



South Gippsland Water draft decision

2018 Water Price Review

3 April 2018



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Contents

Summary	iv
1. Our role and approach to water pricing	1
2. Our assessment of South Gippsland Water's price submission	5
Regulatory period	6
Revenue requirement	7
Operating expenditure	10
Regulatory asset base	21
– Closing regulatory asset base	22
– Forecast regulatory asset base	23
– Capital expenditure	24
– Revenue from customer contributions	29
Cost of debt	29
Return on equity – PREMO rating	30
Regulatory depreciation	30
Tax allowance	31
Demand	31
Form of price control	32
Tariff structures	32
New customer contributions	35
Financial position	35
Customer engagement	36
Outcomes	36
Guaranteed service levels	37
3. PREMO rating	39
Our review of South Gippsland Water's PREMO self-rating	39
– Management	40
– Risk	41
– Engagement	41
– Outcomes	41
4. We invite feedback on our draft decision	43
Attend a public forum	43
Provide written comments or submissions	43

Next steps	44
APPENDIX A – submissions received	45

Summary

In September 2017, South Gippsland Water provided a submission to us on the prices it proposes to charge from 1 July 2018

This draft decision sets out our preliminary views on South Gippsland Water's price submission.^{1 2}

We invite interested parties to comment on our preliminary views in this draft decision before we make a final decision and issue a price determination in June 2018. Details on how to make a submission on our draft decision are provided in Chapter 4.

Our draft decision proposes to approve prices for a two year period from 1 July 2018

South Gippsland Water proposed prices for a five year period. Instead, we propose to approve prices for a two year period. We found South Gippsland Water had made a large number of errors in its price submission, including in its accompanying financial model. During our review, South Gippsland Water made multiple resubmissions of its financial model to correct for previous errors. Each round of corrections produced further errors.

We consider the information provided by South Gippsland Water in its price submission, and its follow up responses to our queries, was insufficient and inadequate, and did not meet the information standards required by our guidance.

It is unclear if we have identified all errors made by South Gippsland Water and we lack confidence in the accuracy of the data used by the water corporation to establish its forecast revenue requirement and proposed prices. We expect price submissions to be underpinned by sound data. This is particularly the case when a water corporation is proposing a large price increase. South Gippsland Water proposed a price increase of around 20 to 25 per cent over the five years from 1 July 2018. This was the largest increase by far proposed by any water corporation.

Given the insufficient and inadequate information provided by South Gippsland Water, we do not think it is in the interests of South Gippsland Water's customers for us to approve a regulatory period of more than two years. A two year period would also allow sufficient time for South Gippsland Water to prepare a new price submission that meets the requirements of the guidance we will issue for its three regulatory year regulatory period from 2020-21 to 2022-23.

¹ Clause 16 of the Water Industry Regulatory Order 2014 requires us to issue a draft decision.

² South Gippsland Water's price submission is available on our website at www.esc.vic.gov.au.

We propose to approve a revenue requirement of \$59.8 million over the two years from 1 July 2018

Our draft decision proposes not to accept the revenue requirement in South Gippsland Water's submission and instead approve a revenue requirement for South Gippsland Water of \$59.8 million over the two year period starting 1 July 2018. This is \$4.0 million or 6.3 per cent lower than proposed by South Gippsland Water for those same two years.

As well as identifying expenditure savings (see page 10 for operating expenditure, and page 24 for capital expenditure), we have formed an initial view that South Gippsland Water's demand forecasts are too low (page 31). Our draft decision on expenditure and demand means prices will be lower than proposed by South Gippsland Water for the two years from 1 July 2018.

We propose not to accept the tariffs proposed by South Gippsland Water

South Gippsland Water proposed to retain most existing tariff structures, including a two-part fixed service and variable water usage component for residential water. However, it proposed to significantly increase the residential variable usage charge relative to the fixed service charge.

We propose not to accept South Gippsland Water's proposed tariffs, because:

- They are not based on efficient costs. As noted above, we have proposed lower expenditure than forecast by South Gippsland Water (see the operating and capital expenditure sections – from page 10 and page 24, respectively).
- The proposed tariffs would have resulted in a significant price shock for some customers – noting in particular, South Gippsland Water's proposal would have seen the residential variable water usage charge increase by 18.8 per cent in 2018-19.

See page 32 for our assessment of tariffs.

Our draft decision is not to accept South Gippsland Water's proposed PREMO rating

As noted above, we consider the information provided by South Gippsland Water in its price submission and in response to our queries, was insufficient and inadequate, compared to the information we requested. South Gippsland Water proposed the largest price increase of any water corporation in our price review, and an overall increase in controllable cost per water customer connection (page 19). We found that in a number of instances, South Gippsland Water's justification for its expenditure and its demand forecasts fell well short of the requirements set out in our guidance. These factors contributed to our view that South Gippsland Water's performance on the Management element of PREMO was below the expectations for a 'Basic' price submission.

We also considered the Risk element was at a 'Basic' rating, rather than the 'Standard' rating proposed by South Gippsland Water. And, we have proposed to adopt a rating of 'Standard' for Engagement, compared to South Gippsland Water's proposed 'Advanced' rating.

In terms of an overall PREMO rating, we have not rated South Gippsland Water's price submission (Table A). More detail is provided in Chapter 3.

Our PREMO rating is an assessment of the water corporation's price submission. It is not an assessment of the water corporation itself.

Table A **PREMO Rating**

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
South Gippsland Water's rating	Standard	Standard	Advanced	Standard	Standard
Commission's rating	Not rated	Basic	Standard	Not rated	Standard

Following its two year regulatory period from 1 July 2018, South Gippsland Water will need to prepare a new price submission for the three year period 2020–23, in accordance with new guidance we will issue.

Among the 16 draft decisions we have released so far, South Gippsland Water is the only corporation we have not assigned an overall PREMO rating (Table B).

Table B Draft decision on PREMO – overall rating

Leading	Advanced	Standard	Basic	Not rated
Goulburn Valley Water	Barwon Water	Coliban Water	Wannon Water	South Gippsland Water
	Central Highlands Water	East Gippsland Water		
	City West Water	Gippsland Water		
	GWMWater	Lower Murray Water (urban)		
	North East Water	Westernport Water		
	South East Water			
	Southern Rural Water			
	Yarra Valley Water			

1. Our role and approach to water pricing

We are Victoria's independent economic regulator

Our role in the water industry is based on the Water Industry Regulatory Order 2014 (WIRO) which is made under the *Water Industry Act 1994* (Vic) (WI Act) and sits within the broader context of the *Essential Services Commission Act 2001* (Vic) (ESC Act). Our role under the WIRO includes regulating the prices and monitoring service standards of the 19 water corporations operating in Victoria.

We are reviewing the prices 17 water corporations propose to charge customers from 1 July 2018

Our review of the prices proposed by the water corporations covers the prescribed services listed in the WIRO.³ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water corporations.⁴

In September 2017, South Gippsland Water provided a submission to us proposing prices for a five year period starting 1 July 2018. Our task is to assess the price submission against the legal framework that governs our role, and make a price determination that takes effect from 1 July 2018. The price determination will specify the maximum prices South Gippsland Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We also issue a final decision that explains the reasons for our price determination.

We assess prices against the WIRO and other legal requirements

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

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

³ The review excludes Melbourne Water and Goulburn-Murray Water. In 2016 we approved prices for Melbourne Water to 30 June 2021 and for Goulburn-Murray Water to 30 June 2020.

⁴ The prescribed services are listed at clause 7(b) of the WIRO.

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

- the matters specified in our guidance⁵
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

A separate document lists the specific objectives and the various matters the commission must have regard to when making a price determination and provides a guide to where the commission has done so in this draft decision.⁶

In 2016, we issued guidance to South Gippsland Water to inform its price submission. The guidance set out how we will assess South Gippsland Water's submission against the matters we must consider under clause 11 of the WIRO.

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve South Gippsland Water's proposed prices.⁷

If we consider the submission does not have adequate regard for the matters specified in clause 11 of the WIRO or comply with our guidance, we may specify maximum prices, or the manner in which prices are to be calculated, determined or otherwise regulated.⁸

The 2018 price review is the first we've undertaken under our new water pricing approach

In 2014, the Victorian Government reviewed and revised the WIRO. The changes allowed us more flexibility to decide on the pricing approach we use in Victoria's water sector. In April 2015 we released a consultation paper to start reviewing our pricing approach.⁹

Over 2015, we held a series of workshops and hosted a conference (in November) to hear from stakeholders and explore alternative ways to approach water pricing.

⁵ Essential Services Commission 2016, *2018 Water Price Review, Guidance paper*, November.

⁶ Essential Services Commission 2018, *South Gippsland Water draft decision, 2018 Water Price Review – commission's consideration of legal requirements*, 3 April. This is located on our website at www.esc.vic.gov.au

⁷ This is a requirement of the WIRO, clause 14(b).

⁸ This is provided for under the WIRO, clause 14(b)(i).

⁹ Essential Services Commission 2015, *Review of Water Pricing Approach, Consultation paper*, April.

In May 2016, we released a position paper setting out our proposed new pricing approach, and invited submissions.¹⁰ We met with each water corporation and other interested parties to help inform their submissions. Submissions were supportive of the overall proposal, in particular the greater focus on customer engagement and value.

