

# Wannon Water final decision

2023 Water Price Review

23 June 2023

## **Acknowledgement**

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

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

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

### **An appropriate citation for this paper is:**

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

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# Contents

<b>Summary</b>	<b>iii</b>
<b>1. Our role and approach to water pricing</b>	<b>1</b>
1.1 We are Victoria's independent economic regulator	1
1.2 We are reviewing the proposed prices of 14 water businesses	1
1.3 We assess prices against the WIRO and other legal requirements	1
1.4 PREMO	5
<b>2. Our assessment of Wannon Water's price submission</b>	<b>7</b>
2.1 Final decision paper outline	7
2.2 Regulatory period	8
<b>3. Customer outcomes</b>	<b>9</b>
3.1 Customer and community engagement	9
3.2 Outcomes	10
3.3 Service standards related to service reliability and faults	11
3.4 Guaranteed service levels	12
<b>4. Revenue requirement</b>	<b>13</b>
4.1 Operating expenditure	16
4.2 Capital expenditure	22
4.3 Regulatory asset base	25
4.4 Rate of return	29
4.5 Regulatory depreciation	32
4.6 Tax allowance	32
<b>5. Demand, tariffs and prices</b>	<b>33</b>
5.1 Demand	33
5.2 Form of price control	33
5.3 Tariff structures and prices	34
5.4 New customer contributions	38
5.5 Adjusting prices	41
<b>6. Financial position</b>	<b>42</b>
<b>7. PREMO rating</b>	<b>43</b>
7.1 Our PREMO assessment of Wannon Water's price submission	43
<b>Appendix A – Submissions received on draft decision</b>	<b>46</b>
<b>Appendix B – Commission's consideration of legal requirements</b>	<b>47</b>
<b>Appendix C – Service standards</b>	<b>57</b>
<b>Appendix D – Guaranteed service level scheme</b>	<b>59</b>
<b>Appendix E – Inputs to calculation of long-term inflation</b>	<b>60</b>

# Summary

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

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

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



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

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

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

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

## **We have approved a revenue requirement of \$376.0 million over 5 years**

Our final decision approves a revenue requirement of \$376.0 million over the 5-year period starting 1 July 2023 (see Chapter 4).<sup>3</sup> This is \$5.2 million or 1.4 per cent higher than our draft decision, which mainly reflects our updates to the cost of debt.

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

Wannon Water has decided to set prices below an amount we would normally approve under our pricing approach. Normally prices would be set to recover its revenue requirement, which is based on an assessment of efficient costs. It has done this to support affordability. We have checked forecasts for key indicators of Wannon Water's financial performance and consider that the business will generate sufficient cash flow to deliver on its service commitments (Chapter 6).

Noting Wannon Water's approach is aimed at supporting affordability and having regard to its forecast financial position, our final decision approves its proposed prices. Wannon Water will not be able to claim revenue foregone due to its decision to set prices below an amount that we would normally approve under our pricing approach, in future regulatory periods.

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

A summary of approved maximum prices for major services delivered by Wannon Water is set out in Section 5.3.2. Notwithstanding that Wannon Water's prices are set below its revenue requirement, customer prices and bills will rise over the 2023–28 regulatory period.

Table A shows the estimated typical bills for different customer groups under our final decision, which reflects Wannon Water's decision to charge below its revenue requirement. For a typical residential owner-occupier, annual bills will rise from \$1,106 in 2022-23 to \$1,193 in 2023-24 (including inflation), an increase of around 7.9 per cent. For a typical residential tenant, bills will increase from around \$207 to \$226 (including inflation).

The bill paid by each customer will vary depending on water use, prices for fixed and variable tariffs, and other charges.

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

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

Customer group	Average consumption (kL p.a.)	2022-23 (current)	2023-24
		\$2022-23	\$2023-24
Residential – owner occupier	142	\$1,106	\$1,193
Residential – tenant	142	\$207	\$226
Non-residential (small)	100	\$1,122	\$1,211
Non-residential (medium)	1,000	\$4,192	\$4,526
Non-residential (large)	5,000	\$15,983	\$17,299

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

## **Wannon Water has committed to delivering outcomes that reflect customer priorities**

Wannon Water plans to deliver the following outcomes for customers:

- Ongoing reliability of water and sewerage services
- Ongoing protection of the environment through action and education, prioritising Country and our communities
- Fair and reasonable bills for all
- Improved water quality in identified communities
- Improved customer experience of our products and services
- Active partnerships for healthy and resilient communities.<sup>4</sup>

Among the key initiatives to deliver on its commitments, Wannon Water will improve access to its financial support programs and build capability to ensure it has proactive hardship identification, communication and outreach. A number of major projects seek to protect the environment and respond to the business’s compliance obligations, and it is on track to be carbon neutral by 2030.

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<sup>4</sup> Wannon Water, 2023 water price submission, September 2022, pp. 26–32.

## **Wannon Water has considered the impacts of relatively high inflation for 2023-24**

Our draft decision sought further information from Wannon Water on how it intends to address the impacts of relatively high inflation in 2023-24 on prices, customer bills, and expenditure. In its response to our draft decision, Wannon Water noted:

- It has experienced, and expects to experience again, some costs increasing by less than the consumer price index while others will increase by more.
- It expects material expenditure increases compared to its price submission forecasts for costs including electricity, IT, insurance, construction and consultant related expenditure, but it has not sought price increases to reflect these.
- By charging below its revenue requirement, it will not fully recover forecast expenditure from its customers.
- The business considered phasing small annual tariff increases to weight them higher in years two to five when assumed forecast inflation is lower. However, it noted this approach is inconsistent with its deliberative community panel's recommendation for steady bill increases now rather than substantial increases later (and impacts its proposal to increase variable water charges to provide customers with more bill control).

Wannon Water's response also noted that under its price cap form of price control, its board will have the opportunity to decide year by year whether to set prices in line with, or lower than the maximum amount determined by the commission. More information is available in Wannon Water's response to our draft decision.<sup>5</sup>

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

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

We accept Wannon Water's proposal to increase its variable water charge and reduce its fixed water service charge. Consistent with our view in our draft decision, we consider Wannon Water's

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<sup>5</sup> Wannon Water, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 9 May 2023, pp. 19-20.

proposal aligns with customer preferences revealed through its engagement for greater bill control. Even though Wannon Water has proposed to increase the variable charge, bills for Wannon Water’s residential customers will continue to have a relatively high proportion of fixed charges compared to variable charges.

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

## **We have rated Wannon Water’s price submission as ‘Standard’ under the PREMO framework**

Consistent with our draft decision, our final decision is to rate Wannon Water’s price submission as ‘Standard’ under the PREMO framework (Table B). This is the same as Wannon Water’s self-rating. Factors in support of Wannon Water’s PREMO rating include that the business implemented a strong engagement program, providing confidence that its proposals are informed by customer priorities and concerns. It also proposed to charge prices below its revenue requirement, helping to minimise the impacts of price increases on its customers. Wannon Water also proposed an improvement in service levels, and mechanisms to update customers and refine service targets during the 2023–28 regulatory period.

We agree with Wannon Water’s self-rating of ‘Leading’ for its price submission Engagement, albeit our final decision adopts a lower PREMO rating than proposed by Wannon Water for the Performance element of PREMO. Our final decision also adopts a ‘Standard’ rating for the Management element of PREMO, compared to the ‘Basic’ adopted in our draft decision based on additional information provided by Wannon Water in response to our draft decision. Our final decision rating for Management is the same as proposed by Wannon Water.

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



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



**Table B**    **PREMO rating**

	<b>Overall PREMO rating</b>	<b>Performance</b>	<b>Risk</b>	<b>Engagement</b>	<b>Management</b>	<b>Outcomes</b>
Wannon Water's self-rating	Standard	Standard	Standard	Leading	Standard	Standard
Commission's rating	Standard	Basic	Standard	Leading	Standard	Standard

# 1. Our role and approach to water pricing

## 1.1 We are Victoria's independent economic regulator

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

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

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.<sup>6</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.<sup>7</sup>

Wannon Water provided a submission to us proposing prices for a 5-year period starting 1 July 2023. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2023. We make a price determination after issuing a draft decision and considering feedback from interested parties, including any response to the draft decision from the water business.

The price determination specifies the maximum prices a water business may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We also issue a final decision that sets out our supporting reasons for our price determination.

