

South Gippsland Water final decision

2023 Water Price Review

23 June 2023

Acknowledgement

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

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

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

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Summary

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

In March 2023, we released our draft decision on the price submission South Gippsland Water submitted to us in September 2022.¹ The draft decision set out our preliminary views on South Gippsland Water's proposals and invited interested parties to make further submissions. We also held a public forum in April 2023. In addition to a response by South Gippsland Water, we received three written submissions on our draft decision, which are available on our website (see Appendix A of this final decision for details).

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



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

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

¹ Our draft decision for South Gippsland Water is available at www.esc.vic.gov.au/waterpricereview.

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

We have approved a revenue requirement of \$202.4 million over 5 years

Our final decision approves a revenue requirement of \$202.4 million over the 5-year period starting 1 July 2023 (see Chapter 4).³ This is \$4.1 million or 2.1 per cent higher than our draft decision, which mainly reflects our updates to the cost of debt.

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

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

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

Typical water and sewerage bills will rise from 1 July 2023

A summary of approved maximum prices for major services delivered by South Gippsland Water is set out in Section 5.3.2. Table A shows the estimated typical bills for different customer groups under our final decision, for 2022-23 (the current year) and 2023-24. For a typical residential owner occupier, estimated annual water and sewerage bills (including inflation) will rise from around \$1,154 currently to \$1,265 in 2023-24, an increase of around 9.6 per cent. For a typical residential tenant, bills (including inflation) will rise from around \$437 currently to \$479 in 2023-24. The bill paid by each customer will vary depending on water use, prices for fixed and variable tariffs, and other charges.

In 2024-25, water and sewerage prices for residential and non-residential customers will generally increase by around 2.5 per cent excluding inflation, before increasing by around 3.5 per cent in each of the following three years, also excluding inflation.

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

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

Customer group	Average consumption (kL p.a.)	2022-23 (current)	2023-24
		\$2022-23	\$2023-24
Residential – owner occupier	121	\$1,154	\$1,265
Residential – tenant	121	\$437	\$479
Non-residential	250	\$1,435	\$1,560

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

South Gippsland Water has committed to delivering a number of key outcomes for its customers

South Gippsland Water plans to deliver the following outcomes for customers:

- Reliability: plan for the future, be reliable and minimise unplanned interruptions to services
- Water: provide safe, clean drinking water
- Wastewater: provide a safe wastewater service that contributes to the liveability of our communities
- Environment: be environmentally sustainable and adapt to a future impacted by climate variability
- Integrity: act with honesty, respect and strive to balance affordability, value-for money and fairness.⁴

Among the key initiatives to deliver on South Gippsland Water’s commitments are projects to protect the environment and ensure that it continues to provide reliable services to its customers.

South Gippsland Water will also continue to target achieving 100 per cent renewable electricity by 2025 and net zero emissions by 2035. It will also introduce new programs such as its co-payment scheme, to help re-engage with customers with outstanding payments and help them reduce debt.

⁴ South Gippsland Water, 2023 water price submission, September 2022, pp. 26–28.

South Gippsland Water has considered the impacts of relatively high inflation for 2023-24

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

- Its price submission had been developed to minimise the cost-of-living pressures on all customers and, in particular, its customers experiencing financial hardship.
- Specific ways in which it is addressing the interests of vulnerable and low-income customers in 2023-24 and beyond include tariffs that collect less than its proposed revenue requirement.
- Its implementation of a targeted co-payment program designed to re-engage with customers with outstanding payments and assist in reducing their debt.
- The business is seeing significant increases in the cost-of-doing-business.

More information is available in South Gippsland Water's response to our draft decision.⁵

Tariff structures will remain the same

Consistent with our draft decision, our final decision approves South Gippsland Water's proposed tariff structures, because they reflect a continuation of its current approach and are generally supported by its customers. For water services, we have approved South Gippsland Water's proposal for a fixed service charge and a variable component that depends on water usage. For residential and non-residential sewerage services, we have approved South Gippsland Water's proposal for a fixed charge only. For non-residential sewerage services to which cistern or trade waste charges apply, we have approved a fixed access fee and a volumetric charge.

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

⁵ South Gippsland Water, *submission in response to the Essential Services Commission 'South Gippsland Water draft decision: 2023 water price review'*, 9 May 2023, pp. 3-4.

We have rated South Gippsland Water’s price submission as ‘Standard’ under the PREMO framework

Consistent with our draft decision, our final decision is to rate South Gippsland Water’s price submission as ‘Standard’ under the PREMO framework (Table B). This is the same as South Gippsland Water’s self-rating. Factors in support of South Gippsland Water’s PREMO rating include that it engaged broadly with its customers, providing opportunities for participation across its service areas, its engagement was inclusive of customers facing vulnerability and that South Gippsland Water proposed an efficiency improvement rate for controllable operating expenditure over the 2023–28 regulatory period of 1.4 per cent, slightly higher than the average of all businesses in the current price review.

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



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

Table B **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
South Gippsland Water’s self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission’s rating	Standard	Standard	Standard	Standard	Standard	Standard

1. Our role and approach to water pricing

1.1 We are Victoria's independent economic regulator

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

1.2 We are reviewing the proposed prices of 14 water businesses

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.⁶ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.⁷

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

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

1.3 We assess prices against the WIRO and other legal requirements

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

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

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

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

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

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance⁸
- the principle that prices should be easily understood by customers and provide signals about the efficient costs of providing services, while avoiding price shocks where possible
- the principle that prices should take into account the interests of customers of the regulated entity, including low income and vulnerable customers.

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

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

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

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

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

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

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



The power for water businesses to charge fees for services they provide is set out in the Water Act 1989.¹² These provisions in the Water Act also govern the processes for and manner in which water businesses may set and impose fees. Each water business must ensure that it complies with these legislative requirements.

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

¹² See part 13, Division 5 and 6 of the Water Act 1989.

Table 1.1 Matters businesses and the commission must have regard to

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

Continued next page

Table 1.1 (continued)

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

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

1.4 PREMO

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

Box 1.1 PREMO

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

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

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

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

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

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

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

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

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

¹⁴ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.

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

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

- South Gippsland Water's price submission
- South Gippsland Water's presentation made directly to commissioners
- South Gippsland Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 28 April 2023¹⁵
- written submissions from interested parties (a list of submissions responding to our draft decision is provided in Appendix A).