We finalised our new approach to water pricing in October 2016.¹¹

Our new pricing approach builds on many aspects of the previous approach. We continue to use the building blocks to estimate the revenue requirement for a water corporation.¹² Our guidance explains the building blocks and how we use it to estimate the revenue requirement.¹³

Among the key changes, the new approach introduces new incentives to help ensure water corporations deliver the outcomes most valued by customers. Our new PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.¹⁴ The PREMO incentive is described next.

Our consultation on the pricing approach informed the guidance we issued water corporations in November 2016 to inform price submissions for the 2018 water price review.

PREMO

PREMO stands for **P**erformance, **R**isk, **E**ngagement, **M**anagement, and **O**utcomes. The purpose of PREMO is to provide an incentive for water corporations to deliver outcomes most valued by customers. It includes incentives for a water corporation to engage with customers to understand their priorities and concerns, and take these into account.

PREMO links the return on equity allowed in the revenue requirement to the value delivered by a water corporation to its customers. Under PREMO, a higher level of ambition in terms of delivering customer value results in a higher return on equity.

¹⁰ Essential Services Commission 2016, *A new model for pricing services in Victoria's water sector, Position paper*, May.

¹¹ For more detail on the new water pricing approach see: Essential Services Commission 2016, *Water Pricing Framework and Approach: Implementing PREMO from 2018*, October.

¹² The revenue requirement is the forecast amount that a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including Environment Protection Authority Victoria and the Department of Health and Human Services.

¹³ Essential Services Commission 2016, *Guidance Paper*, op. cit., pp. 8-9.

¹⁴ In December 2017 we issued early draft decisions for East Gippsland Water, South East Water, Westernport Water and Yarra Valley Water.

Our PREMO rating is an assessment of the water corporation's price submission. It is not an assessment of the water corporation itself.

The 2018 water price review is the first time we've applied our PREMO incentive mechanism.

For the 2018 water price review, a water corporation's ambition in terms of delivering customer value is being assessed against four elements of PREMO – Risk, Engagement, Management and Outcomes.¹⁵

A water corporation must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the justification for the PREMO rating, and also rate the price submission. This process determines the return on equity reflected in the revenue requirement.¹⁶

¹⁵ The Performance element of PREMO will be assessed at the review following the 2018 water price review.

¹⁶ Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 45–49.

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

We have made our draft decision on South Gippsland Water's price submission after considering: South Gippsland Water's price submission, its responses to our queries, and written submissions from interested parties (a list of submissions is provided in Appendix A).

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

Our guidance included a number of matters water corporations must address in their price submissions. Our preliminary assessment of these matters is provided in this chapter.

In our draft decision we have decided not to approve the maximum prices proposed by South Gippsland Water in its submission.

We formed the opinion that South Gippsland Water's price submission did not have adequate regard to the matters specified in clause 11 of the WIRO, or comply with our guidance (including the information requested to be provided in the guidance).¹⁷ We have identified throughout this chapter where, in our opinion, South Gippsland Water's price submission does not comply with clause 11 or meet the requirements of our guidance.

During our assessment we sought further information from South Gippsland Water. We consider the information provided by South Gippsland Water in responses to our queries was insufficient and inadequate to meet the information standards required by our guidance or in our follow up requests.¹⁸

As a consequence we have decided to specify the manner in which South Gippsland Water's prices are to be calculated, determined or otherwise regulated.¹⁹ We have done this by using the best information available to us at this time to estimate South Gippsland Water's revenue requirement.²⁰ This manner of calculating, determining or otherwise regulating South Gippsland

¹⁷ WIRO clause 14(b)(i).

¹⁸ Our guidance paper included a requirement for reasonably-based information. See Essential Services Commission 2016, *Guidance paper*, op. cit., p. 66.

¹⁹ WIRO clause 14(a)(ii).

²⁰ This is provided for under clause 15(b) of the WIRO.

Water's price will impact both South Gippsland Water's revenue requirement and the length of the regulatory period.

South Gippsland Water must submit a response to our draft decision and provide an updated financial model by 8 May 2018 (via email to water@esc.vic.gov.au). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for South Gippsland Water in June 2018.

All financial values referred to in this chapter are in \$2017-18.

Regulatory period

South Gippsland Water proposed a five year regulatory period from 1 July 2018. Our draft decision proposes to adopt a two year regulatory period.

We found the information in South Gippsland Water's initial price submission (including its financial model) contained a large number of errors and matters which required clarification.²¹ During our review, South Gippsland Water resubmitted its financial model ten times to correct for errors identified during our assessment. Each resubmission included new errors or matters requiring further review or follow up with the water corporation. The extent and number of errors, and required corrections made by South Gippsland Water, were of a higher magnitude than for other water corporations.

The consultants assisting us to review South Gippsland Water's expenditure and demand forecasts also noted errors in the information and data provided by South Gippsland Water, including errors in the application of models used by the corporation to establish its expenditure and demand forecasts.²²

Given the extent and frequency of the errors and inconsistencies in the information and data provided by South Gippsland Water in its price submission, we consider its price submission falls into the red-shaded zone of the PREMO matrix set out in our guidance (discussed further in

²¹ The financial model includes the expenditure and demand assumptions (among other things) used to calculate revenue and prices. As such, the financial model is an important part of the supporting justification provided by a water corporation for its proposed revenue requirement and prices.

²² Deloitte Access Economics 2018, *South Gippsland Water – expenditure review for 2018 water price review*, February; KPMG 2018, *Review of South Gippsland Water demand forecasts*, February.

Chapter 3). Our guidance noted that where a water business is in the red zone we can exercise our discretion as to how to approach the price determination for that water corporation.²³ This includes the discretion to approve a shorter regulatory period than proposed.

Having reviewed the information and data provided by South Gippsland Water, and in light of our concerns regarding the quality of that information and data, we consider that it would not be appropriate for us to approve a regulatory period of more than two years.²⁴ A two year period would also allow sufficient time for South Gippsland Water to prepare a new price submission for the three year period 2020-21 to 2022-23, in accordance with new guidance we will issue.

In this chapter we have included our assessment of forecasts for the full five year period proposed by South Gippsland Water in its submission. Given that we only propose to approve a regulatory period of two years, our assessments for the subsequent three years should be considered as indicative estimates only. They do not form a part of our draft decision.

Revenue requirement

Our draft decision proposes to approve a revenue requirement for South Gippsland Water of \$59.8 million over the two years from 1 July 2018 (Table 2.1). This is \$4.0 million or 6.3 per cent lower than proposed by South Gippsland Water for the same period.

²³ Essential Services Commission 2016, *Guidance paper, op. cit.*, p. 46.

²⁴ We note there is a precedent – the commission shortened the regulatory period for Melbourne Water in its 2013 price review. See: Essential Services Commission 2013, *Price review 2013: greater metropolitan water businesses, Final decision*, June, p. xviii.

Table 2.1 Draft decision – revenue requirement
\$ million 2017-18

	Draft decision			Indicative forecast		
	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Operating expenditure	19.8	19.8	39.6	19.6	19.3	19.3
Return on assets	5.9	6.4	12.3	6.8	7.0	7.3
Regulatory depreciation	4.0	4.3	8.4	4.7	5.0	5.4
Non-prescribed revenue offset of revenue requirement	-0.2	-0.2	-0.4	-0.2	-0.2	-0.2
Draft decision – revenue requirement	29.5	30.4	59.8	30.9	31.1	31.8

Note: Numbers have been rounded.

The WIRO states:

In making a price determination, the commission may make reasonable assumptions, based on the best information available to the commission, if in any respect of any matter relevant to the price determination, the regulated entity provides information that the commission considers is insufficient or inadequate when compared to the information requested by the commission.²⁵

We consider the information provided by South Gippsland Water in its price submission, and in response to our requests, was insufficient and inadequate in its regard to the requirements of our guidance that water corporations provide us with reasonably-based information.²⁶

Given this, our draft decision uses the best information available to us at this time, to estimate South Gippsland Water’s revenue requirement. We have only allowed those costs we assess are unavoidable new costs to the water corporation in our assessment of forecast controllable

²⁵ Water Industry Regulatory Order 2014, clause 15(b)(ii).

²⁶ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 66.

Our assessment

operating expenditure (see page 10). We have focused on operating expenditure as this has the most immediate impact on short term prices, without impacting on longer term considerations.

We consider the revenue requirement approved in our draft decision will allow South Gippsland Water to deliver on its proposed customer outcomes, government policy, and obligations monitored by Environment Protection Authority Victoria and the Department of Health and Human Services.²⁷

The adjustments we've proposed in our draft decision on the revenue requirement (relative to South Gippsland Water's proposal) relate to our review of efficient costs and our revised PREMO rating (impacting the return on assets). A summary is provided in Table 2.2.

Our final decision will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, South Gippsland Water must update its revenue requirement and prices to reflect our April 2018 updates to estimates for the cost of debt and inflation.

There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination, and impact on the revenue requirement, South Gippsland Water should update its price submission and also provide us with an updated financial model. Any updates will be publicly available on our website.

²⁷ We met with officers of the Department of Environment, Land, Water and Planning, Department of Health and Human Services, and Environment Protection Authority Victoria, to discuss their expectations of South Gippsland Water in the regulatory period from 1 July 2018. We had regard to their views in our draft decision.

