



Goulburn Valley Water draft decision

2023 Water Price Review

12 April 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

Our draft decision considers Goulburn Valley Water's proposed prices for a 5-year period starting 1 July 2023

This draft decision sets out our preliminary views on Goulburn Valley Water's price submission.¹ Our draft decision should be read together with Goulburn Valley Water's price submission.



We invite interested parties to comment on our preliminary views in this draft decision before we make a final decision and issue a price determination in June 2023. For details of how to provide feedback, see our dedicated Engage Victoria page: <https://engage.vic.gov.au/water-price-review-2023>.

Goulburn Valley Water has committed to delivering outcomes that reflect customer priorities

Goulburn Valley Water plans to deliver the following outcomes for customers:

- provide reliable water and wastewater services customers can trust
- lead action and partner with its communities to grow the region
- care for the environment and adapt to a future impacted by climate variability
- deliver respectful and responsive customer service, balancing affordability, value for money and fairness.²

Delivery of its promises to customers will be stewarded by its Annual Performance Forum, with members made up of customer representatives across its region.

Key initiatives include continued investments in solar sites to help it meet its renewable energy targets, and renewals of existing water and sewerage infrastructure to underpin reliable and safe supply to towns. Goulburn Valley Water has also committed to increasing funding for hardship support programs. It will partner with First Nations peoples to incorporate indigenous knowledge into its practices and re-establish cultural connections with the land and waters.

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

² Goulburn Valley Water, 2023 water price submission, September 2022, p. 10.

Our draft decision approves a lower revenue requirement than proposed by Goulburn Valley Water

Our draft decision is to approve a revenue requirement that will allow Goulburn Valley 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.

Our draft decision is to approve a revenue requirement of \$419.9 million for Goulburn Valley Water over the 5-year period starting 1 July 2023 (Chapter 4).³ This is 5.8 per cent lower than the amount proposed by Goulburn Valley Water. The main reasons for the lower amount proposed in our draft decision are our preliminary views on its forecast operating and capital expenditure (these views are set out in Section 4.1 and 4.2) and its return on equity (Section 4.4.2).

Under Goulburn Valley Water's proposal, generally prices (excluding inflation) will be higher. It proposed increases of 1.85 per cent in 2023-24 and 2024-25, with increases of 2.45 per cent in each of the following 3 years. These estimates exclude inflation (they are in \$2022-23 terms). Goulburn Valley Water proposed smaller increases in the first 2 years taking into account costs of living pressures.

Goulburn Valley Water must respond to our draft decision and propose individual tariffs that reflect our initial views on the revenue requirement. Goulburn Valley Water's response will determine the price and bill impact of our draft decision on individual tariffs and customer groups.

In response to our draft decision, Goulburn Valley Water must consider the inflation environment and the impact on customer prices and bills

Goulburn Valley Water, unlike some other water businesses, proposes to increase prices in real terms over the 2023–28 regulatory period.

Given this and given that since lodgement of its price submission it has become increasingly likely that a relatively high inflation adjustment will be incorporated into 2023-24 prices, Goulburn Valley Water must provide us with further information illustrating how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills.⁴

³ The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health. Along with forecast demand, it is an input to calculating the prices to be charged by a water business.

⁴ This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission, in considering the manner in which a regulated entity's prices are to be calculated,

Prices and estimated bills will change following our draft decision to reflect updates for inflation and the cost of debt. The March Quarter 2023 annual outcome for the consumer price index due for release in late April 2023, will be added to 2023-24 real prices.⁵

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall through 2023 and 2024.⁶ For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.⁷

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to their opening base costs for the 2023–28 regulatory period. Accordingly, it may be the case that the inflation that is added to prices in 2023-24 provides an uplift in revenue that is well above a business's actual costs for the year.

Tariff structures will generally remain the same

For residential and non-residential water services, Goulburn Valley Water proposed a two-part tariff with a fixed service charge and a variable usage component that depends on water use. For residential sewerage services, Goulburn Valley Water proposed a fixed service charge only. For non-residential sewerage services Goulburn Valley Water proposed a two-part tariff with a fixed service charge and a variable usage component. Goulburn Valley Water has also proposed to add a digital meter tariff for new connections in growth towns.

Our draft decision is to accept Goulburn Valley Water's proposed tariff structures, on the basis that they are generally a continuation of Goulburn Valley Water's current approach and otherwise meet the criteria in our guidance. Specifically, the tariff structures ensure a sustainable revenue stream and are simple to understand.

Our draft decision is to not accept Goulburn Valley Water's proposal for a new digital meter tariff. We are seeking additional information from Goulburn Valley Water on the proposed tariff that will inform our final decision.

determined or otherwise regulated, must have regard to whether prices 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.

⁵ Published by the Australian Bureau of Statistics (All Groups – Australia).

⁶ The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) fall to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

⁷ The pricing model issued by the commission includes a forecast for inflation for the full 2023–28 regulatory period (currently 3 per cent). This assumption is used by businesses to enter expenditure values and prices in our pricing model in real terms.

Our draft decision is to accept Goulburn Valley Water's proposed price cap form of price control (Section 5.2) for reasons including because it reflects a continuation of current arrangements, which we have previously approved. This means its maximum prices are fixed subject to updates for inflation and cost of debt, and any other price adjustments we approve in our price determination.

Our draft decision rates Goulburn Valley Water's price submission as 'Standard' under the PREMO framework

Our draft decision adopts an overall PREMO rating of 'Standard', after considering all PREMO elements (as required by our guidance).

This draft overall assessment is particularly influenced by our preliminary view that for the Management element of PREMO, Goulburn Valley Water's price submission should be rated as 'Basic' and for Risk, 'Standard', instead of the 'Advanced' ratings it proposed for each of these elements.

Our draft decision is to rate Goulburn Valley Water's price submission as 'Standard' under the PREMO framework (Table A), compared to the 'Advanced' proposed by Goulburn Valley Water.

In our view, the consequences for customers of the matters in the price submission that relate to the Management and Risk elements of PREMO outweighed the benefits of the proposals relating to the Performance, Engagement and Outcome elements and were sufficient to justify our proposal to rate Goulburn Valley Water's overall price submission as 'Standard'.

The PREMO framework (and the WIRO itself) is built on a sharp focus on efficiency and in turn, sound justification by water businesses for proposed prices.

Our preliminary views are set out in more detail in Chapter 7. Goulburn Valley Water's response to the matters raised in our draft decision will inform our final view on its PREMO price submission rating.

Goulburn Valley Water's price submission received an overall rating of 'Leading' in the 2018 price review.

See Section 1.4 and Chapter 7 for an explanation of the PREMO framework.



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 A **PREMO rating**

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

Among the 14 draft decisions in the 2023 price review, Goulburn Valley Water is one of 9 businesses for which we propose to approve a 'Standard' rating (Table B).

Table B **Draft decision on PREMO — overall rating**

Leading	Advanced	Standard	Basic
	Barwon Water Gippsland Water GWMWater South East Water Yarra Valley Water	Central Highlands Water Coliban Water East Gippsland Water Goulburn Valley Water Lower Murray Water South Gippsland Water Southern Rural Water Wannon Water Westernport Water	

We invite feedback on our draft decision

We invite feedback from stakeholders on our draft decision before we make a final decision and price determination. We expect to release our final decision and price determination in June 2023.

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

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

Table C lists specific issues we are seeking feedback on to inform our final decision and price determination for Goulburn Valley Water.

Table C Specific topics we are particularly interested in stakeholder feedback on

Topic	Specific issue	Draft report reference
New customer contributions	Feedback from developers and other customers about Goulburn Valley Water's proposed new customer contributions charges	Section 5.4

How to provide feedback and stay up to date

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

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

You can provide feedback by:

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

Taking part in a public forum

We plan to hold a public forum on 2 May 2023. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

Provide written comments or submissions

Written comments or submissions in response to this draft decision will be due by 12 May 2023.

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

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

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

2023 Water Price Review
Essential Services Commission
Level 8, 570 Bourke Street
Melbourne VIC 3000

Submission and privacy statement

We encourage transparency in our review processes. It is our policy to publish all submissions to the 2023 water price review on the Essential Services Commission website unless the submitter

has requested confidentiality. When we publish a submission, we will also include some details about the submitter (your name, not your address) unless the submitter has requested anonymity (does not want to be identified).

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

Next steps

Activity	Indicative date
Public forum	2 May 2023
Closing date for submissions on our draft decision	12 May 2023
Release date for our final decision and price determination	June 2023

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 2023.⁸ The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.⁹

Goulburn Valley 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. The price determination will specify the maximum prices Goulburn Valley Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the reasons for our price determination.

1.3 We assess prices against the WIRO and other legal requirements

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

- the objectives and matters specified in clause 8 of the WIRO, which include economic efficiency and viability matters, industry specific matters, customer matters, health, safety, environmental and social matters, and other matters which are specified in sections 8 and 8A of the ESC Act and section 4C of the WI Act

⁸ 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.

⁹ The prescribed services are listed at clause 7(b) of the WIRO.

- 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 guidance¹⁰
- 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 in this draft decision. Table 1.1 summarises the matters we must have regard to and groups them into themes.

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

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

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.¹²

¹⁰ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

¹¹ This is a requirement of the WIRO, clause 14(b).

¹² This is provided for under the WIRO, clause 14(b)(i).

Table 1.1 Matters businesses and the commission must have regard to

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

Continued next page

Table 1.1 (continued)

Benchmarking	Health, safety 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 1995 (WI Act).

1.4 PREMO

PREMO stands for **P**erformance, **R**isk, **E**ngagement, **M**anagement, and **O**utcomes. Each element of PREMO is summarised in Box 1.1.

Box 1.1 PREMO

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

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

First introduced at our 2018 water price review, the purpose of PREMO is to provide incentives for water 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 take these into account in forming its proposals, as outlined in its price submission. These should be evidenced in price submissions by linking the outcomes proposed with findings from a business’s engagement.

Our guidance specifies the way in which we expect water 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

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

For 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

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

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

2. Our assessment of Goulburn Valley Water's price submission

We have made our draft decision on Goulburn Valley Water's price submission after considering:

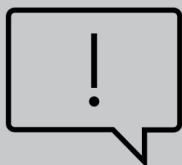
- Goulburn Valley Water's price submission
- Goulburn Valley Water's responses to our queries
- our consultants' reports
- written submissions from interested parties (a list of submissions is provided in Appendix A).

Any reports, submissions or correspondence provided to us that are material to our consideration of Goulburn Valley 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. Goulburn Valley Water's price submission addressed each of these matters. Our preliminary assessment of these matters is provided in this draft decision.

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

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



Goulburn Valley Water must submit a response to our draft decision and provide an updated financial model by 12 May 2023 (via email to water@esc.vic.gov.au). The response will be published on our website. We also invite other interested parties to make a submission.

We intend to make a price determination for Goulburn Valley Water in June 2023.

2.1 Draft decision paper outline

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

- Determine the regulatory period (Section 2.2).
- Confirm the customer outcomes and service levels that Goulburn Valley Water has committed to over the regulatory period (Chapter 3).

Our assessment of Goulburn Valley Water's price submission

- Establish Goulburn Valley 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 Goulburn Valley Water’s financial position, which we have also had regard to.

Chapter 7 outlines our assessment of Goulburn Valley Water’s price submission under the PREMO framework.

2.2 Regulatory period

Our draft 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.¹⁵ 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.¹⁶

Goulburn Valley Water proposed a regulatory period of 5 years. Accordingly, consistent with the reasons outlined in our guidance, our draft decision proposes to set a regulatory period of 5 years.

¹⁵ This is a requirement of the WIRO, clause 9.

¹⁶ 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.

