

# Barwon Water final decision

2023 Water Price Review

23 June 2023

## Acknowledgement

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

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

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

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# Summary

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

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

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



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

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

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

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

## **We have approved a revenue requirement of \$1,156.9 million over 5 years**

Our final decision approves a revenue requirement of \$1,156.9 million over the 5-year period starting 1 July 2023 (see Chapter 4).<sup>3</sup> This is \$19.1 million or 1.7 per cent higher than our draft decision, which mainly reflects our updates to the cost of debt.

This revenue requirement will allow Barwon 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.

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

A summary of approved maximum prices for major services delivered by Barwon Water is set out in Section 5.3.2. Table A shows the estimated typical bills for different customer groups under our final decision, for 2022-23 (the current year) and 2023-24. For a typical residential owner occupier, estimated annual water and sewerage bills (including inflation) will rise from around \$1,076 currently to \$1,141 in 2023-24. For a typical residential tenant, bills (including inflation) will rise from around \$314 currently to \$335 in 2023-24. The bill paid by each customer will vary depending on water use, prices for fixed and variable tariffs, and other charges.

From 2024-25, for major water and sewerage tariffs for residential and non-residential customers, prices will decrease by around 0.9 per cent per year, excluding inflation. Note that bills for residential tenants will be impacted by the progressive removal of a bill rebate over the 2023–28 regulatory period.

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

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

Customer group	Average consumption (kL p.a.)	2022-23 (current)	2023-24
		\$2022-23	\$2023-24
Residential – owner occupier	160	\$1,076	\$1,141
Residential – tenant	160	\$314	\$335
Non-residential (small)	300	\$1,723	\$1,827
Non-residential (medium)	3,000	\$12,827	\$13,603
Non-residential (large)	50,000	\$206,130	\$218,605

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

## **Barwon Water has committed to improving services in key areas**

Barwon Water plans to deliver the following outcomes for customers:

- Safe, secure, sustainable water
- Innovative, reliable services
- Healthier environment
- Trust, affordability and value.<sup>4</sup>

Among key initiatives to deliver on its commitments, through its capital works program Barwon Water will increase the resilience of its infrastructure to deal with challenges including climate change and population growth. It will also increase direct financial support for customers experiencing vulnerability and those affected by family violence. Building on its engagement, Barwon Water will take a caring-for-country approach to its land and waterways in partnership with Traditional Owners, other agencies and community members and continue its support for Traditional Owner self-determination.

These outcomes will be delivered by Barwon Water alongside falling (real) prices, indicating improved value for customers.

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<sup>4</sup> Barwon Water, 2023 water price submission, September 2022, pp. 62-63.

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

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

- its enhanced customer support programs will help address impacts of inflation on bills
- the proposed real price decrease in 2023-24 will protect customers from full inflation impacts
- it will not receive a revenue windfall from higher inflation, noting its analysis that its costs will increase by more than the consumer price index

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

### **Tariff structures will generally remain the same**

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

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

### **Barwon Water's price submission is rated as 'Advanced' under PREMO**

Consistent with our draft decision, our final decision is to rate Barwon Water's price submission as 'Advanced' under the PREMO framework (Table B). This is the same as Barwon Water's self-rating. Factors in support of Barwon Water's PREMO rating include that its engagement provided its customers with a high level of influence on its proposals, including through its 2-year

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<sup>5</sup> Barwon Water, Response to draft decision, May 2023, pp. 1-3.

deliberative process undertaken to develop its long-term strategy ‘Water for our future’, the recommendations from which were incorporated into proposed outcomes.

Barwon Water also proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (2 per cent), contributing to price reductions (excluding inflation). Most targets indicate Barwon Water will deliver improved service outcomes in the 2023–28 period, which along with a proposed reduction in (real) prices, indicates that customer value will be improved. It also provided a price submission that was of a high quality.