Table 2.2 Adjustments to revenue requirement

\$ million 2017-18

	Draft decision			Indicative forecast		
	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Proposed revenue requirement	31.3	32.5	63.8	33.3	33.6	34.5
Operating expenditure	-1.2	-1.5	-2.7	-1.6	-1.4	-1.5
Return on assets	-0.4	-0.5	-0.8	-0.5	-0.7	-0.9
Regulatory depreciation	-0.04	-0.04	-0.1	-0.1	-0.1	-0.1
Non-prescribed revenue offset of revenue requirement	-0.2	-0.2	-0.4	-0.2	-0.2	-0.2
Total adjustments	-1.8	-2.1	-4.0	-2.4	-2.4	-2.6
Draft decision – revenue requirement	29.5	30.4	59.8	30.9	31.1	31.8

Note: Numbers have been rounded

Operating expenditure

Operating expenditure is an input to the revenue requirement. South Gippsland Water's price submission provides detail on its forecast operating expenditure from pages 34 to 39.

We assess both:

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

For controllable operating expenditure, our assessment process first confirms an efficient baseline, based on the last year of actual costs prior to our price review (that is, 2016-17). We then consider the forecast costs relative to this baseline, including the proposed efficiency improvement rate and forecast growth, and any proposed cost changes relative to the baseline. We engaged Deloitte

Our assessment

Access Economics to provide expert advice to inform our assessment of controllable operating expenditure. Deloitte's report on its assessment of South Gippsland Water's expenditure forecast is available on our website.²⁸

For non-controllable expenditure (including bulk water and sewerage services, government charges and licence fees) we confirm the proposed forecasts, with reference to the relevant regulatory body where appropriate.

Table 2.3 sets out our draft decision on South Gippsland Water's forecast operating expenditure, for the purpose of establishing the revenue requirement (Table 2.1). Details of our assessment and reasons for our proposed adjustments to South Gippsland Water's proposal follow, with a summary of our adjustments shown at Table 2.4.

We consider our proposed operating expenditure in this draft decision reflects the expenditure that a prudent service provider would incur when acting efficiently to achieve the lowest cost in delivering the outcomes specified in South Gippsland Water's price submission. We have derived this expenditure benchmark by only allowing those costs we assess are unavoidable new costs to the water corporation. This reflects our lack of confidence in South Gippsland Water's provided information, and is consistent with our draft decision to approve a shorter regulatory period, and our requirement for South Gippsland Water to prepare a new price submission for 2020–23.

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

²⁸ Deloitte Access Economics, op. cit.

Table 2.3 Draft decision – operating expenditure

\$ million 2017-18

	Baseline year	Draft decision			Indicative forecast		
	2016-17	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Baseline controllable operating expenditure	17.4						
Model corrections	0.2						
External price review costs	-0.3						
Baseline controllable operating expenditure	17.3	17.4	17.4	34.8	17.4	17.4	17.4
Electricity rate (emissions offset)		0.2	0.1	0.3	0.02	-0.04	-0.04
Lance Creek net operating costs		0.03	0.2	0.2	0.2	0.2	0.2
Stakeholder collaboration & partnerships		0.1	0.1	0.2	0.04	0.04	0.04
Biosolids management		0.2	0.2	0.3	0.2	0.2	0.2
Ecological risk assessments		0.1	0.1	0.1	0.1	0.1	0.1
Total controllable costs		17.9	18.0	35.9	17.8	17.8	17.8

Table continued on next page

Table 2.3 continued

	Baseline year	Draft decision			Indicative forecast		
	2016-17	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Non-controllable costs							
Bulk services ^a		0.6	0.6	1.2	0.6	0.4	0.4
Environmental contribution ^b		1.2	1.2	2.4	1.1	1.1	1.1
Licence fees - ESC ^c		0.016	0.016	0.033	0.016	0.016	0.025
Licence fees - DHHS ^c		0.010	0.010	0.020	0.010	0.010	0.010
Licence fees - EPA ^c		0.048	0.048	0.095	0.048	0.048	0.048
Draft decision – operating expenditure		19.8	19.8	39.6	19.6	19.3	19.3

^a Bulk services covers the supply of bulk water and sewerage services

^b The Environmental Contribution collects funds from water corporations under the WI Act

^c Licence fees are paid to cover costs incurred by Department of Health and Human Services, Environment Protection Authority Victoria, and the Essential Services Commission in their regulatory activities related to the water corporation

Note: Numbers have been rounded

South Gippsland Water proposed a total forecast controllable operating expenditure of \$96.4 million over a five-year regulatory period. While our draft decision approves a two year period, we have still assessed South Gippsland Water’s controllable operating expenditure forecasts across the five year period. Our estimates for 2020-21 to 2022-23 are provided for indicative purposes only. They do not form a part of this draft decision. Our assessment of South Gippsland Water’s forecasts has:

- Established a 2016-17 baseline year starting point for operating expenditure, verified by South Gippsland Water’s 2016-17 audited regulatory accounts.

Our assessment

- Adopted an assumption for future efficiency savings applying to controllable operating expenditure. We have accepted South Gippsland Water's proposed customer growth rate and average efficiency improvement rate.
- Used Deloitte's expenditure assessment to inform our decision.
- Made an allowance for new costs we have verified, including those related to meeting policy or regulatory obligations. We have removed all proposed expenditure which we consider is not a new and unavoidable cost for South Gippsland Water.

We consider this approach provides South Gippsland Water with sufficient revenue to cover efficient operating expenditure already reflected in its baseline, plus verified new costs above the baseline that cannot be avoided by the corporation during the two-year period.

South Gippsland Water's proposed total forecast controllable operating expenditure for the first two years of the 2018–23 period was \$38.6 million. For the reasons set out below, we propose to reduce this by \$2.7 million (7.0 per cent) to establish a benchmark controllable operating expenditure of \$35.9 million for the two year period we are proposing to approve.

Corrections to its price submission:

During our review, South Gippsland Water's submitted financial model was found to contain numerous errors, which the corporation subsequently corrected over multiple resubmissions. These errors resulted in changes to the 2016-17 baseline year and the forecast controllable operating expenditure across 2018–23. These include:

- Two sets of indexing errors were identified for the 2016-17 baseline year, resulting in a net increase of \$0.24 million. This increased the baseline year controllable operating expenditure from \$17.47 million to \$17.70 million.
- South Gippsland Water also corrected its forecast operating costs across the 2018–23 period due to its indexing errors and an incorrectly applied financial model update, which resulted in an overall increase to the forecast. To offset this increase, South Gippsland Water introduced a negative balancing adjustment to the baseline variations.
- The corrected 2016-17 baseline year and forecasts have resulted in a \$0.54 million reduction to South Gippsland Water's forecast controllable operating expenditure across the five year period (\$0.22 million across our proposed two year period).

Baseline controllable operating expenditure:

- South Gippsland Water has proposed a downward adjustment to its corrected actual 2016-17 baseline year controllable operating expenditure, removing \$0.12 million for recruitment costs, producing a starting point for forecast annual operating expenditure. The resultant figure of \$17.59 million is 7 per cent above the benchmark of \$16.48 million allowed for 2016-17 in the

previous price determination. This is due to increased labour costs associated with new positions and higher project operating expenditure, including sewer side lines (house connection branches), Korumburra emergency water supply and preparing its price submission.²⁹

- Deloitte reviewed and accepted these increased costs, with the exception of the \$0.28 million for preparing its price submission. Deloitte recommended retaining \$0.10 million in the baseline, effectively allowing for \$0.50 million across the 2018–23 period to match the current period, and removing the remaining 0.18 million. However, we do not agree this should be retained for the two year period we are approving – we consider asking customers to pay for the costs of preparing a new price submission is not consistent with an efficient business, and we have therefore removed the full \$0.28 million from the baseline. The resultant baseline figure of \$17.31 million is used for our draft decision.

Efficiency improvement:

- South Gippsland Water’s proposed efficiency improvement rate on controllable operating costs is an average of 1.5 per cent per annum across the five year period (noting it proposed a rate of 1.0 per cent in the first year and 2.0 per cent in the fifth year). This is relatively high compared to its past performance (where it met our mandated 1 per cent efficiency rate). The efficiency rate is also the same as South Gippsland Water’s forecast connection growth rate of 1.5 per cent per annum, giving a flat annual baseline operating cost. For the purposes of making our draft decision, we have accepted South Gippsland Water’s proposed average efficiency improvement rate and growth rate.
- Deloitte noted that South Gippsland Water is a relatively high cost water provider when benchmarked against other water corporations.³⁰ It also increased its operating costs across the 2013–18 period, unlike most other corporations, and forecast one of the lowest net efficiency savings per connection across the proposed 2018–23 period, barely falling below the 2016-17 rate by the end of the period.

Proposed cost changes:

- In its original submission, South Gippsland Water sought additional operating expenditure of \$8.53 million (9.7 per cent) above its growth-adjusted baseline across the five year period (\$3.46 million of this was in the first two years). After the corrections to the baseline and the introduction of the balancing adjustment (described above), this reduced to \$7.03 million

²⁹ Deloitte Access Economics, op. cit., p. 13.

³⁰ South Gippsland Water provided a copy of a benchmarking report for 28 water businesses undertaken by Third Horizon in 2016.

(8.1 per cent) above the corrected annual baseline cost across the five year period (\$2.86 million in the first two years).