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

Our guidance included matters water businesses must address in their price submissions. South Gippsland Water's price submission addressed each of these matters, and our initial assessment of those matters is set out in our draft decision.

We consulted on our draft decision, receiving submissions between 30 March 2023 and 9 May 2023 and holding a hybrid (on-line and in-person) public forum on 28 April 2023. Issues raised during the forum included operational matters related to wastewater and treatment plants, the availability and use of different water supplies, and South Gippsland Water's performance reporting.

South Gippsland Water provided a response to our draft decision, including a revised financial model that reflected the updated cost of debt and inflation figures we provided to businesses in May 2023.¹⁶ In arriving at our final decision, we have considered South Gippsland Water's responses to our draft decision.

This paper sets out our final decision.

¹⁵ A recording of this forum is available on our website.

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

2.1 Final decision paper outline

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

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

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

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

2.2 Regulatory period

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

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

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

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

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

¹⁷ This is a requirement of the WIRO, clause 9.

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

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

3. Customer outcomes

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

This chapter outlines our views on:

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

3.1 Customer and community engagement

Our guidance required South Gippsland Water to engage with customers to inform its price submission. Our guidance also identified principles to guide South Gippsland Water’s engagement.²⁰

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

- began early and was wide-reaching, using feedback from 900 customers and community across 20 of its 21 serviced towns
- covered matters that could influence services and prices, including safe clean water, reliability, wastewater management, environment, people experiencing vulnerability, small businesses, bill impacts and price paths
- reflected the diversity of its customer base, and included extensive engagement with customers experiencing vulnerability and their advocates, as well as Traditional Owners (primarily via the Gippsland Environmental Alliance of which the Gunaikurnai Land and Water Aboriginal Corporation is a member).

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

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

- expanding eligibility for its customer support program
- introducing a co-payment program for residential and small business customers
- improving wastewater reuse at its Foster treatment plant.

Our preliminary view was to accept South Gippsland Water's 'Standard' self-rating for the Engagement element of PREMO on the basis it had designed and delivered an engagement program that was appropriate in the context of the real price increases it proposed in its price submission. Examples outlined in our draft decision included:

- the detailed research South Gippsland Water undertook on the experiences of people facing vulnerability in its service area
- its extensive engagement with people experiencing vulnerability and their advocates
- the broad level of participation South Gippsland Water was able to achieve by using methods that supported customers' engagement preferences.

A submission from Dominic Gilligan, who participated in South Gippsland Water's Consumer Advisory Committee, commented favourably on the quality of South Gippsland Water's engagement with its community as well as its transparency about where and why money is spent.²¹

We consider this feedback is consistent with our draft decision. Our final decision is to accept South Gippsland Water's self-rating of 'Standard' for its price submission engagement.

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

3.2 Outcomes

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

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

- Reliability: plan for the future, be reliable and minimise unplanned interruptions to services

²¹ Dominic Gilligan, *submission to the Essential Services Commission 'South Gippsland Water draft decision: 2023 water price review'*, 1 May 2023.

- Water: provide safe, clean drinking water
- Wastewater: provide a safe wastewater service that contributes to the liveability of our communities
- Environment: be environmentally sustainable and adapt to a future impacted by climate variability
- Integrity: act with honesty, respect and strive to balance affordability, value-for money and fairness

South Gippsland Water’s proposed measures and targets that it will use to report on the performance for each outcome are detailed on pages 26 to 28 of its price submission.

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

We considered its proposed set of outcomes for 2023–28 demonstrated an overall improvement in customer value and was consistent with the requirements of a ‘Standard’ rating for the Outcomes element of PREMO. After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on South Gippsland Water’s outcomes.²²

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

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

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

Our assessment of South Gippsland Water’s outcomes, measures and targets has informed our final decision rating of its price submission for the Outcomes element of PREMO, which is discussed in Chapter 7.

3.3 Service standards related to service reliability and faults

South Gippsland Water provided a list of service standards relating to reliability and attending faults that it will include in its customer charter. Service standards are a common set of services

²² A submission from the Consumer Action Law Centre commended all businesses for working closely with customers to develop their proposed outcomes set. Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2023.

applicable to all Victorian consumers as required by clause 18.2 of the Water Industry Standard – Urban Customer Service (Urban Water Industry Standard). Each water business must specify its own targets against each of these service standards. These service standards and corresponding target service levels are the minimum level of service customers can expect to receive.

Our draft decision summarised South Gippsland Water’s proposed changes in its service standards and the reasons that we considered they comply with the requirements of the Urban Water Industry Standard.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on South Gippsland Water’s service standards. On the basis of the above, our assessment is that the service standards relating to reliability and faults proposed by South Gippsland Water comply with the requirements of the Urban Water Industry Standard.

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

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

3.4 Guaranteed service levels

Our final decision is to accept South Gippsland Water’s proposed guaranteed service levels as set out in Appendix D.

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

South Gippsland Water’s proposed guaranteed service levels are set out on page 29 of its price submission. Our draft decision summarised South Gippsland Water’s proposed changes to its guaranteed service levels in its scheme from July 2023.

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

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

4. Revenue requirement

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

We have used a building block methodology to establish the revenue requirement. This chapter outlines our assessment of South Gippsland 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 South Gippsland Water's PREMO rating (Section 4.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.5)
- establish a benchmark tax allowance (Section 4.6).

Our final decision is to approve a revenue requirement of \$202.4 million.

South Gippsland Water proposed a revenue requirement of \$199.9 million over a 5-year period starting 1 July 2023. Our draft decision adopted a lower revenue requirement of \$198.2 million, mainly as a result of our proposed adjustments to its average asset life for water entitlements and to its closing regulatory asset base to align with South Gippsland Water's regulatory accounts. Our final decision approves a revenue requirement of \$202.4 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

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

Table 4.1 Final decision on South Gippsland Water’s revenue requirement

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	24.8	25.8	25.8	26.1	26.0	128.5
Return on assets	5.7	6.3	7.0	7.5	8.0	34.5
Regulatory depreciation	6.3	7.1	7.9	9.0	10.2	40.5
Tax allowance	-	-	-	-	-	-
Final decision – revenue requirement	36.6	38.9	40.5	42.4	43.9	202.4

Note: Numbers have been rounded.