## 1.3 We assess prices against the WIRO and other legal requirements

Clause 11 of the WIRO specifies the mandatory matters we must have regard to when making a price determination, including matters set out in the WIRO, the WI Act and the ESC Act, and clause 8 of the WIRO requires that we place particular emphasis on the promotion of efficiency related matters. In making a price determination, we have had regard to each of the matters required by clause 11 of the WIRO, including:

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

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<sup>6</sup> The review excludes Melbourne Water, Goulburn-Murray Water, North East Water and Greater Western Water. In 2021 we approved prices for Melbourne Water to 30 June 2026 and in 2020 we approved prices for Goulburn-Murray Water to 30 June 2024. In 2018, we approved prices for North East Water to 30 June 2026. We have approved an extension to the regulatory period for Greater Western Water to 30 June 2024.

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

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

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance<sup>8</sup>
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

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

In October 2021, we issued guidance to water businesses, including Wannon Water, to inform their price submissions. The guidance set out how we would assess Wannon Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Wannon Water would comply with certain requirements and specified information that Wannon Water must provide to us when submitting its price submission.<sup>9</sup>

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve Wannon Water's maximum proposed prices it can charge for the prescribed services it provides.<sup>10</sup>

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



The power for water businesses to charge fees for services they provide is set out in the *Water Act 1989*.<sup>12</sup> These provisions in the Water Act also govern the processes for and manner in which water businesses may set and impose fees. Each water business must ensure that it complies with these legislative requirements.

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<sup>8</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>9</sup> Among these expectations are matters that progress our 'Getting to fair' strategy relating to the water industry. See Essential Services Commission, *Getting to fair: Breaking down barriers to essential services*, August 2021.

<sup>10</sup> This is a requirement of the WIRO, clause 14(a).

<sup>11</sup> This is provided for under the WIRO, clause 14(b)(i).

<sup>12</sup> See Part 13, Division 5 and 6 of the Water Act 1989.

**Table 1.1 Matters businesses and the commission must have regard to**

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

Table 1.1 (continued)

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

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

## 1.4 PREMO

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

### Box 1.1 PREMO

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

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

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

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

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

Our PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.<sup>13</sup>

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<sup>13</sup> In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

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

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as 'Leading', 'Advanced', 'Standard' or 'Basic'. Its proposed return on equity will then reflect its proposed PREMO rating. A 'Leading' submission has the highest return on equity, and a 'Basic' submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business's justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>14</sup>

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<sup>14</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 41–46.

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

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

- Wannon Water's price submission
- Wannon Water's presentation made directly to commissioners
- Wannon Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 27 April 2023<sup>15</sup>
- written submissions from interested parties (a list of submissions responding to our draft decision is provided in Appendix A).

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

Our guidance included matters water businesses must address in their price submissions. Our initial assessment of Wannon Water's price submission is set out in our draft decision.

We consulted on our draft decision, receiving submissions between 6 April and 9 May 2023 and holding an online public forum on 27 April 2023. Themes raised during the forum included the cost reflectiveness of new customer contributions and the disproportionate effect of proposed changes on tenants.

Wannon Water provided a response to our draft decision, including a revised financial model that reflected the updated cost of debt and inflation figures we provided to businesses in May 2023.<sup>16</sup> In arriving at our final decision, we have considered Wannon Water's responses to our draft decision.

This paper sets out our final decision.

### 2.1 Final decision paper outline

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

- Determine the regulatory period (Section 2.2).

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<sup>15</sup> A recording of this forum is available on our website.

<sup>16</sup> All references to Wannon Water's price submission in this document refer to Wannon Water's original price submission that it provided to us in September 2022 rather than its response to our draft decision.



- Confirm the customer outcomes and service levels that Wannon Water has committed to over the regulatory period (Chapter 3).
- Establish Wannon Water's revenue requirement using a building block methodology (Chapter 4).
- Use demand forecasts and the form of price control to convert the revenue requirement to tariffs and prices (Chapter 5).

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

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

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

## 2.2 Regulatory period

Our final decision is to approve a regulatory period of 5 years from 1 July 2023.

We are required to set the term of the regulatory period over which a water business's price determination will apply.<sup>17</sup> Our guidance proposed that we set a 5-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.<sup>18</sup>

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

In a submission on our draft decisions, the Consumer Action Law Centre supported our proposed 5-year regulatory period. It noted that a 5-year period provided customers with predictability around billing and services and that having a uniform period across all businesses included in our current review meant it would be easier to generate public awareness and engagement.<sup>19</sup>

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

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<sup>17</sup> This is a requirement of the WIRO, clause 9.

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

<sup>19</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 4.

## 3. Customer outcomes

The customer outcomes Wannon Water plans to deliver over the regulatory period is a key component of its price submission – confirming its commitments to customers, underpinning its revenue requirement, and feeding in to its PREMO assessment.

This chapter outlines our views on:

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

### 3.1 Customer and community engagement

Our guidance required Wannon Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Wannon Water’s engagement.<sup>20</sup>

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

- began early and was wide-reaching, achieving more than 7,700 instances of engagement using engagement methods well-tailored to the circumstances of customers and its community
- covered topics relevant to services and prices, including affordability, tariff structures, water quality, service levels, customer experience and customer engagement
- probed widely and deeply on the issues affecting people experiencing vulnerability, as evidenced through the number of contacts it had with community support organisations
- expanded on its ongoing partnership and engagement with indigenous leaders and communities.

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

- investing additional funds to identify, communicate with and support customers experiencing payment difficulty

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

- adopting a price path involving incremental increases to customer bills
- investing in new water treatment infrastructure.

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

- establishing its regional advisory forum, which co-designed key elements of its engagement on its pricing submission, and ensured the quality of the consumer input at each stage of the process
- the high level of participation achieved across Wannon Water's diverse customer and community base, particularly the quality of its engagement with Traditional Owners and First Nations people, and people experiencing vulnerability
- Wannon Water's adoption of all the recommendations from its deliberative panel, as well as the unanimous support received from its regional advisory forum.

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

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

## 3.2 Outcomes

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

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

- Ongoing reliability of water and sewerage services
- Ongoing protection of the environment through action and education, prioritising Country and our communities
- Fair and reasonable bills for all
- Improved water quality in identified communities
- Improved customer experience of our products and services
- Active partnerships for healthy and resilient communities

Customer outcomes

Wannon Water's proposed measures and targets that it will use to report on the performance for each outcome are detailed on pages 26 to 32 in its price submission.

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

We considered its proposed set of outcomes for 2023–28 demonstrated an overall improvement in customer value and was consistent with the requirements of a 'Standard' rating for the Outcomes element of PREMO. After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Wannon Water's outcomes.<sup>21</sup>

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

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

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

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

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

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

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

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

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<sup>21</sup> A submission from the Consumer Action Law Centre (CALC) commended all businesses for working closely with customers to develop their proposed outcomes set. Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2023.

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

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

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

### **3.4 Guaranteed service levels**

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

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

Wannon Water's proposed guaranteed service levels are set out on page 34 of its price submission. As summarised in our draft decision, Wannon Water proposed no changes to its guaranteed service levels in its scheme from July 2023.

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

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

## 4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>22</sup> Along with forecast demand, it is an input to calculating prices.

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

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

Our final decision is to approve a revenue requirement of \$376.0 million.

Wannon Water proposed a revenue requirement of \$384.9 million over a 5-year period starting 1 July 2023. Our draft decision adopted a lower revenue requirement of \$370.8 million, mainly as a result of our proposed adjustments to Wannon Water's operating expenditure. Our final decision approves a revenue requirement of \$376.0 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

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<sup>22</sup> We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Wannon Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our final decision.

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

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	48.2	50.3	50.8	51.4	51.2	251.9
Return on assets	10.3	11.0	11.6	12.1	12.6	57.5
Regulatory depreciation	11.6	12.4	13.5	14.4	14.8	66.6
Tax allowance	-	-	-	-	-	-
<b>Final decision – revenue requirement</b>	<b>70.1</b>	<b>73.7</b>	<b>75.9</b>	<b>77.8</b>	<b>78.5</b>	<b>376.0</b>

**Note:** Numbers have been rounded.

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

Wannon Water updated its revenue requirement to reflect our updates to inflation and the cost of debt and, in response to our draft decision, also revised its forecast operating expenditure and capital expenditure.

We also invited Wannon Water to update its forecast costs and revenue requirement in response to any changes arising from the 2023-24 Victorian State Budget (see Section 4.1). In its response to us, it noted it will waive claiming the additional operating costs.

