

Westernport 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 Westernport Water's prices for the next 5 years

In December 2022, we released our draft decision on the price submission Westernport Water submitted to us in September 2022.¹ The draft decision set out our preliminary views on Westernport Water's proposals and invited interested parties to make further submissions. We also held a public forum in February 2023. In addition to a response by Westernport Water, we received three 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 Westernport Water's response, we have made a price determination for Westernport Water.² The price determination sets out the maximum prices Westernport 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 Westernport 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, *Westernport Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

We have approved a revenue requirement of \$138.4 million over 5 years

Our final decision approves a revenue requirement of \$138.4 million over the 5-year period starting 1 July 2023 (see Chapter 4).³ This is \$0.7 million or 0.5 per cent higher than our draft decision, which mainly reflects our updates to the cost of debt.

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

Typical water and sewerage bills will rise from 1 July 2023

A summary of approved maximum prices for major services delivered by Westernport Water is set out in Section 5.3.2. Table A shows the estimated typical bills for different customer groups under our final decision, for 2022-23 (the current year) and 2023-24. For a typical residential owner occupier, estimated annual water and sewerage bills (including inflation) will rise from around \$1,227 currently to \$1,317 in 2023-24, an increase of around 7.3 per cent. For a typical residential tenant, bills (including inflation) will rise from around \$186 currently to \$206 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, water and sewerage prices for residential and non-residential customers will generally change in line with inflation each year.

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

Table A Estimated typical annual water and sewerage bills

Customer group	Average consumption (kL p.a.)	2022-23 (current)	2023-24
		\$2022-23	\$2023-24
Residential – owner occupier	88	\$1,227	\$1,317
Residential – tenant	88	\$186	\$206
Non-residential (small)	500	\$2,096	\$2,283
Non-residential (medium)	651	\$2,415	\$2,638
Non-residential (large)	1,200	\$3,574	\$3,926

Notes: The table shows the average bills for 2023-24 expressed in \$2023-24 terms (which means 7 per cent inflation has been included). Our draft decision included bill estimates based on our draft decision revenue requirement, expressed in \$2022-23 terms as the inflation figure was not available at this time. Our determination for Westernport 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.

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

Westernport Water plans to deliver the following outcomes for customers:

- Provide high-quality drinking water
- Reduce its environmental impact and adapt to climate change
- Resolve sewer blockages quickly
- Keep water interruptions to a minimum
- Be there when needed
- Keep essential services affordable.⁴

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

A customer panel will be appointed by Westernport Water each year to provide commentary on its performance against its outcome commitments. If outcome targets are missed over consecutive years, Westernport Water has committed to providing a corrective action plan to explain to its

⁴ Westernport Water, 2023–28 Water Price Submission, September 2022, p. 5.

customers how performance will improve. Additionally, it has committed to returning funds to the community if targets are not met.

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

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

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

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

Consistent with our draft decision, our final decision is to accept Westernport Water's proposed price cap form of price control on the basis that this is a continuation of Westernport Water's current approach. This means its maximum prices for the regulatory period are fixed subject to updates for inflation and cost of debt, and any other price adjustments we approve in our price determination.

We have rated Westernport Water's price submission as 'Standard' under the PREMO framework

Consistent with our draft decision, our final decision is to rate Westernport Water's price submission as 'Standard' under the PREMO framework (Table B). This is the same as Westernport Water's self-rating. Factors in support of Westernport Water's PREMO rating include that it proposed a relatively high operating cost efficiency target, its commitment to return funds to the community where service targets are not met, and the overall strength of the justification for the prudence and efficiency of its forecast expenditure. It also provided a price submission and supporting model that were generally of a high quality, which facilitated our ability to release an early draft decision in December 2022.

See Section 1.4 for an explanation of the PREMO framework and Chapter 7 for more detail on our assessment of Westernport 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
Westernport Water’s self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission’s rating	Standard	Standard	Standard	Standard	Standard	Standard

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

Westernport Water provided a submission to us proposing prices for a 5-year period starting 1 July 2023. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2023. 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 Westernport 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 Westernport Water, to inform their price submissions. The guidance set out how we would assess Westernport Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Westernport Water would comply with certain requirements and specified information that Westernport Water must provide to us when submitting its price submission.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 Westernport 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 Westernport Water's price submission

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

- Westernport Water's price submission
- Westernport Water's presentation made directly to commissioners
- Westernport Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 16 February 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 Westernport 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. Westernport 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 20 December 2022 and 10 March 2023 and holding an online public forum on 16 February 2023. Themes raised during the forum included the sustainability of water extraction from waterways given climate change and increasing demand.

We acknowledge the concerns and comments raised related to managing water resources in a sustainable manner that enhances environmental water flows and promotes environmental sustainability. The framework for the management of environmental water flows and obligations related to environmental sustainability, as they apply to Victorian Water businesses, are set out in statutory instruments issued to them by government.

Bulk entitlements held by water businesses set out rules that water businesses must comply with about when, where and how much water can be taken from waterways, obligations to release flows for environmental uses, and how water can be used (among other things).¹⁵

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

¹⁵ More information available at <https://www.water.vic.gov.au/planning/bulk-entitlements>.