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

South Gippsland Water updated its revenue requirement to reflect our updates to inflation and the cost of debt and also updated its bulk water charges to reflect the latest information.

South Gippsland Water also updated its forecast operating expenditure to reflect changes announced in the 2023-24 Victorian State Budget (see Section 4.1).

The main reason for the increase in our final decision revenue requirement for South Gippsland Water compared to our draft decision is the updated estimate for the cost of debt, which reflects the rise in borrowing costs since South Gippsland Water prepared its price submission.

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

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

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

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. South Gippsland Water's proposed revenue requirement	37.2	39.1	40.0	41.4	42.3	199.9
B. Total adjustments proposed in our draft decision	-0.4	-0.3	-0.3	-0.3	-0.3	-1.7
Operating expenditure	-0.1	-0.1	-0.0	-0.1	-0.0	-0.2
Return on assets	-0.0	-0.0	-0.0	-0.0	-0.0	-0.2
Regulatory depreciation	-0.3	-0.3	-0.3	-0.3	-0.3	-1.3
C. Draft decision – revenue requirement (C = A+B)	36.8	38.7	39.7	41.0	42.0	198.2
D. Total adjustments in our final decision	-0.2	0.2	0.8	1.4	2.0	4.1
Operating expenditure	0.1	0.1	0.1	0.1	0.2	0.6
Return on assets	-0.3	0.1	0.7	1.2	1.7	3.5
Regulatory depreciation	0.0	0.0	0.0	0.0	0.0	0.0
E. Final decision – revenue requirement (E = C + D)	36.6	38.9	40.5	42.4	43.9	202.4

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

Table 4.3 Estimated revenue foregone

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Final decision – revenue requirement	36.6	38.9	40.5	42.4	43.9	202.4
Final decision – revenue from tariffs (net prescribed revenue) ^a	36.0	37.2	38.9	40.5	42.3	194.8
Revenue foregone	0.7	1.7	1.6	1.9	1.7	7.6

Note: Numbers have been rounded. ^a The calculation of net prescribed revenue uses the prices proposed by South Gippsland Water and approved in our determination.

4.1 Operating expenditure

Our final decision is to adopt a forecast operating expenditure of \$128.50 million for South Gippsland Water for the 2023–28 regulatory period.

Operating expenditure – comprising both controllable and non-controllable expenditure – is a component of the revenue requirement. Our draft decision proposed to adopt a forecast operating expenditure benchmark of \$127.8 million for the 5-year period, which was slightly lower than proposed by South Gippsland Water.

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

Table 4.4 Final decision – operating expenditure

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Controllable operating expenditure	22.84	22.99	23.06	23.32	23.20	115.42
Non-controllable operating expenditure	1.99	2.77	2.78	2.75	2.79	13.08
Bulk services ^a	0.58	1.40	1.45	1.47	1.54	6.43
Environmental contribution ^b	1.32	1.28	1.23	1.19	1.15	6.18
Licence fees – Essential Services Commission ^c	0.03	0.03	0.03	0.03	0.03	0.16
Licence fees – Department of Health ^c	0.01	0.01	0.01	0.01	0.01	0.05
Licence fees – Environment Protection Authority ^c	0.05	0.05	0.05	0.05	0.05	0.25
Final decision – operating expenditure	24.84	25.76	25.84	26.08	25.99	128.50

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

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

Table 4.5 Our adjustments to South Gippsland Water's operating expenditure for our draft and final decisions

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. South Gippsland Water's proposed total operating expenditure	24.80	25.73	25.76	25.99	25.83	128.12
A1 – Our draft decision adjustments to controllable operating costs	-0.05	-0.05	-0.05	-0.05	-0.05	-0.25
A2 – Our draft decision adjustments to non-controllable operating costs	-	-	-	-	-	-
B. Draft decision – total operating expenditure	24.75	25.68	25.71	25.94	25.78	127.87
C. Final adjustments to controllable operating costs	0.10	0.10	0.10	0.10	0.10	0.50
C1 – 2023-24 State Budget updates	0.10	0.10	0.10	0.10	0.10	0.50
D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 + D5)	-0.01	-0.02	0.03	0.04	0.11	0.13
D1 – Environmental contribution	-0.01	-0.01	-0.02	-0.02	-0.03	-0.09
D2 – Licence fees – Essential Services Commission	0.01	0.01	0.01	0.01	0.01	0.04
D3 – Licence fees – Department of Health	-0.00	-0.00	-0.00	-0.00	-0.00	-0.02
D4 – Licence fees – Environment Protection Authority	0.00	0.00	0.00	0.00	0.00	0.02
D5 – External bulk water charges – Melbourne Water	-0.01	-0.02	0.04	0.05	0.12	0.18

Continued next page

Table 4.5 (continued)

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
E. Final decision – total operating expenditure (E = B + C + D)	24.84	25.76	25.84	26.08	25.99	128.50

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

4.1.1 Controllable operating expenditure

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

- We considered South Gippsland Water’s proposal reflects an efficient baseline cost to forecast annual operating expenditure.
- South Gippsland Water had proposed an efficiency improvement rate of 1.4 per cent per year which is slightly higher than the average rate proposed by water businesses in the current price review.
- The efficiency improvement rate is lower than South Gippsland Water’s proposed average cost growth rates of 1.7 per cent per year for 2023–26 and 1.5 per cent per year for 2026–28, effectively delivering a net annual increase to its controllable annual baseline operating costs in each year of the regulatory period.
- We considered South Gippsland Water’s forecast cost adjustment additions were prudent and efficient, after removing the proposed \$0.25 million adjustment to accommodate Victorian Public Sector Executive Reforms and Remuneration costs because we considered wage increases above inflation should be managed by water businesses through productivity improvements or through the growth allowance applied to 2021-22 baseline year costs.
- There is evidence that South Gippsland Water has significantly tested its controllable expenditure requirements.

In its response to our draft decision, South Gippsland Water acknowledged that the Victorian Public Sector Executive Reforms and associated remuneration costs should be funded via inflation increases and updated its controllable operating expenditure to align with our draft decision and therefore accepted our draft decision to remove these costs from its proposed adjustments.²⁴

²⁴ South Gippsland Water, *submission in response to the Essential Services Commission ‘South Gippsland Water draft decision: 2023 water price review’*, 9 May 2023, p. 1.

