

South East 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.

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Summary

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

In March 2023, we released our draft decision on the price submission South East Water submitted to us in September 2022.¹ The draft decision set out our preliminary views on South East Water's proposals and invited interested parties to make further submissions. We also held a public forum in May 2023. In addition to a response by South East Water, we received two 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 South East Water's response, we have made a price determination for South East Water.² The price determination sets out the maximum prices South East 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.

¹ Our draft decision for South East Water is available at www.esc.vic.gov.au/waterpricereview.

² 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, *South East Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

We have approved a revenue requirement of \$4,738.0 million over 5 years

Our final decision approves a revenue requirement of \$4,738.0 million over the 5-year period starting 1 July 2023 (see Chapter 4).³ This is \$106.5 million or 2.3 per cent higher than our draft decision, mainly due to an increase in operating cost forecasts (mainly resulting from updated estimates for bulk water charges payable to Melbourne Water) and our update to the cost of debt which reflects an increase in borrowing costs over the past 12 months.

This revenue requirement will allow South East 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 increase from 1 July 2023

A summary of approved maximum prices for major services delivered by South East 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 \$967 currently to \$990 in 2023-24. For a typical residential tenant, bills (including inflation) will rise from around \$515 currently to \$526 in 2023-24. The bill paid by each customer will vary depending on water use, prices for fixed and variable tariffs, and other charges.

From 2024-25, typical household bills will generally remain unchanged until 2027-28, excluding inflation.

³ The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health. Along with forecast demand, it is an input to calculating 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	150	\$967	\$990
Residential – tenant	150	\$515	\$526
Non-residential (small)	150	\$1,281	\$1,315
Non-residential (medium)	1,000	\$5,594	\$5,742
Non-residential (large)	10,000	\$51,254	\$52,609

Note: 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 South East 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.

Our final decision approves the tariffs proposed by South East Water, subject to a relatively small adjustment that reflects our final decision on its forecast bulk water charges (non-controllable operating expenditure, Section 4.1.2). The adjustment has been made to tariffs from 2024-25 and generally moves key water and sewerage tariffs lower by around 0.1 per cent per year, compared to South East Water’s proposal.

South East Water has committed to delivering a number of key outcomes for its customers

South East Water has committed to delivering the following outcomes for customers:

- ‘Get the basics right, always’
- ‘Warn me, inform me’
- ‘Fair and affordable for all’
- ‘Make my experience better’
- ‘Support my community, protect our environment’.⁴

Recognising the impacts of climate change and growth in its region, South East Water will invest in its infrastructure to help ensure quality and reliable services, support customers to use water wisely, and invest in alternative water supplies. It will also invest in its emergency response planning and achieving net zero emissions by 2030.

⁴ South East Water, 2023–28 water price submission, 30 September 2022, pp. 19-20.

South East Water will also focus on streamlining customer processes and providing customers with information when they need it. As part of its commitment to minimising its impact on the environment and supporting its community, South East Water has committed to continuing to learn from Traditional Owners in its service region, and one of its priorities is to engage with them in water and land planning and management.

Tariff structures will generally remain the same, but South East Water will simplify charges for residential customers

For residential customers receiving both water and sewerage services, South East Water proposed to combine its residential sewage disposal charge and its residential variable water charge. This was justified by South East Water based on support from customers (including their preference for simpler tariffs), and because the change will help customers respond to price signals. Our final decision is that we agree with its justification and our final decision approves this proposed change.

Our final decision is to approve other water and sewerage tariff structures proposed by South East Water because they remain unchanged and are generally supported by customers.

Our final decision also approves South East Water's proposed price cap form of price control, as this is a continuation of its current approach and otherwise meets the requirements of our guidance. 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.

We have rated South East Water's price submission as 'Advanced' under the PREMO framework

Consistent with our draft decision, our final decision is to rate South East Water's price submission as 'Advanced' under the PREMO framework (Table B). This is the same as South East Water's self-rating. Factors in support of South East Water's PREMO rating include that it proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (2 per cent), contributing to real price reductions over the 2023–28 regulatory period. Further, a number of outcome targets proposed by South East Water suggest an improvement in customer service which along with the real price reductions proposed by South East Water indicate customers will receive improved value over the 2023–28 regulatory period.

See Section 1.4 for an explanation of the PREMO framework and Chapter 7 for more detail on our assessment of South East 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

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
South East Water's self-rating	Advanced	Advanced	Advanced	Advanced	Standard	Advanced
Commission's rating	Advanced	Advanced	Advanced	Advanced	Standard	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 2023.⁵ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.⁶

South East 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

⁵ 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.

⁶ 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 guidance⁷
- 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 South East 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 South East Water, to inform their price submissions. The guidance set out how we would assess South East Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that South East Water would comply with certain requirements and specified information that South East Water must provide to us when submitting its price submission.⁸

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 South East Water's maximum proposed prices it can charge for the prescribed services it provides.⁹

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.¹⁰



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

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

⁸ 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.

⁹ This is a requirement of the WIRO, clause 14(a).

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

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

Continued next page

Table 1.1 (continued)

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

Note: References in the table are to the Water Industry Regulatory Order 2014 (WIRO), the Essential Services Commission Act 2001 (ESC Act), and the Water Industry Act 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.¹²

¹² 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.¹³

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

2. Our assessment of South East Water's price submission

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

- South East Water's price submission
- South East Water's presentation made directly to commissioners
- South East Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 2 May 2023¹⁴
- 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 South East 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. South East 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 30 March and 9 May 2023 and holding an online public forum on 2 May 2023. Questions asked by participants and responded to by South East Water during the forum related to the roll-out of digital meters, the cost reflectivity of new customer contributions, and guaranteed service levels.

South East 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 2023.¹⁵ In arriving at our final decision, we have considered South East Water's responses to our draft decision.

This paper sets out our final decision.

¹⁴ A recording of this forum is available on our website.

¹⁵ All references to South East Water's price submission in this document refer to South East 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 South East Water has committed to over the regulatory period (Chapter 3).
- Establish South East 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 South East Water's financial position, which we have also had regard to.

Chapter 7 outlines our assessment of South East 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.¹⁶ 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.¹⁷

South East 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.¹⁸

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.

¹⁶ This is a requirement of the WIRO, clause 9.

¹⁷ 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.

