.7	120.4
Tax allowance	-	-	-	-	-	-
<b>Final decision – revenue requirement</b>	<b>134.6</b>	<b>137.2</b>	<b>140.9</b>	<b>144.5</b>	<b>146.6</b>	<b>703.9</b>

**Note:** Numbers have been rounded

Since our draft decision, we have updated our estimates for the cost of debt, licence fees, environmental contribution, and inflation to reflect the latest available information. We required Gippsland Water to update its revenue requirement and prices to reflect updates on inflation and the cost of debt and we updated the licence fee and environmental contribution estimates.

Gippsland Water provided an updated revenue requirement to reflect the updates to inflation and the cost of debt, as well as updates to its bulk water charges. It also proposed a change to its revenue requirement to reflect a decrease in its controllable operating expenditure due to the closure of facilities for two major customers (see Section 4.1).

Gippsland Water also updated its forecast operating expenditure (and revenue requirement) to reflect changes announced in the 2023-24 Victorian State Budget (see Section 4.1).

The main reason for the increase in our final decision revenue requirement compared to our draft decision is the updated estimate for the cost of debt, which reflects the rise in borrowing costs since Gippsland Water prepared its price submission.

The adjustments to Gippsland Water’s revenue requirement that we have made in our draft and final decisions are set out in Table 4.2, with the reasons outlined in the following sections.

**Table 4.2 Adjustments to revenue requirement – our draft and final decisions**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Gippsland Water's proposed revenue requirement</b>	<b>136.18</b>	<b>137.12</b>	<b>139.13</b>	<b>140.92</b>	<b>141.28</b>	<b>694.64</b>
<b>B. Total adjustments proposed in our draft decision</b>	<b>-0.47</b>	<b>-0.44</b>	<b>-0.43</b>	<b>-0.42</b>	<b>-0.41</b>	<b>-2.17</b>
Operating expenditure	-	0.00	-0.00	-0.00	-0.00	-0.01
Return on assets	-0.25	-0.23	-0.21	-0.20	-0.19	-1.07
Regulatory depreciation	-0.22	-0.22	-0.22	-0.22	-0.22	-1.09
Tax allowance	-	-	-	-	-	-
<b>C. Draft decision – revenue requirement (C = A+B)</b>	<b>135.71</b>	<b>136.68</b>	<b>138.70</b>	<b>140.50</b>	<b>140.87</b>	<b>692.47</b>
<b>D. Total adjustments in our final decision</b>	<b>-1.07</b>	<b>0.52</b>	<b>2.21</b>	<b>4.03</b>	<b>5.75</b>	<b>11.44</b>
Operating expenditure	0.03	0.06	-0.00	-0.01	-0.01	0.06
Return on assets	-1.09	0.47	2.21	4.03	5.76	11.38
Regulatory depreciation	-	-0.00	-0.00	-0.00	-0.00	-0.01
Tax allowance	-	-	-	-	-	-
<b>E. Final decision – revenue requirement (E = C + D)</b>	<b>134.65</b>	<b>137.21</b>	<b>140.91</b>	<b>144.52</b>	<b>146.62</b>	<b>703.90</b>

**Note:** Row A shows the total revenue requirement proposed by Gippsland Water in its price submission. Row B shows the total difference between our draft decision and what Gippsland Water proposed in its price submission. Row C shows the total revenue requirement we adopted in our draft decision. Row D shows the total difference between our final decision (row E) and our draft decision.

## 4.1 Operating expenditure

Our final decision is to adopt a forecast operating expenditure of \$454.9 million for Gippsland Water for the 2023–28 regulatory period.

Operating expenditure – comprising both controllable and non-controllable expenditure – is a component of the revenue requirement. Our draft decision proposed to adopt a forecast operating expenditure of \$454.9 million for the 5-year period, which is the same as the amount proposed by Gippsland Water.

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

**Table 4.3 Final decision – operating expenditure**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>80.99</b>	<b>81.96</b>	<b>83.41</b>	<b>84.49</b>	<b>83.88</b>	<b>414.72</b>
<b>Non-controllable operating expenditure</b>	<b>8.41</b>	<b>8.22</b>	<b>8.04</b>	<b>7.86</b>	<b>7.68</b>	<b>40.21</b>
Bulk services <sup>a</sup>	2.13	2.14	2.14	2.15	2.15	10.71
Environmental contribution <sup>b</sup>	5.75	5.56	5.37	5.19	5.01	26.88
Licence fees – Essential Services Commission <sup>c</sup>	0.12	0.11	0.11	0.11	0.11	0.56
Licence fees – Department of Health <sup>c</sup>	0.04	0.04	0.04	0.04	0.04	0.18
Licence fees – Environment Protection Authority <sup>c</sup>	0.38	0.38	0.38	0.38	0.38	1.88
<b>Final decision – operating expenditure</b>	<b>89.40</b>	<b>90.18</b>	<b>91.44</b>	<b>92.34</b>	<b>91.57</b>	<b>454.93</b>

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

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

Table 4.4 sets out the adjustments we have made to controllable and non-controllable operating expenditure for our draft decision, and since our draft decision. Details of our assessment and the reasons for our final decision adjustments are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).



The operating expenditure that we have adopted for Gippsland Water does not represent the amount that Gippsland 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, meet its legislative and policy objectives, and to maintain services over the regulatory period.

**Table 4.4 Our adjustments to Gippsland Water’s operating expenditure for our draft and final decisions**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Gippsland Water’s proposed total operating expenditure</b>	<b>89.37</b>	<b>90.12</b>	<b>91.44</b>	<b>92.35</b>	<b>91.58</b>	<b>454.87</b>
A1 – Our draft decision adjustments to controllable operating costs	-2.11	-2.13	-2.18	-2.17	-2.16	-10.76
A2 – Our draft decision adjustments to non-controllable operating costs	2.11	2.13	2.18	2.17	2.16	10.76
<b>B. Draft decision – total operating expenditure</b>	<b>89.37</b>	<b>90.12</b>	<b>91.44</b>	<b>92.35</b>	<b>91.58</b>	<b>454.87</b>
<b>C. Final adjustments to controllable operating costs (C1 + C2 + C3)</b>	<b>-0.05</b>	<b>0.02</b>	<b>0.03</b>	<b>0.04</b>	<b>0.04</b>	<b>0.08</b>
C1 – Opal savings	-0.34	-0.34	-0.34	-0.34	-0.34	-1.70
C2 – Saputo savings	-0.04	-0.04	-0.04	-0.04	-0.04	-0.18
C3 – 2023-24 State Budget updates	0.32	0.40	0.41	0.41	0.42	1.95