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

As noted in Section 5.3.2, Wannon Water’s price submission proposed to set prices below an amount that would enable it to recover its revenue requirement – that is, its proposed revenue from tariffs is lower than its proposed revenue requirement. It has reaffirmed this approach in its responses to our draft decision in order to support affordability. Wannon Water will not be able to claim revenue foregone due to its decision to set prices below an amount that we would normally approve under our pricing approach, in future regulatory periods. Our estimate of revenue foregone is set out in Table 4.3.

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

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Wannon Water's proposed revenue requirement</b>	<b>72.8</b>	<b>76.6</b>	<b>77.7</b>	<b>78.9</b>	<b>79.0</b>	<b>384.9</b>
<b>B. Total adjustments proposed in our draft decision</b>	<b>-2.2</b>	<b>-3.1</b>	<b>-2.8</b>	<b>-3.0</b>	<b>-3.0</b>	<b>-14.1</b>
Operating expenditure	-2.2	-3.0	-2.6	-2.6	-2.6	-12.8
Return on assets	0.0	-0.1	-0.2	-0.3	-0.3	-0.9
Regulatory depreciation	0.0	0.0	-0.1	-0.1	-0.2	-0.4
<b>C. Draft decision – revenue requirement (C = A+B)</b>	<b>70.5</b>	<b>73.5</b>	<b>74.8</b>	<b>75.9</b>	<b>76.0</b>	<b>370.8</b>
<b>D. Total adjustments in our final decision</b>	<b>-0.5</b>	<b>0.2</b>	<b>1.0</b>	<b>1.8</b>	<b>2.6</b>	<b>5.2</b>
Operating expenditure	0.0	-0.0	-0.0	-0.1	-0.1	-0.2
Return on assets	-0.5	0.2	1.1	1.9	2.7	5.4
<b>E. Final decision – revenue requirement (E = C + D)</b>	<b>70.1</b>	<b>73.7</b>	<b>75.9</b>	<b>77.8</b>	<b>78.5</b>	<b>376.0</b>

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

**Table 4.3 Estimated revenue foregone**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Final decision – revenue requirement	70.1	73.7	75.9	77.8	78.5	376.0
Final decision – revenue from tariffs (net prescribed revenue) <sup>a</sup>	69.6	70.8	72.0	73.2	74.4	360.0
<b>Revenue foregone</b>	<b>0.4</b>	<b>2.9</b>	<b>3.9</b>	<b>4.6</b>	<b>4.1</b>	<b>16.0</b>

**Note:** Numbers have been rounded. <sup>a</sup> The calculation of net prescribed revenue uses the prices proposed by Wannon Water and approved in our determination.



## 4.1 Operating expenditure

Our final decision is to adopt a forecast operating expenditure of \$251.9 million for Wannon Water for the 2023–28 regulatory period.

Operating expenditure – comprising both controllable and non-controllable expenditure – is a component of the revenue requirement. Our draft decision proposed to adopt a forecast operating expenditure of \$252.14 million for the 5-year period, which is \$12.84 million lower than proposed by Wannon Water.

Table 4.4 sets out our final decision on Wannon Water’s forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

**Table 4.4 Final decision – operating expenditure**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>44.52</b>	<b>46.74</b>	<b>47.32</b>	<b>47.99</b>	<b>47.93</b>	<b>234.50</b>
<b>Non-controllable operating expenditure</b>	<b>3.69</b>	<b>3.58</b>	<b>3.48</b>	<b>3.38</b>	<b>3.28</b>	<b>17.41</b>
Bulk services <sup>a</sup>	0.33	0.33	0.33	0.33	0.33	1.64
Environmental contribution <sup>b</sup>	3.09	2.98	2.88	2.79	2.69	14.43
Licence fees – Essential Services Commission <sup>c</sup>	0.06	0.06	0.06	0.06	0.06	0.29
Licence fees – Department of Health <sup>c</sup>	0.02	0.02	0.02	0.02	0.02	0.12
Licence fees – Environment Protection Authority <sup>c</sup>	0.18	0.18	0.18	0.18	0.18	0.92
<b>Final decision – operating expenditure</b>	<b>48.20</b>	<b>50.33</b>	<b>50.80</b>	<b>51.37</b>	<b>51.21</b>	<b>251.91</b>

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

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

Table 4.5 sets out the adjustments we have made to controllable and non-controllable operating expenditure for our draft decision and since our draft decision. Details of our assessment and the reasons for our final adjustments are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).

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

**Table 4.5 Our adjustments to Wannon Water’s operating expenditure for our draft and final decisions**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Wannon Water’s proposed total operating expenditure</b>	<b>50.36</b>	<b>53.29</b>	<b>53.42</b>	<b>54.02</b>	<b>53.89</b>	<b>264.97</b>
A1 – Our draft decision adjustments to controllable operating costs	-2.19	-2.96	-2.57	-2.56	-2.56	-12.84
A2 – Our draft decision adjustments to non-controllable operating costs	-	-	-	-	-	-
<b>B. Draft decision – total operating expenditure</b>	<b>48.17</b>	<b>50.33</b>	<b>50.85</b>	<b>51.45</b>	<b>51.33</b>	<b>252.14</b>
<b>C. Final adjustments to controllable operating costs (C1)</b>	<b>0.14</b>	<b>0.14</b>	<b>0.14</b>	<b>0.14</b>	<b>0.14</b>	<b>0.69</b>
C1 – Additional contractor support – cybersecurity	0.14	0.14	0.14	0.14	0.14	0.69

Continued next page

Table 4.5 (continued)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 + D5)</b>	<b>-0.10</b>	<b>-0.15</b>	<b>-0.19</b>	<b>-0.22</b>	<b>-0.26</b>	<b>-0.92</b>
D1 – Environmental contribution	-0.01	-0.05	-0.09	-0.13	-0.16	-0.45
D2 – Licence fees – Essential Services Commission	-0.05	-0.05	-0.05	-0.05	-0.05	-0.24
D3 – Licence fees – Department of Health	-0.00	-0.00	-0.00	-0.00	-0.00	-0.01
D4 – Licence fees – Environment Protection Authority	-0.01	-0.01	-0.01	-0.01	-0.01	-0.05
D5 – External bulk water charges – GWMWater	-0.03	-0.03	-0.03	-0.03	-0.03	-0.16
<b>E. Final decision – total operating expenditure (E = B + C + D)</b>	<b>48.20</b>	<b>50.33</b>	<b>50.80</b>	<b>51.37</b>	<b>51.21</b>	<b>251.91</b>

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

#### 4.1.1 Controllable operating expenditure

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

- We did not accept Wannon Water’s proposed baseline operating expenditure forecast, and adopted a provisional controllable operating expenditure baseline of \$44.98 million, based on our expenditure consultant’s advice to remove \$1.2 million for ‘one-off’ projects and \$1.0 million for additional contractor support.
- We identified that the 2021-22 benchmark figure proposed by Wannon Water included \$0.47 million in forecasted additional operating costs for the Warrnambool Sewage Treatment Plant upgrade, which has not been constructed within the current regulatory period. Removing this allowance means Wannon Water’s proposed baseline is \$6.85 million (or 17 per cent) higher than the equivalent benchmark figure of \$40.33 million. This is one of the highest baseline increases proposed for the 2023 water price review.

- We were not satisfied that Wannon Water had adequately explained why its operating expenditure rose suddenly in the 2021-22 baseline year compared to the first 3 years of the current regulatory period, especially given that the 2021-22 baseline year is critical for establishing the efficient forecast for setting prices to apply in the next regulatory period.
- In response to our draft decision, we required Wannon Water to provide a clear account of its controllable operating expenditure and the shifts that occurred in 2021-22, so we could establish an efficient baseline for our final decision and prices for 2023–28.
- Wannon Water had proposed an average efficiency improvement rate of 1.0 per cent per year which was in the lower half when compared to other businesses in the current price review. However, this proposed efficiency improvement rate was higher than Wannon Water’s proposed average cost growth rate of 0.74 per cent per year, which would effectively deliver a net annual decrease of 0.26 per cent per year to its controllable annual baseline operating costs in each year of the regulatory period.
- When compared to other businesses in the current price review, Wannon Water ranks third out of the 13 urban water businesses for lowest net annual changes to controllable operating expenditure.
- We considered Wannon Water’s forecast cost adjustment additions were prudent and efficient after removing \$1.95 million for the operating costs related to the Great Tasting Water project due to uncertainty regarding the scope, cost, timing and delivery of this project.
- There is evidence that Wannon Water has significantly tested its controllable expenditure requirements, resulting in a forecast overall decline (excluding inflation) in controllable operating expenditure per customer connection from 2024-25 onwards.

