



Level 37, 2 Lonsdale St
Melbourne 3000, Australia
Telephone +61 3 9032 1300
 +61 1300 664 969
Facsimile +61 3 9032 1303

2013-18 WATER PRICE REVIEW

DRAFT DECISION VOLUME II:
BARWON WATER

MARCH 2013

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BARWON WATER

1. Purpose of volume II of the draft decision

The Commission is required to issue a draft decision that proposes either to:

- (a) approve all of the prices which a regulated entity may charge for prescribed services, or the manner in which such prices are to be calculated or otherwise determined, as set out in the regulated entity's water plan, until the commencement of the next regulatory period or
- (b) refuse to give the approval referred to above and specifies the reasons for the Commission's proposed refusal (which may include suggested amendments to, or action to be taken in respect of, the Water Plan that, if adopted or taken, may result in the Commission giving that approval) and the date by which a regulated entity must resubmit a revised Water Plan or undertake such action as to ensure compliance.

This volume of the draft decision summarises for each business the suggested amendments or actions that if adopted or taken may result in the Commission giving its approval to the relevant business's proposed prices or the manner in which such prices are to be calculated or otherwise determined. The main reasons for suggested amendments or actions are summarised. More detailed reasons for the Commission's suggested amendments are outlined in volume I of the draft decision.

2. Actions to be taken in response to this draft decision

In response to this draft decision, Barwon Water should by 2 May 2013 resubmit:

- (a) its proposed schedule of tariffs to apply for each year of the regulatory period commencing 1 July 2013 that reflects:
 - (i) the revised revenue requirement set out in table 3
 - (ii) any changes to tariff structure suggested by the Commission.
- (b) the service standards to apply over the regulatory period consistent with any revisions suggested by the Commission set out in table 1.
- (c) the guaranteed service levels (GSLs) to apply over the regulatory period consistent with any revisions suggested by the Commission set out in table 2.

- (d) Information that demonstrates the costs for the Black Rock Recycled Water Plant, Armstrong Creek Recycled Water Transfer and Distribution, and Torquay Recycled Water Dual Pipe projects will be borne by the beneficiaries. Specifically, the additional information provided to the Commission must include plans for:
- (iii) recovering costs from new customer contributions
 - (iv) profiling depreciation to better align cost recovery with asset utilization
 - (v) locational tariffs for the areas that benefit from the projects.
- (e) information on how the proposed pass through of costs relating to any unforeseen requirement for water from the Melbourne pool via the Melbourne Geelong Pipeline will operate.
- (f) the New Customer Contribution Charges (NCCs) proposal with specific actions required by the Commission set out in section 16.

If a business does not submit a revised schedule of tariffs and/or the service standards to apply, or otherwise make a submission as to why it has not adopted the Commission's suggested amendments by the due date, the Commission will specify the prices, or manner in which prices are to be calculated or otherwise determined and the service standards to apply for the regulatory period 2013-14 to 2017-18 as part of its Final Determination.

3. Service standards

Barwon water has propose the following core service standard targets in its Water Plan.

Table 1 Proposed service standards

<i>Service standard</i>	<i>5yr Avg 2008-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Water						
Unplanned water supply interruptions (per 100km)	21.49	30	30	30	30	30
Average time taken to attend bursts and leaks (priority 1) (minutes)	25.39	35	35	35	35	35
Average time taken to attend bursts and leaks (priority 2) (minutes)	41.34	68	68	68	68	68
Average time taken to attend bursts and leaks	215.17	360	360	360	360	360