The Statements of Obligations (General)¹⁶ issued by the Minister for Water sets out guiding principles water businesses must follow when performing their functions to assist in the task of transitioning Victorian an environmentally sustainable economy, and to respond to the challenges of climate change. This also imposes obligations on water businesses in relation to providing their services, including obligations relating to management of water resources, minimising environmental impacts, and compliance with Sustainable Water Strategies.¹⁷

Water businesses are accountable to government for complying with these instruments and government expectations in relation to these instruments.

Our pricing framework and our guidance requires water businesses to ensure the revenue they propose in their price submissions incorporates the efficient cost of meeting legislative and government obligations.

Our final decision approves a revenue requirement, based on Westernport Water's expenditure proposals, that we consider are adequate for the business to deliver the outcomes it has determined are those valued by customers and the community, and its legal and regulatory obligations, including for environmental water and sustainability.

The expenditure benchmarks that we adopt for the key categories of prescribed services, and use to determine prices, do not represent the amount that a water business is required to spend or allocate to particular projects or activities within a prescribed service category.

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. Westernport Water will determine how to best manage the allocation of its revenue and prioritise its expenditure within a regulatory period. This includes responding to its obligations related to environmental water and sustainability.

Westernport 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 2023.¹⁸ In arriving at our final decision, we have considered Westernport Water's responses to our draft decision.

This paper sets out our final decision.

¹⁶ The Statement of Obligations (General) was issued by the Minister for Environment, Climate Change and Water, on 20 December 2015, under section 41(2) of the *Water Industry Act 1994*, and is binding on all Victorian water businesses.

¹⁷ https://www.water.vic.gov.au/__data/assets/pdf_file/0015/54330/Statement-of-Obligations-General.pdf.

¹⁸ All references to Westernport Water's price submission in this document refer to Westernport 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 Westernport Water has committed to over the regulatory period (Chapter 3).
- Establish Westernport Water's revenue requirement using a building block methodology (Chapter 4).
- Use demand forecasts and the form of price control to convert the revenue requirement to tariffs and prices (Chapter 5).

Chapter 6 outlines our consideration of Westernport Water's financial position, which we have also had regard to.

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

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.¹⁹ 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.²⁰

Westernport 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.²¹

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.

¹⁹ This is a requirement of the WIRO, clause 9.

²⁰ For detail on the reasons for using 5 years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, p. 18.

²¹ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 4.

3. Customer outcomes

The customer outcomes Westernport 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:

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

3.1 Customer and community engagement

Our guidance required Westernport Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Westernport Water’s engagement.²²

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

- began early and was wide-reaching, involving feedback from over 2000 customers and community
- covered local issues important to the community, such as understanding the needs of people experiencing vulnerability, quality and reliability of services, the mix of fixed and variable charges in bills, and the water business’s role in preserving the natural environment
- was inclusive of First Nations people and the Traditional Owners by establishing a working relationship with the Bunurong Land Council Aboriginal Corporation.

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

- improving the consistency of water quality and taste
- investing in wetlands to reduce release of wastewater into the ocean

²² 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.

- minor adjustments in the mix of variable and fixed water and sewerage charges, while maintaining support for customers having difficulty affording bills.

Our preliminary view was to accept Westernport Water's 'Standard' self-rating for the Engagement element of PREMO on the basis it had designed and delivered an engagement program well suited to its operating environment and the context of its community. Examples outlined in our draft decision included:

- engaging on a clear set of issues that stakeholders could influence
- tailoring its engagement materials to the audience it was engaging with
- using its deliberative panel to explore topics where customer opinion had been divided.

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 Westernport Water's self-rating of 'Standard' for its price submission engagement.

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

3.2 Outcomes

Westernport 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.

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

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

Westernport Water's proposed measures and targets that it will use to report on its performance for each outcome are detailed on pages 37 to 45 of its price submission.

In our draft decision, we agreed with Westernport 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 a ‘Standard’ rating for the Outcomes element of PREMO. However, we noted that some of the proposed outcome measures and targets were not presented in a manner consistent with our guidance requirements.

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

Following the release of this final decision, we will publish the 2023–28 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 Westernport Water’s outcomes, measures and targets has informed our final decision rating of its price submission for the Outcomes element of PREMO, which is discussed in Chapter 7.

3.3 Service standards related to service reliability and faults

Westernport 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.

Westernport Water’s proposed service standards are set out on page 48 of its price submission.

The service standards proposed by Westernport Water are the same as those for the current 2018–23 regulatory period (with some wording changes required by the updated Water Industry Standard). The target service levels proposed are the same or in some cases an improvement on the target service levels for the current regulatory period. Westernport Water has also specified the minimum pressure as required by the Urban Water Industry Standard.

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

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

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

3.4 Guaranteed service levels

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

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

Westernport Water's proposed guaranteed service levels are set out on page 49 of its price submission. As summarised in our draft decision, Westernport Water proposed no changes to its guaranteed service levels in its scheme from July 2023.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Westernport Water's guaranteed service levels. Our final decision is to accept the guaranteed service levels proposed by Westernport Water on the basis that they have been agreed with customers during its engagement.

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

4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.²³ Along with forecast demand, it is an input to calculating prices.