Following release of the 2023-24 Victorian State Budget on 23 May, we wrote to water businesses to provide them with an opportunity to update their cost forecasts, should they seek to claim any additional costs and reflect these in customer prices.²⁵

South Gippsland Water responded with updated cost forecasts to reflect higher payments relating to payroll tax and WorkCover premiums. We have accepted these additional amounts as they are unavoidable costs that the business faces in delivering prescribed services to its customers.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision is to accept South Gippsland Water's updated forecast controllable operating expenditure as it is consistent with our guidance (Table 4.4).

4.1.2 Non-controllable operating expenditure

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

- South Gippsland Water had followed the approach set out in our guidance to forecast its non-controllable operating costs in its price submission.
- South Gippsland Water's forecast bulk charges were consistent with Melbourne Water's 2021 price determination.

We noted in our draft decision that we would update the forecast non-controllable operating expenditure for our final decision, and also adjust for the latest inflation and external bulk charges data.²⁶

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

We have assumed the licence fees for the Department of Health and the Environment Protection Authority Victoria remain flat in real terms across the period.²⁷

²⁵ Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023

²⁶ Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

²⁷ For the Safe Drinking Water Administration levy, we have used the 2021-22 value provided by the Department of Health and indexed it by the annual rate for fees in 2022-23 (1.75 per cent), as set out by the Department of Treasury and Finance's cost recovery guidelines (<https://www.dtf.vic.gov.au/financial-management-government/indexation-fees-and-penalties>). We have applied the same approach to the 2021-22 licence fee provided by the Environment Protection Authority Victoria.

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

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

We have increased South Gippsland Water’s forecast non-controllable operating expenditure by \$0.13 million across the 2023–28 period, resulting from the following adjustments:

- \$0.04 million increase for licence fees after considering the latest information received from the relevant regulatory authorities
- \$0.09 million decrease for the environmental contribution to account for the latest data on inflation.
- \$0.18 million increase for external bulk water charges as revised by South Gippsland Water to reflect the Melbourne Water Bulk Charges for 2023-24.

Accordingly, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised non-controllable operating expenditure of \$13.08 million over the next regulatory period.

4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$136.3 million.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Our draft decision proposed to adopt a forecast capital expenditure of \$136.3 million for the 5-year period, as proposed by South Gippsland Water.

The reasons for our draft decision were that:

- South Gippsland Water demonstrated it has adopted a reasonable approach to developing its capital program, and that its capital expenditure forecasts are prudent and efficient.
- We considered the planned capital expenditure program is achievable, given South Gippsland Water’s past track record delivering its capital expenditure program.
- South Gippsland Water has an appropriate approach for managing expenditure associated with uncertain projects, excluding from its forecasts approximately \$12 million related to a billing system renewal project and a facilities strategy. South Gippsland Water also deferred \$21.5 million in capital expenditure through its regular prioritisation processes. We reiterate that

²⁸ These fees are yet to be determined by the Minister for Water.

South Gippsland Water will need to demonstrate the prudence and efficiency of these costs if they are indeed incurred during the 2023–28 regulatory period, if seeking to include them in the regulatory asset base for the 2028–33 price review.

- We considered South Gippsland Water’s approach to forecasting its capital expenditure is consistent with the requirements of our guidance.

In response to our draft decision, we requested that South Gippsland Water explain how it has ring-fenced expenditure related to the Venus Bay outfall upgrade from customers, given the outfall upgrade is largely required to service two major trade waste customers. In its response, South Gippsland Water clarified that the expenditure related to this project will be recovered from the relevant customers through non-scheduled tariff revenue.

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$136.3 million for the 5-year period (Table 4.7), as proposed in our draft decision and for the same reasons proposed in our draft decision. We consider this benchmark is consistent with our guidance and the principles in the Water Industry Regulatory Order (2014). Our final decisions on South Gippsland Water’s forecast regulatory asset base (Table 4.7) and revenue requirement (Table 4.1) reflect this benchmark.

The benchmark that we propose to adopt for South Gippsland Water does not represent the amount that South Gippsland 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 South Gippsland Water’s revenue requirement, we are not requiring the business to remove that project. South Gippsland Water determines how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

4.3 Regulatory asset base

A water business’s regulatory asset base is the value of the business’s assets for regulatory purposes.²⁹ The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4) and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

²⁹ These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

Our guidance required South Gippsland Water to propose:

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

4.3.1 Closing regulatory asset base

Our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$211.9 million.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.³⁰ This helps to ensure prices reflect the actual net expenditure of a water business.³¹

Our draft decision adopted a closing regulatory asset base of \$211.9 million at 30 June 2022. This was less than the \$213.9 million proposed by South Gippsland Water in its price submission due to adjustments we made to align with South Gippsland Water's approved regulatory accounts for 2021-22. In response to our draft decision, South Gippsland Water updated the closing regulatory asset base in its financial model to align with our draft decision and its approved regulatory accounts.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. Therefore, our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$211.9 million (Table 4.6).

³⁰ See Section 4.2 for a discussion of South Gippsland Water's capital expenditure.

³¹ Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

Table 4.6 Final decision – closing regulatory asset base (RAB)

\$ million 2022-23

	2019-20	2020-21	2021-22
Opening RAB 1 July	175.8	189.1	203.6
Plus gross capital expenditure	20.0	21.9	16.3
Less government contributions	0.0	0.0	0.0
Less customer contributions	1.8	1.9	2.2
Less proceeds from disposals	0.1	0.2	0.2
Less regulatory depreciation	4.8	5.3	5.7
Closing RAB 30 June	189.1	203.6	211.9

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

Our final decision approves the forecast regulatory asset base outlined in Table 4.7.

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

Our draft decision did not accept South Gippsland Water's forecast regulatory asset base for the period from 1 July 2023 due to our proposed adjustments to its closing regulatory asset base and forecast regulatory depreciation as well as our draft decision to not accept its new customer contributions. Our draft decision set out an indicative forecast regulatory asset base reflecting our draft decision on South Gippsland Water's closing regulatory asset base and regulatory depreciation, but noted these forecasts were subject to South Gippsland Water's response to our draft decision on its new customer contributions.

In response to our draft decision, South Gippsland Water provided updated forecasts for its regulatory asset base that aligned with our draft decision on its closing regulatory asset base and reflected our proposed adjustments to its forecast regulatory depreciation.