Continued next page

**Table 4.4 (continued)**

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 + D5)</b>	<b>0.08</b>	<b>0.03</b>	<b>-0.04</b>	<b>-0.04</b>	<b>-0.06</b>	<b>-0.03</b>
D1 – Environmental contribution	-0.03	-0.05	-0.08	-0.10	-0.12	-0.38
D2 – Licence fees – Essential Services Commission	0.00	0.00	-0.00	-0.01	-0.01	-0.01
D3 – Licence fees – Department of Health	-0.00	-0.00	-0.00	-0.00	-0.00	-0.00
D4 – Licence fees – Environment Protection Authority	0.08	0.08	0.08	0.08	0.08	0.41
D5 – External bulk water charges	0.02	0.00	-0.04	-0.02	-0.01	-0.04
<b>E. Final decision – total operating expenditure (E = B + C + D)</b>	<b>89.40</b>	<b>90.18</b>	<b>91.44</b>	<b>92.34</b>	<b>91.57</b>	<b>454.93</b>

**Note:** See our draft decision for details of the adjustments we proposed in our draft decision (shown in rows A1 and A2). The adjustments shown in rows C and D (and disaggregated in rows C1 to C3 and D1 to D5) are the differences between our draft decision and our final decision and are outlined in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure) of this final decision. Numbers have been rounded.

#### **4.1.1 Controllable operating expenditure**

In relation to controllable operating expenditure, our preliminary findings (outlined in Section 4.1.1 of our draft decision) were that:

- We considered Gippsland Water’s proposal reflected an efficient baseline cost to forecast annual operating expenditure.
- Gippsland Water had proposed an efficiency improvement rate of 0.5 per cent per year, but had not proposed an operating expenditure growth rate to apply across the next regulatory period and instead proposed annual cost adjustments totalling \$4.9 million across the 2023–28 regulatory period to account for growth related costs.
- Using this approach of annual cost adjustments, Gippsland Water has effectively proposed an equivalent efficiency commitment of 1.7 per cent per year against its cost growth allowance, or a net efficiency rate of 0.5 per cent per year.
- Gippsland Water is one of only four water businesses proposing a net average decrease in baseline operating expenditure for the next regulatory period.

- We identified that Gippsland Water had misclassified bulk water charges paid to Melbourne Water and Southern Rural Water as controllable rather than non-controllable operating expenditure. Gippsland Water provided revised figures, which were reflected in our draft decision.
- There is evidence that Gippsland Water has significantly tested its controllable expenditure requirements and that forecast cost adjustment additions were prudent and efficient.

In its response to our draft decision, Gippsland Water advised that two unforeseen events have materialised since its price submission was lodged:

- Saputo Dairy Australia announced on 9 November 2022 that it would be permanently closing its Maffra production facility by March 2023.
- Opal Australia announced in February 2023 that it would immediately close its M5 (white) paper machine located at the Maryvale mill.

These were two of Gippsland Water's major customers and Gippsland Water estimates that the closures will have an associated reduction in controllable operating expenditure of \$1.87 million over the next regulatory period.<sup>22</sup> Our final decision reflects this adjustment because it was based on the latest information available to Gippsland Water.

Following release of the 2023-24 Victorian State Budget on 23 May, we wrote to water businesses to provide them with an opportunity to update their cost forecasts, should they seek to claim any additional costs and reflect these in customer prices.<sup>23</sup>

Gippsland Water responded with updated cost forecasts to reflect higher payments relating to payroll tax and WorkCover premiums. We have accepted these additional amounts as they are unavoidable costs that the business faces in delivering prescribed services to its customers.

No other considerations were presented by Gippsland Water or in submissions received following the draft decision which caused us to change our views on any other aspect of Gippsland Water's operating expenditure.

Accordingly, on the basis that it is consistent with our guidance, our final decision is to adopt a revised controllable operating expenditure of \$414.72 million (Table 4.3).

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<sup>22</sup> Gippsland Water, *submission in response to the Essential Services Commission 'Gippsland Water draft decision: 2023 water price review'*, 18 April 2023, pp. 3-4.

<sup>23</sup> Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023.

### 4.1.2 Non-controllable operating expenditure

In relation to non-controllable operating expenditure, our preliminary findings (outlined in Section 4.1.2 of our draft decision) were that:

- Gippsland Water had followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission, after correctly reclassifying its bulk water charges as non-controllable operating expenditure.
- Gippsland Water's forecast bulk charges were consistent with both Melbourne Water's 2021 price determination and Southern Rural Water's proposed charges for the next regulatory period.

We noted in our draft decision that we would update the forecast non-controllable operating expenditure for our final decision, and also adjust for the latest inflation and external bulk charges data.<sup>24</sup>

For the environmental contribution, we have used the 2022-23 value provided by the Department of Energy, Environment and Climate Action and assumed that this will remain flat in nominal terms (decline in real terms) across the 2023–28 regulatory period.

We have assumed the licence fees for the Department of Health and the Environment Protection Authority Victoria remain flat in real terms across the period.<sup>25</sup>

For our Essential Services Commission licence fee, we have taken our forecast fee estimate schedule, which is based on the expected work program across the 2023–28 regulatory period (which is in nominal dollars) and deflated it into 2022-23 dollars to express the fee in real terms.<sup>26</sup>

In May 2023, we advised Gippsland Water of our approved bulk water charges for Melbourne Water for 2023-24. In response, Gippsland Water updated its forecasts for bulk water charges.

We have decreased Gippsland Water's draft decision forecast non-controllable operating expenditure by \$0.03 million across the 2023–28 period, resulting from the following adjustments:

- \$0.40 million increase for licence fees after considering the latest information received from the relevant regulatory authorities

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<sup>24</sup> Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

<sup>25</sup> For the Safe Drinking Water Administration levy, we have used the 2021-22 value provided by the Department of Health and indexed it by the annual rate for fees in 2022-23 (1.75 per cent), as set out by the Department of Treasury and Finance's cost recovery guidelines (<https://www.dtf.vic.gov.au/financial-management-government/indexation-fees-and-penalties>). We have applied the same approach to the 2021-22 licence fee provided by the Environment Protection Authority Victoria.