- The largest component of this proposed increase was for maintenance and reliability increases of \$3.15 million. This includes expenditure associated with sewer house connection branches and additional operation and maintenance expenditure associated with the Poowong, Loch and Nyora Sewerage Scheme, the Alberton Sewerage Scheme, Meeniyan Sewerage Scheme, and subdivisions for both water and sewer. Deloitte considered that South Gippsland Water had not provided evidence to support such a large increase in maintenance, and had not demonstrated that these were all new costs outside of the growth-adjusted baseline. Deloitte recommended allowing half of the increase sought by South Gippsland Water, removing \$1.57 million.³¹ However, consistent with our draft decision approach to only allow new and unavoidable expenditure above the baseline, we have removed the full amount proposed by South Gippsland Water from the forecast (\$1.25 million in the first two years).
- South Gippsland Water sought \$0.12 million for labour increases above inflation, all in the first two years of the period. Deloitte recommended no adjustment because South Gippsland Water's FTE forecast is flat and there is only a modest wage increase.³² However, consistent with our draft decision approach, we have removed this expenditure from the forecast.
- South Gippsland Water sought additional net expenditure of \$0.23 million for electricity.
 - Deloitte compared the forecast electricity costs above the baseline with its latest forecasts for electricity prices. Deloitte considered that the proposed electricity variations are reasonable.³³
 - Whilst Deloitte does not agree that there will be a continued price rise beyond 2019-20, South Gippsland Water has proposed to manage these costs through its emissions reduction program, with a small net decrease (\$0.6 million) from the baseline across the last three years of the 2018–23 period.
 - We accept Deloitte's view for the purpose of making this draft decision. However we do acknowledge that there is currently uncertainty in forecasting electricity prices and South Gippsland Water's electricity contract expires on 30 June 2018. We request that South Gippsland Water proposes a revised electricity forecast based on its new contract prices in response to our draft decision.
- South Gippsland Water sought \$0.25 million above the baseline for customer support programs. Deloitte's view is that increasing operating expenditure to allow for direct financial assistance to

³¹ Deloitte Access Economics, op. cit., p. 22.

³² Deloitte Access Economics, op. cit., p. 16.

³³ Deloitte Access Economics, op. cit., pp. 17–20.

customers, such as payment matching and debt waivers, is not consistent with prudent and efficient expenditure and does not provide appropriate incentives to the business. Deloitte recommends removing this expenditure.³⁴ We agree with Deloitte's view because we don't consider this to be an actual cost incurred by South Gippsland Water – rather, it represents revenue not collected, and we have therefore removed this amount from operating expenditure. We have increased the allowance for non-collected revenue from \$0.06 million to \$0.10 million per year, to reflect the increase in bills and the customer support for these programs.

- Deloitte has assessed the following proposed new costs and recommended their removal as they were not considered new obligations on the business.³⁵ Rather, they are normal ongoing activities for a water corporation and should be absorbed within the growth-adjusted baseline or funded through efficiency gains resulting from the new initiatives. This includes:
 - \$0.66 million to develop out-dated hydraulic models and develop organisation processes around asset costing
 - \$0.25 million for catchment management
 - \$0.33 million for stakeholder collaboration and partnership
 - \$0.33 million for a secure water supply.
- We agree with Deloitte's view, except for the additional allowance for stakeholder collaboration and partnership. We have allowed this amount (\$0.22 million in the proposed two-year period) in lieu of removing the full cost of preparing a price submission from the baseline.
- South Gippsland Water has forecast \$0.8 million additional expenditure for biosolids management. Deloitte notes that South Gippsland Water's baseline reflects expenditure to deal with biosolids as they are produced, but it does not include expenditure to reduce existing stockpiles. While Deloitte notes that a well-managed biosolids and sludge management strategy should not generally require additional expenditure above the growth-adjusted baseline, Deloitte considers that the size of this increase is material for a small business such as South Gippsland Water, and has not recommended any adjustments.³⁶ We agree with Deloitte, and we have allowed this expenditure above the baseline as we consider it represents a new obligation for the corporation.
- South Gippsland Water has forecast \$0.25 million for ecological risk assessments for its wastewater treatment plants. Deloitte notes this is not a new obligation and has been in place for the past two regulatory periods, although accepts this was not included in the baseline year

³⁴ Deloitte Access Economics, op. cit., p. 23.

³⁵ Deloitte Access Economics, op. cit., pp. 22-23.

³⁶ Deloitte Access Economics, op. cit., p. 23.

for South Gippsland Water. Deloitte has not recommended any adjustments.³⁷ We accept Deloitte's view, and have allowed this additional expenditure to remain.

- Deloitte assessed the remaining proposed new costs above the baseline and has not recommended any further adjustments.³⁸ These include:
 - \$1.55 million for IT costs. Deloitte observed that South Gippsland Water's IT systems and capabilities do appear to be low when compared to other businesses and Deloitte accepts that some 'catch-up' expenditure is necessary.
 - \$0.63 million for operating costs for the new Lance Creek connection to the northern towns. Given the size and scope of the project, Deloitte considers the additional operating costs are reasonable additions to the baseline.
- We accept that the new Lance Creek connection introduces new unavoidable operating costs, and we have included these costs for our draft decision. And while we accept South Gippsland Water may need to improve its IT systems, we consider this is avoidable in the short term and have therefore removed the \$1.55 million proposed additional expenditure (\$0.48 million over the first two years of the period), consistent with our draft decision approach.
- Deloitte also noted that South Gippsland Water had yet to implement some efficiency improvement recommendations identified by Deloitte during the 2013 water price review – these related to fleet expenditure and maintenance depot location and staffing.

The controllable operating expenditure forecast we have adopted for this draft decision represents a reasonable assumption, based on the best information available to us, of efficient costs for South Gippsland Water.³⁹ This will bring about a decrease (in real terms) in controllable operating expenditure per connection relative to the baseline year, well ahead of that proposed by South Gippsland Water, as shown in Figure 2.1.

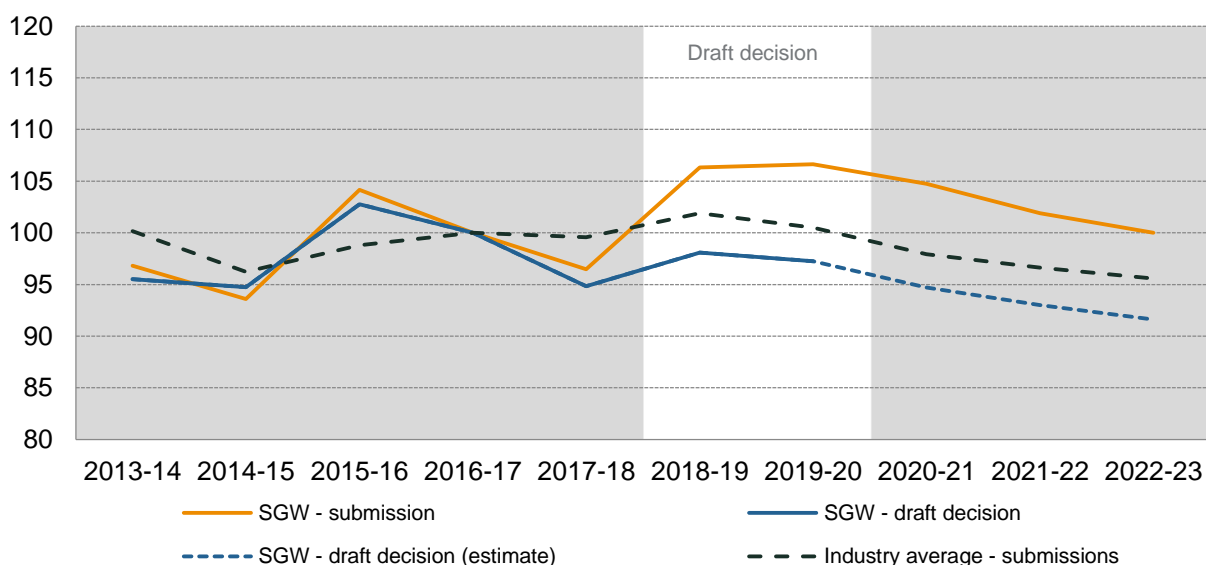
³⁷ Deloitte Access Economics, op. cit., pp. 23-24.

³⁸ Deloitte Access Economics, op. cit., pp. 22-23.

³⁹ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 31.

Figure 2.1 Controllable operating expenditure per water connection

Index: 2016-17=100



Submission – based on actual historical and forecast values provided by the water corporation in its price submission.
 Draft decision – includes any corrections or adjustments to historical and forecast values arising from our assessment.
 Draft decision (estimate) – estimated forecasts arising from our assessment, provided for indicative purposes only.
 Industry average – drawn from the price submissions for all urban water corporations (excludes rural expenditure).

For non-controllable operating expenditure, we have verified South Gippsland Water’s forecasts and adjusted these, where required, based on the latest information received from the relevant regulatory authorities on their licence fees and the environmental contribution. The values we have adopted for our draft decision are set out in Table 2.3.

For the environment contribution, we have used the 2018-19 value provided by the Department of Environment, Land, Water and Planning and assumed that this will remain flat in nominal terms (decline in real terms) across the 2018–23 regulatory period.

We have assumed the licence fees for the Department of Health and Human Services, the Environment Protection Authority Victoria and the Essential Services Commission remain flat in real terms across the period, but with a 50 per cent increase for our commission fee in 2022-23 to align with our regulatory review cycle.⁴⁰

We have verified South Gippsland Water’s forecast external bulk water charges against the current price determination for Melbourne Water.

⁴⁰ The Department of Health and Human Services and the EPA Victoria provided their latest 2016-17 licence fees for making our draft decision. We have also based our forecast on our 2016-17 commission licence fee.