However, as outlined in Section 4.3.2.1, South Gippsland Water did not update its customer contributions in response to our draft decision and our final decision does not approve South

Gippsland Water's forecast customer contributions, and instead adopts forecasts based on our calculations applying its current new customer contributions charges.

Therefore, our final decision is to not accept South Gippsland Water's proposed forecast regulatory asset base and instead adopt a forecast regulatory asset base that reflects our revised forecasts for customer contributions and the associated impacts these revised forecasts have on regulatory depreciation.

Table 4.7 sets out our final decision on South Gippsland Water's forecast regulatory asset base from 1 July 2023.³²

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

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

³² Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

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

\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Opening RAB 1 July	211.9	219.5	247.0	276.1	286.8	295.2
Plus gross capital expenditure	15.8	37.1	39.4	21.8	19.8	18.2
Less government contributions	-	-	-	-	-	-
Less customer contributions	2.0	2.9	2.9	3.0	2.0	2.0
Less proceeds from disposals	0.1	0.3	0.3	0.3	0.3	0.3
Less regulatory depreciation	6.1	6.3	7.1	7.9	9.0	10.2
Closing RAB 30 June	219.5	247.0	276.1	286.8	295.2	300.9

Note: Numbers have been rounded.

4.3.2.1 Customer contributions

Our final decision adopts a forecast for customer contributions as set out in Table 4.7.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.³³

Our draft decision adopted South Gippsland Water's proposed customer contributions for the purposes of calculating the regulatory asset base and revenue requirement in the draft decision.

Our draft decision required South Gippsland Water to provide updated forecasts for revenue from customer contributions that reflected its response to our draft decision on its proposed new customer contributions. Our draft decision also required South Gippsland Water to ensure that the forecast customer contributions in the financial model and new customer contributions model could be reconciled.

South Gippsland Water provided a response to our draft decision but did not propose to update the customer contributions forecasts included in its price submission. Accordingly, as discussed in Section 5.4, our final decision is to maintain South Gippsland Water's current new customer contributions from 2022-23 adjusted for inflation for the 2023–28 regulatory period. We estimated

³³ Revenue from new customer contributions reflects revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

new customer contributions revenue by using South Gippsland Water's forecast new connections multiplied by the new customer contributions adopted in our final decision.

The forecasts of revenue from customer contributions adopted in our final decision are consistent with past outcomes.

For the reasons set out above, our final decision is to adopt the revenue from customer contributions set out in Table 4.7.

4.4 Rate of return

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

4.4.1 Cost of debt

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

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

In May 2023, we provided South Gippsland Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.³⁴ This reflects the rise in borrowing costs over the past 12 months. South Gippsland Water used this updated value to recalculate its revenue requirement.

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

This increase in the cost of debt is the main reason there is an increase in our final decision revenue requirement compared to our draft decision.

³⁴ These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

Table 4.8 Final decision – 10-year cost of debt

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

Note: Numbers have been rounded.

4.4.2 Return on equity

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

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

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business’s self-rating and our rating.³⁵

South Gippsland Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, South Gippsland Water proposed a real return on equity of 4.1 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.³⁶

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

After considering all submissions received in response to our draft decision, our final decision on South Gippsland Water’s overall PREMO rating remains the same as our draft decision. Therefore, our final decision is to adopt South Gippsland Water’s proposed return on equity of 4.1 per cent per year, reflecting our final decision on the overall PREMO rating of its price submission (see Chapter 7).

4.4.3 Long-term inflation forecast

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

³⁵ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

³⁶ Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

being equal. Conversely, a lower long-term inflation rate will flow through to increased prices, all other things being equal.

In addition to updating our estimate for the cost of debt, in May 2023 we also updated businesses on our long-term inflation forecast. We advised businesses that the long-term inflation rate we calculated was 3.5 per cent.³⁷ All businesses adopted this amount to calculate prices in their responses to our draft decision. We checked this estimate again for our final decision, based on the method below.

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

Estimates we have adopted for each year of the 2023–28 regulatory period under the ‘RBA geometric mean’ approach are set out in Appendix E. Using the ‘RBA geometric mean’ approach we estimate an inflation rate of 3.8 per cent.³⁸

For the ‘bond breakeven’ approach, we estimate a 5-year average rate of 3.3 per cent, with the estimates adopted for each year of the 2023–28 regulatory period also set out in Appendix E.³⁹

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

However, to manage the risk that inflation falls well below our forecast, our price determinations include a provision that allows for a reconsideration of the inflation forecast adopted, if inflation falls below 2.5 per cent by 2026-27.⁴⁰ The updated inflation estimate, if needed, would be based on a 5-year averaging period.

³⁷ The inflation rate adopted in our draft decision was 3 per cent.

³⁸ We have decided to use a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

³⁹ Similar to the ‘RBA geometric mean’ approach, we have adopted a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

⁴⁰ With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.

4.5 Regulatory depreciation

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

Regulatory depreciation is a component of South Gippsland Water's revenue requirement and is also an input to calculating the regulatory asset base. As indicated in our draft decision, South Gippsland Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile, which is our preferred approach.⁴¹ However, due to adjustments we proposed to its regulatory asset base and to its assumed asset life for bulk water entitlements, our draft decision did not adopt South Gippsland Water's proposed regulatory depreciation and instead set out an indicative forecast. Our draft decision also stated that we may make further adjustments to South Gippsland Water's depreciation in our final decision based on any new information on its customer contributions.

In response to our draft decision, South Gippsland Water accepted our adjustment to its assumed asset life for water entitlements and updated its forecast regulatory depreciation to align with the indicative forecasts set out in our draft decision.

As outlined in Section 4.3.2.1, for our final decision on South Gippsland Water's customer contributions, we have adopted different forecasts to the indicative forecasts we included in our draft decision. As a result of our final decision on South Gippsland Water's customer contributions, we have revised the forecasts of regulatory depreciation from the indicative forecasts we included in our draft decision.

After considering all submissions received in response to our draft decision, based on the above, our final decision is to adopt the benchmarks for regulatory depreciation as set out in Table 4.7 in Section 4.3.2 because they were calculated in a manner consistent with our guidance.

⁴¹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

4.6 Tax allowance

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

The tax allowance is a component of the revenue requirement.

Our draft decision accepted South Gippsland Water’s forecast of no tax allowance for the 2023–28 regulatory period as it was calculated consistently with the method required by our guidance.⁴²

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision adopts a forecast of no tax allowance for the 5-year regulatory period, as set out in Table 4.1.

