



Greater Western Water draft decision

2024 Water Price Review

26 March 2024



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 2024, *Greater Western Water draft decision: 2024 Water Price Review*, 26 March

Copyright notice

© Essential Services Commission, 2024



This work, Greater Western Water draft decision, is licensed under a Creative Commons Attribution 4.0 licence [creativecommons.org/licenses/by/4.0/]. You are free to re-use the work under that licence, on the condition that you credit the Essential Services Commission as author, indicate if changes were made and comply with the other licence terms.

The licence does not apply to any brand logo, images or photographs within the publication.

Contents

Summary	iii
1. Our role and approach to water pricing	1
1.1 We are Victoria's independent economic regulator	1
1.2 We are reviewing Greater Western Water's proposed prices	1
1.3 We assess prices against the WIRO and other legal requirements	1
1.4 PREMO	5
2. Our assessment of Greater Western Water's price submission	7
2.1 Draft decision paper outline	8
2.2 Regulatory period	8
3. Customer outcomes	9
3.1 Customer engagement	9
3.2 Outcomes	12
3.3 Service standards related to service reliability and faults	18
3.4 Guaranteed service levels	19
4. Revenue requirement	21
4.1 Operating expenditure	23
4.2 Capital expenditure	36
4.3 Regulatory asset base	44
4.4 Rate of return	48
4.5 Regulatory depreciation	50
4.6 Tax allowance	50
5. Demand, tariffs and prices	51
5.1 Demand	51
5.2 Form of price control	51
5.3 Tariff structures and prices	52
5.4 New customer contributions	58
5.5 Adjusting prices	63
6. Financial position	65
7. PREMO rating	67
7.1 Our PREMO assessment of Greater Western Water's price submission	67
Appendix A — Submissions received	74
Appendix B — Commission's consideration of legal requirements	75

Summary

Our draft decision considers Greater Western Water’s proposed prices for a four-year period starting 1 July 2024

This draft decision sets out our preliminary views on Greater Western Water’s price submission.¹ Our draft decision should be read together with Greater Western Water’s price submission.



We invite interested parties to comment on our preliminary views in this draft decision before we make a final decision and issue a price determination in June 2024. For details of how to provide feedback, see our dedicated Engage Victoria page: <https://engage.vic.gov.au/water-price-review-2024>.

This will be our first determination for Greater Western Water

On 1 July 2021, City West Water and Western Water integrated to form Greater Western Water. The existing price determinations set for City West Water in 2018 and Western Water in 2020, and with which Greater Western Water must comply, originally applied until 30 June 2023.

On 14 October 2021, we received a request from Greater Western Water to have the determinations for City West Water and Western Water extended by one year to 30 June 2024.² Greater Western Water requested the additional time ‘to develop a greater level of understanding of the unique circumstances of integration, and how it can deliver long-term benefits to its customers’. We approved Greater Western Water’s request given these benefits.³

In September 2022 we issued guidance to Greater Western Water setting out our information requirements for its price submission. While similar to the guidance we issued businesses for the 2023 water price review, it included modifications to address specific matters arising from the one-year extension to the regulatory period and the integration of the two businesses. We consulted with Greater Western Water in developing the modifications to the guidance.

In September 2023, Greater Western Water lodged its first price submission for our assessment. This set out its proposals relating to customer outcomes and prices, in the context of it needing to consider issues resulting from the merger such as the different prices and tariff structures applying

¹ Clause 16 of the Water Industry Regulatory Order 2014 requires the Essential Services Commission to issue a draft decision; Greater Western Water’s price submission is available on our website at www.esc.vic.gov.au.

² Greater Western Water 2021, *Price determination 12-month extension request*, 14 October.

³ Essential Services Commission 2021, Commission letter to Greater Western Water approving extension of regulatory period, 2 December.

in the regions previously serviced by City West Water and Western Water, different service commitments and levels, and reconsideration of expenditure levels and priorities for the merged business.

The business also undertook a comprehensive engagement program to explore these issues for its price submission. We recognise addressing these matters can be challenging, and for issues such as tariff structures it can take some time to transition to consistent arrangements and balance the impacts on affected customers.

Greater Western Water has committed to delivering outcomes that reflect customer priorities

Greater Western Water plans to deliver the following outcomes for customers:

- your water is safe, consistent and resilient
- when things go wrong, we fix them
- we support our diverse communities and customers
- we enable growth and help businesses thrive
- we heal and care for Country.

Among key initiatives to deliver on its commitments, Greater Western Water will invest to increase the resilience of its infrastructure to deal with challenges including climate change and population growth. It will also increase financial support for customers experiencing vulnerability and for small businesses experiencing hardship. Building on its engagement, Greater Western Water will take a caring-for-Country approach to its land and waterways in partnership with Traditional Owners, agencies, and community members, supported by its new outcome 'heal and care for Country'.

Our draft decision approves a lower revenue requirement than proposed by Greater Western Water

Our draft decision approves a revenue requirement that will allow Greater Western Water to deliver on its customer service commitments, government policy, and obligations monitored by the Environment Protection Authority Victoria and the Department of Health.

Our draft decision is to approve a revenue requirement of \$3,439 million for Greater Western Water over a four-year period starting 1 July 2024 (Chapter 4).⁴ This figure is \$44.0 million or

⁴ The revenue requirement is the forecast amount a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health. Along with forecast demand, it is an input to calculating the prices to be charged by a water corporation.

1.3 per cent lower than proposed by Greater Western Water, mainly reflecting our proposed adjustments to Greater Western Water's controllable operating expenditure benchmarks.

This reduction is partly offset by the impact of our update to the forecast long-term inflation rate, from 3.5 per cent to 3.0 per cent.⁵ The main impact of this update to long-term inflation is to increase the real cost of debt included in the revenue requirement.

The lower revenue requirement we have proposed in our draft decision means Greater Western Water will need to reconsider its maximum prices, which will flow through to customer bills.

Greater Western Water must respond to our draft decision and propose individual tariffs that consider our initial views on the revenue requirement. Prior to our final decision, maximum prices will also need to be updated to reflect our upcoming updates to inflation and the cost of debt, and approved Melbourne Water bulk water and sewerage tariffs for 2024-25.

Our draft decision also provides an opportunity for Greater Western Water to provide further information where we have formed a different preliminary view in our draft decision, compared to its proposals.

In June 2024, we intend to determine prices for Greater Western Water in \$2024-25 terms. This means the annual change in the March Quarter 2024 consumer price index (published by the Australian Bureau of Statistics) needs to be used to calculate 2024-25 maximum approved prices.

Greater Western Water's proposal resulted in generally lower customer bills in 2024-25

Based on Greater Western Water's price submission, the typical annual water and sewerage bill for a residential owner-occupier who uses both water and sewerage services in its central region would fall from \$1,007 to \$996 in 2024-25 and then increase to \$1,005 by 2027-28 (Table A). In its western region, a typical bill for an owner occupier would fall from \$1,099 to \$1,092 in 2024-25, reducing to \$1,052 by 2027-28. These estimates are in \$2023-24 and exclude inflation.

The typical tenant bill in the central region area would decrease from \$531 to \$511 in 2024-25 and remain flat in real terms for the remaining years. In the western region, the typical tenant bill would increase from \$348 to \$355 in 2024-25 and then increase to \$374 by 2027-28.⁶ This increase is impacted by a shift to higher variable charges (and lower fixed charges) in the western region to more closely align with tariffs in the central region. Estimated annual water and sewerage bills for

⁵ Once the March quarter CPI has been released, the commission will re-estimate the long-term inflation forecast prior to final decision, as stated in our guidance p. 40. This may change the long-term inflation forecast from 3.0 per cent.

⁶ These estimated tenant bills do not include the efficiency rebate currently paid to tenants, which will be reduced to zero by 2027-28. This rebate was applied to tenant bills by one of Greater Western Water's antecedent businesses, Western Water.

non-residential customers (by selected water consumption levels) based on Greater Western Water’s price submission proposals, are also shown below.

As noted above, maximum prices will need to be updated following our draft decision, which will impact the estimates for customer bills.

Table A Estimated typical water and sewerage bills based on Greater Western Water’s proposal (\$2023-24)

	Average consumption (kL p.a.)	2023-24 (current)	2024-25	2027-28
Residential – owner occupier – Central	150	\$1,007	\$996	\$1,005
Residential – owner occupier – Western	150	\$1,099	\$1,092	\$1,052
Residential – tenant – Central	150	\$531	\$511	\$511
Residential – tenant – Western ⁷	150	\$348	\$355	\$374
Non-residential (small) – Central	100	\$1,297	\$1,305	\$1,296
Non-residential (small) – Western	100	\$1,057	\$1,056	\$1,026
Non-residential (medium) – Central	1,000	\$5,694	\$5,722	\$5,714
Non-residential (medium) – Western	1,000	\$3,812	\$3,830	\$3,801
Non-residential (large) – Central	5,000	\$25,233	\$25,354	\$25,346
Non-residential (large) – Western	5,000	\$16,056	\$16,162	\$16,133

⁷ Estimated tenant bill does not include the efficiency rebate currently paid to tenants, which will be reduced to zero by 2027-28.

Greater Western Water proposes reforms to support tariff alignment across its regions

Greater Western Water proposed to retain distinct pricing zones – the western region covering the former Western Water region and the central region covering the former City West Water region, in the next regulatory period. Some proposals further the harmonisation of its tariffs in the next four-year regulatory period, supporting a transition to similar prices for similar services across its entire region over the next eight years.

For residential customers receiving both water and sewerage services in its central region, Greater Western Water proposed to combine its residential sewage disposal charge and its residential variable water charge. This means both regions will have only a fixed sewerage charge, supporting consistency. This is supported by customers who sought simpler tariffs and it will send customers signals about the efficient cost of the service.

For its western region, Greater Western Water proposed to remove the third tier of its volumetric water usage tariff for potable water customers. This also aligns the approach across its western and central regions.

For non-residential customers, it proposed unchanged tariff structures for both water and sewerage services.

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

Our draft decision rates Greater Western Water's price submission as 'Standard' under the PREMO framework

Our draft decision is to rate Greater Western Water's price submission as 'Standard' under the PREMO framework (Table B). This is the same as the business's self-rating of its price submission.

Key factors supporting this PREMO rating include:

- despite a substantial program to integrate its antecedent businesses, Greater Western Water generally met its outcome commitments in the current regulatory period, while also charging lower than the maximum prices allowed under prevailing price determinations
- the quality of its engagement program, which we consider provided an extensive opportunity for customers to participate, including low income customers and customers experiencing vulnerability

- the ability for customers to influence its proposals, evidenced by feedback from its community panel members who commented favourably on the alignment between their recommendations and the business's proposals, and endorsement from other engagement participants
- its proposal to exclude capital expenditure of about \$173 million from customer prices due to uncertainty in timing, cost, scope and benefits of associated projects, thereby helping to ensure customers do not pay for projects that do not ultimately proceed or that change in scope
- a new guaranteed service level scheme that better balances risk between customers and the business
- evidence that demonstrates Greater Western Water's outcome measures and targets were developed in consultation with its customers, and that they are supported by customers.

While our draft decision agrees with Greater Western Water's proposed self-rating for the Performance, Risk, Engagement and Outcomes elements of PREMO, our preliminary view is that the Management element should be rated as 'Basic' rather than the 'Standard' proposed by the business.

Some factors support its proposed Management rating. For example, we consider Greater Western Water's price submission was generally well presented, and clearly linked the outcomes of its engagement to planned outcomes and expenditure. Its financial model contained no substantive errors and was consistent with its written submission.

However, a key requirement for a 'Standard' rating for the Management element of PREMO is that proposed expenditure changes can be clearly justified by the business as prudent and efficient expenditure.

Consistent with our draft decision on its forecast operating and capital expenditure, our preliminary view is that Greater Western Water was unable to sufficiently justify elements of its forecasts for prudent and efficient expenditure, as required by our guidance.

The resulting controllable operating expenditure and capital expenditure adjustments that we propose for our draft decision are also large compared with other water businesses at recent price reviews. More detail is available in Chapter 7.



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

Table B **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Greater Western Water's self-rating	Standard	Standard	Standard	Advanced	Standard	Standard
Commission's rating	Standard	Standard	Standard	Advanced	Basic	Standard

We invite feedback on our draft decision

We invite feedback from stakeholders on our draft decision before we make a final decision and price determination. We expect to release our final decision and price determination in June 2024.

Stakeholders may comment on any aspect of our draft decision, including:

- the information we have relied upon in our assessment (such as Greater Western Water's price submission)
- additional matters or issues we should consider before making our final decision
- whether our draft decision on Greater Western Water's price submission has adequate regard to the matters in clause 11 of the Water Industry Regulatory Order 2014 and our guidance.

How to provide feedback and stay up to date

You can stay up to date with our review via the dedicated Engage Victoria website:

<https://engage.vic.gov.au/water-price-review-2023>

You can provide feedback by:

- taking part in a public forum
- providing written comments or submissions.

Taking part in a public forum

We plan to hold a public forum on 2 May 2024. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

Provide written comments or submissions

Written comments or submissions in response to this draft decision will be due by 7 May 2024.

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

We would prefer to receive comments and submissions via the dedicated [Engage Victoria website](#).

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

2024 Water Price Review
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Submission and privacy statement

We encourage transparency in our review processes. It is our policy to publish all submissions to the 2024 water price review on the Essential Services Commission website unless the submitter has requested confidentiality. When we publish a submission, we will also include some details about the submitter (your name, not your address) unless the submitter has requested anonymity (does not want to be identified).

You can request confidentiality and/or anonymity in relation to your submission. Requesting this may affect the weight we can give to your submission.

Next steps

Activity	Indicative date
Public forum	2 May 2024
Closing date for submissions on our draft decision	7 May 2024
Release date for our final decision and price determination	June 2024

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 17 water businesses operating in Victoria.

1.2 We are reviewing Greater Western Water's proposed prices

We are reviewing the prices that Greater Western Water proposes to charge customers for prescribed services from 1 July 2024. Greater Western Water's prescribed services include retail water and sewerage services.⁸

Greater Western Water provided a submission to us proposing prices for a four-year period starting 1 July 2024. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2024. The price determination will specify the maximum prices Greater Western Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the 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 factors we must have regard to when making a price determination, including matters set out in the WIRO, the WI Act and the ESC Act. In reaching this draft decision, we have had regard to each of the matters required by clause 11 of the WIRO, including:

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

⁸ The prescribed services are listed at clause 7(b) of the WIRO.

- the matters specified in our guidance⁹
- 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.

Attachment 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 in this draft decision. Table 1.1 summarises the matters we must have regard to and groups them into themes.

In September 2022, we issued guidance to Greater Western Water to inform its price submission. The guidance set out how we would assess Greater Western Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Greater Western Water would comply with certain requirements and specified information that Greater Western Water must provide to us when submitting its price submission.

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 Greater Western Water's proposed prices.¹⁰

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.¹¹

⁹ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September 2022.

¹⁰ This is a requirement of the WIRO, clause 14(b).

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

Table 1.1 Matters businesses and the commission must have regard to

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

Continued next page

Table 1.1 (continued)

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

Note: References in the table are to the Water Industry Regulatory Order 2014 (WIRO), the Essential Services Commission Act 2001 (ESC Act), and the Water Industry Act 1995 (WI Act).

1.4 PREMO

PREMO stands for **P**erformance, **R**isk, **E**ngagement, **M**anagement, and **O**utcomes. 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 corporations 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 take these into account in forming its proposals, as outlined in its price submission. These 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 corporations to assess themselves by reference to the PREMO elements.

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

For Greater Western Water's 2024 water price review, its ambition in terms of delivering customer value is being assessed against all five elements of PREMO – Performance, Risk, Engagement, Management and Outcomes – and it is the first time the Performance element has been included for Greater Western Water. This assesses the business's performance against its outcomes and proposals from the previous price review (which for Greater Western Water means commitments made by the former City West Water and Western Water businesses at the 2018 and 2020 water price reviews). 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 previously approved outcomes to inform our assessment. Western Water was not required to submit a PREMO rating for its 2020 price review, after it was given a two-year decision in 2018.

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 corporation'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.¹²

¹² Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 41–46.

2. Our assessment of Greater Western Water's price submission

We have made our draft decision on Greater Western Water's price submission after considering:

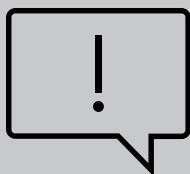
- Greater Western Water's price submission
- Greater Western Water's responses to our queries
- our consultants' reports
- written submissions from interested parties (a list of submissions is provided in Appendix A).