3. Customer outcomes

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

This chapter:

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

3.1 Customer engagement

Our guidance required Goulburn Valley Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Goulburn Valley Water’s engagement.¹⁷

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

- engaged early, informed by ongoing engagement activities since 2018, with targeted engagement taking place from January 2021
- engaged over 3,000 people (or approximately 4.5 per cent of its customer base), including developers, agencies supporting customers experiencing vulnerability and culturally and linguistically diverse communities, tenants, pensioners, families, young people and local councils, through 44 engagement activities and events
- used a range of methods including workshops, online surveys, one-on-one interviews, online focus groups, pop up water cafes, a willingness to pay study, and a range of deliberative processes (including a six-session deliberative forum) with participants representative of its customer base

¹⁷ Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

- engaged using its established forums including its bi-annual meetings of its Annual Performance Forum and its Customer Carbon Advisory Group to ensure longer term issues and priorities were considered in the price review process
- engaged using methods that were inclusive for customers more likely to experience vulnerability, as well as with Traditional Owners and First Nations customers through interviews with Taungurung and Yorta Yorta elders and invitations to participate in activities
- used innovative approaches to engage with a broad cross-section of the community, such as postcards distributed to libraries and QR codes on glass water bottles distributed to cafes
- engaged deeply on matters that influence services and prices, specifically:
 - its level of investment in regional leadership programs within the Goulburn Valley,
 - water pressure
 - the use of digital technology
 - carbon abatement
 - providing support to customers experiencing vulnerability.

More detail on Goulburn Valley Water’s engagement is available in its price submission.¹⁸

Actions proposed to be taken by Goulburn Valley Water provide evidence that its engagement influenced its proposals. For example, in its price submission, Goulburn Valley Water proposed:

- customer supported initiatives including increased funding of its hardship support program by \$2 million over 5 years – in response to feedback, particularly from families and tenants that this support was valuable to people struggling to pay bills and who are not already eligible for government support¹⁹
- improving the water pressure in five towns – in response to feedback that while most customers supported improving water pressure to achieve equal service across regional towns, limiting the improvement to five towns ensured bill increases remained at manageable levels²⁰
- streamlining its guaranteed service levels, from 12 to 5, in response to feedback from the Annual Performance Forum that customers think a payment is warranted only in relation to issues with basic services.²¹

The influence of Goulburn Valley Water’s engagement on its proposals supports the objectives in our pricing framework relating to efficiency and the interests of consumers.

¹⁸ Goulburn Valley Water’s price submission is available on our website at www.esc.vic.gov.au.

¹⁹ Goulburn Valley Water, 2023 water price submission, September 2022, p. 27.

²⁰ Goulburn Valley Water, 2023 water price submission, September 2022, p. 35.

²¹ Goulburn Valley Water, 2023 water price submission, September 2022, p. 15.

We consider that Goulburn Valley Water's engagement achieved a high level of participation across its diverse customer base as seen through the participation in its surveys, community visits and stakeholder interviews. It was able to achieve high quality participation through its various deliberative processes, which included its Annual Performance Forum (44 participants), its carbon advisory group (17 participants) and its deliberative forum (41 participants).

Goulburn Valley Water's engagement was inclusive of Traditional Owners and First Nations people, including by forming partnerships towards shared goals, such as incorporating Indigenous knowledge in new practices, caring for country and re-establishing cultural connections with the land. The Consumer Action Law Centre considered that this partnership approach was an effective way of avoiding demands and unrealistic expectations on Traditional Owner groups for input.

We consider that Goulburn Valley Water's engagement was overall well tailored to the matters it was engaging on, consistent with our guidance. The depth of deliberation and level of influence Goulburn Valley Water afforded customers on complex issues to do with service and price mix enabled it to give effect to the principle regarding tailored engagement set out in our guidance. For example, its deliberative forum, which was held over two days and four evenings, drew on inputs from a range of sources including its willingness to pay study. The purpose of the forum was to better understand the level of support for price options that would give effect to its customers' preference that Goulburn Valley Water be more active in shaping the health and prosperity of the region.²² We saw evidence of the influence of these deliberations in its proposed forecast expenditure and price path in the 2023–28 regulatory period.

We reviewed the information Goulburn Valley Water provided participants of its various engagement activities. Overall, we found materials to be of a high quality and appropriately reflective of the diverse interests of its customer base, including the perspectives of customers who have difficulty paying bills and business customers.

Our review specifically considered the materials Goulburn Valley Water used when engaging via its deliberative forum on willingness to pay projects, as well as the materials it used when engaging with developer stakeholders on its methodology for its new customer contribution pricing approach. Our preliminary view is that Goulburn Valley Water's engagement in these areas could have been more detailed and transparent. We address these areas further in Section 4.1.1.3 and Section 5.4 respectively.

²² Outcome 3 'We will lead action and partner with our communities to grow the region ' was the result of analysis of customer preferences gather through online surveys and stakeholder interviews conducted between January and April 2021.

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

3.2 Outcomes

3.2.1 Performance against outcome commitments 2018–23

As part of our 2018 water price review, Goulburn Valley Water established 'outcomes' it would deliver customers over the following 5 years. These outcomes were reflected in the prices we approved for the period 1 July 2018 to 30 June 2023. Progress against these outcome commitments can indicate whether customers got what they paid for.

A business's price submission should account for its actual performance against its outcome commitments for the current period, from 1 July 2018 to 30 June 2023.²³

We consider Goulburn Valley Water accounted for its annual performance for each measure in its price submission. Table 3.1 lists Goulburn Valley Water's outcome commitments and includes its annual performance results as reported in its price submission and the period-to-date rating published in our 2021-22 Outcomes report.²⁴ The information in this table informs our assessment under the Performance element of PREMO, which is discussed in Chapter 7.

In its 2021-22 outcomes report, Goulburn Valley Water reported it had achieved or exceeded its targets for 85 of its 103 targets (82 per cent) over the first 4 years of the current regulatory period. Of these 103 targets, it rated 13 as amber 'close to achieving target' and 5 as red 'failed to meet target' in the period to date.²⁵

²³ Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

²⁴ Goulburn Valley Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

²⁵ Essential Services Commission, Goulburn Valley Water's outcomes performance 2021-22, October 2022.

Table 3.1 Business self-assessment of performance against Outcome commitments

Outcome	2018-19	2019-20	2020-21	2021-22	Period to date ^a
1. The best price outcomes for customers	Green	Green	Green	Green	Green
2. Renewed focus on water quality and supply	Green	Green	Amber	Amber	Amber
3. Modern and thoughtful customer service	Green	Green	Green	Green	Green
4. Meaningful environmental and recreational outcomes	Green	Amber	Amber	Green	Green

Note: Green = achieved target; Amber = close to achieving target; Red = failed to meet target. ^a This is Goulburn Valley Water’s self-assessment of its performance across the first 4 years of the current regulatory period. Goulburn Valley Water’s performance against Outcome commitments in the final year of the current regulatory period (2022-23) will be published in our 2022-23 Outcomes Report.

In the current regulatory period, Goulburn Valley Water published its annual performance report on its website. It also sought the views of its customers via its Annual Performance Forum before finalising its performance ratings.²⁶

Based on the above, our draft decision is that we agree with Goulburn Valley Water’s self-assessment that it has, overall, met its outcome commitments for the period to date.

3.2.2 Outcome commitments for 2023–28

Goulburn Valley Water engaged with its customers to refine its outcomes for the period from 1 July 2023 to 30 June 2028. It has established four customer outcomes it proposes to deliver:

- provide reliable water and wastewater services customers can trust
- lead action and partner with its communities to grow the region
- care for the environment and adapt to a future impacted by climate variability
- deliver respectful and responsive customer service, balancing affordability, value for money and fairness.²⁷

Among the initiatives to deliver on its commitments, it proposed to increase funding for its hardship programs, invest in achieving carbon emission reductions and continue to maintain and upgrade its infrastructure, including improving water pressure in identified towns. It will also partner with

²⁶ Essential Services Commission, Goulburn Valley Water’s outcomes performance 2021-22, October 2022; Goulburn Valley Water, 2023 water price submission, September 2022, pp. 35–39.

²⁷ Goulburn Valley Water, 2023 water price submission, September 2022, p. 10.

Traditional Owners and First Nations people to incorporate Indigenous knowledge into new practices, caring for country and re-establishing cultural connections with the land and waters.

3.2.3 Our assessment of measures and targets

Goulburn Valley Water proposed a set of 15 measures and targets that it will use to report on performance across the 4 outcomes. These are set out on pages 35 to 39 of its price submission. Performance against these measures will inform our assessment during future price reviews.

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

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.²⁸

Evidence provided by Goulburn Valley Water demonstrates that its outcomes and measures were developed in consultation with its customers, and that they are supported by its customers. For example, between January and April 2021, Goulburn Valley Water validated its current outcomes with its customers via online focus groups, workshops, and online customer surveys to understand customer preferences. Its outcome 3 'we will lead action and partner with our communities to grow the region' was the result of the analysis of customer preferences gathered through these methods. Additionally, its final outcomes and measures were reviewed at two Annual Performance Forum events between May and August 2022.²⁹

Generally, we consider Goulburn Valley Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome. There are some matters that we will follow up with Goulburn Valley Water to improve the clarity and accountability of its targets.

Goulburn Valley Water has dropped its previous measure for full compliance with the Safe Drinking Water Regulations, which we had asked all businesses to include at the 2018 price review.

We will provide Goulburn Valley Water with our standard Outcomes Reporting Template to complete and submit with its response to this draft decision. We will work with the business to ensure the final set of measures complies with our guidance requirements.

²⁸ Essential Services Commission, 2023 water price review: Guidance paper, p. 23.

²⁹ Goulburn Valley Water, 2023 water price submission, September 2022, pp. 42–49.

Goulburn Valley Water's proposed targets suggest customer value is mostly maintained, with some targets either improving on past performance or during the 2023–28 regulatory period.

Goulburn Valley Water will continue to engage with its customers on its performance through its Annual Performance Forum, where progress reports will be shared. It will also establish a performance scorecard in collaboration with customer representatives and publish this on its website.³⁰

On the basis of the above, our draft decision is to accept Goulburn Valley Water's self-assessment of 'Advanced' for the Outcomes element of PREMO, which is discussed further in Chapter 7.

3.3 Service Standards related to service reliability and faults

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

Goulburn Valley Water's proposed service standards relating to reliability and faults can be found in its proposed service standards 2023–28 document.³¹

Goulburn Valley Water has proposed retaining its service standards for the current regulatory period (with some wording changes to align with the updated Water Industry Standard). However, informed by customer preferences, Goulburn Valley Water has updated several of the service levels related to average time to attend water bursts and leaks, average time to attend sewer spills and blockages and average time to rectify a blockage. It has also provided the minimum flow rates as required by the Water Industry Standard.

On the basis of the above, our preliminary assessment is that the service standards relating to reliability and faults proposed by Goulburn Valley Water comply with the requirements of the Water Industry Standard.

Service standards are approved in our Water Industry Standard. Accordingly, in early 2023-24, we will update the Water Industry Standard to reflect approved service standards.

³⁰ Goulburn Valley Water, 2023 water price submission, September 2022, p. 29.

³¹ Goulburn Valley Water, Proposed service standards 2023–28, February 2023.

3.4 Guaranteed service levels

Our draft decision is to accept Goulburn Valley Water's proposed guaranteed service levels but to not accept its proposed rebate amount for the mandatory guaranteed service level.

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.

Goulburn Valley Water's proposed guaranteed service levels are set out on pages 27 and 28 of its price submission. It has proposed to:

- retain two guaranteed service levels from the current 2018–23 regulatory period, including the mandatory guaranteed service level relating to using reasonable endeavours to contact a customer before restriction and legal action
- modify one guaranteed service level relating to a sewer blockage or sewer spill
- remove five guaranteed service levels that related to projects completed in the current regulatory period
- remove an additional four guaranteed service levels as a result of consultation with customers
- create two new guaranteed service levels in response to customer recommendations

Goulburn Valley Water proposed a rebate of \$100 for the mandatory guaranteed service level relating to using reasonable endeavours to contact a customer before restriction and legal action.³²

Goulburn Valley Water consulted with its customers on its guaranteed service levels and rebate levels, in particular with members of its Annual Performance Forum. Goulburn Valley Water asked forum members to vote on which outcome measures they felt most deserved a rebate if the relevant target was not achieved. Forum members then considered the guaranteed service levels with the most votes and considered whether the individual customers or the community should receive a rebate and what the amount of the rebate should be.

In its submission, the Consumer Action Law Centre stated that it was disappointing to see Goulburn Valley Water propose to reduce the number of guaranteed service levels and the amount of the rebate it would provide to customers under the mandatory guaranteed service level if it did not undertake reasonable endeavours to contact a customer before restriction and legal action.³³

³² This amount is in nominal terms, that is, it will not increase further with inflation.

³³ Consumer Action Law Centre, Initial Feedback: 2023–28 Water Price Review, 30 November 2022, p. 8.

