ESSENTIAL SERVICES COMMISSION

2028 Water Price Review

Guidance

15 September 2026

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

The 2028 Water Price Review will set the maximum prices that 16 Victorian water businesses can charge for their water and sewerage services from 1 July 2028. It is the third price review under our PREMO (Performance, Risk, Engagement, Management and Outcomes) incentive framework for most water businesses.[1] This guidance builds on our most recent guidance issued for the 2026 North East Water price review. We have updated it to reflect the outcomes from our PREMO improvement project and matters arising through our engagement with the sector.[2] The 2028 Water Price Review Guidance:

- Provides additional guidance around the criteria and process by which water businesses can benefit from the potential for fast tracking high-quality price submissions through our assessment process.
- Clarifies our expectation that water businesses should put forward their 'best offer'.
- Provides additional guidance on requirements for engaging with First Nations people, including engaging with Traditional Owner groups as holders of rights and interests in relation to land and waterways.
- Emphasises our requirements for long-term planning to support capital investment plans. Ultimately, the pricing submission represents a 'slice' of how a business is proposing to deliver on its longer-term plans and strategies in the long-term interests of its customers.
- Updates the guidance on new customer contributions to reflect the commission's New Customer Contributions Framework issued in January 2026.
- Includes new guidance on large and/or complex connections.
- Outlines our expectations of greater transparency, accountability and reporting of financial performance against approved benchmarks during the regulatory period.
- Sets out a financial incentive scheme for operating expenditure to apply to businesses subject to the 2028 price review.

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1 We first introduced our PREMO (Performance, Risk, Engagement, Management and Outcome) framework at our 2018 price review of 17 Victorian water businesses. Fourteen of these undertook their second PREMO review in 2023, and 2024 for Greater Western Water. Goulburn-Murray Water has completed one PREMO review in 2024 – its 2020 review was not assessed under the PREMO framework, but the business did follow the PREMO principles in preparing its price submission.

2 An independent review by farrierswier following the 2023 and 2024 price reviews confirmed the PREMO framework was still delivering against its original objectives. However, the review identified some potential improvements, and this guidance paper reflects both the outcome of the review and other improvements identified by the commission and other stakeholders. The farrierswier report is published on our website.

The forthcoming asset management audits will examine whether businesses have well-developed asset management processes to underpin their capital and asset renewals programs.[3] Businesses should use the findings from this audit to support their proposals.

Applying the PREMO framework

PREMO incentives provide up-front rewards for ambitious proposals delivering better customer value. However, businesses are ultimately accountable for delivering on their commitments.

The Performance element of PREMO effectively closes the loop on the current regulatory period by addressing two key questions:

- Did the water business deliver on its promises?
- Did customers get what they paid for?

This also establishes a continuum from one regulatory period to the next as businesses seek to maintain or improve customer value, and to address any shortfalls in performance going forward. Customers should expect no less.

Reflecting customer engagement

We expect a water business to engage with its customers across its range of services to understand their preferences for prices and service levels. Water businesses are required to use these engagement insights to inform the outcomes they propose to deliver in their price submissions.

Consideration of community challenges

Price submissions must show consideration of the major challenges which are affecting the Victorian community. This includes the impact of climate change, aging infrastructure, price inflation, heightened economic uncertainty, increased demand and water supply security, and customer vulnerability.

While we anticipate these matters will be prominent in the price submission considerations, they do not materially affect the nature of our guidance. We still expect businesses to justify their forecasts and show how they have sought to manage the risks of this uncertainty on behalf of their customers.

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[3] The Minister for Water wrote to us in March 2026 to request we conduct an asset management audit during 2026 ahead of the 2028 Water Price Review. The Minister noted: 'The objectives of the audit should be to provide greater assurance that water corporations are complying with their asset management obligations, embedding best practice asset management in their business, and can plan for and ensure expenditure incurred in relation to assets used to deliver services to customers is prudent and efficient.' We issued the asset management audit scope to water businesses on 3 August 2026.

Meeting legislative, government and commission requirements

Price submissions must incorporate the efficient cost of meeting legislative and government policy obligations.

The price submission should present a consistent story bringing all these requirements together to show how they interrelate to deliver value to customers. This is the PREMO 'golden thread'.

This guidance sets out how we will assess price submissions aligning with the requirements of the Water Industry Regulatory Order 2014.[4]

In meeting the requirements of the guidance, we expect a business to present its proposal in a clear and succinct manner. The length of a submission does not directly correlate to a specific PREMO rating or potential for fast-tracking, however a well-written, well-presented and well-supported submission supports our ability to assess the proposal.

The PREMO framework gives greater autonomy for businesses that demonstrate clear ownership of their proposals. Key to this is the requirement in our guidance that each business's board attests to:

- the quality and accuracy of its price submission
- its commitment to the customer outcomes proposed.

Ultimately, we expect a price submission to reflect a business's 'best offer' to its customers (irrespective of the PREMO price submission rating).

The price submission must be lodged with us by **Monday 13 September 2027.**

Commission staff can assist businesses to understand the requirements in the guidance, and we expect businesses to provide advance notice of any major changes they are considering.

The water team can be contacted by email: water@esc.vic.gov.au

[4] The WIRO 2014 is available at http://www.gazette.vic.gov.au/gazette/Gazettes2014/GG2014G043.pdf#page=45, pp. 2485–2491.

1. About this guidance

1.1. Our role

We will undertake a review of the maximum prices that 16 water businesses can charge for water and sewerage services for the regulatory period from 1 July 2028 (the 2028 Water Price Review).

The review covers Barwon Water, Central Highlands Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, Goulburn-Murray Water, Greater Western Water, GWMWater, Lower Murray Water, South East Water, South Gippsland Water, Southern Rural Water, Wannon Water, Westernport Water and Yarra Valley Water.

Our pricing powers and functions in Victoria's water industry are governed by the Water Industry Regulatory Order 2014 (WIRO).[5] The order sits within the broader context of the *Water Industry Act 1994* (Vic) (WI Act) and the *Essential Services Commission Act 2001* (Vic) (ESC Act).

We must make a price determination which determines the maximum prices that a water business may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated, from 1 July 2028.[6]

Clause 14 of the WIRO (see Appendix A) requires us to assess a price submission prepared by a water business, and form an opinion on whether the price submission:

- complies with the guidance issued by the commission under clause 13 of the WIRO
- has adequate regard for the matters specified in clause 11 of the WIRO.

Under the WIRO, water businesses are subject to a 'propose-respond' framework. Businesses set out the revenue they consider they will need to deliver their outcomes over the regulatory period, and we review the proposal submitted to us. If we form a view that a price submission complies with our guidance and has adequate regard for the relevant matters specified in the WIRO requirements, then we must approve the maximum prices the water business may charge for prescribed services as proposed in its price submission. If the price submission does not, in our opinion, comply with this guidance or have adequate regard for the relevant matters specified in the WIRO, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.[7]

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5 The WIRO 2014 is available at http://www.gazette.vic.gov.au/gazette/Gazettes2014/GG2014G043.pdf#page=45, pp. 2485–2491.

6 WIRO, clause 10(a). The prescribed services are listed at clause 7(b) of the WIRO.

7 WIRO, clause 14.

1.2. About this paper

We are required to issue price review guidance to water businesses under clause 13 of the WIRO (see Appendix B). In compliance with clause 13 of the WIRO, the guidance sets out our approach to the price review and information requirements for price submissions.[8]

Many elements of the 2028 Water Price Review: Guidance remain unchanged from the guidance we issued for the 2026 North East Water price review.

The updated guidance reflects our:

- *New Customer Contributions Framework* (January 2026)
- '*Getting to Fair: Advancing Equity* strategy for achieving equitable outcomes for Victorians' (July 2026)[9]
- *First Nations Self-Determination Framework* (July 2026)[10]
- Guideline 3 *(2025)* Varying a Price Determination (Re-opening) (September 2025)
- engagement with the sector as part of our PREMO improvement project
- lessons from our recent North East Water and Melbourne Water price reviews
- feedback on the draft guidance we published in July.

We have also:

- provided guiderails on the criteria for eligibility for a fast-tracked assessment (Section 2.5.1)
- set out our performance monitoring and reporting requirements to strengthen accountability throughout the regulatory period (Section 2.6)
- introduced a financial incentive mechanism targeting controllable operating expenditure performance (Section 2.7)
- provided greater clarity on the application of our base-trend-step approach to controllable operating expenditure (Section 3.8)
- clarified the criteria for the capitalisation of statutory expenses (Section 3.8)
- emphasised our expectations for a long-term planning focus, in particular to support capital investment proposals (Section 3.9)
- provided guidance for the approach to large and/or complex connections (Section 3.22)

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8 Clause 13 of the WIRO also requires us to provide guidance following consultation, including with the regulated entities. Over the course of 2026, we consulted with the water businesses and other interested parties on the various elements of this guidance.

9 Essential Services Commission 2026, *Getting to Fair: Advancing Equity*, 21 July.

10 Essential Services Commission 2026, *First Nations Self-Determination Framework: Enabling First Nations-led outcomes at the commission*, 21 July.

- updated the PREMO assessment tool that water businesses must use to inform their PREMO ratings (appendix E),

Where possible we have sought to minimise compliance costs for water businesses.[11] In considering the information required to support a price submission, much of the information should be readily available to a water business and relevant for other purposes such as corporate planning or project justification and prioritisation.

Much of the supporting information detailed in this guidance can be provided by completing the financial model template (issued by us) that forms part of a water business's price submission. We encourage businesses to keep their price submission as clear and succinct as possible. A water business need not include all the supporting information for the claims made in its submission. However, we expect the necessary information will be readily available, and the business must be able to provide any supporting information requested by us in a timely manner.

1.3. Water pricing framework and approach

The PREMO incentive framework includes financial, reputational and procedural incentives to align the interests of water businesses and the customers they serve.

PREMO stands for Performance, Risk, Engagement, Management, and Outcomes. Water businesses must demonstrate their level of ambition in delivering value-for-money for customers in their price submissions across the five 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 the proposed service outcomes represent an improvement, the status quo, or a reduction of service levels?

[11] Under clause 4C(a) of the WI Act, we have an objective to ensure the costs of regulation do not exceed the benefits, wherever possible.

Key elements of the PREMO pricing approach are:

- an emphasis on the role of customer engagement to inform and influence the price submission
- linking the return on equity earned by a water business to the level of ambition in its price submission for Performance, Risk, Engagement, Management and Outcomes
- flexibility mechanisms to help ensure the pricing approach accounts for the diversity of the water business and its customers, and to allow for a streamlined price review process.

Independent reviews by farrierswier following the 2023 and 2024 price reviews confirmed the PREMO framework was delivering against its original objectives. Nevertheless, we have undertaken various actions and updates to strengthen the framework, as listed in Section 1.2 above. This includes publishing a directions paper to help water businesses prepare for the 2028 Water Price Review and bringing forward the release of our guidance.[12]

1.4. Amendments to this guidance

This final guidance has been prepared in consultation with water businesses and other interested parties, including though a public consultation process and an online workshop with water businesses.[13] Our consultation focussed on the key changes to the guidance issued for the 14 water businesses as part of the 2023 water price review.

We may issue additional guidance or amend this final guidance during the price review due to any changes to law, regulations, or the economic environment. We will consult with water businesses and relevant interested parties where any additional guidance or amendment to the guidance is required.

1.5. Structure of this guidance

The guidance is structured as follows:

- Chapter 2 sets out:
  - how we propose to regulate prices
  - our approach and methodology for assessing a price submission and making a price determination
  - the impact of PREMO on price submission information requirements
  - our approach to consultation during the review process
  - the assessment process and the 2028 Water Price Review timeline
  - our expectations for performance monitoring and reporting throughout a regulatory period

[12] Directions paper: Preparing for the 2028 Price Review 2026, 1 April.

[13] Clause 13 of the WIRO requires us to provide guidance following consultation with the regulated entity.

  - our controllable operating expenditure financial incentive mechanism.

- Chapter 3 sets out:
  - the ‘governing criteria’ for each of the components of the building block methodology which will inform the nature and scope of the matters to be included in the price submission, and form the basis of our assessment of the price submission
  - the supporting information required to be included in the price submission.

1.6. Interpretation of this guidance

If a water business requires clarification or interpretation on any matters relating to our pricing framework or this guidance, it should contact commission staff.

If a water business is considering proposing significant or material changes, it should raise this with commission staff as early as possible. This will allow us to consider the proposed changes and the need for any additional guidance to inform the price submission and our subsequent assessment.

Requirements in this guidance described as matters a price submission 'must' address are, unless clarified by the commission, price submission requirements for the purposes of clause 14(b) of the WIRO.

2. Our approach to the price review

This chapter sets out:

- how we will regulate prices[14]
- our approach and methodology to assessing price submissions and making a price determination[15]
- the impact of PREMO on price submission information requirements[16]
- our approach to consultation during the price review process[17]
- the assessment process and the 2028 Water Price Review timeline[18]
- our expectations for performance monitoring and reporting throughout a regulatory period
- our proposed introduction of a controllable operating expenditure financial incentive mechanism.

2.1. How we will regulate prices

Clause 12(b) of the WIRO provides that a price determination may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated, for regulated services in a manner consistent with section 33(5) of the Essential Services Commission Act — that is, in any manner we consider appropriate.

We use a building block methodology to determine the forecast revenues that will provide a water business with a reasonable opportunity to recover:

- a rate of return on prudent and efficient capital expenditure on assets,
- a return of the cost of investing in those assets (through depreciation),
- prudent and efficient operating costs,
- a benchmark tax allowance and
- recovery of costs required to deliver on its service outcomes and comply with relevant health, safety, environmental, social and other regulatory obligations over the regulatory period commencing 1 July 2028. (A list of obligations is shown in Section 3.7.)

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14 WIRO, clause 13(a)(i).

15 WIRO, clause 13(a)(ii).

16 WIRO, clause 13(a)(v).

17 WIRO, clause 13(a)(iv) and 13(a)(viii).

18 WIRO, clause 13(a)(vi) and 13(a)(vii).

For a defined regulatory period, our assessment methodology involves the following steps:

- first, the outcomes that a water business proposes to deliver to its customers will be assessed to validate that they reflect legislative, government policy and technical regulator obligations or demonstrated customer needs
- second, the following 'building blocks' will be determined in accordance with governing criteria for each element (specified in Chapter 3), to:
  - establish an efficient benchmark level of forecast operating expenditure for the next regulatory period
  - establish an efficient benchmark level of forecast capital expenditure for the next regulatory period
  - roll-forward the regulatory asset base
  - 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
    - a benchmark return on equity value determined by a business's PREMO rating
  - establish a return of capital through a regulatory depreciation allowance
  - establish a benchmark tax allowance.

These 'building blocks' will determine the forecast revenue that is required for a water business to deliver on its service outcomes and obligations.

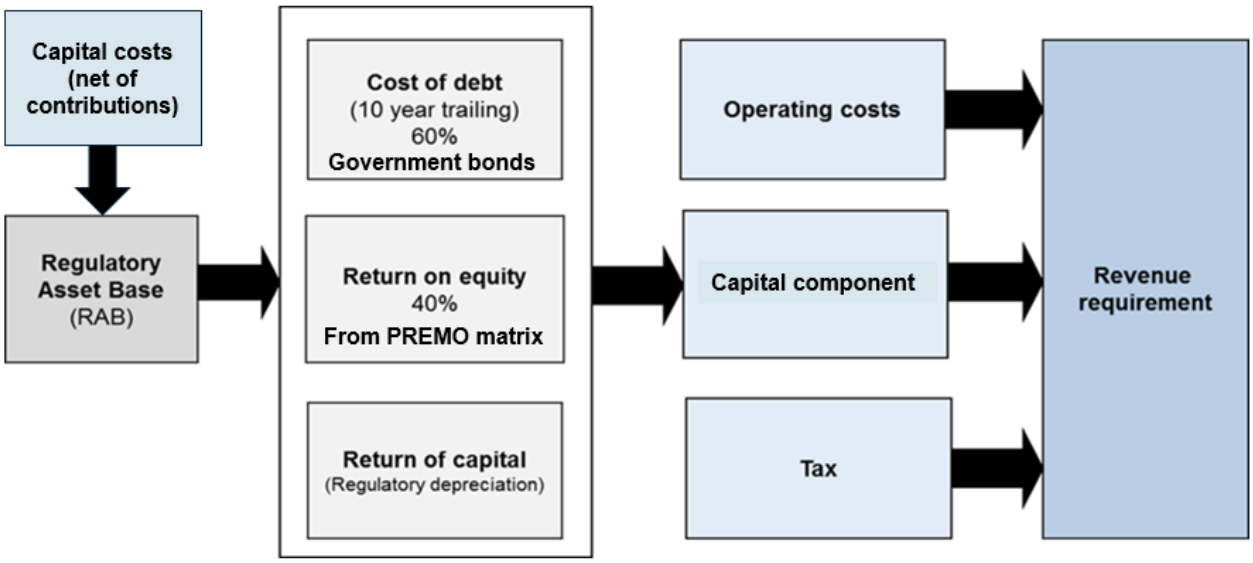
A summary of the building block methodology is shown in Figure 2.1.

Once the revenue requirement for the regulatory period has been established using building blocks, the form of price control that will be applicable to each water business determines how this revenue is to be translated into customer prices.

The prices charged by Victorian water businesses are regulated under various forms of price control, including price caps (that is, fixed maximum prices), revenue caps (which allow prices to vary with changes in demand during the period to recover the maximum revenue), tariff baskets (which allow prices within the basket to be adjusted within an approved constraint) and hybrid forms of control. Subject to meeting the requirements of our guidance, we will continue to provide water businesses with discretion to propose the form of price control to be applied for their regulatory period.

Our price determination will set out the prices that are to apply for the year commencing 1 July 2028, and the prices or the manner in which prices will be calculated for the remaining years of the regulatory period.

Figure 2.1 Revenue under building blocks



2.2. Approach and methodology for assessing the price submission

Our regulatory task is to assess a water business's price submission and form a view about whether or not the price submission:[19]

- has adequate regard for the matters specified in clause 11 of the WIRO
- complies with guidance we issue under clause 13 of the WIRO.

2.2.1. Assessing the extent to which the submission has regard for matters specified in Clause 11

Clause 11 of the WIRO refers to matters specified in the ESC Act, the WI Act, the guidance we issue under clause 13 of the WIRO, and a number of pricing principles (at clause 11(d)) that we must have regard to in making a price determination.[20]

To facilitate our assessment, water businesses are required to support the proposals in their price submission by reference to the matters in clause 11 of the WIRO.

[19] WIRO, clause 14(b)(i).

[20] The matters referred to in clause 11 of the WIRO have been grouped into themes in Appendix C.

In doing so, a water business is required to place particular emphasis on the matters in clause 8(b) of the WIRO which primarily relate to the promotion of various types of efficiency.[21] Chapter 3 of this guidance sets out a number of discrete considerations the price submission must address in order to demonstrate a water business has fully and meaningfully addressed clause 11 of the WIRO.

2.2.2. Assessing compliance with this guidance

Water businesses must lodge their price submission with us by **Monday 13 September 2027**. We expect the price submission (including the financial model template provided by the commission) to comply with Chapter 3 of this guidance. We will assess whether each water business has sufficiently justified its proposals in accordance with the governing criteria in Chapter 3 and satisfied all of the information requirements.

2.2.3. Consequences if we assess non-compliance with this guidance

Consistent with clause 14 of the WIRO, if we form a view that a price submission complies with our guidance and has adequate regard for the matters specified in clause 11 of the WIRO, then we must approve the proposals in the price submission. If the price submission does not, in our opinion, comply with this guidance or have adequate regard for the relevant matters specified in the WIRO, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.[22] This may include us specifying prices for a shorter regulatory period than proposed by the business.

While we expect that a water business's price submission will comply with the requirements of this guidance, our review will generally focus on matters that have a material impact on the prices customers pay or the services customers receive. In practice, if a price submission does not fully comply with the guidance, our intention is to provide the business with an opportunity to provide the information required to demonstrate compliance before we make a draft decision.

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[21] In summary, clause 8(b) of the WIRO provides that in having regard to the overarching objectives in the ESC Act, particular emphasis is to be placed on:

(i) the promotion of efficient use of prescribed services by customers;

(ii) the promotion of efficiency in regulated entities as well as efficiency in, and the financial viability of, the regulated water industry; and

(iii) the provision to regulated entities of incentives to pursue efficiency improvements.'

[22] WIRO, clause 14(b)(i).

2.3. Approach to assessing PREMO price submission ratings

The PREMO incentive mechanism links the return on equity reflected in approved prices to the level of ambition expressed in a price submission. The return on equity will depend on whether the price submission is rated as 'Leading', 'Advanced', 'Standard' or 'Basic'.

Section 3.14 discusses the manner in which a water business should assess its price submission to decide on the submission's PREMO rating, and therefore the return on equity to be reflected in its proposed prices. Appendix E includes a PREMO assessment tool that water businesses must use to inform their PREMO ratings.

The tool includes a set of guiding questions that set out the matters to be considered in assessing a price submission PREMO rating, and examples of what might constitute a 'Leading', 'Advanced', 'Standard' or 'Basic' rating for each element of PREMO. For the 2028 Water Price Review, the ambition expressed in price submissions will be rated according to all five elements of PREMO – Performance, Risk, Engagement, Management and Outcomes.

Informed by its assessment for the five elements of PREMO, a business must propose an overall PREMO rating for its price submission. The assessment tool guides a water business to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, form of price control, tariffs, and demand.

A price submission must meet all the requirements set out in Chapter 3 of this guidance, which represents the minimum requirements for a 'Standard' overall PREMO rating.

We will also rate a price submission, with our decision on the PREMO rating determining the benchmark return on equity to be reflected in approved prices.

Water businesses should have confidence that well justified PREMO self-ratings – those that provide credible information supporting the self-ratings – will be assessed reasonably by us. We want to reward ambition that provides improved value to customers.

Our PREMO rating is an assessment of the water business's price submission and its performance during the current regulatory period. It is not an assessment of the water business itself.

2.4. Our consultation process during the 2028 Water Price Review

A focus on customer engagement by water businesses under PREMO should result in less need for direct engagement by us with customers. This is consistent with our objective to emphasise the business and customer relationship, and to provide businesses with greater autonomy.

We expect price submissions to be heavily informed by customer engagement. As in past price reviews, we will invite submissions from interested parties on the proposals contained in a water business's price submission prior to making a draft decision.

Following the release of our draft decision, we will invite submissions and intend to engage with customers and other interested parties, either by holding public meetings and/or through online platforms, before we make our final decision and issue a price determination.[23]

We will consult with agencies such as the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria.

We will make our papers (including the reports of consultants assisting with our review), water business's price submissions, and submissions from other interested parties, available on our website (www.esc.vic.gov.au) in accordance with our submissions policy.[24] We will also use the Engage Victoria platform for consultation during the 2028 Water Price Review.

If there is information that a water business or an interested party does not want disclosed publicly, because it is confidential or commercially sensitive, the matter should be discussed with commission staff before lodging the submission.

2.5. 2028 Water Price Review process and timeline

A water business must lodge its price submission with us on or before **13 September 2027**.[25] If a water business fails to lodge its submission by this date, we may use our discretion to specify maximum prices.[26]

We will assess price submissions using a three-stage review process:

- **Stage 1**: Initial evaluation to verify the quality and strength of the submission and the proposed outcomes for customers, and to establish what further verification work might be required to inform our draft decision. We may be able to fast track (see Section 2.5.1) the price submission through the additional verification process in stage 2 and make an earlier draft decision to accept prices, or propose relatively minor changes, effectively expediting stage 2.
- **Stage 2**: Conduct further verification work as required, tailored to the quality of the price submission, which may range from simple requests for further information through to a full

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23 WIRO, clause 16(b).

24 View our submissions policy at https://www.esc.vic.gov.au/about-us/our-policies/our-submissions-policy.

25 Clause 13(a)(vi) of the WIRO requires us to provide guidance on the timing and processes we propose to follow in making a price determination. Clause 13(a)(vii) also requires us to specify the date by which a water business is required to deliver its price submissions to us.

26 WIRO, clause 14(b)(ii).

review of cost forecasts by an expert consultant. We may make our draft decision once we have completed the additional review (or reject the price submission if unable to reach a draft decision based on the information submitted).

- **Stage 3:** Public consultation on our draft decision, leading to our final decision and a price determination for each business. An earlier final decision may be made for those businesses that have been fast tracked, if consultation does not identify further significant review being required after the draft decision.

Figure 2.2 sets out our assessment process and timeline for the 2028 Water Price Review.

2.5.1. Our flexible assessment process – fast tracking our price submission assessment

By fast tracking high-quality price submissions, we provide those businesses with early certainty over their price proposals allowing them to focus their resources on delivering services to their customers with a reduced regulatory burden. We recognise the benefits to businesses and want to provide further clarity on how we consider eligibility for fast tracking.

To facilitate a quick and simple stage 1 assessment (and be considered for fast tracking), a price submission must meet a number of criteria. It must:

- be complete and accurate, incorporating all the requirements set out in this guidance paper. This includes the financial model template (see Section 3.23)
- clearly convey its key messages and data to us. Where we have queries, we expect a business to promptly provide clear and robust supporting evidence to justify its proposals
- clearly demonstrate how the business has captured the views of its customers and explain how it has considered feedback.

In addition, we must also be confident that (a) we can assess a proposal under the compressed timeframes for fast tracking, and (b) that businesses are able to deliver on the commitments they have made in their proposal.

Where a business is proposing significant changes (particularly increases) to expenditure and/or prices compared to the current regulatory period, we will need more time to review those changes compared to a business with more modest changes. In forming a view about whether a business will be considered for fast tracking we will consider both the scope of the business's proposals for the upcoming regulatory period and its performance to date in the current period. To assist businesses to determine their likelihood of being eligible for fast tracking, we propose to adopt the following guiderails.

Fast tracking guiderails

Forecast – it is more likely that a business will be considered for fast tracking where its 2028 Water Price Review submission is proposing:

- total controllable operating expenditure that is no more than 10 per cent higher (in real terms) than the total controllable operating expenditure benchmark allowance for the current regulatory period
- a minimal number of operating expenditure step changes
- capital expenditure that is no more than 30 per cent higher (in real terms) than benchmark capital expenditure in the current regulatory period
- minimal changes to tariff structures, service standards or outcomes.

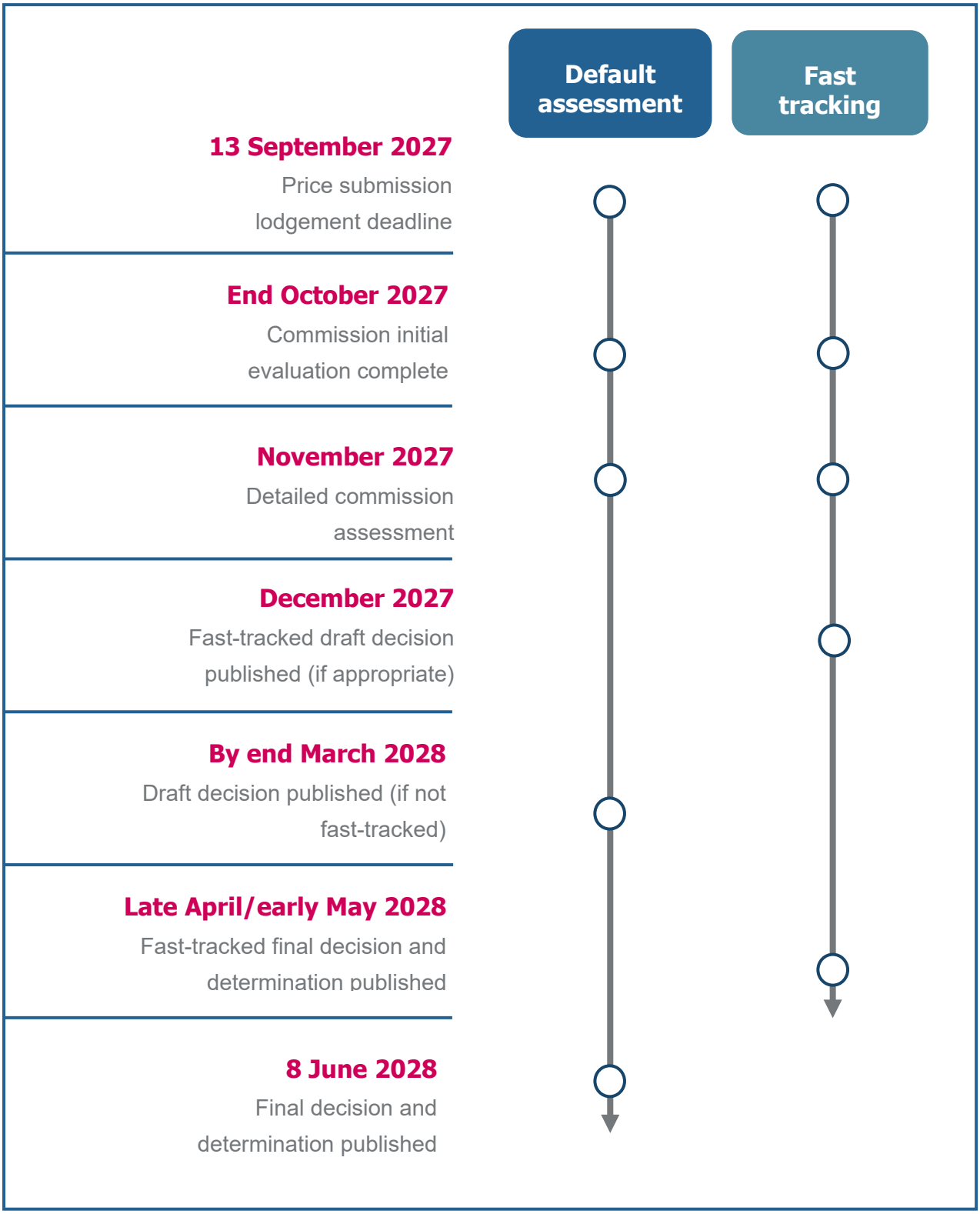
Current period performance – similarly, it is more likely that a business will be considered for fast tracking if its performance in the current regulatory period shows that:

- actual average recurring controllable operating expenditure over the completed years of the current regulatory period is no more than 5 per cent higher than its benchmark
- actual total capital expenditure over the completed years of the current regulatory period is within +/-20 per cent of its benchmark
- it has met, or substantially met, at least 85 per cent of its annual outcome targets set in the current regulatory period.