<sup>26</sup> These fees are yet to be determined by the Minister for Water.

- \$0.38 million decrease for the environmental contribution to account for the latest data on inflation.
- \$0.04 million decrease for external bulk water charges as revised by Gippsland Water to reflect the Melbourne Water bulk charges for 2023-24.

Accordingly, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised non-controllable operating expenditure of \$40.21 million over the next regulatory period.

## 4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$267.7 million.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Our draft decision proposed to adopt a forecast capital expenditure of \$267.7 million for the 5-year period, as proposed by Gippsland Water.

The reasons for our draft decision were:

- Gippsland Water demonstrated it has adopted a reasonable approach to developing its capital program, and that its capital expenditure forecasts are prudent and efficient.
- We considered the planned capital expenditure program is achievable, given Gippsland Water's past track record delivering its capital expenditure program.
- Gippsland Water has an appropriate approach for managing expenditure associated with uncertain projects, excluding \$8.2 million of expenditure for two projects. We reiterate that Gippsland 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.
- We considered Gippsland Water's approach to forecasting its capital expenditure is consistent with the requirements of our guidance.

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$267.7 million for the 5-year period (Table 4.6), as proposed in our draft decision and for the same reasons proposed in our draft decision. We consider this benchmark is consistent with our guidance and the principles in the Water Industry Regulatory Order (2014). Our final decisions on Gippsland Water's forecast regulatory asset base (Table 4.6) and revenue requirement (Table 4.1) reflect this benchmark.

The benchmark that we propose to adopt for Gippsland Water does not represent the amount that Gippsland 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 Gippsland Water's revenue requirement, we are not requiring the business to remove that project. Gippsland Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

### 4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>27</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4) and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Gippsland 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 final decision is to approve a closing regulatory asset base at 30 June 2022 of \$875.0 million.

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>28</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>29</sup>

In our draft decision, we accepted Gippsland Water's proposed closing regulatory asset base on that basis that it was calculated in accordance with the requirements of our guidance and that Gippsland Water had justified the prudence of its projects contributing to higher than forecast capital expenditure.

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<sup>27</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

<sup>28</sup> See Section 4.2 for a discussion of Gippsland Water's capital expenditure.

<sup>29</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 business's water, sewerage or recycled water networks.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. Therefore, our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$875 million (Table 4.5).

**Table 4.5 Final decision – 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>726.7</b>	<b>752.6</b>	<b>781.4</b>	<b>814.0</b>	<b>854.3</b>
Plus gross capital expenditure	49.3	48.8	53.4	63.7	43.5
Less government contributions	-	-	-	-	-
Less customer contributions	3.7	0.0	0.1	1.4	-
Less proceeds from disposals	0.5	0.5	0.3	0.7	0.6
Less regulatory depreciation	19.3	19.5	20.4	21.3	22.3
<b>Closing RAB 30 June</b>	<b>752.6</b>	<b>781.4</b>	<b>814.0</b>	<b>854.3</b>	<b>875.0</b>

**Note:** Numbers have been rounded.

### 4.3.2 Forecast regulatory asset base

Our final decision is to adopt a forecast regulatory asset base as set out in Table 4.6.

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.

Our draft decision did not accept Gippsland Water’s forecast regulatory asset base for the period from 1 July 2023 as we were not satisfied that:

- Gippsland Water had justified amounts above the 2022-23 benchmark adopted in the 2018 water price review for the Drouin Wastewater Treatment Plant
- Gippsland Water had justified additional amounts for inclusion in its forecast regulatory asset base for 2022-23 for the bring-forward of shared assets expenditure, noting these costs are typically recovered through new customer contributions.

In response to our draft decision, Gippsland Water accepted our adjustments to the capital expenditure component of the regulatory asset base for 2022-23 forecast to align this with the

benchmark adopted in the 2018 price review in accordance with our guidance.<sup>30</sup> Gippsland Water also responded to our request for information about why the bringing forward of shared assets expenditure was not reflected in its proposed new customer contributions charges. It advised it would seek to recover the 2022-23 forecast shared assets expenditure using its proposed average incremental cost new customer contribution methodology, and provided revised customer contribution forecasts as a result.

Our final decision on Gippsland Water's forecast regulatory asset base from 1 July 2023 reflects the 2022-23 benchmark adopted in the 2018 price review and Gippsland Water's revised customer contributions forecasts (Table 4.6)

Our final decision on Gippsland Water's forecast regulatory asset base reflects our final decisions on its closing regulatory asset base and the components of the forecast regulatory asset base, which are outlined in the following sections of this final decision paper:

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

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<sup>30</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 38.



**Table 4.6 Final decision – 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>875.0</b>	<b>892.7</b>	<b>929.5</b>	<b>948.7</b>	<b>975.6</b>	<b>993.5</b>
Plus gross capital expenditure	41.7	<b>59.6</b>	48.9	63.1	56.8	39.3
Less government contributions	-	-	-	-	-	-
Less customer contributions	0.4	0.3	6.3	11.7	13.4	9.6
Less proceeds from disposals	0.3	0.8	0.5	0.6	0.3	0.5
Less regulatory depreciation	23.4	21.7	22.9	24.0	25.2	26.7
<b>Closing RAB 30 June</b>	<b>892.7</b>	<b>929.5</b>	<b>948.7</b>	<b>975.6</b>	<b>993.5</b>	<b>996.0</b>

**Note:** Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our final decision is to adopt the benchmarks for customer contributions as set out in Table 4.6.

Our draft decision proposed to accept Gippsland Water’s forecast revenue from customer contributions because they are reasonable, having regard to past trends and its growth forecasts.<sup>31</sup>

In response to our draft decision and as discussed in Section 5.4, Gippsland Water’s proposed new customer contributions have increased as a result of recovering the 2022-23 shared assets sewer expenditure from new customer contributions. Gippsland Water has adjusted the forecast revenue from customer contributions accordingly.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision accepts the benchmark revenue from customer contributions as updated by Gippsland Water as set out in Table 4.6.

<sup>31</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water business’s water, sewerage or recycled water networks.

## 4.4 Rate of return

In establishing the return on assets component of Gippsland Water’s revenue requirement, we have applied a rate of return to Gippsland 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 final decision is to accept the updated cost of debt figures used by Gippsland Water to calculate its revenue requirement.