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



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

**Table B** PREMO rating

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Barwon Water’s self-rating	Advanced	Standard	Advanced	Leading	Advanced	Advanced
Commission’s rating	Advanced	Standard	Advanced	Leading	Advanced	Advanced



# 1. Our role and approach to water pricing

## 1.1 We are Victoria's independent economic regulator

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

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

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

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

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

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

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

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

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

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

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

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

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

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

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve Barwon Water's proposed prices.<sup>10</sup>

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



The power for water businesses to charge fees for services they provide is set out in the *Water Act 1989*.<sup>12</sup> These provisions in the Water Act also govern the process for and manner in which water businesses may set and impose fees. Each water business must ensure that it complies with these legislative requirements.<sup>13</sup>

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

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

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

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

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

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

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

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

Continued next page

**Table 1.1 (continued)**

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

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

## 1.4 PREMO

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

### Box 1.1 PREMO

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

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

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

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

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

Our PREMO framework rewards stronger customer value propositions in price submissions, and an early draft decision is available for price submissions we can assess in a short timeframe.<sup>14</sup>

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<sup>14</sup> In December 2022, we issued early draft decisions for Yarra Valley Water and Westernport Water.

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

Taking into account all five elements of PREMO, a water business must self-assess and propose a rating for its price submission as ‘Leading’, ‘Advanced’, ‘Standard’ or ‘Basic’. Its proposed return on equity will then reflect its proposed PREMO rating. A ‘Leading’ submission has the highest return on equity, and a ‘Basic’ submission the lowest. We assess the self-rating and also assess the price submission more broadly, including the water business’s justification for the proposed PREMO rating, and form our own view of the appropriate rating. This process determines the PREMO rating adopted and the return on equity reflected in the revenue requirement.<sup>15</sup>

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<sup>15</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 41–46.

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

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

- Barwon Water's price submission
- Barwon Water's presentation made directly to commissioners
- Barwon Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 28 April 2023<sup>16</sup>
- written submissions from interested parties (a list of submissions responding to our draft decision is provided in Appendix A).

Any reports, submissions or correspondence provided to us that are material to our consideration of Barwon 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. Barwon Water's price submission addressed each of these matters, and our initial assessment of those matters is set out in our draft decision.

We consulted on our draft decision, receiving submissions between 30 March and 9 May 2023 and holding an online public forum on 28 April 2023. Issues raised during the forum included affordability and environmental water flows, sustainability, and the commission's draft decision to adopt lower cost benchmarks than proposed by Barwon Water for specific projects, and price structures and signals. We have considered these matters for our final decision.

We acknowledge the concerns and comments raised in the forum and submissions related to managing water resources in a sustainable manner that enhances environmental water flows and promotes environmental sustainability. The framework for the management of environmental water flows and obligations related to environmental sustainability, as they apply to Victorian Water businesses, are set out in statutory instruments issued to them by government.

Bulk entitlements held by water businesses set out rules that water businesses must comply with about when, where and how much water can be taken from waterways, obligations to release flows for environmental uses, and how water can be used (among other things).<sup>17</sup>

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<sup>16</sup> A recording of this forum is available on our website.

<sup>17</sup> More information available at <https://www.water.vic.gov.au/planning/bulk-entitlements>.

The Statements of Obligations (General)<sup>18</sup> issued by the Minister for Water sets out guiding principles water businesses must follow when performing their functions to assist in the task of transitioning Victorian an environmentally sustainable economy, and to respond to the challenges of climate change. This also imposes obligations on water businesses in relation to providing their services, including obligations relating to management of water resources, minimising environmental impacts, and compliance with Sustainable Water Strategies.<sup>19</sup>

Water businesses are accountable to government for complying with these instruments and government expectations in relation to these instruments.

Our pricing framework and our guidance requires water businesses to ensure the revenue they propose in their price submissions incorporates the efficient cost of meeting legislative and government obligations.

Our final decision approves a revenue requirement, based on Barwon Water's expenditure proposals, that we consider are adequate for the business to deliver the outcomes it has determined are those valued by customers and the community, and its legal and regulatory obligations, including for environmental water and sustainability.

The expenditure benchmarks that we adopt for the key categories of prescribed services, and use to determine prices, do not represent the amount that a water business is required to spend or allocate to particular projects or activities within a prescribed service category.