Service standard

*5yr Avg 2013-14 2014-15 2015-16 2016-17 2017-18
2008-13*

(priority 3) (minutes)						
Unplanned water supply interruptions restored within 5 hours (per cent)	96.81	96.5	96.5	96.5	96.5	96.5
Planned water supply interruptions restored within 5 hours (per cent)	88.73	80	80	80	80	80
Average unplanned customer minutes off water supply (minutes)	16.14	20	20	20	20	20
Average planned customer minutes off water supply (minutes)	40.03	46.2	46.2	46.2	46.2	46.2
Average frequency of unplanned water supply interruptions (number)	0.15	0.18	0.18	0.18	0.18	0.18
Average frequency of planned water supply interruptions (number)	0.21	0.22	0.22	0.22	0.22	0.22
Average duration of unplanned water supply interruptions (minutes)	107.22	110	110	110	110	110
Average duration of planned water supply interruptions (minutes)	188.6	210	210	210	210	210
Number of customers experiencing 5 unplanned water supply interruptions in the year (number)	32.8	150	150	150	150	150
Unaccounted for water (per cent)	8.81	n.p.	n.p.	n.p.	n.p.	n.p.
Sewerage						
Sewerage blockages (per 100km)	34.86	43	43	43	43	43
Average time to attend sewer spills and blockages (minutes)	49.94	80	80	80	80	80
Average time to rectify a sewer blockage (minutes)	169.76	250	250	250	250	250
Spills contained within 5 hours (per cent)	99.83	100	100	100	100	100

Service standard

	<i>5yr Avg 2008-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Customers receiving more than 3 sewer blockages in the year (number)	0.4	3	3	3	3	3
Customer Service						
Complaints to EWOV (per 1000 customers)	0.7	0.65	0.65	0.65	0.65	0.65
Telephone calls answered within 30 seconds (per cent)	96.12	90	90	90	90	90

Note Data rounded to two decimal places.

Where the proposed service standard target deviated from Barwon Water's actual three year average performance or did not appear to make sense, the Commission sought further information from Barwon Water

The Commission proposes not to approve targets proposed for all service standards apart from those listed below. The targets for all other standards deviated from the five-year average and Barwon Water did not provide a reason as to why they will not be able to maintain that level of service on average over the third regulatory period:

- (a) Unplanned water supply interruptions restored within five hours (per cent)
- (b) Average unplanned customer minutes off water supply (minutes)
- (c) Average frequency of planned water supply interruptions (number per customer per year)
- (d) Average duration of planned water supply interruptions (minutes)
- (e) Complaints to Energy and Water Ombudsman (Victoria) (number per 1000 customers)

In response to this draft decision, Barwon Water is required to either provide adequate reasoning for deviating from the five-year average in setting its targets for these standards or amend them to reflect the five-year average.

4. Guaranteed service level scheme

The Commission proposes to approve each of the proposed guaranteed service levels except as shaded or otherwise indicated in table 2. These guaranteed service levels should be reflected in Barwon Water's Customer Charter.

Table 2 Proposed and approved GSL events and payment levels

<i>Proposed level of service</i>	<i>Proposed payment</i>
No more than two sewer spills on a customer's property per year	553
No more than five unplanned water supply interruptions per customer per year	72
No more than three unplanned sewerage service interruptions to a customer's property per year	72

The Commission proposes to approve the GSL events and payment levels proposed by Barwon Water

5. Revenue requirement

The Commission has adopted the following assumptions in relation to the revenue required over the regulatory period.

Table 3 Breakdown of revenue requirement implied by ESC draft decision
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Operating expenditure	94.6	94.6	94.6	95.3	95.1
Return on existing assets	47.0	45.6	44.2	42.8	41.4
Return on new investments	1.8	4.7	7.1	9.5	11.2
Regulatory depreciation	28.8	29.4	30.2	31.0	31.6
Total	172.2	174.3	176.1	178.6	179.3

6. Rolled forward regulatory asset base

The regulatory asset base as at 1 July 2007 will be rolled forward to reflect approved actual capital expenditure net of customer contributions (new customer and shareholder contributions) and disposals for the 2007-08 to 2011-12 period less any approved allowance for regulatory depreciation. The rolled forward values are shown in table 4.

The Commission has included \$63.7m into Barwon Water's 2011-12 regulatory asset base to represent the costs of the Melbourne-Geelong Pipeline.