Goulburn Valley Water consulted with its customers and relied on the views of customers in the development of its proposed guaranteed service levels and rebate levels.

However, clause 20(c) of the Water Industry Standards specifies that the rebate amount for the mandatory guaranteed service level (using best endeavours to contact a customer before restriction and legal action) must be a minimum of \$300. For this reason, our draft decision is to not accept Goulburn Valley Water's proposed rebate amount for this guaranteed service level.

We propose to accept Goulburn Valley Water's proposed guaranteed service levels with the exception of the rebate amount of the mandatory guaranteed service level, on the basis that they have been agreed with customers during its engagement.

For the mandatory guaranteed service level, we propose to set the rebate at \$300 unless Goulburn Valley Water proposes a higher amount in its response to our draft decision. Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

Guaranteed service levels are approved in our water industry standards. Accordingly, in early 2023-24, we will update the standards to reflect the guaranteed service levels published in our final decision.

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.³⁴ 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 Goulburn Valley 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 Goulburn Valley Water's PREMO rating (Section 4.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.5)
- establish a benchmark tax allowance (Section 4.6).

Our draft decision is to adopt a revenue requirement of \$419.9 million which is 5.8 per cent lower than the \$445.8 million proposed by Goulburn Valley Water.

Goulburn Valley Water proposed a revenue requirement of \$445.8 million over a 5-year period starting 1 July 2023. Our draft decision approves a revenue requirement of \$419.9 million (Table 4.1).

³⁴ 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 Goulburn Valley Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	55.9	56.3	56.9	58.9	57.7	285.7
Return on assets	12.3	12.2	12.3	12.3	12.3	61.4
Regulatory depreciation	10.8	11.8	13.7	15.5	16.3	68.1
Tax allowance	0.8	0.8	0.9	1.1	1.2	4.7
Draft decision – revenue requirement	79.9	81.1	83.8	87.8	87.4	419.9

Note: Numbers have been rounded.

Table 4.2 summarises how our draft decision on Goulburn Valley Water’s revenue requirement (row F) differs to the revenue requirement proposed by Goulburn Valley Water in its price submission (row A). Where our draft decision differs from Goulburn Valley Water’s price submission in relation to a component of the revenue requirement, the adjustment we propose is shown in rows B to E of Table 4.2. The main adjustments relate to Goulburn Valley Water’s proposed operating expenditure and are explained further in Section 4.1.

Our final decision on Goulburn Valley Water’s revenue requirement will be based on the latest available information.

Accordingly, as well as responding to our draft decision and providing an updated price schedule, Goulburn Valley Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

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

Table 4.2 Our proposed adjustments to Goulburn Valley Water’s proposed revenue requirement
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. Goulburn Valley Water’s proposed revenue requirement	83.4	85.4	89.1	93.8	94.1	445.8
B. Operating expenditure	-2.2	-2.6	-3.2	-3.9	-4.5	-16.4
C. Return on assets	-1.2	-1.5	-1.7	-1.7	-1.8	-7.8
D. Regulatory depreciation	0.1	-0.1	-0.2	-0.2	-0.2	-0.6
E. Tax liability	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1
F. Draft decision – revenue requirement	79.9	81.1	83.8	87.8	87.4	419.9

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

4.1 Operating expenditure

Our draft decision is to adopt a forecast operating expenditure of \$285.73 million, which is \$16.4 million or 5.4 per cent lower than proposed by Goulburn Valley Water.

Operating expenditure is a component of the revenue requirement. Goulburn Valley Water’s price submission provides detail on its forecast operating expenditure on page 24.

We assess both:

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

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting’s report on its assessment of Goulburn Valley Water’s expenditure forecast is available on our website.³⁵

³⁵ FTI Consulting, *Goulburn Valley Water – Expenditure Review for 2023 water price review*, February 2023.

Since lodging its price submission with us, we identified that the 2021-22 figures in Goulburn Valley Water's financial model did not align with its approved regulatory accounts due to the treatment of software as a service expense. Goulburn Valley Water subsequently reconciled its financial model by adjusting the total operating expenditure for 2021-22 downwards by \$3 million and removing the associated \$3 million software as a service write-off non-recurring expenditure adjustment. The \$3 million has instead been captured as capital expenditure for 2021-22. This correction to the input data results in no net change to the operating expenditure forecasts.

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

Table 4.3 Draft decision – operating expenditure
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Controllable operating expenditure	51.02	51.53	52.21	54.31	53.12	262.20
Non-controllable operating expenditure	4.88	4.79	4.70	4.62	4.54	23.53
Bulk services ^a	1.06	1.07	1.08	1.10	1.12	5.42
Environmental contribution ^b	3.64	3.53	3.43	3.33	3.23	17.17
Licence fees – Essential Services Commission ^c	0.07	0.07	0.07	0.07	0.07	0.35
Licence fees – Department of Health ^c	0.02	0.02	0.02	0.02	0.02	0.12
Licence fees – Environmental Protection Authority ^c	0.09	0.09	0.09	0.09	0.09	0.46
Draft decision – operating expenditure	55.90	56.32	56.91	58.93	57.66	285.73

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

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

Table 4.4 summarises how our draft decision on Goulburn Valley Water's operating expenditure (row D) and its two components differ from the operating expenditure proposed by Goulburn Valley Water in its price submission (row A). Rows B and C of the table summarise our proposed adjustments to Goulburn Valley Water's proposed controllable and non-controllable operating expenditure.

Details of our assessment and reasons for our proposed adjustments to Goulburn Valley Water's proposal are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).

We consider the operating expenditure proposed in our draft decision reflects the expenditure that a prudent service provider would incur when acting efficiently to achieve the lowest cost in delivering the outcomes specified in Goulburn Valley Water's price submission.

Table 4.4 Our proposed adjustments to Goulburn Valley Water's proposed operating expenditure

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
A. Goulburn Valley Water's proposed total operating expenditure	58.11	58.92	60.16	62.81	62.18	302.18
B. Our total proposed adjustments to controllable operating costs (B1 + B2 + B3)	-2.10	-2.39	-2.92	-3.46	-4.00	-14.87
B1 – Baseline: removal of increased maintenance costs	-0.99	-0.99	-1.00	-1.03	-1.03	-5.04
B2 – Efficiency improvement rate adjustment	0.29	0.00	-0.52	-1.03	-1.57	-2.83
B3 – Step change: customer willingness to pay projects	-1.40	-1.40	-1.40	-1.40	-1.40	-7.00
C. Our total proposed adjustments to non-controllable operating costs (C1)	-0.11	-0.22	-0.32	-0.42	-0.52	-1.58
C1 – Environmental contribution	-0.11	-0.22	-0.32	-0.42	-0.52	-1.58
D. Draft decision – total operating expenditure (D = A + B + C)	55.90	56.32	56.91	58.93	57.66	285.73

Notes: Our proposed adjustments are the differences between our draft decision and what Goulburn Valley Water proposed in its price submission. Row A shows the total operating expenditure proposed by Goulburn Valley Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating costs and non-controllable operating costs shown in rows B and C (and itemised in rows B1 to B3 and C1). Numbers have been rounded.

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

4.1.1 Controllable operating expenditure

Goulburn Valley Water proposed a total forecast controllable operating expenditure of \$277.07 million over a 5-year regulatory period. For the reasons set out below, we propose to adopt a forecast operating expenditure of \$262.20 million for the 2023–28 regulatory period, which is \$14.87 million lower than proposed by Goulburn Valley Water.

Goulburn Valley Water’s forecast controllable operating expenditure for the period from 1 July 2023 is estimated through a series of steps:

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, one-off items are removed or normally occurring items are added in.
2. Apply a growth rate for operating expenditure for the regulatory period – assumed by Goulburn Valley Water to be 1.50 per cent per year.
3. Apply an annual cost efficiency improvement rate – assumed by Goulburn Valley Water to be 1.56 per cent for 2023-24, 0.45 per cent for 2024-25 and 0 per cent per year from 2025-26 to 2027-28, an average of 0.40 per cent across the 5 years.
4. Make adjustments for additional costs or cost saving expected in future years.

4.1.1.1 Baseline controllable operating expenditure

Goulburn Valley Water has proposed a controllable operating expenditure baseline of \$52.13 million, after removing \$4.57 million in non-recurring operating expenditure that occurred in 2021-22. Goulburn Valley Water’s proposed baseline is \$5.33 million (or 11 per cent) higher than the benchmark figure of \$46.80 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Our expenditure consultant requested substantiation of Goulburn Valley Water’s proposed increase to its baseline year operating expenditure benchmark.³⁶ Goulburn Valley Water explained the increase was due to a number of factors including additional compliance work, increased preventative maintenance for operations and assets, operating model changes, chemical costs and transition to cloud based applications.

³⁶ FTI Consulting, *Goulburn Valley Water – Expenditure Review for 2023 water price review*, February 2023, pp. 15–17.

Our expenditure consultant verified these additional costs were recurring and found Goulburn Valley Water's substantiation of these costs to be mostly reasonable, except for one proposed change identified below.³⁷

Our expenditure consultant identified Goulburn Valley Water's proposed baseline included \$1.0 million from increased operating expenditure for maintenance activities in 2021-22 that had been delayed from the previous years. As this is a non-recurring cost, our consultant recommended accepting Goulburn Valley Water's proposed baseline increase after removing \$1.0 million for increased maintenance in 2021-22.

Goulburn Valley Water's explanation to our consultant for the additional expenditure above the 2021-22 benchmark was mainly related to 27 additional full time equivalent employee positions since the 2018 price review. However, the financial models for the 2018 and 2023 price reviews show employee numbers only increased by 18 from 2016-17 to 2021-22, and the growth allowance of 1.32 per cent per year would have provided for about 14 additional positions across the business. In response to our draft decision, Goulburn Valley Water must provide us with information that will enable us to better understand this relationship between increasing employee numbers and the assumptions in the operating expenditure benchmark established at the 2018 price review, including a clear account of its increase in employee numbers, identifying roles related to new activities above the expected additions to accommodate growth in business-as-usual activities.

We reviewed Goulburn Valley Water's proposal and the advice from our expenditure consultant. Given the above, we do not accept Goulburn Valley Water's proposed baseline forecast. For the purposes of establishing a revenue requirement for our draft decision, we will adopt a controllable operating expenditure baseline of \$51.13 million based on our expenditure consultant's advice.

4.1.1.2 Efficiency improvement and growth rate

Goulburn Valley Water proposed an average efficiency improvement rate on its controllable operating costs of 0.40 per cent per annum across the next regulatory period. This is the lowest when compared to other businesses in the current price review.

The efficiency improvement rate is also lower than Goulburn Valley Water's proposed average cost growth rate of 1.50 per cent per annum, effectively delivering a net average annual increase of 1.10 per cent to its controllable annual baseline operating costs in each year of the regulatory period. This net annual increase is the second highest when compared to other businesses in the current price review although Goulburn Valley Water had the lowest typical water bill for customers

³⁷ FTI Consulting, *Goulburn Valley Water – Expenditure Review for 2023 water price review*, February 2023, p. 17.

in Australia in 2020-21.³⁸ Its price submission also noted it has the second lowest cost to serve (operating costs per megalitre) in Victoria in 2020-21.³⁹

The PREMO framework provides water businesses with flexibility to propose the efficiency rate to be reflected in their controllable operating expenditure forecasts. We consider it is reasonable to expect businesses to improve the efficiency of delivery for ongoing or business-as-usual expenditure, consistent with the objectives related to efficiency in the Water Industry Regulatory Order 2014.⁴⁰

The efficiency improvement rate reflected in a business's operating expenditure forecast is a key element for the assessment of the Management element of PREMO. Our guidance noted that an efficiency rate of around 1.4 per cent would be an example of a 'Standard' price submission.⁴¹ Goulburn Valley Water has rated itself as 'Advanced' for this element, and a higher efficiency rate would be more consistent with the higher rating.

Based on the above, our draft decision is to not accept Goulburn Valley Water's proposed efficiency rate and to instead adopt an efficiency improvement rate of 1.0 per cent per annum for all 5 years, instead of the average 0.40 per cent adopted by Goulburn Valley Water. We have adopted 1 per cent per annum because most other water businesses in the current review have identified an average efficiency rate of at least this amount, with the average across businesses being around 1.3 per cent, which suggests a rate of 1.0 per cent should be achievable by Goulburn Valley Water. It is also the minimum rate we expected water businesses to incorporate prior to the introduction of the PREMO framework.