We have reduced South Gippsland Water's forecast non-controllable operating expenditure by \$0.05 million across the five-year 2018–23 period, resulting from our adjustments to:

- increase the Department of Health and Human Services licence fee to \$0.01 million per year (a total increase of \$0.05 million) noting no fee amount was provided in South Gippsland Water's submission
- increase the EPA Victoria licence fee from \$0.029 million to \$0.048 million per year (a total increase of \$0.09 million)
- reduce our commission licence fee from \$0.037 million to \$0.016 million per year, with a value of \$0.025 million in 2022-23 (a total reduction of \$0.09 million)
- reduce the environment contribution forecast by \$0.10 million in 2022-23.

For the proposed two-year period, these licence fee adjustments produce a small net increase of \$0.02 million.

Overall, non-controllable operating expenditure will increase by \$0.67 million from 2017-18 to 2018-19, predominantly due to the introduction of an annual \$0.58 million bulk entitlement for the allocation of water from the Melbourne Water system. The environment contribution also increased from \$1.10 million to \$1.20 million.

Prior to making our final decision, we will adjust South Gippsland Water's forecast non-controllable operating expenditure for the latest inflation and external bulk charges data.

Table 2.4 sets out our proposed adjustments to both controllable and non-controllable operating expenditure.

Table 2.4 Adjustments to operating expenditure

\$ million 2017-18

	Draft decision			Indicative forecast		
	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Proposed total operating expenditure	21.0	21.3	42.3	21.2	20.7	20.7
Model corrections	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1
Baseline adjustment – external price review costs	-0.3	-0.3	-0.6	-0.3	-0.3	-0.3
Cost efficiency improvement rate at 1.52%	-0.1	-0.1	-0.2	-0.1	-0.1	-0.02
Total forecast variations to baseline opex	-0.8	-1.0	-1.8	-1.1	-0.9	-1.0
Total adjustments to controllable costs	-1.2	-1.5	-2.7	-1.6	-1.4	-1.4
Licence fees	0.008	0.008	0.016	0.008	0.008	0.016
Environmental contributions	0.0	0.0	0.0	0.0	0.0	-0.1
Total adjustments to non-controllable costs	0.008	0.008	0.016	0.008	0.008	-0.083
Draft decision - total operating expenditure	19.8	19.8	39.6	19.6	19.3	19.3

Note: Numbers have been rounded

Regulatory asset base

The regulatory asset base is used to estimate the return on assets and regulatory depreciation in the revenue requirement. Our guidance required South Gippsland Water to propose its:

- closing regulatory asset base at 30 June 2017
- forecast regulatory asset base for each year of the regulatory period from 1 July 2018.

Our assessment

Closing regulatory asset base

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period to 30 June 2017. This helps to ensure prices reflect the actual net expenditure of a water corporation.⁴¹

We compared South Gippsland Water's actual net capital expenditure for 2012-13 to 2016-17 with the forecast used to approve maximum prices for the period from 1 July 2013. We undertake a prudence and efficiency review where a water corporation's net capital expenditure is more than 10 per cent above the forecast used to approve maximum prices for the period from 1 July 2013. We believe this approach is reasonable given capital expenditure can be relatively 'lumpy' in nature.

In its price submission, South Gippsland Water assumed \$55.3 million net capital expenditure over the period from 2012-13 to 2016-17. We identified some minor corrections, which reduced this to \$54.6 million. This figure is 3.4 per cent lower than the forecast used to approve maximum prices for the period from 1 July 2013. This is below the 10 per cent threshold identified above, so we have not undertaken a prudence and efficiency review of its past net capital expenditure.

Other than this correction for past net capital expenditure, South Gippsland Water calculated its closing regulatory asset base in accordance with the requirements of our guidance. For these reasons, our draft decision proposes to approve a closing regulatory asset base for 30 June 2017 of \$144.7 million.

Table 2.5 sets out our draft decision on South Gippsland Water's regulatory asset base at 30 June 2017.

⁴¹ Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflects revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

Table 2.5 Closing regulatory asset base
\$ million 2017-18

	2012-13	2013-14	2014-15	2015-16	2016-17
Opening RAB 1 July	112.2	117.3	126.3	141.7	147.0
Plus gross capital expenditure	10.1	13.5	20.4	10.8	8.2
Less government contributions	0.0	0.0	0.0	0.0	5.6
Less customer contributions	0.5	0.4	0.7	0.3	0.7
Less proceeds from disposals	0.6	0.4	0.6	1.3	0.3
Less regulatory depreciation	3.9	3.6	3.7	3.8	3.9
Closing RAB 30 June	117.3	126.3	141.7	147.0	144.7

Note: Numbers have been rounded

Forecast regulatory asset base

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

Table 2.6 sets out our draft decision on South Gippsland Water's proposed forecast regulatory asset base for its two year regulatory period from 1 July 2018.⁴² Our assessment of the components of the forecast regulatory asset base is set out below.

⁴² Our guidance required water corporations to provide an estimate of the components of its regulatory asset base for 2017-18. This is so we can assess the opening asset base for 1 July 2018. Our guidance noted that where the 2017-18 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2013 price determination, the lower amount must be used. The estimates for 2017-18 will be confirmed at the price review following the 2018 water price review.

Our assessment

Table 2.6 Forecast regulatory asset base
\$ million 2017-18

	2017-18	Draft decision		Indicative forecast		
		2018-19	2019-20	2020-21	2021-22	2022-23
Opening RAB 1 July	144.7	147.6	162.0	173.2	182.3	188.2
Plus gross capital expenditure	32.8	19.5	16.6	15.0	12.0	16.4
Less government contributions	24.5	0.0	0.0	0.0	0.0	0.0
Less customer contributions ^a	0.6	0.6	0.6	0.6	0.7	0.7
Less proceeds from disposals	0.5	0.5	0.5	0.5	0.5	0.5
Less regulatory depreciation	4.2	4.0	4.3	4.7	5.0	5.4
Closing RAB 30 June	147.6	162.0	173.2	182.3	188.2	198.0

^a Customer contributions are defined on page 35

Note: Numbers have been rounded

Capital expenditure

Capital expenditure is an input to estimating the regulatory asset base. South Gippsland Water's forecast capital expenditure and supporting information is provided at pages 25 to 33 of its price submission. This is summarised in Figure 2.2, for the current 2013–18 period, and as proposed by the water corporation for the 2018–23 period.

We engaged Deloitte Access Economics to provide expert advice to inform our assessment of capital expenditure. Deloitte's report on its assessment of South Gippsland Water's expenditure forecast is available on our website.⁴³

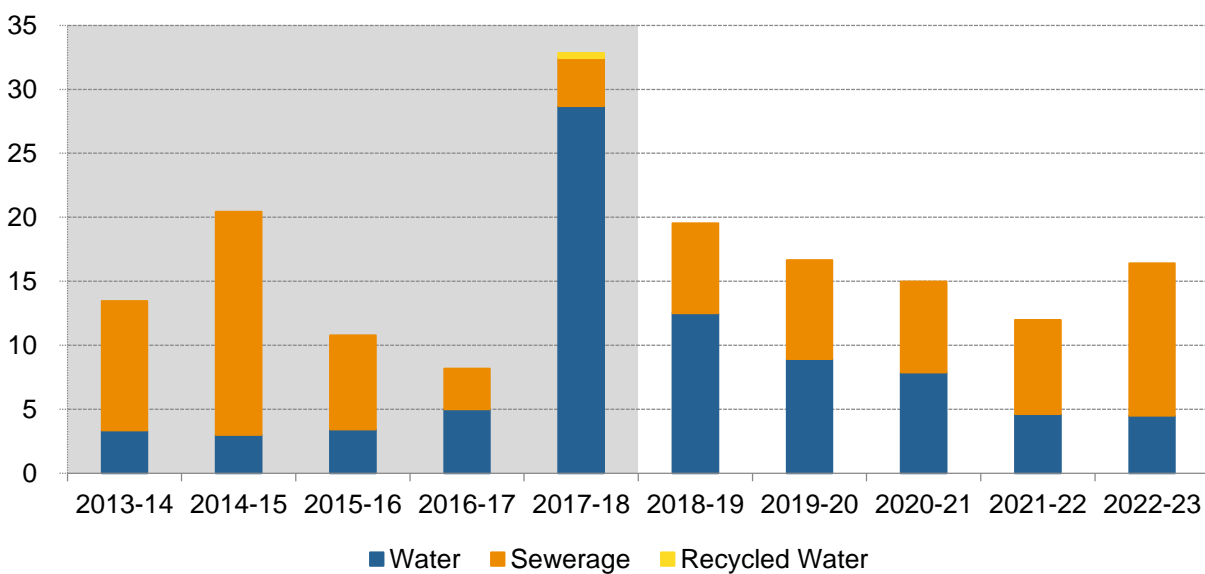
While we have proposed to approve a two-year regulatory period for South Gippsland Water, we have still assessed its five-year capital forecast, consistent with the approach used for the other water corporations. We have not proposed any specific further adjustments due to the shorter period, because:

⁴³ Deloitte Access Economics, op. cit.

- capital expenditure impacts prices over the longer term
- capital expenditure forecasts in the first two years of the period would likely be more robust than in the latter years
- our draft decision requires South Gippsland Water to prepare a new price submission for 2020-21 to 2022-23, which will allow it to address any capital forecasting issues raised in our assessment and Deloitte’s review.