In our draft decision we proposed to approve the cost of debt proposed by Gippsland Water as it used the cost of debt values we specified in our guidance to calculate its revenue requirement. We also noted that our estimate of 3.75 per cent for the cost of debt in 2022-23 would be updated to reflect the latest available data.

In May 2023, we provided Gippsland Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.<sup>32</sup> This reflects the rise in borrowing costs over the past 12 months. Gippsland Water used this updated value to recalculate its revenue requirement. For the above reasons, our final decision adopts the updated figures for the benchmark cost of debt as set out in Table 4.7.

This increase in the cost of debt is the main contributor to the increase in our final decision revenue requirement compared to our draft decision.

**Table 4.7** Final decision – 10-year 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%	6.76%

**Note:** Numbers have been rounded.

<sup>32</sup> These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

## 4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.5 per cent in real terms, which reflects Gippsland Water's PREMO 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 Gippsland Water's PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water business's self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business's self-rating and our rating.<sup>33</sup>

Gippsland Water rated its price submission as 'Advanced'. Based on this PREMO self-rating, Gippsland Water proposed a real return on equity of 4.5 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as 'Advanced'.<sup>34</sup>

Our draft decision adopted Gippsland Water's proposed return on equity, which reflected our preliminary overall PREMO rating of its price submission.

After considering all submissions received in response to our draft decision, our final decision on Gippsland Water's overall PREMO rating remains the same as our draft decision.

Therefore, our final decision is to adopt Gippsland Water's proposed return on equity of 4.5 per cent per year, reflecting our final decision on the overall PREMO rating of its price submission (see Chapter 7).

## 4.4.3 Long term inflation forecast

A long-term inflation forecast is needed to convert the nominal cost of debt (outlined in Section 4.4.2 above) to real terms. A higher rate of inflation means a lower cost of debt in real terms, which would flow through to a lower revenue requirement and lower prices, all other things being equal. Conversely, a lower long-term inflation rate will flow through to increased prices, all other things being equal.

In addition to updating our estimate for the cost of debt, in May 2023 we also updated businesses on our long-term inflation forecast. We advised businesses that the long-term inflation rate we

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<sup>33</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 42-43.

<sup>34</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 42.

calculated was 3.5 per cent.<sup>35</sup> All businesses adopted this amount to calculate prices in their responses to our draft decision. We checked this estimate again for our final decision, based on the method below.

While we have estimated inflation based on the outcome of the two methods specified in our guidance – the ‘RBA geometric mean’ and the ‘bond breakeven’ methods – we have varied our approach given the relatively high near-term inflation environment. While our guidance indicated that our calculation of long-term inflation would cover a 10-year forecast period, we consider in the current high inflation environment, that this would lead to outcomes that underestimate inflation in the 2023–28 regulatory period, which would not be in the interests of customers. Accordingly, we have adopted an averaging period of 5 years. This is consistent with the time period adopted by other economic regulators, including the Australian Energy Regulator.

Estimates we have adopted for each year of the 2023–28 regulatory period under the ‘RBA geometric mean’ approach are set out in Appendix E. Using the ‘RBA geometric mean’ approach we estimate an inflation rate of 3.8 per cent.<sup>36</sup>

For the ‘bond breakeven’ approach, we estimate a 5-year average rate of 3.3 per cent, with the estimates adopted for each year of the 2023–28 regulatory period also set out in Appendix E.<sup>37</sup>

The average outcome under the two approaches is 3.5 per cent, which we have adopted for our final decision.

However, to manage the risk that inflation falls well below our forecast, our price determinations include a provision that allows for a reconsideration of the inflation forecast adopted, if inflation falls below 2.5 per cent by 2026-27.<sup>38</sup> The updated inflation estimate, if needed, would be based on a 5-year averaging period.

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<sup>35</sup> The inflation rate adopted in our draft decision was 3 per cent.

<sup>36</sup> We have decided to use a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>37</sup> Similar to the ‘RBA geometric mean’ approach, we have adopted a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>38</sup> With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.

## 4.5 Regulatory depreciation

Our final decision is to adopt a forecast regulatory depreciation as set out at Table 4.6.

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

As indicated in our draft decision, Gippsland Water's proposed forecast regulatory depreciation was calculated using a straight-line depreciation profile. We stated in our guidance that we prefer this approach.<sup>39</sup> However, due to adjustments we proposed to its forecast regulatory asset base, our draft decision did not accept Gippsland Water's forecast regulatory depreciation.

We required Gippsland Water to respond to our draft decision with an updated estimate for depreciation based on our adjustment to the forecast regulatory asset base. In its response, Gippsland Water provided updated estimates for the forecast regulatory asset base (see Section 4.3.2) and regulatory depreciation.

We received no submissions from other stakeholders on this issue.

On that basis, our final decision is to adopt the updated forecast regulatory depreciation of \$120.4 million provided by Gippsland Water because it was calculated in a manner consistent with our guidance. Our final decision is reflected in Table 4.6 in Section 4.3.2.

## 4.6 Tax allowance

Our final decision is to adopt Gippsland Water's forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Gippsland Water proposed no forecast tax allowance based on an anticipated tax ruling, with a pass-through mechanism to allow its revenue requirement to reflect the tax that would be payable should the ruling not eventuate.

Our draft decision did not accept this proposal, as we considered the benchmark tax allowance should have reflected either the legal obligation applying at the time or a decision by the business to accept the risk on behalf of customers should tax be payable. We did not adjust the tax allowance in the revenue requirement for our draft decision. Instead, we required Gippsland Water to respond to our draft decision confirming its approach to this issue.

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<sup>39</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

In its response to our draft decision, Gippsland Water advised it had received updated advice that it would no longer be in a tax paying position during the 2023–28 regulatory period. Further, it accepted the commission’s draft decision and removed its proposal for an income tax pass through. That is, it will absorb any tax liability on behalf of customers should it become liable to pay income tax during the period. We consider that this approach is appropriate because it sees Gippsland Water, not its customers, absorb the risk in the event that the tax ruling does not pass.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision adopts a forecast of no tax allowance for the 5-year regulatory period, as set out in Table 4.1.

## 5. Demand, tariffs and prices

Once Gippsland 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 final decision is to accept Gippsland Water's demand forecasts.

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

In our draft decision, we accepted Gippsland Water's proposed demand forecasts but required Gippsland Water in its response to our draft decision to demonstrate how it has considered the updated Victorian Government population and dwelling growth estimates that had been made available to water businesses.