We have not proposed a higher amount than 1 per cent as Goulburn Valley Water set an efficiency rate of around 3 per cent per annum in the current 2018–23 regulatory period, well above the rates adopted by other businesses. We also took into account the information that Goulburn Valley Water presented on its 'cost to serve' (on a per megalitre basis) including that it compared favourably to other businesses and the fact that Goulburn Valley Water indicated its current typical bills are among the lowest in Australia.

In response to our draft decision, Goulburn Valley Water must resubmit its forecasts for controllable operating expenditure, reflecting an efficiency improvement rate of at least the amount we have adopted in our draft decision. Alternatively, it must demonstrate how its proposed

³⁸ 2020-21 National Performance Report, Bureau of Meteorology http://www.bom.gov.au/water/npr/docs/2020-21/National_Performance_Report_2019-20_urban_water_utilities.pdf

³⁹ Goulburn Valley Water, 2023 water price submission, September 2022, p. 10.

⁴⁰ See for example, clauses 8(b)(ii) and 8(b)(iii) of the Water Industry Regulatory Order.

⁴¹ Essential Services Commission, 2023 *water price review: Guidance paper*, 26 October 2021, p. 82

efficiency improvement rate meets the efficiency objectives of the Water Industry Regulatory Order 2014.

4.1.1.3 Cost adjustments

Goulburn Valley Water has proposed additional forecast operating expenditure adjustments to the annual baseline, including:

- \$9.0 million for several 'customer willingness to pay' projects
- \$2.8 million to implement and operate new digital systems under a digital strategy
- \$1.9 million to align with its sludge management strategy and meet the EPA biosolids reuse guidelines including the disposal of alum sludge
- \$1.1 million for assistance by external sources to develop its next pricing submission and Urban Water Strategy
- \$1.1 million for operating and maintenance costs of its new solar electricity generation sites from 2025-26 (the capital investment of \$20.5 million is Goulburn Valley Water's largest capital project for the 2023–28 regulatory period)
- \$0.5 million for a Planning Climate Resilience Strategy and other strategies
- \$2.5 million reduction in power and energy costs

The above adjustments (\$16.3 million in additional costs and \$2.5 million in savings from lower power and energy costs) represent an additional \$13.8 million over the regulatory period, or an average of \$2.8 million per year.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline and requested further information from Goulburn Valley Water, including a further breakdown by individual cost item where required, and requested further documentation that supported the prudence and efficiency of each cost item given the limited detail available in the price submission.

Our expenditure consultant assessed each forecast variation against criteria for prudent and efficient operating expenditure and was satisfied each item was appropriately costed and supported by internal documentation, which included evidence of its prudence and efficiency. It therefore considered that Goulburn Valley Water's proposed additions were mostly reasonable and only recommended an adjustment to Goulburn Valley Water's controllable operating expenditure to remove the \$9.0 million step change that relates to the customer willingness to pay projects.

Due to the magnitude of the largest step change of \$9.0 million for customer willingness to pay projects, our expenditure consultant requested further information on the associated projects and the customer engagement processes. Goulburn Valley Water explained that the following programs comprising \$9 million were tested with its deliberative forum:

- Regional leadership for projects related to integrated water management, community projects and awareness (\$4 million proposed)

Revenue requirement

- Local benefits of carbon emissions abatement (\$3 million proposed)
- Supporting customers in need (\$2-3 million proposed).

Our expenditure consultant noted that while there was support via its deliberative forum on these programs, feedback out of the deliberative forum included concerns regarding both the quantum of spend associated with supporting customers in need and the readiness and appropriateness of some other projects. Goulburn Valley Water advised the participants of the deliberative forum that unspent money from these projects would be returned to general funds.

Furthermore, our expenditure consultant was not satisfied that, based on the report prepared by Goulburn Valley Water for the deliberative forum, that forum members were provided with sufficient detail about each of the projects to inform their consideration. Our consultant therefore recommended removing the \$9.0 million associated with the customer willingness to pay program because Goulburn Valley Water provided insufficient detail regarding the projects.

We have considered the advice from our expenditure consultant and Goulburn Valley Water's proposal and our preliminary view is that, because the outcomes and the specific projects for each of the above three programs are not yet defined, the specific costs and customer value for the programs cannot be ascertained.

However, given Goulburn Valley Water has identified that additional support is needed for people struggling to pay bills (including families and tenants), the obligations for water businesses to provide support to customers experiencing financial payment difficulty and vulnerability, and consistent with similar proposals from other water businesses in the current review, our draft decision is to adopt an amount of \$2 million over the 5-year regulatory period.

In its response to our draft decision, we require Goulburn Valley Water to confirm and justify the annual amounts to be allocated to the program, the key initiatives or projects the funding is intended to support, and the outcomes that will be delivered by the initiatives and projects.

For the remaining programs (regional leadership and local benefits of carbon abatement), the information provided by Goulburn Valley Water was insufficient to enable us to establish the prudence and efficiency of the proposed expenditure for our draft decision. On that basis, our draft decision is to remove the associated adjustments proposed by Goulburn Valley Water (\$7 million over 5 years).

Accordingly, we require Goulburn Valley Water to provide additional justification for the prudence and efficiency of these programs in its response to our draft decision, including the following:

- confirming the annual amounts to be allocated to each program
- details on the initiatives or projects the funding is intended to support
- the proposed outcomes that will be delivered by these initiatives and projects.

For the additional \$1.1 million from 2025-26 to maintain the new solar arrays Goulburn Valley Water is building, we accept our consultant has verified these costs. However, we would expect this self-generated electricity would provide a material reduction to the purchased electricity requirements of the business, but we cannot see where these cost savings appear in Goulburn Valley Water's financial model and how they flow on to its customers. In its response to this draft decision, Goulburn Valley Water must provide details on the expected cost savings from its solar generation investments, demonstrate how these have been accounted for in its financial model, and quantify any impact on customer bills.

Our preliminary position is to accept the proposed forecast costs with the exception of the \$7.0 million associated with the two willingness to pay programs, as described above. However, given our concern that operational cost savings are not clearly presented in the forecasts, we cannot verify that the forecast is complete, and therefore prudent and efficient.

4.1.2 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

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

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

Goulburn Valley Water has proposed \$25.10 million in non-controllable operating expenditure over the 2023–28 regulatory period.

Our guidance paper sets out our approach for businesses to forecast their non-controllable operating costs. We consider businesses should forecast licence fees for the Department of Health, the Environment Protection Authority Victoria and the Essential Services Commission to remain flat in real terms, and for the environmental contribution to remain flat in nominal terms (decline in real terms) across the 2023–28 regulatory period. Goulburn Valley Water has partially followed this approach in its price submission but has forecasted the environmental contribution remaining flat in real terms rather than nominal terms.

Our draft decision proposes to reduce Goulburn Valley Water's forecast non-controllable operating expenditure by \$1.58 million across the 2023–28 period, resulting from our adjustments to the environmental contribution to reflect a flat rate in nominal rather than real terms based on the forecast figure from the last year of the current regulatory period (2022-23).

For the purpose of calculating the revenue requirement for our draft decision, we have accepted Goulburn Valley Water's proposed non-controllable operating expenditure after adjusting for a \$1.58 million reduction to the environmental contribution. We have reviewed Goulburn Valley

Water's forecast bulk charges with Goulburn-Murray Water's 2022-23 approved tariffs and require that Goulburn Valley Water respond to our draft decision by:

- providing the list of bulk water tariffs charged by Goulburn-Murray Water for the period 2021-22⁴²
- updating its forecast bulk charges for the period 2022-23 to 2027-28 by using the Commission approved prices for Goulburn-Murray Water in 2022-23
- maintaining the forecast bulk charges at a flat rate in real terms (using a price path of 0 per cent and not applying CPI) during the next regulatory period
- submitting an updated financial model which takes into account these changes.

Prior to making our final decision, we will update the forecast licence fee and environmental contribution values with the relevant regulatory bodies and adjust where necessary for the latest inflation and external bulk charges data.

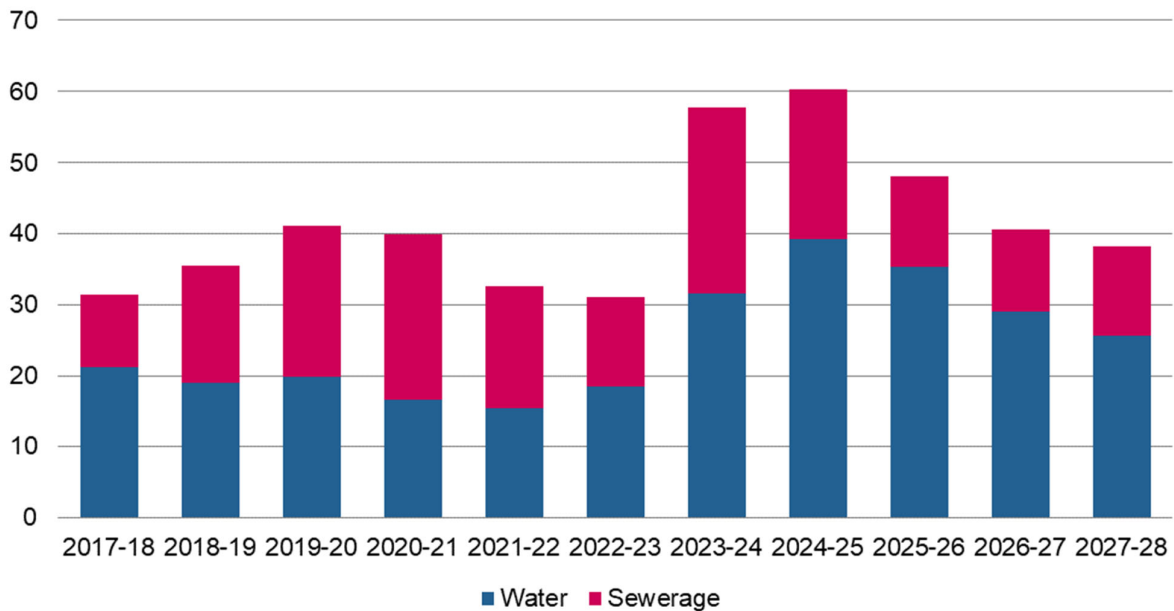
4.2 Capital expenditure

Our draft decision is to adopt a forecast capital expenditure of \$227.5 million, which is \$17.6 million or 7.2 per cent lower than proposed by Goulburn Valley Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Goulburn Valley Water's forecast capital expenditure and supporting information is provided at pages 14, 22 to 24, and 50 to 55 of its price submission. Figure 4.1 shows Goulburn Valley Water's actual gross capital expenditure for 2017-18 and the first 4 years of the current regulatory period (2018-19 to 2021-22) and forecast gross capital expenditure from 2022-23 to 2027-28. The first 5 years of actual expenditure shown in Figure 4.1 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.

⁴² To verify Goulburn Valley Water's bulk water charges, we require Goulburn Valley Water to provide us with a list of bulk water tariffs charged by Goulburn-Murray Water for the financial year 2021-22 as they act as a base year for forecasting bulk water charges for the upcoming regulatory period.

Figure 4.1 Gross capital expenditure by service category
\$ million 2022-23



Note: This graph shows actual figures for 2017-18 to 2021-22, and Goulburn Valley Water’s forecasts for 2022-23 to 2027-28.

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure. FTI Consulting’s report on its assessment of Goulburn Valley Water’s expenditure forecast is available on our website.⁴³

4.2.1 Actual capital expenditure

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

Since lodging its price submission with us, we identified corrections that were needed to Goulburn Valley Water’s reported capital expenditure to reflect its approved regulatory accounts for 2021-22. This resulted in a \$4.6 million increase in actual capital expenditure in 2021-22. This includes the \$3.0 million for software as a service that was initially included as operating expenditure, discussed in Section 4.1. We propose to adopt this change because it is consistent with Goulburn Valley

⁴³ FTI Consulting, *Goulburn Valley Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023.

Water’s approved regulatory accounts (see Section 4.3.1). Our draft decision incorporating these adjustments is set out in Table 4.5 below.