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

3. Customer outcomes

The customer outcomes South East 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:

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

3.1 Customer and community engagement

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

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

- began early and was wide reaching – engaging over 8,500 customers and community
- used a range of methods suited to the issues it engaged on and the context in which it engaged, including for customers experiencing vulnerability
- was responsive to the preferences of its First Nations customers, adopting methods they proposed and ensuring their input informed the recommendations of the community panel
- covered matters that influence services and prices, including sewer spills, digital meters, integrated water management and water conservation.

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

- a price decrease in real terms

¹⁹ 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.

- investment to further develop and deliver its water literacy strategy to build community water knowledge and reduce water bills through behaviour change
- a digital metering program to assist in the identification of problems at an earlier stage leading to fewer disruptions and water savings
- investment in capacity building to improve engagement with Traditional Owners on land and water decision making
- two new guaranteed service levels paid directly to affected customers for water spills inside a customer's house and for failure to notify any planned water supply interruption.

Our draft decision was to accept South East Water's 'Advanced' 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 its proposals. Examples outlined in our draft decision included:

- early involvement from its Customer and Community Advisory Council in designing the engagement program and having oversight of the engagement process
- the extent to which it undertook inclusive engagement, including its methods to support the participation of customers with a disability or high medical needs
- the extent of the training and support it provided its deliberative panel members to assist them consider feedback and make informed recommendations to the business
- the extensive effort to enable a high degree of influence for its First Nations customers who were able to self-determine the nature and extent of their involvement in the development of the price submission.

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 South East Water's self-rating of 'Advanced' for its price submission engagement.

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

3.2 Outcomes

South East 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.

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

- 'Get the basics right, always'
- 'Warn me, inform me'

Customer outcomes

- 'Fair and affordable for all'
- 'Make my experience better'
- 'Support my community, protect my environment'.

South East Water's proposed measures and targets that it will use to report on the performance for each outcome are detailed on pages 36 to 42 of its price submission.

In our draft decision, we agreed with South East 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 South East Water's outcomes.²⁰

However, 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.

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

Following the release of this final decision, we will publish the 2023–28 outcomes 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 South East 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 further in Chapter 7.

3.3 Service standards related to service reliability and faults

South East 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.

²⁰ A submission from the Consumer Action Law Centre 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.

Our draft decision summarised South East Water’s proposed service standards and the reasons that we considered they comply with the requirements of the Urban Water Industry Standard.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on South East Water’s service standards. On that basis, our final assessment is that the service standards relating to reliability and faults proposed by South East Water comply with the requirements of the Urban Water Industry Standard.

These service standards and South East Water’s targets until 2028 are set out in Appendix C.

Service standards are set out in our Urban Water Industry Standard. 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 adopt the 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.

South East Water’s proposed guaranteed service levels are set out on pages 43 to 45 of its price submission and in a letter submitted to us on 1 December 2022.²¹ South East Water outlined that it was committed to implementing a quick and easy bottled water refund process.²² Our draft decision summarised South East Water’s proposed changes in its guaranteed service levels scheme from July 2023 (including the introduction of three new guaranteed service levels), and accepted the proposal on the basis that the guaranteed service levels had been agreed with customers during South East Water’s engagement.

In our draft decision we proposed to accept the guaranteed service levels proposed by South East Water on the basis that they have been agreed with customers during its engagement.

In its response to our draft decision, South East Water provided clarification of the affected customer number thresholds for both parts of its new guaranteed service level focused on water quality.²³ It also clarified that in relation to its guaranteed service level associated with the minimum period prior to planned works, the minimum is two business days, not 48 hours as it previously stated in its original price submission. This further information was clarificatory in nature and does

²¹ South East Water, Additional information on 2023 water price submission: Water quality GSL, 1 December 2022.

²² South East Water, Additional information on 2023 water price submission: Water quality GSL, 1 December 2022.

²³ South East Water, *submission in response to the Essential Services Commission ‘South East Water draft decision: 2023 water price review’*, 9 May 2023, p. 8.

not change our assessment of the proposed changes to South East Water's guaranteed service levels.

On the basis of the above, our final decision is to adopt the updated guaranteed service levels outlined in Appendix D. Guaranteed service levels are approved in our 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 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. 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 South East 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 South East 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 \$4,738.0 million.

South East Water proposed a revenue requirement of \$4,633.0 million over a 5-year period starting 1 July 2023. Our draft decision adopted a revenue requirement of \$4,631.5 million. Our final decision approves a revenue requirement of \$4,738.0 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

Table 4.1 Final decision on South East Water’s revenue requirement

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	703.5	706.5	709.3	706.4	704.2	3,530.0
Return on assets	100.9	104.8	114.4	124.9	136.5	581.4
Regulatory depreciation	118.3	108.1	104.1	110.2	121.4	562.2
Tax allowance	15.1	12.0	10.6	13.0	13.7	64.4
Final decision – revenue requirement	937.8	931.6	938.3	954.5	975.8	4,738.0

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 South East Water to update its revenue requirement and prices to reflect updates to inflation and the cost of debt, and we updated the licence fee and environmental contribution estimates.

In response to our draft decision, South East Water provided an updated revenue requirement to reflect the updates to inflation and the cost of debt. Additionally, South East Water proposed two further adjustments to its revenue requirement related to the cost profile of digital meters and inclusion of the costs and revenues for minor sewerage alteration services. We accepted these proposals and the adjustments are reflected in our final decision revenue requirement.

South East Water also proposed updated forecast operating expenditure to reflect changes announced in the 2023-24 Victorian State Budget (see Section 4.1). We also updated its non-controllable operating expenditure for the latest information on Melbourne Water bulk charges payable by South East Water (Section 4.1.2).

The main reasons for the increase in our final decision revenue requirement compared to our draft decision are the updated bulk water charges and the updated estimate for the cost of debt (which reflects the rise in borrowing costs since South East Water prepared its price submission).