It is important to note that the above guiderails are indicative of the factors that we will consider. Ultimately, the decision to fast track a price submission and make early draft and final decisions will be made at our discretion. We will advise those businesses we have decided to fast track once that decision is made. A business must have all additional required supporting information available and provide this to us promptly when requested, to complete the assessment within the fast-track timeframe.

Following the release of an early draft decision, if our review process finds there are issues that need to be further explored, we may revert a price submission back to the default assessment process described in Figure 2.2.

Figure 2.2 Price review timeline and assessment process



2.6. Monitoring performance delivery before the next price review

The PREMO framework holds water businesses accountable for delivery of their price submission commitments. A price submission sets out a business's proposal for the next regulatory period, and we agree a PREMO rating based on this proposal. This incorporates an *up-front* return on equity reflecting the level of ambition in the proposal – with a higher reward for the more ambitious proposals earning 'Advanced' and 'Leading' PREMO ratings. It is then up to the business to demonstrate it has earned that rating by delivering on its commitments to its customers.

The Performance 'P' element of PREMO requires each business to account for its achievements across the regulatory period against four key components:

- Performance against its target for each outcomes measure to demonstrate that customers received the related value
- Operating expenditure actual spend compared against the approved benchmarks – overspend will likely result in the business seeking price rises
- Capital expenditure actual spend against the approved benchmarks, including delivery of the top 10 major projects against the price submission schedule – overspending or under-delivery will impact value received and future prices
- Customer sentiment and satisfaction according to the commission's quarterly customer survey and the business's own measures.

PREMO performance reporting essentially addresses the question 'did customers get what they paid for?'. However, addressing this question only at the five-yearly price review is, in our view, inadequate. In many instances at the 2023 price review when the Performance element first came into effect, we found businesses struggled to account for their performance across the 5-year span, particularly in clearly explaining performance shortfalls. This was especially evident with attempts to reconcile and justify operating expenditure overspending.

As foreshadowed in our April 2026 Directions Paper, we are bringing a much greater focus to water sector performance monitoring and reporting.[27]

The information requirements for performance reporting are all collected and reported annually – through businesses' outcomes reporting, annual regulatory accounting statements, and quarterly reporting of customer sentiment on our website. This information is available to us and is readily available to businesses to keep close track of their performance year-on-year. In particular, we expect businesses will closely monitor their annual expenditure against the price review benchmarks, identify and understand variations, and have plans to address those variations. We have added expenditure benchmark comparison functions into the regulatory accounting statement

[27] Essential Services Commission 2026, *Directions paper: Preparing for the 2028 Price Review*, 1 April.

templates since 2023-24 to assist with this. We will expand on this further in the 2025-26 template to include mandatory operating expenditure variation reporting and more granular capital expenditure reporting.

We will expand the annual PREMO performance reporting process to include expenditure performance against benchmarks. This will allow water businesses to demonstrate to their customers each year if they are delivering on their promises, consistent with their awarded PREMO rating, and to advise and foreshadow material variations that may impact future prices and value.

2.7. Operating expenditure financial incentive mechanism

The previous section sets out how the commission is moving to increase the accountability and transparency of each business's financial performance. We have observed significant variation in operating expenditure performance across businesses, with some outperforming or matching their regulatory period benchmark while others are underperforming, spending well above their benchmark. Businesses should be actively monitoring and reporting on their expenditure throughout the regulatory period.

The PREMO framework already provides reputational and financial incentives to encourage water businesses to deliver value to their customers. Under PREMO, businesses can earn higher returns when they are more ambitious in their proposed service outcomes, cost efficiencies, and absorption of risk on behalf of customers. Because the approved maximum prices a business can charge are based on its forecast costs, it has an incentive to manage its costs throughout the regulatory period and retain any underspend.

When actual costs are lower than the forecast costs used to establish prices, the business can retain the benefits of any recurring savings up to the end of a pricing period. If the base year (typically year 4 of a 5-year period) reflects these savings, they are then reflected in prices at the start of the next period. In this way, customers also benefit from the savings made by businesses.

When costs are higher than the forecasts used to establish prices, a business is expected to manage this shortfall because it can't increase its prices during the regulatory period, unless it applies to reopen its Price Determination. However, an increase in recurring costs will likely lead to an increase to the proposed baseline for the next regulatory period, leading in turn to a step change in price all other things being equal. Accordingly, we apply a high degree of scrutiny on increases above the benchmark in the baseline year, as described in Section 3.8.

While the PREMO framework has been successful in incentivising businesses to put forward their best offers, there is evidence to suggest that many businesses are falling short in their delivery of those offers, especially in terms of managing actual operating expenditure. Of the 14 businesses that were part of the 2023 price review, we have observed the following when comparing actual

operating expenditure to the benchmarks used to set each business's prices (adjusted to exclude self-reported expenditure on one-off or non-recurring costs) for 2024-25, the second year of the regulatory period:

- Two businesses outperformed their benchmarks by around 2 per cent.
- Five businesses were within 5 per cent or less of their benchmark.
- One business underperformed against its benchmark by just over 5 per cent.
- Six businesses underperformed against their benchmark by between 10 and 15 per cent.

In summary, seven of 14 businesses have significantly exceeded the operating expenditure benchmark allowances for 2024-25 used to approve prices at the 2023 price review.

Performance is an important part of the PREMO framework, and the backward assessment of a business's performance contributes to its overall PREMO rating and rate of return. However, the evidence of significant expenditure over-runs suggests that the reputational incentive of a performance downgrade may not be sufficient. Under PREMO, businesses only face a financial penalty for poor performance (that is a reduced return) if their overall PREMO rating is downgraded.

The PREMO framework provides for the commission to downgrade a business's PREMO rating, thereby lowering the rate of return, during the regulatory period if it considers the business is sufficiently under-performing against its proposal and commitment to its customers. This reflects the focus of PREMO on making businesses accountable to delivering on their promises, whereby the rewards granted at the beginning of the period can be removed or reduced where warranted. However, this rather heavy-handed approach would only apply where a business has not taken adequate steps to address its poor performance. This is why we have considered other options for how we can reinforce the incentives for businesses to put forward their best offer and deliver on that offer. Our proposal is a lighter handed, targeted approach incorporating only operating expenditure.

Our base-trend-step assessment approach to assessing operating expenditure forecasts relies heavily on businesses revealing efficient base-year costs. We do not conduct a detailed bottom-up analysis of all controllable operating expenditure but focus on reviewing the changes to recurring baseline expenditure proposed by businesses. Even under PREMO, information asymmetry exists between the business and the commission. This means a business could still seek to propose the highest baseline year forecast it thinks can be justified, putting the evidentiary burden on us to prove the forecast is not prudent or efficient.

The commission considered introducing expenditure incentives schemes when developing PREMO but decided that the performance element of PREMO would likely be sufficient to drive efficient behaviour, noting the significance of the rewards and penalties available to businesses via their return on equity. While acknowledging the disruptive economic trends that have influenced

the businesses' cost bases in the past six years, including the pandemic and the following supply chain cost pressures, monitoring performance over the last regulatory period and the first two years of this regulatory period has led us to reconsider our position regarding operating expenditure. Introducing an incentive scheme focused on actual operating expenditure would provide an ongoing incentive for businesses to deliver on the ambition set out in their pricing proposals.

Regulators typically adopt financial incentive schemes that cover operating expenditure, capital expenditure and service delivery. This recognises that there are trade-offs between the three. For example, operating expenditure can be reduced by reducing service levels, or in some cases by investing capital instead. The uneven application of incentive schemes could therefore distort business decisions. At this stage, we do not think it is necessary to introduce financial incentive schemes for capital expenditure or service delivery. Most businesses are not overspending compared to capital expenditure benchmarks and we consider that the current financial and non-financial incentives under PREMO are sufficient for service delivery (for example, Guaranteed Service Level schemes and outcome and performance reporting).

2.7.1. Introducing an efficiency benefit sharing scheme

We will adopt an efficiency benefit sharing scheme (EBSS) similar to the one used by the Australian Energy Regulator. Appendix F provides more information on the EBSS including worked examples of how the scheme will work.

Under an EBSS, a business is rewarded (or penalised) for operating expenditure savings (or over expenditure) compared to its benchmarks (set at the outset of the regulatory period) in each year. Businesses receive a benefit (or penalty) based on a share of the cost savings (or overruns) through greater (or lower) revenue in the subsequent regulatory period. The scheme benefits customers by providing a continuous incentive for businesses to pursue efficiency improvements and undertake efficient operating expenditure during the regulatory period.

In addition to strengthening the incentive to control operating costs, an EBSS addresses two specific issues with the base-trend-step approach to forecasting operating expenditure adopted under the PREMO approach.

The efficiency benefit sharing scheme provides:

- a reduced incentive to inflate operating expenditure forecasts in the baseline year (the last full year of actual costs, typically year four of a 5-year period), which are then embedded in the subsequent regulatory period's forecast operating expenditure benchmarks
- a continuous incentive to reduce costs in each year of the regulatory period. Without an EBSS, businesses have a greater incentive to reduce costs in the early years of a regulatory period, as they get to retain the benefits for longer.

The EBSS for controllable operating expenditure will apply to all businesses subject to the 2028 Water Price Review. Each business's performance will be assessed against the benchmarks used to set its prices for the 2028–2033 regulatory period.

The EBSS will therefore impact revenue from the first year of the 2033 regulatory period (2033-34) The scheme will not impact prices or revenue during the 2028–33 regulatory period.

How an efficiency benefit sharing scheme could work

The EBSS needs to be carefully designed to ensure that the financial incentive works as intended. If the scheme is too complicated or difficult for the business to understand and respond to, it is unlikely to be effective.

Not all changes in operating costs can be controlled by businesses. Some costs, which are driven by exogenous factors, such as drought, can be *managed* by businesses but are largely outside of their control. For the EBSS to provide an effective incentive, it needs to focus on those costs that businesses can effectively control. For this reason, we are proposing that the scheme would only apply to controllable operating expenditure and allow for the carve out of costs that have arisen from exogenous factors outside of the business's direct control.

Carve-outs and one-off expenses

In order to ensure the EBSS is fair and does not expose businesses to undue risk, it will only apply to costs that businesses can effectively control. The following will therefore be excluded from calculations:

- non-controllable costs (as defined in the price review submission templates) including external bulk water charges, external temporary water purchases, licence fees and the environmental contribution
- controllable costs identified by the business (or us) that are uncertain and therefore intentionally excluded from the benchmark allowance to manage customer risk, that eventuate during the regulatory period (subject to prudency and efficiency verification)
- other material once-off expenditure associated with exogenous events that a prudent business could not reasonably prevent from occurring or substantially mitigate its cost impact and could not insure (or self-insure) against on reasonable commercial terms. These many include costs associated with natural disasters and extreme events such as severe drought, fire or flood and terrorism.

Where a business seeks to adjust its actual controllable operating expenditure for the purposes of the EBSS calculations, it should provide a detailed explanation of the rationale for doing so. We expect businesses to identify and account for any expenses of this nature in their regulatory accounts starting with the 2028–29 financial year.

Appendix F provides more information on carve-outs and one-off expenses.

The scheme will also include limits on when the rewards and penalties will apply.

The greater the reward or penalty, the greater the incentive on businesses to seek (avoid) the reward (penalty). At the same time, incentives need to be proportionate to the behaviour that the regulator is incentivising and not impact business viability or service standards. To lower the financial risks to water businesses, we are proposing that the size of the overall revenue adjustment associated with the EBSS will be capped at a fixed amount of 1 per cent of the revenue requirement. This is around the same as the impact on revenue from the incremental higher return on equity for attaining a higher PREMO rating (from ‘Standard to ‘Advanced, and from ‘Advanced to ‘Leading’).

Businesses close to or matching their controllable operating expenditure benchmarks will not require a revenue adjustment.

- Any rewards will only apply in the subsequent regulatory period where actual aggregate controllable operating expenditure (after adjustments for one-offs) over the first four years of the regulatory period is more than 2 per cent below the approved benchmarks.
- Any penalties will only apply in the subsequent regulatory period where actual aggregate controllable operating expenditure (after adjustments for one-offs) over the first four years of the regulatory period is more than 5 per cent above the approved benchmarks.
- Total rewards or penalties in the subsequent regulatory period will be capped at 1 per cent of the business’s revenue requirement.

The EBSS should reinforce the incentive businesses already have under PREMO to submit robust and well-articulated proposals because they know they will be judged against the benchmarks they committed to in their pricing submissions. The intent of the EBSS is to create a continuous incentive for efficient expenditure throughout the period, such that the ‘best offer’ a business puts forward in its price submissions is sustained.

We will continue to engage with water businesses to clarify or refine elements of the EBSS as needed. The EBSS will proceed in the form described above and in Appendix F.

3. Required contents of a price submission

Pursuant to clause 13(a)(iii) and 13(a)(v) of the WIRO, this chapter sets out the governing criteria and supporting information requirements for the major components of a water business's price submission, covering the regulatory period commencing 1 July 2028 (the next regulatory period).

A water business should prepare its price submission with the commission as its target audience. Although the price submission will be released publicly, the content and language should be tailored to facilitate our review. A water business may consider other ways – such as fact sheets – to communicate its proposals to other interested parties, including its customers.

Best offer for customers

Under the PREMO framework, businesses put forward their best offer to customers. The price submission needs to explain and demonstrate how the business's proposals for prices and outcomes are connected to what they have heard during engagement with their customers. Price submissions must clearly and succinctly identify and explain how a business's proposal demonstrates value for money for customers – that is, what outcomes will be delivered to customers in return for the prices they pay, and how this reflects what customers value most.

The 'golden thread' in a price submission is the traceable connection between customer evidence, business choices, proposed outcomes, expenditure, services, prices, and ongoing accountability.

Taking a longer-term view

By necessity our assessment of a business's proposals focuses on the regulatory period. However, businesses should be taking a longer-term view. Proposals should demonstrate they are informed by and consistent with long-term plans and strategies. Businesses need to clearly set out where and why expenditure needs to take place now to help support future delivery. The failure to plan for the long-term creates a risk of both under-delivery of services and higher prices in the future. Ultimately, the pricing submission represents a 'slice' of how a business is proposing to deliver on its longer-term plans and strategies.

The pricing submission should also be consistent with the business's other planning documents including its annual corporate plan and its long-term asset management plans.

Price submission requirements

The information requirements specified in this chapter reflect the information we need to undertake the 2028 Water Price Review consistent with the WIRO. Much of the information requested would already exist within normal business practice – for internal planning and corporate reporting, for

example. Also, much of the detail can be provided by completing the financial model template (issued by us) that forms part of a water business's price submission (see Section 3.23).

To support clear and succinct price submissions, a business need not include all the supporting information for the claims made in its submission. However, we expect the necessary information will be readily available. The business must be able to provide any supporting information requested by us in a timely manner. For example, a consultant's report may be referenced in a submission without providing the full report as an attachment. We may request copies of material supporting a price submission, including (where need be) through the issue of compulsory information notices under the ESC Act.

We expect price submissions to focus on those matters which have a material impact on the prices customers pay or the services customers receive.

Under our PREMO incentive framework, a price submission must address all the requirements set out in this guidance to achieve a 'Standard' rating or higher.

3.1. Managing risk

The WIRO requires us to place particular emphasis on matters relating to various efficiencies in undertaking our regulatory functions in Victoria's water sector.[28]

Efficiency is promoted when risk is adequately identified, quantified, and allocated. Prices should reflect the costs incurred in delivering services, incorporating reasonable assumptions about risk.

A water business's price submission must be informed by a robust risk identification process, taking into account a long-term planning horizon. We anticipate such analysis is undertaken by the business as part of its normal business planning. Significant risks must be identified in a price submission. A price submission must also demonstrate that risk has been allocated appropriately, and where a business has decided, it is best placed to carry a risk, identify the approaches it proposes to manage the risk.

Major risks for a water business

Appendix D summarises some of the major risks a water business may face, and potential approaches that water businesses may propose to deal with risk. Some of these relate to climate change, including operational risks related to asset security. Climate change is likely to present a range of risks and challenges to regulated businesses and their customers, particularly in an

[28] WIRO, clause 8(b).

environment where risk has to be managed and resilience built across the supply chain amid increasing uncertainty and change. Key risks may reflect:

- damage to infrastructure – due to changes in weather patterns resulting from climate change (such as flooding, bushfires, or rising sea levels) or increased heat stress
- changing market conditions – due to changes in customer demand for water
- evolving government policy – around emissions reduction obligations and targets
- financing, insurance issues and other related corporate pressures – including where access to financing or insurance is tied to emission levels or to achieving emission reduction targets, or where other businesses in the supply chain place pressure on regulated businesses to reduce emissions
- reputational issues – where reducing or offsetting emissions is viewed as being consistent with a business's social licence to operate.

We anticipate many businesses will propose initiatives aimed at addressing climate change, reflecting their own planning as well as government policy.[29]

There are mechanisms in the framework that enable businesses to deal with uncertainty in relation to demand forecasts (see Appendix D). There are also provisions in determinations to enable reconsideration of pricing within a regulatory period due to uncertain or unforeseen events, including where revenues or costs vary significantly from forecasts.

Balancing cost risk

In past reviews, we observed many water businesses adopting overly risk-averse assumptions in price submissions, which implies that customers are expected to bear more than an efficient allocation of risk (one result of this is that proposed prices are higher than they need to be).

For example, in past price submissions some water businesses have:

- proposed to include the costs for highly uncertain projects and large contingencies in capital expenditure forecasts (and therefore, prices)
- sought to justify price increases on the basis of financial viability concerns, without providing evidence they have fully explored other avenues to manage financial performance.

We expect businesses to manage the risks associated with uncertain capital expenditure forecasting. Rather than including upfront allowances for uncertain projects and contingencies,

[29] The Queensland Competition Authority (QCA) prepared a position paper on its approach to climate change related expenditure, and published a guideline for the water businesses it regulates. This guideline may assist Victorian water businesses in planning for and proposing climate change related spending in their price submissions. See: https://www.qca.org.au/wp-content/uploads/2023/09/qca-climate-change-guideline-september-2023.pdf.

businesses should seek alternative ways to mitigate construction and capital forecasting risk, such as through better project or contract management.

Alternatively, businesses can exclude planned but not fully scoped projects, or projects with uncertain delivery schedules, from upfront cost recovery, noting that actual prudent and efficient capital expenditure will be rolled into its asset base at the end of the regulatory period.

The water sector already adopts techniques such as real options analysis to inform decision making as circumstances unfold, including in relation to infrastructure works. We note evidence of the use of options analysis (or similar methods), along with a business's approach to dealing with uncertainty and allocating risk in relation to demand, can be used to support its PREMO price submission rating.

Businesses concerned about financial viability should demonstrate their financial risks through credit rating assessments undertaken by an independent credit rating agency. Businesses should also demonstrate that they have sought to manage their financial risks before transferring them to customers.

Consideration of First Nations rights and interests

We expect businesses to identify and document the risks and impact of their proposed investment and activities on First Nations rights and interests. This is particularly important in relation to Traditional Owner groups as rights holders in relation to lands and waterways. Businesses should engage with Traditional Owner groups to identify relevant risks and any resulting action plans.

Climate change adaptation and mitigation

In later sections of this chapter, we have specified where we require information on a water business's consideration of risk to support the business's proposals in specific areas including length of the regulatory period, expenditure, demand, form of price control, and tariffs.

Expenditure proposals related to climate change adaptation and mitigation need to consider our expenditure guidance in this chapter. Climate change expenditure by regulated businesses can be broadly divided into two categories:

- Adaptation expenditure focuses on enhancing operational readiness and response, and/or the resilience of infrastructure to better cope with extreme weather events.
- Mitigation expenditure focuses on reducing carbon dioxide equivalent emissions. Such expenditure relates to:
  - responding to changes in government policies
  - meeting existing obligations and targets
  - community sentiment or external corporate factors
  - maintaining a social licence to operate.

Our view is that prudent and efficient expenditure, whether it is climate related or not, can continue to be supported and assessed under our existing frameworks. Consistent with this view, we are open to considering climate change expenditure proposals by regulated businesses.

We are also seeking evidence that water businesses have given strategic consideration to risk and identified those that may have a material impact on the prices customers pay, or the services they receive (taking into account a long-term planning horizon). This is the focus of the information requirements in Section 3.1.1.

3.1.1. Supporting information

In its price submission a water business must:

- identify any significant risks that may impact on customer prices or services, and if requested, make available to us scenario analysis for each risk including an assessment of the nature and scale of the risk and its probability of occurring
- identify how it has addressed significant risks through its proposals, explain how it has considered the allocation of risk, and demonstrate how its proposals support efficiency
- provide evidence that it has given strategic consideration to the allocation and management of risk in developing its price submission – this may involve providing references and making available to us material on its risk identification and management framework or processes, rather than including detail in its price submission.

Upon request, a water business must also make available to us the following information about significant risks it proposes to manage that require cost allowances:

- the categorisation of the risk (as operational or financial risk, for example)
- measurement of the risk including:
  - the nature and scale of the risk
  - the probability of the risk event occurring
  - factors influencing the probability of the risk event occurring
  - the financial or service impact of the risk if it occurs
- options considered for allocating the risk
- rationale for the allocation of the risk, given alternative options
- an explanation of why the regulatory risk mitigation tools listed in Appendix D do not adequately mitigate the risk
- the role customers will be expected to play in dealing with these risks and how customers will be engaged in this process.

3.2. Regulatory period

3.2.1. Criteria

We are required to set the term of the regulatory period over which a water business's price determination will apply.[30]

We propose to set a five-year regulatory period starting 1 July 2028 but remain open to alternatives proposed in a price submission.

A default five-year regulatory period provides the following benefits:

- a relatively long period of certainty for customers about the outcomes to be delivered and prices to be charged
- sufficient time for the business to focus on service delivery and achieving the customer outcomes it has set for the period.

A risk associated with a regulatory period longer than our usual five years is that revenue or expenditure outcomes could diverge significantly from the benchmarks used to establish prices, possibly resulting in customers paying prices which are significantly above, or below, those required to recover efficient costs. Accordingly, a business that proposes a regulatory period longer than five years is required to demonstrate that the benefits of a longer period outweigh the potential risks. If a submission proposes a longer regulatory period, the submission should propose checks and balances that will apply during the longer period to ensure customers are receiving value for money.

Relatively short regulatory periods can increase the cost of reviews and weaken the autonomy businesses have to focus on service delivery for their customers.

A water business considering a regulatory period other than five years should engage with us as soon as possible.

3.2.2. Supporting information

If a water business proposes a five-year regulatory period, it needs only to state this in its price submission, summarising how it has considered any views from customers on a different term. If a business proposes a different term, then its submission must:

- provide reasons for the proposed regulatory period length, having regard to the benefits and risks identified in Section 3.2.1, including demonstrating that the benefits of a longer or shorter period outweigh the risks and costs from a customer's perspective

[30] WIRO, clause 9.

- outline the results of customer engagement on the length of regulatory period, and how feedback has been taken into account.

In addition, if a business proposes a regulatory period longer than five years, its price submission must:

- demonstrate that the expenditure forecasts and asset management plans underpinning the price submission are sufficiently robust, particularly having regard to the capacity of the assets and demand forecasts towards the end of the proposed regulatory period
- include details of mechanisms that will provide both the commission and customers with confidence that prices reflect value for money and efficient service delivery after year five of the proposed regulatory period
- describe how the business will keep customers engaged throughout the longer regulatory period, including how it will update customers on performance
- describe how it will adapt to changing customer needs during the regulatory period, within the constraints of the determination. For example, the approach to re-aligning capital programs in response to customer preferences
- outline its approach to dealing with uncertainty and risk during the regulatory period, particularly financial viability risk, having regard to the mechanisms for mitigating risk outlined in Appendix D.

3.3. Customer engagement

The WIRO requires us to set out our expectations regarding a water business's customer engagement in developing its price submission.[31] A water business must engage with its customers and other key interested parties to inform its price submission.

The purpose of engagement is for the water business to clearly understand what its customers and community value and prioritise across its water and wastewater services. This includes in areas of affordability and services provision now and in the longer term. These insights support, rather than substitute for, the business's own judgement in making decisions about its proposal. The business remains responsible for balancing customer and community views with its obligations, expertise and other relevant evidence.

Water businesses are best placed to design and undertake engagement to suit the circumstances of its customers, community and other interested parties. Accordingly, we have not prescribed how a water business should engage. Instead, we provide engagement principles to guide a water business in the design and delivery of engagement that is honest and genuine. Using these

[31] WIRO, clause 13(a)(iv).

principles a water business can adapt and refine its engagement planning and embed robust engagement practices that span regulatory pricing periods.

Effective use of these principles will support business decision making and deliver outcomes for consumers in the immediate and longer term.

As mentioned in Section 1, this guidance has been updated to reflect the:

- *Getting to Fair: Advancing Equity* strategy for achieving equitable outcomes for Victorians (released in July 2026)[32]
- *First Nations Self-Determination Framework* (released in July 2026).[33]
- *New Customer Contribution Framework (*released in January 2026*).*[34]

Outlined below are the commission's expectations of water businesses when engaging on equitable outcomes for customers, engaging with First Nations people and engaging on developer contributions associated with growth (New Customer Contributions).

Engaging on equitable outcomes for customers

Consistent with our Getting to Fair: Advancing Equity strategy, businesses should seek to understand where outcomes are experienced differently across customer groups or geographic areas, and consider whether any material inequities can reasonably and efficiently be addressed or mitigated. This does not require identical outcomes for all customers, but does require businesses to understand, engage with and explain material differences in outcomes.

In this context, a business should demonstrate in its price submission how it has considered these equity issues, and how its response is reflected throughout its proposal – effectively to describe its 'fairness golden thread'. We have added a guiding question for this into the Engagement section of the PREMO assessment tool in Appendix E.

We recognise most businesses already consider equity issues in developing their price submissions, for example, through:

- additional support measures for customers who experience payment difficulty following unavoidable price increases
- tariff design and pricing zones
- rebalancing tariff structures to help large households and tenants manage the bill impact of unavoidable higher water use

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[32] Essential Services Commission 2026, *Getting to Fair: Advancing Equity,* 21 July.

[33] Essential Services Commission 2026, *First Nations Self-Determination Framework: Enabling First Nations-led outcomes at the commission,* 21 July.

[34] Essential Services Commission 2026, *New Customer Contributions Framework*, 22 January.

- investment decisions that influence service levels (for example, water quality and taste in different towns across its service region).

Understanding and addressing equity through price submission proposals does not mean we expect businesses to move away from locational pricing where it is efficient and cost reflective, but that we expect businesses to examine the overall outcomes achieved for their customers and consider whether they reflect both efficiency and equity. Nor does it mean businesses are expected to equalise service levels across communities or undertake investments that are not prudent and efficient.

Engaging with First Nations people

While the commission does not have a specific legislative requirement to consider First Nations rights and interests in its regulatory decision-making, our overarching legislative objective is to promote the long-term interests of Victorian consumers, having regard to the price, quality and reliability of essential services. By factoring First Nations economic, social and cultural considerations into regulatory and business decisions, we help align economic efficiency with the long-term interests of the community we serve. We do this by fully capturing the value of resources, building resilience into essential services and avoiding shifting costs to future consumers.

As part of the 2028 Water Price Review, we continue to promote inclusive and effective engagement practices that support the participation of First Nations people. This builds on the approach we took with water retailers at the 2023, 2024 and 2026 price reviews.

First Nations customers

We expect businesses to carefully consider how best to engage diverse First Nations voices on consumer issues. This may include First Nations customers, Aboriginal Community Controlled Organisations, Traditional Owner groups and other organisations providing customer support or advocacy to First Nations consumers.

We expect businesses to identify specific barriers to engaging these First Nations customers and organisations, and to put in place inclusive and appropriate engagement mechanisms.

We also expect businesses to demonstrate how the needs and values of First Nations customers were identified early in the engagement process and how these informed and were incorporated into the price submission

Traditional Owner groups

Consistent with the principle of self-determination, we expect water businesses to engage with Traditional Owner groups as holders of rights and interests in relation to land and waterways, particularly on matters relating to land and water management. To do this, we expect water

businesses to invest in and develop ongoing relationships with Traditional Owner groups, in accordance with broader policy settings and obligations. This may include formal partnership arrangements where sought.

We expect water businesses to make best efforts to carry out open-ended, early engagement and build trusting relationships with the Traditional Owners. This should include best efforts to identify and remove barriers that Traditional Owner groups experience when engaging with them, including time, capability and capacity barriers.

It is for water business to identify Traditional Owner groups and develop appropriate engagement and relationship-building processes, having regard to available Victorian Government guidance. This will ultimately depend on local context, such as the number, size, priorities, interest, resourcing, capability and governance structure of local Traditional Owner group/s. What must be demonstrated is genuine efforts to engage, build relationships and identify and remove barriers to engagement. Where this cannot be reasonable achieved, we expect water businesses to explain and justify this result. While we acknowledge progress will be iterative and will require continuous effort; we expect the effectiveness of water business engagement with Traditional Owner groups to strengthen over time.

Through this engagement, we expect water businesses to develop an understanding of Traditional Owner rights, interests, aspirations and priorities as they relate to land, water and related matters. From this understanding, we expect water businesses to work with Traditional Owners to identify appropriate outcomes, including those that might best support align with broader service priorities, commitments and obligations, acknowledging not all Traditional Owner priorities are achievable within the remit of the water business. Engaging with Traditional Owner groups on a narrow set of issues or pre-determined outcomes is not considered consistent with this approach. We note this is consistent with our general expectations regarding a water business's customer and community engagement. That is, it requires genuine negotiation and outcomes focused discussions.

Informed by this engagement we expect a price submission that:

- considers the risks and impacts of proposed investment and activities on Traditional Owner rights and interests, and how these will be mitigated or addressed
- includes tangible self-determined outcomes where possible, and in exceptional circumstances where alignment could not be reasonably achieved, an explanation and justification of the result.

We have provided below two examples demonstrating what tangible self-determined outcomes look like in practice. It should not be treated as an exhaustive list.

Examples of self-determined outcomes

Funding to support capacity-building and enable engagement

Following engagement with Traditional Owners, Greater Western Water included $4 million in operating expenditure in its 2024 price submission to support Traditional Owner-led capacity building and ongoing engagement to deliver on shared projects and initiatives within its Traditional Owner Water Program. Greater Western Water's service area spans the land of five recognised Traditional Owner Aboriginal Corporations, with active agreements in place with two Traditional Owner groups and discussions underway with the remaining three. Through these agreements, Traditional Owner groups have initiated projects that support healthy Country outcomes aligned with Greater Western Water's service priorities.

Where relationships are new or Traditional Owners have identified resourcing as a barrier to participation, this type of funding may be an important enabler towards building relationships and future self-determined outcomes.