Table 4.5 Our proposed adjustments to Goulburn Valley Water’s proposed prescribed capital expenditure
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Total
Goulburn Valley Water’s proposed prescribed capital expenditure	31.39	35.56	41.08	39.98	28.06	31.11	207.18
Our proposed adjustments – regulatory accounting reconciliation	0.00	0.00	0.00	0.00	4.61	0.00	4.61
Draft decision – total prescribed capital expenditure	31.39	35.56	41.08	39.98	32.67	31.11	211.79

Note: Actual total prescribed capital expenditure from 2017-18 to 2021-22, forecast in 2022-23. Numbers have been rounded.

Over the period from 2017-18 to 2021-22, Goulburn Valley Water incurred \$180.7 million in gross capital expenditure, which is \$16.7 million or 10.2 per cent higher than the benchmarks adopted at the 2018 water price review. Over this period in net terms, capital expenditure totalled \$165.1 million, \$9.9 million or 6.4 per cent higher than forecast. Our preliminary view is that this outcome is reasonable given capital expenditure can be lumpy in nature.

Goulburn Valley Water’s price submission also reported on the status of its top 10 major capital projects, which were consistent with the project timelines provided in its major capital projects report as at the end of June 2022.⁴⁴ As at September 2022, Goulburn Valley Water reported that, of the top 10 major projects proposed for the 2018–23 regulatory period, 5 have been completed, 2 are on schedule for completion in 2023-24 and the following 3 projects are deferred:

- Nathalia treated water pipeline project is deferred to enable projects with increased cost forecasts to be reprioritised, following the completion of water treatment plant contingency and redundancy works to address short-term risk. This project is expected to be completed in 2028-29.

⁴⁴ Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 13–15. Goulburn Valley Water’s major projects are reported by the business as part of our annual outcomes reporting process, as part of its commitment to communicate the delivery of its major projects to its customers. The business’s comments are not audited by the commission.

- Shepparton raw water pump station augmentation is partially complete with sufficient contingency to manage short-term risk enabling its deferral. This project is expected to be completed in 2028-29.
- Broadford water treatment plant upgrade is deferred and to be staged over the next two regulatory periods following the completion of optimisation works and is now expected to be completed in 2029-30.

Goulburn Valley Water has deferred the above projects mainly as part of its capital program reprioritisation to manage increased costs for other projects.

4.2.2 Forecast Capital Expenditure

Goulburn Valley Water has proposed \$245 million in forecast capital expenditure over the 2023–28 regulatory period. Our draft decision is to adopt forecast capital expenditure of \$227.5 million (Table 4.6).

Table 4.6 Our proposed adjustments to Goulburn Valley Water’s proposed total forecast capital expenditure
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Goulburn Valley Water’s proposed total forecast capital expenditure	57.80	60.23	48.07	40.59	38.32	245.01
Adjustment – Shepparton – Corporate Office Upgrades – Water allocation	-3.15	-3.75	0.00	0.00	0.00	-6.90
Adjustment – Shepparton – Corporate Office Upgrades – Sewerage allocation	-3.15	-3.75	0.00	0.00	0.00	-6.90
Adjustment – Water Mains Replacement program	-0.75	-0.75	-0.75	-0.75	-0.75	-3.75
Draft decision – total forecast capital expenditure	50.75	51.98	47.32	39.84	37.57	227.46

Note: Actual total prescribed capital expenditure from 2017-18 to 2021-22, forecast in 2022-23. Numbers have been rounded.

For the reasons set out below, our draft decision is to adopt a forecast capital expenditure of \$227.5 million, \$17.6 million lower than the \$245 million forecast proposed by Goulburn Valley Water for the purpose of calculating its revenue requirement:

Revenue requirement

- Goulburn Valley Water's price submission provided evidence that a large majority of its forecasts for capital expenditure are prudent and efficient. Its total proposed capital expenditure is \$64.6 million (35.8 per cent) higher than actual capital expenditure in the current 2018–23 period. Goulburn Valley Water identified that much of this increase is related to its Large Scale Solar project (\$20.5 million) and Shepparton – Corporate Office Upgrades project (\$13.8 million). Goulburn Valley Water's total capital forecast is mainly comprised of expenditure on renewals (\$133.1 million, or 54.3 per cent of the total program).
- Goulburn Valley Water has adopted P50 cost estimates for its capital expenditure forecasts for the 2023–28 period (in line with our guidance) after adopting P40 estimates for the forecasts included in its 2018 price submission.⁴⁵
- Our expenditure consultant requested selected documents from Goulburn Valley Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, our consultant's workshop with the business and Goulburn Valley Water's responses to further questions, our expenditure consultant found that Goulburn Valley Water has a robust approach for developing project scope, the timing of works and cost estimates.⁴⁶
- Goulburn Valley Water has forecast \$108.8 million of capital expenditure on its top 10 major projects, this is 44.4 per cent of its total forecast capital expenditure. Given both the size and nature of major projects proposed by Goulburn Valley Water, our consultant reviewed in detail the business cases and supporting information for all the business's top 10 major projects. Our consultant found that the information provided on most of the projects was appropriately detailed and provided strong justification for the projects and associated expenditures.⁴⁷ However, our consultant recommended an adjustment to Goulburn Valley Water's Shepparton – Corporate Office Upgrades project.
- In relation to the Shepparton – Corporate Office Upgrades project, Goulburn Valley Water has proposed a total of \$13.8 million to action either a lease agreement at a new office site, or the upgrade of its existing office site at Fryers Street, which requires substantive refurbishment. Goulburn Valley Water's proposed capitalisation of \$13.8 million is in line with its forecast cost to redevelop its Fryer Street office site, which it considers is the lower cost option compared to the lease of a new office site (which is the business's preferred option given the outcome of a multi-criteria analysis). Goulburn Valley Water has stated the leasing option would have a

⁴⁵ P50 represents the estimate of costs such that there is a 50 per cent probability of the project being delivered within that cost estimate. A P40 estimate will produce a lower cost forecast, but with a higher likelihood the project delivery will exceed the forecast estimate.

⁴⁶ FTI Consulting, *Goulburn Valley Water: Review of expenditure forecasts – 2023 Water Price Review*, February 2023, pp. 27–29.

⁴⁷ FTI Consulting, *Goulburn Valley Water: Review of expenditure forecasts – 2023 Water Price Review*, February 2023, pp. 30–38.

higher impact on prices compared to the redevelopment of the Fryers Street site. Our consultant noted that the business case for the lease option is expected to be updated pending the outcome of further work with the developer of the new office site to confirm pricing. Our consultant considered that this expenditure should be deferred from inclusion in Goulburn Valley Water's capital expenditure forecast for the next regulatory period given the uncertainty around final cost forecasts, and which option will be the final preferred solution.⁴⁸

- We have reviewed Goulburn Valley Water's proposal and our consultant's advice, and our preliminary position is that the \$13.8 million proposed for the Shepparton – Corporate Office Upgrades project should be deferred to the next regulatory period.
- Our expenditure consultant also reviewed the business's Water Mains Replacement program and associated business case. It noted that Goulburn Valley Water's historic levels of expenditure allocated to this program have delivered failure rates that meet acceptable levels, but that the business has now forecast additional expenditure on this program (a total of \$2.75 million per annum) to account for increased contractor and material costs. This cost forecast is higher than the low-cost scenario Goulburn Valley Water forecast of \$2 million per annum for the next regulatory period, which our consultant considered would still deliver below target failure rates up to at least 2028. Given this, our consultant considered an annual budget in line with the low-cost scenario is appropriate and recommended an adjustment of \$0.75 million per annum for this program. Having reviewed and taken into account Goulburn Valley Water's proposal and our consultant's advice, for the purposes of setting our draft decision, we propose to adjust the forecast Water Mains Replacement program from \$2.75 million per annum to \$2 million per annum.
- Our preliminary view is that while the planned capital expenditure program is larger than the program delivered in the current regulatory period, it is achievable given Goulburn Valley Water's delivery capability and past track record delivering its capital expenditure program. As noted in Section 4.2.1, over the 2018–23 regulatory period Goulburn Valley Water has completed five of its major projects, with two on schedule for completion against their original timelines. Three projects have been deferred to prioritise higher cost projects, or where other lower cost options have addressed risks and allowed deferral where appropriate.⁴⁹ Our expenditure consultant also reviewed the business's capacity to deliver on its larger forecast capital program and noted the business has taken a number of actions to ensure it can deliver the program over the next regulatory period.⁵⁰

⁴⁸ FTI Consulting, *Goulburn Valley Water: Review of Expenditure Forecasts – 2023 Water Price Review*, February 2023, pp. 33-34.

⁴⁹ Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021-22*, 18 October 2022, pp. 13–15.

⁵⁰ FTI Consulting, *Goulburn Valley Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 29.

- Goulburn Valley Water has not specifically identified projects it has excluded from its price submission where there is uncertainty in timing, cost, scope and benefits of capital expenditure. For any additional capital expenditure in the 2023–2028 regulatory period that Goulburn Valley Water proposes to include in the regulatory asset base at the end of the regulatory period, it should note the following:
 - Goulburn Valley Water will need to demonstrate the prudence and efficiency of any additional costs during the 2023–28 regulatory period if they seek to include them in the regulatory asset base for the 2028–33 price review.
 - Deviations from forecasted capital expenditure during the 2023–28 regulatory period will form a key part of our assessment of the Performance element of PREMO at the next price review.

We have reviewed Goulburn Valley Water’s proposals and advice from FTI Consulting, and our preliminary view is that Goulburn Valley Water’s approach to forecasting its capital expenditure is largely consistent with the requirements of our guidance and the principles in the Water Industry Regulatory Order 2014, except for in relation to the matters described above regarding our proposed overall adjustment of \$17.6 million to its total forecast capital expenditure.⁵¹

Our draft decision for total gross capital expenditure is to not accept Goulburn Valley Water’s proposed benchmark and to instead adopt a benchmark of \$227.5 million for the purpose of setting a revenue requirement, reflecting the \$17.6 million adjustment for the Shepparton - Corporate Office Upgrade and Water Mains Replacement programs described above. The benchmark we propose to adopt is set out in Table 4.6.

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

⁵¹ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 32–37.

4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.⁵² The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4), and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Goulburn Valley 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 draft decision is to not accept Goulburn Valley Water's proposed closing regulatory asset base and instead adopt a closing regulatory asset base of \$470.4 million at 30 June 2022.

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 2021-22.⁵³ This helps to ensure prices reflect the actual net expenditure of a water business.⁵⁴

Goulburn Valley Water proposed a closing regulatory asset base of \$467.1 million at 30 June 2022 in the financial model it provided with its price submission.⁵⁵ However, we compared this financial model with Goulburn Valley Water's approved regulatory accounts for 2021-22 and identified some necessary corrections, with the main adjustment related to the treatment of software as a service expenditure for 2021-22 (as noted in Sections 4.1 and 4.2.1).

We compared Goulburn Valley Water's actual net capital expenditure for 2017-18 to 2021-22 with the forecast used to approve maximum prices for the period from 1 July 2018. Typically, if a water business's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory

⁵² 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.

⁵³ See Section 4.2 for a discussion of Goulburn Valley Water's capital expenditure.

⁵⁴ 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.

⁵⁵ Available at www.esc.vic.gov.au.

asset base. We consider this approach is reasonable given capital expenditure can be ‘lumpy’ in nature.

Goulburn Valley Water’s net capital expenditure over the period from 2017-18 to 2021-22 was \$165.1 million. This is \$9.9 million or 6.4 per cent higher than the forecast used to approve maximum prices for the period from 1 July 2018. This is below the 10 per cent threshold noted above, so our preliminary view is to reflect the \$165.1 million in the closing regulatory asset base for 30 June 2022.

Table 4.7 sets out our draft decision on Goulburn Valley Water’s closing regulatory asset base at 30 June 2022.

Table 4.7 Draft decision – closing regulatory asset base (RAB)
\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
Opening RAB 1 July	378.9	391.7	411.2	436.2	458.5
Plus gross capital expenditure	31.4	35.6	41.1	40.0	32.7
Less government contributions	0.6	0.0	0.0	0.0	0.0
Less customer contributions	2.6	2.8	2.4	2.9	4.4
Less proceeds from disposals	1.0	0.9	0.4	0.3	0.6
Less regulatory depreciation	14.4	12.4	13.3	14.5	15.7
Closing RAB 30 June	391.7	411.2	436.2	458.5	470.4

Note: Numbers have been rounded.