The adjustments to South East 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
A. South East Water's proposed revenue requirement	944.2	923.4	921.6	917.5	926.3	4,633.0
B. Total adjustments proposed in our draft decision	-0.7	-0.3	-0.1	-0.1	-0.3	-1.5
Operating expenditure	3.9	3.9	3.9	3.8	3.8	19.4
Return on assets	-2.0	-1.9	-1.9	-1.9	-1.9	-9.6
Regulatory depreciation	-2.2	-2.0	-1.8	-1.9	-2.0	-10.0
Tax allowance	-0.4	-0.3	-0.2	-0.2	-0.2	-1.3
C. Draft decision – revenue requirement (C = A+B)	943.6	923.1	921.5	917.3	926.0	4,631.5
D. Total adjustments in our final decision	-5.8	8.4	16.8	37.2	49.9	106.5
Operating expenditure	2.3	10.2	9.7	20.4	23.1	65.6
Return on assets	-5.2	1.8	10.3	19.7	29.4	56.0
Regulatory depreciation	-0.7	-1.2	-0.9	-0.5	-0.2	-3.5
Tax allowance	-2.1	-2.2	-2.3	-2.4	-2.5	-11.5
E. Final decision – revenue requirement (E = C + D)	937.8	931.6	938.3	954.5	975.8	4,738.0

Note: Row A shows the total revenue requirement proposed by South East Water in its price submission. Row B shows the total difference between our draft decision and what South East 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 \$3,529.97 million for South East 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 \$3,464.4 million for the 5-year period, which was higher than the \$3,445 million proposed by South East Water mainly due to adjustments we proposed to align with its regulatory accounts.

Table 4.3 sets out our final decision on South East 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
Controllable operating expenditure	167.40	168.92	169.58	168.05	167.06	841.01
Non-controllable operating expenditure	536.08	537.63	539.70	538.40	537.14	2,688.96
Bulk services ^a	492.96	495.95	499.42	499.47	499.51	2,487.30
Environmental contribution ^b	41.99	40.57	39.20	37.87	36.59	196.23
Licence fees – Essential Services Commission ^c	0.79	0.76	0.73	0.71	0.69	3.68
Licence fees – Department of Health ^c	0.28	0.28	0.28	0.28	0.28	1.41
Licence fees – Environment Protection Authority ^c	0.07	0.07	0.07	0.07	0.07	0.34
Final decision – operating expenditure	703.48	706.55	709.28	706.45	704.20	3,529.97

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

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

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).

Revenue requirement

The operating expenditure that we have adopted for South East Water does not represent the amount that South East 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 South East Water’s operating expenditure for our draft and final decisions
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. South East Water’s proposed total operating expenditure	697.27	692.50	695.74	682.23	677.28	3,455.02
A1 – Our draft decision adjustments to controllable operating costs	3.95	3.90	3.86	3.84	3.82	19.37
A2 – Our draft decision adjustments to non-controllable operating costs	-	-	-	-	-	-
B. Draft decision – total operating expenditure	701.22	696.40	699.59	686.07	681.11	3,464.39
C. Final adjustments to controllable operating costs (C1 + C2 + C3)	3.71	5.64	5.59	5.57	5.55	26.04
C1 – Minor sewer alterations reclassification	4.88	4.82	4.77	4.76	4.74	23.97
C2 – Digital metering cost reprofiling	-1.58	0.40	0.40	0.40	0.40	0.00
C3 – 2023-24 State Budget updates	0.42	0.42	0.42	0.42	0.42	2.08

Continued next page

Table 4.4 (continued)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 + D5)	-1.44	4.51	4.10	14.81	17.55	39.53
D1 – Environmental contribution	-0.20	-0.39	-0.57	-0.74	-0.90	-2.81
D2 – Licence fees – Essential Services Commission	0.38	0.38	0.15	-0.16	-0.19	0.56
D3 – Licence fees – Department of Health	0.21	0.21	0.21	0.21	0.21	1.06
D4 – Licence fees – Environment Protection Authority	-0.22	-0.22	-0.22	-0.22	-0.22	-1.12
D5 – External bulk water charges	-1.60	4.55	4.53	15.73	18.64	41.85
E. Final decision – total operating expenditure (E = B + C + D)	703.48	706.55	709.28	706.45	704.20	3,529.97

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 rows 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 identified some capital expenditure in South East Water’s 2021-22 regulatory accounts that should have been treated as operating expenditure. Correcting for this resulted in a net increase of \$4.35 million to the baseline controllable operating expenditure, with a resulting increase of \$21.05 million in forecast operating expenditure across the 2023–28 regulatory period.
- We were not able to confirm that the new baseline of \$148.8 million (after adjusting to reconcile with the regulatory accounts, as described above) reflected an efficient baseline cost to forecast annual operating expenditure. However, we adopted this figure for the purposes of establishing South East Water’s revenue requirement for our draft decision, and requested the business provide further details on the timing of changes in its capitalisation policy across the 2018–23 regulatory period.

- South East Water had proposed an efficiency improvement rate of 2.0 per cent per year which is one of the highest rates when compared with other businesses in the current price review.
- As the efficiency improvement rate is higher than South East Water's proposed average cost growth rate (an average of 1.13 per cent per year) for the next regulatory period, this will effectively deliver a net annual decrease to its controllable baseline operating costs in each year of the regulatory period.
- We considered South East Water's forecast cost adjustment additions were prudent and efficient after removing the \$1.68 million step change that related to water literacy.
- There is evidence that South East Water has significantly tested its controllable expenditure requirements.

In its response to our draft decision, South East Water accepted our draft decision adjustments to its controllable operating expenditure. As requested, it also provided further information on the previous changes in its capitalisation policy on certain costs, and a timeline to show how these changes correlated with the baseline and 2021-22 benchmarks established at the 2018 price review.²⁴ We have verified that these shifts of capital expenditure to operating expenditure were not included in the 2018 operating expenditure baseline, and therefore were not included in the benchmark figure for 2021-22. Accordingly, we accept this explanation supports South East Water's proposed increase above the 2021-22 controllable operating expenditure benchmark, and this is consistent with our draft decision to adopt an efficient baseline of \$148.8 million.

South East Water also proposed two amendments to its controllable operating expenditure forecast:²⁵

- A reduction in operating expenditure associated with the digital meter program for 2023-24 due to supply chain issues resulting in delays to the commencement of the digital meter program, with those costs to be recovered in later years of the regulatory period. This results in a cost neutral change for the next regulatory period as it simply re-profiles the costs.
- An addition of \$4.95 million to the baseline for expenditure associated with minor sewer alterations requested by existing customers to their existing sewer assets, which South East Water has identified as prescribed services under the Water Industry Regulatory Order 2014. These costs were previously classified as non-prescribed services in the pricing model and were therefore not included in the controllable operating expenditure baseline.

²⁴ South East Water, *submission in response to the Essential Services Commission 'South East Water draft decision: 2023 water price review'*, 9 May 2023, pp. 14–15.

²⁵ South East Water, *submission in response to the Essential Services Commission 'South East Water draft decision: 2023 water price review'*, 9 May 2023, pp. 3–4.