Traditional Owner-led project delivery

Barwon Water has partnered with Wadawurrung Traditional Owners Aboriginal Corporation on two projects to rehabilitate the areas surrounding decommissioned infrastructure, Murrk Ngubitj Yarram Yaluk (the former Bellarine Basin) and Porronggitj Karrong (Ovoid Sewer Aqueduct).

Led by Wadawurrung Traditional Owners Aboriginal Corporation, these projects align water business priorities with Wadawurrrung's Healthy Country plans, delivering new public spaces and improving the environment, while incorporating Traditional Owner Cultural values.

Businesses should refer to existing good practice guidance on engagement, such as the principles of engagement issued by the Department of Energy, Environment and Climate Action, and the guidance issued by First Peoples – State Relations, when designing and delivering their engagement with Traditional Owners.[35]

Engaging on New Customer Contributions

Consistent with our New Customer Contributions Framework, we expect a water business to:

[35] Department of Energy, Environment and Climate Action (October 2024), *Traditional Owner and Aboriginal Community Engagement Framework (Edition 2),* viewed 14 July 2026, https://www.deeca.vic.gov.au/__data/assets/pdf_file/0023/758300/DEECA-Traditional-Owner-and-Aboriginal-Community-Engagement-Framework.pdf. First Peoples – State Relations (20 Feb 2024) *Engaging Traditional Owners*, Department of Premier and Cabinet, viewed 26 June 2026, https://www.firstpeoplesrelations.vic.gov.au/engaging-traditional-owners.

- actively engage with its customers in specific areas impacted by infrastructure costs, upgrades, or the addition of new connections
- engage with both existing and future customers to ensure a fair and reasonable division of growth costs and benefits between the groups
- tailor its engagement with new and existing customers to suit proposed New Customer Contribution charges (for example, changes in price or scale of any subsidy and the timeframe to remove it).

3.3.1. Engagement Principles

The principles are consistent with previous price reviews, updating the language to clarify our expectations.

The following principles guide water businesses' engagement with customers, community and wider interested parties:

- The engagement program should give priority to matters that have a significant influence on the services provided and prices charged by the business, including where impacts are cumulative, emerge over the longer term or affect future customers.
- A water business should engage early in its price submission planning, drawing on insights from its wider engagement program. The engagement should be ongoing to keep testing proposals with customers and with other relevant parties.
- The engagement program, and individual engagement activities, should be tailored to suit the complexity and materiality of the issues on which the water business is seeking to engage, and to the circumstances facing its customers and community, including First Nations people and people experiencing vulnerability.
- A water business should provide its customers and other interested parties (including organisations that represent wider community interests) with a reasonable and fair opportunity to participate, including engagement processes that are inclusive, with measures in place to address barriers to participation.
- A water business should be transparent and accountable for ensuring that information provided to engagement participants is accurate, balanced and sufficiently complete to support informed participation, and for communicating its engagement outcomes to the wider community.
- A water business should demonstrate in its price submission how the views of customers and interested parties have been taken into account and where these views have influenced proposed outcomes, expenditure, services and prices.

We note that insights from a water business's engagement may complement its justification for forecast operating or capital expenditure. However, customer support should not be used on its own to justify the prudency and efficiency of expenditure proposals. Refer to Sections 3.8 and 3.9 for our expenditure criteria.

3.3.2. Criteria

The assessment criteria set out below relate to our customer engagement principles.

Our engagement assessment will consider:

- The business's justification for its decisions on how and when to engage, and the matters that it decided to engage on. This includes its approaches to engagement with customers experiencing vulnerability, and to inform its longer-term planning.
- Whether all interested parties who are affected by the outcomes of the price submission, were given a reasonable and fair opportunity to participate and that barriers to participation were removed or mitigated. This includes the efforts a business made to deliver processes that were inclusive for current and future customers as well as with organisations that represent wider community interests.
- The transparency, balance and adequacy of the information to achieve participant understanding of the issues, particularly where the issues are complex, or the matter involves material change from an existing approach. This includes whether participants were given a sufficiently complete picture of relevant costs, benefits, trade-offs, uncertainty and longer-term consequences, and sufficient time for participants to meaningfully consider the issues.
- The depth and quality of the engagement on issues that are material to services and, prices, including over the longer term. This includes the opportunities for deep consideration on issues involving differential price and service outcomes, and on issues involving the distribution of costs and benefits across customer groups or future generations.
- The extent to which the business can demonstrate it investigated material differences in customer outcomes and considered whether they can reasonably and efficiently be addressed or mitigated.
- How feedback received through engagement informed its proposals (and how this was communicated back to engagement participants and the business's wider community).
- The business's justification for how it will address customer and community expectations that will not or cannot be met.
- The extent to which the business can demonstrate:
  - the strength of its relationships with Traditional Owner groups (or demonstrate its best effort to build these relationships)

  - its level of understanding about the rights, interests, and priorities of the Traditional Owner groups in its region
  - the extent to which it provided meaningful opportunities for self-determined Traditional Owner outcomes to be identified and integrated into decision-making.

- The extent to which the business provided meaningful opportunities for interested parties to share their views on New Customer Contribution proposals.

3.3.3. Supporting information

We have updated the supporting information requirements to provide greater clarity on the evidence and justification we expect from water businesses, including where engagement on issues of customer interest has not occurred. A water business's price submission must describe:

- How it decided on the matters it would engage on, and the level of influence available to customers and interested parties.
- How its engagement on its pricing submission supports or aligns with its wider engagement program, including on past price reviews and its Urban Water Strategy engagement.
- How its engagement addressed longer-term planning to deliver future customer needs.
- How its engagement sought to understand any equity considerations affecting customers.
- How it validated the accuracy and adequacy of information it provided to engagement participants.
- How it ensured its engagement was universal and inclusive of customers and the community affected by the outcomes proposed in the price submission.
- How engagement was appropriate and sensitive to the people it was seeking to engage with, including the measures it put in place to reduce barriers to participation.[36]
- How it ensured customers and interested parties were fully informed on complex issues, and had the opportunity to deeply consider issues relating to differential price and service outcomes, and on issues involving the distribution of costs and benefits across customer groups or future generations.
- What it learned from customer engagement, and how it satisfied itself that customers were given a reasonable and fair opportunity to participate, and that any views expressed were sufficiently representative of affected customers and relevant members of its wider community.

[36] See Essential Services Commission, Summary report: Sensitive and appropriate engagement with customers experiencing vulnerability.2021.

- How it engaged with Traditional Owner groups, including:
  - describing when and what it engaged on with Traditional Owner groups, and how it took into account the legal rights and interests of its Traditional Owner groups when engaging[37]
  - identifying the Traditional Owner groups that it consulted, as well as any key Traditional Owner groups it was unable to engage with and the measures it is putting in place to improve these engagement outcomes
  - describing how Traditional Owner priorities have or have not been reflected in the pricing submission
  - identifying the risks and impacts of proposed investment and activities on Traditional Owner rights and interests, and how these will be mitigated or addressed.
- Its process for engaging on New Customer Contributions, including:
  - describing when and how it engaged on New Customer Contributions, and what information it consulted on
  - identifying the interested parties consulted
  - outlining how the outcomes of engagement have been reflected in the ~~proposed~~ New Customer Contribution proposals.
- How feedback was taken into account by the business in reaching its proposals, including what changed as a result of its engagement.
- How the business will address expectations that will not or cannot be met.
- The reasons engagement on a matter of customer interest was limited or did not occur, and how these will be mitigated or addressed.

A business must make available, or provide on request, resources and materials provided to customers during its engagement, and any customer feedback about the engagement program.

3.3.4. Customer engagement and PREMO

As noted above, we have not prescribed how water businesses should engage with their customers and community. However, we note that engagement programs that consistently and effectively embed participation and influence for customers, and which achieve this across all stages of the pricing cycle, will more easily justify a higher PREMO Engagement rating.

A water business may wish to use the customer engagement diagram (Figure 3.1) as a descriptive tool to self-assess its engagement and to support its PREMO Engagement rating.

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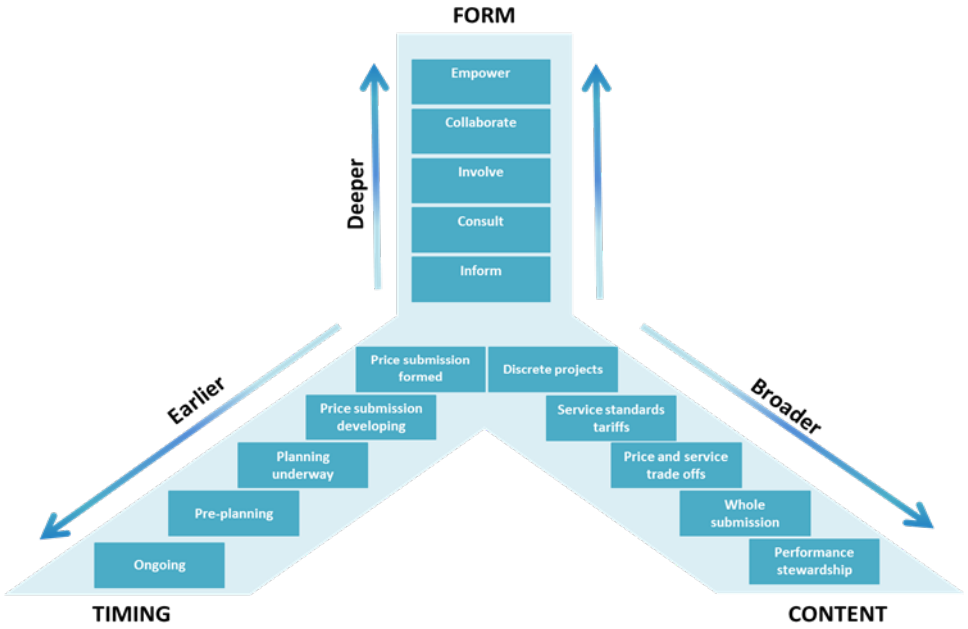
[37] See: First Peoples – State Relations (20 Feb 2024) *Engaging Traditional Owners*, Department of Premier and Cabinet, viewed 26 June 2026, https://www.firstpeoplesrelations.vic.gov.au/engaging-traditional-owners.

Figure 3.1 Customer engagement diagram



3.4. Outcomes

A water business must propose a set of outcomes that represent the value its customers will receive during the next regulatory period. A business must define measurable outputs and deliverables, with associated annual targets, that will be monitored during the next regulatory period to demonstrate the achievement of each outcome.

This set of outcomes and performance targets is essentially a water business's commitment to its customers for the regulatory period. Actual performance against these output measures and targets will allow a business to clearly demonstrate whether its customers received the value they paid for. It will also inform the rating for the Performance element of PREMO at the next price review.

A water business must report at least annually to its customers on its performance against the specified output measures for each outcome. Water businesses already have established self-reporting practices in place for reporting directly to customers as soon as practical after the completion of each reporting year. We also report water businesses' annual performance against their outcome commitments through our annual Outcomes Report published on our website.

We consider the outcomes commitment and reporting process to be dynamic – it is not a 'set-and-forget' activity tied exclusively to price reviews. To this end, we encourage regular interaction with customers throughout the regulatory period to:

- report on performance and gain an insight into customer views of the business's performance – this can include customer involvement and endorsement of the annual self-rating process
- test if customer values have shifted
- consider and, where appropriate, improve or add new measures and targets to reflect changing circumstances or customer needs.

Outcomes in subsequent PREMO reviews

Water businesses will already have in place a set of outcomes, output measures and targets that were established at the 2023 and 2024 price reviews, consistent with our guidance requirements. For the regulatory period beginning in 2028, we don't expect businesses will need to establish a new set of outcomes from scratch. Rather, this is an opportunity for businesses to re-test customer expectations, with a mind to refresh, update and evolve outcome commitments in line with their customers' evolving preferences. We consider retaining significant continuity across periods is important, especially in relation to delivering core services and value. Businesses can focus on challenging themselves to improve against existing measures by setting more ambitious targets.

Accordingly, this price submission should account for the business's actual performance against its outcome commitments for the current regulatory period, which also informs its Performance PREMO rating. The price submission should explore the changes in outcome commitments from the current regulatory period to the next.

3.4.1. Criteria

Proposed outcomes must demonstrate linkages to customer preferences, as revealed through the business's customer engagement program.

Proposed output measures for each outcome must:

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand.

The output measures must also have performance targets listed for each year of the regulatory period.

The set of outcome measures proposed by the business should reflect both:

- specific commitments made by the business to address customer preferences revealed through the engagement processes
- core 'business-as-usual' performance measures that provide a broad representation of the underlying value received by all customers and general customer expectations.

Businesses should consider including measures that demonstrate a commitment to forward-looking processes consistent with a longer-term focus. This could draw on existing activities or measures, for example the business's results under the Water Services Association of Australia's Aquamark benchmarking and asset management framework.

The submission must identify where a business has dropped or modified a current measure and explain why the change was necessary. Given the previous work to ensure the current measures meet the guidance requirements, changes should be the exception, rather than the norm, especially where related to business-as-usual activities and operations.

The water business must outline how it will address shortfalls in meeting an outcome, and it must also commit to reporting at least annually to its customers on its performance against its proposed output measures for each outcome.

An example of how an outcome links to outputs and deliverables, programs and activities, and inputs is provided in Table 3.1.

Mandatory output measures

Customers and community expect that their water business comply with key regulatory requirements, especially those with potential widespread consequences for non-compliance. We consider the revenue requirement we approve for a business is sufficient to meet all its legislative, regulatory and government policy obligations (see Section 3.7).

Accordingly, the following performance measures are considered fundamental for an urban water business and must be included in its proposed set of measures against its most relevant outcome commitment, with suitable annual targets.

- Number of non-compliances with the Safe Drinking Water Regulations.
- Number of non-compliances with EPA licence(s).

Table 3.1 Example – outcome measurement and delivery
Safe clean drinking water for all customers

Outcome	Safe clean drinking water for all customers
Outputs and deliverables • Measures and targets • Key projects	• Number of non-compliances with the Safe Drinking Water Regulations • Number of boil water notices issued • Water quality complaints per 100 customers • Percentage of customers that trust the safety of water supply (through customer survey responses, such as an annual survey, with the rating methodology stated in the measure) • Completion of specific water quality related capital projects • Publish annual water quality report
Activities and processes • Business programs • Specific actions to be developed/implemented	• Catchment to tap water quality management • Upgrade treatment plant to implement dual barrier protection in accordance with the *Safe Drinking Water Act 2003* • Water mains cleaning program • Protections to avoid down time at water treatment plants • Hazard Analysis and Critical Control Points certification • Pass water quality regulator's audit (Department of Health) • Undertake water quality testing in accordance with regulations • Investigate water quality complaints
Inputs • Costs and/or cost movements • Resources required	• $ - opex and capex costs, or cost changes, to deliver or improve the specific programs • Price impact • Resources • Business unit responsibility

Source: Updated from original table in Essential Services Commission 2016, Water Pricing Framework and Approach, October, p. 20.

3.4.2. Supporting information

A price submission must:

- present a set of customer outcomes, linked to customer preferences, each with clear and unambiguous output measures and associated targets (retaining existing measures for continuity across periods, where appropriate)
- for each output measure, state the performance target for each year of the regulatory period and provide past performance as a reference point (for at least the last two years before the regulatory period)
- explain how the outcomes, output measures and targets were informed by the business's customer engagement program
- clearly explain its chosen output measure targets and how they represent continued or improved customer value if they are set below current business performance

- specify the key actions, activities, and programs that the business will undertake to meet its targets (and consequently deliver its outcomes commitments)
- demonstrate the connection between the output measures, key actions, activities and programs proposed and achievement of a specified outcome
- present and explain any cost increases or savings for operating or capital expenditure that correspond to each outcome (Sections 3.8 and 3.9)
- explain how the cost increases or cost savings are reflected in prices charged to customers
- explain how the business will respond to underperformance in delivery of its outcomes
- outline a process by which it will report at least annually to its customers on its performance against the specific output measures for each outcome.

A business may also choose to describe in its price submission how the business might adapt its outcomes, output measures and targets to respond to changing customer preferences, including an ongoing customer engagement program to inform business priorities throughout the next regulatory period.

3.5. Service standards relating to reliability and faults

A service standard allows a water business to define a level of service a typical customer can expect to receive. We require each water business to specify a target level of service for the list of service standards relating to reliability and attending faults that align with provisions in our urban or rural water industry standards, as applicable.[38] A price review provides businesses with an opportunity to review the specified target level for each of its service standards in consultation with its customers.

A business must also explain how any proposed changes in service standard target levels relative to equivalent service standard target levels in the current regulatory period were informed by customer preferences, and the resulting impacts on expenditure forecasts and customer value.

3.6. Guaranteed Service Levels

Water businesses must propose Guaranteed Service Levels (GSLs) for the regulatory period from 1 July 2028 (a GSL scheme). Guaranteed Service Levels define a business's commitment to deliver a specified service level to individual customers. For each Guaranteed Service Level, a

[38] Essential Services Commission 2024, Water Industry Standard – Urban Customer Service, clause 18.2; Essential Services Commission 2024, Water Industry Standard – Rural Customer Service, clause 1.5.

business commits to a payment or a rebate on bills to those who have received a level of service below the guaranteed level.[39]

A price review provides the business with an opportunity to review the nature of its Guaranteed Service Levels, and the payment or rebate amount that will apply in the event of a breach of a Guaranteed Service Level. The rebate amounts should be reviewed in consultation with customers.

A water business may use its proposed Guaranteed Service Level scheme to support its rating for the 'Risk' element of PREMO. The customer payment or rebate amounts established under the Guaranteed Service Level scheme can indicate the extent to which a business is taking on revenue risk to provide incentives for it to deliver efficient levels of service to customers.

3.6.1. Criteria

A Guaranteed Service Level scheme must:

- reflect the main service priorities and concerns of customers, informed by a water business's customer engagement
- provide incentives for the business to provide efficient service levels to all customers
- define each Guaranteed Service Level objectively, in a way that is easy to understand, and is able to be reported.

Mandatory Guaranteed Service Level

The following Guaranteed Service Level is mandatory for an urban water business to include in its proposed set of Guaranteed Service Levels, with a suitable rebate or payment for a breach.

This requirement, and details on the reasonable endeavours required, are set out at clause 15.4 of our Water Industry Standard – Urban Customer Service.

- Restricting the water supply of, or taking legal action against, a residential customer prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying.

[39] Essential Services Commission 2024, Water Industry Standard – Urban Customer Service, clause 20; Essential Services Commission 2024, Water Industry Standard – Rural Customer Service, clause 2.

3.6.2. Supporting information

A price submission must specify each Guaranteed Service Level and the corresponding payment or rebate amount that will apply where a customer has received a level of service below the guaranteed level. A price submission must identify and justify any changes to the Guaranteed Service Level scheme compared with those approved for the current regulatory period.

For any new or amended Guaranteed Service Level, the price submission must:

- explain the basis for the Guaranteed Service Level, including how it has been informed by customer engagement
- specify whether benefits to customers (or community) will take the form of payments or rebates
- explain the reasons for the proposed size of the customer payment or rebate that applies to each Guaranteed Service Level.

A water business must also justify any proposal to remove a guaranteed service level that was in place during the current regulatory period, including how the proposal has been informed by customer engagement.

3.7. Revenue requirement

Our decision on a water business's revenue requirement for the next regulatory period must meet the WIRO objectives of promoting and providing incentives for efficiency in the regulated entities, as well as efficiency in, and the financial viability of, the regulated water industry.[40]

The revenue requirement proposed in its price submission must provide the water business with sufficient revenue to efficiently meet all its legislative, regulatory and government policy obligations. This includes, but is not limited to, the items listed in Box 3.1 below.

[40] WIRO, clause 8(b).

Box 3.1 Legislative, regulatory and policy obligations

- Legislation and matters administered by the Essential Services Commission
- Legislation and matters administered by the Environment Protection Authority Victoria
- Legislation and matters administered by the Department of Health
- Legislation and matters administered by the Department of Energy, Environment and Climate Action
- Legislation and matters relevant to First Nations rights and interests
- Health and safety legislation
- Gender Equality Act 2020 (Vic)
- The Victorian Government Climate Change Strategy
- The Victorian Government's Housing Statement

3.7.1. Criteria

The required revenue for a water business for the next regulatory period will be estimated by the building block approach, under which the building blocks are:

- prudent and efficient forecast operating expenditure – determined in accordance with Section 3.8
- prudent and efficient forecast capital expenditure – determined in accordance with Section 3.9
- return on the regulatory asset base (RAB) – determined in accordance with the sections below:
  - the 'roll forward' of the RAB – determined in accordance with Section 3.11
  - the cost of debt – determined in accordance with Section 3.13
  - return on equity – determined in accordance with Sections 3.14 and 3.15
- return of capital through a regulatory depreciation allowance – determined in accordance with Section 3.12
- a benchmark tax allowance – determined in accordance with Section 3.16.

The revenue requirement is net of any additional revenue earned from regulated assets, outside of the revenue earned through scheduled tariffs – for example, revenue from the sale of water entitlement allocations, or the sale of electricity generated from customer-funded regulated assets. The revenue requirement is also net of any revenue earned from non-prescribed services (discussed at Section 3.24.9).

3.7.2. Supporting information

The price submission, including the financial model, must specify a water business's forecast total revenue requirement for each year of the next regulatory period.

The price submission must also provide an estimate of the required revenue for each year after the next regulatory period to at least 2037-38. It must provide a brief explanation of the trend in the forecast over the next two regulatory periods from 1 July 2028.

3.8. Forecast operating expenditure

Our high-level review of operating expenditure forecasts results in a benchmark allowance that is used to establish a revenue requirement for calculating prices. This benchmark is based on current information available to the water business at the time of preparing its price submission, and the business's ability to justify forecast changes to the previous benchmarks.

This process should not be interpreted as the commission approving operating expenditure budgets – rather, the benchmarks serve as a point-in-time approximation of the expenditure likely to be incurred by the water business across the regulatory period.

Businesses should therefore focus on presenting and justifying the key cost changes from existing benchmarks in their proposed forecasts, rather than attempting to precisely align forecasts with their more detailed operating budgets.

We note that operating expenditure typically accounts for 60 to 70 per cent of the revenue requirement for most Victorian water businesses.

3.8.1. Criteria

The forecast operating expenditure to be included for the purposes of calculating the revenue requirement is operating expenditure which would be incurred by a prudent service provider acting efficiently to achieve the lowest cost of delivering on service outcomes over the regulatory period, taking into account a long-term planning horizon (prudent and efficient forecast operating expenditure).

We consider that a prudent and efficient operating expenditure forecast has the following characteristics:

- baseline year expenditure is reflective of efficient recurring operating costs and is used as a basis to forecast expenditure
- forecast operating expenditure incorporates reasonable expectations for expenditure growth and cost efficiency improvement
- expenditure requirements above the baseline year (adjusted for growth and efficiency improvements) are fully explained and justified.

In order to ensure that actual and forecast operating expenditure is efficient, we expect that water businesses will have investigated opportunities to collaborate across the sector with the aim of reducing costs or improving service standards.

Operating expenditure with uncertain outcomes

If a business seeks additional operating expenditure for investments where the outcomes are uncertain (pilot or demonstration projects, for example) we expect it to consider how risk is being shared if customers are being asked to cover all additional expenditure. Businesses should also clarify how they will demonstrate the value of these investments to customers.

At the next price review, the business would need to demonstrate the prudency and efficiency of this expenditure if seeking to have it included in the baseline, or to support new or ongoing expenditure in its price submission.

This expectation should not discourage businesses from seeking to invest in areas where a flexible approach is required, such as in building relationships with Traditional Owners and working with them to define and deliver self-determined outcomes.

3.8.2. Supporting information

A price submission must include a forecast of total prudent and efficient operating expenditure for each year of the next regulatory period. Forecast operating expenditure is to be presented separately for each major service category.[41]

For total and annual forecast operating expenditure and for each major service category, forecast operating expenditure for each year of the next regulatory period, and beyond to at least 2042-43, must be further broken down where relevant, in the financial model template for:

- operations and maintenance
- bulk charges (further broken down into bulk charges by type and system, examples from previous submissions include: transfer charges, Greater Yarra System – Thompson River fixed charges (now Bulk water headwork charges – South Central Pool), Victorian Desalination Plant – Water Order charges)
- treatment
- customer service and billing
- GSL payments
- licence fees (Essential Services Commission, Department of Health, and EPA Victoria)

[41] Depending on the business, the major service categories include water, sewerage, recycled water, bulk water, rural water, irrigation, drainage, domestic and stock, and diversions

- corporate costs
- other operating expenditure.

Forecasts for the environmental contribution must also be provided in the financial model template. Where future amounts are not yet available, businesses must use the last approved annual amount as its annual forecast in subsequent years.

For the 15-year operating expenditure outlook, we expect forecasts for years 1 to 5 to be robust and detailed, given these directly inform the prices we are approving from 1 July 2028. For years 6 to 15, businesses should use the best available information to reflect anticipated expenditure trends and any known material changes.

A water business must also provide actual operating expenditure for the current regulatory period (using latest forecasts for 2027-28), categorised in the same way as above, in the financial model template.

Forecast operating expenditure must be presented relative to a reference or baseline operating year, with allowance for expenditure growth (for example, based on customers or demand growth) and cost efficiency improvements over the next regulatory period. Any significant changes in the forecast years' costs relative to this baseline year must be clearly presented and explained, including how they are reflected in the proposed customer outcomes and how they represent improved customer value (Section 3.4).

Our financial model template sets out the forecast operating costs consistent with this base-trend-step approach, described below.

Establishing the baseline controllable operating expenditure

In preparing forecast operating expenditure, a price submission must establish a baseline controllable operating expenditure which comprises efficient recurring controllable costs from the last full year of actual data (2026-27) for those activities and services that are expected to be incurred throughout the next regulatory period.

The baseline is established from the actual prescribed operating expenditure for 2026-27, adjusted to:

- remove any non-controllable expenditure[42]
- remove any one-off or non-recurring expenditure items incurred in that year, or add any normally occurring items that did not occur in that year

[42] Controllable costs are those that can be directly or indirectly influenced by the business's operational decisions. Examples of non-controllable costs include: bulk water costs (where prices are set by the commission), regulatory licence fees, and the environmental contribution.

- remove any further ongoing cost savings or efficiency commitments that will be realised in the final year of the current regulatory period (2027-28).

A business should not remove ongoing recurring business-as-usual expenditure from the baseline. If the cost for a particular item is forecast to change (other than by the growth and efficiency allowances) then the variation amount should be presented as a step change. This is to ensure the proposed baseline allowance is properly reconciled against the benchmark on a like-for-like basis.

A price submission must justify the adjustments proposed to the baseline year in order to establish the baseline controllable operating expenditure and demonstrate that this represents efficient ongoing operating costs (consistent with any efficiency targets for the current regulatory period).

The price submission must reconcile proposed baseline controllable operating expenditure against the benchmark controllable operating expenditure allowance for 2026-27 established at the previous price review. This reconciliation should include consideration of:

- actual growth rate compared with the forecast assumptions
- efficiency gains achieved compared with the business's forecast assumptions
- any other new costs, cost escalations or variations from the forecast assumptions.

We expect water businesses will be able to provide appropriate quantitative evidence to support their baseline cost reconciliation, including demonstrated efficiency gains achieved during the period. Where adequate evidence is not provided to demonstrate proposed baseline cost increases are recurring, prudent and efficient, we will not accept the proposed increase. The price submission should also highlight how customers have been impacted by any change from forecasts.

A water business's baseline year actual expenditure must reconcile with its audited regulatory account data for 2026-27.

Trends – growth and inflation escalations and efficiency improvement

Having established an efficient recurring baseline, our approach to establishing an operating expenditure benchmark provides for cost escalations to cover both growth and inflation, and requires a business to commit to achieving annual efficiency gains on business-as-usual operating costs. Accordingly, a water business must propose and justify:

- its forecast expenditure growth rate assumptions (for each year)[43]
- an annual cost efficiency improvement rate on business-as-usual operations (for each year).

[43] Businesses should draw on Victoria in Future forecasts, Australian Bureau of Statistics data, and other information as required.

Growth rate

The expenditure growth allowance addresses all growth-related costs as they apply to both existing and new operations. That is, it addresses increased operating costs associated with higher throughputs on existing assets, and additional operating costs associated with expanding assets. It serves as a simple proxy to escalate the cost allowance across all components of the operating expenditure base as the customer base grows – labour, maintenance, operational costs (such as water or sewerage treatment), and corporate overheads.

We expect an efficient business would achieve economies of scale as its customer and operation base grows – especially when considering a portion of the operating costs for a water business would be fixed costs. Accordingly, we expect the proposed growth rate would not exceed, and would likely be lower than, the forecast customer connection growth rate.

Inflation allowance

Our pricing framework also allows for cost increases due to inflation. Expenditure forecasts are set in real dollars, and annual tariffs approved across the regulatory period are indexed to inflation for the preceding year. Applying inflation to the approved prices effectively assumes a corresponding inflationary increase across all input costs. Like the expenditure growth rate, this applies equally across all components of the operating expenditure base. Given individual input costs do not all rise directly in line with the inflation rate, and some costs may even fall, this approach means some increases above inflation may be effectively offset by increases below inflation.

When the inflation rate significantly exceeds actual rates of cost increase, the business will receive additional revenue above that needed to cover those cost increases. This also allows the business to offset cost rises greater than inflation or fund some other costs not included in its forecasts.

Efficiency improvement rate

The regulatory framework places a strong emphasis on efficiency. This is the principal objective under the WIRO – in particular, clause 8(b)(iii) requires us to ‘place particular emphasis on ... the provision to regulated entities of incentives to pursue efficiency improvements’. For controllable operating expenditure, we expect businesses to achieve efficiencies on their recurring business-as-usual operating costs, in the form of an annual efficiency improvement rate. PREMO allows each business to put forward its annual efficiency improvement rather than the commission imposing a rate. Businesses need not identify in advance how these savings will be realised, but the commitment will be reflected in the final forecast operating expenditure benchmark allowance we approve.

Businesses should propose realistic efficiency targets, giving due consideration to their proposed expenditure growth rates. Our PREMO assessment tool provides further guidance on efficiency rates.

Step changes – cost adjustments to the growth-adjusted baseline allowance

The baseline allowance, including any accepted increases to the previous benchmark, plus the growth allowance and annual adjustments for inflation should provide almost all of a business's controllable operating expenditure needs. However, a business may propose further changes to its forecast to reflect material future cost increases not covered by these allowances, or future cost savings it will realise during the period.