4.3.2 Forecast regulatory asset base

Our draft decision is to not accept Goulburn Valley Water’s proposed forecast regulatory asset base.

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

Consistent with the requirements of our guidance, Goulburn Valley Water proposed to include the 2018 benchmark for capital expenditure in its forecast regulatory asset base.⁵⁶

Based on our proposed adjustments to Goulburn Valley Water’s closing regulatory asset base (Section 4.3.1), and our draft decision to not accept Goulburn Valley Water’s proposed new customer contributions (Section 5.4), our draft decision is to not accept Goulburn Valley Water’s proposed forecast regulatory asset base.

Table 4.8 sets out our draft decision on Goulburn Valley Water’s forecast regulatory asset base from 1 July 2023. Our assessments of the other components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

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

Table 4.8 **Draft 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	470.4	482.8	516.7	550.8	578.3	596.3
Plus gross capital expenditure	31.1	50.8	52.0	47.3	39.8	37.6
Less government contributions	0.0	0.0	0.0	0.0	0.0	0.0
Less customer contributions	3.0	5.0	5.1	5.2	5.3	5.4
Less proceeds from disposals	0.5	1.0	1.0	1.0	1.0	1.0
Less regulatory depreciation	15.3	10.8	11.8	13.7	15.5	16.3
Closing RAB 30 June	482.8	516.7	550.8	578.3	596.3	611.1

Note: Numbers have been rounded.

⁵⁶ 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.

4.3.2.1 Customer contributions

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

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.⁵⁷

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

For the purposes of calculating the regulatory asset base and revenue requirement in our draft decision, we have accepted Goulburn Valley Water's proposed customer contributions forecast.

However, Goulburn Valley Water will need to update its customer contribution forecasts in response to our draft decision.

4.4 Rate of return

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

4.4.1 Cost of debt

Our draft decision is to accept the cost of debt proposed by Goulburn Valley Water.

Our guidance required Goulburn Valley Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Goulburn Valley Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, as set out in Table 4.9, our draft decision is to accept the cost of debt proposed by Goulburn Valley Water, noting that the cost of debt estimates will be updated following the release of the Australian Bureau of Statistics March Quarter 2023 consumer price index.

⁵⁷ Revenue from new customer contributions reflects revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

Table 4.9 Draft decision – 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%	3.75% ^a

Note: Numbers have been rounded. ^a Estimated cost of debt – we will update the 2022-23 figure before the final decision and price determination.

4.4.2 Return on equity

Our draft decision is to not accept Goulburn Valley Water’s proposed return on equity of 4.5 per cent, and instead adopt a return on equity of 3.9 per cent which reflects our preliminary view on Goulburn Valley 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 Goulburn Valley 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.⁵⁸ We reviewed the return on equity values in the matrix in mid-2022 given the change in market conditions that has occurred since we published our guidance in October 2021. We consider that the values in our matrix reflect the medium-term real rates of return.⁵⁹

Goulburn Valley Water rated its price submission as ‘Advanced’. Based on this PREMO self-rating, Goulburn Valley Water proposed a return on equity of 4.5 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Advanced’.⁶⁰

⁵⁸ Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

⁵⁹ We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity adopted by interstate regulators in the following publications: Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW’s rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

⁶⁰ Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

As outlined in Chapter 7, our draft decision is to adopt an overall PREMO rating of 'Standard'. This results in a return on equity of 3.9 per cent.

4.5 Regulatory depreciation

Our draft decision is to not accept Goulburn Valley Water's forecast regulatory depreciation.

Regulatory depreciation is a component of Goulburn Valley Water's revenue requirement and is also an input to calculating the regulatory asset base. Goulburn Valley Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile.⁶¹ We noted in our guidance that we prefer this approach.⁶²

However, because our draft decision is to not accept Goulburn Valley Water's forecast regulatory asset base, our draft decision proposes to not accept Goulburn Valley Water's forecast regulatory depreciation.

For the purposes of this draft decision, we have adopted the regulatory depreciation as shown in Table 4.8 in Section 4.3.2 above. Our approach for the purposes of the draft decision adopts Goulburn Valley Water's assumed asset lives but recalculates depreciation based on our proposed changes to the regulatory asset base. In response to our draft decision Goulburn Valley Water must update its forecast for regulatory depreciation.

4.6 Tax allowance

Our draft decision is to not accept Goulburn Valley Water's proposed forecast tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Goulburn Valley Water has proposed a tax allowance of \$5.8 million in its revenue requirement for the 2023–28 regulatory period. However, because our draft decision is to not accept Goulburn Valley Water's forecast revenue requirement, our draft decision is to not accept Goulburn Valley Water's proposed tax allowance.

For the purposes of this draft decision, we have adopted the tax allowance as shown in Table 4.1 in Chapter 4. This uses our adjusted figures for Goulburn Valley Water's forecast revenue requirement. In response to our draft decision Goulburn Valley Water must update its forecast for its tax allowance.

⁶¹ For the period from 2022-23 to 2027-28, Goulburn Valley Water proposed a regulatory depreciation of \$83.9 million.

⁶² Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

5. Demand, tariffs and prices

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

5.1 Demand

Our draft decision is to accept Goulburn Valley Water's demand forecasts.

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

Goulburn Valley Water's demand forecasts are set out at pages 15 and 25 of its price submission and are also included in its financial model.⁶³

Our draft decision is to accept Goulburn Valley Water's demand forecasts for the purpose of approving maximum prices, because they were developed consistently with the requirements of our guidance. Since lodgement of its price submission, updated Victorian Government population and dwelling growth estimates have been made available to water businesses.

In its response to our draft decision, Goulburn Valley Water must demonstrate how it has considered these updated estimates and if required, identify and justify any changes to its demand forecasts (any updates must also be included in its pricing model submitted in response to our draft decision).

5.2 Form of price control

Our draft decision is to accept Goulburn Valley Water's proposed price cap form of price control.

Our guidance indicated we would have particular regard to whether a business proposed to continue its existing form of price control or introduce a new form of price control.⁶⁴

Goulburn Valley Water proposed a price cap form of price control as set out on page 8 of its price submission. This is the same as its current approach.

Our draft decision is to accept Goulburn Valley Water's proposed form of price control because:

⁶³ In response to our request for information, Goulburn Valley Water also submitted additional reference materials supporting its demand forecast.

⁶⁴ Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

- it largely reflects a continuation of current arrangements, with some changes to reflect the near-term inflation outlook (demonstrating consideration of customer interests)
- it provides sufficient revenue to cover the forecast efficient costs of providing services and for Goulburn Valley Water to deliver on any health, safety and environmental obligations
- it provides Goulburn Valley Water’s customers with price certainty
- it is easy to explain to customers
- demand risk is more efficiently managed by Goulburn Valley Water than by its customers
- it is otherwise consistent with the requirements of our guidance.

5.3 Tariff structures and prices

Our draft decision is to accept Goulburn Valley Water’s proposed tariff structures.

Our draft decision is to not accept Goulburn Valley Water’s proposed digital meter tariff.

Goulburn Valley Water’s proposed tariffs are set out at pages 60 to 70 of its price submission.

Our draft decision does not approve prices for each tariff. Prices will need to be updated by Goulburn Valley Water to reflect our updates to inflation and cost of debt estimates prior to our final decision. They may also need to be updated depending on our further review of its proposed expenditure and new customer contributions. Goulburn Valley Water will need to update the revenue from miscellaneous services in its financial model to reflect a correction to calculating developer charges and respond to our initial views on its proposed digital meter tariff. Our reasons for not approving the proposed new digital meter tariff in our draft decision are explained in Section 5.3.4.

5.3.1 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.⁶⁵ 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.

Goulburn Valley Water generally proposed to maintain its existing tariff structures.⁶⁶

⁶⁵ Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

⁶⁶ From 2019 to 2022 Goulburn Valley Water performed a tariff structure trial for residential customers in Cobram and Kilmore. The trial included an option for a lower fixed water service charge and a higher water volume charge. The aim was to give customers more control over their bills, incentivise lower water usage with greater bill impact resulting from changes in usage. The participation rate was low, and the participants had lower average water usage than the total customer base. The average yearly saving was \$100 per household and did not lead to overall reduced usage

For residential and non-residential water services, it proposed a two-part tariff with a fixed service charge and a variable usage component that depends on water use. For residential sewerage services, Goulburn Valley Water proposed a fixed service charge only. For non-residential sewerage services, Goulburn Valley Water proposed a two-part tariff with a fixed service charge and a variable usage component.

The Consumer Action Law Centre expressed caution against tariff structures that assign more weight to variable charges.⁶⁷ A different view was noted in an anonymous submission that considered that a pricing structure that uses a large supply charge and small usage costs doesn't encourage customers to save water. A submission by the Concerned Waterways Alliance noted it fails to understand why inclining block tariffs are not adopted by all water businesses. However, changes to tariff structures can impact customers in different ways – for example, they can impact on affordability for larger households.⁶⁸

We consider that water businesses are often best placed to consider the interests of customers in designing tariffs, and that Goulburn Valley Water's existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our draft decision is to accept Goulburn Valley Water's proposed tariff structures, on the basis that they are generally a continuation of Goulburn Valley Water's current approach and otherwise meet the criteria in our guidance.

Our preliminary view is that the two-part tariff structure proposed by Goulburn Valley Water for its water services will promote the efficient use of 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.⁶⁹ We also consider two-part tariff structures are easy to understand.

For sewerage services, we consider Goulburn Valley Water's proposed fixed charge for residential customers is easy to understand. A two-part tariff for non-residential customers sends these customers signals about efficient costs.⁷⁰

Goulburn Valley Water has confirmed its proposed tariff for recycled water is calculated in accordance with the pricing principles in our guidance.

or increased satisfaction. Goulburn Valley Water concluded the trial in June 2022 with no recommendation to adjust its current tariff structures.

⁶⁷ Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, pp. 5-6.

⁶⁸ Concerned Waterways Alliance, submission to the Essential Services Commission Water Price Review 2023, 1 December 2022.

⁶⁹ 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.

⁷⁰ Our reasons are outlined in our 2013 draft decisions on price review 2013-14 to 2017-18.

5.3.2 Prices

The prices proposed by Goulburn Valley Water for water and sewerage services are set out on pages 30 to 31 of its price submission.

Under Goulburn Valley Water's proposal, generally prices (excluding inflation) will be higher:

- Residential water and sewerage bills for a typical household would increase annually by 1.85 per cent more than inflation in 2023-24 and 2024-25. These bills would increase annually by 2.45 per cent more than inflation from 2025-26 to 2027-28. This two-step price path was proposed by Goulburn Valley Water taking into account the near-term inflation outlook and cost of living pressures.
- Prices for non-residential water and sewerage services follow a similar price path to residential services, with fixed and variable charges generally proposed to increase by 1.85 per cent more than inflation each year in 2023-24 and 2024-25, and increase by 2.45 per cent each year from 2025-26 to 2027-28.

In May 2023, we intend to determine prices for Goulburn Valley Water in \$2023-24 terms. This means we will add the annual change in the March Quarter 2023 consumer price index (published by the Australian Bureau of Statistics) to its 2023-24 prices, which will also flow through to customer bills.

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high.⁷¹ For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to their opening base costs for the 2023–28 regulatory period. Considering this, and Goulburn Valley Water's proposal for increasing prices in real terms over the 2023–28 regulatory period, we are seeking further information from Goulburn Valley Water in response to our draft decision on how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.⁷²

⁷¹ The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

⁷² This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission must have regard to principles that the manner in which a regulated entity's prices are to be calculated, determined or otherwise regulated, should 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.

As part of its response, Goulburn Valley Water must demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and whether they are reasonable taking into account that some of its key costs are unlikely to increase as much as near-term inflation.

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

5.3.3 Addressing the interests of low income and vulnerable customers

In making our price determination, we must have regard to whether Goulburn Valley Water's prices take into account the interests of customers, including low income and vulnerable customers.⁷³

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

- a price path in the first 2 years to take into account cost of living pressures
- an additional \$2 million over 5 years to support customers experiencing payment difficulties
- developing tools to help residential and business customers save water
- delivering a water conservation education program.