We are satisfied with South East Water's two proposed amendments to its controllable operating expenditure because they are consistent with our guidance. While the inclusion of minor sewer alterations will increase the controllable operating expenditure for the next regulatory period, it will not result in higher customer prices, because the revenue from this service (incurred costs recovered from the customers requesting the alterations) has also been included in the financial model, and exceeds the cost forecast.²⁶ Accordingly, for our final decision we have adopted a higher efficient baseline of \$153.7 million, and increased the total controllable operating expenditure for the period by \$23.97 million to include these costs.

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.²⁷

South East Water responded with updated cost forecasts to reflect higher payments relating to payroll tax, land 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.

After considering all submissions received in response to our draft decision, on the basis that South East Water's proposed controllable operating expenditure is consistent with our guidance, our final decision is to accept South East Water's revised proposed controllable operating expenditure of \$841.0 million (Table 4.3).

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:

- South East Water had followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission.
- South East Water's forecast bulk charges were consistent with Melbourne Water's 2021 price determination.

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.²⁸

²⁶ South East Water, *submission in response to the Essential Services Commission 'South East Water draft decision: 2023 water price review'*, 9 May 2023, p. 3.

²⁷ Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023.

²⁸ Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

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.²⁹

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.³⁰

For Melbourne Water external bulk water charges, South East Water updated its bulk charges estimates after our draft decision to reflect updated information provided to it by Melbourne Water. As these figures included assumptions about future changes in the cost of debt and other changes in tariff structures that we have yet to consider or approve, we have not accepted the figures provided by South East Water.

We have instead calculated the external bulk water charges payable by South East Water based on the approved Melbourne Water bulk tariffs for 2023-24, and adopted the prescribed price movement applicable to these tariffs for 2024-25 and 2025-26 as set out in the Melbourne Water price determination, which is effective until 30 June 2026. For 2026-27 and 2027-28, we have held the bulk charges payable by South East Water to Melbourne Water constant, noting a new determination will be made in respect of these prices by the end of June 2026.

The adjustment mechanism in South East Water’s determination will enable its prices to adjust within the 2023–28 regulatory period to account for differences between forecast bulk water costs adopted in our final decision and its actual costs.

A summary of the external bulk water charges proposed and adopted for our final decision is shown in Table 4.5 below.

²⁹ 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.

³⁰ These fees are yet to be determined by the Minister for Water.

Table 4.5 Melbourne Water external bulk water charges payable by South East Water
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
South East Water's initial proposal	494.56	491.40	494.88	483.74	480.87	2,445.45
Draft decision	494.56	491.40	494.88	483.74	480.87	2,445.45
South East Water's update following updated Melbourne Water advice	492.96	494.47	505.19	497.28	503.20	2,493.10
Final decision	492.96	495.95	499.42	499.47	499.51	2,487.30

Notes: Numbers have been rounded.

We have increased South East Water's forecast non-controllable operating expenditure by \$39.53 million across the 2023–28 regulatory period, resulting from the following adjustments:

- \$0.49 million increase for licence fees after considering the latest information received from the relevant regulatory authorities
- \$2.81 million decrease for the environmental contribution to account for the latest data on inflation.
- \$41.85 million increase for external bulk water charges to reflect the approved Melbourne Water bulk charges for 2023-24 and align with the 2021 Melbourne Water price determination.

Accordingly, consistent with the reasoning in our guidance, our final decision is to adopt a revised non-controllable operating expenditure of \$2,688.96 million over the 5-year regulatory period.

4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$1,897.6 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 \$1,897.6 million for the 5-year period, which was \$23.5 million lower than the \$1,921.1 million proposed by South East Water.

The reasons for our draft decision were that:

- South East Water demonstrated it has adopted a reasonable approach to developing its capital program, and that its capital expenditure forecasts are prudent and efficient.
- We identified the inappropriate treatment of some corporate overhead costs as capital expenditure in South East Water's 2021-22 regulatory accounts, and corrected these to be operating expenditure (also discussed in Section 4.1.1). This adjustment resulted in the

removal of \$23.5 million of related forecast capital expenditure across the 2023–28 regulatory period.

- South East Water’s digital metering rollout (\$203.5 million across the regulatory period) has been developed following robust analysis on its digital metering trial results, has been developed based on sound risk assessment approaches and includes appropriate cost forecasts. South East Water has also committed to absorbing any cost overruns in the rollout.
- We considered the planned capital expenditure program is achievable, given the steps South East Water has taken to improve its delivery capability and its past track record delivering its capital expenditure program.
- We considered South East Water’s approach to forecasting its capital expenditure is consistent with the requirements of our guidance.

Table 4.6 Adjustments to forecast capital expenditure – our draft and final decisions
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. South East Water’s proposed forecast capital expenditure	351.96	380.20	392.38	399.87	396.65	1,921.07
A1 Adjustment – capitalisation of operating expenditure reversal	-4.70	-4.70	-4.70	-4.70	-4.70	-23.52
B. Draft decision – total capital expenditure	347.26	375.50	387.67	395.17	391.95	1,897.55
C. Total adjustments in our final decision	-21.26	5.32	5.32	5.32	5.32	0.00
C1 Re-profiling of digital metering rollout capital expenditure	-21.26	5.32	5.32	5.32	5.32	0.00
D. Final decision – total forecast capital expenditure (D = B + C)	325.99	380.82	392.99	400.48	397.26	1,897.55

Note: Row A shows the total forecast capital expenditure proposed by South East Water in its price submission. Row B shows the total forecast capital expenditure we adopted in our draft decision. Row C shows the total difference between our final decision (row D) and our draft decision, with the adjustment detailed in row C1. Numbers have been rounded.

In our draft decision, we requested that South East Water provide further information on how it proposes to manage the immediate price impacts of the digital metering proposal, given the time frame over which it anticipates the benefits will be realised. In response to our draft decision, South East Water amended the cost profile of its digital metering roll out given supply chain issues it had encountered, which will reduce the number of meters it expects to install in 2023-24 but increase

the number to be installed in later years of the roll-out. South East Water stated its revised forecast reduces the costs to be recovered in the first year of the regulatory period and smooth the costs of the program over the remainder of the period. We accept this approach because it better reflects when South East Water will incur the capital expenditure to deliver its roll out, and it will lower the amount of revenue South East Water will seek to recover from customers in the first year of the regulatory period, which will deliver benefit to customers given it has chosen to pass on the full impact of inflation to customers in 2023-24.

South East Water accepted our draft decision reduction of \$23.5 million to its capital expenditure forecast, and updated its capital expenditure forecasts in response to our draft decision to reflect the 2021-22 regulatory account correction to re-assign some corporate overhead costs from capital expenditure to operating expenditure.