We have used a building block methodology to establish the revenue requirement. This chapter outlines our assessment of Westernport Water's revenue requirement based on the following steps:

- establish an efficient benchmark level of forecast operating expenditure for the next regulatory period (Section 4.1)
- establish an efficient benchmark level of forecast capital expenditure for the next regulatory period (Section 4.2)
- roll-forward the regulatory asset base (Section 4.3)
- apply a rate of return to the regulatory asset base, calculated using:
 - a benchmark cost of debt estimated using a 10-year trailing average approach (Section 4.4.1)
 - a benchmark return on equity value determined by Westernport Water's PREMO rating (Section 4.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.5)
- establish a benchmark tax allowance (Section 4.6).

Our final decision is to approve a revenue requirement of \$138.4 million for Westernport Water for the 2023–28 regulatory period.

Our draft decision approved a revenue requirement of \$137.7 million over a 5-year period starting 1 July 2023, which was the same as the revenue requirement proposed by Westernport Water. Our final decision approves a revenue requirement of \$138.4 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

²³ We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Westernport Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our final decision.

Table 4.1 Final decision on Westernport Water’s revenue requirement

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	18.7	18.8	18.7	18.9	18.7	93.9
Return on assets	3.6	3.7	3.9	4.1	4.3	19.7
Regulatory depreciation	4.0	4.2	4.6	5.1	6.0	23.9
Tax allowance	0.1	0.1	0.1	0.2	0.4	0.9
Final decision – revenue requirement	26.4	26.9	27.4	28.3	29.5	138.4

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

Westernport Water also updated its bulk water charges to reflect the latest information and, in response to our draft decision, proposed updates to its regulatory asset base, regulatory depreciation and tax allowance. These updates are discussed in the relevant sections below.

The main reason for the increase in the revenue requirement since our draft decision is the change in the return on assets reflecting Westernport Water’s updates to its regulatory asset base and our update to the cost of debt (which reflects the rise in borrowing costs since Westernport Water prepared its submission).

The adjustments to Westernport 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. Westernport Water's proposed revenue requirement	26.73	26.99	27.22	27.89	28.85	137.67
B. Total adjustments proposed in our draft decision	-	-	-	-	-	-
C. Draft decision – revenue requirement (C = A+B)	26.73	26.99	27.22	27.89	28.85	137.67
D. Total adjustments in our final decision	-0.30	-0.11	0.13	0.38	0.63	0.74
Operating expenditure	-0.09	-0.15	-0.19	-0.24	-0.26	-0.92
Return on assets	-0.17	0.09	0.37	0.67	0.94	1.90
Regulatory depreciation	0.01	0.01	0.01	0.01	0.01	0.06
Tax allowance	-0.06	-0.06	-0.06	-0.06	-0.06	-0.29
E. Final decision – revenue requirement (E = C + D)	26.43	26.88	27.35	28.27	29.48	138.41

Note: Row A shows the total revenue requirement proposed by Westernport Water in its price submission. Row B shows the total difference between our draft decision and what Westernport 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. Numbers have been rounded.

4.1 Operating expenditure

Our final decision is to adopt a forecast operating expenditure of \$93.9 million for Westernport 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 \$94.8 million for the 5-year period, as proposed by Westernport Water.

Table 4.3 sets out our final decision on Westernport 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	17.17	17.30	17.17	17.42	17.28	86.34
Non-controllable operating expenditure	1.55	1.53	1.51	1.48	1.46	7.52
Bulk services ^a	0.42	0.43	0.44	0.44	0.46	2.19
Environmental contribution ^b	1.04	1.00	0.97	0.94	0.91	4.86
Licence fees – Essential Services Commission ^c	0.02	0.02	0.02	0.02	0.02	0.11
Licence fees – Department of Health ^c	0.01	0.01	0.01	0.01	0.01	0.04
Licence fees – Environment Protection Authority ^c	0.04	0.04	0.04	0.04	0.04	0.18
Other non-controllable – defined benefits	0.03	0.03	0.03	0.03	0.03	0.15
Final decision – operating expenditure	18.72	18.82	18.68	18.89	18.75	93.86

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).

The operating expenditure that we have adopted for Westernport Water does not represent the amount that Westernport Water is required to spend or allocate to particular operational, maintenance and administrative activities. Rather, it is a benchmark that represents assumptions about the overall level of operating expenditure (to be recovered through prices) that we consider sufficient to operate the business efficiently and to maintain services over the regulatory period.

Table 4.4 Our adjustments to Westernport 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. Westernport Water’s proposed total operating expenditure	18.81	18.97	18.87	19.13	19.01	94.78
A1 – Our draft decision adjustments to controllable operating costs	-	-	-	-	-	-
A2 – Our draft decision adjustments to non-controllable operating costs	-	-	-	-	-	-
B. Draft decision – total operating expenditure	18.81	18.97	18.87	19.13	19.01	94.78
C. Final adjustments to controllable operating costs	-0.05	-0.09	-0.14	-0.18	-0.22	-0.68
C1 – Employee costs adjustment	-0.05	-0.09	-0.14	-0.18	-0.22	-0.68
D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 + D5)	-0.04	-0.05	-0.05	-0.06	-0.04	-0.25
D1 – Environmental contribution	-0.01	-0.01	-0.02	-0.02	-0.03	-0.09
D2 – Licence fees – Essential Services Commission	-0.01	-0.01	-0.01	-0.01	-0.01	-0.03
D3 – Licence fees – Department of Health	-0.03	-0.03	-0.03	-0.03	-0.03	-0.13
D4 – Licence fees – Environment Protection Authority	0.00	0.00	0.00	0.00	0.00	0.01
D5 – External bulk water charges – Melbourne Water	-0.00	-0.01	-0.00	-0.00	0.02	0.003