As noted in Section 3.1, Goulburn Valley Water's price submission was informed by engagement that was inclusive of the experiences of customers experiencing payment difficulties along with insights from community support workers.

5.3.4 Unique services

Goulburn Valley Water proposed to change its charge to developers for processing requests for new connections. Goulburn Valley Water proposed a three-tiered charge based on the number of lots. We reviewed the calculation of the three-tiered charge and found some minor errors, which Goulburn Valley Water subsequently corrected. We also verified that the proposal was supported by developers.⁷⁴

On the basis that developers supported the proposed charges, our draft decision is to accept the corrected new charges. Goulburn Valley Water will need to update the revenue from miscellaneous services in response to this draft decision, to reflect the corrected charges.

⁷³ Water Industry Regulatory Order 2014 clause 11(d)(iii).

⁷⁴ Goulburn Valley Water, Response to request for information, 22 December 2022.

Proposed digital meter charge

Goulburn Valley Water proposed a new digital meter charge for new connections in growth towns at a cost of \$326 per connection.⁷⁵ Currently, new connections can only be charged for a mechanical water meter (\$183). The proposal is based on a pilot project that has yet to be completed and, because it has not been completed, the benefits for customers of the upgrade to digital meters are not yet clear.⁷⁶

The Consumer Action Law Centre opposed Goulburn Valley Water's proposed digital meter tariff because it has concerns that the proposed charges are double the current price for a new connection of a mechanical water meter, making digital meters inaccessible to low-income households.⁷⁷

Our draft decision is to not accept Goulburn Valley Water's proposed tariff for digital meters because, as yet, it is unclear how the digital meter tariff reduces peak demand or benefits customers.

In response to this draft decision Goulburn Valley Water must identify the benefits of digital meters to new customers, including identifying any peak demand reduction.

5.4 New customer contributions

Our draft decision is to not accept Goulburn Valley Water's proposed standard new customer contributions or negotiated new customer contribution framework.

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

Goulburn Valley Water's proposed new customer contributions are set out at pages 31 and 32 of its price submission. Goulburn Valley Water proposed using a model based on average

⁷⁵ Growth towns are Barmah, Broadford, Kialla Lakes, Kilmore, Mansfield, Wandong and Woods Point.

⁷⁶ Goulburn Valley Water submitted additional reference materials to support the digital meter installations.

⁷⁷ Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 6.

incremental cost to estimate its new customer contributions, rather than the net incremental cost approach it has used in the past.⁷⁸

Goulburn Valley Water proposed a new customer contribution for water services of \$3,700 in 2023-24 compared to \$2,891 in 2022-23, and a new customer contribution for wastewater services of \$1,700 in 2023-24 compared to \$0 in 2022-23. Goulburn Valley Water proposed not to increase its customer contributions in real terms from years 2 to 5 of the regulatory period.

Goulburn Valley Water put forward two reasons for using the average incremental cost approach, namely, that it will address:⁷⁹

- the demand risk associated with the recent development boom in its service area
- a perceived lack of transparency in the rationale and calculation of existing new customer contributions.

We consider the net incremental cost approach outlined in our guidance, and previously adopted by Goulburn Valley Water, also enables water businesses to address the risks associated with changes in development, allows for cost reflectivity and is transparent, and that these issues can be flexibly dealt with by applying that approach.⁸⁰ Further, water businesses have the flexibility to negotiate different charges for different developments or growth areas as circumstances may require.

We reviewed the average incremental cost methodology and consider it may be capable of meeting our new customer contribution pricing principles and the relevant requirements of the Water Act 1989 (refer to Appendix C in relation to the Water Act 1989). Relevantly, and as set out in Sections 5.4.2, 5.4.3 and 5.4.4 below, the guidance requires that new customer contributions must:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

⁷⁸ The average incremental cost approach calculates the new customer contribution charge by dividing the capital and operating cost of a growth area by the number of connections in that area. The net incremental cost approach applies the incremental revenue less incremental cost to estimate the new customer contribution charge.

⁷⁹ New Customer Contributions, September 2022, p. 2. This is a reference material provided by Goulburn Valley Water as part of its price submission.

⁸⁰ Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, pp. 59-60.

However, our draft decision is to not accept Goulburn Valley Water's proposed new customer contributions as it has not provided us with adequate information or justification for us to be satisfied that its approach complies with our guidance requirements. Our reasons are explained below.

5.4.1 Fair and reasonable costs

Section 268(3) of the Water Act 1989 requires that:

The amount of payment required from an owner must be assessed by the Authority to be fair and reasonable, taking into account the benefit to that property relative to the benefit to other properties.

As set out in Appendix C, our preliminary view is that the proposed average incremental cost methodology can comply with this requirement if growth related costs have been appropriately attributed between new customer contributions and ongoing charges, and if new customer contribution revenues have been accounted for when setting the regulatory asset base for ongoing charges.

We are currently reviewing Goulburn Valley Water's growth capital expenditure to ensure that assets allocated to new customer contributions are reasonable. We consider that Goulburn Valley Water has not provided us with sufficient information to enable us to be satisfied that it has implemented the average incremental cost approach according to the Water Act Section 268(3). Our reasons are outlined below.

5.4.2 Incremental infrastructure and associated costs

Our preliminary view is that Goulburn Valley Water's proposed standard new customer contributions do not meet the new customer contributions pricing principle set out in our guidance that requires having regard to the incremental infrastructure and associated costs.

Our preliminary review of Goulburn Valley Water's allocation of growth capital expenditure to new customer contributions has found that the forecast costs may not be reasonable and appropriately attributed to developers. The purpose of checking this is to verify that assets are appropriately allocated to new customer contributions and also not included in the costs that contribute to the prices charged for other services and to other customers.⁸¹

Our preliminary review of Goulburn Valley Water's allocation of growth capital expenditure to new customer contributions and finds Goulburn Valley Water's methodology is unclear and it has not

⁸¹ That is, counted in the regulatory asset base and then again in the new customer contribution model, thereby allowing the business to earn revenues twice on the same asset.

provided policy documentation supporting the allocation methodology. Further, details regarding capital expenditure allocation are unclear and cannot be clearly allocated to growth.

In response to our draft decision, we require Goulburn Valley Water to provide further information on how it has allocated its capital expenditure to new customer contributions.

We also note that to meet this principle, Goulburn Valley Water's growth capital expenditure included in the new customer contributions and the regulatory asset base must reconcile.

5.4.3 Incremental future revenues that will be earned from customers at connection points

Our guidance requires that new customer contributions must have regard to future revenue that will be earned from customers at the relevant connection.

Our preliminary view is that the average incremental cost methodology can indirectly meet that new customer contribution pricing principle if the new customer contributions include new customers in the demand forecasts in the business's pricing model. We consider that including new customers in the demand forecasts in the pricing model is sufficient to meet the requirements of the pricing principle if the numbers reconcile between the pricing model and the new customer contributions model.

We require further information from Goulburn Valley Water on the allocation of its assets between its pricing model and new customer contributions model as we are not satisfied that capital expenditures are appropriately allocated to the new customer contributions model. We have not been able to confirm that assets have not been double counted.

Accordingly, Goulburn Valley Water has not provided us with sufficient information to enable us to be satisfied that it has had regard to incremental future revenues that will be earned from customers at the relevant connections.

5.4.4 Avoidable costs of connection and standalone costs of connection

Our guidance sets out that new customer contributions must be greater than the avoidable cost of that connection and less than the standalone cost of the connection.

Goulburn Valley Water's proposed new customer contributions reflect the average incremental costs in its new customer contributions model. Because the calculated new customer contributions have been applied without a cap, this pricing principle can be expected to have been complied with. However, given we cannot verify the assets included in the pricing model with those in the new customer contribution model to ensure assets have not been double counted, our preliminary view is that Goulburn Valley Water has not met this pricing principle.

5.4.5 Engagement and transparency matters

Goulburn Valley Water has provided developers' feedback on its proposed new customer contributions, but it is not clear what was presented to stakeholders about the proposed average incremental cost methodology.

Our preliminary view is that Goulburn Valley Water has not provided sufficient transparency to stakeholders to allow them to provide meaningful comments on the proposed methodology.

To assist stakeholders, we have outlined in Appendix C to our draft decision how we consider the average incremental cost methodology may meet the relevant requirements in the Water Act 1989. We are interested in receiving stakeholder feedback on our preliminary views.

5.4.6 Next steps

Our draft decision is to not accept Goulburn Valley Water's proposed new customer contributions because it has not met our guidance.

In response to our draft decision in relation to new customer contributions, Goulburn Valley Water must provide further information on how it has allocated its capital expenditure to new customer contributions.

Alternatively, in response to the draft decision, Goulburn Valley Water can recalculate its new customer contributions using the current methodology.

We are interested in feedback from developers and customers regarding the proposed new customer contributions.

5.4.7 Negotiated new customer contributions framework

Goulburn Valley Water has provided its negotiating framework for negotiated new customer contribution contracts. We are still assessing the proposed average incremental cost approach used by Goulburn Valley Water to calculate negotiated new customer contributions. For this reason, our draft decision is to not accept Goulburn Valley Water's proposed framework for negotiated new customer contributions.

5.5 Adjusting prices

Our draft decision is to not accept Goulburn Valley Water's proposed price adjustment mechanisms as outlined in its price submission.

Goulburn Valley Water's proposed price adjustment mechanisms are not clearly set out in its price submission. The business provided further details in response to our written queries and confirmed it does not plan to change its approach to price adjustment mechanisms, which include annual cost

of debt adjustments. However, in response to our draft decision, we require Goulburn Valley Water to confirm its proposed approach to adjusting prices.

In the absence of this information, our intention is to adopt the adjustment mechanisms specified in Goulburn Valley Water's current price determination on the basis that we have approved them previously.

6. Financial position

We have reviewed key indicators of Goulburn Valley Water's financial performance and our preliminary view is that Goulburn Valley 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.⁸² 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.

Goulburn Valley Water's price submission and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on Goulburn Valley Water's assumptions about its revenue and expenditure. We have reviewed the key indicators of financial performance and our preliminary view is that we consider Goulburn Valley Water will generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

⁸² 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 Goulburn Valley 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.⁸³ We required Goulburn Valley 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 Goulburn Valley Water to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control, and tariffs.

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

7.1 Our PREMO assessment of Goulburn Valley Water's price submission

Our draft decision is to rate Goulburn Valley Water's price submission as 'Standard' under PREMO, which is different to Goulburn Valley Water's self-rating of 'Advanced'.

Goulburn Valley Water's self-rating for each of the PREMO elements and its overall self-rating of its price submission are shown in Table 7.1. This table also includes our proposed ratings following our assessment of Goulburn Valley Water's price submission.

⁸³ 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
Goulburn Valley Water's self-rating	Advanced	Advanced	Advanced	Advanced	Advanced	Advanced
Commission's rating	Standard	Advanced	Standard	Advanced	Basic	Advanced

Our draft decision is to not accept Goulburn Valley Water's proposed overall PREMO self-rating of its submission as 'Advanced' and instead rate it as 'Standard'. This is reflected in the return on equity we propose to approve for Goulburn Valley Water (see Section 4.4.2). We have formed this view after reviewing Goulburn Valley Water's proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

7.1.1 Performance

For the 2023 price review, a business's rating for the Performance element of PREMO is based on a combination of its overall PREMO rating at its most recent price review, and its level of performance based on achievement of outcomes (related to service targets and performance against expenditure benchmarks set at the previous price review) and customer sentiment.⁸⁴

As noted in Section 3.2, we agree with Goulburn Valley Water's self-assessment that it has, overall, met its outcome commitments for the period to date. In its 2021-22 outcomes report, Goulburn Valley Water reported it had achieved or exceeded its targets for 85 of its 103 targets (82 per cent) over the first 4 years of the current regulatory period. Its performance was assessed by customers through its Annual Performance Forum, supporting accountability.

In terms of customer perceptions, Goulburn Valley Water generally sat mid-table on the commission's survey of customer sentiment – covering measures of overall satisfaction, value for money, trust, and reputation in the community.⁸⁵ In our most recent survey (January 2023), it ranked sixth of sixteen in terms of value for money, and seventh for reputation. It ranked lower for trust and overall satisfaction. Its price submission noted other survey results where it ranked relatively well on measures relating to customer satisfaction.

⁸⁴ As set out in Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 74-75. Guiding questions are set out on page 45.