In response to our draft decision, Gippsland Water reviewed its forecasts against the updated Victorian Government estimates and did not adjust its demand forecasts as its forecasts are closely aligned with the updated Victorian Government growth estimates for its service area. Given the closeness between Gippsland Water's forecasts and the Victorian Government estimates, we consider this an appropriate approach.

On that basis, our final decision approves Gippsland Water's demand forecasts because they were estimated consistently with the requirements of our guidance.

### 5.2 Form of price control

Our final decision is to accept Gippsland Water's proposed price cap form of price control.

Our draft decision accepted Gippsland Water's proposal to retain a price cap form of price control. Among other things, we considered that a price cap provides customers with price certainty, and means Gippsland Water is managing demand risk on behalf of its customers.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision approves Gippsland Water's proposed price cap form of price control.<sup>40</sup>

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<sup>40</sup> We note our determinations allow water businesses flexibility to apply to change from a price cap to a weighted average price cap or tariff basket within a regulatory period.

## 5.3 Tariff structures and prices

Our draft decision accepted Gippsland Water’s proposed tariff structures but, like all our draft decisions in this review, did not approve prices for each tariff, because Gippsland Water needed to update its proposed prices to reflect our updates to inflation and cost of debt estimates.

Our final decision on tariff structures and prices is set out below.

### 5.3.1 Tariff structures

Our final decision is to accept Gippsland Water’s proposed tariff structures.

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>41</sup> This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our draft decision accepted Gippsland Water’s proposal to retain its existing tariff structures, including:

- for water services – a two-part tariff with a fixed service charge and a variable usage component that depends on water use
- for residential sewerage services – a fixed charge only
- for non-residential sewerage services – a two-part tariff with a fixed service charge and a variable usage component.

In our draft decision, we considered the two-part structure for water services will promote the efficient use of these services. It also sends customers a signal about the costs of their water use and is an approach that is commonly applied in other states and territories.<sup>42</sup> We also considered two-part tariff structures were easy to understand.

In our draft decision, in relation to sewerage services, we considered the proposed fixed charge for residential customers was easy to understand and that the two-part tariff for non-residential customers sent these customers signals about efficient costs.<sup>43</sup>

The Consumer Action Law Centre noted that the water businesses in our current review have generally proposed no changes in their tariffs, particularly the balance between fixed and variable

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<sup>41</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 51.

<sup>42</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>43</sup> Our reasons are outlined in our 2013 draft decisions on price review 2013-14 to 2017-18.



charges. The Centre supported this outcome, given the impact on tenants when more weight is assigned to variable charges.<sup>44</sup> We consider that Gippsland Water’s proposal retains such a balance.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Gippsland Water’s tariff structures.

For the reasons set out above and given Gippsland Water’s proposed tariff structures are a continuation of its current approach, our final decision is to approve Gippsland Water’s proposed tariff structures.

### 5.3.2 Prices

Our final decision is to accept the revised prices proposed by Gippsland Water.

In our draft decision, we noted that Gippsland Water would need to propose updated prices to reflect our draft decision on its revenue requirement and our updates to inflation and cost of debt estimates.

Following our draft decision, Gippsland Water proposed revised prices that reflect the updates to our inflation and cost of debt of debt estimates, and to bulk water charges (see Section 4.1). Gippsland Water’s revised prices also reflect changes to its revenue requirement as a result of its response to our draft decision and to changes announced in the Victorian State Budget (See Section 4.1).

Gippsland Water’s revised prices also reflect changes to its assumptions relating to the closure of some facilities owned by its two major customers, as discussed in Section 4.1.1. Gippsland Water has readjusted its prices to cover the reduced revenue forecast from these major customers.<sup>45</sup> As a result, customer savings from Gippsland Water’s proposed price reduction in real terms over the 2023–28 regulatory period will slightly decrease compared to its original price submission.

In response to our draft decision, a Gippsland Water customer submitted that customers living in a block of units, who shared the same water and sewer lines, should not be charged the same prices as a house, given they do not receive individual services like a standalone house.<sup>46</sup>

Victorian (and interstate) water businesses including Gippsland Water, generally adopt a postage stamp pricing approach. This means that customers generally pay the same prices for water and

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<sup>44</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2023, p. 2.

<sup>45</sup> Closure of Saputo Maffra production facilities in March 2023 and immediate partial closure of Opal Maryvale.

<sup>46</sup> Patrick Ansell, *submission to the Essential Services Commission ‘Gippsland Water draft decision: 2023 water price review’*, 21 March 2023.

sewerage services, rather than pricing according to the different costs to provide services to individual customers. While more granular approaches to pricing could be adopted, this needs to be balanced against factors such as the complexity and costs of administering more granular pricing, and issues associated with equity of access to water and sewerage services.

Whilst a block of units might be provided services through one bulk water and one bulk sewerage pipeline, if each unit is provided its own separate water and sewerage service, a water business is entitled to charge water and sewerage service and usage charges to each unit. The *Water Act 1989* allows Gippsland Water to impose charges on an owner or occupier of a property for works and services provided to that property. We have responsibility to determine the maximum charges Gippsland Water can levy for services it provides. Gippsland Water must not levy charges that exceed this.

Our final decision is to approve the revised prices proposed by Gippsland Water because they have been calculated in a manner consistent with our guidance.

Our price determination for Gippsland Water sets out the maximum prices it may charge for the 5-year period from 1 July 2023 (or the manner in which its prices are to be calculated, determined, or otherwise regulated). Approved maximum prices for water and sewerage services applying to most residential and non-residential customers are set out in Tables 5.1 and 5.2. After 2023-24, water and sewerage prices will generally decrease by around 0.1 per cent per year, excluding inflation.

**Table 5.1 Final decision – water prices**

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Variable (\$/kL)	2.3209	2.3174	2.3139	2.3104	2.3070
Fixed (\$/year)	184.76	184.48	184.20	183.93	183.65
<b>Non-residential</b>					
Variable (\$/kL)	2.3209	2.3174	2.3139	2.3104	2.3070
Fixed (\$/year)	184.76	184.48	184.20	183.93	183.65

**Notes:** These prices have been expressed in \$2023-24 terms, which means 7 per cent inflation has been factored into the prices for 2023-24. For the remaining years shown, inflation will be added each year based on the latest inflation data. The figures in other tables of this report are expressed in \$2022-23, which means inflation has not been accounted for in 2023-24 or the remaining years of the 2023–28 regulatory period. Fixed prices relate to customers with 20mm sized pipes.