If proposing any step changes to the forecast operating expenditure, a price submission must:

- demonstrate why any proposed cost increases are not covered within the growth allowance, or by inflation, or absorbed within the stated net efficiency improvement rate
- demonstrate how proposed material cost changes relate to the proposed customer outcomes and the associated outputs and deliverables (Section 3.4), and in particular:
  - identify and explain operating expenditure savings or new operating expenditure arising from capital expenditure and projects, and how they relate to the forecast growth rate and cost efficiency improvement rate[44]
  - explain any trend or major annual variations in forecast operating expenditure (including identifying cost items that are having an upward or downward influence on operating expenditure) compared with historic operating expenditure[45]
- demonstrate that proposed material cost increases associated with new or revised regulatory obligations and policy requirements are prudent and efficient.

Given the above, we anticipate a limited number of material step changes in businesses' proposals. Where a business proposes numerous step changes reflecting relatively minor cost increases, we may consider applying a suitable materiality threshold having regard to the proposed growth and efficiency rates.

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[44] We expect material operating cost savings resulting from a major capital investment be presented as a step reduction to the baseline, rather than embedded in the efficiency rate. Such savings are not true efficiency gains if they only result from significant additional expenditure. Likewise, new operating costs arising from capital investments should also be presented as a forecast step change above the baseline. We expect business cases for capital investments would clearly identify any expected operational savings or cost increases as part of the business's internal review and approval processes.

[45] Including, but not limited to, assumptions and trends relating to:
- wage and salary escalations, total labour costs and employee number assumptions
- electricity and energy costs, and underlying volume and load assumptions
- information technology costs
- other risks that have been identified by the business.

Other operating expenditure considerations

Non-controllable operating expenditure

A price submission must set out and where relevant justify the non-controllable cost forecasts including:

- bulk water purchases from other water businesses
- regulatory licence fees
- environmental contribution
- any other proposed non-controllable costs.

We will confirm these proposed costs, updating where required to reflect the latest bulk water prices we have approved, and information from other regulatory authorities.

Non-prescribed operating expenditure

Businesses must ensure all costs associated with non-prescribed activities have been appropriately excluded from prescribed expenditure forecasts. The price submission should explain the business's approach to allocating shared costs, especially where related to non-prescribed business activities, or reference documentation that may be requested by the commission to verify the chosen approach.

Expenditure for AI initiatives

We encourage water businesses to investigate improvement opportunities made available through the deployment of artificial intelligence (AI) tools. As with all material expenditure proposals, we expect price submissions to set out the proposed costs and anticipated benefits of AI related initiatives, including how customers will share in the benefits arising from any gains relating to this expenditure.

Capitalising expense items

For regulatory pricing purposes, in limited circumstances businesses may propose to capitalise certain statutory operating expense items where (a) it is appropriate to spread the cost recovery over a longer timeframe, and (b) where it meets the guidance and WIRO requirements.

However, as a general rule, price submissions should reflect the appropriate statutory treatment of expenses. Capitalisation of statutory expenses should be by exception only, and will only be accepted by the commission where:

- capitalisation proposals are clearly set out in the price submission

- capitalisation will make a material impact to customer bills compared to being treated as a statutory expense
- the items to be capitalised are true 'one-offs' where benefits are expected across two or more regulatory periods (for example, major IT project development and implementation, or lagoon desludging costs). For the avoidance of doubt, recurring schedules of regular operating costs for IT projects should not be capitalised.

In order for the commission to consider whether capitalisation is appropriate (and for the commission to ensure that regulatory accounts are prepared consistently with projections in the price submission) a price submission will need to:

- explicitly set out any capitalisation proposals at a project/item level
- explain why capitalisation is appropriate
- identify what the depreciation (cost recovery) period will be
- provide a comparison showing the revenue or price impact for both treatments (operating expenditure compared with capital expenditure).

Ideally, a business should discuss with commission staff in advance where it intends proposing to capitalise expense costs, so the appropriate treatment can be agreed prior to lodging the price submission. Any proposed capitalisation of an operating expense item must be presented as a discrete line item in the financial model template (Capex_FO input tab) and identified by capital type 'Capitalised expense', as described in Section 3.9.

A business's annual regulatory accounting statements should be consistent with any variation to statutory accounting principles that has been approved by the commission for pricing purposes, or that is being proposed by the business for commission approval.

Opportunities for cross-sector collaboration

Finally, businesses should provide information on action they have taken to identify opportunities for cross-sector collaboration, including:

- areas where they currently, or propose to, work with other water businesses in order to reduce operating (or capital) costs
- opportunities they have investigated during the current regulatory period to work with other water businesses, but which have not come to fruition.

3.9. Forecast capital expenditure

Capital expenditure forecasting essentially involves anticipating the scope, timing and costs for a large number of various sized projects, ranging from the replacement of existing assets at the end of their lives to the construction of major new assets and facilities. While our consideration of forecast capital expenditure focuses on the proposed investments over the next regulatory period, we expect water businesses will have robust longer-term strategic investment planning processes with at least a 20-to-30 year planning horizon. Businesses should demonstrate how their proposed capital investment fits within this long-term outlook and is supported by up-to-date master planning.

In preparing capital forecasts, water businesses should avoid including speculative capital expenditure in their price submission forecasts. Where capital projects are not fully scoped, costed or internally approved (via an approved business case, for example) at the time of preparing the price submission, a business should consider the following options so that customers are not asked to bear the full cost should the project scope or timing change:

1. Include sufficient expenditure to cover only the development costs of the project, with efficient actual construction costs incurred during the period to be rolled into the regulatory asset base at the end of the period, along with any accumulated interest. This provides sufficient revenue allowance for the project to proceed during the next regulatory period, with cost recovery to commence in the following regulatory period at no net loss to the business.
2. Include development costs and a notional allowance for construction, with the balance of efficient construction costs (plus associated interest if required) to be rolled into the RAB at the end of the period. This allows a reasonable portion of the project, based on the various options and cost estimates at the time of preparing the price submission, to be included in prices.
3. Identify the project as a possible 'uncertain or unforeseen event' to be addressed via the mechanisms outlined in Section 3.20 during the regulatory period.

Businesses should also consider the above options for projects where the benefits are unclear or have not been fully defined, or where the linkages to customer value have not been established.

3.9.1. Criteria

The forecast capital expenditure to be included for the purposes of determining the required revenue is capital expenditure that would be incurred by a prudent service provider acting efficiently to achieve the lowest cost of delivering service outcomes, taking into account a long-term planning horizon (prudent and efficient forecast capital expenditure).

We consider that prudent and efficient capital expenditure has the following characteristics which reduce the risk borne by customers:

- required expenditure is based on a P50 estimate, in which there is an equal likelihood of project costs being higher or lower than forecast (noting a P50 estimate may not be appropriate where a proposed capital program is dominated by one or two major projects)
- contingency allowances are optimised
- forecast capital expenditure for renewals incorporates expectations for a reasonable rate of improvement in cost efficiency
- risks of project delays and cost overruns are managed through contractual agreements with service providers
- investment timing is consistent with and supported by long-term planning outlooks
- program deliverability risk is minimised and appropriately borne by the water business.

Where actual construction costs are found to exceed their efficient level, we will not roll these inefficient expenditures into the regulatory asset base. Inefficient costs will be borne by the water business and will not be recovered from customers.

3.9.2. Supporting information

A price submission must include a forecast of total prudent and efficient capital expenditure for the next regulatory period, including forecast capital expenditure for each year of the next regulatory period, and beyond to 2042-43.

Forecast capital expenditure is to be presented by major service category and by the following cost drivers:[46]

- forecast capital expenditure to maintain service standards – that is, renewals
- forecast capital expenditure to expand services – that is, growth
- forecast capital expenditure to make improvements or upgrades to existing services or to comply with existing or changed government or regulator obligations – that is, improvements/compliance.

Actual capital expenditure in the current regulatory period

The business's financial model template must also specify actual capital expenditure for the current regulatory period (with an updated forecast for 2027-28) and also for the final year of the previous

[46] Major service categories for urban water businesses are water, sewerage, and recycled water. For rural water businesses, they include: rural water, irrigation, drainage, domestic and stock, and diversions.

period (2022-23 for most businesses, and 2023-24 for Greater Western Water and Goulburn-Murray Water), categorised in the same way as above.

The business's price submission must identify and explain any material cost or timing discrepancies between actual capital expenditure in the current regulatory period and the level of capital expenditure approved in its current price determination. This must include a reconciliation showing how the business has met its commitments to delivering its major capital projects in the current regulatory period, consistent with the annual major project reporting that has occurred over the period. Impacts on customer service levels and value due to non-delivery must also be identified. This information will form part of our assessment of a water business's Performance element under the PREMO framework. Forecasting accuracy and deliverability during the current period will also be considered in our assessment of the proposed capital expenditure forecast for the 2028–33 regulatory period.

We also expect that businesses will report to both customers and the commission on the outcomes that have been achieved from capital expenditure in trials or pilots in the current regulatory period, and in particular, an assessment of customer value for money. As well as providing an assessment of customer value for money arising from trials or pilots, where relevant, price submissions must identify how the outcomes of these trials or pilots have informed proposed future projects and expenditure. This is necessary to inform whether it is efficient to support any expansion of pilot programs into future capital expenditure.

Classifying forecast capital expenditure

Capital expenditure will fall into one of four key types:

- Major capital projects – large, discrete capital investment projects (may be completed within a regulatory period or may span more than one period).
- Capital programs – ongoing programs of capital expenditure allocation, containing multiple works or projects (for example; water main renewals, sewer odour management, ICT equipment upgrades).
- Other capital expenditure – typically smaller discrete projects and programs.
- Capitalised expense – any statutory expense items proposed to be capitalised for pricing purposes.

A price submission must present the capital expenditure forecasts set out according to these four key types, as follows:

Major capital projects – comprising the 'top 10' discrete capital projects, by total capital cost within the forecast period, to be started or completed during the next regulatory period. A business may also include significant discrete projects that fall outside the top 10 by cost but are scheduled for the next regulatory period.

For each of these major projects, the following should be provided:

- the project name and scope, and relevant major service and asset category
- justification for the project, including the cost driver
- start and completion dates
- total capital cost (itemising any government or customer contributions), and expenditure by year
- objectives of the project, including how the project aligns with the various customer outcomes proposed (Section 3.4) or addresses any major risks (Section 3.1)
- and have available:
  - a business case outlining the options considered for achieving the identified objectives and the approach to identifying the optimal solution[47]
  - risk analysis of the selected option and plans to mitigate the identified risks to ensure the project can be delivered on budget and on time
  - the incentive and penalty payment arrangements with contractors[48]
  - information to identify whether the project has (or will be) the subject of competitive tendering.

Capital programs – all key capital expenditure programs or allocations that will be ongoing throughout the regulatory period (excluding any discrete projects separately specified in the 'top 10' above).

For each program, provide:

- the program (or cost allocation) name, and relevant major service category
- the cost driver
- total capital cost (itemising any contributions), and expenditure by year
- objectives of the program, including how the program aligns with the various customer outcomes proposed (Section 3.4) or addresses any major risks (Section 3.1)
- historical annual costs, and an explanation for significant increases or decreases in the forecast average annual expenditure
- and have available:
  - the list of projects (where known) included within the program or cost allocation for the next regulatory period, and business cases and options analyses

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[47] This should also include an assessment of a 'do nothing' option. Cost comparisons of various options should consider P5, P50 and P95 estimates. Forecasts for capital expenditure must be based on the P50 estimate.

[48] A business's proposed prices must reflect incentive and penalty payment arrangements that are based on a symmetrical sharing of risk for delivery or non-delivery of projects.

  - a description of the methodology for assessing risk and prioritising projects within the program
  - the cost estimation basis.

Other capital expenditure – all other capital expenditure not associated with a defined major project or major capital program. Ideally, smaller cost items should be grouped into one or more programs or similar-themed cost allocations as appropriate, to be included under the capital programs list, as above. This simplifies capital expenditure input into the financial model template and allows comparison of similar cost areas across regulatory periods. However, businesses may still list individual projects or cost items where appropriate.

Capitalised expense – any proposed capitalisation of an operating expense item must be clearly identified and presented as a discrete line item in the financial model template and in the body of the price submission. Section 3.8.2 describes the supporting information requirements, including:

- justification for treating as capital
- proposed period for cost recovery.

Presenting forecast capital expenditure

Consistent with the above capital expenditure breakdowns (by type and major service category) in the price submission or financial model template where appropriate, a water business must also:

- for each year of the next regulatory period, and beyond to 2042-43, provide annual forecasts for capital expenditure separately identifying (where appropriate) and reconciling:
  - total capital expenditure
  - contributions (government and customer)
  - gifted assets
  - proceeds from asset sales
  - written down value of assets disposed
  - net capital expenditure
- explain the methodology used to estimate forecast capital expenditure
- identify and explain the key assumptions which underpin the capital expenditure forecasts by each major service category, and how any risks or uncertainties have been addressed
- justify asset renewal program expenditure proposals through demonstrated robust asset management practices, including appropriate use of performance and condition monitoring – businesses may draw on the findings of their 2026 asset management audit to support their proposal
- justify the timeframe for delivering the proposed new capital expenditure given the business's delivery of major projects in the past, and in particular how the business will resource and

ensure delivery of its capital program where it is proposing a significant increase from previous periods

- explain the reasons for the trend or any major annual variations in forecast capital expenditure (including identifying cost items that are having an upward or downward influence on capital expenditure), compared with historic capital expenditure
- justify the total forecast capital expenditure against the criteria in Section 3.9.1, taking into account:
  - forecast demand
  - any relevant industry or economy-wide benchmarks of expenditure
  - the substitution possibilities between forecast operating expenditure and forecast capital expenditure.

Our financial model template sets out the forecast capital expenditure consistent with the breakdowns and methodology described above. It requires a 15-year capital forecast outlook spanning three 5-year regulatory periods.

Climate change costs

A water business must identify and explain its proposed climate change related investment in its price submission, and show how it has had regard to:

- the matters set out in Section 3.1 relating to managing risks associated with climate change
- the guidance provided by the Queensland Competition Authority setting out the four key elements of a robust business case for climate-related spending, reproduced in Appendix D.

Reconciling forecast capital investment outlook

A water business must identify significant deviation in its forecast expenditure profiles across the next 15 years from the forecast outlook for any years within that period presented at its last price review. (Our financial model template for our last price review required 10 years of forecast expenditure, so for the 2028 Water Price Review, this comparison is limited to the previously proposed capital expenditure outlook to 2032-33. For future price reviews, the comparison will cover the 10 years beyond the next regulatory period.)

A business must explain the drivers for major investment changes from previous outlooks, and why it had not previously identified this expenditure requirement in its long-term planning and capital expenditure outlook. This supports the credibility of the business's forecasting accuracy.

3.10. Return on regulatory asset base

A regulatory rate of return is applied to the regulatory asset base (RAB) to calculate the annual return on the RAB to be included in the revenue requirement. The regulatory rate of return comprises two components: a return on equity and a cost of debt.

The benchmark cost of debt will be determined based on a trailing average approach. A benchmark gearing level of 60:40 debt to equity will apply.

The formula for the regulatory rate of return (post-tax, real) is therefore:

Regulatory rate of return (RRR) = Re 0.4 + Rd 0.6

Where: Re = PREMO rate of return on equity

Rd = benchmark 10 year trailing average rate for the cost of debt.

The benchmark regulatory rate of return must be calculated in nominal terms and then converted to real terms.[49]

3.11. Forecast regulatory asset base

3.11.1. Criteria

The regulatory asset base (RAB) calculated for the purposes of determining the revenue requirement must reflect capital expenditure (less regulatory depreciation, contributions and/or asset disposals) which would be incurred by a prudent service provider acting efficiently to achieve the lowest cost of delivering on service outcomes, taking into account a long-term planning horizon (prudency criteria).

The opening RAB must be calculated as follows:

Opening RAB 1 July 2028 = RAB at 1 July 2023 (or 1 July 2024) (adjusted to reflect 2022-23 (or 2023-24) actual and inflation adjusted to $2028)

+ Actual capital expenditure (gross) 2023-24 (or 2024-25) to 2026-27 and inflation adjusted to $2028

+ Forecast capital expenditure (gross) 2027-28* and inflation adjusted to $2028

− Actual contributions 2023-24 (or 2024-25) to 2026-27 and inflation adjusted to $2028

− Forecast contributions 2027-28** and inflation adjusted to $2028

[49] The Fisher equation will be used to convert cost of debt from nominal to real estimates; that is: (1 + nominal rate) = (1 + real rate) * (1 + inflation rate).
Refer to Section 3.13.1 for our approach to estimating the forecast inflation in the financial model template.

- Forecast regulatory depreciation 2023-24 to 2026-27* and inflation adjusted to $2028
- Proceeds from disposal of assets 2023-24 (or 2024-25) to 2026-27 and inflation adjusted to $2028
- Forecast proceeds from disposal of assets 2027-28** and inflation adjusted to $2028

(* denotes the forecast used at the 2023 and 2024 price determination)

(** denotes the latest available forecast for 2027-28)

Our financial model template requires a water business to provide its updated gross capital expenditure forecast for 2027-28 (the final year of the current period) alongside the forecast benchmark for that year from its previous price review, and to select which of the two values it proposes to roll into the opening RAB from 1 July 2028. We expect the business to use the lower amount. If the business seeks to roll in the higher amount, or a different figure between the two values, it must advise us in advance that it intends to do so – any decision to roll in a higher amount will necessarily consider the total aggregate spend across the regulatory period. Similarly, if the updated contributions forecast for 2027-28 is higher than the forecast benchmark for that year in the 2023 and 2024 price determination, then we would generally expect the business to use the higher amount.

The above approach must be used to determine the opening value on 1 July for each subsequent year in the next regulatory period, using the forecasts for capital expenditure, customer and government contributions, regulatory depreciation and asset disposals.

3.11.2. Supporting information

A price submission must propose the:

- closing value for the RAB at 30 June 2027 (using actual data)
- opening value of the RAB at 1 July 2028 (calculated according to the criteria above)
- forecast value of the RAB for each year of the next regulatory period, in accordance with the prudency criteria set out above
- forecast value of the RAB for each year after the next regulatory period until at least 2042-43.

The price submission must also:

- provide estimates for regulatory depreciation (Section 3.12)
- provide separate data and justify estimates for:
  - government contributions – federal, state and local government contributions towards the capital cost of a project
  - customer contributions – upfront cash payments made by new customers
  - the value of gifted assets – assets constructed and then handed over to the water business to operate and maintain

- include estimates of revenue expected from disposal of assets for each year from 1 July 2028, to be deducted from the roll forward of the RAB.

To assist with our review, we may seek further information on a water business's justification for capital expenditure in 2022-23 and in the period 2023-24 to 2026-27. We may also request a reconciliation of actual net capital expenditure against the benchmarks in the water business's 2023 and 2024 price determination (Section 3.9.2), including for any expenditure related to trials or pilot programs.

3.12. Regulatory depreciation

We recognise a return of capital expenditure (regulatory depreciation) for an asset when the asset enters service. We prefer a straight-line depreciation profile, which is the simplest approach.

The estimates and profiles for regulatory depreciation should reflect reasonable assumptions about asset life and utilisation, and should align with statutory accounting lives. Businesses should consider benefit matching for large and long-life assets where there is lumpy investment or low utilisation of an asset in the early years after an investment.

Water businesses can propose an alternative approach to straight-line depreciation having regard to the following assessment principles:

- the depreciation rate should account for technological change, projected future demand and any other factors that may affect the value of the assets in the future
- the technical lives of assets
- impact on prices over the long-term.

3.13. Cost of debt

In determining the revenue requirement, we use a benchmark gearing ratio and debt cost, rather than each business's actual parameters. We will use a 10-year trailing average approach to estimate the benchmark cost of debt. The trailing average approach will determine the whole cost of debt (covering the risk-free rate and debt risk premium). We use a Reserve Bank of Australia (RBA) data set to estimate the cost of debt and also add an amount to reflect debt raising costs. The averaging period will be the 10 years preceding the year in which the rate applies.

Each year, the 10-year trailing average cost of debt will be updated by rolling forward the data series by one year, such that the:

- cost of debt for the roll-forward (previous) year reflects the yields of the RBA 10-year BBB rated corporate bond – Reserve Bank of Australia Table F3 series FNFYBBB10M

- annual update is a simple average of 12 months of the RBA 10-year BBB rated corporate bond over 1 April in the previous calendar year to 31 March in the current calendar year and the assumption of 0.15 per cent for debt raising costs
- trailing average is a simple average of 10 years of cost of debt
- cost of debt is calculated in nominal terms which would then be converted to real terms based on our long-term inflation estimate.[50]

The historical data series for the cost of debt calculated using the method described above is set out in Table 3.2.

Table 3.2 Annual cost of debt (values for calculating trailing average)
Nominal values

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Cost of debt	4.61%	3.31%	3.05%	3.75%	6.76%	6.53%	5.84%	5.59%	5.59%[a]	5.59%[a]

[a] The cost of debt for 2026-27 and 2027-28 will be updated to reflect annual averages based on actual data, prior to the final decision, consistent with the methodology outlined in Section 3.13.

Data source: Reserve Bank Australia, Treasury Corporation Victoria and the Essential Services Commission.

These benchmark values are used in calculating a business's revenue requirement and prices, subject to any updated values we provide before we make a price determination (the values in Table 3.2 will be reflected in the financial model template we provide to businesses). We refer to a business's actual cost of debt and gearing when assessing financial viability (refer to Section 3.23).

3.13.1. Forecast for expected inflation

The forecast for expected inflation is an input to calculating the trailing average cost of debt. We need to convert the nominal cost of debt to real terms consistent with our real post-tax pricing model. Our approach to estimating expected inflation is:

- We estimate expected inflation based on the simple average of the 'RBA geometric' and 'bond breakeven' inflation rates. We will use a five-year average for both.
- The value for 2028-29 reflects actual inflation – that is, calculated based on the annual percentage change in the Australian Bureau of Statistics March 2028 consumer price index (all groups, Australia).

[50] The Fisher equation will be used to convert cost of debt from nominal to real estimates; that is: (1 + nominal rate) = (1 + real rate) * (1 + inflation rate). Refer to Section 3.13.1. for our approach to estimating the forecast inflation in the financial model template.

- After 2028-29, the 'RBA geometric' inflation rate will use the RBA forecast consumer price index inflation rate for year two and three of the regulatory period, and a glide path to the RBA target inflation band of two to three per cent for years four and five.
- After 2028-29, the 'bond breakeven' inflation rate will use values implied by the difference between the yields on 10-year nominal and indexed (inflation-linked) Commonwealth Government Securities.

This approach is consistent with the approach we have adopted at recent price reviews. The forecast for expected inflation will be released in early May 2028 together with the actual cost of debt for 2027-28.

3.13.2. Approach to forecasting the cost of debt for the revenue requirement

To establish a revenue requirement, we need to adopt an assumption for the future benchmark nominal cost of debt, noting estimates are 'trued up' for actuals annually during the regulatory period. To do so we adopt the most recent annual benchmark cost of debt (at the time of our determination) as the new figure that is rolled in to the 10-year trailing average.

For price submissions, we will provide water businesses with the actual benchmark cost of debt for 2026-27 (and the March quarter 2027 consumer price index) around early May 2027, and then we will update for the actual benchmark cost of debt for 2027-28 for our final decision.

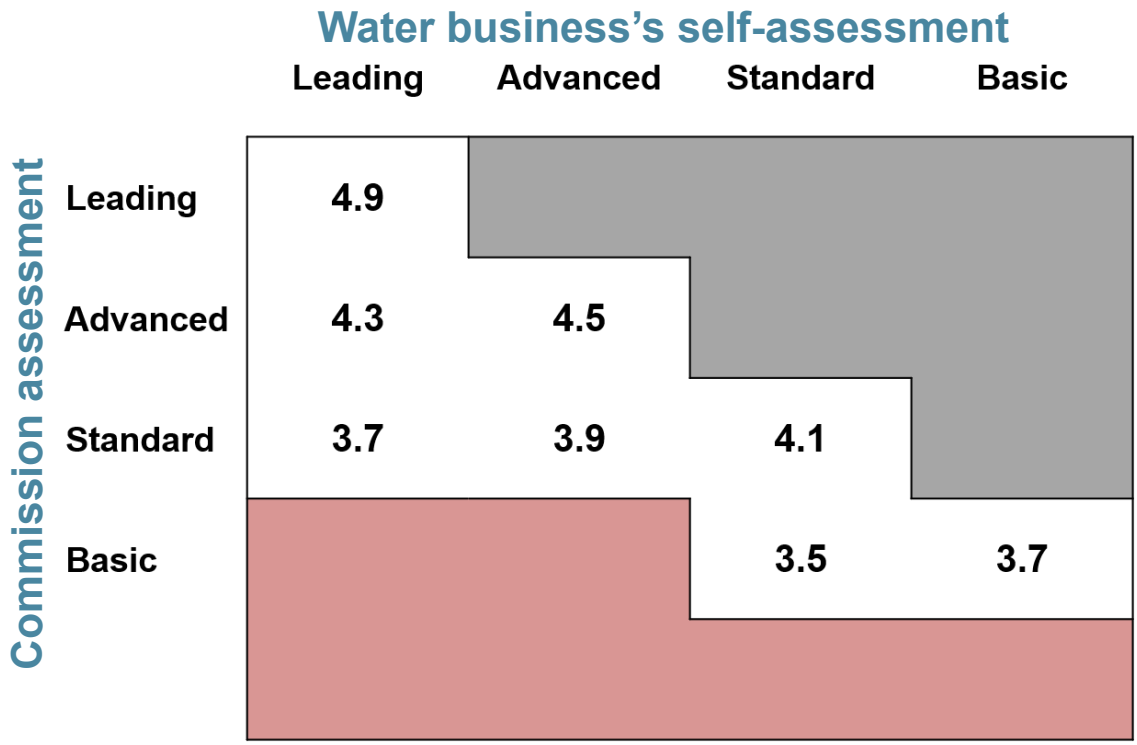
3.14. PREMO rating

The return on equity to be reflected in prices will be established via the PREMO incentive mechanism, under which a water business's return on equity will be linked to the level of ambition expressed in its price submission.

Under PREMO, a water business must self-assess the level of ambition of its price submission as either 'Leading', 'Advanced', 'Standard' or 'Basic'. We will independently assess the price submission and also rate it as 'Leading', 'Advanced', 'Standard' or 'Basic'. This two-stage PREMO assessment and rating process will determine the return on equity to be reflected in approved prices.

The range of possible values (in real terms) for the return on equity resulting from the two-stage assessment and rating process is provided in Figure 3.2. We will review these values in July 2027 to ensure they remain appropriate and will advise water businesses of any changes at that time. Information on the derivation of these values is provided in Section 3.15.

Figure 3.2 Regulated return on equity
Real per year rate (per cent)



Note: A water business must self-assess its price submission before lodging with us. We then complete our assessment of the price submission.

A water business will achieve the highest return on equity for its nominated PREMO rating when the commission and the water business align in their respective assessments. Situations of aligned assessments are represented by the upper diagonal of the matrix shown in Figure 3.2. The more ambitious the submission according to both the business and the commission, the greater will be the allowed return on equity.

The grey shaded area above this diagonal indicates where we will not assess a price submission more favourably than the water business's self-assessment. This provides an incentive for the business to put forward its best offer, and to provide an honest assessment of the appropriate price submission rating.

If we find a water business has overstated its ambition, then the return on equity will be lower than had it accurately assessed itself. This can be seen in the diminishing values moving left along each row in Figure 3.2.

We consider that the incentives embedded in the return on equity matrix at Figure 3.2 are in the best interests of Victorian water customers, as it reduces the likelihood of a water business being allowed rates of return that are not commensurate with the outcomes it proposes to achieve. It also supports an incentive-based framework that will deliver better consumer outcomes.

The (red) shaded zone at the bottom of the matrix represents an area within which we will reserve our discretion. For example, we may require the water business to resubmit its proposal or approve a shortened regulatory period if we rate its submission to be in this part of the matrix.

Together, the design features of the matrix provide businesses with a strong incentive to assess their price submissions accurately and honestly.

If, during its price submission assessment, the commission downgrades a business's PREMO rating, the commission (at its discretion) may elect to include specific conditions or performance criteria in the price determination that, if met, would allow the business to apply to have its original PREMO rating restored. This would likely involve the business demonstrating efficiency improvements or better service during the regulatory period, over a timeframe we specify. A successful application to the commission may result in an increase in revenue requirement corresponding to the higher equity return rate, which would in turn be reflected in prices.

The ambition expressed in the price submission will be rated according to all five elements of PREMO – Performance, Risk, Engagement, Management and Outcomes.

A water business must self-rate its price submission for each of these five elements and use these ratings to arrive at its overall PREMO rating and corresponding return on equity.

3.14.1. Criteria

A price submission must identify the water business's self-rating of its submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. A price submission must also identify the rating for the Performance, Risk, Engagement, Management and Outcomes elements of PREMO.

We will agree with a business's self-ratings where transparent and credible evidence has been provided that justifies the ratings. The guiding questions in Table 3.3 set out the matters we will consider in assessing a water business's proposed rating for each PREMO element.

Appendix E includes a PREMO assessment tool that water businesses must use to inform their PREMO ratings. The tool includes examples of what might constitute a 'Leading', 'Advanced', 'Standard' or 'Basic' rating for each element of PREMO. Informed by the assessment for each element of PREMO, a business must propose an overall PREMO rating for its price submission. Appendix E also includes a scoring methodology to assist businesses with this rating process, noting use of the scoring methodology is not mandatory.

A price submission must address all the requirements set out in this guidance to achieve a 'Standard' rating or higher.

Table 3.3 Guiding questions for PREMO assessment

PREMO Element	Guiding questions
Performance	• To what extent has the business demonstrated delivery of its customer outcomes commitment over the current regulatory period? Did its customers get what they paid for? • How does actual operating expenditure across the current period compare with the business's established benchmark allowance, and to what extent has the water business rationalised any discrepancies? • How does actual capital expenditure across the current period compare with the established benchmark allowance, and to what extent has the business rationalised any discrepancies? • To what extent does customer sentiment demonstrate satisfaction in the business's performance over the current regulatory period?
Risk	• To what extent has the business demonstrated a robust process for identifying risk, and how it has decided who should bear these risks? i.e such that customers are not paying more than they need to. • To what extent does the proposed Guaranteed Service Level (GSL) scheme provide incentives for the business to be accountable for the quality of services delivered, and provide incentives to deliver valued services efficiently?
Engagement	• To what extent has the water business engaged on matters that are most influential on services and prices? • Did the business access engagement insights early at a time it could influence its planning? • To what extent has the engagement program been tailored to suit the complexity and materiality of the issues the business is engaging on? • To what extent has the business demonstrated that all relevant parties had an opportunity to participate? • To what extent was the business's engagement accessible and inclusive to customers and community who hold an interest in, or who will bear the costs of, proposals in the pricing submission? • How accurate was the information used in the business's engagement materials, and how transparent was the business in the way it communicated its engagement outcomes? • How influential was engagement on the pricing submission? • To what extent has the business demonstrated how its engagement with customers has influenced its submission? • To what extent has the business identified and considered where any material inequities can reasonably and efficiently be addressed or mitigated? • To what extent has the business demonstrated effective engagement with First Nations customers? • To what extent has the business demonstrated effective engagement with Traditional Owner groups?