In response to our draft decision, Wannon Water provided:

- further explanation addressing the controllable operating expenditure shifts that occurred from 2020-21 to 2021-22
- further context on our proposed baseline operating expenditure reductions
- comment on our proposal to remove the operating expenditure related to the Great Tasting Water capital project.<sup>23</sup>

For the controllable operating expenditure shifts that occurred in 2021-22, Wannon Water provided a detailed breakdown of the increased costs, with the major increases attributed to digital transformation (including cyber resilience) which had been pushed back to 2021-22 due to the pandemic, increased regulatory compliance costs, and other observed price and cost increases.<sup>24</sup>

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<sup>23</sup> Wannon Water, *submission in response to the Essential Services Commission ‘Wannon Water draft decision: 2023 water price review’*, 9 May 2023, pp. 3–11.

<sup>24</sup> Wannon Water, *submission in response to the Essential Services Commission ‘Wannon Water draft decision: 2023 water price review’*, 9 May 2023, pp. 3–8.

The breakdown identified the main cost drivers as increased labour (own full-time equivalent staff and contractors) and software licence fees. We consider Wannon Water has now adequately explained the significant step change in costs from 2020-21 to 2021-22, addressing the concern we raised in our draft decision.

Wannon Water's response provided further justification for the \$1.2 million that was removed from the proposed higher baseline in our draft decision, which Wannon Water has explained is for 'one-off' operating projects.<sup>25</sup> We referred Wannon Water's response to our expenditure consultant, FTI Consulting. Our consultant confirmed its earlier view that these costs have been routinely incurred in previous years, that the 2021-22 costs were consistent with previous years, and that Wannon Water has not demonstrated its claim for an increase in baseline costs for this item. We accept that these project costs are necessary and include various recurring operating expenses, however if they were already included in the benchmark forecasts established at the 2018 price review, there is no justification for the \$1.2 million increase to the baseline.

In response to our removal of \$1.0 million from the baseline for additional contractor support, Wannon Water provided information to support the re-inclusion of \$0.14 million for specialist support for cyber security.<sup>26</sup> We are satisfied with the justification provided, and this view was supported by our expenditure consultant.

In its initial response to our draft decision, Wannon Water requested we revisit our decision to remove the operating costs associated with the Great Tasting Water capital project, but stated it was willing to accept our draft decision because its proposal to under-recover revenue meant there would be no change to its proposed customer prices. It did state, however, that it expected actual operating expenditure for this project would appear above the 2026-27 benchmark in its next price submission. Wannon Water provided an updated response, advising that \$26.1 million in funding had now been allocated for this project in the 2023-24 Commonwealth Government budget.<sup>27</sup> Despite this new certainty that the project will proceed in the 2023–28 regulatory period, Wannon Water is still willing to accept the removal of all operating expenditure associated with this project, consistent with our draft decision.

We acknowledge Wannon Water's position that its proposed under-recovery of revenue in the 2023–28 regulatory period means adjustments we make to its operating expenditure allowances will not result in adjustments to its proposed prices. Yet we must still establish a prudent and

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<sup>25</sup> Wannon Water, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 9 May 2023, pp. 9–10.

<sup>26</sup> Wannon Water, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 9 May 2023, pp. 10–11.

<sup>27</sup> Wannon Water, Update to Wannon Water's response to draft decision, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 22 May 2023, pp. 1-2. Also discussed in Commonwealth of Australia, Budget Paper No. 2, *'Budget Measures 2023–24'*, 9 May 2023, p. 75.

efficient benchmark to inform the maximum revenue allowance, and as a meaningful reference for the 2026-27 baseline year for the 2028 price review. Our final decision on controllable operating expenditure maintains our draft decision to remove the \$1.2 million Wannon Water stated was for 'one-off' projects from the increased 2021-22 baseline and to remove all forecast operating costs associated with the Great Tasting Water project. However, it re-instates \$0.14 million to the 2021-22 baseline for cyber security contractor support.

Following release of the 2023-24 Victorian State Budget on 23 May, we wrote to water businesses to provide them with an opportunity to update their cost forecasts, should they seek to claim any additional costs and reflect these in customer prices.<sup>28</sup>

Wannon Water responded that it would waive claiming the additional operating costs resulting from the 2023-24 State Budget.

After considering all submissions received in response to our draft decision, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised forecast controllable operating expenditure of \$234.50 million (Table 4.4) for Wannon Water over the next regulatory period.

#### 4.1.2 Non-controllable operating expenditure

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

- Wannon Water had followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission.
- We would verify Wannon Water's forecast bulk charges with GWMWater's charges for the next regulatory period once our final decision is made for GWMWater's 2023 price review.

We noted in our draft decision that we would update the forecast non-controllable operating expenditure for our final decision, and also adjust for the latest inflation and external bulk charges data.<sup>29</sup>

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

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<sup>28</sup> Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023

<sup>29</sup> Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

We have assumed the licence fees for the Department of Health and the Environment Protection Authority Victoria remain flat in real terms across the period.<sup>30</sup>

For our Essential Services Commission licence fee, we have taken our forecast fee estimate schedule, which is based on the expected work program across the 2023–28 regulatory period (which is in nominal dollars) and deflated it into 2022-23 dollars to express the fee in real terms.<sup>31</sup>

We have reduced Wannon Water’s forecast non-controllable operating expenditure by \$0.92 million across the 2023–28 period, resulting from the following adjustments:

- \$0.30 million decrease for licence fees after considering the latest information received from the relevant regulatory authorities
- \$0.45 million decrease for the environmental contribution to account for the latest data on inflation.
- \$0.16 million decrease for external bulk charges to reflect GWMWater’s approved bulk charges.

Accordingly, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised non-controllable operating expenditure of \$17.41 million over the 2023–28 regulatory period.

## 4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$143.0 million between 2023-24 and 2027-28.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Our draft decision proposed to adopt a forecast capital expenditure of \$143.0 million for the 5-year period, which is \$14.2 million lower than the \$157.2 million proposed by Wannon Water.

The reasons for our draft decision were that:

- Wannon Water demonstrated it has adopted a reasonable approach to developing its capital program, and that its capital expenditure forecasts are largely prudent and efficient.

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<sup>30</sup> For the Safe Drinking Water Administration levy, we have used the 2021-22 value provided by the Department of Health and indexed it by the annual rate for fees in 2022-23 (1.75 per cent), as set out by the Department of Treasury and Finance’s cost recovery guidelines (<https://www.dtf.vic.gov.au/financial-management-government/indexation-fees-and-penalties>). We have applied the same approach to the 2021-22 licence fee provided by the Environment Protection Authority Victoria.

<sup>31</sup> These fees are yet to be determined by the Minister for Water.

- The Great Tasting Water project was at the very early stages of development, and still awaiting government funding decisions, with a high level of uncertainty regarding the timing and delivery of the project. While recognising Wannon Water's commitment to this project, we considered it was more appropriate to exclude the expenditure while the project was being further developed, and we reduced Wannon Water's forecast for this project by \$14.2 million, retaining \$1.6 million for design and development costs.
- We considered the planned capital expenditure program is achievable given the size of its forecast capital program, the number of actions Wannon Water has taken to increase its capacity to deliver, and the advanced stage of the Warrnambool Sewage Treatment Plant upgrade.
- We considered Wannon Water's approach to forecasting its capital expenditure, other than the adjustment described above, is consistent with the requirements of our guidance.

Our draft decision invited Wannon Water to propose an alternative approach to the Great Tasting Water project to ensure the project proceeds to meet customer expectations.

In its initial response to our draft decision, Wannon Water accepted our draft decision approach, given its proposed prices would under-collect revenue, and additional capital expenditure would not impact customer tariffs. Wannon Water provided an updated response, advising that \$26.1 million in funding had now been allocated for this project in the 2023-24 Commonwealth Government budget.<sup>32</sup> With funding now confirmed, Wannon Water provided a revised total forecast for this work of \$52.2 million, with \$21.5 million of this to be recovered from customers, noting it expects the funding agreement will include an obligation to deliver the works for all three planned towns over 6 years.