**Table 5.2 Final decision – sewerage prices**

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Fixed (\$/year)	848.88	847.60	846.33	845.06	843.79
<b>Non-residential</b>					
Variable (\$/kL)	4.5102	4.5102	4.5102	4.5102	4.5102
Fixed (\$/year)	848.88	847.60	846.33	845.06	843.79

**Notes:** These prices have been expressed in \$2023-24 terms, which means 7 per cent inflation has been factored into the prices for 2023-24. For the remaining years shown, inflation will be added each year based on the latest inflation data. The figures in other tables of this report are expressed in \$2022-23, which means inflation has not been accounted for in 2023-24 or the remaining years of the 2023–28 regulatory period. Fixed prices relate to customers with 20mm sized pipes.

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

In making our price determination, we must have regard to whether Gippsland Water’s prices take into account the interests of customers, including low income and vulnerable customers.<sup>47</sup>

As outlined in our draft decision, there is evidence that Gippsland Water has sought to address the interests of low income and vulnerable customers because it has proposed:

- to never restrict a customer’s water supply due to non-payment of bills, if Gippsland Water knows the customer is in hardship
- increasing involvement in future planning for people experiencing vulnerability through representation on its Customer Reference Group and Customer Sounding Board over the next 5 years
- adding two resources to its customer care team, and upskilling more staff to reach out early and provide tailored support for customers having difficulty
- investing in more targeted hardship support awareness campaigns (in response to feedback from its Customer Reference Group about the need to increase awareness of the support it provides to people experiencing financial difficulty).

The Consumer Action Law Centre expressed concerns that Gippsland Water does not appear to be proposing increased investment in its hardship programs.<sup>48</sup>

<sup>47</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

<sup>48</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, pp. 3–5.

We acknowledge the submission from the Consumer Action Law Centre and consider that Gippsland Water has taken into account the interests of low income and vulnerable customers through the initiatives above, as well as through its proposal to reduce its prices in real terms over the 2023-28 regulatory period.

#### 5.3.4 Other services

As indicated in our draft decision, Gippsland Water proposed adjustments to its trade waste methodology and tariffs and its miscellaneous fees and charges to make them cost reflective, and Gippsland Water has confirmed that its adjusted trade waste methodology and tariffs and its miscellaneous fees and charges are calculated in accordance with the pricing principles referenced in our guidance.<sup>49</sup>

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Gippsland Water's proposed trade waste tariffs and miscellaneous fees and charges.

Accordingly, our final decision accepts Gippsland Water's proposed trade waste tariffs and miscellaneous fees and charges because we consider that they are cost reflective and are calculated in accordance with the pricing principles in our guidance.

### 5.4 New customer contributions

Our final decision is to accept Gippsland Water's proposed new customer contributions and its negotiated new customer contribution framework.

New customer contributions (or developer charges) are levied by water businesses when a new connection is made to its water, sewerage or recycled water networks. New customer contributions can be either standard or negotiated. Standard charges apply to new connections in areas where infrastructure requirements and growth rates are relatively well known and designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.<sup>50</sup>

Negotiated charges allow water businesses and developers to negotiate a site-specific arrangement where standard charges are not fair and reasonable or where a new connection is outside the areas eligible for standard charges.<sup>51</sup>

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<sup>49</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 53.

<sup>50</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

<sup>51</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

As outlined in our draft decision, Gippsland Water proposed using a model based on average incremental cost to estimate its new customer contributions rather than the net incremental cost approach it has used in the past.

Our draft decision approved Gippsland Water's proposed new customer contributions because they met the new customer contribution pricing principles outlined in our guidance.<sup>52</sup> Gippsland Water's proposed new customer contributions excludes tax liability based on Gippsland Water's assumption that it will not be in a tax paying position pending an Australian Taxation Office decision on tax on gifted assets.

In response to our draft decision and as discussed in Section 4.3.2, Gippsland Water's 2022-23 shared assets sewer expenditure have been excluded from the 2022-23 opening regulatory asset base and proposed to be recovered from new customer contributions starting from 1 July 2023.<sup>53</sup> Gippsland Water also updated its assumption on long term inflation in its new customer contributions models. These two changes have resulted in a slight increase in new customer contributions compared to its original proposal. We considered Gippsland Water's proposed two adjustments are consistent with the commission's advice. Gippsland Water also confirmed that it will not be liable for an income tax payment during the 2023–28 regulatory period.

We have reviewed Gippsland Water's revised new customer contribution proposals against our paper guidance requirements.

In coming to our final decision, we have had regard to if and how Gippsland Water's proposal is consistent with the aims of the new customer contribution framework, which are to:

- send signals to developers about the costs of developing in different locations
- share the costs and benefits of growth between new and existing customers
- administer new customer contributions in a transparent way.<sup>54</sup>

On balance, we consider we can approve Gippsland Water's revised new customer contributions because the business has sufficiently addressed the pricing principles in our guidance and its proposal meets the aims of the new customer contributions framework.

Gippsland Water's proposed new customer contributions are based on cost reflective pricing across regions. This sends signals to developers about the costs of developing in different locations.

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<sup>52</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 59.

<sup>53</sup> Gippsland Water, *Response to 2022-23 water price review draft decision*, April 2023, p. 2.

<sup>54</sup> Essential Services Commission, *New Customer Contributions Explanatory Note Final*, December 2013, p.2.

The Consumer Action Law Centre made a submission on our draft decisions which reiterated its support for water businesses moving to higher more cost reflective new customer contributions. The Consumer Action Law Centre also supported our draft decision's call for clarity on the full proposed terms for transitioning to cost reflectivity.<sup>55</sup> Gippsland Water's proposed new customer contributions are cost reflective except for Moe/Newborough. Gippsland Water's proposed approach is part of a reasonable, transparent and customer-supported transition path for the Moe/Newborough system.

The Consumer Action Law Centre stated that in calculating new customer contribution charges water businesses should use the methodology proposed by the commission or provide justification of why their methodology is preferable.<sup>56</sup> Gippsland Water has provided public information on why it chose to adopt the average incremental cost method including information on the average incremental cost method and how it is meeting the legislative requirements.<sup>57</sup>

Our final decision is to approve Gippsland Water's proposed new customer contributions.