No other considerations were presented by South East Water or in submissions received following the draft decision which caused us to change our views on capital expenditure.

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$1,897.6 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 South East Water's forecast regulatory asset base (Table 4.8) and revenue requirement (Table 4.1) reflect this benchmark.

The benchmark that we propose to adopt for South East Water does not represent the amount that South East 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 South East Water's revenue requirement, we are not requiring the business to remove that project. South East 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.³¹ 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.

³¹ 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.

Our guidance required South East 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 \$4,001.1 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 2021-22.³² This helps to ensure prices reflect the actual net expenditure of a water business.³³

Our draft decision adopted a closing regulatory asset base of \$4,001.1 million at 30 June 2022. This was less than the \$4,003.0 million proposed by South East Water in its price submission due to corrections to South East Water's regulatory accounts relating to past capital expenditure. In response to our draft decision, South East Water updated the closing regulatory asset base in its financial model to align with our draft decision and its approved regulatory accounts.

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 \$4,001.1 million (Table 4.7).

³² See Section 4.2 for a discussion of South East Water's capital expenditure.

³³ 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.

Table 4.7 Final decision – closing regulatory asset base (RAB)

\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
Opening RAB 1 July	3,688.8	3,722.2	3,748.3	3,877.0	3,969.8
Plus gross capital expenditure	168.6	227.8	281.9	253.5	188.0
Less government contributions	0.0	0.0	0.0	0.0	0.0
Less customer contributions	48.4	45.0	35.9	33.6	32.5
Less proceeds from disposals	2.3	90.7	42.2	42.6	30.6
Less regulatory depreciation	84.5	66.1	75.1	84.6	93.6
Closing RAB 30 June	3,722.2	3,748.3	3,877.0	3,969.8	4,001.1

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

Our final decision approves the forecast regulatory asset base as set out in Table 4.8.

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 South East Water's forecast regulatory asset base for the period from 1 July 2023 based on our proposed adjustments to South East Water's closing regulatory asset base and forecast capital expenditure and our draft decision to not accept its proposed new customer contributions. Our draft decision on South East Water's forecast regulatory asset base was also based on a lower forecast for capital expenditure in 2022-23 than proposed by South East Water because our guidance specified that the amount should reflect the forecast adopted in the 2018 price determination.

In response to our draft decision, South East Water accepted our adjustment to its closing regulatory asset base and also the use of the 2022-23 forecast capital expenditure adopted in the 2018 price determination as the basis to calculate its forecast regulatory asset base. South East Water provided an updated forecast regulatory asset base that reflected these aspects of our draft decision and as well as its proposed changes to its capital expenditure profile across the regulatory period (see Section 4.2)

Table 4.8 sets out our final decision on South East Water’s forecast regulatory asset base from 1 July 2023.³⁴

Our final decision on South East 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).

Table 4.8 Final decision – forecast regulatory asset base (RAB)

\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Opening RAB 1 July	4,001.1	4,071.7	4,231.7	4,467.8	4,718.3	4,960.7
Plus gross capital expenditure	219.6	326.0	380.8	393.0	400.5	397.3
Less government contributions	12.3	12.5	-	-	-	-
Less customer contributions	33.0	33.2	34.7	36.5	45.9	48.0
Less proceeds from disposals	1.9	1.9	1.9	1.9	1.9	1.9
Less regulatory depreciation	101.8	118.3	108.1	104.1	110.2	121.4
Closing RAB 30 June	4,071.7	4,231.7	4,467.8	4,718.3	4,960.7	5,186.7

Note: Numbers have been rounded.

³⁴ 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.

4.3.2.1 Customer contributions

Our final decision adopts a forecast for customer contributions as set out in Table 4.8.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.³⁵

Our draft decision adopted South East Water's proposed customer contributions forecast for the purposes of calculating the regulatory asset base and the revenue requirement but did not approve the proposed customer contributions forecast because of our draft decision on its proposed new customer contributions. Our draft decision required South East Water to provide updated forecasts and justification for revenue from customer contributions that reflected its response to our draft decision on its proposed new customer contributions.

In response to our draft decision, South East Water did not revise its proposed new customer contributions and therefore did not update its forecast for revenue from customer contributions.

However, as outlined in Section 5.4, we have accepted South East Water's proposed new customer contributions, with the exception of the proposed contribution for recycled water in 'other areas' (infill) locations. Our final decision on South East Water's new customer contributions does not change the customer contributions forecasts included in our draft decision as South East Water has forecasted zero connections for recycled water in other areas (infill) locations over the regulatory period (and therefore it had not included any revenue from these connections in its customer contributions).

After considering all submissions received in response to our draft decision, our final decision is to adopt the benchmark revenue from customer contributions set out in Table 4.8, which reflects our final decision on South East Water's new customer contributions.

4.4 Rate of return

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

³⁵ Revenue from new customer contributions reflects revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

4.4.1 Cost of debt

Our final decision is to accept the updated cost of debt figures used by South East Water to calculate its revenue requirement.

In our draft decision we proposed to approve the cost of debt proposed by South East 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 South East Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.³⁶ This reflects the rise in borrowing costs over the past 12 months. South East 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 4.9.

Table 4.9 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.

4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.1 per cent in real terms.

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 South East 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.³⁷

³⁶ These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

³⁷ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 42-43.

South East Water rated its price submission as ‘Advanced’. The maximum return on equity allowed in our guidance for a price submission rated as ‘Advanced’ is 4.5 per cent.³⁸ However, South East Water proposed to adopt a lower return on equity of 4.1 per cent, equivalent to the maximum return on equity for a price submission rated as ‘Standard’. South East Water explained its proposal to adopt the lower return on equity was to manage price impacts for its customers and maintain affordable services, while ensuring it can deliver outcomes and undertake necessary investments.

Our draft decision adopted South East Water’s proposed return on equity, which reflected our preliminary overall PREMO rating of its price submission, and because this was below the maximum amount that South East Water could propose.

After considering all submissions received in response to our draft decision, our final decisions on South East Water’s overall PREMO rating and its return on equity remain the same as our draft decision.

Therefore, our final decision is to adopt South East Water’s proposed return on equity of 4.1 per cent per year.

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 calculated was 3.5 per cent.³⁹ 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

³⁸ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 42.

³⁹ The inflation rate adopted in our draft decision was 3 per cent.