Continued next page

Table 3.3 (continued)

PREMO Element	Guiding questions
Management	• To what extent has the business demonstrated how its proposed prices reflect only prudent and efficient expenditure? • To what extent has the business demonstrated sound long-term planning beyond the regulatory period? • To what extent has the business demonstrated sound asset management? • To what extent has the business justified its commitment to cost efficiency or productivity improvements? • Are new customer contributions developed in accordance with the guidance paper? • To what extent has the business provided evidence that there is senior level, including board level, ownership and commitment to its submission and its outcomes? • To what extent has the business demonstrated its price submission is an 'open book'? • To what extent has the business justified or provided assurance about the quality of the submission, including the quality of supporting information on forecast costs or projects?
Outcomes	• Has the business provided evidence that the outcomes proposed have taken into account the views, concerns and priorities of customers? • Has the business proposed outputs to support each of its outcomes, which are measurable, robust and deliverable? • Has the business provided evidence that the outputs it has proposed are reasonable measures of performance against stated outcomes? • Has the business provided sufficient explanation of how the outcomes it has proposed align to the forecast expenditure requested? • Has the business demonstrated a process to measure performance against each outcome and to inform customers?

3.14.2. Supporting information

A price submission must provide information that satisfies the procedural requirements set out in the criteria above.

A price submission must also:

- identify the reasons for the self-ratings for the Performance, Risk, Engagement, Management and Outcomes elements of PREMO, with reference to the guiding questions above
- identify the reasons for the price submission's overall PREMO rating.

3.15. Return on equity

The price submission PREMO rating proposed by a water business will correspond with a value for a return on equity to be reflected in its price submission (Table 3.4).

Table 3.4 Maximum return on equity for each PREMO rating

Real per year rate (per cent)

	Leading	Advanced	Standard	Basic
Maximum return on equity to be reflected in a business's proposed revenue requirement	4.9	4.5	4.1	3.7

The (nominal) return on equity is calculated by the formula:

$$RoE = Rf + \beta * MRP$$

Where:

- Rf is the (long-term) nominal risk-free rate, measured using Commonwealth bonds, and represents the return an investor would expect from a riskless investment
- β is the equity beta, which measures a firm's exposure to systematic risk
- MRP is the market risk premium which measures the difference between the expected return on a market portfolio and the return on a risk-free investment

The return on equity (RoE) is then expressed in real terms by deflating by inflation.

Importantly, under the PREMO framework we determine the return on equity using **long run** estimates of the return expected by a private investor. This provides for greater consistency on the return on equity, which translates to more revenue stability and certainty for businesses, and price stability for customers.

Table 3.5 Parameter inputs for return on equity calculation

Parameter	Value	Comments
Nominal risk-free rate	3.37%	Taken as the midpoint of the Reserve Bank of Australia (RBA's) F2 monthly 10-year bonds for 20 years from June 2006 to May 2026.
Long-term market risk premium (MRP)	6.0%	We have consistently adopted an MRP of 6.0 per cent in our decisions. This value is in line with that adopted by other regulators in regulatory decisions which tend to range from 5.9 per cent to 6.1 per cent. We note that in its August 2026 update on WACC the Independent Pricing and Regulatory Tribunal of NSW (IPART) has estimated the current market risk premium at 5.7 per cent.
Equity beta	0.6	This is the same equity beta that we adopted for the 2023 and 2026 price determinations. It is lower than that adopted for 2026 water price decisions by IPART in respect of Central Coast Council (0.7), the Office of the Tasmanian Economic Regulator (OTER) in respect of TasWater (0.65) and by the Essential Services Commission of South Australia (ESCOSA) for its 2024 decision in n relation to SA Water (0.67). However, we note it is now higher than that proposed by the Australian Energy Regulator (AER) for the energy sector (0.55).[51] Arguments can be made for a lower beta for water businesses compared to energy businesses – water has a lower elasticity of demand than energy, and water businesses are less subject to the risks (including the risks of asset stranding) associated with a rapidly changing energy market.
Long-term Inflation	2.9%	We estimate expected inflation based on the simple average of the 'RBA geometric' and 'bond breakeven' inflation rates. We use a five-year average for both. This is the same inflation rate we used for our 2026 determinations for North East Water and Melbourne Water.

The long-term parameter values set out in Table 3.5 generate a return on equity of 4.0 per cent. However, having regard to the benefits of consistency and noting that long-term rates are currently below short-term rates, we propose to adopt the same return on equity as for our 2023, 2024 and 2026 price reviews, which is 4.1 per cent for a Standard rated business.

We note that the lowest value in the matrix is above the estimated cost of debt, and therefore supports revenue sufficiency for water businesses.

The difference between the rating categories, 0.4 per cent, is approximately equivalent to a 1 per cent price change for most businesses.

[51] See AER 29 May 2026, *Draft 2026 Rate of Return Instrument Explanatory Statement*, available at Draft 2026 Rate of Return Instrument | Australian Energy Regulator (AER).

We will, however, take into account any changes in current or long-term market conditions, including updates for forecast inflation, the market risk premium and risk-free rate, before finalising the return on equity values in the PREMO matrix in May 2027.

3.15.1. Criteria

A water business's proposed revenue requirement must incorporate a value for the return on equity that is no higher than the value specified in Table 3.4 for its proposed price submission rating. For example, an 'Advanced' rating will correspond with a maximum return on equity of 4.5 per cent. No further supporting information regarding the water business's return on equity is required.

3.16. Tax allowance

3.16.1. Criteria

The tax allowance included for the purposes of determining the required revenue must reflect an estimate of the corporate income tax to be paid, less the imputation credits that would be received by a hypothetical private investor in the water business. In estimating the value of imputation credits the water business must multiply the annual estimated corporate income tax bill by an imputation factor.[52]

This is consistent with the income tax calculation in the financial model template.

3.16.2. Calculating the tax allowance

Once the financial model template is populated by the water business it will produce an estimate of the business's future nominal tax allowance based on the following formula:

$ETC_t = (ETI_t \times r_t)\ (1 - \gamma)$, where:

- ETC_t is an estimate of the future nominal tax allowance
- ETI_t is an estimate of the taxable income for each regulatory year
- r_t is the expected statutory income tax rate for each regulatory year
- γ is the value of imputation credits (which will be at the rate of $0.50 for every $1 of company tax paid, as in past price reviews).

[52] While franked dividends are not generally paid by government businesses, in order to maintain competitive neutrality, it is necessary to make an assumption of the value of imputation credits for a hypothetical private investor in the regulated entity. Therefore, it will be necessary to assume a value of imputation credits in the tax calculation.

In relation to the estimate of ETI_t for each year of the next regulatory period:

- the revenue and expenditure estimates used in the calculation are the same revenue and expenditure estimates used to establish maximum prices (except that customer contributions and gifted assets are treated as revenue)
- the interest expenses (deductions) reflect the nominal cost of debt and the assumed stock of debt (that is, gearing multiplied by the regulatory asset base)[53]
- the calculation allows for an adjustment to reflect tax depreciation.

The financial model template adjusts the nominal tax allowance for inflation in order to derive the real tax allowance for each regulatory year. This estimate must be used by the water business as the basis for its tax allowance forecasts. The forecast tax allowance may also be informed by the business's latest estimate of tax to be paid over the next regulatory period.

The financial model template allows the tax rate to be entered for each year of the next regulatory period, to allow a business to reflect any expected changes in the applicable tax rate. Businesses should estimate the applicable tax rate and include it in the relevant input fields in the financial model template. The tax allowance is in addition to the RoE.

3.16.3. Supporting information

The price submission must propose a total tax allowance for the next regulatory period. An estimate must also be provided for each year of the next regulatory period.

The price submission must also:

- state the basis on which the tax allowance for the next regulatory period has been calculated
- in the financial model template, provide an estimate of the income tax for each year after the next regulatory period up until at least 2042-43
- make available to us the business's latest corporate forecasts for annual tax payments for the next regulatory period, and the basis for the forecasts.

3.17. Demand

The commission notes there is inherent uncertainty in relation to demand forecasts, including as a result of climate change, population projections, and firm commitments for connection of new large load customers for water or recycled water. As well as considering the risk mitigation tools available in the regulatory framework (see Appendix D), as in past reviews, businesses need to provide evidence that a range of supply and demand scenarios have been modelled. How a

[53] The tax allowance benchmarks in the price determination will be kept constant for the regulatory period, and will not vary with the cost of debt.

business proposes to manage the uncertainty in its demand forecasting will be a key input into its PREMO Risk rating.

3.17.1. Criteria

Demand forecasts proposed by a water business must represent the best available estimates derived from an appropriate forecasting methodology. Assumptions on the key drivers of demand over the next regulatory period must be well explained and reasonable. These assumptions must be based on the latest data and evidence available.

3.17.2. Supporting information

A price submission must summarise demand forecasts, including expected trends for the next two regulatory periods, as well as outline the key assumptions adopted to develop those forecasts. A business should use at least a 15-year horizon for demand forecasting and scenario work and reflect this in its price submission.

The price submission must also include:

- a description of the key demand forecasting issues that lists and justifies the most important assumptions adopted in generating the forecasts – demand forecasts should be based on the latest available Victoria in Future estimates provided by the Victorian Government, with variations and underlying assumptions clearly explained
- details of forecast demand from firm commitments for connection of new large load customers (data centres, for example) for water or recycled water
- a description of the forecasting methodology used, and the justification for using the methodology
- reference to any external reports or information relied upon
- a description of how forecasts have accounted for the impact of any proposed changes to tariff structures or form of price control expected in the next regulatory period
- details on the levels of restrictions or nature of any permanent water conservation measures reflected in the forecast
- written information on where price elasticity was applied, the input assumptions used, and how the assumptions were translated into the business's demand forecasts
- an explanation of how demand forecasts are consistent with proposed expenditure (in terms of the level and nature of expenditure).

A water business must also make available evidence that a range of supply and demand scenarios were modelled. This should include low, normal and high water inflow scenarios, and consideration of a range of 'low' to 'high' population growth assumptions. Written justification must be provided for the selection of the forecasts proposed.

The financial model template will require a water business to provide detailed demand forecasts for every tariff and tariff category, by residential and non-residential customers. If detailed forecasts at this level are unavailable, a business must explain why and provide estimated demand for these services. The detail in the model does not need to be reproduced in the price submission.

3.18. Form of price control

We recognise various options for water businesses to consider in terms of the form of price control. Most businesses currently use a price cap, revenue cap, or tariff (or price) basket form of price control. A different form of price control may be used for the different services delivered by a water business.

In considering whether to approve a proposed price control, we will have particular regard to whether the proposal involves a continuation of an existing form of control or the introduction of a new price control. Where an existing price control structure is being continued, the justification requirements below may be satisfied more easily.

Where a change is proposed, however, the water business will need to provide evidence to demonstrate that the new price control better satisfies the requirements in clause 11 of the WIRO than the existing structure.

3.18.1. Criteria

We will assess proposals against the following factors:

- the business's justification for the proposed form of control, including its consideration of efficiency and risk allocation and management
- the business's approach to consultation on the form of control and how the views of customers were taken into account
- where a change to the form of price control is proposed, whether the business has considered and demonstrated that appropriate transition strategies will be implemented for affected customers
- the administrative complexity of the proposed form of control
- the ability of customers to understand the resulting tariffs and tariff movements throughout the regulatory period.

In assessing a business's proposed form of price control, in particular where a change is proposed, we will place a strong weighting on the feedback a water business received from its customers.

3.18.2. Supporting information

The price submission must:

- clearly state the proposed form of price control to apply to each service over the next regulatory period
- include the formula to give effect to the form of price control, including any proposed side constraints if the water business is proposing a revenue cap form of price control
- if applicable, specify and justify which tariffs are subject to a tariff basket form of control and how those tariffs are grouped (for example, according to similar cost structures, customer class or service category).

If changes to the form of price control are proposed, then a price submission must:

- explain how the proposed form of control would operate and services affected
- demonstrate that the business has consulted with potentially affected customers, and explain how the feedback from customers informed its proposals, and how the change benefits customers
- provide data and supporting information that describes how the proposed form of price control is consistent with providing signals about the efficient cost of delivering services and how it is likely to impact on price stability
- explain how the business considered risk allocation and management (including demand and financial risk)
- explain how a transition to a new form of price control may impact customers, and the water business's approach to minimising any adverse impacts.

3.19. Prices and tariff structures

We typically provide businesses with a large degree of discretion to decide on tariff structures. This recognises that businesses are often best placed to consider the interests of its customers in designing tariffs and that existing tariff structures have been developed over time to deal with a variety of local circumstances. We intend to continue this approach. If a water business proposes tariff reforms, it should engage with its customers and take into consideration their views in its proposal.

The price submission must list each of the proposed tariffs to apply in the next regulatory period and include:

- each element of a multi-part tariff structure
- a price for each tariff, including miscellaneous services
- where relevant, the pricing principles that it proposes to apply in setting prices.

We anticipate prices for recycled water and unique services such as trade waste and miscellaneous services will be set with reference to pricing principles. The pricing principles for miscellaneous services are outlined in Section 3.19.4.

There may be instances where tariffs are proposed that relate to a very small proportion of revenue or are applicable to very few customers (for example, some rural tariffs). In these cases, a water business may propose specific pricing principles.

In developing its pricing proposal, we encourage water businesses to consider the tariff assessment principles listed in Table 3.5.

Table 3.5 Tariff principles

Principle	Description
Sustainable revenue	Tariff structures, levels and the form of price control should ensure an economically sustainable revenue stream over the regulatory period.
Subsidy free pricing and inefficient bypass	For each tariff class, the revenue expected to be recovered should lie on or between an upper bound representing the stand alone cost of serving the customers in that class and a lower bound representing the avoidable cost of not serving those customers.
Tariff structures	Tariff structures should be simple, understandable and cost reflective. **Bulk Water Charges Structure** - A two-part charge comprising a fixed charge and a volumetric component to recover a bulk supplier's revenue requirement from its customers for each bulk water service. **Retail Water Tariffs Structure** - A two-part tariff comprising a fixed charge and a volumetric component to recover a water business's revenue requirement from each tariff class. **Sewerage Charges** - The tariff structure should reflect the cost structure, and may comprise a one or two-part tariff (all fixed, all volumetric or a fixed charge and a volumetric component). **Trade Waste** - Trade waste charges should be load-based where measurement is feasible and where the benefits outweigh the costs.
Determining fixed charges	Fixed charges should be calculated to recover the difference between the total revenue requirement for a tariff class and the revenue recovered through volumetric charges.
Determining volumetric charges	The volumetric charge should have regard to the long run or short run marginal costs, where appropriate.
Customer focus	Retail tariff and service offerings, and the form of price control, should have regard to: • the ability of customers to understand the tariff and service offering and respond to price signals • customer preferences and needs in relation to service standards or new services • the costs of implementing the tariff offering, including administration and marketing costs • price path stability.

Continued next page

Table 3.5 continued

Principle	Description
Locational and postage stamp pricing	Postage stamp pricing comprises retail tariffs that do not reflect any differences in costs of distribution systems by time or location. Postage stamp pricing should be applied when water supply is predominantly interconnected and/or is more equitable and administratively simple. Locational pricing comprises tariffs that vary by location – reflecting the cost structure of water supply, transport and treatment across the business. Locational pricing should be applied when water supply is less integrated and where there are material differences in costs between water networks. The WIRO does not specify whether a business should use locational or postage stamp pricing. It is up to the business to make the case for which is most appropriate.

The principles in Table 3.5 provide guidance for businesses to check their proposed tariffs are consistent with the WIRO, including that tariffs provide signals to customers about the efficient costs of providing services. Compliance with the tariff assessment principles may also support a water business's proposed PREMO rating.

3.19.1. Rural prices

We recognise that rural water businesses face issues in setting tariff structures and pricing which differ from urban businesses. However, the tariff assessment principles outlined in our framework and approach paper are also relevant to rural tariffs.

Since July 2023 rural tariffs pertaining to rural infrastructure services that were formerly regulated under the Commonwealth Water Charge Rules 2010 are now assessed against the principles in clause 11 of the WIRO.

We encourage water businesses to continue unbundling and disaggregating their costs to reflect the different elements of the supply chain (that is, storage, transport and retail costs). Unbundled tariffs provide better price signals to customers and assist with benchmarking of costs.

3.19.2. Criteria

We will assess proposals against the following factors:

- the business's consideration of risk and efficiency – particularly how proposed tariffs are consistent with providing signals about the efficient cost of delivering services
- the extent to which proposed new tariffs or tariff structures are consistent with the tariff assessment principles in Table 3.5
- the business's approach to engagement on the tariff structures and how the views of customers were taken into account

- whether the business has considered and demonstrated that appropriate transition strategies will be implemented for any materially affected customers
- where applicable, whether the business has justified changes to its tariff strategy
- the ability for customers to understand the resulting tariffs and tariff movements throughout the regulatory period.

For price levels, we will assess proposals against the following factors:

- the business's justification for the proposed prices, particularly how proposed prices are consistent with providing signals about the efficient cost of delivering services, and providing incentives for the business to pursue efficiency improvements
- how the business has taken into account the interests of customers, in particular low-income customers and customers experiencing vulnerability
- whether the business has adequate transition strategies in place to manage the impacts of significant price shocks for affected customers.

The matters the commission must have regard to in making a decision are set out under clause 11 of the WIRO (see Appendix C). We will have particular regard to whether tariffs are continuing in the same form as applied during the last period, or whether changes are proposed.

We recognise that an important objective includes avoiding price shocks for customers where possible. Where an existing tariff structure is being continued, this may be satisfied more easily. Where changes from existing tariff structures are proposed, however, the business will need to provide evidence to demonstrate that the amended tariff structure better satisfies clause 11 of the WIRO than the existing structure.

3.19.3. Supporting information

A price submission must:

- include a tariff schedule listing each tariff and the price (or principles) proposed, including each element of a multi-part tariff structure and miscellaneous tariffs
- outline the business's tariff strategy and highlight any major proposed changes during the regulatory period commencing 1 July 2028
- provide indicative bill impacts for key customer groups – for residential (owner occupiers and tenants) and business customers (small, medium and large), estimates must be provided for each year of the regulatory period using representative consumption amounts and specified in real terms
- include a summary of the business's approach to engagement on its proposed tariffs and how the views of customers and other key stakeholders informed the price submission

- for any changes in tariff structures and principles, or new tariffs:
  - state how each tariff is to be applied – for example, frequency of charging, customer class, applying prices through connection or meter size
  - describe the relationship between the proposed price for a service and the associated short run or long run marginal cost
  - provide data and supporting information that describes how proposed new tariffs are consistent with providing signals about the efficient cost of delivering services[54]
  - justify how the proposed change delivers better signals to customers about the efficient costs of service provision
  - describe how the business considered risk and its allocation and management
  - provide a summary of the business's approach to engagement and how the views of customers informed the price submission
  - update the bill calculator in the financial model template, reflecting the proposed tariffs and price levels
- for real price changes of more than 10 per cent for any tariff in any year for the next regulatory period commencing 1 July 2028:[55]
  - describe the relationship between the cost of service provision and the proposed price
  - provide a summary of the business's approach to engagement (including the approach to identifying affected customers)
  - summarise the customer feedback received on the proposed price increase
  - describe the transition arrangements considered, and ultimately proposed, for affected customers
- provide estimated tariffs for each service for each year beyond the next regulatory period up until at least 2042-43 in the financial model template
- provide the Top 10 miscellaneous charges by forecast revenue for the next regulatory period and the following period up until 2042-43 in the financial model template
- provide supporting information that describes how proposed miscellaneous tariffs are calculated in accordance with requirements in the WIRO and the pricing principles provided below

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[54] We require the price submission to propose prices that seek to reduce and minimise cross-subsidies. The extent to which this may be achieved will depend on a range of factors, including how well any adverse customer impacts may be managed. These issues will need to be explored in price submissions.

[55] Clause 11(d)(ii) of the WIRO requires the commission to have regard to the principle that prices should provide signals about the efficient costs of providing services, while avoiding 'price shocks' where possible. In previous price reviews we have defined a price shock as an increase of greater than 10 per cent in any year for any individual tariff. For any proposed price increases of greater than 10 per cent in any year, a business will need to consider the merits of the increase while having regard to the cost of delivering the particular service (that is, cost reflectivity) and the impacts on its customers.

- for Goulburn Murray Water – its price submission must address how it has improved the collection of data to ensure diversion tariffs for small scale diverters are cost reflective, as required by its 2024 price decision.

3.19.4. Pricing principles for miscellaneous services

Miscellaneous services are services that may include one or more characteristics such as:

- provided infrequently, or to a small subset of customers
- provided as ancillary to the main (for example, water, sewerage) services
- low cost in nature, and/or represent a small proportion of a water business's revenue
- may include a pass-through of another entity's costs.

Prices for miscellaneous services must be set according to actual costs calculated on the basis of the aggregate of:

- direct third party or contractor invoice cost
- direct marginal internal costs, including labour, materials and transport costs
- a fair contribution to overheads.

For bank dishonour, debt collection and legal fees, the third-party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

3.20. Adjusting prices

A price submission must specify any proposed price adjustment mechanisms to apply in the next regulatory period. Previous determinations have included common mechanisms that allow for prices to adjust in order to take into account:

- events which were uncertain or unforeseen at the time the determination was made
- differences between forecast and actual desalination costs (covered by desalination security payments and the cost of any water ordered)
- annual changes to the benchmark cost of debt.

Our view is that these adjustment mechanisms have worked well, and we propose these arrangements will continue.

Businesses may also propose the pass through of specified changes in costs when defined grounds or conditions are met, provided that a clearly articulated justification is included in the price submission.

Where there is a potential policy or regulatory change that is known but uncertain in its impact on costs, the change may be nominated in a business's price submission as a potential pass-through,

or an uncertain or unforeseen event. Large capital projects which are anticipated but have not been fully scoped or costed (as described in Section 3.9) may be nominated as an uncertain event.

The proposed price control formulas must continue to include a mechanism to allow for price adjustments to occur on an annual basis, including desalination water orders for relevant businesses.

Where a water business proposes to continue with the existing price adjustment mechanisms, the supporting information requirements will be easily satisfied. Where a change is proposed, the business will need to provide evidence to demonstrate how the new or amended adjustment mechanism satisfies the requirements in clause 11 of the WIRO.

The commission's Guideline 3 (2025): Varying a Price Determination (Re-opening) addresses the circumstances in which a price determination may be varied, and the process for varying a determination.[56] Guideline 3 covers both uncertain or unforeseen events, as well as specific pass-throughs sought by individual businesses. Proposed price adjustment mechanisms and processes must be consistent with this guideline.

3.20.1. Criteria

In approving proposed pass-through or uncertain or unforeseen events, we will consider:

- the extent to which the event is outside the business's control and poses significant risk of cost changes during the period
- the extent to which the nominated event is uncertain in its impacts and/or timing
- whether it is reasonable that the business's customers should bear risk associated with the nominated event
- the impact of the nominated event on efficiency incentives for the water business
- the ability for the business to otherwise manage the risk and cost impact posed by the event – for example, in its form of price control, tariff structures or approach to contracting
- whether the proposal is consistent with Guideline 3.

3.20.2. Supporting information

A price submission must:

- Specify any proposed price adjustment mechanisms to apply in the regulatory period commencing 1 July 2028, and specify the proposed process and/or formula for adjusting prices. (The process must be consistent with Guideline 3 (2025)).

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[56] See: water-guideline-guideline3-2025-varying-a-price-determination-20250930.pdf

- If proposing new or changed price adjustment mechanisms:
  - clearly specify and explain how the adjustments would work
  - demonstrate that the business has sought to appropriately balance revenue and cost risk between the business and its customers, without materially impacting on price stability
  - justify any proposal against relevant matters in clause 11 of the WIRO and consistency with proposed outcomes.

For any identified pass-through or uncertain and unforeseen events, the price submission must also:

- describe each proposed event, and explain why it is uncertain in its timing or impacts on the business or its customers
- explain why it is appropriate that customers should bear risk associated with the event
- explain how the business considered the impacts on its incentives to pursue efficiencies
- propose a price adjustment mechanism to implement the pass-through which is consistent with Guideline 3 (2025).

3.20.3. Schedule of prices to be included in the determination (Schedule 2)

A template of the schedule of prices from the determination (Schedule 2) has been included in the financial model template. Businesses must complete the tariff and price components of the schedule of prices including the price path movement in the template when they submit their financial model template.

3.21. New Customer Contributions

New Customer Contributions (NCC) are a prescribed service for urban water businesses. We reviewed our approach to setting NCCs in 2024 and 2025, which resulted in the *New Customer Contributions Framework*, January 2026.[57]

Various elements of PREMO have direct relevance to how water businesses explain, justify and administer their NCCs (see below).

Risk

NCCs and asset gifting practices inherently involve trading off the risk of:

- prudently foreseeing and building for growth between connection applicants and water businesses
- asset utilisation and forecast incremental revenue realisation risks

[57] See New Customer Contributions Framework.

- cost recovery consequences for growth investment between connection applicants and ongoing water service customers.

Engagement

Given the above risk trade-offs, engagement with both connection applicants and ongoing water service customers on the risk trade-offs and adequacy of growth planning, Development Servicing Plans and NCC pricing in managing those risks is essential.

Performance

Connection services, like any regulated service, should be subject to clear performance commitments from water businesses. Businesses should set targets for such performance and disclose their actual performance levels against those targets.

3.21.1. Criteria

Water businesses must use approved pricing principles (outlined in Box 3.3) and in Section 3.22 for large and/or complex loads and sewer mining, to calculate the net incremental cost of connections. Water businesses must also apply definitions outlined in Appendix H (Appendix A – Glossary, New Customer Contributions Framework) when calculating NCCs. If a water business wants to amend definitions, then it must first discuss its proposed amendments with commission staff before applying them to its NCC calculations.

New Customer Contributions will either be standard or negotiated. Standard NCCs are approved by the commission as part of the business's determination. Negotiated NCCs, are agreed between a developer and the business, applying the principles and net incremental cashflow methodology, as set out in our NCC model.

Box 3.3 New Customer Contributions pricing principles

A proposed NCC must have regard to:

- **incremental infrastructure and associated costs** in one or more of the statutory cost categories attributable to a given connection, which must be greater than the avoidable cost of not servicing the connection and less than the standalone cost of servicing that connection (incremental cost)[58]
- **incremental future revenues (or other benefit) that will be earned from customers at that connection.**

[58] Statutory cost categories mean costs for works imposed under Division 6 of Part 13 of the *Water Act 1989.*

3.21.2. Supporting information

A water business's price submission must include:

- a connection policy
- information that supports the calculation of NCCs, including where a business proposes standard NCCs.
- evidence of engagement with developers and existing customers on how their views have informed the proposed charges, particularly if proposed standard NCCs are significantly higher than the existing NCCs or aren't currently fully recovering costs. Engagement should also include any proposed changes to the negotiated framework.
- specific details about the proposed NCC charges and how they are to be applied; for example, by customer class (water, sewerage, recycled water), location or development type (infill, greenfield)
- NCC model/s outlining how proposed standard NCCs will be calculated, including accompanying notes describing the data sources and input assumptions used.

The supporting information will enable us to determine if the proposed NCC charges have been established in accordance with the NCC pricing principles (see Box 3.3).

New Customer Contributions: commission requirements

- We expect businesses to use the commission's NCC model to calculate maximum standard New Customer Contributions. This should be supported by accompanying notes (as referenced above) to facilitate our assessment of the model and proposed charges. If a business is considering using a different model or approach, it must advise us as early as possible.
- A price submission must provide the model(s) used to calculate the standard NCC charges including accompanying notes describing the data sources and input assumptions used. The model(s) must use the same financial parameters as in the commission's Financial Model Template.
- If a water business develops and submits a bespoke NCC model instead of using our illustrative working models, we expect comprehensive documentation to assist the assessment of the model used. The business must advise us as early as possible that it intends to use a bespoke model. The water business must demonstrate to our satisfaction that this model meets the requirements of our guidance and the *Water Act 1989* and delivers against the NCC pricing principles.

The price submission must:

- provide details about how the forecast developer contributions in the financial model template have been derived and explain how past outcomes for contributions have been considered, and

assumptions about future connections growth. This includes how costs have been allocated to new customer contributions

- provide details of how the business has evaluated the connecting parties' assumptions about forecast growth and considered the risks of alternative outcomes and their potential impacts on customers'
- include a copy of the negotiated NCC framework to be applied for the forthcoming regulatory period, clearly identifying any proposed changes (for example, using tracked changes in a Word document).

3.21.3. Connection Policy

A price submission must include a connection policy for approval by the commission. Once approved it must be published on a water business's website.

The connection policies will:

- ensure a sufficient and transparent connection process and pricing
- support well informed connection applications and negotiations.

An approved and published connection policy should serve as a comprehensive guide for connection applicants.

The connection policy should clearly outline:

- the types of connection services and customers covered
- eligibility criteria and thresholds for standard NCCs
- the connection processes
- charges payable
- dispute resolution arrangements.

A connection policy must address the minimum content set out in Table 3.6.