We wish to highlight that, to the extent necessary, developers may wish to consider using a negotiated new customer contribution in lieu of using the standard new customer contributions.

Regarding Gippsland Water's proposed negotiated new customer contribution framework, our draft decision accepted the framework. No new considerations were presented by Gippsland Water or in submissions received following the draft decision which caused us to change our views on Gippsland Water's negotiated new customer contribution framework. Our final decision is to accept Gippsland Water's negotiated new customer contribution framework because it is consistent with the requirements of the guidance.<sup>58</sup>

If there is a dispute between a developer and a water business (whether in relation to a standard or negotiated new customer contributions), developers may use the dispute resolution offered by a water business as part of its new customer contribution negotiating framework. In addition, developers may follow the *Water Act 1989* process to object and seek internal review by the water business, and to pursue unresolved matters through the Victorian Civil and Administrative Tribunal.<sup>59</sup>

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<sup>55</sup> Consumer Action Law Centre, Feedback on standard draft decisions: 2023 Water Price Review, 5 May 2023, p. 3.

<sup>56</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, p. 3.

<sup>57</sup> Gippsland Water, *Price submission 2023–28, September 2022*, pp. 224-233.

<sup>58</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 59.

<sup>59</sup> *Water Act 1989*, section 271.

## 5.4.1 Review of the framework for new customer contributions

Our guideline for new customer contributions establishes our expectations for standard new customer contributions and bespoke negotiated new customer contributions. However, in light of issues we identified during our 2023 water price review, we believe that a review of the regulatory framework for new customer contributions is necessary. Our review will aim to identify and address key implementation issues for water businesses, establish consistency in setting new customer contributions across the sector, and define the purpose and content of the negotiating framework.

### 5.4.1.1 Current issues

Our experience reviewing the new customer contributions proposals of water businesses in the current price review has identified varied practices across businesses in terms of their approach and substantiation of proposed charges to meet our guidance and the objectives of the framework. This includes varied approaches to the inclusion of costs in new customer contributions, differentiated pricing, and use of negotiated new customer contributions.

A number of businesses in the current price review also based their new customer contributions on an average incremental cost methodology, rather than the net incremental cost approach adopted in the past. We want to explore the issues associated with having different underlying approaches and how this affects confidence and transparency in the way new customer contributions are arrived at.

Other issues we have identified in the current review – such as varied approaches to locational and incremental cost reflectivity – and the transparency of new customer contributions and the nature of engagement, may also be covered in the review.

### 5.4.1.2 Next steps

In 2023-24, we intend to initiate a review of the framework for new customer contributions by issuing a consultation paper. This paper will outline the proposed scope of the review and seek feedback from stakeholders. We encourage stakeholders to suggest any other important matters that they believe should be included in the review.

Throughout the review process, we will actively engage with industry and stakeholders to gather their input.

## 5.5 Adjusting prices

Our final decision is to accept Gippsland Water's proposed price adjustment mechanism related to cost of debt adjustments.

Our draft decision was to not accept Gippsland Water's proposed price adjustment mechanisms to account for any tax liability but to accept Gippsland Water's proposed mechanism related to cost of debt adjustments.

In response to our draft decision and as discussed in Section 4.6, Gippsland Water advised us that it would not be liable for an income tax payment during the 2023–28 regulatory period. Gippsland Water has removed its proposed income tax pass through mechanism. It also stated that should it be in a tax paying position during the regulatory period, that it would absorb the tax liability and not pass it on to customers. We consider this approach appropriate because it means that Gippsland Water, not its customers, bear the risk in the event that it is in a tax paying position.

No new considerations were presented by other stakeholders in submissions received following our draft decision.

Consistent with our draft decision, our final decision accepts Gippsland Water's proposed price adjustment mechanism related to cost of debt adjustments as it is a continuation of its current approach.



## 6. Financial position

We have reviewed key indicators of Gippsland Water's financial performance and consider that Gippsland 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>60</sup> We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the Water Industry Regulatory Order (2014) to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

Our guidance set out key indicators of forecast financial performance. We have reviewed forecasts for these key indicators based on our final decision on Gippsland Water's prices. We have assessed that under our final decision, Gippsland Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

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<sup>60</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 business's revenue requirement to that business's level of ambition expressed in its price submission. Our guidance required Gippsland 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>61</sup> We required Gippsland 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 Gippsland 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 assessed and rated Gippsland Water's price submission. As outlined in our guidance, the combination of Gippsland Water's self-rating and our rating has determined the return on equity we have adopted to calculate Gippsland Water's revenue requirement in our final decision.

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

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

Gippsland 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 draft and final ratings of Gippsland Water's price submission. This rating is reflected in the return on equity we have approved for Gippsland Water (see Section 4.4.2).

Our PREMO assessment is set out in our draft decision.

No new considerations were presented by Gippsland Water or in submissions received following our draft decision.

For that reason and for the reasons set out in our draft decision, our final decision is to agree with Gippsland Water's proposed overall PREMO self-rating of 'Advanced'.

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<sup>61</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.

**Table 7.1**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Gippsland Water's self-rating	Advanced	Advanced	Leading	Leading	Advanced	Advanced
Commission's draft decision rating	Advanced	Advanced	Leading	Leading	Advanced	Advanced
Commission's final decision rating	Advanced	Advanced	Leading	Leading	Advanced	Advanced

In summary, the following matters support Gippsland Water's self-rating of its price submission as 'Advanced':

- Gippsland Water proposed relatively large real price reductions, underpinned by efficiencies and management of risk on behalf of customers – including through excluding \$8.2 million of uncertain project costs from its expenditure forecasts and adopting relatively optimistic demand projections (noting it faces downside revenue risk if demand does not meet these projections)
- Gippsland Water is performing well compared to most other businesses on its controllable operating costs in the current regulatory period, relative to benchmarks set at the 2018 price review
- its recognition of the possible impacts of a high inflation outlook on prices in the near term, and a proposed price path that helps to manage these impacts for its customers
- the overall strength of the justification for the prudence and efficiency of its forecast expenditure
- a strong engagement program which gives confidence that its proposals are informed by deep insights into customer priorities and concerns
- alignment of outcome commitments with customer priorities, with improvements in a number of outcome measures and targets adding to customer value
- sound performance against its outcome commitments in the current regulatory period, and a major project delivery record that compares favourably to other water businesses
- it provided a price submission and supporting model that were generally of a high quality.