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.⁴⁰

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.⁴¹

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 2026-27.⁴² The updated inflation estimate, if needed, would be based on a 5-year averaging period.

4.5 Regulatory depreciation

Our final decision is to adopt the benchmarks for regulatory depreciation as set out in Table 4.8.

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

As indicated in our draft decision, South East Water’s proposed forecast regulatory depreciation was calculated using a straight-line depreciation profile. We stated in our guidance that we prefer this approach.⁴³ However, due to adjustments we proposed to its forecast regulatory asset base, our draft decision did not accept South East Water’s forecast regulatory depreciation.

We required South East 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, South East Water provided updated estimates for regulatory depreciation, which reflected its updated

⁴⁰ 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.

⁴¹ 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.

⁴² With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.

⁴³ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

forecast regulatory asset base (Section 4.3.2) and updated capital expenditure profile (Section 4.2).

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 \$562.2 million provided by South East Water because it was calculated in a manner consistent with our guidance. Our final decision is reflected in Table 4.8 in Section 4.3.2.

4.6 Tax allowance

Our final decision is to adopt South East Water's forecast of \$64.4 million tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. South East Water proposed a tax allowance of \$77.3 million in its revenue requirement for the 2023–28 regulatory period. Our draft decision was to accept a lower tax allowance of \$76.0 million, reflecting proposed adjustments to its forecast costs and revenue.

In response to our draft decision, South East Water updated its estimates of forecast tax to reflect our updates to the cost of debt and inflation. We consider South East Water's updated estimates were calculated in a manner consistent with our guidance. The revisions lower the forecasts for tax payments by South East Water by around \$11.6 million over the 5-year regulatory period from 1 July 2023, compared to our draft decision (Table 4.2).

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision adopts a forecast tax allowance of \$64.4 million for the 5-year regulatory period, as set out in Table 4.1.

5. Demand, tariffs and prices

Once South East 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 South East Water's demand forecasts.

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

In our draft decision, we accepted South East Water's proposed demand forecasts but required South East Water 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, South East Water reviewed its forecasts against the updated Victorian Government estimates but did not adjust its demand forecasts as it considered its forecasts remained closely aligned with the updated Victorian Government estimates over the next 10 years. Given the closeness between South East Water's forecasts and the Victorian Government estimates, we consider this an appropriate approach.

On that basis, our final decision approves South East 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 South East Water's proposed tariff basket form of price control for core water, sewerage and trade waste charges, including limiting price increases for individual tariffs to 3 per cent per year (excluding inflation).

Our final decision is to accept South East Water's proposed price cap form of price control for miscellaneous charges.

Our draft decision accepted South East Water's proposal to retain a tariff basket form of price control for core water, sewerage and trade waste charges (including limiting price increases for individual tariffs to 3 per cent per year in real terms) and a price cap form of price control for miscellaneous charges, as the approach was a continuation of its current approach and was consistent with our guidance.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision approves South East Water's proposed tariff basket and price cap forms of price control.

5.3 Tariff structures and prices

Our draft decision accepted South East Water's proposed tariff structures but, like all our draft decisions in this review, did not approve prices for each tariff, because South East 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 South East 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.⁴⁴ 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.

South East Water proposed to retain its existing tariff structures with some changes to sewerage disposal charges. It proposed:

- For residential customers receiving water services only – that these customers continue to pay a fixed charge and a charge that varies with water use.
- For residential customers receiving both water and sewerage services – that these customers pay a fixed charge and a new higher variable charge (compared to water only customers) that incorporates the costs of disposing sewage.
- For non-residential customers – that these customers continue to pay a fixed charge and a charge that varies with water use.
- For recycled water services – that these customers continue to pay a variable usage charge only.

Our draft decision accepted South East Water's proposal on the basis that they were either a continuation of the existing arrangements and were supported by customers.

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

⁴⁴ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 51.

and is an approach that is commonly applied in other states and territories.⁴⁵ We also considered that two-part tariff structures are 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.

A submission from the Consumer Action Law Centre expressed support towards water businesses generally retaining the balance between fixed and variable charges, given the disproportionate impact on tenants when more weight is assigned to variable charges.⁴⁶ We consider that South East Water's proposal retains such a balance.

A submission from the Registered Accommodation Association of Victoria asked us to consider multiple room rooming houses being charged based on the number of rooms.⁴⁷ This reflects the current inclining block pricing structure whereby a typical rooming house would generally always be paying at a higher inclining block rate, with little ability to respond to pricing signals. As noted above, businesses are often best placed to consider the interests of their customers in designing tariffs and that existing tariff structures have been developed over time to deal with a variety of local circumstances. We consider a different approach to charging rooming houses might be considered by the business in future periods. However, we note that any such approach may be administratively complex, given the variation in the number of rooms in rooming houses.

After considering all submissions received in response to our draft decision, for the reasons set out above and given South East Water's proposed tariff structures are generally a continuation of its current approach and otherwise meet the criteria in our guidance, our final decision is to approve South East Water's proposed tariff structures.

⁴⁵ 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.

⁴⁶ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, p. 2.

⁴⁷ Registered Accommodation Association of Victoria submission on water pricing for rooming houses in Victoria, 25 May 2023.

5.3.2 Prices

Our final decision is to accept the revised prices proposed by South East Water, subject to our adjustment to reflect our update to bulk water charges (non-controllable operating expenditure).

In our draft decision, we indicated that South East 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, South East Water proposed updated prices that reflected our draft decision on its revenue requirement and our updates to the cost of debt and inflation. South East Water also revised its prices to reflect updates it proposed to its bulk water charges and in response to changes announced in the Victorian State Budget that impacted its revenue requirement (See Section 4.1).

In response to our draft decisions, we received a submission from the Registered Accommodation Association of Victoria, which sought an inclining block pricing structure based on the number of rooms in the accommodation.⁴⁸ As noted in our draft decision, we provide water businesses with a large degree of discretion to decide on tariff structures. This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that the existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our final decision is to approve the revised prices proposed by South East Water, subject to our adjustment that reflects our final decision on its forecast bulk water charges (non-controllable operating expenditure, Section 4.1.2). The adjustment has been made to tariffs from 2024-25 to 2027-28 (and generally moves key water and sewerage tariffs lower by around 0.1 per cent per year, compared to South East Water's proposal).

Our price determination for South East 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.

⁴⁸ Registered Accommodation Association of Victoria, *Submission on water pricing for rooming houses in Victoria*, 26 May 2023.