Table 3.6 Required content of connection policies[59]

Element	Content required
Connection services	Definitions of each connection service, the customers to whom they apply, details for when standard charges apply and the eligibility criteria for each approved standard NCC, including thresholds for small-scale standard NCCs.
Processes	Details of the application processes, contact details, information and documentation needed, and timeframes for assessing applications/enquiries and progressing these through stages of the application and connection process. Where a water business proposes service level commitments for the response timeframes to steps in its connection process, those would be included here too.
Negotiations	Sets out the water business's negotiating framework including addressing our minimum requirements for negotiating frameworks discussed below.
Fees and charges	A comprehensive schedule of fees and charges that may be payable during a connection process, or the method through which charges will be calculated and relevant inputs to those calculations. This may include details of: • standard charges and charge setting methods for negotiated NCCs • schedule of rates for miscellaneous charges (for example, for charges payable to recover the cost of preparing and administering negotiated NCCs or for assessing designs for gifted assets and auditing their construction quality before interconnection) • schedule, rates and application of charges for large and/or complex loads, where they can be made publicly available • approach(es) to incremental cost estimation in negotiated NCCs • approach(es) to incremental demand forecasting • circumstances where tax may be payable on the incremental costing or gifting • approach to bring forward costs.
Asset gifting and rebates	The water business's arrangements for asset gifting, including: • circumstances where gifting will be required • circumstances where upsizing may be required • how incremental benefits are assessed and where and how rebates are applied • arrangements for approving designs, auditing assets before connection, providing plans and installation maps • circumstances where incremental tax costs may be charged.
Terms	Connection application and connection agreement terms and conditions. Requirements for security fees.
Dispute resolution	Rights to and processes for dispute resolution, including internal escalation and external dispute resolution pathways.

Continued next page

[59] ESC NCC Framework: January 2026, refer Section 5.1 Connection policy requirements and minimum content

Table 3.6 Continued

Element	Content required
Development Service Plans for service areas eligible for each standard NCC	Where a water business is proposing standard NCCs, we will require that Development Servicing Plans are published, describing the expected timing and sequencing of development and infrastructure for the services and locations that will be eligible for the standard NCCs. The commission requires that Development Servicing Plans should meet the following conditions: • are made publicly available on the water business's website and provided as a basis for deriving standard NCC's during a price review • describe the expected timing and sequencing of development and infrastructure delivery to various locations • provide the connection applicant with sufficient information to enable informed negotiations and transparent assessment of bring-forward costs • are reviewed regularly and updated whenever changes occur. The minimum content we require in a Development Servicing Plan is set out in Appendix H (see New Customer Contributions Framework – Appendix B). A Development Servicing Plan is not required where a: • proposed standard NCC relates to an infill area that is not the subject of a Development Servicing Plan • proposed standard NCC is for a small-scale connecting customer NCC • regional water business relies upon local government plans rather than its own Development Servicing Plan. It should provide these plans and demonstrate how its forecast incremental costs are consistent with those plans.
Policies for attributing costs and benefits to incremental cost calculations	Water businesses proposing standard NCCs must keep and submit a cost and benefit attribution policy. This policy must clearly explain the incremental cost estimation approach used and the underlying assumptions. This approach should be applied consistently over time and enable replicable cost estimates and benefits assessments based on the information in the policy. The cost and benefit attribution policy should address (where relevant) the: • types of attributed assets and costs • allocators used • treatment of sunk costs • consideration of avoided cost benefits. Although this is not a requirement for negotiated NCCs, under the Water Act such information should be made available during a negotiation to support any proposed NCC.[60]

Continued next page

[60] Section 268(4)(c) of the Water Act 1989 requires that a notice imposing an NCC must specify 'any works or services that have been or will be provided' among other things.

Table 3.6 Continued

Element	Content required
Evidence of incremental benefits	Water businesses proposing standard NCCs must provide evidence that they have considered incremental benefits in calculating standard NCCs. One way to do this is to include the present day value of incremental revenues in their NCC calculations. Preferred NCC calculation illustrative working models provided by the commission in Section 6.1 of the New Customer Contributions Framework will support compliance with this requirement.
Evidence of compliance with avoidable cost-efficient pricing bound	Businesses should provide evidence that they have complied with the avoidable cost-efficient pricing bounds in the NCC principles which requires that the costs associated with the NCC must be greater than the avoidable cost of not serving the connection, and less than the standalone cost of serving that connection. The *New Customer Contribution Framework* provides more guidance on how to show compliance with the cost-efficient pricing bound, including in Table 6.1. When demonstrating compliance with the efficient pricing, a water business should consider the cost of servicing the collective customer group specified in the proposed eligibility criteria.

3.22. Large and/or complex connections (including sewer mining)

The charging and servicing of large and/or complex connections is an emerging issue for the water sector. Due to the magnitude and complexity of these developments, we are setting the pricing principles and approach businesses must adopt when assessing these developments to ensure the full costs and benefits of resourcing and servicing for water, recycled water and sewerage are considered. We expect these charges to be negotiated and go beyond capital contribution charges set out under the New Customer Contributions Framework.

Large and/or complex connections – are new or amended connections that meet both conditions A and B:

- Condition A – The new or amended connection:
  - is a direct connection to a water business's works, or
  - has an instantaneous peak, annual demand, or trade waste load significantly higher or different to those of residential, domestic or light commercial users as set out in the connections policies of the water business in whose district the development is located.
- Condition B – The new or amended connection requires the water business to:
  - construct works to service the connection directly, or indirectly via the water business's works, or
  - construct works earlier and/or at a greater capacity than planned.

A water business's price submission must include:

- miscellaneous charges to recover:
  - investigation and application costs
  - ongoing fixed, usage and reservation costs
  - disconnection costs
  - any other up-front or ongoing operating costs incurred by the water business to service the new connection
- capital contributions charges using the New Customer Contributions pricing principles to recover the costs of constructing or bringing forward infrastructure required for the new connection
- sewer mining charges that have regard to connection costs, monitoring costs, metering costs, administrative costs, extraction costs and benefits, and discharge costs.

A price submission must also explain how revenue from large and/or complex connections is treated, including:

- whether and how ongoing charges from these connections offset the revenue requirement recovered from other customers
- how the connection is reflected in demand forecasts and the proposed form of price control
- how capital contributions and special charges are treated in the roll-forward of the regulatory asset base, so that costs recovered from a connection applicant are not also recovered from other customers.

3.22.1. Pricing principles for large and/or complex connections

Proposed charges for large and/or complex connections must be consistent with the pricing principles set out in this section.

Application and investigation charges pricing principles

Application and investigation charges must be set to reflect actual cost calculated as the aggregate of:

- direct third party or contractor invoice cost
- direct marginal internal costs including labour, materials and transport costs
- a fair contribution to overheads.

For bank dishonour, debt collection and legal fees, the third-party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

Capital contribution charges pricing principles

Capital contribution charges should be calculated by applying the NCC pricing principles set out in Box 3.3 within Section 3.21 above.

The efficient pricing bound applies to assessing the adequacy of the incremental costs included in the calculation of capital contribution charges. Where the connection arrangement requires assets to be gifted to a water business, the value of those gifted assets will be excluded for the purposes of calculating net costs (and will be excluded from the water business's regulatory asset base).

Where the connection arrangement requires assets delivered by a water business or directly by a direct customer, the incremental costs and benefits and gifted assets attributable to those other entities will be excluded for the purposes of calculating water business's special charges.

Incremental costs must include:

a) incremental financing costs associated with constructing an asset sooner than planned; and/or
b) connection-specific costs (for example, transfer network extensions) and incremental shared network costs (for example, supply, transfer and treatment augmentations) to meet the levels of service required at the connection.

Incremental financing costs

Incremental financing costs should be calculated as per the formula set out in current determinations, assuming a 'Standard' PREMO rating return on equity (currently 4.1 per cent).

Ongoing charges pricing principles

Prices for ongoing charges must be set as follows:

- variable prices should have regard to the long run marginal cost of providing services (including, in the case of sewage and/or trade waste, trade waste transfer, treatment and disposal)
- the total revenue received from each customer should be greater than the cost that would be avoided from ceasing to serve that customer, and (subject to meeting avoidable cost) less than the standalone cost of providing the service to the customer in the most efficient manner
- the methodology used to allocate common and fixed costs (including a fair contribution of overheads) to that customer should be clearly articulated and be consistent with any guidance provided by the commission
- costs should include the full cost of resourcing and servicing both water and/or recycled water
- prices should reflect reasonable assumptions regarding the customer's demand for services (including, in the case of trade waste, the volume and strength of trade waste anticipated to be produced by that customer)
- prices should include any direct third party or contractor invoice cost and/or direct marginal internal costs including labour, materials and transport costs

- prices should include any costs associated with environmental offsets, or equivalent, as agreed with the connection applicant
- depreciation rates should reflect the utilisation of the assets in servicing the large and/or complex connections
- rates of return used to determine prices should be based on a 'Standard' PREMO rating return on equity (currently 4.1 per cent)
- customers should be provided with full details of the manner in which prices have been calculated, and any new, renewed or renegotiated contractual agreements with customers should indicate that the prices to apply are subject to any determination made by the commission
- for bank dishonour, debt collection and legal fees, the third-party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

Water businesses should evaluate the demand forecasts provided by the connection applicant, identify risks to those forecasts being achieved and consider how those risks can be mitigated.

Disconnection charges pricing principles

Prices for disconnection charges must be set according to the actual cost calculated on the basis of the aggregate of:

- any remaining capital costs to ensure that existing customers are protected and to avoid stranded assets
- direct third party or contractor invoice cost
- direct marginal internal costs including labour, materials and transport costs
- a fair contribution to overheads.

For bank dishonour, debt collection and legal fees, the third-party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

3.22.2. Sewer mining charges pricing principles and application of charges

Sewer mining is the practice of extracting sewage from a water business's works and treating the sewage to recover a desired resource (for example, recycled water) by a sewer miner, where expressly permitted by the water business. Sewer mining also involves the management of waste byproducts by way of disposal back to a water business's works (where permitted).

Prices for sewer mining must be set as follows:

- variable prices should have regard to the long run marginal cost of providing services (including, in the case of sewage and/or trade waste disposal, trade waste transfer, treatment and disposal)

- the total revenue received from the sewer miner should be greater than the cost that would be avoided from ceasing to serve the sewer miner, and (subject to meeting avoidable cost) less than the stand alone cost of providing the service to the sewer miner in the most efficient manner
- the methodology used to allocate common and fixed costs (including a fair contribution of overheads) to the sewer miner should be clearly articulated and be consistent with any guidance provided by the commission
- prices should reflect reasonable assumptions regarding the sewer miner's demand for services (including, in the case of trade waste, the volume and strength of trade waste anticipated to be produced by the sewer miner)
- prices should include any direct third party or contractor invoice cost and/or direct marginal internal costs including labour, materials and transport costs
- depreciation rates should reflect the utilisation of the assets in servicing the large and/or complex connections
- rates of return used to determine prices should be based on a 'Standard' PREMO rating return on equity (currently 4.1 per cent)
- sewer miners should be provided with full details of the manner in which prices have been calculated and any new, renewed or renegotiated contractual agreements with customers should indicate that the prices to apply are subject to any determination made by the commission
- for bank dishonour, debt collection and legal fees, the third-party costs must be charged directly to the customer with no contribution for internal costs or a contribution to overheads.

Application of the charges

Where a sewer miner requires infrastructure to be built by the water business, it will be treated as a large and/or complex connection for pricing purposes.

Prices for sewer mining must be set to recover:

- application and investigation costs – including, but not limited to, investigation and feasibility studies of works to be undertaken by water businesses
- connection costs – costs to water businesses to allow a sewer miner to construct physical infrastructure and access the sewer including, but not limited to, infrastructure costs, augmentation and bring-forward infrastructure costs. Disconnection costs would be incurred by the operator when a sewer mining operation ceased
- monitoring costs – costs incurred monitoring and managing the composition of sewage extractions from, and discharges into, the sewerage system. Monitoring confirms whether technical, operational, safety and any trade waste acceptance standards are being met by a sewer miner

- metering costs – costs incurred measuring the quantities and qualities of sewage extracted and trade waste returned to the sewer by the sewer miner, for monitoring and billing purposes. Costs could include, but are not limited to, installing, maintaining and reading meters and the costs of developing a protocol for measuring sewage volumes;
- administrative costs – including, but not limited to, costs incurred to reach agreement with a sewer miner on terms and conditions, to finalise a contract and to monitor performance under the contract. This would include billing costs. There may be additional costs to revise or develop maintenance and emergency plans that take the sewer mining operation into account;
- extraction costs and benefits – costs and benefits that reflect reasonable assumptions regarding the sewer miner's extraction. This would include costs that may be avoided or deferred (either capital or operating costs) by water businesses by reduction in sewage volumes and loads at the treatment plant, and costs incurred by water businesses to make the connection available;
- discharge costs – costs associated with discharging waste into the sewer.

Take or pay charges may apply if conditions in the supply agreement have not been met.

Where the sewer miner is located on a serviced property, the owner or occupier of that property will also be liable for water, sewerage, trade waste and recycled water charges by the water business in whose district it is located as declared under the Water Act, at the prices resolved by that water business.

3.23. Financial position

The commission must have regard to the financial viability of Victorian water businesses (see Appendix C). We conduct a financeability test which compares five financial ratios (the 'financial indicators') against thresholds based on the levels required for businesses to maintain an investment grade credit rating. The financial model template calculates estimates for the financial indicators specified in Tables 3.7and 3.8 for each year to 2037-38.

We reviewed the financial sustainability metrics in 2024, and introduced several changes:[61]

- A new financial indicator (RCF/Net debt), to assist with assessing if the size of a business's dividend or capital repatriation payments will result in a financeability concern.[62]

[61] NERA Economic Consulting, *Assessment of Financial Viability Indicators for the Victorian Water Sector*, 1 May 2024 is available on our website at https://www.esc.vic.gov.au/sites/default/files/documents/water-financial-viability-assessment-nera-report-2024.pdf

[62] RCF refers to Retained Cash Flows

- We reclassified an existing indicator – the FFO/Net debt indicator, which measures the capacity of a business to repay debt and provides a medium-term view of a business's financeability – from a secondary to a primary indicator of financeability.[63]
- We introduced a notional test in addition to the actual test – both use the same indicators and are based on the business's proposal and any changes from our decision
  - The notional test calculates the indicators based on a 'notional efficient business', which may have different inputs (like the level of gearing or cost of debt) to the business. This notional test allows us to assess whether an efficient business would raise sufficient funds to remain financeable throughout the regulatory period.
  - The actual test calculates the indicators using the business's own financial inputs and assumptions, to test whether the business would raise sufficient finance and remain financeable throughout the regulatory period based on its proposed prices and financial policy in any given price submission.

Water businesses must populate the financial model template to enable our assessment of their financial position in the context of the prices proposed in their price submission. Businesses should also provide us with the findings of any independent ratings assessments conducted by an independent credit ratings agency since their last price submission, if seeking a financial viability adjustment.

[63] FFO refers to Funds from Operations

Table 3.7 Financial indicators – actual test

Indicator	Calculation	Benchmark Range	Description
Primary indicator — used to determine size of any viability adjustments			
FFO interest cover	(FFO + net interest) / net interest	> 1.5 times < 1.8 times used as a caution	Measures the extent of the cash flow buffer a water business has to meet its debt obligations.
FFO / Net debt (%)	FFO / (Interest bearing liabilities – cash)	> 6 per cent	Measures the extent to which the serviceability of debt is improving, remaining stable, or declining.
Secondary indicators — used only as contextual information to determine whether an adjustment is necessary			
Net Debt / Regulatory Asset Value (%) (Gearing)	(Interest bearing liabilities – cash) / RAV	< 80 per cent	Measures the debt component of the regulatory capital structure.
RCF / Net debt (%)	RCF / (Interest bearing liabilities – cash)	> 4 per cent	Measures the extent to which the serviceability of debt is improving, remaining stable, or declining once cash extracted from the business is considered.
Internal financing ratio (%)	(FFO – dividends) / net capital expenditure	> 35 per cent	Measures the extent to which an entity has cash remaining to finance a prudent portion of capital expenditure after making dividends.

Notes: FFO refers to 'funds from operations' and RAV refers to the 'regulatory asset value'. RCF refers to 'retained cash flow', which is calculated by subtracting dividends from FFO.

Table 3.8 Financial indicators – notional Test

Indicator	Calculation	Benchmark range	Description
Primary indicators — used to determine size of any viability adjustments			
FFO interest cover	(FFO + net interest) / net interest	> 1.5 times < 1.8 times used as a caution	Measures the extent of the cash flow buffer a business has to meet its debt obligations.
FFO / Net debt (%)	FFO / (Interest bearing liabilities – cash)	> 6 per cent	Measures the extent to which the serviceability of debt is improving, remaining stable, or declining.
Secondary indicators — used only as contextual information to determine whether an adjustment is necessary			
Internal financing ratio (%)	(FFO – dividends) / net capital expenditure	> 35 per cent	Measures the extent to which an entity has cash remaining to finance a prudent portion of capital expenditure after making dividends.

Notes: The notional test uses benchmark inputs like the notional level of gearing and cost of debt. FFO refers to 'funds from operations' and RAV refers to the 'regulatory asset value'. Regarding FFO interest cover, the commission believes the 1.8 times benchmark signals a need for caution from the business and closer observation by the commission in its price reviews and performance reporting. But until a business breaches or is forecast to breach the benchmark of 1.5 times, it is unlikely the commission would make a viability adjustment.

3.24. Additional requirements

3.24.1. Executive summary and submission 'snapshot'

A price submission must contain a focused executive summary which outlines and brings together the key elements of its proposals. The summary should include:

- an overview of proposed prices
- indicative bill impacts of the proposed prices, by key customer group
- an overview of the outcomes proposed for customers, including how services will change from previous levels
- the business's nominated PREMO rating
- an attestation from the board on the quality and accuracy of information provided in the price submission.

The water business must also complete the Price Submission Snapshot summary template provided by commission staff and submit this with its price submission.

3.24.2. Board attestation

Our guidance requires the board of a water business to attest to the quality of its price submission and its compliance with our guidance (in all material respects). Our reason for including the attestation is to promote board involvement and ownership of its business's proposals. This attestation, endorsed by a resolution of the board of directors, must be included in the price submission.

The form of the required attestation is below:

> The directors of [name of water business] having made such reasonable inquiries of management as we considered necessary (or having satisfied ourselves that we have no query), attest that, to the best of our knowledge, for the purpose of proposing prices for the Essential Services Commission's 2028 Water Price Review:
>
> - information and documentation provided in the price submission and relied upon to support [name of water business]'s price submission is reasonably based, complete and accurate in all material respects
> - financial and demand forecasts are [name of water business]'s best estimates, and supporting information is available to justify the assumptions and methodologies used
> - the price submission satisfies the requirements of the 2028 Water Price Review guidance paper issued by the Essential Services Commission in all material respects.

To support its PREMO rating, a water business may wish to make available to us information on the procedures implemented to ensure its price submission reflects the requirements of our guidance.

The justification for a water business's final PREMO self-rating is always the sole responsibility of the business, even if it engages a third party to review and advise on its proposed PREMO self-rating.

3.24.3. Financial model

A water business must complete the financial model template prepared by the commission to accompany its price submission. A water business's price submission must be consistent with the data provided in the financial model template.[64] Where there is any discrepancy between the price submission and the financial model template, we will rely on the data in the financial model

[64] The financial model template requires a water business to provide detailed information on key assumptions underpinning its prices (such as expenditure estimates) so we can assess its proposal. The model also provides a mechanism for a water business to estimate its revenue allowance and prices. The model will require both historic and forecast data. Historic data must be consistent with the business's regulatory accounts.

template. The financial model template will clearly identify the cells for which a water business must provide data. A water business must not amend any other cells in the financial model template – this includes adding rows, columns, or information not requested by the commission.

The model will include a forecast inflation rate (refer to Section 3.13.1 for information on our approach to estimating forecast inflation). The inflation rate will be used to estimate components of the regulatory rate of return (see Section 3.10) and estimates for financial indicators (see Section 3.23).

We will provide the following values to water businesses to enter into the financial model template in May 2027:

1. actual March quarter annual CPI value for 2027-28
2. actual cost of debt value for 2026-27 and an updated estimate cost of debt value for 2027-28.

We will update for the actual cost of debt for 2027-28 for our final decision.

3.24.4. Requirement for reasonably based information

All information contained in the price submission (and financial model template – see Section 3.24.3) must be reasonably-based. All financial and demand related information must represent the best available estimates at the time of finalising the submission.

3.24.5. Basis upon which information is provided

All financial information (including prices, operating and capital expenditure) in a price submission (and financial model template) must be in 2027-28 dollars (with the March quarter 2027 CPI as the base).

All reports, studies or any other materials (for example, research reports, policy documents, and cost benefit analysis or studies) which are relied upon in the price submission must be made available to the commission at lodgement or on request.

3.24.6. Confidentiality

We will publish each price submission, financial model template and any supplementary information on our website. If there is information that a water business does not want disclosed publicly, because it is confidential or commercially sensitive, this should be discussed with commission staff before lodging the price submission. As per our submissions policy, we may require a business to provide a redacted version for public disclosure on our website.[65]

[65] View our submissions policy at https://www.esc.vic.gov.au/about-us/our-policies/our-submissions-policy.

3.24.7. Accessibility

The commission intends to use the Engage Victoria platform for its consultation during the 2028 Water Price Review. If not addressed by the water business's price submission lodged with the commission, the water business must provide an accessible version of its price submission and supplements (public versions).

3.24.8. Notification of changes to assumptions

During the price review, a water business must promptly advise us if it becomes aware of any event that may require substantial changes to the assumptions underpinning the proposals in its price submission. A water business must also explain the basis for any changes to assumptions, explain the impact on its proposals, and demonstrate compliance with relevant sections of the guidance.

In the event of any changes, a water business must promptly provide us with an updated financial model template, reconciling changes to the financial model template provided to the commission with its price submission as lodged on or before 13 September 2027.

3.24.9. Non-prescribed services

While we have no role in regulating prices for non-prescribed services, we need to be satisfied that these services have been correctly classified as not related to regulated services, and that the costs of these services are accurately identified and excluded from the regulated cost base. A water business's price submission and financial model template must identify whether it provides any non-prescribed services, and where relevant, provide or reference information that demonstrates that the costs of any non-prescribed services have been excluded from its expenditure and price calculations related to its prescribed services.

Where a water business identifies costs to deliver both prescribed and non-prescribed services, its price submission must justify the extent that costs are relevant to prescribed services (and should be recovered from customers through regulated prices).[66] A water business must also be able to justify the approach or methodology it has applied to allocate any shared costs between its prescribed and non-prescribed services.

Further, where a business is providing non-prescribed services, its price submission and financial model template should clearly identify where any profit generated via the provision of non-prescribed services has been used to offset its revenue requirement to deliver prescribed services.

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[66] Prescribed services are set out in WIRO, clause 7(b).

Appendix A – Approach for making a price determination

WIRO clause 14

a) In making a price determination the Commission may either:

i. approve the maximum prices the regulated entity may charge for prescribed services, or the manner in which the regulated entity's prices are to be calculated, determined or otherwise regulated, as proposed by the regulated entity in its price submission; or

ii. specify the maximum prices the regulated entity may charge for prescribed services, or the manner in which the regulated entity's prices are to be calculated, determined or otherwise regulated.

b) The Commission may only specify the maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated, if:

i. the price submission of the regulated entity does not, in the Commission's opinion, comply with the guidance provided by the Commission under clause 13 or have adequate regard for the matters specified in clause 11; or

ii. the regulated entity failed to submit a price submission to the Commission within the time period specified for this by the Commission.

Excerpt from Water Industry Regulatory Order 2014.

Appendix B – Matters to include in guidance

WIRO clause 13(a)

Before making a price determination and following consultation, including with the relevant regulated entity, the Commission must provide guidance to the regulated entity setting out:

i. the manner in which the Commission proposes to regulate the prices which the regulated entity may charge for prescribed services for the regulatory period consistent with Section 33(5) of the Essential Services Commission Act and this Order;

ii. the approach and methodology which the Commission proposes to adopt to assess a price submission and make a price determination for the regulatory period consistent with Section 33(2) of the Essential Services Commission Act and this Order;

iii. the Commission's expectations of the nature and scope of matters to be addressed by the regulated entity in its price submission;

iv. the Commission's expectations regarding customer consultation by the regulated entity in developing its price submission;

v. the Commission's expectations of the information required to be provided by the regulated entity to enable the Commission to make a price determination;

vi. the timing and processes the Commission proposes to follow in making a price determination consistent with Section 35 of the Essential Services Commission Act and the Commission's Charter of Consultation and Regulatory Practice;

vii. the date by which the regulated entity is to deliver its price submission to the Commission; and

viii. any other matter that the Commission considers should be included in the guidance provided to the regulated entity or in the regulated entity's price submission.

Excerpt from Water Industry Regulatory Order 2014 with references to the *Essential Services Commission Act 2001* (Vic).

Appendix C – Matters businesses and the commission must have regard to

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
• 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]	• 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]	• 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]

Benchmarking	Health, safety and social obligations	Other
• any relevant interstate and international benchmarks for prices, costs and return on assets in comparable industries [s 33(3)(d), ESC Act]	• 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]	• 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]

Excerpts from Water Industry Regulatory Order 2014, the *Essential Services Commission Act 2001* (Vic), and the *Water Industry Act 1994* (Vic).

Appendix D – Risk management

Types of risk

Water businesses face a range of risks, both within and outside of their control, for example:

- Inflow risk, which presents as an inability for water businesses to meet customer demand due to extended low rainfall and inflows.
- Demand forecasting risk results where actual customer demand during a regulatory period differs materially from the forecasts. It can be mitigated through effective demand forecasting and scenario modelling, variable tariff structures, or the form of price control.
- Operational risks, such as a breach of health, environmental or customer performance standards, can result from inadequate processes within water businesses, asset failures or external factors. Water businesses can manage these risks through managing operating policies, capital investment, maintenance policies, contracts and insurance.
- Construction risks arise from underestimating costs or project delays. Water businesses can manage these risks through effective forecasting and contract management, as well as including reasonable contingency allowances in cost forecasts. Including cost contingencies in water revenue allowances transfers risk of project cost overruns to customers. Businesses should also factor in reasonable timelines for approval processes.
- Regulatory and policy risks result from changes in laws and regulations that materially affect the costs or revenue potential and are typically mitigated via a pass-through mechanism.
- Financial risks are those arising from factors which affect the whole economy, such as rising interest rates or economic downturn. These risks are reflected in the cost of debt which forms part of the regulatory rate of return.
- Business risks result from a loss of revenue due to new technology or a change in the competitive landscape. Water businesses can mitigate some of these risks through innovative business practices and continually seeking cost efficiencies.
- Climate change is likely to present a range of risks and challenges to water businesses and their customers, particularly in an environment where risk has to be managed and resilience built across the supply chain amid increasing uncertainty and change. Impacts from climate change may appear as any of the above risk types. In considering climate change related risks and any associated expenditure proposals, we expect businesses to explicitly state what environmental items they are including and suggest they refer to the guidance provided by the

Queensland Competition Authority, and in particular, Table 1 from page 7 (captured below) which sets out the four key elements of a robust business case for climate-related spending.[67]

Table 1: The four key elements of a robust business case for climate-related spending

Demonstrated need	Any climate-related spending proposal should solve an identified problem. If not required by law, it should fulfil a demonstrated need, whether it be for increasing or sustaining the service potential of the facility, or for mitigating carbon emissions. This need should be demonstrated with reference to a coherent long-term strategy, and should not be ad hoc (see Section 2.1). The need may reflect the impact of externalities, community expectations and government priorities, as well as direct impacts on customers and the infrastructure owner. This might be demonstrated through a quantitative approach or, where that is not possible or reasonable, through a qualitative analysis.
Consultation with customers	The proposal should have regard to customers' views, including their risk preferences. Consultation should include potential customers, where this is possible. What have customers said about their preferred approach to the climate-related spending? Have customers been provided with robust and transparent information? How have their views been taken into account when choosing the proposed approach? This consultation could be demonstrated through customer letters of support or, as is done for some regulated businesses, a customer vote process. The consultation on an individual investment may be less important than consultation on a coherent overall strategy, either for asset management or mitigation (see Section 2.1).
Demonstrated consideration of options	The business should show it has considered a range of alternative ways to address the identified problem. What options have been considered in assessing both the scope and standard of the planned spending? What are the pros and cons of those options? Are the options consistent with any hierarchy of options identified in the long-term strategy? The business case should explain how and why the proposed approach has been selected over the alternatives to address the climate-related risk or achieve the desired level of mitigation. Both the direct costs of the investment and indirect costs of not acting should be considered.
Efficient cost	The efficient cost should reflect value for money, rather than a simplistic choice of lowest upfront cost. Least cost should be considered over the life of an asset for infrastructure investment, and as part of a long-term strategy for operating expenditure, including mitigation. Efficient cost also reflects externalities, in addition to the costs directly incurred by the regulated business and, ultimately, its customers. The upfront cost could be established through an appropriate process, such as a competitive tender.