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

Our guidance included matters Greater Western Water must address in its price submission. Greater Western Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this draft decision.

We found Greater Western Water's price submission provided evidence that its engagement sought to capture the main priorities and concerns of customers, and that it has taken this feedback into account (see Section 3.1 on customer engagement).

Unless otherwise noted, all financial values referred to in this draft decision paper are in \$2023-24, which means inflation is excluded.



Greater Western Water must submit a response to our draft decision and provide an updated financial model by 7 May 2024 (via email to water@esc.vic.gov.au). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for Greater Western Water in June 2024.

2.1 Draft decision paper outline

This decision paper is structured around the steps we take to arrive at our price determination. In summary, these steps are:

- Determine the regulatory period (Section 2.2).
- Confirm the customer outcomes and service levels that Greater Western Water has committed to over the regulatory period (Chapter 3).
- Establish Greater Western 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 Greater Western Water's financial position, which we have also had regard to.

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

2.2 Regulatory period

Our draft decision is to approve a regulatory period of four years from 1 July 2024.

We are required to set the term of the regulatory period over which a water business's price determination will apply.¹³ Our guidance proposed that we set a four-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.¹⁴

Greater Western Water proposed a regulatory period of four years. Accordingly, consistent with the reasons outlined in our guidance, our draft decision proposes to set a regulatory period of four years.

¹³ This is a requirement of the WIRO, clause 9.

¹⁴ For detail on the reasons for using four years as the default regulatory period, see: Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September 2022, p. 18.

3. Customer outcomes

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

This chapter:

- examines Greater Western Water’s engagement with its customers in preparing its price submission
- reviews whether Greater Western Water has delivered on the outcomes it committed to for the current regulatory period (2018–23 plus 2023-24)
- examines the customer outcomes Greater Western Water is committing to for the next regulatory period
- outlines Greater Western Water’s service standards
- outlines Greater Western Water’s proposed guaranteed service levels.

3.1 Customer engagement

Our guidance required Greater Western Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Greater Western Water on its engagement.¹⁵

We consider Greater Western Water’s engagement aligned with these principles in a number of ways. Greater Western Water:

- engaged early and sought customer insights to improve the design of its engagement program, which ran between July 2021 and August 2023
- considered the views of 8,000 people across its service area
- used a wide of range of methods across six sequential stages which included customer focus groups, interviews, workshops, bill simulator and best-worst scenario surveys, face-to-face engagement in regional communities, and a five-session deliberative panel
- held inclusive engagement activities to hear from a wide range of customer groups including youth, international students, retirees, culturally diverse customers, customers living with a disability, small businesses, customers experiencing financial hardship and not for profit community groups

¹⁵ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 20.

- tailored its engagement methods to engage sensitively with the five registered Traditional Owner groups in its service area and offered cultural safety for its First Nations customers who participated in its deliberative panel
- engaged on six priority topics identified by customers, which then influenced proposals for matters such as unplanned disruptions, harmonising service levels, sourcing water from alternative sources, waterway health and communications with its customers.

More detail on Greater Western Water’s engagement is available in its price submission.¹⁶

Actions Greater Western Water proposed to take in response to customer feedback provide evidence that its engagement influenced its proposals. For example, in its price submission, Greater Western Water proposed:

- outcomes that reflect the key findings from its engagement process with high levels of customer endorsement that they reflect customer priorities¹⁷
- increased expenditure for customer support programs and services for small businesses based on strong customer feedback to increase support for those experiencing vulnerability and for small businesses experiencing hardship¹⁸
- a new water quality guaranteed service level, and an increase to the number of guaranteed service levels available for customers in its western service area in response to feedback on the importance of aligning service levels between its central and western service areas¹⁹
- to undertake seven large renewals and reticulation programs, and invest in its asset monitoring program in response to customer recommendations to maintain unplanned disruption levels and improve its customer communications²⁰
- upgrades to five treatment plants to increase capacity and treatment levels to support waterway health in response to feedback calling for investment in sewage treatment plants to improve recycled water quality²¹
- investment to improve water supply reliability for the Macedon Ranges and for Sunbury and Melton in response to the deliberative panel’s recommendation to improve services in the outer areas of the service region.

¹⁶ Greater Western Water’s price submission is available on our website at www.esc.vic.gov.au/greater-western-water-price-review-2024.

¹⁷ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 22.

¹⁸ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 35.

¹⁹ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 48–49.

²⁰ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 11.

²¹ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 13

The influence of Greater Western Water's engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of consumers.

Our preliminary view is that Greater Western Water has designed and delivered a sound engagement program with strong customer and stakeholder influence on the proposals presented in its submission, which was appropriate in the context of a new business with a newly merged customer base.

We consider that Greater Western Water's six-stage engagement program, delivered over two years, was effectively structured, with customers' feedback and stakeholders' insights from each stage incorporated into the subsequent stages. Engagement commenced early and focused on understanding customer communication and engagement preferences. It also focused on determining customers' tariff and sewage disposal charge preferences. These early findings informed the content and methods of future engagement including a comprehensive deliberative process to conclude its engagement process.

Greater Western Water sought to obtain guidance from its First Nations customers on how to best engage with them for this price submission and beyond, including meeting separately with the five different Traditional Owner groups in its service area. This engagement was sensitive and appropriate, consistent with the expectations set out in our guidance.

Greater Western Water's engagement offered multiple ways for customers to participate including through a bill simulator survey, focus groups with representative groups from its customer base, and a deliberative process. Its bill simulator and best-worst scenario surveys were written in plain English. The surveys were designed to be easy to understand and complete, and made available in different languages that are commonly spoken in its service area.²² When designing its deliberative process, it allocated two seats for First Nations customers and effectively facilitated those customers' participation throughout the process. Its engagement program was inclusive and provided opportunities to participate and engage with the diverse voices from its customer base and particularly from customer groups experiencing vulnerability.

Greater Western Water demonstrated a strong commitment to the outcomes of its engagement processes. The 15 recommendations from the deliberative panel influenced its project and investment proposals. The business also considered the panel's expenditure recommendations for the six customer priority areas and the panel's recommendations to spend more in the highest risk areas first and keep bills affordable. The business provided high quality materials and tools to panel members that allowed them to make informed decisions. For example, Greater Western Water provided panel members with a tool to estimate the bill impact for the different customer

²² The survey was made available in Mandarin, Arabic and Vietnamese and it was designed to require low digital literacy when filling it out.

types from various revenue requirement scenarios. We consider the use of a deliberative panel supported in-depth customer participation on issues relevant to customer services and prices.

Participants expressed high levels of satisfaction and confidence with the engagement outcomes as Greater Western Water incorporated and addressed most of their recommendations and concerns in its proposals. Feedback video recordings from participants in the deliberative process indicate a strong alignment between the business proposals and the engagement program results. Maribyrnong City Council, Brimbank City Council and the recently established customer advisory group also sent letters endorsing Greater Western Water's engagement processes and business proposals.²³

Submissions received raised no concerns with Greater Western Water's engagement process, with one stakeholder encouraging ongoing community engagement beyond the price review.²⁴

On the basis of the above, our preliminary view is that on balance we agree with its self-rating of 'Advanced' for its price submission engagement. See Chapter 7 for more detail on our PREMO assessment of Greater Western Water's price submission.

3.2 Outcomes

3.2.1 Performance against outcome commitments 2018–23

As part of our 2018 and 2020 water price reviews, the former City West Water and Western Water businesses established outcomes they would deliver to their customers over their regulatory periods and these outcomes were reflected in the prices we approved. Progress against these outcome commitments can indicate whether customers got what they paid for.

Greater Western Water's price submission should account for its actual performance against its outcome commitments of the two former businesses (City West Water and Western Water) for the period 1 July 2018 to 30 June 2023.²⁵ Given the 12-month extension to the previous pricing determinations, Greater Western Water has now begun monitoring its 2023-24 performance against the outcome commitments it proposed in its 2024 price submission and its performance against these will be published in our 2023-24 Outcomes Report.

²³ The Customer advisory group was formed with three experts that represent the community, including vulnerable customers, and industry experts in the service area including Consumer Action Law Centre, Melton City Council, and Carbon and Energy Markets

²⁴ Friends of Steele Creek submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 3 December 2023.

²⁵ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 23–24.

We acknowledge Greater Western Water accounted for its annual performance and its overall rating for the 2018–23 period for each outcome of the two former businesses. It also self-assessed its overall performance for the period in its price submission, rating itself amber ‘close to achieving’ for its central (former City West Water) service area, and green ‘met’ for its western (former Western Water) service area.²⁶

Tables 3.1 and 3.2 list Greater Western Water’s outcome commitments for its former City West Water and Western Water service areas and include its annual performance results and its end of period rating for each outcome as reported in its price submission.²⁷ The information in these tables informs our assessment under the Performance element of PREMO, which is discussed in Chapter 7.

²⁶ Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 153–157.

²⁷ Greater Western Water provided an end of period rating for its City West Water and Western Water service areas in its price submission.

Central region (City West Water commitments)

Table 3.1 Greater Western Water’s self-assessment of performance against the City West Water Outcome commitments

Outcome	2018-19	2019-20	2020-21	2021-22	2022-23	Overall rating ^a
1. Services to my home and business are safe, reliable and efficiently managed	Amber	Amber	Amber	Amber	Amber	Amber
2. Customer service is accessible and my enquiries are resolved promptly	Green	Green	Green	Green	Amber	Green
3. Billing and payment options are efficient and convenient	Green	Green	Amber	Red	Red	Amber
4. Customers in hardship are supported	Green	Amber	Green	Green	Amber	Green
5. The whole of the water cycle is managed in an environmentally sustainable way	Green	Green	Green	Green	Green	Green
6. CWW is a valued partner in servicing a growing Melbourne	Amber	Amber	Amber	Green	Green	Green

Note: Green = achieved target; Amber = close to achieving target; Red = failed to meet target. ^a This is Greater Western Water’s self-assessment of its performance across the 2018–23 period as City West Water. Greater Western Water’s 2023-24 performance will be monitored and reported against the Outcome commitments it proposed in its 2024 price submission, and its performance against these will be published in our 2023-24 Outcomes Report.

Greater Western Water considers it has achieved or exceeded its targets for 140 of its 204 total measures it reported for its City West Water area over the 2018–23 period. Of these 204 performance measures, 20 (10 per cent) have been rated as amber ‘close to achieving target’ and 44 (21 per cent) as red ‘failed to meet target’.²⁸

Greater Western Water almost met its ‘billing and payment options are efficient and convenient’ outcome for its City West Water service area. In its price submission, Greater Western Water stated that it saw the number of estimated meter reads increase dramatically through 2019–22 driven by the Covid-19 pandemic restrictions, and subsequently observed a rise in payment and bill complaints driven by corrections to bills. It also paused the promotion of its online accounts as it

²⁸ Essential Services Commission, Greater Western Water’s (formerly City West Water) outcomes performance 2022-23, October 2023. For information on Greater Western Water’s assessment of its performance see Greater Western Water, 2024 water price submission, September 2023, pp. 153–157.

integrated and rescoped its replacement billing system, impacting its ability to meet its annual targets for its ‘customers with registered online accounts’ measure.²⁹

Western region (Western Water commitments)

Table 3.2 Greater Western Water’s self-assessment of performance against the Western Water Outcome commitments

Outcome	2018-19	2019-20	2020-21	2021-22	2022-23	Overall rating ^a
1. Fair and affordable charges for all customers	Green	Green	Green	Green	Green	Green
2. Reliable, safe services to existing and new customers	Green	Green	Green	Green	Green	Green
3. Innovative approaches to addressing customer needs	Green	Green	Green	Green	Green	Green
4. Care of the environment	Amber	Amber	Amber	Amber	Red	Red
5. Sustainable contribution to the community and regional livability	Green	Amber	Green	Green	Amber	Amber

Note: Green = achieved target; Amber = close to achieving target; Red = failed to meet target. ^a This is Greater Western Water’s self-assessment of its performance across the 2018–23 period as Western Water. Greater Western Water’s 2023-24 performance will be monitored and reported against the Outcome commitments it proposed in its 2024 price submission, and its performance against these will be published in our 2023-24 Outcomes Report.

Greater Western Water considers it has achieved or exceeded its targets for 79 of its 106 total measures it reported for its Western Water service area over the 2018–23 period. Of these 106 performance measures, 15 (14 per cent) have been rated as amber ‘close to achieving target’ and 12 (11 per cent) as red ‘failed to meet target’.³⁰

Greater Western Water almost met its ‘care of the environment’ outcome for its Western Water service area. In its price submission, Greater Western Water stated it fell short in managing its treatment and disposal of sewage in a safe and compliant manner, with a high number of sewer spills occurring over the period. It stated that this was driven partially by La Nina conditions, with

²⁹ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 155; Essential Services Commission 2023, Greater Western Water’s (formerly City West Water) outcomes performance 2022-23, October.

³⁰ Essential Services Commission 2023, Greater Western Water’s (formerly Western Water’s service area) outcomes performance 2022-23, December. For information on Greater Western Water’s assessment of its performance see Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 153–157.

higher rainfall leading to greater likelihood of spills from sewer overflows. It had also set ambitious targets of zero annual sewer spills throughout the period.³¹

We received four submissions from environmental groups responding to Greater Western Water's price submission, raising concerns about the current condition of Greater Western Water's water and wastewater treatment plants and their impact on waterways and native wildlife.³² Greater Western Water's proposed capital program includes major investment to upgrade several wastewater treatment plants to address these issues (see capital expenditure Section 4.2.2).

Across the 2018–23 period, Greater Western Water published its performance results twice a year on its website.³³

Based on the figures and explanation provided above, our draft decision is that we agree with Greater Western Water's self-assessment that it has, overall, met its outcome commitments for the 2018–23 period.

3.2.2 Outcome commitments for 2023–28

Greater Western Water engaged with its customers to refine its outcomes for the period from 1 July 2023 to 30 June 2028. It has proposed a single outcomes set which unifies its central (City West Water) and western (Western Water) service areas, and it has begun monitoring its 2023-24 performance against these new outcomes and targets. It has established five outcomes it proposes to deliver:

- Your water is safe, consistent and resilient
- When things go wrong, we fix them
- We support our diverse communities and customers
- We enable growth and help businesses thrive
- We heal and care for Country.

³¹ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 157; Essential Services Commission 2023, *Greater Western Water's (formerly Western Water) outcomes performance 2022-23*, October.

³² Friends of Steele Creek submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 3 December 2023.

Macedon Water Think Tank submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 13 December 2023.

Werribee River Association submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 13 December 2023.

Concerned Waterways Alliance, submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 14 December 2023.

³³ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 153.

Among the initiatives to deliver on its commitments, Greater Western Water plans to improve water supply reliability in the Macedon Ranges and Sunbury, as well as ensure water security for Sunbury and the western region. To help support communities, it is investing in its water and sewerage networks, particularly to renew water main infrastructure and provide sewer services to growth regions. It is also investing heavily to improve its asset ecosystem and asset monitoring.³⁴

3.2.3 Our assessment of measures and targets

Greater Western Water proposed a set of 21 measures and annual targets that it will use to report on performance across the 5 outcomes. These are set out in *Appendix C: Customer Scorecard* on pages 202 to 204 of its price submission. Performance against these measures will inform our assessment during future price reviews.

We have assessed Greater Western Water's proposed measures against the criteria set out in our guidance which states that proposed output measures for each outcome must:

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.³⁵

Evidence provided by Greater Western Water demonstrates that its outcomes, measures, and targets were developed in consultation with its customers, and that they are supported by most of its customers who engaged in the process. Greater Western Water has established an ongoing customer forum (discussed below); it provided its customer forum with its proposed outcomes and measures for those outcomes, and the customer forum was given the opportunity to select which measures best represented their values. The customer forum then endorsed the outcomes and measures. Greater Western Water also sought additional support from its Customer Advisory Group to endorse its outcome set.³⁶

Generally, we consider Greater Western Water's measures will provide a sound basis to track performance and delivery against each outcome, once the matters we identified in our assessment have been addressed. We have provided Greater Western Water with our standard outcomes

³⁴ Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 22–45.

³⁵ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 24.

³⁶ Greater Western Water 2023, *2024 Price Submission, Appendix C: Customer Scorecard*, 28 September, pp. 202–204; Insync and Mosaic Lab 2023, *Customer Forum Summary Report*, June.

reporting template, and we will work with the business to ensure its final set of measures complies with our guidance requirements.

Greater Western Water's proposed targets for its outcome measures generally suggests customer service levels will remain steady. However, several measures are unclear in how customer outcomes change.