Continued next page

Table 4.4 (continued)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
E. Final decision – total operating expenditure (E = B + C + D)	18.72	18.82	18.68	18.89	18.75	93.86

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 D1 to D5) are the differences between our draft decision and our final decision and are outlined in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure) of this final decision. Numbers have been rounded.

4.1.1 Controllable operating expenditure

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

- We considered Westernport Water’s proposal reflected an efficient baseline cost to forecast annual operating expenditure.
- Westernport Water had proposed an efficiency improvement rate of 1.5 per cent per year which is higher than many other businesses in the current price review but is lower than its proposed average cost growth rates of 2.0 per cent per year for 2023-24 to 2025-26 and 1.8 per cent per year from 2026-27 to 2027-28.
- Its average cost growth rate was lower than forecast customer growth across the period, leading to reductions in controllable costs per customer.
- There is evidence that Westernport Water has significantly tested its controllable expenditure requirements and that forecast cost adjustment additions were prudent and efficient.

Following our draft decision, Westernport Water provided an updated financial model with a forecast reduction of \$0.68 million for the employee costs step change in the next regulatory period compared to our draft decision. We accept this adjustment as it takes into account Westernport Water’s latest labour costs forecast which delivers a reduction in controllable operating expenditure and creates a more accurate benchmark for the next water price review.

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.²⁴

Westernport Water responded that due to the thresholds of the new payroll tax and land tax levies, these changes will not materially impact its forecast expenditure. It advised it would absorb the

²⁴ Victorian Government, *Budget papers ‘2023/24 State Budget papers’*, 23 May 2023

levies if thresholds were met during the regulatory period. We have accepted Westernport Water's response to this issue.

After considering all submissions received in response to our draft decision, on the basis that Westernport Water's proposed controllable operating expenditure is consistent with our guidance, our final decision is to accept Westernport Water's proposed controllable operating expenditure (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:

- Westernport Water had followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission.
- Westernport 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.²⁵

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.²⁶

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.²⁷

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

²⁵ Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

²⁶ 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.

²⁷ These fees are yet to be determined by the Minister for Water.

We have reduced Westernport Water’s forecast non-controllable operating expenditure by \$0.25 million across the 2023–28 period, resulting from the following adjustments:

- \$0.16 million decrease for licence fees after considering the latest information received from the relevant regulatory authorities
- \$0.09 million decrease for the environmental contribution to account for the latest data on inflation
- \$0.003 million increase for external bulk water charges as revised by Westernport Water to reflect the Melbourne Water Bulk Charges for 2023-24.

Accordingly, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised non-controllable operating expenditure of \$7.52 million over the 5-year regulatory period.

4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$42.3 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 \$42.3 million for the 5-year period, as proposed by Westernport Water.

The reasons for our draft decision were that:

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

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$42.3 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 Westernport Water’s forecast regulatory asset base (Table 4.6) and revenue requirement (Table 4.1) reflect this benchmark.

The benchmark that we propose to adopt for Westernport Water does not represent the amount that Westernport Water is required to spend or allocate to particular projects. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we

consider sufficient to operate the business and to maintain or improve services over the regulatory period. Where we have made an adjustment to exclude a project's capital expenditure from Westernport Water's revenue requirement, we are not requiring the business to remove that project. Westernport Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.²⁸ The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4) and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Westernport Water to propose:

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

4.3.1 Closing regulatory asset base

Our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$146.9 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 2021-22.²⁹ This helps to ensure prices reflect the actual net expenditure of a water business.³⁰

Our draft decision did not accept Westernport Water's proposed closing regulatory asset base, but adopted Westernport Water's proposed figure for the purpose of calculating the revenue requirement in our draft decision. In response to our draft decision, we required Westernport Water to update its closing regulatory asset base to reflect its approved regulatory accounts for 2021-22.

²⁸ 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.

²⁹ See Section 4.2 for a discussion of Westernport Water's capital expenditure.

³⁰ 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.

In response to our draft decision, Westernport Water provided an updated model to reflect its approved regulatory accounts. We consider Westernport Water has calculated its revised closing regulatory asset base consistently with the requirements of our guidance. For these reasons, our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$146.9 million (Table 4.5).

Table 4.5 Final decision – closing regulatory asset base (RAB)
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
Opening RAB 1 July	131.3	132.3	133.6	136.6	142.6
Plus gross capital expenditure	5.2	5.2	7.2	10.0	8.8
Less government contributions	-	-	-	-	-
Less customer contributions	1.0	1.1	1.2	0.7	0.6
Less proceeds from disposals	0.3	0.1	0.2	0.2	0.4
Less regulatory depreciation	2.9	2.6	2.8	3.1	3.4
Closing RAB 30 June	132.3	133.6	136.6	142.6	146.9

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

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

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

Our draft decision did not accept Westernport Water’s forecast regulatory asset base for the period from 1 July 2023 to 30 June 2028. However, for the purpose of calculating the revenue requirement for our draft decision, we adopted the forecast regulatory asset base proposed by Westernport Water. Our draft decision required the business to update its forecasts to reflect its approved regulatory accounts for 2021-22, and to reflect any changes to forecast customer contributions arising from our further review of its proposed new customer contributions.