However, despite this new certainty about investing in this project during the 2023–28 period, Wannon Water stated it is still willing to accept our draft decision allowance of \$1.6 million, highlighting the likely additional capital expenditure to be recovered at the end of the period has increased to approximately \$20 million.

We consider this approach is appropriate, given the development works still required and the uncertainty in the timing of the project identified in our draft decision. We also note that our decision has no impact on Wannon Water's customer tariffs over the next regulatory period, given its proposal to under-recover revenue from customers during the period. Further, we do not consider this approach increases the risk Wannon Water bears on behalf of its customers in the

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<sup>32</sup> Wannon Water, Update to Wannon Water's response to draft decision, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 22 May 2023, pp. 1-2. Also discussed in Commonwealth of Australia, Budget Paper No. 2, 'Budget Measures 2023–24', 9 May 2023, p. 75.



next period, for the same reason. Accordingly, our final decision relating to the capital expenditure for this project remains unchanged from our draft decision.

Our draft decision also required Wannon Water to exclude the costs of its Warrnambool Sewage Treatment Plant upgrade project from its price path until the upgrade is delivered and operational. In response to our draft decision, Wannon Water put forward a revised capital expenditure forecast, which shifted the full \$52.7 million of capital expenditure related to this project to 2025-26.<sup>33</sup> However, in doing so, it noted:

- its proposal to under-recover revenue for 2023–28 already provided lower customer prices that could be considered to exclude costs associated with this project
- its price submission proposal only added \$14.25 million to the regulatory asset base in 2022-23, compared to the expected spend of \$53.6 million, with the balance to be added at the end of the period
- new operating expenditure associated with the upgrade works is included in its operating expenditure forecasts after the project is complete and the plant operational.

We recognise Wannon Water's willingness to accept our draft decision requirement and to adjust its capital expenditure profile. However, we also acknowledge the proposed revenue under-recovery does address our concerns regarding the delivery timing for this project, with the proposed lower prices effectively excluding the costs of this project. We consider this negates the need to adjust the capital expenditure profile for this project, and we will retain the profile in Wannon Water's original price submission, and adopted in our draft decision, which ensures the expenditure benchmarks will better reflect the anticipated investment profile. Accordingly, our final decision on capital expenditure for this project remains unchanged from our draft decision.

Wannon Water also disputed our draft decision view that it did not specifically identify any project costs it had excluded where there was uncertainty in the timing, cost, scope and benefits of the capital expenditure, and that this finding was likely to have had a negative impact on its PREMO rating.<sup>34</sup> Wannon Water's response to our draft decision reiterated it has deferred \$15 million in projects until the next regulatory period 'to ensure customer bills aren't higher than they need to be, and that there is a higher likelihood of the program being delivered'.<sup>35</sup> We acknowledge this was stated in its price submission, but this appears to be deferred costs, rather than costs likely to be incurred during the period that Wannon Water will carry.

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<sup>33</sup> Wannon Water, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 9 May 2023, p. 14.

<sup>34</sup> Wannon Water, *submission in response to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 9 May 2023, p. 15.

<sup>35</sup> Wannon Water, 2023 water price submission, September 2022, p. 29.

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$143.0 million for the 5-year period (Table 4.7), as proposed in our draft decision and for the same reasons proposed in our draft decision. We consider this benchmark is consistent with our guidance and the principles in the Water Industry Regulatory Order (2014). Our final decisions on Wannon Water's forecast regulatory asset base (Table 4.7) and revenue requirement (Table 4.1) reflect this benchmark.

The benchmark that we propose to adopt for Wannon Water does not represent the amount that Wannon Water is required to spend or allocate to particular projects. Rather, it represents assumptions about the overall level of expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain or improve services over the regulatory period. Where we have made an adjustment to exclude a project's capital expenditure from Wannon Water's revenue requirement, we are not requiring the business to remove that project. Wannon Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

### **4.3 Regulatory asset base**

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>36</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4) and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Wannon Water to propose:

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

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<sup>36</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

### 4.3.1 Closing regulatory asset base

Our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$400.4 million.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.<sup>37</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>38</sup>

Our draft decision adopted a closing regulatory asset base of \$400.4 million at 30 June 2022. This was slightly higher than the \$400.1 million proposed by Wannon Water in its price submission due to minor adjustments we made to align with Wannon Water's approved regulatory accounts for 2021-22. In response to our draft decision, Wannon Water updated the closing regulatory asset base in its financial model to align with our draft decision.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. Therefore, our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$400.4 million (Table 4.6).

**Table 4.6 Final decision – closing regulatory asset base (RAB)**  
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
<b>Opening RAB 1 July</b>	<b>359.0</b>	<b>370.5</b>	<b>386.0</b>	<b>392.6</b>	<b>399.7</b>
Plus gross capital expenditure	23.1	28.9	28.4	23.9	16.7
Less government contributions	0.0	0.9	6.6	2.5	0.1
Less customer contributions	0.4	0.8	2.5	1.2	1.6
Less proceeds from disposals	0.5	0.7	0.9	0.6	0.5
Less regulatory depreciation	10.6	11.1	11.7	12.5	13.8
<b>Closing RAB 30 June</b>	<b>370.5</b>	<b>386.0</b>	<b>392.6</b>	<b>399.7</b>	<b>400.4</b>

**Note:** Numbers have been rounded.

<sup>37</sup> See Section 4.2 for a discussion of Wannon Water's capital expenditure.

<sup>38</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

### 4.3.2 Forecast regulatory asset base

Our final decision is to accept a forecast regulatory asset base as set out in Table 4.7.

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

Our draft decision did not accept Wannon Water's forecast regulatory asset base for the period from 1 July 2023 due to adjustments we proposed to Wannon Water's forecast capital expenditure.

In response to our draft decision, Wannon Water agreed with our position on the Great Tasting Water Project and the Warrnambool Sewage Treatment Plant upgrade. Wannon Water also proposed to carry forward capital costs of the Warrnambool Sewage Treatment Plant upgrade until its completion in 2025-26, which we had suggested in Section 5.3.2 of our draft decision.

However, having considered Wannon Water's explanation on the Warrnambool Sewage Treatment Plant upgrade, which does not impact the under recovery of revenue, our final decision is to adopt the capital expenditure position in our draft decision, which is consistent with Wannon Water's original price submission proposal.

Table 4.7 sets out our final decision on Wannon Water's forecast regulatory asset base from 1 July 2023.<sup>39</sup>

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

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

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<sup>39</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 38.

**Table 4.7 Final decision – forecast regulatory asset base (RAB)**

\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Opening RAB 1 July</b>	<b>400.4</b>	<b>399.6</b>	<b>447.4</b>	<b>464.7</b>	<b>466.7</b>	<b>467.8</b>
Plus gross capital expenditure	14.9	61.5	31.8	17.5	17.6	14.7
Less government contributions	-	-	-	-	-	-
Less customer contributions	1.0	1.5	1.5	1.5	1.5	1.5
Less proceeds from disposals	0.6	0.6	0.6	0.6	0.6	0.6
Less regulatory depreciation	14.3	11.6	12.4	13.5	14.4	14.8
<b>Closing RAB 30 June</b>	<b>399.6</b>	<b>447.4</b>	<b>464.7</b>	<b>466.7</b>	<b>467.8</b>	<b>465.6</b>

**Note:** Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our final decision is to adopt the benchmarks for customer contributions as set out in Table 4.7.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>40</sup>

Our draft decision used Wannon Water’s proposed customer contributions forecasts (based on its financial model) for the purposes of calculating the regulatory asset base and revenue requirement in our draft decision. However, we required Wannon Water to provide updated forecasts for revenue from customer contributions that reflected its response to our draft decision on its proposed new customer contributions. We also required Wannon Water to reconcile its proposed customer contributions in its financial model and new customer contributions model.

As discussed in Section 5.4, our final decision is to accept Wannon Water’s proposal to adopt its current new customer contributions charges at the 2022-23 levels. We compared Wannon Water’s forecasts for customer contributions with past outcomes and consider they are reasonable, having regard to past trends and its growth forecasts.

<sup>40</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water business’s water, sewerage or recycled water networks.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision accepts Wannon Water’s proposed revenue from customer contributions as set out in Table 4.7.

## 4.4 Rate of return

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

### 4.4.1 Cost of debt

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

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

In May 2023, we provided Wannon Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.<sup>41</sup> This reflects the rise in borrowing costs over the past 12 months. Wannon Water used this updated value to recalculate its revenue requirement.