Table 4 **Updated regulatory asset base**
\$m 2012-13

	<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>
Opening RAB	536.7	575.8	643.6	704.6	802.0
<i>Plus</i> Gross Capital expenditure	66.8	95.3	96.2	141.8	287.4
<i>Less</i> Government contributions	5.1	5.0	8.5	11.1	35.7
<i>Less</i> Customer contributions	2.9	3.2	4.3	7.7	49.5
<i>Less</i> Proceeds from disposals	1.6	1.3	1.3	1.4	0.8
<i>Less</i> Regulatory depreciation	18.0	18.1	21.1	24.1	25.6
Closing RAB	575.8	643.6	704.6	802.0	977.8

The regulatory asset base as at 1 July 2012 will be rolled forward to reflect approved estimates of capital expenditure net of customer contributions (new customer and shareholder contributions) and disposals for the 2012-13 to 2017-18 period less any approved allowance for regulatory depreciation.

The Commission has adopted the following assumptions in relation to regulatory asset base over the regulatory period:

Table 5 **Rolled forward regulatory asset base**
\$m 2012-13

	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Opening RAB	977.8	1 020.2	1 065.6	1 085.4	1 110.4	1 125.6
<i>Plus</i> Gross Capital expenditure	68.8	94.3	64.3	68.9	61.3	45.8
<i>Less</i> Government contributions	0.1	6.4	1.5	0.0	0.0	0.0
<i>Less</i> Customer contributions	2.4	11.9	11.9	11.9	13.2	13.2
<i>Less</i> Proceeds from disposals	1.7	1.7	1.8	1.8	1.9	1.9
<i>Less</i> Regulatory depreciation	28.1	28.8	29.4	30.2	31.0	31.6
Closing RAB	1 014.3	1 065.6	1 085.4	1 110.4	1 125.6	1 124.6

7. Weighted average cost of capital

The Commission has adopted a weighted average cost of capital (WACC) of 4.7 per cent for all water businesses. The table below outlines the individual components for the WACC.

Table 6 **Real post-tax WACC**

<i>Real risk free rate</i>	<i>Equity beta</i>	<i>Market risk premium</i>	<i>Debt margin</i>	<i>Financing structure (gearing)</i>	<i>Franking credit value</i>	<i>WACC</i>
<i>per cent</i>	<i>β</i>	<i>per cent</i>	<i>per cent</i>	<i>per cent</i>	<i>γ</i>	<i>per cent</i>
0.679 – 1.023	0.65	6.0	3.03 - 4.53	60	0.5	4.7

8. Operating expenditure

The Commission has made the following assumptions about operating expenditure forecasts over the regulatory period:

Table 7 **Proposed and approved operating expenditure assumptions**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed operating expenditure	93.67	94.51	95.60	97.66	98.89
Revisions and adjustments	0.97	0.14	-1.04	-2.35	-3.81
Draft decision – operating expenditure	94.64	94.65	94.56	95.31	95.08

The Commission's assumptions reflect the following adjustments to Barwon Water's proposed operating expenditure forecasts:

Table 8 **Adjustments to operating expenditure**
\$m 2012-13

<i>Expenditure item</i>	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Labour	0.87	0.25	-0.57	-1.41	-2.27
Electricity	-1.03	-1.21	-1.54	-1.98	-2.57
Defined benefits	1.19	1.16	1.13	1.10	1.07
Environment Contribution	0.00	-0.01	-0.01	-0.02	-0.02
Licence fees	-0.05	-0.05	-0.05	-0.04	-0.02
Total	0.97	0.14	-1.04	-2.35	-3.81

- (a) Adjustments reflect changes to wage rates to make them consistent with the new wage policy (section 4.2.1 of Deloitte's expenditure report).
- (b) Adjustments reflect changes to electricity prices – to reflect Procurement Australia's quote (section 4.2.2 of Deloitte's expenditure report).
- (c) Adjustments reflect recovery of \$12.11 million defined benefit superannuation payments made to Vision Super in 2012 (section 4.2.3 of Deloitte's expenditure review).
- (d) Adjustments reflect recent advice from the Department of Sustainability and Environment on the environmental contribution for the next regulatory period (chapter 6 of volume I of this draft decision).