In response to our draft decision, Westernport Water updated its forecast regulatory asset base to reflect its approved regulatory accounts for 2021-22. We consider Westernport Water has

calculated its updated forecast regulatory asset base consistently with the requirements of our guidance.

Table 4.6 sets out our final decision on Westernport Water's forecast regulatory asset base from 1 July 2023.³¹

Our final decision on Westernport 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 4.6 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	146.9	146.4	152.4	155.2	158.4	162.0
Plus gross capital expenditure	4.0	11.0	8.1	8.8	9.6	4.8
Less government contributions	-	-	-	-	-	-
Less customer contributions	0.7	1.0	1.0	1.0	0.9	0.9
Less proceeds from disposals	0.1	0.1	0.1	0.1	0.1	0.1
Less regulatory depreciation	3.7	4.0	4.2	4.6	5.1	6.0
Closing RAB 30 June	146.4	152.4	155.2	158.4	162.0	159.7

Note: Numbers have been rounded.

³¹ 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 is to accept the benchmarks for customer contributions as set out in Table 4.6.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.³²

Our draft decision adopted Westernport Water's proposed customer contributions for the purposes of calculating the regulatory asset base and revenue requirement in the draft decision. We compared Westernport Water's updated forecasts for customer contributions with past outcomes. We considered Westernport Water's forecast contributions were reasonable, having regard to past trends and its growth forecasts. However, we stated that our final decision was subject to our ongoing review of Westernport Water's new customer contributions.

As discussed in Section 5.4, our final decision accepts Westernport Water's new customer contributions. We received no submissions from other stakeholders on this issue.

For the reasons set out above, our final decision is to accept Westernport Water's proposed revenue from customer contributions as set out in Table 4.6.

4.4 Rate of return

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

4.4.1 Cost of debt

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

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

³² Revenue from new customer contributions reflects revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

In May 2023, we provided Westernport Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.³³ This reflects the rise in borrowing costs over the past 12 months. Westernport Water used this updated value to recalculate its revenue requirement. Westernport Water used this updated value to recalculate its revenue requirement.

For the above reasons, our final decision adopts the updated figures for the benchmark cost of debt as set out in Table 4.7.

Table 4.7 Final decision – 10-year cost of debt

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Cost of debt (nominal)	7.05%	5.36%	5.27%	4.91%	4.53%	4.61%	3.31%	3.05%	3.75%	6.76%

Note: Numbers have been rounded.

4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.1 per cent in real terms, which reflects Westernport Water’s PREMO rating.

Under our PREMO incentive mechanism, which we have applied since 2018, the return on equity we adopt to calculate the revenue requirement is linked to a business’s PREMO rating. See Chapter 7 for an explanation of PREMO and our assessment of Westernport 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.³⁴

Westernport Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Westernport Water proposed a real return on equity of 4.1 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.³⁵

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

³³ These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

³⁴ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 42-43.

³⁵ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 42.

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

Therefore, our final decision is to adopt Westernport Water's proposed return on equity of 4.1 per cent per year, reflecting our final decision on the overall PREMO rating of its price submission (see Chapter 7).

4.4.3 Long-term inflation forecast

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

In addition to updating our estimate for the cost of debt, in May 2023 we also updated businesses on our long-term inflation forecast. We advised businesses that the long-term inflation rate we calculated was 3.5 per cent.³⁶ All businesses adopted this amount to calculate prices in their responses to our draft decision. We checked this estimate again for our final decision, based on the method below.

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

Estimates we have adopted for each year of the 2023–28 regulatory period under the 'RBA geometric mean' approach are set out in Appendix E. Using the 'RBA geometric mean' approach we estimate an inflation rate of 3.8 per cent.³⁷

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.³⁸

³⁶ The inflation rate adopted in our draft decision was 3 per cent.

³⁷ 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.

³⁸ 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.

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 2026-27.³⁹ The updated inflation estimate, if needed, would be based on a 5-year averaging period.

4.5 Regulatory depreciation

Our final decision is to accept the benchmarks for regulatory depreciation as set out in Table 4.6.

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

As indicated in our draft decision, Westernport Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile, which is our preferred approach.⁴⁰ In its price submission, Westernport Water adopted an average asset life of approximately 35 years, which is shorter than the 55 years it proposed, and we accepted, in the 2018 price review.

Our preliminary position outlined in our draft decision was to accept Westernport Water's proposed asset lives. However, we requested Westernport Water provide further justification of its approach, including by providing responses to the following questions:

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

In response to our draft decision, Westernport Water advised that its proposed asset lives were the result of a comprehensive review that led to more accurate asset data and that the shorter asset lives would provide a stronger link between its asset base and the period during which customers will receive benefit.

³⁹ With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.