For the above reasons, our final decision adopts the updated figures for the benchmark cost of debt as set out in Table 4.8.

**Table 4.8 Final decision – 10-year cost of debt**

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

**Note:** Numbers have been rounded.

<sup>41</sup> These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

## 4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.1 per cent in real terms, which reflects our overall PREMO rating of Wannon Water's price submission.

Under our PREMO incentive mechanism, which we have applied since 2018, the return on equity we adopt to calculate the revenue requirement is linked to a business's PREMO rating. See Chapter 7 for an explanation of PREMO and our assessment of Wannon Water's PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water business's self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business's self-rating and our rating.<sup>42</sup>

Wannon Water rated its price submission as 'Standard'. Based on this PREMO self-rating, Wannon Water proposed a real return on equity of 4.1 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as 'Standard'.<sup>43</sup>

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

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

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

## 4.4.3 Long term inflation forecast

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

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

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

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

calculated was 3.5 per cent.<sup>44</sup> All businesses adopted this amount to calculate prices in their responses to our draft decision. We checked this estimate again for our final decision, based on the method below.

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

Estimates we have adopted for each year of the 2023–28 regulatory period under the ‘RBA geometric mean’ approach are set out in Appendix E. Using the ‘RBA geometric mean’ approach we estimate an inflation rate of 3.8 per cent.<sup>45</sup>

For the ‘bond breakeven’ approach, we estimate a 5-year average rate of 3.3 per cent, with the estimates adopted for each year of the 2023–28 regulatory period also set out in Appendix E.<sup>46</sup>

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

However, to manage the risk that inflation falls well below our forecast, our price determinations include a provision that allows for a reconsideration of the inflation forecast adopted, if inflation falls below 2.5 per cent by 2026-27.<sup>47</sup> The updated inflation estimate, if needed, would be based on a 5-year averaging period.

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<sup>44</sup> The inflation rate adopted in our draft decision was 3 per cent.

<sup>45</sup> We have decided to use a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>46</sup> Similar to the ‘RBA geometric mean’ approach, we have adopted a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>47</sup> With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.



## 4.5 Regulatory depreciation

Our final decision is to adopt a forecast regulatory depreciation of \$66.6 million for Wannon Water for the 2023–28 regulatory period.

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

As indicated in our draft decision, Wannon Water’s forecast regulatory depreciation was calculated using a straight-line depreciation profile, which is our preferred approach.<sup>48</sup> However, as we proposed adjustments to its capital expenditure and did not accept its forecast regulatory asset base, our draft decision did not accept Wannon Water’s forecast regulatory depreciation.

In response to our draft decision, Wannon Water provided an updated forecast regulatory depreciation that reflected our draft decision on its forecast capital expenditure and regulatory asset base.

After considering all submissions received in response to our draft decision, on the basis of the above, our final decision is to adopt a forecast regulatory depreciation of \$66.6 million for the 2023–28 regulatory period (Table 4.7 in Section 4.3.2).

## 4.6 Tax allowance

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

The tax allowance is a component of the revenue requirement.

Our draft decision was to accept Wannon Water’s forecast of no tax allowance as it was calculated consistently with the method required by our guidance.<sup>49</sup>

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision accepts Wannon Water’s forecast tax allowance as set out in Table 4.1.

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<sup>48</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

<sup>49</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 47–48.

## 5. Demand, tariffs and prices

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

### 5.1 Demand

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

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

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

In response to our draft decision, Wannon Water did not adjust its demand forecasts as its forecasts remained higher than the updated Victorian Government estimates for its service area. Wannon Water noted the difference was not material and proposed to absorb the risks associated with its demand forecasts.

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

### 5.2 Form of price control

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

Our draft decision accepted Wannon Water's proposal to retain a price cap form of price control. Among other things, we considered that a price cap provides customers with price certainty, and allows Wannon Water to manage demand risk on behalf of its customers, which we consider is more efficient than customers managing that risk. Further, this is a continuation of Wannon Water's current approach.

After considering all submissions received in response to our draft decision, for the reasons set out above our final decision approves Wannon Water's proposed price cap form of price control.<sup>50</sup>

## 5.3 Tariff structures and prices

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

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

### 5.3.1 Tariff structures

Our final decision is to accept Wannon Water's proposed tariff structures.

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>51</sup> This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Wannon Water's current tariff structures include:

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

Wannon Water proposed to generally maintain these existing tariff structures, with a change to the mix of fixed and variable charges for its residential water service.

In our draft decision, we considered Wannon Water's proposal to increase the variable charge and reduce the fixed charge of its residential water charges aligns with customer preferences revealed through its engagement for greater bill control. Even though Wannon Water has proposed to increase the variable charge, bills for Wannon Water's residential customers will continue to have a relatively high proportion of fixed charges compared to variable charges.

We considered the two-part structure for water services will promote the efficient use of these services. It also sends customers a signal about the costs of their water use and is an approach

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<sup>50</sup> We note our determinations allow water businesses flexibility to apply to change from a price cap to a weighted average price cap or tariff basket within a regulatory period.

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

that is commonly applied in other states and territories.<sup>52</sup> We also considered two-part tariff structures are easy to understand. We considered Wannon Water's proposed tariffs will allow it to recover sufficient revenue to cover efficient costs.

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

We received one submission, from the Consumer Action Law Centre, which said that while it previously noted concerns about Wannon Water's change to the proportion of fixed and variable charges, it was now satisfied following our draft decision that the business had taken steps to address any impacts on renters and customers experiencing vulnerability.<sup>53</sup>

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

For the reasons set out above and given Wannon Water's proposed tariff structures are generally a continuation of its current approach and otherwise meet the criteria in our guidance, our final decision is to approve Wannon Water's proposed tariffs structures.

### 5.3.2 Prices

Our final decision is to accept Wannon Water's proposed prices.

In our draft decision, we required that Wannon Water propose updated prices to reflect any updates to its revenue requirement and impacts from higher inflation.

In its response to our draft decision, Wannon Water did not propose to change the prices proposed in its price submission.

Wannon Water has decided to set prices below an amount we would normally approve under our pricing approach. Normally prices would be set to recover its revenue requirement, which is based on an assessment of efficient costs. It has done this to support affordability. We have checked forecasts for key indicators of Wannon Water's financial performance and consider that the business will generate sufficient cash flow to deliver on its service commitments (Chapter 6).

Wannon Water will not be able to claim revenue foregone due to its decision to set prices below an amount that we would normally approve under our pricing approach, in future regulatory periods.

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<sup>52</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>53</sup> Consumer Action Law Centre, *submission to the Essential Services Commission 'Wannon Water draft decision: 2023 water price review'*, 5 May 2023.

The Consumer Action Law Centre submitted that Wannon Water’s proposal to under-recover its revenue requirement and charge lower prices addresses affordability concerns and addresses inflation and cost-of-living pressures impacting its customers.<sup>54</sup>

After considering all submissions received following our draft decision, our final decision is to accept Wannon Water’s proposed prices.

Notwithstanding that Wannon Water’s prices are set below its revenue requirement, customer prices and bills will rise over the 2023–28 regulatory period.

Our price determination for Wannon Water sets out the maximum prices it may charge for the 5-year period from 1 July 2023 (or the manner in which its prices are to be calculated, determined, or otherwise regulated). Approved maximum prices for water and sewerage services applying to most residential and non-residential customers are set out in Tables 5.1 and 5.2.

**Table 5.1 Final decision – water prices**  
\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Variable (\$/kL)	1.5952	1.6272	1.6597	1.6929	1.7268
Fixed (\$/year)	185.24	183.01	180.80	178.62	176.46
<b>Non-residential</b>					
Variable (\$/kL)	2.4433	2.4922	2.5420	2.5929	2.6447
Fixed – small (20 mm) (\$/year)	185.24	183.01	180.80	178.62	176.46
Fixed – medium (40 mm) (\$/year)	1,301.05	1,285.34	1,269.83	1,254.50	1,239.35
Fixed – large (100 mm) (\$/year)	4,301.39	4,249.46	4,198.15	4,147.47	4,097.40

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

<sup>54</sup> Consumer Action Law Centre *submission to the Essential Services Commission ‘Wannon Water draft decision: 2023 water price review’*, 5 May 2023.