Our decision to approve a two-year period, rather than the proposed five, should therefore have no immediate impact on South Gippsland Water’s longer-term capital investment program.

Figure 2.2 Gross capital expenditure by service category
\$ million 2017-18



Note: actuals for 2013-14 to 2016-17 and water corporation forecasts for 2017-18 to 2022-23

South Gippsland Water proposed a total gross capital expenditure of \$88.2 million over a five-year regulatory period. For the reasons set out below, we propose to reduce this by \$8.7 million to establish a benchmark gross capital expenditure of \$79.5 million over five years:

- South Gippsland Water’s proposed forecast for gross capital expenditure is \$2.6 million (3 per cent) higher than for the current five-year regulatory period. However the approved capital expenditure for the 2013–18 period was \$73.8 million. The main reason for exceeding the forecast was the Lance Creek water connection project exceeding the original budget by some \$9 million.
- Deloitte requested selected documents from South Gippsland Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, these demonstrate that South

Gippsland Water usually has a reasonable approach for developing project scope, the timing of works and cost estimates.

- Deloitte reviewed information for South Gippsland Water’s seven largest major projects for the period: the Lance Creek water connection project, Wonthaggi sewer system expansion, Leongatha raw water transfer main renewal, Inverloch sewer system expansion and renewal, Wonthaggi wastewater treatment plant treated effluent pumping, and the Fish Creek treated water distribution main renewal. Deloitte also reviewed information for the renewals expenditure program. The information provided by South Gippsland Water supported the prudence and efficiency of most of these projects, with some notable exceptions.
- Deloitte assessed the proposed renewals expenditure program and found it was still largely based on asset age and material, with limited condition assessments to verify the asset was indeed at the end of its useful life.
 - It found there was no clear evidence of an increase in water leaks or bursts to justify the proposed large increase in water main renewals. Deloitte has therefore proposed a reduction of \$0.4 million per year to return expenditure for water main renewals to the same level as in the current 2013–18 regulatory period. We accept Deloitte’s recommendation as it is more reflective of efficient capital expenditure and consistent with our guidance requirements for justification for increased costs.
 - Deloitte did not recommend any adjustment to the sewer renewal program, and noted the recorded sewer blockage data shows a clear trend of increasing blockages and spills to customer property.⁴⁴ However, it did note South Gippsland Water has proposed to renew significantly more sewer main than in previous years, at a lower unit price. We accept Deloitte’s recommendation to retain the proposed sewer renewals expenditure, but we require South Gippsland Water to establish clear reporting measures and targets to demonstrate to customers that it is achieving its proposed higher, and more efficient, sewer renewal rates.
- For the Leongatha raw water transfer main renewal, Deloitte found the current business case did not provide sufficient justification for the preferred option. Deloitte recommended \$0.5 million of the proposed \$5.0 million is approved for South Gippsland Water to investigate the hydraulic capacity, potential blockage and alternative strategies for the Leongatha raw water supply. We accept Deloitte’s recommendation as it is more reflective of efficient capital expenditure and we

⁴⁴ Deloitte Access Economics, op. cit., pp. 29-30.

have removed \$4.5 million from the forecast, noting that this applies to expenditure beyond our proposed two-year 2018–20 period.⁴⁵

- For the Fish Creek treated water distribution main renewal, Deloitte notes that South Gippsland Water has not demonstrated the proposed water main renewal is the most efficient option to achieve the objective of reducing leakage from 30 per cent to 15 per cent. Deloitte recommends the \$0.20 million budget proposed over the first three years is retained for leak detection investigation as a first step. Deloitte recommends that the remaining \$2.02 million proposed for the last two years of the period are deferred pending the outcome of the leak detection investigations. We accept Deloitte’s recommendation as a more prudent approach to reducing leakage in the Fish Creek system.⁴⁶
- We consider the planned capital expenditure program is achievable, given South Gippsland Water’s past track record delivering its capital expenditure program. Over the current 2013–18 regulatory period, South Gippsland Water is expected to deliver two of its planned major projects, with another two projects delayed but expected to be finished in 2018-19. The Foster wastewater treatment plant rising main pipeline and storage was able to be deferred until 2023-24 due to a reuse scheme and minor treatment plant upgrade.
- Where there is uncertainty in timing and scope of capital expenditure, South Gippsland Water says it has excluded these projects from its price submission. However, it has not identified any specific projects or associated costs that have been excluded at this time. This approach is consistent with our guidance for managing uncertain expenditure. For our draft decision, we accept South Gippsland Water’s proposal for addressing uncertainty, noting the following:
 - South Gippsland Water will need to demonstrate the prudence and efficiency of any additional costs if they are indeed incurred during the 2018–20 period if seeking to include them in the regulatory asset base.
 - Variations in capital expenditure from forecast during the 2018–20 period will form a key part of our assessment of the Performance element of PREMO at the next price review.

For the proposed two-year regulatory period, our draft decision reduces South Gippsland Water’s proposed capital expenditure of \$37.1 million by \$0.88 million, to establish a benchmark gross capital expenditure of \$36.2 million. The larger adjustments proposed by Deloitte were to capital expenditure forecasts beyond 2019-20, and can be addressed by South Gippsland Water in its 2020 price submission.

⁴⁵ Deloitte Access Economics, op. cit., pp. 31-32.

⁴⁶ Deloitte Access Economics, op. cit., pp. 33-34.

Table 2.7 below sets out our proposed adjustments to South Gippsland Water’s forecast to establish our draft decision benchmark for gross capital expenditure, consistent with our guidance and WIRO principles.⁴⁷ This benchmark is used to calculate the forecast regulatory asset base (Table 2.6) and the revenue requirement (Table 2.1).

Table 2.7 Draft decision – gross capital expenditure
\$ million 2017-18

	Draft decision			Indicative forecast		
	2018-19	2019-20	Total	2020-21	2021-22	2022-23
Proposed gross capital expenditure	20.0	17.1	37.1	16.4	16.9	17.9
Leongatha raw water transfer main renewal	0.0	0.0	0.0	-1.0	-3.5	0.0
Water reticulation renewal allocation	-0.4	-0.4	-0.9	-0.4	-0.4	-0.4
Fish creek treated water distribution main renewal	0.0	0.0	0.0	0.0	-1.0	-1.0
Total adjustments to gross capital expenditure	-0.4	-0.4	-0.9	-1.4	-4.9	-1.5
Draft decision – gross capital expenditure	19.5	16.6	36.2	15.0	12.0	16.4

Note: Numbers have been rounded

The benchmark that we adopt for South Gippsland Water does not represent the amount that the water corporation is required to spend or allocate to particular projects. Where we have made an adjustment to exclude a project’s capital expenditure from South Gippsland Water’s revenue requirement, we are not requiring the corporation to remove that project. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we

⁴⁷ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 35.

consider sufficient to operate the business and to maintain or improve services over the regulatory period. South Gippsland Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

Revenue from customer contributions

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.⁴⁸

Our draft decision proposes not to accept South Gippsland Water’s forecasts for customer contributions as we are proposing not to accept South Gippsland Water’s proposed tariff structures and new customer contributions.⁴⁹

We invite South Gippsland Water to re-forecast revenue from customer contributions in response to our draft decision on its revenue requirement and tariff structures.

Cost of debt

Our guidance required South Gippsland Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. South Gippsland Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, our draft decision accepts the cost of debt proposed by South Gippsland Water, as set out in Table 2.8.

Table 2.8 Trailing average cost of debt

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Cost of debt (nominal)	6.9%	7.4%	7.0%	6.3%	5.3%	7.1%	5.4%	5.3%	4.9%	4.9%*

* Estimated cost of debt – we will update the 2017-18 figure before the final decision and price determination.

Note: Numbers have been rounded

From 2016, we accepted a ten-year trailing average approach to estimating the benchmark cost of debt, changing from an on-the-day approach. The trailing average approach better aligns the actual cost of debt for an efficient business to the regulated benchmark, compared with an on-the-

⁴⁸ Revenue from new customer contributions reflects revenue earned from new connections made to a water corporation’s water, sewerage or recycled water networks.

⁴⁹ Forecast customer contributions are dependent on the South Gippsland Water’s proposed charges.

day approach.⁵⁰ We consider the ten year trailing average approach helps to minimise risk to water corporations and provides better incentives for long-term investment.

Return on equity – PREMO rating

South Gippsland Water rated its price submission as ‘Standard’. Based on its PREMO self-rating, South Gippsland Water proposed a rate of return on equity of 4.5 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.⁵¹

Our draft decision proposes not to accept South Gippsland Water’s PREMO self-rating and proposed return on equity of 4.5 per cent per annum, consistent with our PREMO assessment (see Chapter 3). Our draft decision proposes to adopt a return on equity of 3.9 per cent per annum, the minimum rate specified in our guidance.⁵²

Our draft decision on the return on equity is consistent with the approach set out in our guidance. The range for the return on equity set out in our guidance had regard to the return on equity recently allowed or estimated by regulators in other Australian jurisdictions for the water industry.⁵³

Regulatory depreciation

Regulatory depreciation is an input to calculating the regulatory asset base. South Gippsland Water’s forecast regulatory depreciation was calculated using a straight line depreciation profile.⁵⁴ We noted in our guidance that we prefer this approach.⁵⁵

Our draft decision on regulatory depreciation differs from South Gippsland Water’s proposal due to our proposed adjustments to capital expenditure. Our final decision will confirm the regulatory depreciation to be reflected in the forecast regulatory asset base.