⁴⁰ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

In terms of affordability, Westernport Water's response to our draft decision said that while customers asked Westernport Water to prioritise affordability, they also stated that it should not be at the expense of performance.

Following our draft decision, we reviewed the estimated asset lives used by Westernport Water. It's assumed asset lives for pricing purposes (35 years) aligned with the average for the technical design life of assets recorded in its depreciation schedules.

We received no submissions from other stakeholders on this issue.

Our final decision is to accept Westernport Water's forecast regulatory depreciation as it was calculated in a manner consistent with our guidance (see Table 4.6 in Section 4.3.2).⁴¹

Through the course of this price review, we have identified a diversity of depreciation practices and variations of these over time by some water businesses.

We note that many regulators in addition to maintaining the regulatory asset base in their financial templates, also maintain depreciation schedules by asset class. These automatically calculate depreciation over successive regulatory periods. The calculated depreciation schedule then sets out the basis on which the assets constituting the regulatory asset base are to be depreciated for the purpose of determining:

- allowed revenues for regulatory depreciation over successive regulatory periods
- the regulatory asset base roll forward.

We note Westernport Water and some other water businesses have used the discretion available in our financial template to nominate the remaining asset lives for existing assets, and we have not required the maintenance of a transparent depreciation schedule of the form described above.

We will consult on and review our depreciation guidance and financial templates to inform future guidance for our water price reviews. This will include assessing if assets from the commencement of the 2023-24 regulatory period should be maintained in individual asset class depreciation schedules in the financial template.

⁴¹ We noted in our guidance that we prefer a straight-line depreciation profile. Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

4.6 Tax allowance

Our final decision is to accept Westernport Water's updated forecast tax allowance of \$0.92 million for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Our draft decision was to accept Westernport Water's forecast tax allowance of \$1.2 million in its revenue requirement for the 2023-28 regulatory period as it was calculated consistently with the method required by our guidance.⁴²

In response to our draft decision, Westernport Water updated its forecast tax allowance to reflect changes in its tax liability resulting from the change in its revenue requirement, which reflects updates to its regulatory asset base and to the cost of debt and inflation.

After considering all submissions received in response to our draft decision, and for the reasons set out above, our final decision accepts a forecast tax allowance of \$0.92 million for the 5-year regulatory period, as set out in Table 4.1.

⁴² Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 47-48.

5. Demand, tariffs and prices

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

5.1 Demand

Our final decision is to accept Westernport Water's demand forecasts.

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

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

In response to our draft decision, Westernport Water did not adjust its demand forecasts to reflect the updated and lower Victorian Government growth estimates for its service area. Instead, Westernport Water proposed to absorb the demand risks rather than adding further pressure to customer prices by reflecting the lower demand growth estimates.

On the basis that Westernport Water's proposal means that the water business, not customers, absorb the risk related to lower growth estimates for its service area, and because it was estimated consistently with the requirements of our guidance, our final decision approves Westernport Water's demand forecasts.

5.2 Form of price control

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

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

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. For the reasons set out above, our final decision approves Westernport Water's proposed price cap form of price control.

5.3 Tariff structures and prices

Our draft decision accepted Westernport Water’s proposed tariff structures but, like all our draft decisions in this review, did not approve prices for each tariff, because Westernport 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 Westernport 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.⁴³ This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our draft decision was to accept Westernport Water’s proposed tariff structures, comprising:

- for residential and non-residential water services – a two-part tariff structure with a fixed service charge and a variable component that depends on water use (with a 1.6 per cent reduction in its fixed service charge and a 3.8 per cent increase in its variable usage charge)
- for residential and non-residential sewerage services – a fixed service charge only
- for residential and non-residential recycled water services – a fixed charge and a variable charge.

In our draft decision, we considered the two-part structure for water services and for non-residential sewerage services will promote the efficient use of these services and that the two-part structure for recycled water services sends customers a signal about the costs of their water use.⁴⁴ We also considered that a two-part tariff structure is easy to understand and is an approach that is commonly applied in other states and territories.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision.

For the reasons set out above and given Westernport 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 Westernport Water’s proposed tariff structures.

⁴³ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 51.

⁴⁴ 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.

5.3.2 Prices

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

In our draft decision, we noted that Westernport Water would need to propose updated prices to reflect any updates to its revenue requirement, including any changes to its depreciation forecasts, any changes arising from our review of new customer contributions, and its update to the regulatory asset base. Our draft decision also noted that Westernport Water's proposed prices may need to be updated to reflect our updates to inflation and cost of debt estimates.

Westernport Water advised that it would not propose updated prices in response to our draft decision, or to the increase in its revenue requirement as a result of updates to inflation, the cost of debt and bulk charges, or as a result of changes announced in the Victorian State Budget (See Chapter 4). This means it will forgo revenue to keep prices as it proposed in its price submission.

We received an anonymous submission that said Westernport Water should consider customers' incomes in determining the prices that they charge to those customers, and that it should lower water prices.⁴⁵ We are of the view that Westernport Water has adequately engaged with customers and has considered the views of customers in its proposal. In particular, Westernport Water will increase the amount of hardship grants in 2023-24 in recognition of affordability issues, and more broadly has a program that is intended to support customers experiencing payment difficulty.