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

5. Demand, tariffs and prices

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

5.1 Demand

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

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

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

In response to our draft decision, South Gippsland Water did not adjust its demand forecasts as it considered there was minimal shift in the updated Victorian Government growth estimates for its service area and noted that regional growth often performed above the Victorian Government estimates.

We have considered South Gippsland Water's response and accept its reasons for not updating its demand forecasts. We consider South Gippsland Water's demand forecasts were estimated consistently with the requirements of our guidance. Accordingly, our final decision approves South Gippsland Water's demand forecasts.

5.2 Form of price control

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

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

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

For the reasons set out above, our final decision approves South Gippsland Water's proposed price cap form of price control.⁴³

5.3 Tariff structures and prices

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

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

5.3.1 Tariff structures

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

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.⁴⁴ This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our draft decision accepted South Gippsland Water's proposal to retain its existing tariff structures, including:

- for residential and non-residential water services – a two-part tariff with a fixed access charge and a variable usage charge
- for residential and non-residential sewerage services (for which customers are not required to pay cistern or trade waste charges) – a fixed access charge only
- for non-residential sewerage services (for which customers are required to pay cistern or trade waste charges) – a two-part tariff with a fixed cistern access charge and a volumetric cistern charge
- for recycled water services – a variable usage charge only.

In our draft decision, we considered the two-part structure for water services will promote efficient use of the services. It also sends customers a signal about the costs of their water use and is an approach that is commonly applied in other states and territories.⁴⁵ We also considered two-part

⁴³ We note our determinations allow water corporations flexibility to apply to change from a price cap to a weighted average price cap or tariff basket within a regulatory period.

⁴⁴ Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

⁴⁵ 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.

tariff structures are easy to understand. In relation to sewerage services, we considered the proposed fixed charge for residential customers is easy to understand and the two-part tariff for non-residential customers sends these customers signals about efficient costs.

A submission by the Consumer Action Law Centre supported water businesses generally retaining the balance between fixed and variable charges, given the disproportionate impact on tenants when more weight is assigned to variable charges.⁴⁶ We consider that South Gippsland Water's proposal retains such a balance.

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

For the reasons set out above and given South Gippsland Water's proposed tariff structures are a continuation of its current approach, our final decision is to approve South Gippsland Water's proposed tariffs structures.

5.3.2 Prices

Our final decision is to accept the revised prices proposed by South Gippsland Water.

In our draft decision, we indicated that South Gippsland Water would need to propose updated prices to reflect our draft decision on its revenue requirement and our updates to inflation and cost of debt estimates.

Following our draft decision, South Gippsland Water proposed revised prices in response to our draft decision and updates to inflation and cost of debt estimates. South Gippsland Water also revised its prices in response to updated bulk water charges and to changes announced in the Victorian State Budget that impacted its revenue requirement (See Section 4.1).

In its price submission, South Gippsland Water proposed to set prices below an amount that would enable it to recover its revenue requirement. Its revised prices reflect a continuation of this proposal – that is, its proposed revenue from its revised tariffs is lower than its revised revenue requirement.

In its response to our draft decision, South Gippsland Water re-emphasised that its proposed price path is aimed at minimising the cost-of-living pressure in the current high inflation environment, in particular, on customers experiencing financial hardship.⁴⁷ In a submission on our draft decisions, the Consumer Action Law Centre noted its support for South Gippsland Water's proposal to

⁴⁶ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, p. 2.

⁴⁷ South Gippsland Water, Submission in response to the Essential Services Commission 'South Gippsland Water draft decision: 2023 water price review', 30 March 2023, p. 3.

under-recover its forecast costs, below the revenue requirement, and charge lower prices as an appropriate approach to addressing high inflation and customer affordability concerns.⁴⁸

We have approved its proposal to under-recover its revenue requirement as we acknowledge South Gippsland Water aims to address affordability for customers, and we consider the business will generate sufficient cash flow to deliver on its obligations.

South Gippsland Water’s response to our draft decision also explained that its proposal is to recover forecast expenditure associated with the Venus Bay Outfall upgrade only from the two main beneficiaries of the asset via new trade waste agreements that are currently under negotiation. We consider this approach to be consistent with the efficiency objectives of the Water Industry Regulatory Order.⁴⁹

Our final decision is to approve the revised prices proposed by Gippsland Water because they have been calculated in a matter consistent with our guidance.

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

In 2024-25, water and sewerage prices for residential and non-residential customers will generally increase by around 2.5 per cent excluding inflation, before increasing by around 3.5 per cent in each of the following 3 years, also excluding inflation.

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

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential and non-residential					
Variable (\$/kL)	2.3942	2.4529	2.5375	2.6251	2.7156
Fixed (\$/year)	382.13	391.49	404.99	418.97	433.42

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

⁴⁸ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, p. 2.

⁴⁹ South Gippsland Water, Submission in response to the Essential Services Commission ‘South Gippsland Water draft decision: 2023 water price review’, p. 4.

Table 5.2 Final decision – sewerage prices

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
Residential and non-residential					
Fixed (\$/year)	593.05	607.58	628.54	650.22	672.66

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

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether South Gippsland Water’s prices take into account the interests of customers, including low income and vulnerable customers.⁵⁰

As outlined in our draft decision we considered that South Gippsland Water has done so by proposing:

- tariffs that are forecast to collect less than its proposed revenue requirement
- tariffs that were informed by an extensive customer engagement program
- a 2 per cent price increase upfront with a gradual approach to further price increases, which had been tested with customers experiencing vulnerability
- to implement a targeted co-payment program designed to re-engage customers with outstanding payments and assist in reducing their debt
- an extension of its customer supports to non-residential customers
- to continue providing additional funds to the state government-funded Community Rebate Scheme, to allow additional customers to access the scheme and receive repairs or plumbing upgrades with the aim of reducing their water use and bills.

The Consumer Action Law Centre remained concerned that South Gippsland Water did not appear to be proposing increased investment in its hardship programs.⁵¹ While South Gippsland Water has not identified a monetary value for the activities listed above that will support low income customers and customers experiencing vulnerability, we are satisfied that it has expanded the reach of its customer support program ensuring that customers facing difficulty paying bills will be able to access the assistance they need.