Our draft decision on regulatory depreciation is shown in Table 2.1.

⁵⁰ For more detail on the trailing average and on the day approaches to the cost of debt, see Essential Services Commission 2016, *Water pricing framework*, op. cit., p.27.

⁵¹ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 49.

⁵² Essential Services Commission 2016, *Guidance paper*, op. cit., p. 45.

⁵³ Essential Services Commission of South Australia 2016, *SA Water regulatory determination 2016, Final determination*, June; Independent Pricing and Regulatory Tribunal 2017, *WACC biannual update*, August.

⁵⁴ For the period from 2018-19 to 2022-23, South Gippsland Water proposed a regulatory depreciation of \$23.8 million.

⁵⁵ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 42.

Tax allowance

The tax allowance is an input into the revenue requirement. South Gippsland Water has proposed no allowance for tax in its revenue requirement. Our draft decision is to accept the forecast as it was calculated consistently with the method required by our guidance.⁵⁶

Demand

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

South Gippsland Water's demand forecasts are set out at pages 16 to 21 of its price submission, and are also included in its financial model.

We engaged KPMG to undertake an independent review of South Gippsland Water's demand forecasts. KPMG recommended a number of amendments based on its findings.⁵⁷ The main findings of the consultant were:

- some of South Gippsland Water's forecasts were not arithmetically accurate, or did not appropriately reflect the forecasting method adopted by the corporation
- some of South Gippsland Water's forecasts were not consistent with historical trends
- assumptions used by South Gippsland Water on price elasticity were incorrectly applied.

We have reviewed KPMG's report and have confidence in its findings and recommendations. Based on KPMG's findings, we consider South Gippsland Water's demand forecasts are not consistent with the requirements of our guidance because:

- they do not represent the best available estimates derived from an appropriate forecasting methodology
- assumptions on the key drivers of demand over the next regulatory period are not well explained and not reasonable.⁵⁸

KPMG's revised demand forecast is higher than South Gippsland Water's proposed forecast. A higher demand forecast means lower prices for a given revenue requirement.

For the purpose of this draft decision, we propose to adopt KPMG's demand forecasts (as set out on page 6 of its report). However, we note that KPMG's revised demand forecast was based on South Gippsland Water's original assumptions about revenue and prices. Our draft decision

⁵⁶ Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 50-51.

⁵⁷ KPMG, op. cit.

⁵⁸ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 52.

proposes a lower revenue requirement, which will lower prices. Because demand can be sensitive to price movements, our draft decision may impact assumptions about forecast water demand.

South Gippsland Water must respond to our draft decision with updated demand forecasts reflecting the lower revenue requirement (and therefore prices), and consistent with the requirements set out in our guidance.⁵⁹

Form of price control

South Gippsland Water currently uses a price cap form of price control. It has proposed to continue with a price cap for the majority of its tariffs. It has proposed a revenue cap form of price control for a small number of minor sewerage and trade waste tariffs to enable intra-period tariff reform and new tariff structures from 2020-21.

Our draft decision is to accept South Gippsland Water's proposed price cap form of price control. A price cap will allow South Gippsland Water to recover sufficient revenue to cover the forecast efficient costs of providing services. A price cap also provides customers with price certainty, and means a water corporation is managing demand risk on behalf of its customers. We consider demand risk is more efficiently managed by a water corporation, rather than its customers.

We propose not to accept South Gippsland Water's revenue cap form of price control as we only propose to approve a two-year regulatory period (2018-19 to 2019-20). South Gippsland Water can address its proposed tariff reforms in its 2020 price submission.

Tariff structures

South Gippsland Water's proposed tariffs are set out at pages 52 and 53 of its price submission. South Gippsland Water proposed an 8 per cent real increase in tariffs in 2018-19 and a 3.5 per cent real increase per annum for the remaining four years, giving an overall price increase of about 20 to 25 per cent over its proposed five year period.

As outlined in our guidance, we have provided the water corporations with a large degree of discretion to decide on individual tariff structures.⁶⁰ This recognises water corporations are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.⁶¹

⁵⁹ Essential Services Commission 2016, *Guidance paper*, op. cit., pp. 52-53.

⁶⁰ Tariff structure refers to the way in which prices are grouped and the manner of charging, for example, water and sewerage charges, fixed and variable charges.

⁶¹ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 55.

South Gippsland Water proposed to retain the following existing tariffs:

- for residential and non-residential water services, a two-part tariff with a fixed service charge and a variable usage component, however it proposed to significantly increase the variable charge relative to the fixed (with both subject to large increases over the period)
- for residential sewerage services, a fixed charge only
- for non-residential sewerage services, a fixed access fee and a volumetric cistern fee for 2018-19 and 2019-20 (then implement restructured non-residential sewerage tariffs from 2020-21, discussed below in tariff changes).

It also proposed a number of other minor changes, including intra-period tariff restructures from 2020-21 such as the removal of volumetric cistern fees.

We propose not to accept South Gippsland Water's proposed tariffs for the following reasons:

- They are not based on efficient costs (we have amended the expenditure forecasts as discussed in our operating and capital expenditure sections).⁶²
- They are not cost reflective.⁶³
- The proposed tariffs will result in price shock for customers.
- The price shock is exacerbated for tenants.
- There are inconsistencies between the written price submission and the financial model, and numerous errors identified in the model during our assessment.

We acknowledge that a higher variable charge (relative to fixed) does send a price signal to customers, however, we consider an increase of 18.8 per cent in the first year represents a price shock, which is exacerbated for tenants (who only pay the variable charge) and low income and vulnerable customers.⁶⁴ A submission by the Consumer Action Law Centre highlighted the impact price changes may have on some customers, particularly those with low or fixed incomes who 'already carefully manage their consumption and budget'.⁶⁵ While South Gippsland Water stated customers supported some increase in the variable water charge to provide greater control over

⁶² WIRO clause 11(d)(ii)

⁶³ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 56.

⁶⁴ WIRO clause 11(d)(iii)

⁶⁵ Consumer Action Law Centre 2017, *Initial Feedback: 2018 Water Price Review*, 15 November.

their bills, we could not find evidence that customers supported a price increase of this magnitude.⁶⁶

Our guidance required consistency across the written submission and the financial model. Inconsistencies open the possibility that customers were presented with incorrect prices during the consultation and engagement processes.

We invite South Gippsland Water to submit its proposed minor sewerage and trade waste tariff reforms for implementation in 2020-21 in its 2020 price submission.

Draft decision

For the reasons set out above, our draft decision proposes not to approve South Gippsland Water's proposed tariff structures.

Prior to our final decision and price determination, South Gippsland Water must submit updated tariff structures and prices in response to our draft decision revenue requirement, that also reflect the requirements of the WIRO and our guidance. These must also reflect our updates to cost of debt and inflation estimates, which we will provide in late April 2018.

Adjusting prices

South Gippsland Water's proposed price adjustment mechanisms are at page 23 of its price submission and outlined in response to our queries. It proposed:

- to continue with its existing uncertain and unforeseen events mechanism⁶⁷
- a cost of debt adjustment mechanism that allows prices to adjust for changes in the cost of debt.

Our draft decision accepts South Gippsland Water's proposal to continue with the existing uncertain and unforeseen events mechanism. Our guidance recommended that the mechanism continues in its current form for all water corporations.

We reviewed South Gippsland Water's proposed cost of debt adjustment mechanism and found it requires minor corrections. We invite South Gippsland Water to work with the commission on a revised price adjustment formula that allows prices to adjust to changes in the cost of debt.

⁶⁶ South Gippsland Water's price submission outlines that customers wanted real price increases in any given year to be kept below 10 per cent (p. 46). We also note that there were also some minor tariffs that were increasing by more than 10 per cent in 2018-19.

⁶⁷ South Gippsland Water did not propose any changes to its existing mechanisms.

New customer contributions

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

South Gippsland Water's proposed charges for new customer contributions are set out at page 53 of its price submission. For water and sewerage charges, South Gippsland Water has proposed that the 2017-18 charge be maintained.

South Gippsland Water proposed that existing unique charges applying to Poowong, Loch, Nyora and Alberton be abolished and one standard new customer contributions apply. As per the new customer contributions framework, where standard new customer contributions are unreasonable for a particular development, South Gippsland Water proposes to negotiate site-specific arrangements in line with new customer contributions principles.⁶⁸

Because we have not approved South Gippsland Water's proposed tariff structures, we cannot approve its proposed new customer contributions.⁶⁹ South Gippsland Water must resubmit new customer contributions in response to our draft decision, along with its updated tariff structures.

Financial position

In approving prices, we must have regard to the financial viability of the water industry.⁷⁰ We interpret the financial viability requirements under the *Essential Services Commission Act 2001* (Vic) and the *Water Industry Regulatory Order (2014)* to mean that the prices we approve should provide a high level of certainty that each water corporation can generate sufficient cash flow to deliver on service commitments, including financing costs arising from investments to meet service expectations.

South Gippsland Water's price submission and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on South Gippsland Water's assumptions about revenue and expenditure. Our draft decision proposes adjustments to revenue and expenditure. We have reviewed the key indicators of financial performance based on our draft decision, and consider they will generate sufficient cash flow to allow South Gippsland

⁶⁸ Essential Services Commission 2016, *Guidance paper*, op. cit., p. 62.

⁶⁹ This is because calculating NCCs is dependent on the other tariffs charged by a water corporation.