As indicated above, Greater Western Water has established an ongoing customer forum that will meet annually to track its performance against its outcomes 'score card'. Greater Western Water has committed to publishing its performance on its website.³⁷

Our draft decision accepts Greater Western Water's self-assessment of 'Standard' for the Outcome element of PREMO, which is discussed further in Chapter 7.

3.3 Service standards related to service reliability and faults

Service standards are a common set of services applicable to all Victorian consumers required under clause 18.2 of the *Water Industry Standard – Urban Customer Service* (Water Industry Standard). Each water business must specify its own service levels against each of these service standards. Rather than performance measures, these service standards and corresponding service levels are the minimum level of service customers can expect to receive.

Greater Western Water's proposed service standards relating to reliability and faults can be found on pages 46 and 47 of its price submission.

Greater Western Water has proposed a revised set of service standards for the 2024–28 regulatory period, which consolidates the current two sets of service standards from the former City West Water and Western Water businesses and aligns the service levels with Greater Western Water's average performance over the past three years. This is consistent with customer feedback Greater Western Water received through its deliberative panel to maintain current service levels and to adopt the same service levels across Greater Western Water's central and western service areas.

Greater Western Water has proposed the following:

- Where its three-year average performance outperformed either the former City West Water or Western Water service levels, it will maintain the minimum existing service level target.
- Where its three-year average performance was between or fell short of the former City West Water and Western Water service levels, it has set the service level target equal to its three-year average performance.

³⁷ Greater Western Water 2023, *2024 Price Submission*, September 2023, p. 22.

Greater Western Water has also specified its minimum water pressure as required by the Water Industry Standard.

Our preliminary assessment is that the service standards relating to reliability and faults proposed by Greater Western Water comply with the requirements of the Water Industry Standard.

Service standards are approved in our Water Industry Standard. Accordingly, in early 2024-25, we will update the Water Industry Standard to reflect approved service standards.

3.4 Guaranteed service levels

Our draft decision is to accept Greater Western Water's proposed guaranteed service levels.

Guaranteed service levels define a water corporation'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.

Greater Western Water's proposed guaranteed service levels are set out on pages 48 to 51 of its price submission.

Greater Western Water's proposed guaranteed service levels consolidate the current guaranteed service level schemes from the former City West Water and Western Water businesses and increase the rebate amounts in line with inflation.

Greater Western Water has proposed to adopt all the guaranteed service levels, with increased rebates, from the former City West Water scheme. The Western Water scheme is largely a subset of the City West Water scheme and as such customers in the former Western Water service area will see an increase in the number of guaranteed service levels. Greater Western Water has also proposed an additional guaranteed service level for water quality events, which was developed in consultation with Melbourne Water, South East Water and Yarra Valley Water to ensure a consistent response for customers affected by system-wide water quality events across Melbourne. In accordance with these other water businesses, when water quality advisories are issued it proposes a community rebate of:

- \$5,000 for small, localised events impacting less than 50 customers
- \$10,000 for each affected postcode for advisories that affect more than 50 customers.

Greater Western Water consulted on its proposed guaranteed service levels with its customers in an online forum held in May 2023. Feedback from this forum indicates customers support Greater Western Water's proposed guaranteed service levels.³⁸

We propose to accept Greater Western Water's proposed guaranteed service levels, on the basis that they have been agreed with customers during its engagement. Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

Guaranteed service levels are approved in our water industry standards. Accordingly, in early 2024-25, we will update the standards to reflect the guaranteed service levels published in our final decision.

³⁸ Greater Western Water 2023, *Greater Western Water Customer Forum Summary Report*, 8 June, pp. 19–20.

4. Revenue requirement

The revenue requirement is the forecast amount a water corporation needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.³⁹ 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 Greater Western 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 Greater Western 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 draft decision is to adopt a revenue requirement of \$3,439 million, 1.3 per cent lower than that proposed by Greater Western Water.

Greater Western Water proposed a revenue requirement of \$3,483 million over a 4-year period starting 1 July 2024. Our draft decision approves a revenue requirement of \$3,439 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

³⁹ 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 Greater Western Water in the regulatory period from 1 July 2024. We had regard to their views in arriving at our draft decision.

Table 4.1 Draft decision on Greater Western Water’s revenue requirement
\$ million 2022-23

	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	610.8	612.8	612.9	615.0	2,451.5
Return on assets	93.3	99.6	106.2	113.7	412.9
Regulatory depreciation	100.4	104.7	109.5	114.2	428.8
Tax allowance	34.0	36.7	36.7	38.5	145.8
Draft decision – revenue requirement	838.5	853.8	865.3	881.4	3,439.0

Note: Numbers have been rounded.

Table 4.2 summarises how our draft decision on Greater Western Water’s revenue requirement (row F) differs to the revenue requirement proposed by Greater Western Water in its price submission (row A). Adjustments relate to operating expenditure and capital expenditure (which flows through to return on assets and depreciation) and the impact of our adjustment to our long-term inflation rate (which also mainly impacts return on assets).

Where our draft decision differs from Greater Western Water’s price submission in relation to a component of the revenue requirement, the adjustment we propose is shown in rows B to E of Table 4.2.

Our final decision on Greater Western Water’s revenue requirement will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Greater Western Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2024. Its maximum prices will also need to be updated to reflect our approved tariffs for Melbourne Water’s bulk charges to apply in 2024-25.

There may be changes in laws or government policy before we make a price determination. If any such changes occur between the draft decision and the price determination that impact on its forecast costs and the revenue requirement, Greater Western Water should update its price submission and provide us with an updated financial model. It also should notify us of any material changes that impact its forecast costs, revenue requirement or prices (including demand). Any updates to its submission or pricing model will be made publicly available on our website.

Table 4.2 Our proposed adjustments to Greater Western Water’s proposed revenue requirement
\$ million 2023-24

	2024-25	2025-26	2026-27	2027-28	Total
A. Greater Western Water’s proposed revenue requirement	846.7	864.0	877.5	894.7	3,483.0
B. Operating expenditure	-17.6	-17.4	-17.2	-17.2	-69.4
C. Return on assets	9.2	8.7	7.8	7.4	33.1
D. Regulatory depreciation	-1.8	-3.3	-4.6	-5.3	-15.0
E. Tax allowance	1.8	1.8	1.8	1.8	7.2
F. Draft decision – revenue requirement (A + B+C+D+E)	838.5	853.8	865.3	881.4	3,439.0

Notes: Our proposed adjustments are the differences between our draft decision and what Greater Western Water proposed in its price submission. Row A shows the total revenue requirement proposed by Greater Western Water in its price submission. We have arrived at our draft decision (row F) by proposing the relevant adjustments to the components of the revenue requirement shown in rows B to E. Numbers have been rounded.

4.1 Operating expenditure

Our draft decision is to adopt a forecast operating expenditure of \$2,451.5 million, which is 2.8 per cent lower than proposed by Greater Western Water. This adjustment mainly reflects Greater Western Water’s inability to justify its proposed baseline controllable operating expenditure as a basis to forecast prudent and efficient expenditure.

Operating expenditure is a component of the revenue requirement. Greater Western Water’s price submission provides detail on its forecast operating expenditure from pages 67 to 84, and further in Appendix H (pages 223 to 257).

We assess both:

- controllable operating expenditure – comprising all costs that can be directly or indirectly influenced by a water corporation’s decisions
- non-controllable operating expenditure – comprising all costs that cannot be directly or indirectly influenced by a water corporation’s decisions.

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure.⁴⁰ FTI Consulting's report on its assessment of Greater Western Water's expenditure forecast is available on our website.⁴¹

Table 4.3 sets out our draft decision on Greater Western Water's forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

Table 4.3 Draft decision – operating expenditure
\$ million 2023-24

	2024-25	2025-26	2026-27	2027-28	Total
Controllable operating expenditure	200.47	200.83	201.32	202.66	805.27
Non-controllable operating expenditure	410.33	411.96	411.60	412.38	1,646.27
Bulk services ^a	376.52	379.10	379.68	381.36	1,516.66
Environmental contribution ^b	32.92	31.97	31.03	30.13	126.05
Licence fees – Essential Services Commission ^c	0.56	0.56	0.56	0.56	2.26
Licence fees – Department of Health ^c	0.14	0.14	0.14	0.14	0.54
Licence fees – Environmental Protection Authority ^c	0.19	0.19	0.19	0.19	0.76
Draft decision – operating expenditure	610.80	612.78	612.92	615.04	2,451.54

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

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

Table 4.4 summarises how our draft decision on Greater Western Water's operating expenditure (row D) and its two components differ from the operating expenditure proposed by Greater Western Water in its price submission (row A). Rows B and C of the table summarise our proposed adjustments to Greater Western Water's proposed controllable and non-controllable operating expenditure (the cost categories shown in rows B1.1 to B1.4 are Greater Western Water's own descriptions).

⁴⁰ FTI Consulting provided input into the commission's expenditure assessment for 14 water businesses during our recent 2023 water price review. We consider this recent experience ensures the assessment and advice of Greater Western Water's expenditure forecasts will be consistent with the process we undertook for the 2023 price review.

⁴¹ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February.

Details of our assessment and reasons for our proposed adjustments to Greater Western Water's proposal are included below in Section 4.1.1 (context of our review), Section 4.1.2 (controllable operating costs) and Section 4.1.3 (non-controllable operating costs).

We consider the operating expenditure proposed in our draft decision reflects the operating expenditure that we were able to verify as prudent and efficient over the course of making our draft decision.⁴²

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

Table 4.4 Our proposed adjustments to Greater Western Water's proposed operating expenditure
\$ million 2023-24

	2024-25	2025-26	2026-27	2027-28	Total
A. Greater Western Water's proposed total operating expenditure	628.35	630.17	630.16	632.22	2,520.90
B. Our total proposed adjustments to controllable operating costs (B1 + B2)	-17.72	-17.69	-17.68	-17.76	-70.85
B1 – Total baseline adjustments (after amended efficiency factor)^a	-15.09	-14.07	-12.95	-12.98	-55.09
B1.1 – Removal of Integration costs	-1.21	-1.13	-1.04	-1.04	-4.41
B1.2 – Removal of Transformation - Compliance costs	-2.95	-2.75	-2.54	-2.54	-10.78
B1.3 – Removal of Transformation - Corporate costs	-0.68	-0.63	-0.58	-0.59	-2.48
B1.4 – Removal of Transformation - Customer costs	-0.92	-0.86	-0.79	-0.79	-3.37
B1.5 – Removal of field maintenance	-6.23	-5.81	-5.35	-5.36	-22.74
B1.6 – Removal of Labour	-0.81	-0.76	-0.70	-0.70	-2.97
B1.7 – Removal of unexplained baseline increase	-2.28	-2.13	-1.96	-1.96	-8.33

⁴² We consider prudent and efficient operating expenditure are operating costs that a prudent service provider would incur when acting efficiently to achieve the lowest cost in delivering the outcomes specified in Greater Western Water's price submission.

B2 – Total step change adjustments	-2.63	-3.62	-4.73	-4.78	-15.76
B2.1 – Removal of Billing & Collection system contingency	-0.77	-0.78	-0.80	-0.81	-3.16
B2.2 – Reallocation of Billing & Collection system cost saving from efficiency rate	-1.86	-2.84	-3.93	-3.97	-12.60
C. Our total proposed adjustments to non-controllable operating costs (C1)	0.16	0.31	0.45	0.58	1.49
C1 – Long-term inflation update impact on environmental contribution forecast	0.16	0.31	0.45	0.58	1.49
D. Draft decision – total operating expenditure (D = A + B + C)	610.80	612.78	612.92	615.04	2,451.54

Notes: Our proposed adjustments are the differences between our draft decision and what Greater Western Water proposed in its price submission. Row A shows the total operating expenditure proposed by Greater Western Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating costs and non-controllable operating costs shown in rows B and C (and disaggregated in rows B1.1 to B2.2 and row C1). Numbers have been rounded. ^a Our adjustments to Greater Western Water’s baseline operating expenditure (B1.1 to B1.7) capture the impact of our removal of Billing and Collection system cost savings from the proposed efficiency rate (see Section 4.1.2). These savings have been reallocated as step change adjustments in row B2.2, representing no overall net change for this adjustment.

4.1.1 Context of our review

4.1.1.1 Our guidance to Greater Western Water

Our assessment of Greater Western Water’s operating expenditure must consider the implications of the business integration on efficient costs. Our guidance, developed in consultation with Greater Western Water, set out specific requirements to enable us to do so, namely:⁴³

- clearly identify both one-off transition costs and operational efficiencies compared to the two former businesses in its actual and forecast operating expenditure
- compare these cost variations with the sum of the expenditure benchmarks and forecasts from the 2018 and 2020 price reviews for the former businesses
- include necessary information to support its operating cost forecast and assumptions for the extension year, 2023-24.

Our guidance also stated we expect Greater Western Water’s price submission will identify and explain any significant forecast cost efficiencies it anticipates from the business integration, and

⁴³ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 30.

clearly explain where costs have risen above the forecast benchmarks due to business transition costs.⁴⁴

4.1.1.2 Key focus areas for our review

After our initial review of Greater Western Water's price submission and financial model, and our expenditure consultant's 'stage one' assessment report, we identified the following key focus areas for our consultant's detailed operating expenditure assessment:

- The increase in proposed recurring baseline year controllable operating expenditure. Greater Western Water has proposed a baseline that is \$25.5 million (13.8 per cent) above the benchmarks established for the two former businesses. Verification that these additional baseline costs are recurring efficient costs for the newly integrated business is crucial in setting an efficient cost benchmark. The price submission did not clearly identify the additional ongoing costs incurred to manage the integration of the two businesses from other additional ongoing costs and the realised or expected savings resulting from the integration. Our expenditure consultant would need to analyse and assess whether these costs (and savings) are recurring and whether they are efficient.
- Labour costs and recruitment strategy, given the observed 35 per cent increase in FTE employees across the current regulatory period.⁴⁵
- Forecast efficiency rate assumptions and methodology. Greater Western Water's price submission did not set out specific forecast cost reductions resulting from the integration of the two businesses or from its further investments in business transformation. Rather, it bundled any such savings up in its proposed overall efficiency rate (which averaged 3.0 per cent per annum). We required our expenditure consultant to analyse and assess these cost savings.

In its report, our consultant describes the challenges it encountered with verifying Greater Western Water's expenditure proposals, stating it often received supporting documentation that was lacking the detailed information it required to assess prudence and efficiency.⁴⁶ Our consultant required several meetings with Greater Western Water staff, and multiple follow-up questions to requests for information, to enable us and our consultant to be able to properly assess the expenditure proposal. Consistent with our assessment process, where our consultant has been able to verify the proposed costs are prudent and efficient, it has recommended that we accept them. However,

⁴⁴ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 32–33.

⁴⁵ Greater Western Water's price submission indicates total FTEs increased from 470 at the end of 2017-18, to 493 in 2019-20, to 587 in 2020-21 following the merger announcement in October 2020, to 634 as at 30 June 2023. The forecast then remains relatively flat at 635 FTEs until 2033.

⁴⁶ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 4.

in some instances where it has been unable to verify whether the proposed costs are prudent and efficient based on the available information provided by Greater Western Water, it has recommended that they be removed from the forecast allowance.

4.1.2 Controllable operating expenditure

Greater Western Water proposed a total forecast controllable operating expenditure of \$876.1 million over a four-year regulatory period. For the reasons set out below, we propose to adopt a forecast operating expenditure of \$805.27 million for the 2024–28 regulatory period, which is \$70.9 million lower than proposed by Greater Western Water.