⁵⁰ Water Industry Regulatory Order 2014 clause 11(d)(iii).

⁵¹ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, pp. 3–5.

5.3.4 Other services

As indicated in our draft decision, South Gippsland 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.

After considering all submissions received in response to our draft decision, our final decision approves South Gippsland Water's approach to calculating tariffs for trade waste and miscellaneous services in accordance with the pricing principles referenced in our guidance which promote cost reflectivity of tariffs.

5.4 New customer contributions

Our final decision is to not accept South Gippsland Water's proposed new customer contributions and instead to maintain South Gippsland Water's current new customer contribution from 2022-23 (adjusted for inflation) for the 2023–28 regulatory period.

Our final decision is to accept South Gippsland Water's proposed negotiating framework for new customer contributions.

New customer contributions (or developer charges) are levied by water businesses when a new connection is made to its water, sewerage or recycled water networks in a given part of its service area. New customer contributions can be either standard or negotiated. Standard charges apply to new connections in areas where infrastructure requirements and growth rates are relatively well known and designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.⁵² Negotiated charges allow water businesses and developers to negotiate a site-specific arrangement where standard charges are not fair and reasonable or where a new connection is outside the areas eligible for standard charges.⁵³

As outlined in our draft decision South Gippsland Water proposed to increase its new customer contributions from water and sewer services from \$2,517 in 2022-23 to \$2,971 in 2023-24 then have its new customer contributions remain flat in real terms during the 2023–28 regulatory period.

Our draft decision did not approve South Gippsland Water's proposed new customer contributions because we indicated that we needed to continue our review of the reasonableness of South Gippsland Water's proposed inclusion of sunk costs, including for renewals, in its proposed new customer contributions. Also, South Gippsland Water's data showed that the growth capital

⁵² Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

⁵³ Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

expenditure and new customer contributions revenue included in the new customer contributions and financial models from 2023-24 to 2032-33 did not match.

In response to our draft decision, South Gippsland Water submitted an updated new customer contributions model and financial model. We analysed the updated models, and found:

- The growth capital expenditure and new customer contributions revenue included in these updated models from 2023-24 to 2032-33 did not match.
- The updated new customer contributions model included more incremental capital expenditure than the price submission new customer contributions model. Part of this added incremental capital expenditure was explained as a correction to the price submission model, but South Gippsland Water did not provide a reason for adding the remainder.
- Other inputs in the updated new customer contributions model, such as the number of customers connected, were updated without explanation.

South Gippsland Water's updated calculations resulted in new customer contributions that are higher than those proposed in its price submission. However, it did not propose to update the new customer contributions it proposed in its price submission.

The Consumer Action Law Centre made a submission on our draft decisions which reiterated its support for water businesses moving to higher more cost reflective new customer contributions. The Consumer Action Law Centre also supported our draft decision's call for clarity on the full proposed terms for transitioning to cost reflectivity.⁵⁴ South Gippsland Water did not provide a plan for transitioning to cost reflectivity.

Our consultants, FTI Consulting, assessed the reasonableness of South Gippsland Water's new customer contribution-related capital expenditure and concluded they had low confidence in the appropriateness and robustness of all of the capital expenditure included in South Gippsland Water's new customer contributions (\$427.2 million) due to poor documentation on South Gippsland Water's allocation of capital expenditure.⁵⁵

Having reviewed both FTI Consulting's findings and South Gippsland Water's response to our draft decision, and for the reasons set out above, we do not accept South Gippsland Water's proposed standard new customer contributions. Accordingly, our final decision is to maintain South Gippsland Water's current new customer contributions from 2022-23 (adjusted for inflation) for the 2023—28 regulatory period.

⁵⁴ Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 3.

⁵⁵ FTI Consulting, *Review of new customer contribution-related capital expenditure for South Gippsland Water*, May 2023, pp. 10-11.

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

Regarding South Gippsland Water's proposed negotiated new customer contribution framework, our draft decision proposed to accept the framework because it complied with the requirements of our new customer contribution pricing principles.

We have considered all submissions received following our draft decision and, for the reasons set out above, our final decision is to accept South Gippsland Water's proposed negotiated new customer contribution framework.

Our price determination for South Gippsland Water sets out the approved new customer contribution charges from 1 July 2023 (or the manner in which its prices are to be calculated, determined, or otherwise regulated).

If there is a dispute between a developer and a water business (whether in relation to a standard or negotiated new customer contributions), developers may use the dispute resolution offered by a water business as part of its new customer contribution negotiating framework. In addition, developers may follow the *Water Act 1989* process to object and seek internal review by the water business, and to pursue unresolved matters through the Victorian Civil and Administrative Tribunal.⁵⁶

5.4.1 Review of the framework for new customer contributions

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

5.4.1.1 Current issues

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

⁵⁶ *Water Act 1989*, section 271.

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

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

5.4.1.2 Next steps

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

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

5.5 Adjusting prices

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

Our draft decision accepted South Gippsland Water's proposal to:

- continue with its existing uncertain and unforeseen events mechanism
- account for the difference between forecast and actual non-controllable costs associated with Melbourne Water
- continue with annual changes to the benchmark cost of debt and Consumer Price Index.

The price determination specifies an adjustment process for updates to the cost of debt. However, where South Gippsland Water's revenue forecast is below the revenue requirement approved by the commission in connection with this Determination, if the annual cost of debt update results in a negative adjustment to South Gippsland Water's revenue, it will not be passed through.

South Gippsland Water also proposed to pass through taxes such as environmental contributions. Our draft decision indicated that South Gippsland Water's uncertain and unforeseen mechanism provides for changes in taxes during the regulatory period to be passed through at the discretion of the commission. South Gippsland Water can apply to pass through material changes in taxes during the regulatory period under this mechanism.

Our final decision approves South Gippsland Water’s proposed price adjustment mechanisms, on the basis that they reflect a continuation of its existing approach and because they are otherwise consistent with the requirements of our guidance.

6. Financial position

We have reviewed key indicators of South Gippsland Water's financial performance and consider that South Gippsland 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.⁵⁷ We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the Water Industry Regulatory Order (2014) to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

Our guidance set out key indicators of forecast financial performance. We have reviewed forecasts for these key indicators based on our final decision on South Gippsland Water's prices. We have assessed that under our final decision, South Gippsland Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

⁵⁷ WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

7. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water business's revenue requirement to that business's level of ambition expressed in its price submission. Our guidance required South Gippsland 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.⁵⁸ We required South Gippsland 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 South Gippsland Water to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control, and tariffs.