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

Our price determination for Westernport 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.

From 2024-25, water and sewerage prices for residential and non-residential customers will generally change in line with inflation each year.

⁴⁵ Anonymous, *submission to the Essential Services Commission 'Westernport Water draft decision: 2023 water price review'*, 19 December 2022.

Table 5.1 Final decision – water prices

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential and non-residential					
Variable (\$/kL)	2.3465	2.3465	2.3465	2.3465	2.3465
Fixed (\$/year)	429.79	429.79	429.79	429.79	429.79

Notes: These prices have been expressed in \$2023-24 terms, which means 7 per cent inflation has been factored into the prices for 2023-24. For the remaining years shown, inflation will be added each year based on the latest inflation data. The figures in other tables of this report are expressed in \$2022-23, which means inflation has not been accounted for in 2023-24 or the remaining years of the 2023–28 regulatory period. The non-residential fixed prices are based on the 'Non-Residential 20mm Access Charge'. Non-residential prices have been calculated based on volumes provided by Westernport Water.

Table 5.2 Final decision – sewerage prices

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential					
Fixed (\$/year)	680.35	680.35	680.35	680.35	680.35
Non-residential					
Fixed (\$/year) – 1 cistern	680.35	680.35	680.35	680.35	680.35
Fixed (\$/year) – each additional cistern	251.26	251.26	251.26	251.26	251.26

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. Non-residential prices have been calculated based on volumes provided by Westernport Water. Numbers have been rounded.

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether Westernport Water's prices take into account the interests of customers, including low income and vulnerable customers.⁴⁶

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

- maintaining an efficiency improvement rate greater than the industry average, helping to minimise prices and bills

⁴⁶ Water Industry Regulatory Order 2014 clause 11(d)(iii).

- increasing the target number of hardship grants in the first year of the regulatory period
- introducing a target for the number of utility relief grants it facilitates each year.

We have considered all submissions in response to our draft decision, however, our views on how Westernport Water has addressed the interests of low income and vulnerable customers remain the same as expressed in our draft decision.

5.3.4 Other services

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

Given this, our final decision is to approve Westernport Water's proposed tariffs for trade waste and miscellaneous services.

5.4 New customer contributions

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

New customer contributions (or developer charges) are levied by water businesses when a new connection is made to its water, sewerage or recycled water networks. New customer contributions can be either standard or negotiated. Standard charges apply to new connections in areas where infrastructure requirements and growth rates are relatively well known and designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.⁴⁷ Negotiated charges allow water businesses and developers to negotiate a site-specific arrangement where standard charges are not fair and reasonable or where a new connection is outside the areas eligible for standard charges.⁴⁸

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

Our draft decision proposed to accept Westernport Water's proposed new customer contributions subject to any further information on the average incremental cost methodology that the commission received in response to our draft decision or through our 2023 water price review.

⁴⁷ Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

⁴⁸ Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

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

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

- send signals to developers about the costs of developing in different locations
- share the costs and benefits of growth between new and existing customers
- administer new customer contributions in a transparent way.⁴⁹

We consider that Westernport Water's proposed new customer contributions has addressed the pricing principles in our guidance and its proposal meets the aims of the new customer contributions framework.

In our draft decision, we said that our acceptance of Westernport Water's proposed new customer contributions is subject to any further information on the average incremental cost methodology that the commission received in response to our draft decision or through our 2023 water price review. MG Estates in its submission to Coliban Water's stated that the average incremental cost method did not meet the new customer contributions pricing principle of having regard to incremental future revenues because there is no residual value assigned to infrastructure that might serve new customers beyond the planning period.⁵⁰ We are satisfied that Westernport Water's proposal as a whole advances the aims of our new customer contributions framework.

For the reasons set out above, our final decision approves Westernport Water's proposed new customer contributions as they are consistent with the requirements of our guidance.

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 Westernport Water's proposed negotiated new customer contribution framework, our draft decision accepted the framework. No new considerations were presented by Westernport Water or in submissions received following the draft decision which caused us to change our views on Westernport Water's negotiated new customer contribution framework. Our final decision is to accept Westernport Water's negotiated new customer contribution framework because it is consistent with the requirements of the guidance.⁵¹

⁴⁹ Essential Services Commission, *New Customer Contributions Explanatory Note Final*, December 2013, p.2.

⁵⁰ MG Estates, *Draft decision for Coliban Water – MG Estates PTY LTD submission*, 11 May 2023, pp. 1-3.

⁵¹ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 59.

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.⁵²

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.

⁵² *Water Act 1989*, section 271.

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 Westernport Water's proposed price adjustment mechanisms.

Our draft decision accepted Westernport Water's proposal to continue using the same price adjustment mechanisms, 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.

For the reasons outlined above, our final decision accepts Westernport Water's proposed price adjustment mechanisms.

6. Financial position

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

In approving prices, we must have regard to the financial viability of the water industry.⁵³ 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 Westernport Water's prices. We have assessed that under our final decision, Westernport Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

⁵³ 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 Westernport Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.⁵⁴ We required Westernport Water to self-rate its price submission as either 'Leading', 'Advanced', 'Standard' or 'Basic', with 'Leading' being the most ambitious and 'Basic' the least.