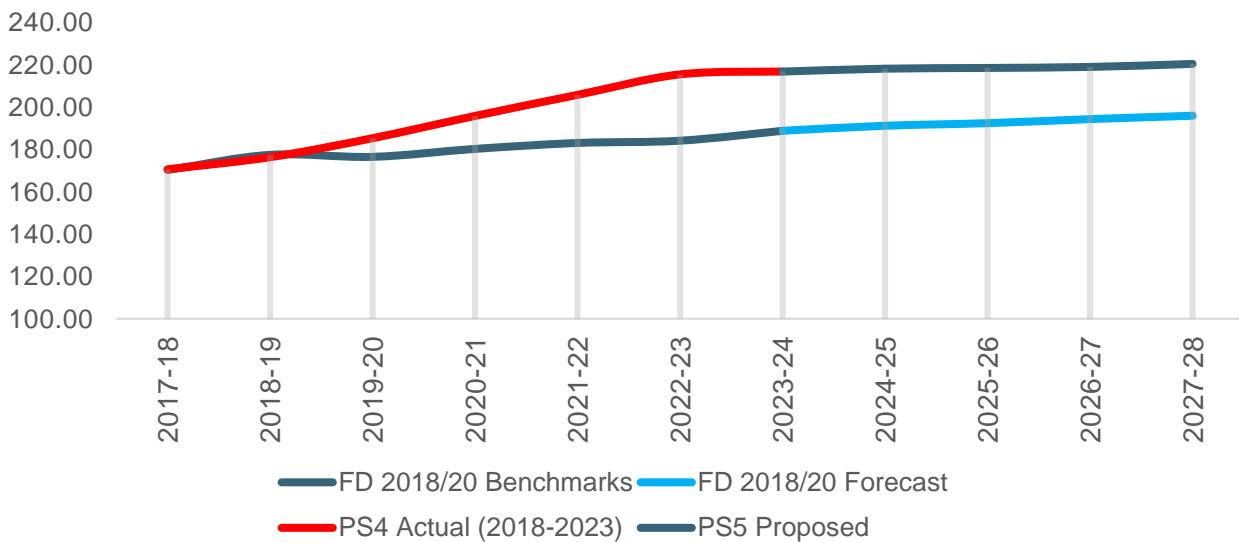
Greater Western Water’s forecast controllable operating expenditure for the period from 1 July 2024 is estimated through a series of steps:

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2022-23) after noncontrollable expenditure and one-off (non-recurring) items are removed or normally occurring items are added in.
2. Apply a growth rate for operating expenditure for the regulatory period – assumed by Greater Western Water to be 2.8 per cent per year on average.
3. Apply an annual cost efficiency improvement rate – assumed by Greater Western Water to be 3.0 per cent per year on average.
4. Make adjustments for additional costs or cost savings expected in future years.

4.1.2.1 Baseline controllable operating expenditure

Greater Western Water has proposed a controllable operating expenditure baseline of \$209.6 million, after removing \$5.9 million in non-recurring operating expenditure that occurred in 2022-23. Greater Western Water’s proposed baseline is \$25.5 million (or 13.8 per cent) higher than the aggregate benchmark figure of \$184.1 million of controllable operating expenditure for 2022-23, which reflects the sum of the City West Water and Western Water benchmarks established in our 2018 and 2020 price determinations, respectively. Greater Western Water’s historical and forecast controllable operating expenditure is displayed in Figure 4.1 below, which shows the divergence of actual costs from the previous benchmarks set for City West Water and Western Water.

Figure 4.1 Actual and forecast controllable operating expenditure
\$ million 2023-24



Note: This graph shows actual figures for 2017-18 to 2022-23, and Greater Western Water’s forecasts for 2023-24 to 2027-28, against the sum of the antecedent businesses’ controllable operating expenditure benchmarks set in 2018 and 2020 respectively, and the outlook for the 2023–28 period at that time.

Our expenditure consultant requested further substantiation of Greater Western Water’s proposed increase to its baseline year operating expenditure benchmark, to better understand the cost drivers identified by Greater Western Water in table 21 of its price submission.⁴⁷ In response to this request, Greater Western Water amended some of its figures in this table, as shown below in Table 4.5.⁴⁸

The cost categories shown in Table 4.5 are Greater Western Water’s own descriptions for the cost increases above its benchmark. Much of our consultant’s assessment work involved working with Greater Western Water to break down these broad categories to reveal the underlying cost components and cost increase drivers, so it could verify if they were recurring prudent and efficient costs. Details of our consultant’s findings are available in its report, which can be accessed on our website.

⁴⁷ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 76, Table 21.

⁴⁸ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 19.

Table 4.5 Greater Western Water’s categorisation of expenditure above antecedent businesses’ 2022-23 controllable operating expenditure benchmark
\$ million 2023-24

Category	Price submission	Amended
Integration	1.19	1.19
Transformation – Asset	1.19	1.19
Transformation – Compliance	3.54	3.54
Transformation – Corporate	0.76	0.76
Transformation – Customer	1.17	1.03
Transformation – Safety	0.29	0.29
Changes in obligations	1.33	1.33
External cost drivers	12.69	12.69
Labour movements	3.00	0.91
Remaining Variance (unexplained baseline increases)	0.32	2.55
Total	25.48	25.48

Note: Greater Western Water revised its breakdown of costs above the benchmark allowance during our consultant’s investigation, lowering the amounts categorised under ‘Labour movements’ and ‘Transformation – Customer’ when it found some of these costs were already embedded within the other categories. This alteration led Greater Western Water to increase the ‘remaining variance’ value to \$2.55 million. Some of these figures are net values, representing cost increases which are partially offset by efficiencies or cost savings.

After an extensive review process, involving numerous requests for further information and subsequent interrogation of the responses provided by Greater Western Water, our consultant was unable to verify the recurring nature or the prudence and efficiency of the proposed increase to the baseline allowance above the previously established benchmarks. Given these findings, our consultant recommended that a total of \$16.86 million of the proposed increase to the baseline allowance be removed from the forecasts.

Our consultant’s specific recommended adjustments to the proposed baseline allowance, and the impact on Greater Western Water’s forecast operating expenditure across the next regulatory period is outlined in Table 4.6 below. The details of our consultant’s review and analysis and the reasoning for its recommendations is set out in its final report.⁴⁹

⁴⁹ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 14–38.

Table 4.6 FTI Consulting’s recommended baseline operating expenditure adjustments
\$ million 2023-24

Recommended adjustments:					
	2022-23 (Baseline year)	2024-25	2025-26	2026-27	2027-28
Integration costs	-1.35	-1.21	-1.13	-1.04	-1.04
Compliance obligations	-3.3	-2.95	-2.75	-2.54	-2.54
Corporate costs	-0.76	-0.68	-0.63	-0.58	-0.59
Customer and community engagement	-1.03	-0.92	-0.86	-0.79	-0.79
Field maintenance	-6.96	-6.23	-5.81	-5.35	-5.36
Labour costs	-0.91	-0.81	-0.76	-0.70	-0.70
Unexplained baseline increases	-2.55	-2.28	-2.13	-1.96	-1.96
Total recommended baseline adjustments	-16.86	-15.09	-14.07	-12.95	-12.98

Note: The difference in value across each year of the regulatory period arises when the compounding annual growth and efficiency rates are applied to the baseline year adjustment for each line item. This calculation uses the adjusted efficiency rate we recommend in Section 4.1.2.2 below.

Regarding the remaining \$8.6 million of new baseline expenditure proposed by Greater Western Water, our expenditure consultant was able to verify that these additional costs were recurring, and it found Greater Western Water’s substantiation of these costs to be reasonable. Accordingly, it recommended accepting these costs as recurring baseline operating expenditure.

In its price submission and subsequent information provided to our consultant, Greater Western Water identified areas in which it had achieved some cost efficiencies (for example, in energy costs and IT costs). However, these cost savings have been offset by larger cost increases in other business areas (for example, in field maintenance or labour costs).

We reviewed Greater Western Water’s proposal and the advice from our expenditure consultant. We agree with our consultant’s advice to remove expenditure from the forecast where it cannot be verified as prudent and efficient, as required by our guidance. We therefore propose to remove \$16.86 million from the proposed baseline allowance, for the reasons set out above.

Based on the above, our draft decision adopts a baseline allowance of \$192.8 million, which reflects the baseline expenditure that we could verify as prudent, efficient and recurring, to forecast annual controllable operating expenditure for the purpose of our draft decision.

4.1.2.2 Efficiency improvement and growth rate

Greater Western Water proposed an average efficiency improvement rate on its controllable operating costs of 3.0 per cent per annum. This is a higher rate than the 2.0 per cent per annum proposed by both City West Water and Western Water in their 2018 and 2020 price submissions, respectively.

However, Greater Western Water states this efficiency figure also includes efficiencies it is expecting to realise from its integration and transformation programs (accounting for 1.6 per cent of the average 3.0 per cent) along with unidentified efficiencies it expects to deliver through economies of scale and scope (1.4 per cent of the average 3.0 per cent).⁵⁰ In effect, Greater Western Water has included all of its forecast cost reductions within its proposed efficiency improvement rate.

Our expenditure consultant assessed the efficiency rate and the underlying forecast cost savings proposed by Greater Western Water.⁵¹ Our consultant recommended that the identified cost savings arising from the 'Platypus' billing and collection system capital project should be removed from the proposed efficiency rate and reallocated as a downward cost variation (see Section 4.1.2.3 below). We agree with our consultant's recommendation, because we consider that identified operating expenditure savings derived from significant capital investment would be more appropriately categorised as forecast cost variations, rather than an 'efficiency gain', in the same way that new operating costs from new assets are presented as step changes above the baseline. This has no net change to the forecast operating expenditure.

Greater Western Water has also proposed an average annual operating expenditure growth rate of 2.8 per cent per annum based on its forecast water connection growth rate in the next regulatory period. Its average net growth rate (growth rate minus efficiency rate) is -0.2 per cent per annum, however this increases to a net positive figure of 0.3 per cent after removing the Platypus project benefits as described above. In comparison, the other metropolitan Melbourne water retailers put forward average annual net growth rates of -0.3 per cent (Yarra Valley Water) and -0.9 per cent (South East Water) in their 2023 price submissions.

Our consultant stated in its report that Greater Western Water's net efficiency factor of 0.2 per cent would place it in the middle of the table compared with other businesses assessed at our 2023 price review. However, if the efficiencies attributable to its transformation and integration programs

⁵⁰ Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 241–242.

⁵¹ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 48–52.

were excluded to provide a more direct comparison with other businesses, Greater Western Water would have the lowest net efficiency factor of all Victorian businesses.⁵²

We have considered Greater Western Water's proposal and our consultant's report. As described above, our preliminary view is that only 1.4 per cent of the 3.0 per cent figure is properly considered efficiencies expected to be delivered through economies of scale and scope (as compared to the 1.6 per cent that comprise the integration and transformation efficiencies). However, an efficiency improvement rate of 1.4 per cent per annum is consistent with a 'Standard' PREMO rating, and similar to other water businesses at our 2023 price review.

4.1.2.3 Cost adjustments

Greater Western Water has proposed additional forecast operating expenditure above the annual baseline, including:

- Operating costs related to its new 'Platypus' billing and collections system (\$15.8 million)
- Additional support for vulnerable customers and customers experiencing payment difficulty (\$5.2 million)
- The operation of new or upgraded assets (\$5.1 million)
 - Macedon Ranges Transfer augmentation
 - Romsey Recycled Water Plant
 - Romsey Water Filtration Plant
 - Western Irrigation Network.
- Costs to comply with the Security of Critical Infrastructure Act (2018) and ensure the security of critical infrastructure (\$4.5 million)
- Traditional owner engagement and partnership program (\$4.0 million).⁵³

The above costs represent an additional \$34.5 million over the regulatory period, or an average of \$8.6 million per annum.

Greater Western Water stated in its price submission that it has not proposed \$6.35 million in additional superannuation and payroll tax obligations as cost adjustments in the next regulatory period and has indicated that it will fund these increased costs from its workforce optimisation plan.⁵⁴

⁵² FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 51–52.

⁵³ Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 79–80

⁵⁴ Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 251–252.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline and requested further information from Greater Western Water, including proposed operational plans or business plans for accompanying capital expenditure, as well as underlying breakdowns of costs and assumptions underpinning the business's forecasts.

Our consultant considered the majority of the proposed costs are appropriately tied to the operation of new assets or increasing obligations, not able to be met within existing baseline operating expenditure, and are mostly prudent and efficient. However, our consultant recommended that an annual contingency amount (an average of \$0.8 million, or \$3.2 million across the four-year period) be removed from Greater Western Water's forecast billing and collections system costs on the basis that it is not tied to any specific business activity and that the risk in forecasting the operating costs of the Platypus system should be managed within the business and not passed on to customers.⁵⁵

Further, our consultant also recommended that the forecast cost savings to be realised from the rollout of Greater Western Water's new Platypus billing and collection system be presented as a cost reduction in the forecast, rather than captured within the business's proposed efficiency rate, because they are identified savings from a major capital investment (see also Section 4.1.2.2). This results in a downward adjustment of \$12.6 million across the next regulatory period (noting there is no net change to the cost forecast, given it is simply reallocated from Greater Western Water's proposed efficiency rate).

We have reviewed Greater Western Water's proposal and the advice from our expenditure consultant and propose to remove the contingency allowance for billing system costs, because we consider it appropriate the business should carry this risk. We also agree that the expected \$12.6 million savings from the new Platypus billing system, arising from a major capital investment by Greater Western Water, should be more transparently shown as future cost savings, in the same way the proposed \$15.8 million additional operating costs for that system have been presented, rather than as efficiency gains. Our preliminary view is that Greater Western Water's proposed cost adjustments are justified and represent efficient controllable operating expenditure after the following adjustments:

- removal of the \$3.2 million contingency allowance in the forecast billings and collections system additional operating costs
- removal of \$12.6 million representing the anticipated cost savings from the rollout of the new billing and collections system (noting a corresponding reduction in the proposed efficiency rate will reinstate a corresponding \$12.6 million to the growth-adjusted baseline allowance).

⁵⁵ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 42.

Draft decision on controllable operating expenditure

Our assessment of forecast controllable operating expenditure hinges on the establishment of an efficient baseline allowance, which our guidance states must reflect efficient recurring controllable costs. Greater Western Water proposed a considerable increase to its baseline year allowance above the efficient benchmarks of City West Water and Western Water. However, its proposal then presents a high efficiency improvement rate which incorporates yet-to-be-realised benefits from the business integration, which indicates the proposed baseline increases are not recurring and efficient costs. The proposed efficiency rate also included expected cost savings from capital investment in its new billing system, which we do not consider to be properly categorised as an ‘efficiency gain’, as described above.

Our consultant engaged extensively with Greater Western Water to obtain the information required to assess its cost forecasts, and this information has enabled our consultant to verify much, but not all, of the proposed expenditure. Despite ample opportunity to do so, Greater Western Water was unable to provide the information necessary for our consultant to verify a significant portion of the proposed increase in the baseline allowance as recurring and efficient costs.

We have reviewed Greater Western Water’s proposal and the advice from our consultant. Based on this, our draft decision is to adopt a maximum verified controllable operating expenditure allowance of \$805.3 million.

4.1.3 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

- obtaining the most recent information from the relevant regulatory authorities on their licence fees and the environmental contribution
- adjusting the forecasts proposed by Greater Western Water where required.

The values we have adopted for our draft decision are set out above in Table 4.3.

Greater Western Water has proposed \$1,644.8 million (an average of \$411.2 million per year) in non-controllable operating expenditure over the 2024–28 regulatory period. This is an average annual decrease of \$34.5 million compared to the 2018–23 regulatory period (\$445.6 million per year on average), due to decreases in external bulk water charges (desalination security payments) and forecast decreases in the real value of the environmental contribution.

Our guidance paper sets out our approach for businesses to forecast their non-controllable operating costs. We consider businesses should forecast licence fees for the Department of Health, the Environment Protection Authority Victoria and the Essential Services Commission to remain flat in real terms, and for the environmental contribution to remain flat in nominal terms (decline in real terms) across the 2024–28 regulatory period. Greater Western Water has followed this approach in its price submission.

We have revised our long-term inflation rate from 3.5 per cent per annum, down to 3.0 per cent per annum. This has increased the forecast real value of the environmental contribution by \$1.5 million (1.2 per cent) across the next regulatory period.⁵⁶ We have adopted this updated figure for our draft decision (see Table 4.4).

Accordingly, consistent with the reasoning in our guidance paper, our draft decision is to accept Greater Western Water's proposed non-controllable operating expenditure forecast, noting our inflation adjustment's impact on Greater Western Water's forecast environmental contribution. We have verified that Greater Western Water's forecast bulk charges are consistent with Melbourne Water's 2021 price determination and Southern Rural Water's 2023 price determination. Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation data.⁵⁷ The benchmark will also need to be updated prior to our final decision to reflect our approved tariffs for Melbourne Water's bulk charges for 2024-25.