- (e) Adjustments reflect recent advice from the Department of Health and Environment Protection Authority on their respective licence fees for the next regulatory period. Also includes the Commission's adjustments ESC licence fees (chapter 6 of volume I of this draft decision).

9. Capital expenditure

The Commission has made the following assumptions about capital expenditure forecasts over the regulatory period:

Table 9 **Proposed and approved capital expenditure assumptions**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed capital expenditure	95.83	63.93	68.90	85.94	45.44
Draft decision – capital expenditure	94.31	64.27	68.93	61.28	45.77

The Commission's assumptions reflect the following adjustments to Barwon Water's proposed capital expenditure forecasts:

Table 10 **Adjustments to capital expenditure**
\$m 2012-13

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Sewer mains - replacement / rehabilitation	-1.52	0.34	0.34	0.34	0.34
Colac water source expansion	0.00	0.00	0.00	-25.34	0.00
Inverleigh low level feeder main	0.00	0.00	-0.31	0.34	-0.01
Total ESC Adjustment	-1.52	0.34	0.03	-24.66	0.34

- (a) Sewer mains-replacement/rehabilitation – Deloitte accepted Barwon Water’s suggested deferral of a small amount of expenditure from 2013-14 to allow the new panel contract to be implemented (section 5.3 of Deloitte’s expenditure report).
- (b) Colac water source expansion – Deloitte recommended deferral of the majority of capital expenditure, leaving expenditure for further options analysis and community consultation, particularly the consideration of the trade-offs involved in meeting different reliability targets (section 5.4 of Deloitte’s expenditure report).
- (c) Inverleigh low level feeder main – Deloitte accepted Barwon Water’s latest cost estimates (section 5.6 of Deloitte’s expenditure report).

Barwon Water has identified the following key capital projects that it proposes to deliver during the regulatory period.

Table 11 Key capital projects

	<i>Expected completion date</i>
Sewer mains replacement and rehabilitation	2013-14 to 2017-18
Colac water source expansion	2016-17
Water mains water replacements	2013-14 to 2017-18
Inverleigh low level feeder main	2017-18
Black Rock water reclamation plant hydraulic capacity upgrade	2015-16
Sewer main relining	2013-14 to 2016-17
Apollo Bay bulk water supply expansion	2014-15
Aireys inlet water treatment plant	2016-17
Pettavel water basin upgrade	2014-15
Vehicles replacement	2013-14 to 2014-15

10. Demand forecasts

- (a) The Commission has made the following assumptions about demand for various services over the regulatory period.
- (b) The Commission has adjusted proposed demand forecasts where indicated.

(c) Table 12 **Number of water connections**

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Residential					
Proposed connections	132 079	134 676	137 274	139 980	142 864
Draft decision – connections	132 079	134 676	137 274	139 980	142 864
Non-residential					
Proposed connections	11 740	11 971	12 202	12 443	12 699
Draft decision – connections	11 740	11 971	12 202	12 443	12 699
Proposed – total connections	143 819	146 647	149 477	152 423	155 563
Draft decision – total connections	143 819	146 647	149 477	152 423	155 563

Table 13 **Number of sewerage connections**

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Residential					
Proposed connections	120 143	122 506	124 869	127 331	129 954
Draft decision – connections	120 143	122 506	124 869	127 331	129 954
Non-residential					
Proposed connections	9 162	9 342	9 522	9 710	9 910
Draft decision – connections	9 162	9 342	9 522	9 710	9 910
Proposed – total connections	129 305	131 847	134 391	137 040	139 863
Draft decision – total connections	129 305	131 847	134 391	137 040	139 863

Table 14 **Residential water consumption**
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed average consumption (kL)	166	167	167	167	167
Draft decision – average consumption (kL)	166	167	167	167	167
Proposed total residential consumption	21 989	22 488	22 973	23 366	23 819
Draft decision – total residential consumption	21 989	22 488	22 973	23 366	23 819