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

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

7.1 Our PREMO assessment of Westernport Water's price submission

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

Westernport Water's self-rating for each of the PREMO elements and its overall self-rating are shown in Table 7.1. This table also includes our draft and final ratings of Westernport Water's price submission. This rating is reflected in the return on equity we have approved for Westernport Water (see Section 4.4.2). No new considerations were presented by Westernport Water or in submissions received following our draft decision.

Our PREMO assessment is set out in our draft decision.

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

⁵⁴ 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
Westernport Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's draft decision rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's final decision rating	Standard	Standard	Standard	Standard	Standard	Standard

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

- a relatively high operating cost efficiency target
- relatively strong outcomes on the commission's customer perception survey
- alignment of customer views on service priorities and improvements, with its proposed outcomes commitments and targets
- its commitment to return funds to the community where service targets are not met
- the introduction of an independent process to review its performance against outcome commitments
- it excluded uncertain capital expenditure from its prices – these project costs will be carried by the business and included at the end of the regulatory period if they are incurred
- the overall strength of the justification for the prudence and efficiency of its forecast expenditure
- a relatively good track record of delivering its major projects in the current regulatory period compared to other businesses.

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

Appendix A – Submissions received on draft decision

Name or organisation	Date received
Anonymous	19 December 2022
Westernport Water	10 March 2023
Consumer Action Law Centre	5 May 2023
Registered Accommodation Association of Victoria	26 May 2023

Appendix B – Commission’s consideration of legal requirements

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

Below, we describe how we apply the mandatory factors and where we have done so in our final decision for Westernport 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.⁵⁵ Our draft and final decisions provide further information on where we have considered our guidance, and Westernport Water’s compliance with our guidance, in making our price determination.⁵⁶

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

Economic efficiency and viability matters

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

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

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

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

⁵⁵ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

⁵⁶ Essential Services Commission, *Westernport Water draft decision: 2023 water price review*, 20 December 2022; Essential Services Commission, *Westernport 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 Westernport Water has demonstrated its proposed outcomes reflect customer service priorities, and whether its tariffs and forecast costs reflect efficient levels of expenditure.

The following chapters and sections of our 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 Westernport Water to recover borrowing costs associated with its investment in services, and generate a return on assets.⁵⁷

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 Westernport Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

⁵⁷ 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 Westernport Water to deliver services that are covered by the prescribed services listed in the WIRO.

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

Our final decision provides for Westernport Water to generate a return on assets through:

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

ESC Act Section 33(3)(d) requires us to have regard to ‘any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries’.

In assessing costs, prices and return on assets we have had regard to relevant interstate benchmarks:

- indicative bills paid by customers in other jurisdictions in Australia⁵⁸
- operating and capital expenditure costs per connection throughout Australia⁵⁹
- tariff structures applied by water businesses throughout Australia⁶⁰
- the regulatory rate of return set by other regulators.⁶¹

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

⁵⁸ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

⁵⁹ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

⁶⁰ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

⁶¹ 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 Westernport Water’s prices ‘enable customers or potential customers of the regulated entity to easily understand prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated’.

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

- feedback from customers during a water 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 Westernport Water’s prices ‘provide signals about the efficient costs of providing prescribed services to customers while avoiding price shocks where possible’.

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

The following chapters and sections of our 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 Westernport 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 Westernport 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 Westernport Water to deliver the outcomes valued by customers, and on its health, safety, environmental sustainability and social obligations.

The following chapters and sections of our 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, Westernport 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 2016.⁶²

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.⁶³

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

⁶² Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

⁶³ 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.⁶⁴

⁶⁴ 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 Westernport 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 (kPa)	300 kPa	300 kPa	300 kPa	300 kPa	300 kPa
Maximum number of unplanned water supply interruptions a customer should experience in any 12-month period	4	4	4	4	4
Average time taken to attend bursts and leaks (priority 1) (minutes)	30	30	30	30	30
Average time taken to attend bursts and leaks (priority 2) (minutes)	35	35	35	35	35
Average time taken to attend bursts and leaks (priority 3) (minutes)	300	300	300	300	300
Average duration of unplanned water supply interruptions (minutes)	85	85	85	85	85
Average duration of planned water supply interruptions (minutes)	157	157	157	157	157

Sewerage service standards

Sewerage	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer should experience in any 12 month period	3	3	3	3	3
Average time to attend sewer spills and blockages (minutes)	35	35	35	35	35
Average time to rectify a sewer blockage (minutes)	150	150	150	150	150
Maximum time taken to contain a sewer spill (minutes)	300	300	300	300	300

Appendix D – Guaranteed service level scheme

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

Westernport 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 Westernport Water.

Westernport Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
We will limit unplanned interruptions to no more than 4 in any 12-month period.	\$75
All water quality complaints will receive a response within three business days after notification (noting resolution may take longer).	\$100
We will not restrict the water supply of a residential customer, or take legal action, prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying	Reimbursement of Annual Water Access Fee or \$350 for tenants.
We will contain sewage spills within a house resulting from the failure of our pipes within one hour of notification	Reimbursement of Annual Wastewater Access Fee or \$550 for tenants in addition to clean-up costs.
We will contain sewage spills onto property within five hours of notification	\$350

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