4.2 Capital expenditure

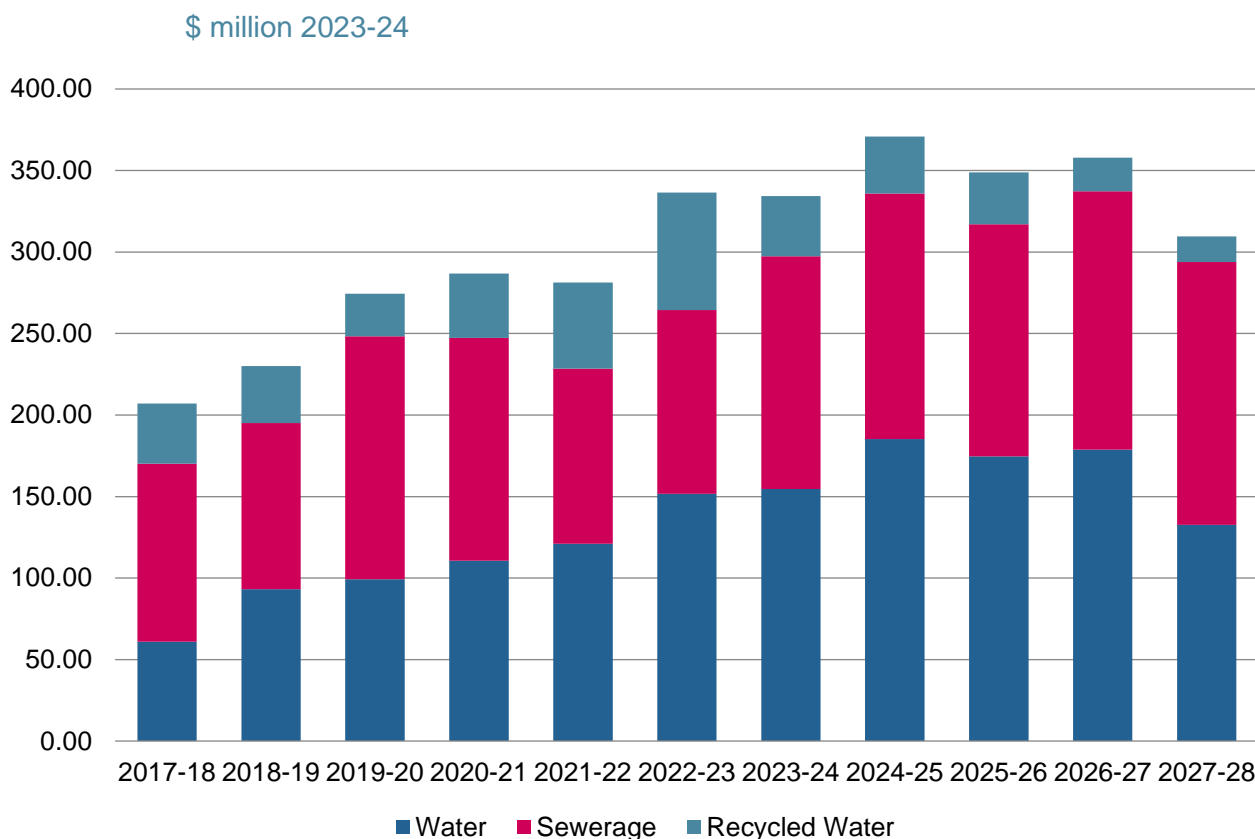
Our draft decision is to adopt a forecast capital expenditure of \$1,561.0 million, which is \$160.4 million or 9.3 per cent lower than proposed by Greater Western Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Greater Western Water's forecast capital expenditure and supporting information is provided on pages 56 to 66 and appendices F, G and I (pages 207 to 222 and 258 to 261) of its price submission. Figure 4.2 shows Greater Western Water's actual gross capital expenditure for 2017-18 and the original 2018–23 regulatory period (2018-19 to 2022-23) and forecast gross capital expenditure from 2023-24 to 2027-28. The first six years of actual expenditure shown in Figure 4.2 (2017-18 to 2022-23) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.

⁵⁶ The environmental contribution is set as a flat nominal value in four-year tranches. The nominal value must be deflated by our forecast inflation to produce a real value, which is then subject to the annual inflation adjustments. A lower long-term inflation forecast reduces this deflation amount, producing a higher real value.

⁵⁷ We anticipate the Department of Energy, Environment and Climate Action will publish the environmental contribution values to apply to each water business from 1 July 2024 during May 2024. Our final decision will include the latest values for Greater Western Water.

Figure 4.2 Gross capital expenditure by service category



Note: This graph shows actual figures for 2017-18 to 2022-23, and Greater Western Water’s forecasts for 2023-24 to 2027-28.

Our assessment of Greater Western Water’s capital expenditure must consider the implications of the business integration on efficient costs. Our guidance, developed in consultation with Greater Western Water, set out specific requirements to enable us to do so, namely:⁵⁸

- clearly identify movements in its actual and forecast capital investment program arising from the integration
- compare these cost variations with the sum of the expenditure benchmarks and forecasts from the 2018 and 2020 price reviews for the former businesses
- include necessary information to support its capital expenditure forecast and assumptions for the extension year, 2023-24 (which has not been previously assessed for prudence and efficiency).

⁵⁸ Essential Services Commission 2022, 2024 *Greater Western Water price review: Guidance paper*, 20 September, pp. 35–36.

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure.⁵⁹ FTI Consulting's report on its assessment of Greater Western Water's expenditure forecast is available on our website.⁶⁰

4.2.1 Actual capital expenditure

The PREMO framework involves reviewing a business's actual performance over the current regulatory period, against its proposals and commitments made to its customers in its previous price submission. This includes a comparison of its actual capital expenditure against the approved expenditure forecasts for the current regulatory period.

Greater Western Water has incurred \$1,616.1 million in actual gross capital expenditure over the six years from 2017-18 to 2022-23. This is \$281.1 million (or 21.1 per cent) above the relevant benchmark amounts for City West Water and Western Water combined. In net terms (that is, once any contributions or disposals are accounted for), it has exceeded the forecast used to approve maximum prices for the combined businesses of City West Water and Western Water by \$128.0 million, or 12.4 per cent.

Greater Western Water's price submission provided several reasons for its increased expenditure (relative to the benchmark) in the current regulatory period:⁶¹

- higher than forecast customer growth, particularly in the western region, leading to capital projects being brought forward
- increases in unit rates, driven by supply chain constraints
- aging infrastructure which required significant increased expenditure on renewals
- new systems required to support the business integration, such as its new billing and collections system
- it considers the capital expenditure forecasts put forward by Western Water in its 2020 price review were underestimated.

Greater Western Water has also recorded significant variances in its delivery of the major projects that were approved as part of City West Water's 2018 and Western Water's 2020 price determinations.⁶² Of the ten City West Water major projects seven have been completed, two have been deferred due to slower than anticipated demand growth and wet weather event impacts on

⁵⁹ FTI Consulting provided input into the commission's expenditure assessment for 14 water businesses during our recent 2023 water price review. We consider this recent experience ensures the assessment and advice of Greater Western Water's expenditure forecasts will be consistent with the process that we undertook for the 2023 price review.

⁶⁰ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February.

⁶¹ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 165.

⁶² Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 166–167.

inflows, while its billing and collection system replacement project (Platypus) has been delayed and rescope to accommodate the integrated business but is expected to be completed in 2023-24.

Of the twelve Western Water major projects:

- three have been completed
- five have been delayed due to:
 - changes in scope
 - alignment with other construction/upgrades,
 - engagement requirements
 - extended procurement periods
 - environmental approval requirements
- one project has been cancelled and rescope to deliver a larger package of upgrades
- one project has been deferred due to lower than forecasted demand and wet weather impacts on inflows
- one project is scheduled to be completed on time in 2023-24
- one project is an ongoing annual program of works.

Our expenditure consultant reviewed the capital expenditure delivered in the current regulatory period and the reasoning for variances put forward by Greater Western Water. Our consultant considered that the increased level of expenditure compared to the benchmark is reasonable based on the information provided by Greater Western Water.⁶³

We have considered Greater Western Water's price submission and our expenditure consultant's view and consider the actual capital expenditure Greater Western Water has incurred from 2017-18 to 2022-23 is appropriate for the purpose of calculating its regulatory asset base (see Section 4.3.1).

4.2.2 Forecast capital expenditure

We have reviewed Greater Western Water's proposed forecast capital expenditure and our draft decision is to adopt a forecast capital expenditure of \$1,561.0 million, which is \$160.4 million (or 9.3 per cent) lower than that proposed by Greater Western Water.

⁶³ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 56.

Table 4.7 Our proposed adjustments to Greater Western Water’s proposed total forecast capital expenditure
\$ million 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Greater Western Water’s – proposed total forecast capital expenditure	334.35	370.86	348.77	357.92	309.52	1,721.42
Adjustments – Water Main Renewal Program	-15.88	-15.88	-15.88	-15.88	-15.91	-79.43
Adjustments – Storm Water Harvesting Fund	-0.21	-0.86	-4.28	-4.28	-3.21	-12.84
Adjustments – Asset Ecosystem – Asset Foundations	-12.15	-20.41	-20.23	-10.59	-4.76	-68.13
Draft decision – total forecast capital expenditure	306.11	333.72	308.37	327.17	285.64	1,561.01

Note: Numbers have been rounded.

For the reasons set out below, our draft decision is to not accept the forecast capital expenditure of \$1721.4 million proposed by Greater Western Water, and to adopt a lower forecast of \$1,561.0 million for the purpose of calculating its revenue requirement:

- Greater Western Water’s price submission provided evidence that a majority of its forecasts for capital expenditure are prudent and efficient. Its total proposed capital expenditure over the five years is \$312.3 million (22.2 per cent) higher than capital expenditure it incurred across the 2018–23 regulatory period. This is mainly driven by growth (\$842.8 million, 49 per cent of its capital program) and renewals expenditure (\$531.8 million, 30.9 per cent of its capital program). A majority of Greater Western Water’s forecast capital expenditure is included in programs or projects outside its top ten major projects which account for \$379.4 million, or 22 per cent.
- Our expenditure consultant requested selected documents from Greater Western Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program.⁶⁴ Based on the sample of documents reviewed, FTI’s workshop with the business and subsequent meetings and information requests, our expenditure consultant found that for a majority of the overall program, Greater Western Water has a robust approach for developing project scopes, the timing of works and cost estimates.

⁶⁴ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 56–58.

- Our expenditure consultant reviewed business cases and supporting information related to all ten of Greater Western Water’s major projects and considered that the information provided supported the prudence and efficiency of the proposed projects.⁶⁵ Our consultant recommended no adjustments to cost forecasts or timing. We agree with our expenditure consultant’s view because we consider that, for the purposes of our draft decision, the prudence and efficiency of its forecast top ten major projects has been justified, consistent with our guidance.
- Our expenditure consultant also reviewed several major capital programs and other capital projects. Our consultant considered that the documents provided to support these programs varied in detail and quality, and it required significant additional supporting information to complete its review.⁶⁶ Our consultant has recommended the following adjustments to Greater Western Water’s capital program:
 - Water Main Performance Renewals program (forecast \$197.7 million). Our expenditure consultant recommended reducing this by \$79.4 million across the 2023–28 period, based on information provided by Greater Western Water that indicated a lower level of combined renewals across both the central and western business areas would still deliver a level of water customer interruptions lower than the target of five in a rolling 12-month period, at a lower cost than proposed by the business.⁶⁷
 - Asset Ecosystem – Asset Foundations (forecast \$68.1 million). Our expenditure consultant recommended removing the full \$68.1 million from the 2023–28 capital forecast because the project justification documentation provided by Greater Western Water did not provide sufficient detail to assess the prudence and efficiency of the projects. Greater Western Water advised that it had not prepared business cases for the seven individual projects that comprise the broader project, nor quantified the proposed benefits, despite the significant levels of proposed expenditure.⁶⁸
 - Stormwater Harvesting (forecast \$12.8 million). Greater Western Water has included this expenditure to fund potential partner organisations in delivering stormwater harvesting schemes. Our expenditure consultant recommended removing the full \$12.8 million from the 2023–28 period, given that Greater Western Water was unable to provide or identify

⁶⁵ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 59–65.

⁶⁶ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 68–70.

⁶⁷ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 65–67.

⁶⁸ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, pp. 73–74.

individual projects or stormwater harvesting business cases for review, meaning that underlying prudence and efficiency cannot be assessed.⁶⁹

- We have reviewed Greater Western Water's proposal and the advice from our expenditure consultant. We agree with FTI Consulting's assessment and recommendations for the reasons set out below, and we have made the following adjustments for our draft decision:
 - Removed \$79.4 million from the forecast for the Water Main Performance Renewals program because our preliminary view is that the stated objective can be achieved more efficiently.
 - Removed the full \$68.1 million forecast for the Asset Ecosystem – Asset Foundations program because the constituent projects have not yet been fully scoped and costed, and the prudence and efficiency could not be verified on the information provided by Greater Western Water. In those circumstances, we do not consider customers should be asked to carry the cost uncertainty for this work.
 - Removed the full \$12.8 million forecast for the Stormwater Harvesting program – this is essentially a grant scheme to be run by Greater Western Water, and while there was strong customer support for this program, the benefits, prudence and efficiency of the expenditure cannot be established on the information provided by Greater Western Water. However, should Greater Western Water seek to provide more information to justify this expenditure, we require it to demonstrate how the delivery of these works is relevant to the provision of prescribed services in the Water Industry Regulatory Order 2014. Further, Greater Western Water must also explain its proposed treatment of these costs as operating or capital expenditure.
- Greater Western Water also proposed to capitalise a portion of its Asset Delivery Organisation Review (ADOR) program (\$5.8 million) in the next regulatory period because it is a large irregular cost which delivers benefits to customers over two or more regulatory periods.⁷⁰ This project is intended to deliver increased procurement and capital project delivery within the organisation. This is in addition to capitalising project costs related to its Platypus Billing and Collection system project and other discrete Information Technology projects it has capitalised previously. Greater Western Water has stated that it has excluded licensing and operating costs from its capitalisation proposals. We propose to accept this proposal because it meets our requirements for capitalising expense items set out in our guidance, and we consider it appropriate to spread the cost recovery of these items over a longer timeframe.⁷¹

⁶⁹ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 72.

⁷⁰ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 259–260.

⁷¹ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 34–35.

- We received four submissions from environmental groups responding to Greater Western Water's price submission.⁷² These groups raised concerns about the condition of Greater Western Water's water and wastewater treatment plants and their impact on waterways and native wildlife, and the quality of recycled water, including for agricultural purposes. We acknowledge the importance of waterway health, and the environmental obligations Greater Western Water must meet in delivering its water and sewerage services to customers. Greater Western Water must plan its forecast capital program to ensure it complies with all relevant environmental obligations. Greater Western Water has proposed \$330.0 million of capital expenditure related to water and sewerage treatment across the 2023–28 period, while three of its top ten major projects are related to upgrades to the Woodend, Gisborne and Romsey wastewater treatment plants. We have not proposed any adjustments to this expenditure, or any other expenditure related to its treatment assets or allocated to meeting growth and compliance obligations. We expect Greater Western Water will maintain an open dialogue with these interested stakeholder groups, and keep its community informed on the delivery of these major investments.
- Our preliminary view is that the planned capital expenditure program is achievable given Greater Western Water's project planning and prioritisation processes, along with its Asset Delivery Organisation Review which is currently underway. Our expenditure consultant also considered that Greater Western Water is capable of delivering its forecast capital program.⁷³ In coming to this view we have also considered Greater Western Water's past track record in delivering its capital expenditure program (it has completed only ten of City West Water and Western Water's 22 planned major projects) and its explanation of this material variation from its forecast (see Section 4.2.1 above).⁷⁴ Overall, our preliminary view is that Greater Western Water has proposed a capital program which is deliverable, largely prudent and efficient, and necessary given customer growth rates and compliance obligations.
- Greater Western Water has excluded approximately \$173 million of speculative projects from its price submission where there is uncertainty in timing, cost, scope and benefits of capital

⁷² Friends of Steele Creek submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 3 December 2023.

Macedon Water Think Tank submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 13 December 2023.

Werribee River Association submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 13 December 2023.

Concerned Waterways Alliance, submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 14 December 2023.

⁷³ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 59.

⁷⁴ Essential Services Commission 2023, *Status of Major Projects Supplement: Outcomes report 2022-23*, 31 October, pp. 16–28; Greater Western Water 2023, *2024 Price Submission*, 28 September, pp. 166–167.

expenditure.⁷⁵ This equates to about 10 per cent of the forecast capital expenditure. The proposed \$68.1 million that we did not allow for the Asset Ecosystem – Asset Foundations program could also be considered as uncertain project expenditure. This approach is consistent with our guidance for managing uncertain expenditure. Our draft decision is to accept Greater Western Water’s proposal for addressing uncertainty, noting the following:

- Greater Western Water will need to demonstrate the prudence and efficiency of these costs if they are indeed incurred over the 2023–28 period if seeking to include them in the regulatory asset base for the 2028–33 price review.
- Deviations from forecasted capital expenditure during the 2023–28 period will form a key part of our assessment of the Performance element of PREMO at the next price review.