Table 5.1 Final decision – water prices

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential					
Variable (\$/kL) block 1	3.4928	3.4893	3.4858	3.4823	3.4788
Variable (\$/kL) block 2	4.4566	4.4521	4.4476	4.4431	4.4386
Fixed (\$/year)	85.93	85.84	85.75	85.66	85.57
Non-residential					
Variable (\$/kL)	3.5576	3.5540	3.5504	3.5468	3.5432
Fixed (\$/year)	85.93	85.84	85.75	85.66	85.57

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.

Table 5.2 Final decision – sewerage prices

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential					
Fixed (\$/year)	377.48	377.10	376.72	376.34	375.96
Non-residential					
Variable (\$/kL)	1.8332	1.8313	1.8294	1.8275	1.8256
Fixed (\$/year)	448.27	447.82	447.37	446.92	446.47

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.

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether South East Water’s prices take into account the interests of customers, including low income and vulnerable customers.⁴⁹

⁴⁹ Water Industry Regulatory Order 2014 clause 11(d)(iii).

As outlined in our draft decision we considered that South East Water has done so in the following ways:

- real price reductions across all core water and sewerage services for the first year of the regulatory period (helping to manage the impacts of relatively high inflation on customers' bills) then maintaining the price levels for the remaining years
- tariffs that reflect efficient costs for delivering services
- tariff reform that was informed by an extensive customer engagement program
- a continuation of assistance for customers experiencing difficulty in paying bills
- increased investment in engagement with Traditional Owners who can be amongst the most vulnerable members of the community, to support their capacity to collaborate in land and water decision making.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on how South East Water has taken into account the interests of low income and vulnerable customers.

5.3.4 Other services

Our final decision approves South East Water's proposed prices for unique services including trade waste and miscellaneous services because 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 South East Water's proposed new customer contributions except for the proposed contribution for recycled water in the 'other areas' (infill) locations.

Our final decision is to accept South East Water's proposed negotiating framework for negotiated new customer contributions.

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 in a given part of its service area. 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.⁵⁰ Negotiated charges allow water businesses and

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

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.⁵¹

As outlined in our draft decision, South East Water proposed to:

- increase the new customer contributions in the Casey and Cardinia growth areas and 'other areas' by 5 per cent per year in real terms
- remove the new customer contributions for lot sizes 300m² or less that are located in the Casey and Cardinia regions, on the basis that the relationship between lot size and the cost to connect has diminished
- introduce new customer contributions for the Fishermans Bend precinct.⁵²

Our draft decision did not approve South East Water's proposed new customer contributions because we did not consider South East Water's proposed standard new customer contributions to be cost reflective as these were not based on its calculated new customer contributions. We indicated in our draft decision that South East Water needed to explain its transition plan toward achieving cost reflectivity for each growth area and to set out how it proposes to fund any shortfall in revenue from new customer contributions. We also indicated that we needed to continue our review of the reasonableness of South East Water's proposed inclusion of sunk costs, including for renewals, in its proposed new customer contributions.

In response to our draft decision and subsequent information requests, South East Water maintained its price submission proposal on new customer contributions, on the basis that:

- taking into account the relatively high inflation rate, a 5 per cent real increase per year in new customer contributions for the Casey and Cardinia growth areas and 'other areas' would translate to about a 10 per cent nominal increase
- its proposal aims to avoid price shock for connecting customers, consistent with the pricing principles set out in the Water Industry Regulatory Order (2014).

South East Water also provided justification for including sunk costs in its new customer contributions based on its practices in its 2013 and 2018 price submissions.

In coming to our final decision, we have had regard to if and how South East 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

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

⁵² Around 30 per cent of the incremental cost associated with the Fishermans Bend precinct area is proposed to be recovered through new customer contributions with the remaining 70 per cent to be recovered from the broader community. South Easter Water should consider allocating a higher proportion of incremental costs to the Fishermans Bend precinct area since it is a locational specific charge.

- share the costs and benefits of growth between new and existing customers
- administer new customer contributions in a transparent way.⁵³

We have carefully considered the impact of the issues relating to cost reflectivity and avoidable cost, the reasonableness and transparency of the proposal and whether it is supported by customers, and whether the proposal as a whole advances the aims of our new customer contributions framework.

Our consultants, FTI Consulting, assessed the reasonableness of South East Water's new customer contribution-related capital expenditure and concluded high confidence in the growth expenditure forecasts for South East Water's growth areas (Casey, Cardinia and Fishermans Bend), but low confidence in the majority of its infill (other areas) capital expenditure.⁵⁴ Our consultant's low confidence in infill capital expenditure related primarily to our consultant's assessment of how South East Water has had regard to the commission's incremental cost pricing principles outlined in our guidance.⁵⁵

Having considered both our consultant's findings and South East Water's responses to FTI Consulting's draft report, we are satisfied that South East Water has had regard to incremental costs when calculating its proposed contributions, apart from recycled water in other areas (infill).

On balance, we consider we can approve South East Water's proposed new customer contributions because its proposal meets the aims of the new customer contributions framework, apart from the new customer contribution for recycled water in other areas (infill).

South East Water's proposed new customer contribution for recycled water in other areas (infill) has a connection forecast of zero across the 2023–28 regulatory period. South East Water has proposed to retain this charge, despite:

- there being no calculated new customer contribution due to the zero connection forecast, and
- South East Water itself identifying that 'recycled water in these areas is inherently different in nature and as a result is generally considered through a specific scheme or project that may receive government or community funding'.⁵⁶

In these circumstances, we consider it is more appropriate to use negotiated new customer contributions for recycled water for these other areas, if required. This case-by-case flexibility

⁵³ Essential Services Commission, *New Customer Contributions Explanatory Note Final*, December 2013, p. 2.

⁵⁴ FTI Consulting, *Review of new customer contribution-related capital expenditure for South East Water*, May 2023, p. 13.

⁵⁵ FTI Consulting, *Review of new customer contribution-related capital expenditure for South East Water*, May 2023, p. 12.

⁵⁶ South East Water, *Response to request for information*, 9 May 2023, p. 2.

would administer new customer contributions in a more transparent way and better send signals to developers about the costs of developing in different locations.

For the reasons described above, our final decision is to approve South East Water's proposed new customer contributions apart from its new customer contribution charge for recycled water in other areas, which we consider is better dealt with by its negotiated new customer contributions framework.