[67] Queensland Competition Authority 2023, Guideline: Climate change related spending, September. The guideline is available at: https://www.qca.org.au/wp-content/uploads/2023/09/qca-climate-change-guideline-september-2023.pdf

Regulatory risk mitigation tools

The regulatory regime established through the WIRO and developed in detail through previous reviews generally identifies, categorises and allocates risk in accordance with standard principles and seeks to provide efficiency incentives to water businesses. The regulatory framework provides the following tools to mitigate or manage risk:

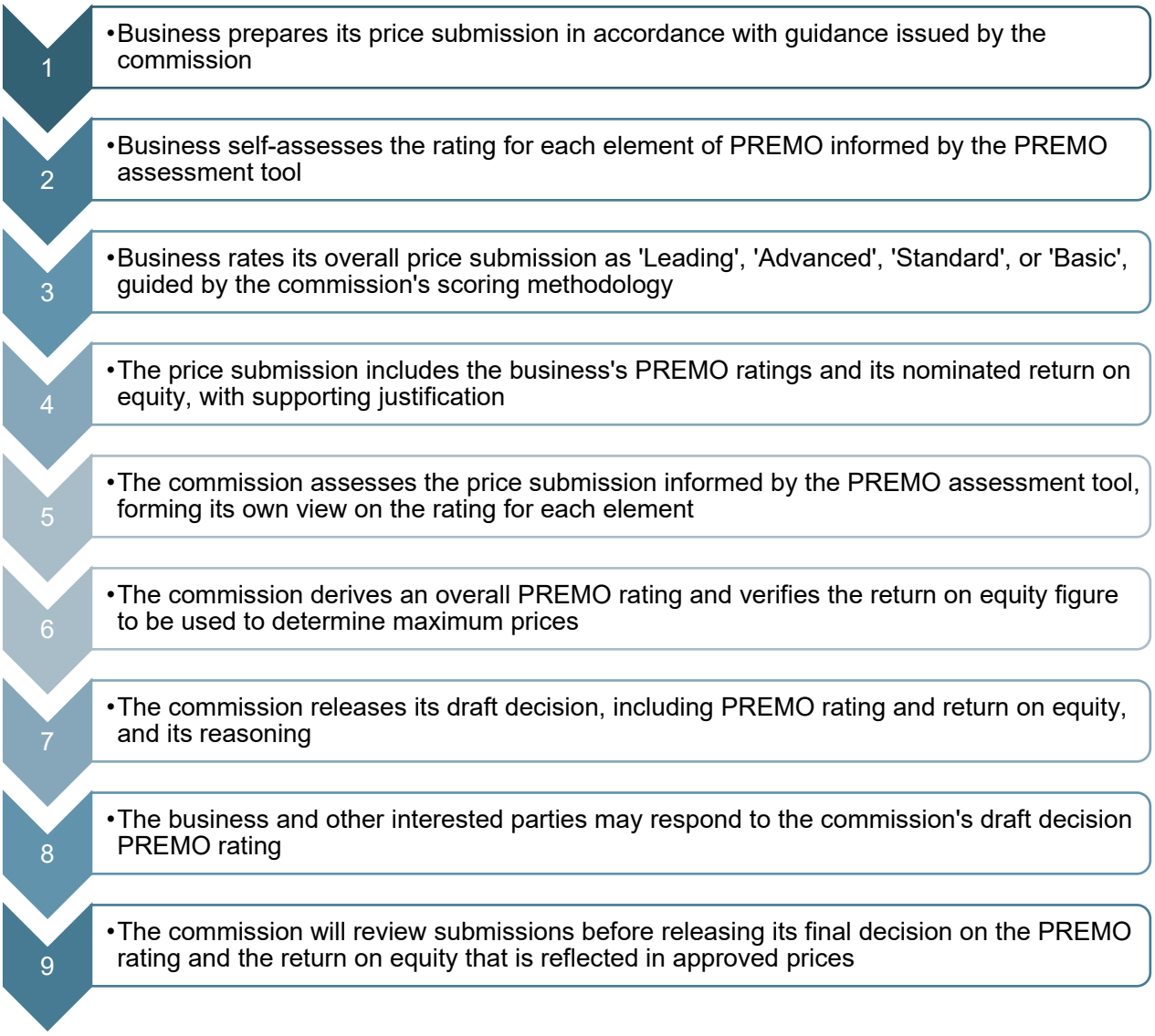
- Recovery of forecast operating and capital expenditure – the forecast expenditure contained within the price submission must be consistent with the risk allocation and incentives provided within the regulatory framework. Therefore, it is important that forecasts are prepared on this basis. Where a water business seeks recovery of costs for managing risks, we expect it to demonstrate the need for this and provide supporting information in its price submission (Sections 3.8 and 3.9).
- Indexation of prices – this ensures that water businesses remain fully responsible for management of controllable costs, and that it does not need to bear the full risk associated with general price inflation.
- Rate of return – this provides compensation for non-diversifiable risk (Section 3.10).
- Form of the price control – this provides a mitigating tool for water businesses. Section 3.18 contains our views on the form of the price control for the next regulatory period. The commission also notes that the form of price control can assist in managing the risk that actual demand varies from forecast demand.
- Tariff structures – Section 3.19 sets out the guiding pricing principles for new tariff structures. The impacts of any shift in the mix of service and variable charges in tariffs on risk sharing between a water business and its customers will need to be addressed in the price submission.
- Length of the regulatory period – a shorter regulatory period can reduce the risk of forecasting uncertainty (see Section 3.2).
- Pass-through mechanisms – significant uncertainties that materially affect water businesses and that occur within the regulatory period are generally treated as pass-through events. These events must be clearly identified in the price determination. The uncertain or unforeseen events mechanism established by the commission for the 2008 and 2009 water price reviews provides another option for managing and mitigating risks, subject to certain criteria (see Section 3.20).

Appendix E – Establishing a PREMO rating

PREMO rating process

The steps for a water business and the commission to establish the PREMO rating for the business's price submission is outlined in Figure A below.

Figure A Process for rating a price submission



PREMO assessment tool

The PREMO assessment tool provides:

- A set of guiding questions for rating price submissions. These will help businesses understand what evidence and justification we expect.
- Examples to demonstrate what might constitute ‘Leading’, ‘Advanced’, ‘Standard’ or ‘Basic’ ambition for the PREMO elements.

The assessment tool **does not** provide an exhaustive list of what may be taken into account by a water business or by us in arriving at a price submission rating. A business may provide further arguments to support its ratings. Further, if a business considers that it does not meet one of the examples in the tool for a given rating, this does not mean it cannot achieve that overall rating, as the business should consider on balance how it meets the guiding questions.

As stated in Section 3.14.1, a price submission must address all the requirements set out in this guidance to achieve a ‘Standard’ rating or higher. The assessment tool is therefore most useful for identifying the requirements to support a higher rating of ‘Advanced’ or ‘Leading’.

The PREMO assessment tool is provided in the following pages for the Performance, Risk, Engagement, Management and Outcomes elements of PREMO.

Performance

The Performance element is a backward look at how a business has performed relative to its own commitments at the last price review. The Performance rating should therefore reflect the final overall PREMO rating awarded to the business for the current regulatory period, recognising that higher overall PREMO ratings reflect more ambitious proposals.

Our assessment tool provides examples in terms of a business's current overall PREMO rating, rather than in absolute terms of Standard, Advanced and Leading ratings as for the other four forward-looking PREMO elements.

The Performance element rating can be considered as follows:

- **Current overall PREMO rating** = Achieved commitments – demonstrated delivery of promised outcomes, account for any material cost variations, and demonstrate customer satisfaction.
- **A higher PREMO rating than current** = Exceeded commitments – demonstrated out-performance whereby customers received significantly higher value than they paid for.
- **A lower PREMO rating than current** = Did not meet commitments – a material shortfall in performance where customers did not receive the value they paid for (or where higher incurred costs will lead to a price rise, and therefore lower value, in the next period).

The Performance element rating may rise or fall by more than one rating level for very large changes in performance and value relative to the business's proposals made at its previous price review, as set out in Table A.

Table A Example rating of the Performance element

Overall PREMO rating from previous price review	Performance rating in price submission for 2028 water price review		
	Exceeded commitments	Achieved commitments	Did not meet commitments
Leading	Leading	Leading	Advanced/Standard/Basic
Advanced	Leading	Advanced	Standard/Basic
Standard	Leading/Advanced	Standard	Basic
Basic	Advanced/Standard	Standard	Basic

Note: Where a business was rated Basic at the previous price review, achieving expectations would produce a Standard rating for the Performance element.

In support of its rating for the Performance element, a business's price submission must show how its performance in the current regulatory period has compared with its forecasts and expectations, and account for significant variations.

Establishing an overall PREMO rating

Having established an appropriate self-rating for each of the five PREMO elements informed by the PREMO assessment tool, a business must then establish its overall PREMO rating for its price submission. A business should give equal consideration to all five elements – Performance, Risk, Engagement, Management and Outcomes.

In undertaking this self-assessment, a business should consider the interplay between the various PREMO framework elements and how each supports the overall rating. For example, a business should question the strength of its 'golden thread' if it self-rates the Engagement element as 'Leading' but all other PREMO elements as 'Standard', with an overall 'Standard' rating.

The price submission should clearly explain how the business has arrived at its self-rating for each element and its overall PREMO rating.

Performance

Guiding questions	Examples reflecting a lower rating than current	Examples reflecting achievement of the current rating	Examples reflecting a higher rating than current
To what extent has the business demonstrated delivery of its customer outcomes commitment over the current regulatory period? **Did its customers get what they paid for?**	**Delivery of customer outcomes**		
	The business has underperformed on its outcomes commitments, falling short of delivering the value its customers expected. The business did not adequately own its underperformance or address shortfalls with its customers.	The business has generally delivered on its outcome commitments, by meeting its performance targets for most output measures across the regulatory period. The business achieved an overall 'met' rating for its Outcomes across the regulatory period. The business clearly took ownership for shortfalls in performance throughout the period and explained to customers what it would do to address each shortfall. The business can show it took suitable actions to improve performance. The business's major capital project program was largely delivered as forecast, with material variations in timing and cost clearly explained to customers through its annual reporting processes.	The business consistently met all its outcome commitments, OR Where it fell a little short on some targets, it clearly outperformed on others to deliver great customer value. The business adjusted its revenue recovery to reflect a shortfall in performance or major project delivery, to ensure customers did not pay for infrastructure, services or value they did not receive. The business reviewed and re-tested its proposed outcome measures and performance targets with customers throughout the period, to ensure they remained relevant and continued to reflect what customers valued. Where appropriate, measures and targets were amended through consultation with customers.

Performance

Guiding questions	Examples reflecting a lower rating than current	Examples reflecting achievement of the current rating	Examples reflecting a higher rating than current
How does actual operating expenditure across the current period compare with the business's established benchmark allowance, and to what extent has the business rationalised any discrepancies?	**Operating expenditure**		
	The business's recurring controllable operating expenditure exceeded the benchmark allowances, and the additional expenditure did not provide material customer value improvements above those expected this regulatory period.	Actual recurring controllable operating expenditure was largely consistent with the benchmark allowances set in the price review. Variations to controllable operating expenditure relative to the benchmark are clearly identified and explained in terms of its impact on customer value.	The business outperformed the controllable operating expenditure benchmarks while meeting its outcome expectations, representing better value for customers going forward.
How does actual capital expenditure across the current period compare with the business's established benchmark allowance, and to what extent has the business rationalised any discrepancies?	**Capital expenditure**		
	The business fell well short of delivering the major capital project programs it committed to at the previous price review. The program was delivered, but well over budget, resulting in a material increase in the RAB roll-in and upward impact on future prices. The business materially underspent its capital expenditure forecast and failed to deliver key projects within the period.	Actual capital expenditure was largely consistent with the benchmark allowances set in its last price review. Significant variations to forecast capital expenditure are clearly identified and explained. This includes uncertain capital expenditure that was excluded from the price benchmarks.	The business delivered its major capital project program (or met its objectives through more efficient means) below the forecast expenditure benchmarks, representing better value for customers going forward through a reduced RAB roll-in.

Performance

Guiding questions	Examples reflecting a lower rating than current	Examples reflecting achievement of the current rating	Examples reflecting a higher rating than current
To what extent does customer sentiment demonstrate satisfaction in the business's performance over the current regulatory period?	**Customer sentiment**		
	The business reports an ongoing downward trend in customer sentiment across the regulatory period.	The business consistently scores on par with the statewide average in the ESC's quarterly customer perception survey. The business demonstrates a noticeable lift in positive customer sentiment across the period. The business's own customer survey work demonstrates it meets expectations or shows a positive trend across the period.	The business consistently scores above the statewide average in the ESC's quarterly customer perception survey. The business demonstrates a significant lift in positive customer sentiment across the period. The business's own customer survey work demonstrates it exceeded expectations or shows a significant positive trend across the period.

Risk

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated a robust process for identifying risk, and how it has decided who should bear these risks? i.e such that customers are not paying more than they need to.	**Guidance requirements and Statement of Obligations**			
	The business has not met the requirements of the commission's Guidance Paper in relation to risk. The business has sought to transfer risk to customers which is not supported by customer views. The business has not sought to minimise cost and/or price impacts from risk management.	The business meets the requirements of the commission's Guidance Paper in relation to risk.	The business has implemented a new approach that reduces price increases through better risk management, or through accepting risk on behalf of customers.	The business has implemented an approach that reduces costs through better risk management, to a level that sets it apart from industry peers. In its price submission, the business proposes correction mechanisms to adjust the return on equity where its performance does not meet the outcomes established at the price review.
	The business cannot demonstrate compliance with risk standards specified in the Statement of Obligations.	The business demonstrates compliance with risk standards specified in the Statement of Obligations (e.g. ISO 31000).	The business has been accredited for compliance with risk standards specified in the Statement of Obligations.	

Risk

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated a robust process for identifying risk, and how it has decided who should bear these risks? i.e such that customers are not paying more than they need to.	**Capital expenditure forecasts**			
	Projects are proposed that have incomplete scope, no business cases, or are not feasible in terms of timelines for delivery.	The business can demonstrate that it has thoroughly evaluated the feasibility of commencement and completion dates for major projects. Business cases are available for all major projects. The overall scale of the capital investment program is deliverable.	The business can demonstrate a robust optimisation process that has informed what projects need to be completed, and the timing of those projects. For example, real options analysis has informed planning and ability to adapt to changing circumstances (e.g. variations in demand from forecast) and is evident in proposals. The business has structured itself to deliver any large uplift in capital investment.	

Risk

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated a robust process for identifying risk, and how it has decided who should bear these risks? i.e such that customers are not paying more than they need to.	**Capital expenditure forecasts**			
	The business cannot demonstrate that its aggregate capital expenditure forecasts are consistent with a P50 estimate (noting this is likely not to be appropriate where a business's capital program is dominated by one or two projects).	The business has undertaken a Monte Carlo analysis for all major projects. The business can demonstrate that its aggregate capital expenditure forecasts are consistent with a P50 estimate (noting this is likely to be inappropriate where a program is dominated by one or two projects). The estimate must be based on the latest credible information on costs. The business uses regulatory tools such as the pass through and uncertain or unforeseen events mechanisms where appropriate for projects (or operating activities) with uncertain timing or costs. The business has evaluated whether major projects should be funded via capital or operating expenditure for pricing purposes.		

Risk

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated a robust process for identifying risk, and how it has decided who should bear these risks? i.e such that customers are not paying more than they need to.	The business adopts assumptions that seek to maximise unit rates proposed.	The unit rates used to evaluate projects and options reflect recent historical trends, and/or independently verified market forecasts.		
	Form of price control and tariffs			
	The form of price control and/or tariffs over-allocates risk to customers (e.g. higher fixed tariffs versus variable may reflect a business putting more volume risk on its customers).	Through the form of price control and tariffs proposed, the submission appropriately balances revenue and cost risk between the business and its customers, without materially impacting on price stability (e.g. higher variable tariffs versus fixed may reflect a business taking on greater volume risk on behalf of customers).		
	Financial viability			
	The business cannot support its assessment of financial viability by reference to cash flow projections and independent benchmarks (e.g. credit rating metrics}	The business can support its assessment of financial viability by reference to cash flow projections and independent benchmarks (e.g. credit rating metrics).	The business has had its financial position reviewed by an independent credit ratings agency.	

Risk

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent does the proposed guaranteed service level (GSL) scheme provide incentives for the business to be accountable for the quality of services delivered, and provide incentives to deliver valued services efficiently?	**Guaranteed service levels**			
	The business has not proposed a GSL scheme that reflects the main service concerns and priorities of customers.	The business has proposed a GSL scheme that reflects the main service concerns and priorities of customers	The business has refined its GSL scheme to provide greater service accountability to customers, or to provide increased incentives to deliver services efficiently. The business has proposed a GSL scheme that compares favourably to industry peers in terms of incentives to deliver services efficiently.	

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the water business engaged on matters that are most influential on services and prices?	**Engagement that is material to services and prices**			
	Engagement was on limited issues, or issues that were peripheral to, or not consequential on the outcomes, services or prices.	The business's engagement effort and resources were proportionate to the materiality of the engagement outcomes on services and prices.	The business demonstrated strong awareness of all areas material to service and price outcomes; it engaged with customers on key areas, and achieved strong engagement outcomes in these areas.	The water business was thorough in identifying all areas relating to service and price outcomes, and was consistent in its engagement effort in each of these areas.
Did the business access engagement insights early at a time it could influence its planning?	**Engagement timelines**			
	Engagement commenced after key aspects of the engagement approach were already in place.	Insights from past engagement and wider engagement activities were used in the design and delivery of current engagement processes. The business tested its engagement approach with its customers and community.	Price submission engagement is informed by past engagement outcomes, and aligns with other processes the business is already engaging on. Early engagement set the strategic priorities for the business's wider engagement program. The business sought participant feedback on its engagement approach at regular points throughout its price review engagement.	Price submission engagement is informed by past engagement outcomes, and is integrated with other processes the business is already engaging on. Community values and priorities set the strategic priorities for the business's wider engagement program. The business regularly checked in with an advisory body on its engagement approach. For example a consultative committee.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the engagement program been tailored to suit the complexity and materiality of the issues the business is engaging on?	**Suitability of engagement methods**			
	The business's engagement approach is not well justified and engagement methods are poorly suited to the content and circumstances facing the business and its customers.	The business used a range of engagement methods that it could justify as appropriate for the customer circumstances and the complexity of issues, including any trade-offs and long-term issues.	The engagement program includes a range of ways for customers and community to participate. It includes methods well suited to the circumstances facing customers and other key stakeholders. Engagement methods allow for understanding and exploration of the complex issues, including where there are trade-offs or long-term consequences. Water business engagement included appropriate communication methods for presenting a whole-of-submission story (including unavoidable price increases).	The engagement program includes a range of ways for customers and community to participate. It includes methods tailored to the circumstances facing customers and the wider community. Engagement methods allow for exploration and deliberation of the complex issues raised, including where there are trade-offs and long-term consequences. Water business engagement effectively communicated its whole-of-submission story (including unavoidable price increases).
To what extent has the business demonstrated that all relevant parties had an opportunity to participate?	**Representative engagement**			
	Key interested parties were not engaged with.	Engagement processes were accessible to customers and wider interested parties.	The business identified and engaged with a variety of customer groups and wider interested parties. Key stakeholders assessed the engagement as effective.	The business proactively identified and engaged with a wide variety of customer groups and wider and interested parties. The business engagement with various interest groups was of a consistent high quality.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent was the business's engagement accessible and inclusive to customers and community who hold an interest in, or who will bear the costs of, proposals in the pricing submission?	**Accessible and inclusive engagement**			
	Barriers to participation were not identified or addressed.	The business took steps to identify and overcome individual and systemic barriers to inclusion within its engagement program. It was able to explain and justify its approach. The engagement was inclusive of wider community interests and priorities where these were relevant to the delivery of the water business functions. The business engagement was representative of people who are experiencing vulnerability, or whose vulnerability might be exacerbated as a result of the outcomes of the price submission.	The business was effective in understanding and overcoming barriers to inclusion. Its approach was endorsed as effective by key engagement participants. The engagement was able to surface the circumstances and perspectives of customers experiencing vulnerability and disadvantage. The engagement was inclusive of the perspectives of young and future customers where decisions have long-lived consequences. Organisations representing areas of community interest had meaningful opportunities to participate and at a time they could respond to how engagement outcomes were informing proposals. The business was able to explain and build understanding within its customer base on the circumstances and proposals that are influential on its various customer groups.	The business was proactive in overcoming barriers to inclusion, and engagement participants were consistent in their support or endorsement of the approach. The engagement was proactive in seeking out the perspectives of young and future customers where decisions have long-lived consequences. Organisations representing areas of community interest were involved early in the development of the engagement program, had meaningful opportunities to participate and time to respond to how engagement outcomes were informing proposals. The business was successful in building empathy with its engaged customers and community of the circumstances and perspectives of customers experiencing vulnerability and disadvantage. The business was able to explain and build acceptance within its customer base on the circumstances and proposals affecting its various customer groups.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
How accurate was the information used in the business's engagement materials, and how transparent was the business in the way it communicated its engagement outcomes?	**Accurate and transparent information**			
	The business either did not test the accuracy and appropriateness of the instruction and information or did but did not act on the feedback before engaging with participants. Engagement participants were not well supported on technical matters, or had insufficient time to fully consider the issues. The engagement outcome was predictable due to the framing of questions or engagement design.	In focused topics, the business tested and verified the accuracy and appropriateness of the instruction and information to engagement participants. The business engagement with participants on technical matters was supported with appropriate time to fully consider options available to them. Engagement methods and information provided to participants avoided known and avoidable biases. The business has been transparent on the information it provided engagement participants, and on its engagement outcomes. The business was transparent in how it communicated its engagement outcomes to the wider community.	The business tested and verified the accuracy and appropriateness of the instruction and information to engagement participants. For example, using expert advice or expert panels. The business has been transparent on key aspects of its engagement design and engagement materials. The business engagement with participants on technical matters was well supported, with time to deliberate on suitable options. Engagement methods and information provided to participants were well balanced and actively addressed known and avoidable biases. The business was able to build understanding of the engagement outcomes with its wider community.	The business fully challenged and verified the accuracy and appropriateness of its instruction and information to engagement participants. For example, by using customer or technical challenge panels. Engagement materials were endorsed as well balanced and appropriate for the engagement method and the level of influence. The business has been fully transparent with information about its engagement design and engagement materials. The water business engagement material on technical or contested matters was well balanced, and participants were well supported with time to deliberate on the issues and trade-offs presented. Participants were educated and empowered to avoid biases as part of the engagement program. The business was able to explain and build acceptance of the engagement outcomes with its wider community.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
How influential was engagement on the pricing submission? **To what extent has the business demonstrated how its engagement with customers has influenced its submission?**	**Influence of engagement**			
	Engagement outcomes were not influential and the reasons for this were not well justified or were absent from the pricing submission.	Engagement outcomes were influential on price submission proposals and relevant to service and price outcomes, including the business's new customer contributions proposal. The pricing submission explained clearly how insights were incorporated into the business's proposal. Areas where the business did not engage, or where engagement findings were not adopted, were clearly set out and communicated to customers.	Engagement outcomes were adopted in full in key areas that were influential on services and prices. The pricing submission explained clearly how engagement insights were incorporated into the business's proposal. Areas where engagement findings were not adopted were well justified and explained to affected customers.	Engagement outcomes that were influential on services and prices were adopted consistently and in full. The pricing submission set out clearly where engagement insights were incorporated into the business's proposal.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business identified and considered where any material inequities can reasonably and efficiently be addressed or mitigated?	**Getting to Fair: Engagement on equitable outcomes for customers**			
	The business has not demonstrated it has investigated material differences in customer outcomes across customer groups or geographic areas.	The business can demonstrate that it has investigated material differences in customer outcomes and considered whether they are reasonable, having regard to customer needs, costs and relevant constraints.	The business can demonstrate that it has identified material disparities in outcomes and has incorporated proportionate and cost-effective actions into its plans to address them. Where material differences remain, the business can explain why and how they will be managed or mitigated.	The business uses disaggregated evidence and engagement with affected customers and communities to systematically identify and respond to material differences in outcomes. It has tested efficient options to reduce inequitable outcomes, including targeted, staged or collaborative approaches, and has a credible longer-term pathway for addressing significant disparities that cannot reasonably or efficiently be resolved within the regulatory period.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated effective engagement with First Nations customers?	**Engagement with First Nations customers**			
	The business did not provide appropriate mechanisms for First Nations engagement in its engagement program. The needs and values of First Nations customers and organisations were not identified, or did not meaningfully inform the price submission.	The business took steps to identify barriers to First Nations inclusion within its engagement program. The business provided inclusive and culturally safe engagement mechanisms for First Nations customers and organisations. The business demonstrates how the needs and values of First Nations customers were identified through engagement and how they informed the price submission.	The business demonstrated an understanding of the diversity of First Nations stakeholders to be engaged on customer issues. The business provided culturally safe engagement mechanisms for First Nations customers and organisations, and was effective in understanding and overcoming barriers in First Nations participation in its engagement program. The business demonstrates how the needs and values of First Nations customers were identified through engagement and incorporated into the price submission.	The business demonstrates a nuanced understanding of the diversity of First Nations stakeholders to be engaged on customer issues. The business provided culturally safe engagement mechanisms for First Nations customers and organisations, and was proactive in understanding and overcoming barriers to First Nations participation in its engagement program. The business demonstrates a nuanced understanding of the needs and values of First Nations customers, and incorporated these into its price submission.

Engagement

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated effective engagement with Traditional Owner groups?	**Engagement with Traditional Owner groups**			
	The business did not make best efforts to build relationships with Traditional Owner groups or identify barriers to Traditional Owner group participation in its engagement program. The business did not include self-determined outcomes in its price submission, and could not reasonably justify why.	The business provided inclusive and culturally safe engagement mechanisms for Traditional Owner groups. The business made best efforts to build relationships with all relevant Traditional Owner groups and to identify and overcome barriers to Traditional Owner group participation in its engagement program. The business took steps to understand Traditional Owner rights, interests, priorities and aspirations early in the engagement process, and worked with Traditional Owner groups to agree appropriate self-determined outcomes for inclusion in the price submission, or has reasonably justified why this was not possible.	The business was able to demonstrate inclusive and culturally safe engagement with Traditional Owner groups. The business is building enduring relationships with Traditional Owner groups outside of the price submission process, and has identified and overcome barriers to Traditional Owner group relationship-building and participation in its engagement program. The business demonstrates an understanding of Traditional Owner rights, interests, priorities and aspirations as they relate to water management. The business has provided meaningful opportunities for self-determined Traditional Owner outcomes to be identified early and tested through the engagement process and incorporated into its price submission.	The business demonstrates strong and supported relationships with Traditional Owner groups (for example, through partnership arrangements). The business has established enduring relationships beyond the price submission process (for example, incorporation in longer-term plans and strategies). The business demonstrates a deep understanding of Traditional Owner rights, interests, priorities and aspirations as they relate to water management. The business provided meaningful opportunities for self-determined Traditional Owner outcomes to be identified early and tested through the engagement process and incorporated into a price submission. The business considered the risks and impacts of its broader investment and activities on Traditional Owner rights and interests, and has sought to mitigate or address them, where possible.

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated how its proposed prices reflect only prudent and efficient expenditure?	**Prudent and efficient expenditure**			
		Water business expenditure is consistent with that which would be incurred by a prudent service provider acting efficiently to achieve the lowest cost of delivering on service outcomes, taking into account a long-term planning horizon.	The business has proposed a significant improvement in the cost efficiency of the services delivered.	The business has proposed a very significant improvement in the cost efficiency of the services delivered.
	Proposals relating to major expenditure changes, projects or reforms are not adequately supported by multiple and independent measures to support justification.	Multiple and independent measures are used to support justification for the prudency and efficiency of major expenditure changes, projects or reforms.		

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated how its proposed prices reflect only prudent and efficient expenditure?	**Prudent and efficient expenditure**			
	The business has not provided timely access to robust business cases that validate the basis for all major projects and capital programs. The business has not proposed efficiency improvements in relation to its capital renewals program.	The business can provide business cases and justification for all major projects and capital programs, including evidence that a range of options have been considered.	The business has proposed a significant improvement in the efficiency of its capital program or new ways of delivering the program. Independent assessment of deliverability of capital program.	The business has proposed a very significant improvement in the efficiency of its capital program. The rate of improvement in capital expenditure efficiency places the business as a leader in the industry.
		The price submission/expenditure forecasts include delivery of government policy commitments (reflected at efficient cost).		
	Forecasts for expenditure (including benchmarks for labour, energy and construction costs) and demand are not based on sound methodologies and assumptions.	Forecasts for expenditure (including benchmarks for labour, energy and construction costs) and demand are based on sound methodologies and assumptions.		

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated how its proposed prices reflect only prudent and efficient expenditure?	**Prudent and efficient expenditure**			
	The business has not provided evidence that it has actively sought to reprioritise its expenditure plans to mitigate the cost and price impacts of any new obligations (whether imposed by government or technical regulator, or to address a new service priority revealed through engagement).	The business can demonstrate that it has actively sought to reprioritise its expenditure plans to mitigate the cost and price impacts of any new obligations (whether imposed by government or technical regulator, or to address a new service priority revealed through engagement).		
	The business has not proposed adequate mitigation strategies to avoid any price shocks.	The business has proposed adequate mitigation strategies to avoid any price shocks.		

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated sound long-term planning beyond the regulatory period?	**Long-term planning horizon**			
	Proposed capital expenditure is not consistent with or supported by robust long-term plans and strategies.	Proposed capital expenditure is consistent with and supported by the business's long-term plans and strategies.	The business can demonstrate a long-term planning horizon for its capital and renewals investment, reflecting clear prioritisation of projects informed by asset condition, risk and performance data.	The business has demonstrated and reflected consideration for life cycle costing within its long-term planning and decision processes.
	The financial model template does not adequately identify forecast operating and capital costs beyond the regulatory period.	The financial model sets out costs beyond the regulatory period in accordance with the guidance paper.	The financial model forecast for future periods is informed by a robust understanding of future capital needs, long term strategic planning, and asset management systems.	
			Clear links between price submission, asset master planning, and corporate plans.	

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business demonstrated sound asset management?	**Asset management**			
	The business cannot demonstrate compliance with asset management standards specified in the Statement of Obligations. Gaps in asset register, performance or condition data, poor links between asset management systems and capital and renewals programs.	The business demonstrates compliance with asset management standards specified in the Statement of Obligations (e.g. ISO 55000). This might be shown through findings of the 2026 asset management audit.	The business has been accredited for compliance with asset management standards specified in the Statement of Obligations. Asset management audit finds strong links between asset management system and the development of capital and renewal programs. Demonstrated strong performance on independent benchmarking of asset management systems (such as WSAA Aquamark).	The business demonstrates that its asset management approach is informing long-term investment decisions that deliver better value for customers, including by optimising maintenance and renewal, managing asset risk and avoiding or deferring unnecessary expenditure.

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business justified its commitment to cost efficiency or productivity improvements?	**Efficiency improvement**			
	Forecast controllable operating expenditure incorporates a rate of efficiency improvement that is below 1.0 per cent.	Forecast controllable operating expenditure incorporates a rate of efficiency improvement of at least 1.0 per cent per year.	Forecast controllable operating expenditure incorporates a rate of efficiency improvement that is ambitious but achievable. This should reflect the business's current position and recent efficiencies achieved. Alternatively, evidence is provided that demonstrates the business is at or near to the efficiency frontier for the sector. The operating expenditure forecast places the business well ahead of the industry average in terms of cost efficiency.	Forecast controllable operating expenditure incorporates a rate of efficiency improvement that is significantly above the requirements identified for an Advanced rating. Alternatively, evidence is provided that demonstrates the business is a leader in relation to operating at the efficiency frontier for the sector. The operating expenditure forecast places the business as a leader in the industry in terms of cost efficiency.
	Business has not demonstrated that it has considered cross-sector opportunities to reduce costs or improve services.	Business can demonstrate it has investigated opportunities for cross-sector collaboration with the aim of reducing costs or improving service standards.	Business can show opportunities for collaborating across the sector have been incorporated into the submission.	Business can demonstrate material customer benefits from collaboration, with collaboration embedded in ongoing planning and delivery.

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
Are new customer contributions developed in accordance with the guidance paper?	**New customer contributions**			
	New customer contributions are not developed in accordance with the framework and guidance paper. Engagement did not meet requirements set out in the guidance.	New customer contributions developed through proportionate and effective engagement with development community and existing customers. New customer contributions are set out, justified and consistently applied (including cost and benefit attribution policies). The business's Connection Policy includes average timeframes to negotiate connections. Development Servicing Plans and the business's negotiation framework have been provided.	The business's negotiation framework, Connection Policy and Developer Servicing Plans are well developed and clearly presented. The business can demonstrate governance arrangements for cost and benefit attribution policies. Board endorsement where forecast NCC revenues represent material forecast growth capex. The business sets clear performance targets including connection timeframes (informed by engagement) and report performance against these targets.	