We have reviewed Greater Western Water’s proposals and the advice from FTI Consulting. We agree with our consultant’s assessment and consider Greater Western Water’s approach to forecasting its capital expenditure is largely consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014, except as identified above in relation to the adjustments that we have proposed.⁷⁶

Therefore, our draft decision for total gross capital expenditure is to not accept Greater Western Water’s proposed benchmark. Our draft decision adopts a forecast capital expenditure benchmark of \$1,561.0 million over the five-year period 2023–2028 (Tables 4.7 and 4.9).

The benchmark that we propose to adopt for Greater Western Water does not represent the amount that Greater Western 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 Greater Western Water’s revenue requirement, we are not requiring the corporation to remove that project. Greater Western 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 corporation’s regulatory asset base is the value of the corporation’s assets for regulatory purposes.⁷⁷ The regulatory asset base is used to estimate the return on assets (discussed in

⁷⁵ Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 166–167.

⁷⁶ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 35–40.

⁷⁷ These values were set initially for the water corporations by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

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 Greater Western Water to propose:

- the closing value of its regulatory asset base at 30 June 2023 (using actual data)
- the opening value of its regulatory asset base at 1 July 2024 (calculated according to the criteria outlined in the guidance)
- the forecast value of its regulatory asset base for each year of the regulatory period (2024-25 to 2027-28), in accordance with the prudence criteria outlined in the guidance.

4.3.1 Closing regulatory asset base

Our draft decision is to accept Greater Western Water's closing regulatory asset base.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2022-23.⁷⁸ This helps to ensure prices reflect the actual net expenditure of a water corporation.⁷⁹

Greater Western Water's proposed closing asset base at 30 June 2023 is provided at page 122 of its price submission.⁸⁰

We compared Greater Western Water's actual net capital expenditure for 2017-18 to 2022-23 with the forecast used to approve maximum prices for the period from 1 July 2018. Typically, if a water corporation's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature. We also acknowledge that transitioning to a merged entity may result in project reprioritisation, affecting the profile of capital expenditure.

Greater Western Water's net capital expenditure over the period from 2017-18 to 2022-23 was \$1,156.9 million. This is \$128.0 million or 12.4 per cent higher than the forecast used to approve maximum prices for the combined businesses of City West Water and Western Water.

As noted in Section 4.2.1, our expenditure consultant reviewed the capital expenditure delivered in the current regulatory period and the reasoning for variances put forward by Greater Western

⁷⁸ See Section 4.2 for a discussion of Greater Western Water's capital expenditure.

⁷⁹ 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 corporation's water, sewerage or recycled water networks.

⁸⁰ Available at www.esc.vic.gov.au.

Water. Our consultant considered that the increased level of expenditure compared to the benchmark is reasonable based on the information provided by Greater Western Water.⁸¹

We have reviewed the recommendations of our expenditure consultant and agree with their view. On this basis, our draft decision is to accept Greater Western Water's proposed closing regulatory asset base for 30 June 2023 of \$3,255.5 million as it meets the requirements of our guidance.

Table 4.8 sets out our draft decision on Greater Western Water's closing regulatory asset base at 30 June 2023.

Table 4.8 Draft decision – closing regulatory asset base (RAB)
\$ million 2023-24

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Opening RAB 1 July	2,699.7	2,766.9	2,826.8	2,914.8	3,021.1	3,109.6
Plus gross capital expenditure	207.0	230.1	274.5	286.8	281.4	336.4
Less government contributions	-	-	-	-	12.1	5.7
Less customer contributions	58.7	68.8	85.3	72.9	67.7	88.1
Less proceeds from disposals	1.0	1.3	0.8	1.0	3.0	1.0
Less regulatory depreciation	80.2	100.0	100.4	106.6	110.0	95.8
Closing RAB 30 June	2,766.9	2,826.8	2,914.8	3,021.1	3,109.6	3,255.5

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

Our draft decision is to not accept Greater Western Water's proposed forecast regulatory asset base.

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.

⁸¹ FTI Consulting 2024, *Greater Western Water: Review of Expenditure Forecasts - 2024 water price review*, February, p. 55.

Our draft decision is to not accept Greater Western Water’s forecast regulatory asset base for the period from 1 July 2023 based on our proposed adjustments to Greater Western Water’s forecast capital expenditure. As described above in Section 4.2, our preliminary position is that Greater Western Water has not met the prudence and efficiency requirements of our guidance for all of its proposed forecast capital expenditure.

Table 4.9 sets out our draft decision on Greater Western Water’s forecast regulatory asset base from 1 July 2024.⁸² Our assessments of the components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

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

Table 4.9 Draft decision – forecast regulatory asset base (RAB)
\$ million 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Opening RAB 1 July	3,255.5	3,374.4	3,512.6	3,630.4	3,770.7
Plus gross capital expenditure	306.1	333.7	308.4	327.2	285.6
Less government contributions	15.6	18.2	0.2	-	-
Less customer contributions	75.5	76.1	84.9	76.6	81.4
Less proceeds from disposals	0.8	0.8	0.8	0.8	0.8
Less regulatory depreciation	95.3	100.4	104.7	109.5	114.2
Closing RAB 30 June	3,374.4	3,512.6	3,630.4	3,770.7	3,860.0

Note: Numbers have been rounded

⁸² Our guidance required Greater Western Water to provide an estimate of the components of its regulatory asset base for 2023-24. This was so we could assess the opening asset base for 1 July 2024. Our guidance noted that where developer contribution forecasts are higher than the forecast benchmark for 2023-24 in the 2018 and 2020 price determinations, Greater Western Water must use the higher amount. In practice, our final decision will use the latest forecast from Greater Western Water based on year-to-date actual contributions. The estimates for 2023-24 will be confirmed at the next price review following the 2024 water price review. Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September 2022, pp. 41–42.

4.3.2.1 Customer contributions

Our draft decision is to not accept Greater Western Water's forecasts for revenue from customer contributions.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.⁸³

New customer contributions are a key input to revenue from customer contributions. Since our draft decision is to not accept Greater Western Water's proposed new customer contribution charges, our draft decision is to not accept Greater Western Water's forecasts for customer contributions (Section 5.4).

However, for the purposes of calculating the regulatory asset base and revenue requirement in our draft decision, we have adopted Greater Western Water's proposed customer contributions forecast based on its financial model. The forecast appears reasonable, having regard to past trends and growth forecasts. However, we note that our final decision is subject to our ongoing review of Greater Western Water's new customer contributions (Section 5.4).

4.4 Rate of return

In establishing the return on assets component of Greater Western Water's revenue requirement, we have applied a rate of return to Greater Western 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 draft decision is to accept the cost of debt proposed by Greater Western Water.

Our guidance required Greater Western Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Greater Western Water used the cost of debt values we specified, as set out in Table 4.10, to calculate its revenue requirement. For this reason, our draft decision is to accept the cost of debt proposed by Greater Western Water, noting that the cost of debt estimates will be updated following the release of the Australian Bureau of Statistics March Quarter 2024 consumer price index.

⁸³ Revenue from new customer contributions reflects revenue earned from new connections made to the water corporation's water, sewerage or recycled water networks.

Table 4.10 Draft decision – cost of debt

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Cost of debt (nominal)	5.36%	5.27%	4.91%	4.53%	4.61%	3.31%	3.05%	3.75%	6.76%	6.76% ^a

Note: Numbers have been rounded. ^a Estimated cost of debt – we will update the 2023-24 figure before the final decision and price determination.

4.4.2 Return on equity

Our draft decision is to adopt a return on equity of 4.1 per cent, which reflects Greater Western Water’s PREMO self-rating.

Under our PREMO incentive mechanism, which we have applied since 2018, the return on equity we adopt to calculate the revenue requirement is linked to a business’s PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water corporation’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 corporation’s self-rating and our rating.⁸⁴ We consider that the values in our matrix reflect the medium-term real rates of return.⁸⁵

Greater Western Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Greater Western Water proposed a return on equity of 4.1 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.⁸⁶

As outlined in Chapter 7, our draft decision is to agree with Greater Western Water’s overall PREMO self-rating and therefore to adopt its proposed return on equity.

⁸⁴ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 46–47.

⁸⁵ We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity adopted by interstate regulators in the following publications: 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.

⁸⁶ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 51.

4.5 Regulatory depreciation

Our draft decision is to not accept Greater Western Water's forecast regulatory depreciation.

Regulatory depreciation is a component of Greater Western Water's revenue requirement and is also an input to calculating the regulatory asset base. Greater Western Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile.⁸⁷ We noted in our guidance that we prefer this approach.⁸⁸

Greater Western Water's proposed depreciation for the next regulatory period is \$443.7 million and was calculated in a manner consistent with our guidance. However, given our draft decision is to not accept its proposed forecast regulatory asset base, we require Greater Western Water to recalculate regulatory depreciation in response to our draft decision. For this reason, our draft decision proposes to not accept Greater Western Water's forecast regulatory depreciation.

Our draft decision on regulatory depreciation is shown in Table 4.9 in Section 4.3.2.

4.6 Tax allowance

Our draft decision is to not accept Greater Western Water's proposed tax forecast for the 2024–28 regulatory period.

The tax allowance is a component of the revenue requirement. Greater Western Water has proposed a tax allowance of \$138.7 million in its revenue requirement for the 2024–28 regulatory period.

As our draft decision proposes an adjustment to its revenue requirement, our draft decision is to not accept Greater Western Water's proposed tax allowance. Greater Western Water must provide an updated estimate in response to our draft decision. We also require Greater Western Water to cross check the model calculation with its own internal forecasts, and provide evidence that the benchmark calculation is appropriate.

⁸⁷ For the period from 2024–25 to 2027–28, Greater Western Water proposed a regulatory depreciation of \$443.7 million.

⁸⁸ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 43.

5. Demand, tariffs and prices

Once Greater Western 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 draft decision is to accept Greater Western Water's demand forecasts.

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

Greater Western Water's demand forecasts are set out on pages 126 to 152 of its price submission and are also included in its financial model.

Our draft decision is to accept Greater Western Water's demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance, including basing demand forecasts on the latest available Victoria in Future estimates issued by the Victorian Government.⁸⁹

However, since Greater Western Water lodged its price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses. We require Greater Western Water to consider the updated estimates and, if required, identify and justify any changes to its demand forecasts. Any updates must also be included in its pricing model submitted in response to our draft decision.

5.2 Form of price control

Our draft decision is to accept Greater Western Water's proposed tariff basket form of price control for the majority of its tariffs, and price cap form of price control for miscellaneous tariffs.

Our guidance stated we would have particular regard to whether a corporation proposed to continue its existing form of price control or introduce a new form of price control.⁹⁰

⁸⁹ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 53–54.

⁹⁰ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 54–55.

Greater Western Water proposed a tariff basket form of price control for the majority of its core water and sewerage and trade waste service charges as set out on page 112 of its price submission. This is the same as its current approach. Greater Western Water also proposed to maintain its price increase limit at 10 per cent per annum (in real terms). It also proposed to retain a price cap form of price control for miscellaneous charges.

Our draft decision is to accept Greater Western Water's proposed tariff-basket form of price control for core services because:

- it is a continuation of its current approach, which we have previously approved
- it provides flexibility for Greater Western Water to support the alignment of prices for its two regions over time
- it provides sufficient revenue to cover the forecast efficient costs of providing services and for Greater Western Water to deliver on any health, safety and environmental obligations
- it provides flexibility to the business to rebalance prices without over (or under) collecting revenue
- it provides protections around price stability for customers by limiting price increases under its tariff basket constraint to 10 per cent per annum (in real terms) on individual price increases
- it enables Greater Western Water to smooth bill movements over the remainder of the regulatory period
- it is otherwise consistent with the requirements of our guidance.

Our draft decision is to accept Greater Western Water's proposed price cap form of price control for its miscellaneous charges because it is consistent with the requirements of our guidance, and is a continuation of its current approach, which we have previously approved.

5.3 Tariff structures and prices

Our draft decision is to accept Greater Western Water's proposed tariff structures.

Greater Western Water's proposed tariffs are set out on pages 88 to 106 of its price submission.

As noted in its price submission, the next regulatory period provides an opportunity for Greater Western Water to deliver and stage key tariff reforms. As noted above, a tariff basket form of price control provides flexibility (and within certain constraints) to align prices within a regulatory period, consistent with customer preferences for similar prices for similar services. It has also proposed changes to some tariff structures to support greater alignment between its two regions in the next regulatory period, in the context of its longer-term tariff strategy.

Our draft decision considers proposals related to tariff structures, the price path proposed, and any submissions on the level of prices or bills. We do not approve prices for each tariff at this draft decision stage of a price review. Prices will need to be updated by Greater Western Water to reflect our updates to inflation and cost of debt estimates prior to our final decision, and approved Melbourne Water bulk charges for 2024-25. They may also need to be updated depending on our further review of its revenue requirement.

5.3.1 Tariff structures

As outlined in our guidance, we have provided the water corporations with a large degree of discretion to decide on individual tariff structures.⁹¹ This recognises water corporations are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances. For Greater Western Water, a key consideration for the next regulatory period was differing tariff structures currently applying in its central and western regions.

Greater Western Water proposed to largely maintain its existing tariff structures, with some changes to support greater alignment between its western and central regions.

Central service area tariff structures

For residential customers receiving water services only, Greater Western Water proposed a fixed and variable water charge.

For residential customers receiving both water and sewerage services, Greater Western Water proposed to combine the residential sewage disposal charge and its residential variable water charge. This means customers pay a fixed charge and a charge that varies with water use. However, the variable charge is higher than for water-only customers because it incorporates the costs of sewage disposal. Greater Western Water considers this change will simplify customer bills and better enable customers to understand how their water and sewerage bill is calculated. Greater Western Water also noted that the removal of the separate sewage disposal charge will ensure the tariff structure is consistent with the other two metropolitan water businesses.⁹²

⁹¹ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 56.

⁹² Greater Western Water 2023, *2024 Price Submission*, 28 September, p. 91.

For non-residential customers, the tariff structure remains unchanged. Customers will continue paying fixed charges for water and a sewerage connection fee, as well as a variable fee for water and sewage usage.

With regard to recycled water, Greater Western Water proposed a continuation of the current approach, where residential customers pay a two-part tariff (that is, a fixed service charge and a variable usage fee) for recycled water, and non-residential customers pay only a usage charge.

Western service area tariff structures

For all residential customers, Greater Western Water proposed to remove the third step water usage charge from 2024-25 to align the tariff structure across its central and western regions.

It proposed to retain fixed service charges for water and sewerage customers, and no variable sewage disposal charge.

For non-residential customers, Greater Western Water proposed to maintain the existing tariff structure. Customers will continue paying fixed charges for water and sewerage network connections. Customers will also continue to pay a water usage fee.

With regard to recycled water, Greater Western Water proposed to maintain the current tariff structure. Residential and non-residential customers will both continue to pay a two-part tariff (that is, a fixed service charge and a variable usage fee) for recycled water.⁹³

In addition, Greater Western Water proposed to continue to gradually unwind the government efficiency rebate paid to tenants and will cease this payment by 2027-28.

Draft decision

Our draft decision is to accept Greater Western Water's proposed tariff structures, on the basis that they are generally a continuation of Greater Western Water's current approach, the proposed tariff reforms meet the criteria in our guidance, and they are generally supported by its customers.

⁹³ Greater Western Water has previously calculated its recycled water variable usage charge for non-residential customers in the western region in accordance with the pricing principals in our guidance. Greater Western Water has proposed a single variable usage tariff for Class A recycled water for both residential and non-residential customers. Usage charges for different recycled water classes will continue to be calculated in accordance with the pricing principles.

Our preliminary view is Greater Western Water's proposed two-part tariff structure for its water services will promote efficient use of services. It is also easy for customers to understand and is an approach commonly applied in other states and territories.⁹⁴

In relation to sewerage services, we consider Greater Western Water's proposed change to its sewage usage charge for its central region residential customers (combining with the variable water charge) is easy to understand and consistent with its engagement findings – both service areas will now have only a fixed sewerage charge. A two-part tariff for non-residential customers sends these customers signals about efficient costs.⁹⁵

While our draft decision proposes to approve this change, we consider Greater Western Water should ensure it has identified customers who may be adversely impacted as a result of combining its water and sewage disposal charge, and to proactively address this prior to implementation.

5.3.2 Prices

Greater Western Water's proposed prices for water and sewerage services are set out on pages 96 to 106 of its price submission.