Table 15 **Non-residential water consumption**
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed non-residential consumption	8 202	8 388	8 569	8 716	8 885
Draft decision – non-residential consumption	8 202	8 388	8 569	8 716	8 885

Table 16 **Total water consumption**
ML

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed total consumption	30 191	30 876	31 542	32 082	32 704
Draft decision – total consumption	30 191	30 876	31 542	32 082	32 704

Table 17 **Non-residential volumetric sewage**
KL

	<i>2013-14</i>	<i>2014-15</i>	<i>2015-16</i>	<i>2016-17</i>	<i>2017-18</i>
Proposed total consumption	2 882 631	2 948 005	3 011 584	3 063 109	3 122 517
Draft decision – total consumption	2 882 631	2 948 005	3 011 584	3 063 109	3 122 517

11. Form of price control

The Commission proposes to approve a hybrid form of price control, whereby:

- (a) it approves price caps for Barwon Water and
- (b) these businesses may propose to move to a tariff basket at the time of the annual price review within the period.

Where a business proposes to transfer to a hybrid form of price control during the next regulatory period, and where that proposal results in a material tariff change, the Commission proposes to require the business to consult with customers. The determinations will require water businesses to provide evidence of customer consultation (including customer consultative committees) and a statement about customer impacts and how the business will address those impacts.

12. Retail water tariffs

- (a) The Commission proposes to approve Barwon Water's proposed retail water tariff structure.

13. Retail sewerage tariffs

- (a) The Commission proposes to approve Barwon Water's proposed retail sewerage tariff structure.

14. Trade waste charges

- (a) The Commission proposes to approve the trade waste tariffs proposed by Barwon Water.
- (b) The Commission requires Barwon Water to continue to include the Commission's trade waste pricing principles in its tariff schedules. Barwon Water is required to use the pricing principles when determining trade waste charges for customers to whom scheduled prices do not apply.

15. Recycled water

- (a) The Commission proposes to approve Barwon Water's proposed recycled water tariff structure for residential third pipe schemes.
- (b) The Commission proposes to approve Barwon Water's proposed pricing principles on the basis that they are consistent with the pricing principles set out below.
- (c) The Commission considers that Barwon Water should set its recycled water prices according to a set of principles that ensure that prices:
 - (i) have regard to the price of any substitutes and customers' willingness to pay
 - (ii) cover the full cost of providing the service (with the exception of services related to specified obligations or maintaining balance of supply and demand)
 - (iii) include a variable component.
- (d) Where a business does not propose to fully recover the costs associated with recycled water, it must demonstrate to the Commission that:
 - (i) it has assessed the costs and benefits of pursuing the recycled water project
 - (ii) it has clearly identified the basis on which any revenue shortfall is to be recovered
 - (iii) if the revenue shortfall is to be recovered from non-recycled water customers, either that the project is required by 'specified obligations' or that there has been consultation with the affected customers about their willingness to pay for the benefits of increased recycling.

16. New Customer contributions

Table 18 **New customer contributions charges**
\$2012-13 \$ per lot

Water ^a	3 340
Sewerage	1 100

^a combined water and recycled water charge

Subject to Barwon Water amending its NCC proposal consistent with the specific actions required by the Commission described below, the Commission proposes to approve the manner in which Water's NCC charges are determined.