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business provided evidence that there is senior level, including Board level, ownership and commitment to its submission and its outcomes?	**Board assurance**			
	The Board of Directors has not attested that it has undertaken appropriate internal procedures to assure themselves of the quality and accuracy of their price submission. The attestation included in the commission's guidance is not included with the price submission.	The Board of Directors has attested that it has undertaken appropriate internal procedures to assure themselves of the quality and accuracy of their price submission. The attestation included in the commission's guidance is provided with the price submission.		
To what extent has the business demonstrated its price submission is an 'open book'?	**Information and transparency**			
	The business is not transparent in providing information to the commission on stakeholder views, or any other information or assessments that may be relevant to the assessment of key initiatives or proposals.	The business is transparent in providing information to the commission on stakeholder views or other information or assessments that may be relevant to the assessment of key initiatives or proposals.		
	The business has not provided timely access to meaningful and robust supporting documentation, on request from the commission.	The business retains meaningful and robust supporting documentation to justify its proposals, with ongoing access available to the commission.		

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business justified or provided assurance about the quality of the submission, including the quality of supporting information on forecast costs or projects?	**General requirements**			
	The price submission does not address all requirements set out in the commission's Guidance Paper	The price submission addresses all requirements specified in the commission's Guidance Paper.		
	The financial model template is incomplete and/or inconsistent with the price submission or with regulatory accounting statements prepared during the current regulatory period.	The financial model template provided to the commission is completed with no material error and requires minimal adjustment by the commission. The financial model template is consistent with the written price submission and with regulatory accounting statements prepared during the current regulatory period.		
	The price submission and supporting information are provided to the commission after the time requested.	The price submission and supporting information are provided to the commission by the time requested.		

Management

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
To what extent has the business justified or provided assurance about the quality of the submission, including the quality of supporting information on forecast costs or projects?	**General requirements (continued)**			
	The price submission is contradictory across main elements of the submission (e.g. there is inconsistency between the business's demand forecasts and capital works program for example).	The price submission is internally consistent, demonstrating alignment between different elements of the price submission (e.g. there is consistency between the outcomes proposed, and demand and expenditure forecasts).		
		Forecast depreciation adopts a straight-line calculation approach. Alternative approaches are clearly justified.		

Outcomes

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
	Overall customer value			
	The business has proposed degradation in customer outcomes, not justified or supported by customer feedback. This represents a reduction in customer value.	The outcomes proposed are broadly consistent with existing levels of service provided to customers. This might be reflected by output targets maintaining current performance. The proposed output measures reflect core business-as-usual expectations as well as specific commitments arising through the engagement processes.	The outcomes proposed reflect a significant improvement in customer value delivered. This might be demonstrated by improvements in output targets (or performance measures) for outcomes that matter most to most customers, or similar targets at lower prices. The business proposes outcomes that are ahead of the industry average or the business's own past performance (measured by reference to output targets).	The outcomes proposed reflect a very significant improvement in customer value delivered. The business proposes outcomes that lead the industry.

Outcomes

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
Has the business provided evidence that the outcomes proposed have taken into account the views, concerns and priorities of customers? **Has the business proposed outputs to support each of its outcomes, which are measurable, robust and deliverable?** **Has the business provided evidence that the outputs it has proposed are reasonable measures of performance against stated outcomes?**	**Outcomes and measures**			
	Outcomes are not defined in ways that reflect customer and community value.	All outcomes proposed have been defined in ways that reflect customer and community value. This should reflect broader customer interests including water supply security, climate adaptation and other environmental considerations.	The proposed outcomes and measures recognise and reflect diversity in the business's customer base. Proposed outcomes reflect customer and community interests in environmental outcomes, and demonstrate a long-term focus.	
	The business has proposed outputs that are not appropriate measures of performance for each outcome proposed. Measures and deliverables are not clearly defined.	The business has proposed outputs that are appropriate measures of performance for each outcome proposed. Measures and deliverables are clearly defined and unambiguous.		
	The outcomes proposed do not clearly reflect customer preferences and priorities revealed through engagement.	The outcomes proposed have been prioritised by the business in terms of importance to customers as revealed through customer engagement. The business's expenditure forecasts reflect the prioritisation of outcomes.		

Outcomes

Guiding questions	Examples for a Basic submission	Examples for a Standard submission	Examples for an Advanced submission	Examples for a Leading submission
	Outcomes and measures (continued)			
	Where applicable, the business has not explained or justified why outcomes proposed are not consistent with customer preferences and priorities.	Where applicable, the business has explained or justified why outcomes proposed are not consistent with customer preferences and priorities.		
Has the business provided sufficient explanation of how the outcomes it has proposed align to the forecast expenditure requested?	**Expenditure**			
	The level and composition of forecast expenditure is inconsistent with the outcomes proposed.	The level and composition of forecast expenditure is consistent with the outcomes proposed.		
	The expenditure profile has not changed to reflect customer priorities.	The expenditure profile has changed where required to reflect customer priorities.		
Has the business demonstrated a process to measure performance against each outcome and to inform customers?	**Outcome performance reporting**			
	The business has not committed to a process for monitoring and reporting to customers on its performance against outcomes.	The business has an established customer performance reporting approach that is targeted to customer needs, including across different regions and customer types.	The performance reporting approach is justified as being well ahead of peers in terms of accessibility, transparency, and information provided to customers on performance.	

An approach to establishing a PREMO rating

As noted above, a business should give equal consideration to all five elements – Performance, Risk, Engagement, Management and Outcomes – when establishing an overall PREMO price submission rating. Table B steps out a scoring methodology businesses could use to help self-rate their price submission against the five elements of PREMO and to rate their overall price submission. It is not mandatory that a business use this scoring methodology to rate its price submission.[68]

Table B summarises possible scores for each element of PREMO. The scores for each element are summed, and the aggregated score ranges shown effectively allow only one element to be rated lower than the overall PREMO rating, unless countered by higher ratings. The exception is 'Leading' which would allow two elements to be rated 'Advanced' or one element 'Standard'.

For example, an overall 'Advanced' rating would require at least 4 elements at 'Advanced' (4x3) and one 'Standard' (1x2) for an aggregate score of 14. If 2 elements are 'Standard' (2x2), would need 2 at 'Advanced' (2x3) and one at 'Leading' (1x4) for an aggregate score of 14.

Table B An approach to scoring for an overall PREMO rating

Rating	Possible scores for each element of PREMO	Aggregated score of 5 elements for an overall PREMO rating
Leading	4	18 to 20
Advanced	3	14 to 17
Standard	2	9 to 13
Basic	1	5 to 8

To reiterate, the scoring methodology outlined here is only a guide. We will assess each business's reasoning for its overall price submission PREMO rating. In other words, the score as shown above on its own is not justification for a particular price submission rating. Similarly, a business ultimately has the discretion to select any PREMO price submission rating, even if it may not correspond with an aggregated score.

[68] We do not allocate a score against all the matters listed in the PREMO assessment tool when we assess a water business's price submission, or rely on this scoring methodology to confirm the overall PRMEO rating.

Appendix F – Efficiency benefit sharing scheme

This Appendix provides more information on the proposed operation of the efficiency benefit sharing scheme (EBSS) set out in Section 2.7 which will apply to operating expenditure (opex) incurred in the regulatory period beginning on 1 July 2028. It also addresses comments and queries regarding the EBSS which were raised in response to the draft guidance.

The rationale for the introduction of an EBSS is set out in Section 2.7. In summary, in recent years we have been concerned that despite the incentives embedded under the PREMO approach, and even after adjusting for once-off and non-recurring costs, controllable operating expenditure has been materially above benchmarks for around half the sector. We therefore propose to introduce an incentive scheme focused on actual controllable operating expenditure.

The EBSS will be similar to the EBSS applied by the Australian Energy Regulator (AER). An EBSS is also part of IPART's water regulatory framework, although it operates slightly differently (and in a more complex manner) compared to the AER scheme.

Our EBSS will:

- only apply to controllable operating expenditure
- provide for the 'carve out' of changes in costs due to exogenous factors outside of water businesses' control
- be limited in impact to a maximum of 1 per cent of a business's revenue requirement. Businesses close to or matching their controllable operating expenditure benchmarks (after applying the above considerations) will not be subject to any revenue adjustments.

How an efficiency benefit sharing scheme operates

In essence, the EBSS provides businesses with a short-term reward, in the form of additional revenue in the subsequent regulatory period, where actual costs have been below benchmarks. Where costs are above benchmarks, businesses receive less revenue in the subsequent period.

While the mechanism initially might sound counter-intuitive – in that high-performing businesses can charge customers more – it is clearly in the interests of customers. It is only where sustained cost reductions are achieved – thus benefitting customers – that businesses will receive higher revenue. This additional revenue is less than would be raised had the business not made efficiency savings. The long-term benefits to customers as a result of lower opex feeding through to lower bills will considerably outweigh the shorter-term impacts.

A simple example illustrating how the EBSS works is provided below. An EBSS is in place for the 5-year regulatory period 2028–2033 (RP1). Benchmark controllable operating expenditure (B) set for RP1 in 2028 (inflated to $2033) is in cells E5 to I5.

	D	E	F	G	H	I	J	K	L	M	N
		Regulatory period 1 (RP1)					Regulatory period 2 (RP2)				
4	Year	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36	2036-37	2037-38
5	Benchmark opex (B) $m	100	102	103	104	106	101	102	103	104	105
6	(Adjusted) Actual (A) $m	98	98	99	101	103					
7	Cumulative saving (B-A) $m	2	4	4	3	3					
8	Efficiency gain (E) $m	2	2	0	-1	0					
9	Carry-over of gains made in										
10	2028-29		2	2	2	2	2				
11	2029-30			2	2	2	2	2			
12	2030-31				0	0	0	0	0		
13	2031-32					-1	-1	-1	-1	-1	
14	2032-33						0	0	0	0	0
15	2033-34							0	0	0	0
16	2034-35								0	0	0
17	2035-36									0	0
18	2036-37										0
19	2037-38										
20	Carry over (C)						3	1	-1	-1	0
21	Benchmark opex + Carry-over (B+C)						104	103	102	103	105

Adjusted actual controllable operating expenditure (A) for the first four years of RP1 is shown in cells E6 to H6. Operating expenditure in year five of RP1 is not yet known and is assumed here to be the difference between benchmark and actual controllable operating expenditure in year four (minus $3 million) plus the benchmark controllable operating expenditure in year five.

Calculating gains and losses

For year 1 of the RP1 regulatory period, the incremental efficiency gain (loss) is the difference between benchmark and the adjusted actual controllable operating expenditure (100 - 98 = 2). In the last four years of RP1, the incremental efficiency gain (loss) is the change in actual controllable operating expenditure from the previous year, relative to the benchmark change in controllable operating expenditure.

For year two, the actual change in operating expenditure is 0 (98 - 98), the change in benchmark operating expenditure is plus 2 (102 - 100) and the incremental efficiency gain is plus 2. For year three, the change in actual operating expenditure is 1 (99 - 98), the benchmark change is 1 (103 - 102), and the incremental efficiency gain is 0. In year four, the change in actual operating expenditure is plus 2, the benchmark change is plus 1 and there is an efficiency loss of minus 1.

In formulaic terms, the incremental efficiency gain (E) for any year (y) is:

$$E = (B_y - A_y) - (B_{y-1} - A_{y-1})$$

The incremental efficiency gains are retained by the business for five years beyond the year in which they were achieved, including within RP1. The efficiency gain in 2028–29 is carried forward for five years from 2029–30 to 2033–34 (row 10). Similarly, the efficiency gain in year two is carried forward to 2034–35 (row 11).

Carryover amounts

The efficiency gain amounts as they flow into RP2 are summed, and added to the total revenue requirement in a separate 'building block'. For 2033–34, an efficiency carryover building block of plus 3 is added to the other revenue requirement building blocks. An efficiency carryover building block of +1 is added in 2034–35.

When the carryover amounts into RP3 from RP2 are calculated, an adjustment is made to reflect the difference between assumed and actual operating expenditure in the final year of RP1.

Limits on rewards and penalties

In the absence of caps and thresholds on rewards and penalties, businesses have a strong incentive to make efficiency gains and avoid penalties. However we consider some limits on the application of the EBSS, particularly during its initial application, are warranted. Therefore, businesses close to or matching their controllable operating expenditure benchmarks will not be subject to a revenue adjustment.

- any rewards will only apply in the subsequent regulatory period where actual aggregate controllable operating expenditure (after adjustments for one-offs) over the first four years of the regulatory period is more than 2 per cent below the approved benchmarks.
- any penalties will only apply in the subsequent regulatory period where actual aggregate controllable operating expenditure (after adjustments for one-offs) over the first four years of the regulatory period is more than 5 per cent above the approved benchmarks.
- total rewards or penalties in the subsequent regulatory period will be capped at 1 per cent of the business's revenue requirement.

The thresholds within which the EBSS will not apply (i.e. where expenditure is within -2 per cent to plus 5 per cent of the benchmark after four years) have been developed with regard to actual outcomes compared to benchmarks in recent years, and recognise that:

- there will naturally be year-to-year fluctuations in expenditure and compared to benchmarks. Forecasting opex is not an exact science. Small deviations from benchmarks over a multi-year period should not be rewarded or penalised, and the incentive mechanism only applies to changes in opex that are sustained year on year.
- however, businesses should be incentivised not to spend at a materially higher level than forecast. We believe that 5 per cent provides an appropriate 'safety net' that caters for

unexpected costs (in terms of both unanticipated items as well as cost increases above inflation for anticipated items), changes in demand (customer numbers and volumes) and forecasting errors, but that beyond this threshold it is reasonable that penalties kick in
- at the same time, where businesses can achieve and sustain greater efficiencies than reflected in their opex benchmarks, they should benefit from doing so. Recognising that it is not easy to achieve efficiencies, the threshold for rewards of 2 per cent is lower than the 5 per cent for penalties.

The cap for rewards and penalties of 1 per cent of the business's forthcoming regulated revenue requirement also reflects a balance between providing a material incentive, but at the same time not endangering business viability or creating price shocks for customers. It is also broadly consistent with the size of the PREMO rating incentive. It provides for a relatively 'soft' introduction of the EBSS.

In the majority of cases where rewards and penalties are applied (i.e. where expenditure is greater than 5 per cent above or greater than 2 per cent below benchmarks) then the 1 per cent of revenue cap will kick in to limit the reward or penalties. This is because, for many businesses, controllable opex is more than 50 per cent of revenue. An exception is where non-controllable opex is a significant portion of revenue – which is notably the case for the Melbourne retailers.

Ultimately, we believe these caps and thresholds will provide an appropriate balance between the need to increase incentives to manage operating expenditure, but at the same time avoid the risks associated with uncapped rewards and penalties.

Carve-outs and one-off expenses

In order to ensure the EBSS is fair and does not expose businesses to undue risk, it will only apply to costs that businesses can effectively control. The following non-controllable costs (as defined in the price review submission templates) will therefore be excluded from calculations:

- external bulk water charges
- external temporary water purchases
- licence fees
- the environmental contribution.

Other material, one-off expenditure will also be excluded from the EBSS calculation. These will typically be expenses associated with exogenous events that a prudent business could not reasonably prevent from occurring or substantially mitigate its cost impact, and could not insure (or self-insure) against on reasonable commercial terms. It is not possible to provide an exhaustive list of such expenses, but they may include additional unforeseen costs associated with:

- changes to statutory or licence obligations

- natural disasters and extreme events, such as severe drought, fire or flood and terrorism. This would include short term responses for unforeseen water treatment, pumping, carting or public communications expenditure as well as long-term responses such as spending on demand management, leak detection and water efficiency – to the extent that they are the most efficient response to such disasters/events.
- controllable costs identified by the business (or us) that are uncertain and therefore intentionally excluded from the benchmark allowance to manage customer risk, that eventuate during the regulatory period (subject to prudency and efficiency verification)
- sustained and significant changes to material input costs.

Changes in accounting treatment will also be considered.

For example, the commission has noted the following examples of non-recurring expenditure provided by businesses in 2024-25:

- additional energy expenditure associated with pumping due to dry weather and energy plant damage
- implementation of an ERP that was originally treated as capital expenditure, but which changed to operating expenditure due to being a cloud-based project.

Where a business seeks to adjust its actual controllable opex for the purposes of the EBSS calculations, it should provide a detailed explanation of the rationale for doing so. We expect businesses to identify and account for any expenses of this nature in their regulatory accounts starting with the 2028-29 financial year.

In considering whether adjustments should be made, as with our approach to pass-throughs for unforeseen and uncertain events, no adjustments to actual outcomes will be made where matters have not been managed or taken into account appropriately throughout the regulatory period. To take a hypothetical example, where a business inappropriately underspends on asset maintenance it will be unlikely to get a 'carve out' for once-off expenses in the event the asset subsequently fails. Or where a business does not invest in appropriate demand management, leak detection and water efficiency, we may not allow a full carve-out for drought response costs.[69]

We will also consider making an adjustment where costs associated with unanticipated changes in demand are materially different from forecast, but in most cases consider that any differences can be absorbed within the plus 5 per cent or minus 2 per cent band.

[69] The importance of ensuring carve-outs do not incentivise inefficient spending or risk-taking was highlighted in a submission to the draft guidance by the Friends of the Gippsland Lakes.

Adjustments will be symmetric – for example if statutory or licence changes materially reduce costs the commission will look to adjust opex benchmarks downwards accordingly.

Other efficiency benefit sharing scheme design elements

One comment raised in response to the draft guidance was that some businesses have been more efficient than others in recent years and therefore may have less ability to reduce costs than others. It was therefore suggested that rewards and penalties could be adjusted to reflect historical performance. However, we do not propose to do so. While it is true that not all Victorian water businesses will be at the exact same point on the efficiency frontier, and therefore some will have a greater opportunity to earn rewards under the EBSS than others, it would be a highly complex and intrusive process to establish relative efficiency and then make individual-business adjustments to the EBSS. It is important that the EBSS is as simple and straightforward as possible, and applies equally to all businesses. To the extent that we consider a water business is materially inefficient we will address this when setting opex benchmarks, rather than through the EBSS mechanism.

Another query arising from submissions was whether businesses proposing more ambitious efficiency targets would face the same rewards and penalties as those with a less ambitious target. Again, we do not propose to apply a different regime to different businesses. All businesses are expected to put forward their best offers, including in relation to efficiency targets, in their price submissions. These offers will reflect where businesses' current position and their own views of costs and efficiency improvements. Where we have concerns that opex forecasts and efficiency targets are overly conservative, again these will be addressed through the opex benchmarks. [70]

No changes to the financial model template for the 2028 Water Price Review need to be made to accommodate the EBSS. The financial model template for the 2033 Water Price Review will include any necessary amendments.

Relationship to other PREMO elements

Some responses to the draft guidance paper expressed concern that the EBSS could result in businesses with high opex relative to benchmarks being rewarded or penalised multiple times under the PREMO framework.

It is correct that higher (or lower) actual opex costs compared to benchmarks will have a financial implication for businesses through the EBSS and also through the performance (P) element of the PREMO rating.

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[70] At the same time, while being best offers, proposals must also be achievable and realistic. Unduly optimistic forecasts will eventually impact customers negatively through opex increases in the following period. Customers have an interest in stable and predictable prices.

We believe that this additional incentive is necessary given it appears the performance element of PREMO may not currently be providing strong enough incentives for efficiency. At the same time we do not consider the addition of the EBSS to be unduly punishing or rewarding from a financial perspective. Firstly, we note that actual opex compared to benchmarks is just one of several parts of the performance element, and in turn performance is just one part of the overall PREMO rating. Second, as set out above, EBSS rewards and penalties will be capped at 1 per cent of the annual revenue requirement.

Historic opex performance will also be a part of our assessment of eligibility for fast-tracking. However, again opex performance is just one element of this assessment and a decision regarding fast-tracking does not have material financial implications for businesses.

Additional worked examples

The following three examples show how the EBSS will apply.

- Example 1 is the case of a business where reductions in adjusted controllable opex are less than the 2 per cent threshold, and hence no revenue adjustment applies
- Example 2 is the case where the full amount of the revenue adjustment (in this case a reward) applies
- Example 3 is the case where a penalty is impacted by the 1 per cent cap.

Example 1 – Alpha Water Business

Assume that in 2028 Alpha Water Business had the following opex benchmarks established through the price review process.

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total benchmark opex $m	123	125	126	126	129
Less non-controllable opex					
Licence fees	1	1	1	1	1
Bulk water purchases	22	22	22	22	22
Total benchmark controllable opex (B)	100	102	103	103	106

(Note that all figures in this and the following examples are expressed in $2033).

Actual opex, as known in September 2032, was as follows:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total actual opex $m	122	128	127	126	Not known
Less actual non-controllable opex					
Licence fees	1	1	1	1	Not known
Bulk water purchases	23	22	23	24	Not known
Total actual controllable opex (A)	98	105	103	101	Not known

In addition, Alpha Water Business had a major water treatment plant outage in 2029-30 due to a bushfire in its catchment. It incurred $2 million in 2029-30 and 2030-31 in unexpected water cartage opex. These costs were identified at the time in its regulatory accounts for the respective years and the commission has confirmed they were material, one-off and out of Alpha's control. Opex for the purposes of the EBSS is therefore:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total actual controllable opex (B)	98	105	103	101	Not known
Less water carting opex		2	2		
Opex for the purposes of EBSS	98	103	101	101	Not known

Total (adjusted) actual controllable opex over the first four years of the regulatory period is 98+103+101+101=403. This compares with a benchmark total controllable opex of 100+102+103+103=408, a 1.2 per cent reduction (5/408). As this reduction is less than 2 per cent, then no EBSS adjustment will apply for the subsequent regulatory period.

Example 2 – Beta Water Business

Suppose that Beta Water Business had the same benchmarks as in the previous example:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total benchmark opex $m	123	125	126	126	129
Less non-controllable opex					
Licence fees	1	1	1	1	1
Bulk water purchases	22	22	22	22	22
Total benchmark controllable opex (B)	100	102	103	103	106

Beta Water Business's actual opex is as follows:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total actual opex $m	120	123	126	122	Not known
Less actual non-controllable opex					
Licence fees	1	1	1	1	Not known
Bulk water purchases	22	22	22	22	Not known
Total actual controllable opex (A)	97	100	103	99	Not known

Beta Water Business had no one-off adjustments to make to its controllable costs.

Total (adjusted) actual controllable opex over the first four years of the regulatory period is 97+100+103+99=399. This compares with a benchmark total controllable opex of 100+102+103+103=408, a 2.2 per cent reduction (9/408). As this reduction is greater than 2 per cent, then an EBSS reward can apply for the subsequent regulatory period, with the annual reward amounts calculated as follows:

Year	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36	2036-37	2037-38
Benchmark controllable opex (B) $m	100	102	103	103	106					
(Adjusted) Actual controllable opex (C) $m	97	100	103	99	102					
Cumulative saving (B-C) $m	3	2	0	4	4					
Efficiency gain (E) $m	3	-1	-2	4	0					
Carry-over of gains made in										
2028-29		3	3	3	3	3				
2029-30			-1	-1	-1	-1	-1			
2030-31				-2	-2	-2	-2	-2		
2031-32					4	4	4	4	4	
2032-33						0	0	0	0	0
Carry over added to revenue requirement						**4**	**1**	**2**	**4**	**0**

Points to note from the table above:

- The EBSS adjustment is calculated as follows:
  - In respect of 2028-29 it is the difference between benchmark controllable opex and adjusted actual controllable opex
  - In respect of 2029-30 to 2031-32 it is the difference between
    - The change in benchmark opex compared to the previous year, and
    - The change in actual opex compared to the previous year
  - In respect of 2032–33 it is assumed to be zero.

The total potential reward in this case is 4+1+2+4=11. Suppose that as a result of the price review for the subsequent regulatory period the following revenue requirement is set:

Year	2033-34	2034-35	2035-36	2036-37	2037-38
Total revenue requirement	250	260	270	280	285

The total potential carryover reward of 11 equates to 0.82 per cent of the total benchmark controllable opex for the subsequent regulatory period of 250+260+270+280+285=1,345. This is within the proposed 1 per cent cap on rewards (and penalties) so the full amount of the carryover reward will apply.

Example 3 – Gamma Water Business

Suppose that Gamma Water Business had the following benchmarks:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total benchmark opex $m	123	125	126	126	129
Less non-controllable opex					
Licence fees	1	1	1	1	1
Bulk water purchases	22	22	22	22	22
Total benchmark controllable opex (B)	100	102	103	103	106

Gamma Water Business significantly overspent its benchmarks due to higher wages costs incurred from the first year of the regulatory period, and its actual opex is as follows:

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total actual opex $m	130	136	136	137	Not known
Less actual non-controllable opex					
Licence fees	1	1	1	1	Not known
Bulk water purchases	22	22	22	22	Not known
Total actual controllable opex (A)	107	113	113	114	Not known

As per Alpha, Gamma Water Business had once-off water carting costs which can be subtracted from its controllable opex.

Year	2028-29	2029-30	2030-31	2031-32	2032-33
Total actual controllable opex (A)	107	113	113	114	Not known
Less water carting opex		2	2		
Opex for the purposes of EBSS (C)	107	111	111	114	Not known

Actual adjusted controllable opex of 107+111+111+114=443 is 8.6 per cent higher than the benchmark of 100+102+103+103=408. As this is greater than the 5 per cent threshold, then EBSS penalties will apply. The calculation of the penalties is as follows:

Year	2028-29	2029-30	2030-31	2031-32	2032-33	2033-34	2034-35	2035-36	2036-37	2037-38
Benchmark controllable opex (B) $m	100	102	103	103	106					
(Adjusted) Actual controllable opex (C) $m	107	111	111	114	117					
Cumulative saving (B-C) $m	-7	-9	-8	-11	-11					
Efficiency gain (E) $m	-7	-2	1	-3	0					
Carry-over of gains made in										
2028-29		-7	-7	-7	-7	-7				
2029-30			-2	-2	-2	-2	-2			
2030-31				1	1	1	1	1		
2031-32					-3	-3	-3	-3	-3	
2032-33						0	0	0	0	0
Carry over subtracted from revenue requirement						**-11**	**-4**	**-2**	**-3**	**0**

Using the same total revenue requirement in the subsequent regulatory period as for Beta Water Business, the total penalty of 11+4+2+3= 20 is 1.49 per cent of 1,345. This is 49 per cent higher than the 1 per cent cap, which equates to a penalty of 13.45. The commission proposes that the penalty in each year of the subsequent regulatory period would be adjusted down proportionately - in this case by 1/1.49 – so that the actual penalty amounts would be:

Year	2033-34	2034-35	2035-36	2036-37	2037-38
Penalty subtracted from total revenue requirement	-7.40	-2.69	-1.35	-2.02	0.00

Appendix G – Large and/or complex connections (including sewer mining) definitions

Charge	Definition
Application and investigation charges	Costs associated with reviewing, investigating and assessing the feasibility of an application from a connection applicant to connect to works. This may include investigating whether a new direct connection is required, or whether any assets upstream (or downstream) may need to be brought forward to service the new connection. The activities these charges may apply to include, but are not limited to: • technical assessments (including preliminary technical assessments) • investigations and feasibility studies • commercial and/or financial model development • site visits • internal or external reports including engineering, environment, legal and planning reviews • detailed design • administrative processing • any other direct or indirect cost associated with the investigation or application to connect. Connection applicants would be provided with a budget estimate where costs exceed a threshold of $10,000 as costs could be significant depending on the size and complexity.
Special charges	One-off charges to recover the total incremental cost of a large and/or complex connection to water business works or any asset due to the connection (net of benefits). Other than in the case of a direct connection, special charges are charged to the water business to which an applicant seeks to connect and are subsequently passed through to the connection applicant via a negotiated New Customer Contribution. All costs and all benefits associated with a new connection would be included in the special charge calculation including, but not limited to, the costs of any new water entitlement, water treatment, desalinated water, recycled water, sewage treatment, water network, recycled water network, sewerage network capacity, environmental offsets, tax implications and any other costs associated with the large and/or complex connection.

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Charge	Definition
Ongoing charges	Prices for ongoing charges payable to a water business or directly from a direct customer in respect of a large and/or complex connection, will include fixed charges and usage charges, and may include reservation charges for supplementary or intermittent supply. Ongoing charges, including any take or pay charges, are applicable to the connection unless the property has disconnected and may be included in a supply agreement. Fixed charges may include annual service charges that reflect ongoing metering, monitoring and other costs incurred directly or indirectly by water business with the connection. Reservation charges may apply if the new connection requires supplementary and/or intermittent back-up supply. Take or pay charges may apply if conditions in the supply agreement have not been met.
Disconnection charges	Disconnection charges apply to address circumstances when the large and/or complex connection: • ceases operations, abandons or removes the physical connections to the business's works, or the supply agreement with the customer is terminated, and • has paid a special charge to a bulk water supplier directly or via the water business, and • the special charge was calculated on the basis of ongoing incremental revenue beyond the date of disconnection or the water business needs to invest in rectifying or making its works safe following the disconnection. Disconnection charges must be set to recover the costs of: • any works constructed by a water businesses to serve a given large and/or complex connection and must consider the forecast utilisation of the works constructed by the wider customer base, including any contribution made to the water business • rectification, repair and making good any damage to the site arising from the works • any and all remediation works necessary to return the site to a condition compliant with applicable environmental laws. Depending on whether capital costs have been fully recovered upfront, a disconnection charge may reflect the cost of expenditure to make the works safe or remove the works. This can include rehabilitation and rectification works that are required to return water business's works as whole and functioning.

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Charge	Definition
Disconnection charges (continued)	In the case where capital costs have not been fully recovered over the lifetime of the large customer, a disconnection charge may reflect any remaining capital costs to ensure that existing customers are protected and avoid stranded assets. In setting disconnection charges, water business must consider, after assessing relevant financial and other risks to the connection applicant and project, whether a proportion of estimated disconnection fees should be secured by requiring provision of a bank guarantee, letter of credit or other similar instrument, which must be transferable to any successor or subsequent operator over the life of the connection. Any security arrangement should take account of the financing and other costs incurred by the customer.

Appendix H – New Customer Contributions Framework

The New Customer Contributions Framework can be found on the commission's website using the following link:

New customer contributions guiding resources | Essential Services Commission