Under Greater Western Water's proposal, central and western service area prices will align over the next eight years. As noted earlier, Greater Western Water will need to consider its maximum prices given our draft decision on its revenue requirement.

In the central region, under its price submission proposal the majority of water prices for residential and non-residential customers would increase by up to 3 per cent in 2024-25 (excluding inflation) and remain flat in real terms for the rest of the regulatory period.

Sewerage service charges for residential customers would increase by about 1 per cent per annum until 2027-28. For non-residential customers, the service fee will fall by 0.6 per cent per annum for the rest of the regulatory period.⁹⁶

For the central service area's recycled water prices, the service fee for residential customers would increase by 6.1 per cent in 2024-25, and the annual increases will then steadily fall to a 5.2 per cent increase for the final year of the regulatory period. However, the recycled water usage fee for residential customers would fall by 0.3 per cent per annum across the whole regulatory period. For

⁹⁴ 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.

⁹⁵ Our reasons are outlined in our 2013 draft decisions on price review 2013-14 to 2017-18.

⁹⁶ In its price submission, Greater Western Water refers to fixed service charges as 'network fees'.

non-residential customers, the usage fee would fall by 0.2 per cent per annum across the regulatory period.

Under its price submission proposal, in the western region, water service charges for most residential and non-residential customers would increase by 3 per cent in 2024-25 and then remain flat in real terms for the rest of the period.⁹⁷ However, the water usage charge for residential customers would increase by 0.5 to 1.9 per cent per annum depending on the level of consumption. Non-residential customers' water usage charge would increase by 0.7 per cent in 2024-25 and then remain flat in real terms for the rest of the regulatory period.

Sewerage service charges for residential customers and non-residential customers would fall by about 4 per cent and 1.8 per cent per annum respectively.

With regard to recycled water prices, for both residential and non-residential customers, the service charge in the western region would fall by 7 per cent per annum (on average) and the usage charge would increase by about 2.5 per cent per annum until 2027-28.

We received several public submissions from Greater Western Water stakeholders expressing concerns regarding the affordability of service charges under Greater Western Water's proposals. One submission highlighted the impact of price increases on lower socio-economic groups.⁹⁸ Our views on Greater Western Water's approach to addressing the interests of low income and vulnerable customers are outlined below in Section 5.3.3. This included a proposed price path that focused on bill reduction in the first year of the regulatory period for the majority of its customers, in consideration of the near-term inflation outlook and cost of living pressures.

In May 2024, we intend to determine prices for Greater Western Water in \$2024-25 terms. This means we will add the annual change in the March Quarter 2024 consumer price index (published by the Australian Bureau of Statistics) to its 2024-25 prices, which will also flow through to customer bills.

Greater Western Water's prices will also be affected by our draft decision on the revenue requirement, which is outlined in Chapter 4. In response to our draft decision, Greater Western Water will need to propose updated prices that reflect our draft decision and any updates to its revenue requirement.

⁹⁷ This is relevant to customers using a 20 mm meter which makes up the majority of residential and non-residential customers.

⁹⁸ David Mould, submission to the Essential Services Commission on Greater Western Water's 2024 price submission, 24 October 2023.

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether Greater Western Water's prices take into account the interests of customers, including low income and vulnerable customers.⁹⁹

There is evidence that Greater Western Water has sought to address the interests of low income and vulnerable customers because Greater Western Water proposed:

- new expenditure in line with the priorities of the deliberative panel, whose participants were representatives of Greater Western Water's customer base, including low income customers and customers experiencing vulnerability
- increased spending on its customer support program to improve early intervention and increase uptake of customer support by culturally and linguistically diverse customers (which addresses the issues raised in customer submissions)
- investment to align services and service levels for regional (western service area) customers with the service levels available in urban (central) areas
- a price path that focused on bill reduction in the first year of the regulatory period for the majority of its customers in consideration of the near-term inflation outlook and cost of living pressures
- removing the third step water usage charge for residential customers in its western region in recognition of the affordability impact of the third step on large families who are less able to reduce usage in response to pricing signals
- simplifying its tariff structures by removing the sewage disposal charge and combining it with water usage charges which enables customers to understand their bill more easily.

As noted in Section 3.1, Greater Western Water's price submission was informed by engagement that was inclusive for customers more likely to experience vulnerability, including youth, international students, retirees, culturally diverse customers, customers living with a disability, customers experiencing financial hardship and not-for-profit community groups.

5.3.4 Trade waste and miscellaneous services

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

⁹⁹ Water Industry Regulatory Order 2014 clause 11(d)(iii).

Greater Western Water proposed to invert the risk rank labelling of its trade waste categories in its western region to be consistent with the risk rank ordering for its central region – both regions will now have risk rank 1 as the highest risk trade waste customer category.¹⁰⁰ This is a change in name only, with no consequential change in tariffs for trade waste customers. The central and western regions will still have different trade waste charges. Greater Western Water plans to review its trade waste tariffs during the next regulatory period and engage with its customers for its 2028 price submission.

Our draft decision is to approve the trade waste and miscellaneous services tariffs because they are calculated in accordance with the pricing principles in our guidance.

5.4 New customer contributions

Our draft decision is to not accept Greater Western Water’s proposed standard new customer contributions.

Our draft decision is to accept Greater Western Water’s negotiated customer contribution framework.

Greater Western Water’s proposed new customer contributions are set out on pages 107 to 109 of its price submission. Greater Western Water proposed to use the net incremental cost approach to estimate its new customer contributions, consistent with Western Water’s approach in 2020 and City West Water’s approach in 2018.

New customer contributions (or developer charges) are levied by water businesses when a new connection is made to its water, sewerage or recycled water networks in a given part of its service areas. 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 are designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden and improve the timeliness and predictability of costs faced by developers.¹⁰¹ For Greater Western Water, ‘standard’ new customer contributions include greenfield and infill new customer contributions, as well as recycled water new customer contributions. Negotiated charges allow water businesses and developers to

¹⁰⁰ We require a water business to have a clear classification process for its trade waste customers, but it is up to each water business to define these classifications – see Essential Services Commission 2022, *Water Industry Standard – Trade Waste Customer Service*, 27 September, pp. 6–7

¹⁰¹ Essential Services Commission 2013, *New customer contributions: explanatory note*, December, p. 3.

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.¹⁰²

Like other tariffs, Greater Western Water considered the different charging arrangements for new customer contributions in the former City West Water (central) and Western Water (western) regions. New customer contributions in the central region comprise a standard water charge and a standard sewer charge with a dedicated recycled water charge applying in the Greek Hill and West Werribee recycled water zones. In the western region, charges are either infill or greenfield, with a per lot connection charge that is fully inclusive of water, recycled water, and sewer connections.

Greater Western Water proposed to:

- align the standard/infill new customer contributions between its central and western regions (now called standard new customer contributions)¹⁰³
- maintain the greenfield new customer contributions in its western region¹⁰⁴
- continue to charge recycled water new customer contributions for West Werribee and Greek Hill areas
- increase new customer contributions in 2024-25 by 5 to 10 per cent, except for infill new customer contributions for its western region which it proposed to decrease by 42 per cent¹⁰⁵
- cap the increase in new customer contributions to five per cent annually in real terms from 2025-26 to 2027-28.

Greater Western Water outlined in its price submission that its proposed approach is based on:

- maintaining affordability for new connections
- developer support for the approach, consistent with the outcomes of its engagement with developers
- potential changes to the commission's new customer contributions framework following a planned review from 2024-25
- consistency with Yarra Valley Water's and South East Water's proposed price paths for new customer contributions during their 2023–28 regulatory period.

¹⁰² Essential Services Commission 2013, *New customer contributions: explanatory note*, December, p. 3.

¹⁰³ From 2024-25, a uniform new customer contribution charge of \$1,830 (for combined water and sewer) for infill areas will apply across the Greater Western Water region.

¹⁰⁴ From 2024-25, a greenfield new customer contribution charge of \$7,616 will apply. Greenfield new customer contributions do not apply to the central region.

¹⁰⁵ The 42 per cent decrease is due to Greater Western Water's proposal to align the western region infill new customer contribution with the central region.

Table 5.1 compares Greater Western Water’s proposed new customer contributions with its calculated (modelled) charge for 2024-25.¹⁰⁶

Table 5.1 Current, proposed and modelled new customer contributions, 2023-24 to 2024-25 (\$2023-24)

Current structure	New structure	Service connection	Current 2023-24	Proposed 2024-25	Modelled 2024-25
City West Water Standard	Greater Western Water Standard	Water	830	915	922
		Sewer	830	915	2,863
		Total	1,659	1,830	3,776
Western Water Infill	Greater Western Water Standard	Water	1,567	915	922
		Sewer	1,567	915	2,863
		Total	3,134	1,830	3,776
Western Water Greenfield	Western Greenfield	Water	3,627	3,808	6,372
		Sewer	3,627	3,808	8,597
		Total	7,255	7,616	14,831
West Werribee and Greek Hill	West Werribee and Greek Hill	Recycled water	3,000	3,149	12,390

We have reviewed Greater Western Water’s proposed new customer contributions and our preliminary view based on the information that has been provided to date is that Greater Western Water has not provided us with adequate information or justification for us to be satisfied that its proposal regarding uniform standard new customer contributions for both infill and greenfield is compliant with the assessment criteria in our guidance.¹⁰⁷

We are concerned the current proposal has prioritised uniformity and alignment of charges over its regions rather than justify its proposal having regard to the guidance criteria.

¹⁰⁶ Greater Western Water 2023, *2024 Price submission*, 28 September, p. 108.

¹⁰⁷ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 63–64.

Greater Western Water sought to justify its proposed standard and greenfield new customer contributions by reference to potential changes to the commission's new customer contributions framework and consistency with Yarra Valley Water and South East Water's price path. However, these matters are not relevant to the compliance of the proposal with the new customer contributions principles in our guidance.

There is insufficient justification for a uniform greenfield new customer contribution

On the information provided to us at the time of this draft decision, Greater Western Water has not sufficiently justified the application of a uniform greenfield new customer contribution in the western region (Western Greenfield tariff in Table 5.1 above).¹⁰⁸

We asked Greater Western Water to provide us with its cost analysis of providing services to new connections within the different western region greenfield areas. Greater Western Water was unable to provide this and stated that:

- in many of the western greenfield areas, water and sewerage are treated locally, [so different] locations are similar with regard to the service that is provided
- some greenfield locations had very low forecast connections, driving the modelled charge unreasonably high
- developers indicated they want an easy to administer charging structure and are keen to avoid location-based charging as it can bring unfair advantages and disadvantages
- the approach is a continuation of the existing tariff structures.

We have not yet seen quantitative evidence from Greater Western Water to demonstrate that the costs of providing services to new connections in its western greenfield areas are sufficiently consistent such that a common charge is justifiable. During its engagement with developers, Greater Western Water indicated that it will investigate the costs for major greenfield development areas in Hume, Melton and Wyndham.¹⁰⁹

¹⁰⁸ Clause 11(d)(ii) of the 2014 WIRO requires the commission to have regard to whether the regulated entity's prices provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers). The commission will necessarily have regard to relevant information about costs including costs of servicing particular locations. The 2014 WIRO also requires the commission to place particular emphasis on certain matters including 'the promotion of efficient use of prescribed services by customers' (clause 8(b)(i)). Ensuring that prices, including new customer contributions, appropriately reflect costs (including costs in particular locations) is therefore a fundamental part of the commission's role in making a price determination.

¹⁰⁹ Greater Western Water, Presentation slides for the Development Industry Forum 1: GWW 2023 price submission, April 2023; Greater Western Water, Presentation slides for the Development Industry Forum 3: GWW 2023 price submission, August 2023.

Accordingly, our preliminary view is that Greater Western Water’s proposed greenfield new customer contribution has not met our guidance requirements, because it has not demonstrated that it meets the pricing principle to have regard to the incremental infrastructure and associated costs attributable to a given connection.¹¹⁰ Greater Western Water has the opportunity to respond to our draft decision with information to support how its proposal is compliant with the new customer contribution pricing principles.

Proposed standard new customer contributions do not appear cost reflective

Our guidance sets out the pricing principles, and states that “Standard and negotiated new customer contribution charges will have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection”. In essence, this requires new customer contributions to be cost reflective.

We have reviewed Greater Western Water’s proposed standard new customer contributions and we observe that most are lower than the charges calculated in its new customer contributions pricing model (see Table 5.1 above). Greater Western Water estimates, based on its current assumptions on expenditure and demand, that its new customer contributions will be cost reflective by 2040, and potentially longer for recycled water.

Regarding the alignment of standard new customer contributions between the central and western regions, we consider Greater Western Water has not sufficiently justified its proposals against the guidance principles, noting a proposed 42 per cent reduction of the current western infill charge which was approved as meeting the guidance principles at Western Water’s 2020 price review.

We understand that moving to cost reflectivity often requires transition over a reasonable period of time, particularly where the gap from current charges is large, to better enable stakeholders to adjust to new arrangements.

For its future price submissions, Greater Western Water should provide additional detail on its transition plans for new customer contributions, informed by engagement, to achieve more cost reflective charges. This may be informed by our upcoming review of the new customer contribution framework. As noted below, we are seeking further information from Greater Western Water to inform our final decision.

¹¹⁰ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 63.

Draft decision

Our draft decision is to not approve Greater Western Water's proposed standard new customer contributions because, based on the information provided to date, our preliminary view is that they do not meet our guidance.

In response to our draft decision in relation to standard new customer contributions, Greater Western Water must:

- explain how its proposed uniform standard new customer contributions consider the guidance principles
- provide its justification, including the cost analysis it is based on, to support a uniform greenfield new customer contribution in the western greenfield areas.

We are seeking further views from stakeholders – including customers and developers – about Greater Western Water's proposed standard new customer contributions and transition path to higher charges.

Negotiated new customer contributions framework

We reviewed Greater Western Water's proposed negotiated new customer contributions framework. Our draft decision accepts Greater Western Water's proposed framework for negotiated new customer contributions because it complies with our new customer contributions pricing principles.

5.5 Adjusting prices

Our draft decision is to accept Greater Western Water's proposed price adjustment mechanisms.

Greater Western Water's proposed price adjustment mechanisms are set out on page 114 of its price submission. It proposed the following price adjustment mechanisms, which are similar to those in the current regulatory period with some minor adjustments:

- a rolling 10-year average cost of debt
- to pass through the annual desalination water order and changes to the security charge
- to pass through other annual changes to Melbourne Water's bulk water and sewerage prices including cost of debt adjustments where applicable.

Greater Western Water proposed to extend its cost of debt adjustment to water and sewage usage tariffs.¹¹¹ This will allow it to pass through the savings from falling cost of debt to tenants.

Our preliminary assessment is that Greater Western Water's proposed price adjustment mechanisms satisfy the requirements of our guidance. Further, they are mainly a continuation of Greater Western Water's current arrangements. Therefore, our draft decision accepts Greater Western Water's proposed price adjustment mechanisms.

¹¹¹ Greater Western Water began extending the cost of debt adjustments to its usage charge, in addition to the service charge, for its 2021-22 prices as part of its strategy to transition to uniform tariffs.

6. Financial position

We have reviewed key indicators of Greater Western Water's financial performance and our preliminary view is that Greater Western 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.¹¹² 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 corporation can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

Greater Western Water's 2024 price submission (pages 125 to 126) and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on Greater Western Water's assumptions about its revenue and expenditure.

Our draft decision proposes a different revenue requirement to Greater Western Water. Accordingly, the estimates for the key indicators are different under our draft decision to those estimated by Greater Western Water, but as shown in Table 6.1, the differences are small.

As noted in our guidance, the primary indicator in our assessment of the financial position of a business is Funds from Operations (FFO) interest cover. Under our draft decision, Greater Western Water is projected to remain above the minimum benchmark for FFO interest cover.

Gearing (Net debt / Regulatory asset value) is forecast to remain above the maximum threshold of 70 per cent. Utility businesses commonly operate at gearing levels above this threshold and this is influenced by the capital program proposed by Greater Western Water (which we acknowledge is partly driven by the integration needs of the business). Similarly, outcomes for Funds from Operations / Net Debt, and the internal financing ratio, are sensitive to the scope and timing of the increases in capital expenditure proposed by Greater Western Water.

Businesses are primarily responsible for managing their financial performance and our expectation is they will explore avenues to address any concerns prior to seeking a financial viability adjustment to their maximum prices, which is a last resort safeguard available in the pricing framework. Moreover, the financial viability metrics are likely to change in the lead up to our final

¹¹² WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

decision, given upcoming adjustments including the long-term inflation rate. We will undertake a further assessment at the time of our final decision.