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 Centre also supported our draft decision's call for clarity on the full proposed terms for transitioning to cost reflectivity.⁵⁷ As noted above, on balance we consider that South East Water has had regard to a fair and reasonable allocation of incremental infrastructure and associated costs when determining its proposed new customer contributions, apart from recycled water in other areas (discussed below).

We wish to highlight that, to the extent necessary, the new customer contribution framework allows water businesses and developers to negotiate new customer contribution in lieu of using the standard new customer contributions.

Regarding South East Water's proposed negotiated new customer contribution framework, our draft decision proposed to accept the framework because it complied with the requirements of our new customer contribution pricing principles.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision. For the reasons set out above, our final decision is to accept South East Water's proposed negotiated new customer contribution framework.

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.

⁵⁷ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 3.

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 South East Water's proposed price adjustment mechanisms.

Our draft decision accepted South East Water's proposal to continue using the same price adjustment mechanisms as it has in place in the current regulatory period, on the basis that they are a continuation of its existing approach, which we have approved in the past.

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 accepts South East Water's proposed price adjustment mechanisms.

6. Financial position

We have reviewed key indicators of South East Water's financial performance and consider that South East 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.⁵⁸ 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 South East Water's prices. We have assessed that under our final decision, South East Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

⁵⁸ 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 South East 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.⁵⁹ We required South East 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 South East 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 South East Water's price submission. As outlined in our guidance, the combination of South East Water's self-rating and our rating has determined the return on equity we have adopted to calculate South East Water's revenue requirement in our final decision.

7.1 Our PREMO assessment of South East Water's price submission

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

South East 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 South East Water's price submission. This rating is reflected in the return on equity we have approved for South East Water (see Section 4.4.2).

Our PREMO assessment is set out in our draft decision.

No new considerations were presented by South East Water or in submissions received following our draft decision that caused us to change our assessment. For that reason and for the reasons set out in our draft decision, our final decision is to agree with South East Water's proposed overall PREMO self-rating of 'Advanced'.

⁵⁹ 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
South East Water's self-rating	Advanced	Advanced	Advanced	Advanced	Standard	Advanced
Commission's draft decision rating	Advanced	Advanced	Advanced	Advanced	Standard	Advanced
Commission's final decision rating	Advanced	Advanced	Advanced	Advanced	Standard	Advanced

Our PREMO assessment is provided in our draft decision. In summary, the following matters support South East Water's self-rating of its price submission as 'Advanced':

- South East Water generally met its outcome commitments in the current regulatory period, and recorded relatively strong outcomes in our survey of customer sentiment
- South East Water received strong endorsement from its customer panel members on the alignment between the panel's recommendations and the business's proposals
- South East Water proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (2 per cent), contributing to real price reductions over the 2023–28 regulatory period
- South East Water's proposal to reduce prices in real terms from 1 July 2023 (and then generally remaining flat) to help manage the impacts of expected high inflation on customer bills
- a number of outcome targets proposed by South East Water suggest an improvement in customer service which along with the real price reductions proposed by South East Water indicate customers will receive improved value over the 2023–28 regulatory period.

Appendix A – Submissions received on draft decision

Name or organisation	Date received
Consumer Action Law Centre	5 May 2023
South East Water	9 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 South East 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.⁶⁰ Our draft and final decisions provide further information on where we have considered our guidance, and South East Water’s compliance with our guidance, in making our price determination.⁶¹

Note: all chapter and section numbers referenced below refer to our final decision for South East 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).

⁶⁰ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

⁶¹ Essential Services Commission, *South East Water draft decision: 2023 water price review*, 30 March 2023; Essential Services Commission, *South East 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 South East 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 South East Water to recover borrowing costs associated with its investment in services, and generate a return on assets.⁶²

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 South East 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.

⁶² 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 South East 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 South East 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 Australia⁶³
- operating and capital expenditure costs per connection throughout Australia⁶⁴
- tariff structures applied by water businesses throughout Australia⁶⁵
- the regulatory rate of return set by other regulators.⁶⁶

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 South East Water’s proposals, including through submissions and public meetings.

⁶³ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

⁶⁴ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

⁶⁵ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

⁶⁶ 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 South East 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 South East 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 South East 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 South East 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)

Appendix B – Commission’s consideration of legal requirements

- 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 South East 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 South East 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, South East 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 2016.⁶⁷

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.⁶⁸

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

⁶⁷ Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

⁶⁸ 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.⁶⁹

⁶⁹ 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 South East 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 Urban Water Industry Standard to 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 (L/minute)	20	20	20	20	20
Maximum number of unplanned water supply interruptions a customer may experience in any 12-month period	5	5	5	5	5
Average time taken to attend priority 1 bursts and leaks (minutes)	36	36	36	36	36
Average time taken to attend priority 2 bursts and leaks (minutes)	92	92	92	92	92
Average time taken to attend priority 3 bursts and leaks (minutes)	317	317	317	317	317
Average time taken to restore customers' water supply – planned (minutes)	88	88	88	88	88
Average time taken to restore customers' water supply – unplanned (minutes)	179	179	179	179	179

Sewerage service standards

	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer may experience in any 12-month period	2	2	2	2	2
Average time taken to attend sewer spills and blockages (minutes)	47	47	47	47	47
Average time taken to rectify a sewer blockage (minutes)	137	137	137	137	137
Maximum time taken to contain a sewer spill (minutes)	300	300	300	300	300

Appendix D – Guaranteed service level scheme

We have adopted the following service level obligations and corresponding payment amounts for failure to attain the stated obligation as the guaranteed service level scheme for South East 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, South East 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.

South East 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 South East Water.

South East Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
Water spill within the house caused by South East Water	\$1,500
Failure to provide a minimum of 2 business days’ notice to a customer of any planned water supply interruption impacting their property	\$60
More than 5 unplanned disruptions to services (water, sewer and water quality) in any 12-month period	\$60
Sewer spill within the house	\$3,000
More than 2 unplanned sewerage service interruptions in any 12-month period	\$60
Unplanned water supply interruption longer than 5 hours	\$60
Unplanned sewerage service interruption not restored within 4 hours	\$60
Sewage spill not contained within 5 hours of notification	\$1,000
Restricting the water supply of, or taking legal action against, a residential customer prior to taking reasonable endeavours (as defined by the Essential Services Commission) to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying	\$500

[Continued next page](#)

South East Water's guaranteed service level scheme (continued)

Service level obligation	Payment (\$)
Water quality	
A water quality advisory notice is issued:	
• Affecting less than 50 customers	\$5000 community rebate
• Affecting 50 or more customers	\$10,000 community rebate per impacted postcode

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