**Table 5.2 Final decision – sewerage prices**

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Fixed (\$/year)	781.36	789.17	797.07	805.04	813.09
<b>Non-residential</b>					
Variable (\$/kL)	1.6419	1.6419	1.6419	1.6419	1.6419
Fixed (\$/year)	781.36	789.17	797.07	805.04	813.09

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

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

In making our price determination, we must have regard to whether Wannon Water’s prices take into account the interests of customers, including low income and vulnerable customers.<sup>55</sup>

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

- giving price certainty to customers over the regulatory period through a price cap
- under-recovering its revenue requirement by \$23 million and increasing its debt to minimise the anticipated cost of living pressures during the 2023–28 regulatory period
- improving access to its financial support programs by investing \$500,000 over the 5-year regulatory period to ensure proactive identification of vulnerable customers and improved communication and outreach programs
- providing an additional \$200,000 in financial support over the regulatory period for customers finding it difficult to pay their bills.

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

<sup>55</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

### 5.3.4 Other services

In our draft decision, we considered Wannon Water's proposal for trade waste and miscellaneous services were calculated in accordance with the pricing principles referenced in our guidance.

After considering all submissions received in response to our draft decision, our final decision is to approve Wannon Water's proposed tariffs for trade waste and miscellaneous services.

## 5.4 New customer contributions

Our final decision is to accept Wannon Water's proposed new customer contributions and its proposed negotiating framework for negotiated new customer contributions.

New customer contributions (or developer charges) are levied by water businesses when a new connection is made to its water, sewerage or recycled water networks. New customer contributions can be either standard or negotiated. Standard charges apply to new connections in areas where infrastructure requirements and growth rates are relatively well known and designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.<sup>56</sup>

Negotiated charges allow water businesses and developers to negotiate a site-specific arrangement where standard charges are not fair and reasonable or where a new connection is outside the areas eligible for standard charges.<sup>57</sup>

Our draft decision proposed to not accept Wannon Water's proposal to adopt its current (2022-23) new customer contributions in 2023-24 and to keep them flat in real terms across the 2023–28 regulatory period because they do not appear to be cost reflective. We requested Wannon Water to:

- update its modelled new customer contributions for each area and ensure the parameters used are consistent with the financial model
- demonstrate that the growth capital expenditure and customer contributions revenue included in the regulatory asset based and the new customer contributions model can be reconciled
- submit its transition plan towards the application of cost reflective new customer contributions.
- Set out how it proposes to fund any shortfall in revenue from new customer contributions compared to the estimated costs of providing the service.

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<sup>56</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

<sup>57</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

Our draft decision accepted Wannon Water's negotiated new customer contribution framework as it was consistent with our guidance.

In response to our draft decision, Wannon Water:

- updated its cost modelling for the Warrnambool area using the parameters in its pricing model
- did not update its cost modelling for the North Dennington Growth Area and All Other Areas as it considered new connections in these areas are small and inconsequential in terms of revenue
- advised that it considered the \$2,200 discount for the Warrnambool roof water harvesting area and the new customer contributions for 'All Other Areas' remain appropriate.

We have reviewed Wannon Water's proposed new customer contribution proposal against our guidance paper requirements.

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

- send signals to developers about the costs of developing in different locations
- share the costs and benefits of growth between new and existing customers
- administer new customer contributions in a transparent way.<sup>58</sup>

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

Wannon Water has not proposed any changes to its new customer contributions from its current charges or from its 2013 charges (before inflation) despite higher calculated new customer contributions. Our review of population growth indicates low growth in the area that Wannon Water services and so there is no need for charges to increase to cover additional costs associated with population growth.

Wannon Water could do more on transitioning to cost-reflective pricing and engaging stakeholders (developers and the broader customer group) on its proposal to charge below cost-reflective pricing. However, our final decision is to approve Wannon Water's proposed new customer contributions as, on balance:

- Wannon Water's proposed new customer contributions consider costs by location, hence it sends signals to developers about the costs of developing in different locations
- the proposed charges appear to be supported by stakeholders with Wannon Water receiving little feedback from stakeholders during its engagement to change its current charges

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<sup>58</sup> Essential Services Commission, *New Customer Contributions Explanatory Note Final*, December 2013, p.2.



- the proposed charges appear to share the costs and benefits of growth between new and existing customers.

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

Our final decision is to approve Wannon Water's negotiating framework for negotiated new customer contributions as it is consistent with our guidance.

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

#### **5.4.1 Review of the framework for new customer contributions**

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

##### **5.4.1.1 Current issues**

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

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

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

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

#### **5.4.1.2 Next steps**

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

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

### **5.5 Adjusting prices**

Our final decision is to accept Wannon Water's proposed price adjustment mechanisms.

Our draft decision accepted Wannon Water's proposal to continue the existing uncertain and unforeseen events mechanism as it reflects a continuation of current arrangements. Our final decision approves the uncertain and unforeseen event mechanism for the same reason.

Our draft decision did not accept Wannon Water's proposed adjustment mechanism relating to the cost of debt and requested that it propose an adjustment mechanism that will enable prices to adjust downward where they would otherwise exceed the revenue requirement in a particular year. We also considered the adjustment should limit downward movements to match the revenue requirement.

Under our final decision, and noting the business's decision to charge below its revenue requirement, net prescribed revenue (revenue from approved tariffs) will be lower than the calculated revenue requirement in each year of the 2023–28 regulatory period.

In response to our draft decision, Wannon Water revised its cost of debt adjustment mechanism. We approve the revised proposal because it ensures that the gap between net prescribed revenue and the revenue requirement does not increase further because of annual cost of debt adjustments. This will support the business's financial position.

## 6. Financial position

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

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

Our guidance set out key indicators of forecast financial performance. We have reviewed forecasts for these key indicators based on our final decision on Wannon Water's prices. Notwithstanding that Wannon Water has decided to charge prices that will under-recover compared to our final decision on its revenue requirement, we have assessed that under our final decision, Wannon Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations. It has comfortably met the thresholds we noted in our guidance on its financial indicators.

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<sup>60</sup> WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

## 7. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water business's revenue requirement to that business's level of ambition expressed in its price submission. Our guidance required Wannon Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.<sup>61</sup> We required Wannon Water to self-rate its price submission as either 'Leading', 'Advanced', 'Standard' or 'Basic', with 'Leading' being the most ambitious and 'Basic' the least.

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

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

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

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

Wannon Water's self-rating for each of the PREMO elements and its overall self-rating are shown in Table 7.1. This table also includes our draft and final ratings of Wannon Water's price submission.

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<sup>61</sup> This is the first price review we have done where the rating has been based on all five elements of PREMO. In our 2018 price review, our PREMO assessment was against only four of the elements — Risk, Engagement, Management and Outcomes.

**Table 7.1**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Wannon Water’s self-rating	Standard	Standard	Standard	Leading	Standard	Standard
Commission’s draft decision rating	Standard	Basic	Standard	Leading	Basic	Standard
Commission’s final decision rating	Standard	Basic	Standard	Leading	Standard	Standard

Our preliminary PREMO assessment is set out in our draft decision.

Our final decision is to agree with Wannon Water’s proposed overall PREMO self-rating of ‘Standard’. This rating is reflected in the return on equity we have approved for Wannon Water (see Section 4.4.2).

The following matters support an overall rating of ‘Standard’ for Wannon Water’s price submission:

- a strong engagement program in which Wannon Water provided participants with a high level of influence on its proposals, including the use of a deliberative forum to explore proposed price changes and its tariffs, that provided information that enabled panel members to make informed decisions about the impacts of price increases on low income customers and customers experiencing vulnerability
- its proposal to continue to use a price cap form of price control, providing price certainty for customers and accepting demand risk on behalf of customers
- proposing to increase the variable proportion of customer bills, adding to the demand risk accepted by the business
- the targets proposed by Wannon Water for its outcome measures suggest an overall improvement in customer value
- Wannon Water’s commitment to reporting annually to its customers on how it has performed against its outcome commitments, and to review targets where it proposes an increase in service and value as part of its annual engagement program
- its plan to establish an annual forum with representatives from its diverse customer groups to discuss new or unexpected issues, which we consider provides a good level of accountability for performance.

Our draft decision rated the Management element of PREMO as ‘Basic’ instead of ‘Standard’ as proposed by Wannon Water. Noting the commission’s lower rating, in its response to our draft

decision, Wannon Water sought to reaffirm its self-rating of 'Standard' by providing justification for the operating expenditure that influenced the commission's assessment and rating.