⁷⁰ WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

Water to deliver on service commitments, including financing costs arising from investments to meet service expectations.

Customer engagement

Our guidance required South Gippsland Water to engage with customers to inform its price submission.

The engagement by South Gippsland Water:

- took place between June 2016 and September 2017
- used a range of methods including surveys, interviews, deliberative workshops and forums
- sought views from an advisory group of community members appointed by South Gippsland Water, as well as special interest groups, and community groups
- covered topics such as prices, service levels, hardship support and protecting the environment.

More detail on South Gippsland Water's engagement is available in its price submission.⁷¹

Evidence that South Gippsland Water's engagement influenced its proposals includes:

- a proposal to adjust the share of water variable charges in residential bills, to provide customers with greater bill control
- increasing rebates paid to customers who experience interruptions in water and sewerage services in response to feedback that customers value reliability
- reviewing water and sewer developer charges to improve timeliness and predictability
- planning for hardship support to vulnerable customers adversely affected by tariff changes.

However, we are concerned with some aspects of South Gippsland Water's engagement. South Gippsland Water proposed price increases substantially higher than past levels that would have resulted in a price shock for some customers (page 32).

In our view, South Gippsland Water could have done more to ensure customer groups most affected by its proposed price increases had the opportunity to participate, and could have made greater effort to ensure their views were taken into account.

Outcomes

The outcomes South Gippsland Water proposed to deliver from 1 July 2018 are to:

- partner with community, local government and business to plan for future years

⁷¹ South Gippsland Water's price submission is available on our website at www.esc.vic.gov.au. See pages 4 to 11.

- be reliable, minimise unplanned interruptions to services and commit to communicating well with its customers
- provide safe clean drinking water for the benefit of its customers and communities
- provide a safe wastewater service that contributes to the health and liveability of its communities and environment
- be environmentally responsible, sustainable and adapt to a future impacted by climate variability
- treat all customers and community with honesty, respect and strive to balance affordability, value for money and fairness.

South Gippsland Water proposed measures and activities it will use to report on progress against achieving each outcome. These are set out at page 15 of its price submission.

We will engage with South Gippsland Water to finalise the measures and targets used to assess performance against its outcomes, and how it will report this publicly. Performance against these measures will inform our assessment during future price reviews.

Guaranteed service levels

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

South Gippsland Water's proposed GSLs are set out on pages 41 and 42 of its price submission and were reviewed in consultation with its pricing submission advisory panel. It has made no changes to the hardship GSL, and proposed to increase the GSL amount from \$75 to \$100 for unplanned water and sewer interruptions that last longer than 5 hours. Other GSLs remain unchanged.

We propose to accept South Gippsland Water's GSLs as proposed, given they were tested with customers during its customer engagement. Final GSLs will be subject to our consideration of any feedback following the release of our draft decision.

3. PREMO rating

PREMO is an incentive mechanism that links the return on equity to a water corporation's level of ambition in delivering value to its customers.

For the 2018 price review, a water corporation must rate its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. The rating is based on an assessment against the Risk, Engagement, Management and Outcomes elements of PREMO. A 'Leading' price submission is allowed the highest return on equity, and a 'Basic' the lowest.

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

In Chapter 2, we noted our draft decision is not to accept South Gippsland Water's proposed return on equity of 4.5 per cent. Instead, we propose to allow a return on equity of 3.9 per cent. Below, we set out our preliminary assessment of South Gippsland Water's proposed PREMO rating.

Our review of South Gippsland Water's PREMO self-rating

South Gippsland Water's proposed PREMO rating, and our draft decision is summarised below.

Table 3.1 PREMO Rating

	Overall PREMO rating	Risk	Engagement	Management	Outcomes
South Gippsland Water's rating	Standard	Standard	Advanced	Standard	Standard
Commission's rating	Not rated	Basic	Standard	Not rated	Standard

Our draft decision is not to accept South Gippsland Water's proposed overall PREMO self-rating of 'Standard'. We have not assigned South Gippsland Water an overall PREMO rating.

We consider the information provided by South Gippsland Water in its price submission, and its follow up responses to our queries, was insufficient and inadequate, and did not meet the information standards required by our guidance, falling short of a 'Basic' rating. As such, we consider that its submission is consistent with a grading in the red-shaded zone in the PREMO

matrix – our guidance stated this red-shaded zone represents an area within which we would reserve our discretion.⁷²

Accordingly, we propose to approve a regulatory period of two years, rather than the five years proposed by South Gippsland Water (as discussed on page 6).

Our view on each element of PREMO is set out below.

Management

We have not assigned a rating for the Management element of PREMO. South Gippsland Water proposed a ‘Standard’ rating.

PREMO was designed to provide incentives for water corporations to deliver high quality price submissions, with accurate and consistent data. Compared to past price reviews, we have generally found water corporations have reduced the number of errors in their price submissions, contributing to an overall improvement in quality. This has not been the case for South Gippsland Water’s price submission. We found:

- South Gippsland Water’s price submission (including its financial model) included a large number of errors. This included ten resubmissions of its financial model to correct for previous errors. Each subsequent model included new errors requiring further review or follow up with the water corporation, adding to the complexity and costs of our assessment.
- Consultants assisting us to review South Gippsland Water’s expenditure and demand forecasts also noted errors in the data provided by South Gippsland Water, or errors in the application of models used by the corporation to establish its expenditure and demand forecasts.

The data provided by South Gippsland Water was of such poor quality that it made our assessment difficult, and we lack confidence in data provided by the corporation. Given this, our draft decision uses the best information available to us at this time, to estimate South Gippsland Water’s revenue requirement.

South Gippsland Water proposed the largest price increase of any water corporation covered by our current price review. Its forecasts incorporated an overall increase in controllable operating expenditure per water customer connection – one of only two water corporations to do so. Our review found opportunities to reduce expenditure forecasts below those proposed by South Gippsland Water in its price submission, demonstrating it had not done all it could to mitigate its proposed price increases.

⁷² Essential Services Commission 2016, *Guidance paper*, op. cit., p. 45-46. This includes, for example, requiring a water corporation to resubmit its proposal, or approving a shortened pricing period.

For the reasons set out above, our draft decision does not assign a rating for the Management element of PREMO.

Risk

Our draft decision proposes to approve a 'Basic' rating for the Risk element of PREMO, compared to the 'Standard' rating proposed by South Gippsland Water. Our reasons are:

- South Gippsland Water proposed a large increase in its asset renewals program, mainly informed by an age-based assessment of assets. We consider that a 'Standard' water corporation would use mainly condition-based assessments to inform asset renewals, particularly when relatively large price increases are proposed to support an expanded renewals program (which is the case for South Gippsland Water).
- Where a water corporation proposes relatively large price increases, we would expect to see clear evidence of its efforts to contain costs to mitigate customer impact. It remains unclear how South Gippsland Water has sought to minimise price impacts on its customers.

Engagement

South Gippsland Water self-rated its Engagement as 'Advanced'.

South Gippsland Water's engagement included an advisory panel, and a community survey on prices and tariffs, concessions, customer service and communications. Its engagement started relatively early, and allowed time for the corporation to re-test proposals with its advisory panel and customers before finalising them.

However, we are concerned with some aspects of South Gippsland Water's engagement. South Gippsland Water proposed price increases substantially higher than past levels that would have resulted in a price shock for some customers (page 33). In our view, South Gippsland Water could have done more to ensure customer groups most affected by its proposed price increases had the opportunity to participate, and could have made greater effort to ensure their views were taken into account. We do not consider this is consistent with an 'Advanced' rating.

For these reasons, our draft decision proposes to rate the Engagement element of 'PREMO' as Standard.

Outcomes

In support of South Gippsland Water's self-rating for the Outcome element of PREMO we note the influence of its engagement on its approach to maintaining services around current levels and increasing rebates to customers who experience service interruptions. This is consistent with a 'Standard' rating under PREMO.

4. We invite feedback on our draft decision

We invite feedback from stakeholders on our draft decision before we make a final decision and price determination. Our final decision and price determination will be made in June 2018.

Stakeholders may comment on any aspect of our draft decision, including the information we have relied upon in our assessment (such as South Gippsland Water's price submission). Feedback may also cover:

- additional matters or issues we should consider before making our final decision
- whether our draft decision on South Gippsland Water's price submission has adequate regard to the matters in clause 11 of the WIRO and our guidance.

How to provide feedback:

Attend a public forum

We will hold a public forum in April or May 2018. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. We will publish details of public forums at www.esc.vic.gov.au/waterpricereview.

Provide written comments or submissions

Written comments or submissions in response to this draft decision will be due in early May 2018.

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

We would prefer to receive comments and submissions via our website at www.esc.vic.gov.au/waterpricereview.

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

2018 Water Price Review
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

We usually make all comments and submissions publicly available in the interests of transparency. If you wish part or all of your submission to be private, please discuss with commission staff.

We invite feedback

If you cannot access documents related to our price review, please contact us to make alternative arrangements (phone (03) 9032 1300).

Next steps

Indicative dates are provided below. To keep up-to-date, visit our website at www.esc.vic.gov.au/waterpricereview.

- April or May 2018 – public forum.
- 8 May 2018 – closing date for submissions on our draft decision.
- June 2018 – release date for final decision and price determination.

APPENDIX A – submissions received

Name or organisation	Date received
Environment Protection Authority Victoria	12 December 2017
Consumer Action Law Centre	15 November 2017
Mr G Mallon	7 November 2017