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

7.1 Our PREMO assessment of South Gippsland Water's price submission

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

South Gippsland Water's self-rating for each of the PREMO elements and its overall self-rating are shown in Table 7.1. This table also includes our draft and final ratings of South Gippsland Water's price submission. This rating is reflected in the return on equity we have approved for South Gippsland Water (see Section 4.4.2).

Our PREMO assessment is set out in our draft decision.

Our final decision is to agree with South Gippsland Water's proposed overall PREMO self-rating of 'Standard'.

⁵⁸ This is the first price review we have done where the rating has been based on all five elements of PREMO. In our 2018 price review, our PREMO assessment was against only four of the elements — Risk, Engagement, Management and Outcomes.

Table 7.1 **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
South Gippsland Water's self-rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's draft decision rating	Standard	Standard	Standard	Standard	Standard	Standard
Commission's final decision rating	Standard	Standard	Standard	Standard	Standard	Standard

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

- the proposal to charge amounts below its revenue requirement, taking on risk and helping to manage affordability for customers
- South Gippsland Water generally met expectations for delivery against outcome commitments
- South Gippsland Water's proposal to charge lower than its forecast revenue requirement to help address affordability for its customers
- South Gippsland Water engaged broadly with its customers, providing opportunities for participation across its service areas, and its engagement was inclusive of customers facing vulnerability
- South Gippsland Water was able to achieve strong alignment between consumer preferences and the proposals in its submission, including its proposals for additional support for customers who may be experiencing vulnerability
- South Gippsland Water proposed an efficiency improvement rate for controllable operating expenditure over the 2023–28 regulatory period of 1.4 per cent, slightly higher than the average of all businesses in the current price review
- South Gippsland Water identified \$12 million of uncertain capital expenditure it had excluded from its prices – these project costs will be carried by the business and included at the end of the regulatory period if they are incurred
- South Gippsland Water developed its proposed outcomes in consultation with its customers, and they are supported by customers.

Appendix A – Submissions received on draft decision

Name or organisation	Date received
Dominic Gilligan	1 May 2023
Consumer Action Law Centre	5 May 2023
South Gippsland Water	9 May 2023
Registered Accommodation Association of Victoria	26 May 2023

Appendix B – Commission’s consideration of legal requirements

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

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

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.⁵⁹ Our draft and final decisions provide further information on where we have considered our guidance, and South Gippsland Water’s compliance with our guidance, in making our price determination.⁶⁰

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

Economic efficiency and viability matters

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

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

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

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

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

⁶⁰ Essential Services Commission, *South Gippsland Water draft decision: 2023 water price review*, 30 March 2023; Essential Services Commission, *South Gippsland Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable South Gippsland Water to recover borrowing costs associated with its investment in services, and generate a return on assets.⁶¹

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

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

We have had regard to this matter in Chapter 6.

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

In preparing our final decision, we have had regard to the extent South Gippsland 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.

⁶¹ The regulatory rate of return is comprised of the cost of debt and the return on equity.

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

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

Industry specific matters

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

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

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

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

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

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

Our final decision provides for South Gippsland 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 Australia⁶²
- operating and capital expenditure costs per connection throughout Australia⁶³
- tariff structures applied by water businesses throughout Australia⁶⁴
- the regulatory rate of return set by other regulators.⁶⁵

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

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

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

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

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

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

⁶² Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

⁶³ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

⁶⁴ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

⁶⁵ Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW's rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water's water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

Customer matters

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

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

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

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

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

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

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

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

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

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

WIRO Clause 11(d)(i) requires us to have regard to whether South Gippsland 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 South Gippsland Water’s prices enable customers or potential customers to easily understand prices, or the manner in which prices are calculated, determined or otherwise regulated:

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

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

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

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

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

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

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

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

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

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

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

Appendix B – Commission’s consideration of legal requirements

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

Health, safety, environmental and social obligations

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

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

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

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

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

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

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

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

Other matters

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

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

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

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

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.⁶⁶

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.⁶⁷

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

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

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

⁶⁶ Essential Services Commission 2016, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October, pp. 11–13.

⁶⁷ Essential Services Commission, *2023 water price review: Guidance paper*, p. 2.

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

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.⁶⁸

⁶⁸ Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.

Appendix C – Service standards

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

Water service standards – excluding flow rates

	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of unplanned water supply interruptions a customer may experience in any 12-month period	5	5	5	5	5
Average time (minutes) taken to attend bursts and leaks (Priority 1)	30	30	30	30	30
Average time (minutes) taken to attend bursts and leaks (Priority 2)	35	35	35	35	35
Average time (minutes) taken to attend bursts and leaks (Priority 3)	500	500	500	500	500
Average duration (minutes) of unplanned water supply interruptions	110	110	110	110	110
Average duration (minutes) of planned water supply interruptions	240	240	240	240	240

Water service standards – flow rates

	Diameter of the property service pipe (mm)				
	20	25	32	40	50
Minimum flow rate (litres per minute)	20	35	60	90	160

Sewerage service standards

	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer may experience in any 12-month period	3	3	3	3	3
Average time (minutes) to attend sewer spills and blockages	30	30	30	30	30
Average time (minutes) to rectify a sewer blockage	120	120	120	120	120
Maximum time taken to contain a sewer spill (minutes)	300	300	300	300	300

Appendix D – Guaranteed service level scheme

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

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

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

South Gippsland Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
South Gippsland Water will rebate the customer an amount when it fails to restore sewer supply within 5 hours of notification to a customer’s property.	\$100
South Gippsland Water will pay the customer an amount if it causes a sewage spill within a customer’s house. It will also clean up the house and provide alternative accommodation as required.	\$1000
South Gippsland Water will facilitate a once-off grant process to a water supply community impacted by a major water quality event (boil water advice) ^a	\$10,000 community grant ^a
South Gippsland Water will rebate the customer an amount where it restricts the water supply of, or takes legal action against, a residential customer prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying.	\$300

Note: These are nominal amounts, that is, the amount of payment will not be impacted by inflation. ^a Community grant to be provided in accordance with the guaranteed service level key principles and administration processes agreed with customers.

Appendix E – Inputs to calculation of long-term inflation

Inflation – annual estimates (per cent)

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