One of the main reasons for the 'Basic' rating we adopted for Management in our draft decision was our view that Wannon Water had not adequately explained why its operating expenditure rose suddenly in the 2021-22 baseline year compared to the first 3 years of the current regulatory period, especially given that the 2021-22 baseline year is critical for establishing the efficient forecast for setting prices to apply in the next regulatory period.

In its response to our draft decision, Wannon Water provided further explanation addressing the controllable operating expenditure shifts that occurred from 2020-21 to 2021-22. As noted in Section 4.1.1, we consider Wannon Water has now adequately explained the significant step change in costs from 2020-21 to 2021-22, addressing the concern we raised in our draft decision. Accordingly, we have updated our rating for the Management element to a rating of 'Standard' compared to the draft decision rating of 'Basic'.

Wannon Water's response to our draft decision also submitted that our proposed adjustments for expenditure seemed excessive, particularly given its proposed approach to under-recover its revenue requirement. We also acknowledge that Wannon Water proposed to charge below its revenue requirement. However, one of our main tasks in a price review is to establish a prudent and efficient benchmark for costs to determine an efficient revenue requirement. The decision to not fully recover the revenue requirement is a decision made by the business, not the commission.

Consistent with our draft decision, our final decision rates the Performance element of PREMO as 'Basic'.

## Appendix A – Submissions received on draft decision

Name or organisation	Date received
Consumer Action Law Centre	5 May 2023
Wannon Water	9 May 2023
Wannon Water	22 May 2023
Registered Accommodation Association of Victoria	26 May 2023

## Appendix B – Commission’s consideration of legal requirements

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

Below, we describe how we apply the mandatory factors and where we have done so in our final decision for Wannon Water.

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.<sup>62</sup> Our draft and final decisions provide further information on where we have considered our guidance, and Wannon Water’s compliance with our guidance, in making our price determination.<sup>63</sup>

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

### **Economic efficiency and viability matters**

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

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

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

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

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

<sup>63</sup> Essential Services Commission, *Wannon Water draft decision: 2023 water price review*, 6 April 2023; Essential Services Commission, *Wannon Water Determination: 1 July 2023 – 30 June 2028*, 23 Month 2023.



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

**WIRO clause 8(b)(ii) requires us to have regard to the ‘promotion of efficiency in regulated entities as well as efficiency in, and financial viability of, the regulated water industry’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost promotes efficiency in regulated entities and the water industry. Our final decision has therefore had regard to the extent that Wannon Water has demonstrated its proposed outcomes reflect customer service priorities, and whether its tariffs and forecast costs reflect efficient levels of expenditure.

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

- Our consideration of customer engagement (Section 3.1).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).
- Our assessment of financial viability (Chapter 6).

**WIRO clause 8(b)(iii) requires us to have regard to the ‘provision to regulated entities of incentives to pursue efficiency improvements’.**

We consider that the delivery of outcomes which reflect customer service priorities at an efficient cost provides regulated entities incentives to pursue efficiency improvements. The following chapters and sections of our final decision involved consideration of this factor:

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

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

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

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

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

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

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

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

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

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

We have had regard to this matter in Chapter 6.

**ESC Act section 33(3)(b) requires us to have regard to the ‘efficient costs of producing or supplying regulated goods or services and of complying with relevant legislation and relevant health, safety, environmental and social legislation applying to the regulated industry’.**

In preparing our final decision, we have had regard to the extent Wannon Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

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

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

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

## **Industry specific matters**

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

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

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

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

We have had regard to the prescribed services listed in the WIRO in making our final decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Wannon Water to deliver services that are covered by the prescribed services listed in the WIRO.

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

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

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

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

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

- indicative bills paid by customers in other jurisdictions in Australia<sup>65</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>66</sup>
- tariff structures applied by water businesses throughout Australia<sup>67</sup>
- the regulatory rate of return set by other regulators.<sup>68</sup>

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

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

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

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

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

Our price review also considers the views of stakeholders affected by Wannon Water’s proposals, including through submissions and public meetings.

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

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

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

<sup>68</sup> Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW's rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water's water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

## **Customer matters**

**ESC Act section 8(1) requires us to have regard to the fact that the ‘objective of the commission is to promote the long term interests of Victorian consumers’.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers is consistent with promoting the long-term interests of Victorian consumers.

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

- Our consideration of customer engagement (Section 3.1).
- Our consideration of outcomes (Section 3.2).
- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).
- Our assessment of financial viability (Chapter 6).

**ESC Act Section 8(2) requires us to ‘have regard to the price, quality and reliability of essential services’ in seeking to achieve the objective in section 8(1) of the ESC Act.**

We consider that promoting efficiency in delivering outcomes that align to service priorities of customers, and allowing businesses to meet regulatory and policy obligations is consistent with this objective.

In terms of prices, the following chapters and sections of our final decision involved consideration of this factor:

- Our consideration of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our consideration of demand (Section 5.1).
- Our consideration of tariffs (Section 5.3).

In terms of the quality and reliability of services, the following sections of our final decision involved consideration of this factor:

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

**WIRO Clause 11(d)(i) requires us to have regard to whether Wannon Water’s prices ‘enable customers or potential customers of the regulated entity to easily understand prices charged by the regulated entity for prescribed services or the manner in which such prices are calculated, determined or otherwise regulated’.**

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

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

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

- Our consideration of tariffs and the form of price control (Section 5.2 and Section 5.3).

**WIRO Clause 11(d)(ii) requires us to have regard to whether Wannon Water’s prices ‘provide signals about the efficient costs of providing prescribed services to customers while avoiding price shocks where possible’.**

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

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

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

**WIRO Clause 11(d)(iii) requires us to have regard to whether Wannon Water’s prices ‘take into account the interests of customers of the regulated entity, including low income and vulnerable customers’.**

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

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

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

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

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

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

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

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

- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of the form of price control (Section 5.2).

**WI Act section 4C(c) requires us to ‘ensure that regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities’.**

Our final decision proposes to approve a revenue requirement that will enable Wannon Water to deliver the outcomes valued by customers, and on its health, safety, environmental sustainability and social obligations.

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

- Our assessment of the revenue requirement (Chapter 4).
- Our assessment of efficient operating expenditure (Section 4.1) and capital expenditure (Section 4.2).
- Our assessment of tariffs (Section 5.3).

## **Other matters**

**ESC Act section 8A(1)(c) requires us to have regard to ‘the degree of, and scope for, competition within the industry, including countervailing market power and information asymmetries’.**

In relation to the above, Wannon Water does not face any competition in the delivery of its prescribed services within its region. Our final decision takes this into account through our consideration of forecast efficient costs, and considering the service priorities of customers as revealed through a business’s customer engagement.

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

## Appendix C – Service standards

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

### Water service standards – excluding flow rates

Service standard	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of unplanned water supply interruptions a customer may experience in any 12-month period (number)	5	5	5	5	5
Average time taken to attend bursts and leaks (priority 1) (minutes)	22	22	22	22	22
Average time taken to attend bursts and leaks (priority 2) (minutes)	24	24	24	24	24
Average time taken to attend bursts and leaks (priority 3) (minutes)	51	51	51	51	51
Average duration of unplanned water supply interruptions (minutes)	138	138	138	138	138
Average duration of planned water supply interruptions (minutes)	149	149	149	149	149

### Water service standards – flow rates

	Water meter size				
	20mm meter	25 mm meter	32 mm meter	40 mm meter	50 mm meter
Minimum flow rate (litres per minute)	20	35	60	90	160

## Sewerage service standards

Service standard	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer may experience in any 12- month period (number)	3	3	3	3	3
Average time to attend sewer spills and blockages (minutes)	40	40	40	40	40
Average time to rectify a sewer blockage (minutes)	114	114	114	114	114
Maximum time taken to contain a sewage spill (minutes)	300	300	300	300	300

## Appendix D – Guaranteed service level scheme

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

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

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

### Wannon Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
Subject to exclusions, if there are more than two unplanned interruptions to the service supplying water to the customer’s property in any 12-month period, the customer will be entitled to a GSL rebate of \$100.	\$100
Subject to exclusions, if there is a sewerage spill in a customer’s house the customer will be entitled to a GSL rebate of \$500.	\$500
Subject to exclusions, if there is a sewerage spill on a customer’s property the customer will be entitled to a GSL rebate of \$100.	\$100
If Wannon Water restricts the water supply of, or takes legal action against, a residential customer prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying, the customer will be entitled to a GSL rebate of \$300.	\$300

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

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

Inflation – annual estimates (per cent)

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