For our draft decision, consistent with our primary focus on Funds from Operations (FFO) interest cover, we consider Greater Western Water will generate sufficient cash flow to deliver its services and meet its obligations in the next regulatory period.

Table 6.1 Financial indicator scores calculated from Greater Western Water’s proposal, our draft decision and our benchmarks

		2024-25	2025-26	2026-27	2027-28
FFO interest cover (times)	ESC benchmark	>1.5	>1.5	>1.5	>1.5
	GWW proposal	1.87	1.87	1.75	1.71
	Draft Decision	1.98	1.98	1.87	1.82
Net Debt / RAV (Gearing) (%)	ESC benchmark	<70%	<70%	<70%	<70%
	GWW proposal	75.6%	78.4%	80.4%	82.9%
	Draft Decision	76.0%	78.8%	80.7%	83.3%
FFO / Net debt (%)	ESC benchmark	>10%	>10%	>10%	>10%
	GWW proposal	4.1%	4.2%	3.7%	3.6%
	Draft Decision	4.6%	4.8%	4.3%	4.2%
Internal financing ratio (%)	ESC benchmark	>35%	>35%	>35%	>35%
	GWW proposal	9.6%	14.7%	11.2%	12.5%
	Draft Decision	13.9%	20.6%	15.7%	18.1%

7. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water corporation's revenue requirement to that corporation's level of ambition expressed in its price submission. Our guidance required Greater Western 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.¹¹³ We required Greater Western 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 Greater Western 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 also assessed and rated Greater Western Water's price submission. As outlined in our guidance, the combination of Greater Western Water's self-rating and our rating has determined the return on equity we have adopted to calculate Greater Western Water's revenue requirement in our draft decision.

7.1 Our PREMO assessment of Greater Western Water's price submission

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

Greater Western 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 proposed ratings following our assessment of Greater Western Water's price submission.

¹¹³ This is the first price review for Greater Western Water 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. Western Water was not required to provide a PREMO self-rating for its 2020 price review after receiving a 2-year pricing decision in 2018.

Table 7.1 **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Greater Western Water's self-rating	Standard	Standard	Standard	Advanced	Standard	Standard
Commission's rating	Standard	Standard	Standard	Advanced	Basic	Standard

Our preliminary view is that we agree with Greater Western Water's proposed overall PREMO self-rating of 'Standard'. This is reflected in the return on equity we propose to approve for Greater Western Water (see Section 4.4.2). We have formed this view after reviewing Greater Western Water's proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

7.1.1 Performance

For the 2024 price review, Greater Western Water's rating for the Performance element of PREMO is based on a combination of its overall PREMO rating at its most recent price reviews for City West Water and Western Water, and its level of performance based on achievement of outcomes (related to service targets and performance against expenditure benchmarks set at the previous price review) and customer sentiment.¹¹⁴ Our guidance required Greater Western Water's price submission to show how it has considered the performance and the previous PREMO ratings of City West Water and Western Water.

As noted in Section 3.2, we agree with Greater Western Water's self-assessment that it has, overall, met its outcome commitments for the period to date, despite a substantial program to integrate its antecedent businesses, while also charging lower than the maximum prices allowed under prevailing price determinations. This includes performance against the outcome commitments of City West Water and Western Water prior to the formation of Greater Western Water, and its subsequent performance as the new entity against those commitments. It also showed ownership of shortfalls in performance, providing reasoning and its response to the shortfalls in its annual reporting to us, and in its twice-annual reporting to customers.

This was delivered while also using its existing tariff basket form of price control to commence the process of aligning customer prices across its two regions.

¹¹⁴ As set out in Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, pp. 80–81. Guiding questions are set out on page 49.

In terms of customer perceptions, Greater Western Water's results on the commission's survey of customer sentiment – covering measures of overall satisfaction, value for money, trust, and reputation in the community – were generally consistent with other water businesses over the equivalent period. Results for all four measures trended upwards, peaking in early 2022 before dipping again over 2023, but remaining higher than at the outset. This is summarised at pages 157 to 163 of its price submission.¹¹⁵

Greater Western Water's controllable operating costs in 2022-23 were \$25.5 million (13.8 per cent) higher than the combined benchmark of the two former businesses established at the 2018 and 2020 water price reviews. As discussed in Section 4.1.2, the higher than benchmark outcome reflects a number of different cost drivers, including rising input costs and costs related to the integration and transformation of the business, which outweighs cost efficiencies achieved so far through the business integration. However, Greater Western Water provided insufficient information to enable us to verify that all of these proposed cost increases were efficient recurring costs, and our draft decision was only to accept approximately one third of the proposed costs.

Greater Western Water's capital expenditure for 2017-18 to 2022-23 is higher than the benchmarks adopted at the 2018 City West Water and 2020 Western Water price reviews, in both gross (21 per cent) and net (12 per cent) terms. It completed 7 of 10 major capital projects in the central region but varied more from its plan in the western region with 3 of 12 projects completed. Greater Western Water has transparently explained the reasons for these variations and project delays, including impacts from the pandemic and changes in expected population growth movements, particularly in the western region. Our preliminary view is that the information provided by Greater Western Water demonstrates that the actual expenditure incurred during the 2018–23 period reflects prudent and efficient expenditure (Section 4.2.1).

City West Water achieved an overall rating of 'Advanced' in 2018, and we considered Western Water's 2020 price submission did not meet the requirements for a 'Standard' rating, so it would be appropriate to consider Greater Western Water's most recent overall PREMO rating would average out at 'Standard'. In our view, Greater Western Water's self-rating of 'Standard' in effect recognises that it fell short of its City West Water performance expectations in the current period, and met its Western Water expectations. We consider this self-rating is appropriate given the increase in controllable costs above the benchmark in 2022-23.

On the basis of the above, our draft decision is to accept Greater Western Water's self-rating of 'Standard' for the Performance element of PREMO.

¹¹⁵ The commission's customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

7.1.2 Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don't pay more than they need to), and the business's proposed guaranteed service level scheme (including that it provides incentives for the business to deliver valued services efficiently).¹¹⁶

In support of its self-rating of 'Standard' for the Risk element of PREMO, Greater Western Water's price submission provided an overview of eight key regulatory risk categories and the allocation of these risks between the business and its customers, based on its internal risk management framework.

Key factors we identified that support Greater Western Water's self-rating include:

- Continuing with a tariff basket form of price control for the majority of its core water and sewerage and trade waste service charges, and a price cap form of price control for miscellaneous charges. The tariff basket will assist in managing short-term price shocks/fluctuations for customers, with price increases limited to 10 per cent per annum (in real terms).
- Not proposing to pass on additional costs associated with changes in the payroll tax or superannuation guarantee, but to recover these additional costs through workforce optimisation.
- Excluding capital expenditure of about \$173 million from customer prices due to uncertainty in timing, cost, scope and benefits of associated projects, thereby helping to ensure customers do not pay for projects that do not ultimately proceed or that change in scope.
- A new guaranteed service level scheme that better balances risk between customers and the business. The scheme extends the existing central region guaranteed service level scheme to the western region, and adds a new water quality guaranteed service level, expanding guarantees to all customers. Greater Western Water will absorb all costs of the scheme.
- Its risk management policies and procedures are consistent with ISO31000, and its asset management framework is consistent with the ISO55000 standard.

However, our draft decision has proposed reductions to the operating and capital expenditure forecasts put forward by Greater Western Water, and we did not accept its proposed standard new customer contribution on the basis they were not cost reflective. Our views on these matters are discussed under the Management element in Section 7.1.4 below.

Our draft decision is to accept Greater Western Water's self-rating of its price submission as 'Standard' for Risk.

¹¹⁶ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 49.

7.1.3 Engagement

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations peoples and those experiencing vulnerability.¹¹⁷

Our draft decision is to accept Greater Western Water's self-rating of 'Advanced' for the Engagement element of PREMO on the basis of the overall quality of its engagement program and the level of influence it afforded its stakeholders, as described below.

Greater Western Water designed inclusive engagement methods and provided an extensive opportunity to participate to its diverse groups of customers including those experiencing vulnerability.

Key aspects of Greater Western Water's engagement were influential on its submission, as evidenced by feedback from its community panel members who commented favourably on the alignment between their recommendations and the business's proposals. Further, it received strong endorsement of the level of influence of customers on its pricing proposals from its Customer Advisory Group, and the Maribyrnong and Brimbank City Councils had a positive view of its engagement program and the proposed engagement outcomes.

7.1.4 Management

The Management element of PREMO is assessed against guiding questions that cover matters such as the efficiency of proposed expenditure and prices, the quality of the business's submission and supporting information to justify proposals, and evidence that there is senior-level ownership and commitment to the proposals contained in the submission.¹¹⁸

We consider Greater Western Water's price submission was generally well presented, and clearly linked the outcomes of its engagement to planned outcomes and expenditure. Its financial model contained no substantive errors and was consistent with its written submission. The Greater Western Water Board has also attested to the accuracy of the information contained in its submission, as required by our guidance.

Greater Western Water's price submission reflects considerable work to harmonise its two tariff structures from the central and western regions, simplifying tariffs with the removal of the third tier water usage charge for western region customers and the sewer disposal charge for central region

¹¹⁷ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 49.

¹¹⁸ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 49.

customers. However, our preliminary view is that the proposed standard new customer contributions are not consistent with the pricing principles in our guidance because we don't have sufficient information to verify they are cost reflective.

Greater Western Water's price submission presents an average efficiency improvement rate for controllable operating expenditure of 3.0 per cent per year, however more than half this figure comprises identified and unidentified cost savings from its business integration and transformation programs and major capital investment in a new billing system. The underlying base efficiency improvement rate is 1.4 per cent, which is on par for a 'Standard' PREMO rating.

As noted in Section 4.1.2, our preliminary view is that Greater Western Water has not sufficiently justified the baseline amount for its operating expenditure benchmarks. The information provided by Greater Western Water was insufficient to enable our expenditure consultant to verify whether approximately two thirds of the additional expenditure it incurred above baseline in 2022-23 was recurring and efficient, and our draft decision is to remove it from the forecast.

Greater Western Water's capital expenditure forecast was mostly verified as prudent and efficient and deliverable within the regulatory period, however the information provided by Greater Western Water was insufficient to enable our consultant to verify all of the proposed expenditure.

A key requirement for a 'Standard' rating for the Management element of PREMO is that proposed expenditure changes can be clearly justified by the business as prudent and efficient expenditure. Consistent with our draft decision on its forecast operating and capital expenditure, our preliminary view is that Greater Western Water was unable to sufficiently justify elements of its forecasts for prudent and efficient expenditure, as required by our guidance, despite having ample opportunity to do so.

The adjustments that we propose for our draft decision are also large compared with other water businesses at recent price reviews. The 8.1 per cent reduction to controllable operating expenditure is higher than the largest adjustment from the 2023 price review, of 5.4 per cent, and that business's PREMO rating for management was also reduced to 'Basic'. Our proposed \$160 million adjustment to capital expenditure was also high compared to similar businesses – in 2023, South East Water's forecast was adjusted down by \$25 million and Yarra Valley Water required no adjustment.

Given these factors noted above, our draft decision is to not accept Greater Western Water's self-rating of its price submission as 'Standard' for Management, and instead adopt a rating of 'Basic'.

7.1.5 Outcomes

The Outcomes element of PREMO is assessed against guiding questions focused on:

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.¹¹⁹

Greater Western Water has prepared a single set of outcomes and measures, combining and consolidating the two former sets prepared by City West Water and Western Water.

As noted in Section 3.2, our preliminary view is that Greater Western Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by customers.

It did this through a customer forum whose members selected the measures which best represented their values from a pool of proposed outcome promises. The outcomes, measures and targets were endorsed by both the customer forum and Greater Western Water's Customer Advisory Group.

Section 3.1 provides a list of commitments where we consider Greater Western Water has demonstrated the influence of customers on its proposed outcomes and other initiatives.

Generally, we consider Greater Western Water's measures will provide a sound basis to track performance and delivery against each outcome, once the matters we identified in our assessment have been addressed. We are working with Greater Western Water to ensure its final set of measures is consistent with our guidance. Most targets indicate Greater Western Water will deliver its customers a similar level of service to the current period, which aligns with its stated objective of similar prices for similar service.

Greater Western Water has committed to reporting on its performance against its outcome commitments by publishing its performance on its website. It has also established an ongoing customer forum that will meet annually to track its performance against its outcomes 'score card'.

Accordingly, our draft decision is to accept Greater Western Water's self-rating of 'Standard' for the Outcomes element of PREMO.

¹¹⁹ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September 2022, p. 49.

Appendix A — Submissions received

Name or organisation	Date received
Christine Hicks	11 October 2023
David Mould	24 October 2023
Helen van de Berg/Friends of Steele Creek	3 December 2023
John Forrester on behalf of Werribee River Association	13 December 2023
Macedon Water Think Tank	13 December 2023
Concerned Waterways Alliance	14 December 2023

We also received 5 confidential submissions from stakeholders requesting their submission not be published.

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 draft decision for Greater Western Water.

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.¹²⁰ We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Greater Western Water’s compliance with our guidance, in reaching our preliminary view.

Note: all chapter and section numbers referenced below refer to our draft decision for Greater Western 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 draft 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).

¹²⁰ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September.

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 draft decision has therefore had regard to the extent that Greater Western 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 draft 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 draft 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 corporation to retain the benefits of any cost efficiencies it generates until the end of its regulatory period. In other words, a water corporation 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 corporations 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 corporation promotes efficiency in the water industry.

The following chapters and sections of our draft 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 Greater Western Water to recover borrowing costs associated with its investment in services, and generate a return on assets.¹²¹

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 corporation can maintain an investment grade credit rating. Further, prices should enable each corporation 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 draft decision, we have had regard to the extent Greater Western 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.

The following chapters and sections of our draft 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).

¹²¹ The regulatory rate of return is comprised of the cost of debt and the return on equity.

- 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 corporation to propose outcomes, tariff structures and expenditure that reflect its particular circumstances. We consider that taking into account the particular circumstances of each water corporation is consistent with taking into account the particular circumstances of the water industry.

The following chapters and sections of our draft 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 decision. This includes adopting operating and capital expenditure benchmarks that we consider will allow Greater Western 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 draft decision provides for Greater Western 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 Australia¹²²
- operating and capital expenditure costs per connection throughout Australia¹²³
- tariff structures applied by water corporations throughout Australia¹²⁴
- the regulatory rate of return set by other regulators.¹²⁵

We are not aware of any international benchmarks that are relevant to our 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 corporation to propose outcomes, a revenue requirement, expenditure and tariffs that reflect its particular circumstances and operating environment.

The following chapters and sections of our draft 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 Greater Western Water’s proposals, including through submissions and public meetings.

¹²² Bureau of Meteorology 2024, *National performance report 2022-23; urban water utilities, part A*, March.

¹²³ Bureau of Meteorology 2024, *National performance report 2022-23; urban water utilities, part A*, March.

¹²⁴ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

¹²⁵ 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 draft 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).

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 draft 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 draft 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 Greater Western 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 Greater Western 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 corporation’s engagement
- the structure of individual tariffs
- the proposed form of price control
- any changes to tariffs and how water corporations explain them to customers.

The following sections of our draft 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 Greater Western 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 draft 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 Greater Western 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, assistance available to customers having difficulty paying bills is relevant to this objective.

The following chapters and sections of our draft 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 assessment of tariff structure 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 draft decision proposes to approve a revenue requirement that will enable Greater Western Water to deliver the outcomes valued by customers, and on its legal and regulatory obligations.

The following chapters and sections of our draft 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 draft decision proposes to approve a revenue requirement that will enable Greater Western 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 draft 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, Greater Western Water does not face any competition in the delivery of its prescribed services within its region. Our draft 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 draft 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 corporations. Our PREMO water pricing approach provides incentives for a water corporation to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.¹²⁶

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 corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations 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 corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.¹²⁷

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 corporation’s revenue requirement
- allows water corporations to implement various forms of price control, including price caps and revenue caps

¹²⁶ Essential Services Commission 2016, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October, pp. 11–13.

¹²⁷ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 28 September, p. 2–3.

- 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 corporations may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water corporations and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income customers and customers experiencing vulnerability), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water corporations. Our guidance noted that much of the information required in price submissions should be readily available to water corporations as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.¹²⁸

¹²⁸ Essential Services Commission 2022, *2024 Greater Western Water price review: Guidance paper*, 20 September, p. 2–3.