## Appendix A – Submissions received on draft decision

Name or organisation	Date received
Patrick Ansell	21 March 2023
Gippsland Water	18 April 2023
Patrick Ansell	20 April 2023
Consumer Action Law Centre	5 May 2023
Registered Accommodation Association of Victoria	26 May 2023

## 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 final decision for Gippsland Water.

The WIRO requires the Commission to place particular emphasis on the promotion of efficient use of prescribed services by customers, the promotion of efficiency in water businesses as well as efficiency in, and the financial viability of, the regulated water industry and the provision to regulated entities of incentives to pursue efficiency improvements.

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>62</sup> Our draft and final decisions provide further information on where we have considered our guidance, and Gippsland Water’s compliance with our guidance, in making our price determination.<sup>63</sup>

Note: all chapter and section numbers referenced below refer to our final decision for Gippsland 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 final decision involved consideration of this factor:

- Our consideration of customer engagement (Section 3.1).
- Our assessment of the revenue requirement (Chapter 4).

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<sup>62</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>63</sup> Essential Services Commission, *Gippsland Water draft decision: 2023 water price review*, 2 March 2023; Essential Services Commission, *Gippsland Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

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

**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 final decision has therefore had regard to the extent that Gippsland 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 final 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 final decision involved consideration of this factor:

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

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

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

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

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

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

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable Gippsland Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>64</sup>

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

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

We have had regard to this matter in 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 final decision, we have had regard to the extent Gippsland 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.

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<sup>64</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.

The following chapters and sections of our final 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).

## **Industry specific matters**

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

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

The following chapters and sections of our final 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 final decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Gippsland 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 final decision provides for Gippsland 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>65</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>66</sup>
- tariff structures applied by water businesses throughout Australia<sup>67</sup>
- the regulatory rate of return set by other regulators.<sup>68</sup>

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

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

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

The following chapters and sections of our final 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 Gippsland Water’s proposals, including through submissions and public meetings.

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<sup>65</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

<sup>66</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>67</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>68</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 final 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 assessment of financial viability (Chapter 6).

**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 final 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 final 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 Gippsland 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 Gippsland Water’s prices enable customers or potential customers to easily understand prices, or the manner in which prices are calculated, determined or otherwise regulated:

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

The following sections of our final 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 Gippsland 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 final 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 Gippsland Water’s prices ‘take into account the interests of customers of the regulated entity, including low income and vulnerable customers’.**

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

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

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

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

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

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

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

The following chapters and sections of our final 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 final decision proposes to approve a revenue requirement that will enable Gippsland 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 final 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, Gippsland Water does not face any competition in the delivery of its prescribed services within its region. Our final 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 final decision involved consideration of this factor:

- Our assessment of engagement (Section 3.1)
- Our assessment of outcomes (Section 3.2)
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>69</sup>

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>70</sup>

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

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

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

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<sup>69</sup> Essential Services Commission 2016, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October, pp. 11–13.

<sup>70</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 2.

- allows for consultation with key stakeholders during a price review, including through the release of a draft decision.

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>71</sup>

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<sup>71</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, 26 October 2021, p. 2.

## Appendix C – Service standards

We have accepted the following standards, and conditions of service and supply, and associated targets for Gippsland Water. Service standards are set out in the Water Industry Standard –Urban Customer Service (Urban Water Industry Standard). Accordingly, in early 2023-24, we will update the Water Industry Standard to reflect adopt these service standards and targets.

### Water service standards

	2023-24	2024-25	2025-26	2026-27	2027-28
Minimum water pressure or flow rate a customer should receive (kPa or L/min)	137.3 kPa	137.3 kPa	137.3 kPa	137.3 kPa	137.3 kPa
Maximum number of unplanned water supply interruptions a customer should experience in any 12-month period	5	5	5	5	5
Average time taken to attend bursts and leaks (priority 1) (minutes)	35	35	35	35	35
Average time taken to attend bursts and leaks (priority 2) (minutes)	90	90	90	90	90
Average time taken to attend bursts and leaks (priority 3) (minutes)	1500	1500	1500	1500	1500
Average duration of unplanned water supply interruptions (minutes)	90	90	90	90	90
Average duration of planned water supply interruptions (minutes)	150	150	150	150	150

## Sewerage service standards

	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer should experience in any 12-month period	3	3	3	3	3
Average time to attend sewer spills and blockages (minutes)	40	40	40	40	40
Average time to rectify a sewer blockage (minutes)	95	95	95	95	95
Maximum time taken to contain a sewer spill (minutes)	300	300	300	300	300



## Appendix D – Guaranteed service level scheme

We have accepted the following service level obligations and corresponding payment amounts for failure to attain the stated obligation as the guaranteed service level scheme for Gippsland Water. Guaranteed service levels are approved in the Water Industry Standard – Urban Customer Service (Urban Water Industry Standard). Accordingly, in early 2023-24, we will update the Urban Water Industry Standard to reflect the guaranteed service levels set out below.

In accordance with clause 20(b) of the Urban Water Industry Standard, Gippsland Water must ensure that any payment is made to a customer as soon as practicable after a customer becomes entitled to the guaranteed service level payment.

Gippsland Water is not required to make a payment where the failure to meet the service level is due to the action or inaction of the customer or a third party. For the avoidance of doubt, a third party does not include any person or firm acting on behalf of Gippsland Water.

### Gippsland Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
If we restrict the water supply of, or take legal action against, a residential customers prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying	\$300 per day to a maximum of \$900 until their service is restored.
If we are required to issue a ‘boil water’ alert, we will contribute \$10,000 to the affected community.	\$10,000
If a planned interruption goes longer than advised then each affected customer will be compensated by a \$50 credit to their next water bill.	\$50
If a customer is affected by a planned interruption and was not provided a minimum of five days notification, we will credit that customer \$50 on their next water bill.	\$50
If a sewerage spill is not contained in a house within one hour then affected customers will receive \$500.	\$500

Note: These are nominal amounts, that is, the amount of payment will not be impacted by inflation.

## Appendix E – Inputs to calculation of long-term inflation

### Inflation – annual estimates (per cent)

	2023-24	2024-25	2025-26	2026-27	2027-28	Average
RBA geometric mean	7.0	4.1	3.1	2.5	2.5	3.8
Bond breakeven	7.0	2.3	2.3	2.3	2.3	3.3