⁸⁵ The commission's customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

Goulburn Valley Water's controllable operating costs during the current regulatory period are forecast to be higher than the benchmark established at the 2018 water price review.

In 2021-22 (the last available year of audited results), its proposed controllable operating expenditure was around 11 per cent higher than the benchmark established at the 2018 price review, which is higher than the average of all businesses in the current review (around 9 per cent). While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to manage and reprioritise costs closely having regard to the price review benchmarks.

In terms of capital expenditure, over the period from 2017-18 to 2021-22, its gross capital expenditure was around 10.2 per cent higher than the benchmarks established at the 2018 water price review. In net terms, Goulburn Valley Water's capital expenditure was 6.4 per cent higher. We consider this is a reasonable outcome given the lumpy nature of capital investment.

As Goulburn Valley Water received a PREMO rating of 'Leading' at its 2018 price review, if it considered it generally met expectations, it could claim a rating of 'Leading' for Performance. Goulburn Valley Water has proposed a self-rating of 'Advanced'. We accept this rating for the Performance element of PREMO.

7.1.2 Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don't pay more than they need to), and the business's proposed guaranteed service level scheme (including that it provides incentives for the business to deliver valued services efficiently).⁸⁶

In support of its self-rating of its price submission as 'Advanced' for the Risk element of PREMO, Goulburn Valley Water provided an overview of key risks and its views on its acceptance of risk on behalf of its customers.⁸⁷ Key factors supporting its risk rating include:

- reviewing effective asset lives which resulted in an extended period of recovery, helping to reduce customer prices
- proposing to continue with a price cap form of price control, accepting demand risk on behalf of its customers
- testing its guaranteed service level scheme to ensure it remains aligned with customer expectations about service priorities

⁸⁶ Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

⁸⁷ Goulburn Valley Water, 2023 water price submission, September 2022, pp. 14-15.

- undertaking Monte Carlo analysis for major projects, and not increasing estimates of input prices despite recent increases, to accept more risk on behalf of its customers.

We consider that Goulburn Valley Water's approach to risk overall, is more consistent with a rating of 'Standard', rather than the 'Advanced' it proposed.

Other businesses receiving an 'Advanced' rating for risk in the current water price review have generally adopted approaches that take on greater risk or demonstrate greater accountability for performance. These include mechanisms to return funds to customers where performance targets were not met and taking on risk associated with demand or revenue from major customers.

Based on the above, our draft decision is to not accept Goulburn Valley Water's self-rating of its price submission as 'Advanced' for the Risk element of PREMO, and instead adopt a rating of 'Standard'.

7.1.3 Engagement

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations people and those experiencing vulnerability.⁸⁸

Our draft decision is to accept Goulburn Valley Water's self-rating of 'Advanced' for the Engagement element of PREMO on the basis of the overall suitability of its engagement methods used to address complex issues relating to affordability and future prosperity.

Goulburn Valley Water was able to achieve high levels of participation across its engagement processes, including by incorporating the views of customers experiencing payment difficulty at key points. Goulburn Valley Water achieved an overall high level of influence in its price submission, particularly in relation to the role of customers in helping shape the engagement agenda, and its acceptance of recommendations towards the final set of pricing and expenditure proposals. See Section 3.1 for further detail.

7.1.4 Management

The Management element of PREMO is assessed against guiding questions that cover matters such as the efficiency of proposed expenditure and prices, the quality of the business's submission and supporting information to justify proposals, and evidence that there is senior-level ownership and commitment to the proposals contained in the submission.⁸⁹

⁸⁸ Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

⁸⁹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

Consistent with the requirements of our guidance the Goulburn Valley Water Board has also attested to the accuracy of the information contained in its submission.

However, in comparison to all businesses in the current water price review, Goulburn Valley Water proposed the lowest efficiency improvement rate (an average of around 0.4 per cent per year) for controllable operating expenditure over the next regulatory period.⁹⁰ In forming our preliminary view, we considered the information that Goulburn Valley Water presented on its 'cost to serve' (on a per megalitre basis) which it noted compared favourably to other businesses and the fact that Goulburn Valley Water indicated its current bills are among the lowest in Australia.

However, we also considered that its proposed efficiency improvement rate was well below the average of water businesses in the current review (around 1.3 per cent). Goulburn Valley Water's proposed efficiency improvement rate is also well below the rates specified in our guidance as examples of a 'Standard' PREMO rating in our current review (approximately 1.4 per cent per annum) and an 'Advanced' PREMO rating (approximately 1.9 per cent per annum).⁹¹

Further, as noted in Section 4.1.1, we cannot identify where Goulburn Valley Water has accounted for expected operating efficiencies or for savings delivered from major capital investments or programs (for example, savings arising from its \$20.5 million Large Scale Solar generation project).

In terms of the prudence and efficiency of Goulburn Valley Water's forecast expenditure, our preliminary view is that Goulburn Valley Water has also not substantiated key elements of its forecast costs including the 'willingness to pay' projects and funding for new positions (Section 4.1.1).

For these reasons, our draft decision proposes to rate Goulburn Valley Water's price submission as 'Basic' for the Management element of PREMO, compared to the 'Advanced' it proposed.

7.1.5 Outcomes

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

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.⁹²

As noted in Section 3.2, our preliminary view is that Goulburn Valley Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its

⁹⁰ With an assumed efficiency path of 1.6 per cent, 0.5 per cent, 0 per cent, 0 per cent, and 0 per cent per year over the 2023–28 regulatory period.

⁹¹ Essential Services Commission, *2023 water price review: Guidance paper*, p. 82.

⁹² Essential Services Commission, *2023 water price review: Guidance paper*, p. 45.

customers, and that they are supported by customers. For example, Goulburn Valley Water validated its current outcomes with its customers via online focus groups, workshops, and online customer surveys to understand customer preferences between January and April 2021. Its final outcomes and measures were reviewed at two Annual Performance Forum events between May and August 2022.

Generally, we consider Goulburn Valley Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome. Similar to most businesses, there are some matters that we will follow up with Goulburn Valley Water to improve the clarity and accountability of its targets as described above in Section 3.2.3.

Goulburn Valley Water's proposed targets suggest customer value is mostly maintained, with some targets either improving on past performance or during the 2023–28 regulatory period.

Goulburn Valley Water will continue to engage with its customers on its performance through its Annual Performance Forum, where progress reports will be shared. It will also establish a performance scorecard in collaboration with customer representatives and publish this on its website. We consider this supports accountability by Goulburn Valley Water to its customers.

Based on the above, our draft decision is to accept Goulburn Valley Water's self-assessment of its price submission as 'Advanced' for the Outcomes element of PREMO.

7.1.6 Summary

Our draft decision adopts an overall PREMO rating of 'Standard', after considering all PREMO elements (as required by our guidance). This draft overall assessment is particularly influenced by our preliminary view that for the Management element of PREMO, Goulburn Valley Water's price submission should be rated as 'Basic' and for Risk, 'Standard', instead of the 'Advanced' ratings it proposed for each of these elements.

In our view, the consequences for customers of the matters referred to above in Sections 7.1.2 and 7.1.4 regarding the Management and Risk elements of PREMO of the price submission outweighed the benefits of the proposals referred to in relation to the Performance, Engagement and Outcome elements and were sufficient to justify our proposal to rate Goulburn Valley Water's overall price submission as 'Standard'. The PREMO framework (and the Water Industry Regulatory Order 2014 itself) is built on a sharp focus on efficiency and in turn, sound justification by water businesses for proposed prices.

Goulburn Valley Water's response to the matters raised in our draft decision will inform our final view on its PREMO price submission rating.

Appendix A — Submissions received

Name or organisation	Date received
Anonymous	7 October 2022
Consumer Action Law Centre	30 November 2022
Concerned Waterways Alliance	1 December 2022
Concerned Waterways Alliance	21 December 2022

Appendix B — Commission’s consideration of legal requirements

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

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.⁹³ We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Goulburn Valley Water’s compliance with our guidance, in reaching our preliminary view.

Note: all chapter and section numbers referenced below refer to our draft decision for Goulburn Valley Water.

Economic efficiency and viability matters

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

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

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

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

⁹³ Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

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

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

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

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

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

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

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

Additionally, our pricing approach allows a water 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 draft decision involved consideration of this factor:

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

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable Goulburn Valley Water to recover borrowing costs associated with its investment in services, and generate a return on assets.⁹⁴

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

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

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

⁹⁴ The regulatory rate of return is comprised of the cost of debt and the return on equity.

- Our assessment of tariffs (Section 5.3).

Industry specific matters

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

Our pricing approach allows each water 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 draft decision involved consideration of this factor:

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

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

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

Our draft decision provides for Goulburn Valley 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 Australia⁹⁵
- operating and capital expenditure costs per connection throughout Australia⁹⁶
- tariff structures applied by water businesses throughout Australia⁹⁷
- the regulatory rate of return set by other regulators.⁹⁸

We are not aware of any international benchmarks that are relevant to our draft 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 draft decision involved consideration of this factor:

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

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

⁹⁵ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

⁹⁶ Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

⁹⁷ Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

⁹⁸ Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW’s rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

Customer matters

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

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

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

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

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

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

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

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

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

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

WIRO Clause 11(d)(i) requires us to have regard to whether Goulburn Valley 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 Goulburn Valley 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 draft decision involved consideration of this factor:

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

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

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

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

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

WIRO Clause 11(d)(iii) requires us to have regard to whether Goulburn Valley 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 draft decision involved consideration of this factor:

- Our consideration of customer engagement (Section 3.1)

Commission's consideration of legal requirements

- Our consideration of outcomes (Section 3.2)
- Our consideration of guaranteed service levels (Section 3.4)
- Our consideration of tariff structures and prices (Chapter 5)

Health, safety, environmental and social obligations

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

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

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

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

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

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

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

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

Other matters

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

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

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

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

We consider that our pricing approach helps to address market power and information asymmetries relating to the water 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 2016.⁹⁹

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.¹⁰⁰

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

⁹⁹ Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

¹⁰⁰ 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.¹⁰¹

¹⁰¹ Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.

Appendix C — Average incremental cost methodology and the Water Act

The average incremental cost methodology is capable of complying with section 268(3) of the Water Act 1989.

Section 268(3) of the Water Act 1989 states:

(3) The amount of payment required from an owner must be assessed by the Authority to be fair and reasonable, taking into account the benefit to that property relative to the benefit to other properties.

To take into account the benefit to a connecting property relative to the benefit to other properties, a new customer contribution charging regime must determine how much a connecting party should pay upfront versus what will be paid through ongoing charges. Ongoing charges are paid by both the connecting party and all other customers via inclusion in the regulatory asset base.

The water business undertakes this task by deciding:

1. The value of any upfront contribution, and
2. The amount of growth capital expenditure that can be added to the regulatory asset base.

This is the way in which the water business can satisfy the requirement in the Water Act of ‘taking into account the benefit to that property relative to the benefit to other properties’.

This regulatory price setting and cost recovery task can be done through the incremental costs minus incremental revenues calculation required in the current new customer contribution guidance,¹⁰² applied in conjunction with a building block approach that only adds net capital expenditure (that is, gross capital expenditure less contributions) into the regulatory asset base.

It is also possible to do this task by applying the benefits assessment at a planning stage. When setting standard new customer contributions, a water business can determine what costs relate to new connections and what relate to existing customers, and then direct the costs accordingly to new customer contributions and the regulatory asset base (or regulated operating expenditure allowance). By ensuring that the calculation of the building block revenues accounts for this view of

¹⁰² Essential Services Commission, Estimator Guidance – New Customer Contributions (September 2012); see also Essential Services Commission, Explanatory Notes – New Customer Contributions for The Victorian Water Industry (9 December 2013) and Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 59.

relative benefits and does not double count the cost recovery, the equivalent regulatory outcome can be achieved.

Accordingly, the average incremental cost approach may be capable of complying with the section 268(3) requirements, provided that:

1. Growth related costs have been appropriately attributed between new customer contribution and ongoing charges. This requires that the basis of attributing expenditure to new customer contribution versus the ongoing charges from all customers is clear and can be reconciled between gross costs and the net costs included in Goulburn Valley Water's financial model.
2. New customer contribution revenues have been accounted for when setting the regulatory asset base for ongoing charges. This requires that the new customer contribution revenues in the financial model can be reconciled back to the new customer contribution models.