The Commission requires Barwon Water to:

- a) Assess how they can improve the cost reflectivity of its NCC proposal and to present options on offering more location specific NCC. If the option is a uniform or combined NCC then the water business must demonstrate that there is little material difference between NCC calculated for specific locations or services.
- b) Confirm that all NCC charges have been calculated in accordance the core pricing principles.
- c) Improve the transparency of its NCC proposal by providing maps to show the boundaries around the areas (or towns) within which standard NCC apply. Or define any threshold that must be met in order for an NCC to be levied.
- d) Clearly describe the circumstances (i.e. eligibility criteria) under which NCC will negotiated and confirm that it will apply the core pricing principles when such NCC are negotiated.
- e) Consult with other water businesses to develop a best practice negotiating framework.
- f) Consult with other regional water businesses to propose a common water industry timeframe to estimate capital costs.
- g) Consult with stakeholders following the draft decision
- h) Make other modelling adjustments:
 - i. Update calculations of standard NCC with any expenditure adjustments arising from the draft decision
 - ii. Update calculations of standard NCC with any demand adjustments arising from the draft decision
 - iii. Review NCC calculations and only include tax rates in the model only for the years the business expects to pay tax
 - iv. Update calculations of standard NCC with the Commission's draft decision on the Weighted Average Cost of Capital (WACC).
 - v. Resubmit a forecast of NCC revenue for each service for each year of the third regulatory period, following changes made in accordance with the above.
- i) Consult with stakeholders on appropriate transition arrangements.

17. Miscellaneous charges

- (a) The Commission proposes to approve the miscellaneous services fees and charges proposed by Barwon Water.
- (b) In response to this draft decision, Barwon Water is required to submit:
 - (i) definitions and proposed charges for connection fees, information fees and meter reading fees, if these are not already included in its core set of miscellaneous services.
 - (ii) if proposing any miscellaneous charges for developers:
 - o the name all charges relating to developers
 - o explain how these charges relate to NCCs
 - o define the services that will be provided for these charges.

18. Reopening prices

For the third regulatory period, the Commission proposes to approve an uncertain and unforeseen events mechanism that sets out a process for a reopening of price determinations to account for events that were uncertain or unforeseen at the time of the price review, which the businesses could not control or effectively manage such as:

- (a) unsustainable or unwarranted differences between actual and forecast demand level
- (b) changes in legislative and other government imposed obligations
- (c) catastrophic events (such as fire, earthquake or act of terrorism).

Key features of the mechanism are:

- (d) A water business (by application to the Commission) or the Commission may initiate a reopening.
- (e) Prices can either be raised or reduced as a result of an uncertain or unforeseen event.
- (f) An adjustment to prices may be implemented by the Commission at any time within a regulatory period (and not only on 1 July in any year), or at the end of the regulatory period.
- (g) There will be no nominal thresholds for applications (based on differences between forecast and actual outcomes for expenditure, revenue and demand). However in applying to reopen a decision, the water business will need to demonstrate it does not have the financial resources or operational capacity to manage its exposure.
- (h) The Commission proposes to reserve the discretion to limit the reopening of a determination to a single event, rather than the full suite of factors influencing business costs and revenues where:
 - i. the impact of an uncertain and unforeseen event on business costs or revenues is material, and
 - ii. the effects of which can be isolated with certainty

The Commission will only approve a mid-period price adjustment proposed by a water business, when it is satisfied:

- (i) the event is clearly outside the business's control and not predictable with any confidence
- (j) the business has exhausted all opportunities within its control to mitigate against the circumstances in which it finds itself, including demonstrable reprioritisation of its operating and capital expenditure programs
- (k) customers are not unduly exposed to risk or price fluctuations
- (l) the impact of the event is material, clearly observable and verifiable, and
- (m) the net impact on costs or revenue of all changes that occurred during the period being considered is significant (except in cases where the Commission identifies a material event for which the effects can be isolated).

In determining whether a mid-period price adjustment is appropriate the Commission will focus on the business's ability to absorb the impacts of any event on costs or revenues, with particular emphasis on the business' viability ratios.

Pass through events

Barwon Water proposed a pass through for any unforeseen requirement for water from the Melbourne pool via the Melbourne-Geelong Pipeline. The Commission proposes to approve the pass through event proposed by Barwon Water relating to any unforeseen requirement for water from the Melbourne pool via the Melbourne Geelong Pipeline—this approval is subject to Barwon Water providing more information on how this will be implemented. We propose not to approve other pass throughs proposed by Barwon Water.