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. Barwon Water will determine how to best manage the allocation of its revenue and prioritise its expenditure within a regulatory period. This includes responding to its obligations related to environmental water and sustainability.

Barwon Water provided a response to our draft decision, including a revised financial model that reflected the updated cost of debt and inflation figures we provided to businesses in May 2023.<sup>20</sup> In arriving at our final decision, we have also considered Barwon Water's responses to our draft decision.

This paper sets out our final decision.

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<sup>18</sup> The Statement of Obligations (General) was issued by the Minister for Environment, Climate Change and Water, on 20 December 2015, under section 41(2) of the *Water Industry Act 1994*, and is binding on all Victorian water businesses.

<sup>19</sup> [https://www.water.vic.gov.au/\\_\\_data/assets/pdf\\_file/0015/54330/Statement-of-Obligations-General.pdf](https://www.water.vic.gov.au/__data/assets/pdf_file/0015/54330/Statement-of-Obligations-General.pdf).

<sup>20</sup> All references to Barwon Water's price submission in this document refer to Barwon Water's original price submission that it provided to us in September 2022 rather than its response to our draft decision.



## 2.1 Final decision paper outline

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

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

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

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

## 2.2 Regulatory period

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

We are required to set the term of the regulatory period over which a water business's price determination will apply.<sup>21</sup> Our guidance proposed that we set a 5-year regulatory period, but also noted we were open to justified alternatives proposed in a price submission.<sup>22</sup>

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

In a submission on our draft decisions, the Consumer Action Law Centre supported our proposed 5-year regulatory period. It noted that a 5-year period provided customers with predictability around billing and services and that having a uniform period across all businesses included in our current review meant it would be easier to generate public awareness and engagement.<sup>23</sup>

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

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<sup>21</sup> This is a requirement of the WIRO, clause 9.

<sup>22</sup> For detail on the reasons for using 5 years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, p. 18.

<sup>23</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 Water Price Review*, 5 May 2023, p. 4.

## 3. Customer outcomes

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

This chapter outlines our views on:

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

### 3.1 Customer and community engagement

Our guidance required Barwon Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Barwon Water’s engagement.<sup>24</sup>

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

- commenced early and was informed by ongoing engagement activities since 2017
- was wide reaching and involved engagement with over 336,000 customers and community from across its geographical area
- used a range of suitable methods for effective and deeper participation
- was inclusive of First Nations people as well as people at risk of vulnerability.

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

- boosting financial assistance for customers experiencing vulnerability
- installing digital meters in areas that will benefit most from water efficiency measures
- developing new public open space as an environmental and cultural asset in response to its engagement with First Nations people, including regarding land management

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<sup>24</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 20. This guidance includes a focus on engagement by businesses with First Nations people and people experiencing vulnerability which are actions identified in our ‘Getting to fair’ strategy. See Essential Services Commission, *Getting to fair: Breaking down barriers to essential services*, August 2021.

- upgrading the quality of recycled water where there is willingness to pay a higher price for the service in order to expand the productive use of recycled water.

Our draft decision was to accept Barwon Water's 'Leading' self-rating for the Engagement element of PREMO on the basis it had designed and delivered a high-quality engagement program and achieved strong customer and stakeholder influence on the proposals in its submission. Examples outlined in our draft decision included:

- the integration of the outcomes of past engagement activities in its price submission engagement, specifically its 2018 Customer Support Strategy, its 4-year Regional Forum and its 2-year deliberative process undertaken to develop its long-term strategy 'Water for our future'
- the extent of the customer and community participation it was able to achieve, particularly across its various deliberative processes
- its meaningful engagement with First Nations people through its formal partnership with Wadawurrung Traditional Owners Aboriginal Corporation established for their involvement in Barwon Water's strategic projects.

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

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

## **3.2 Outcomes**

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

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

- Safe, secure, sustainable water
- Innovative, reliable services
- Healthier environment
- Trust, affordability and value.

Barwon Water's proposed measures and targets that it will use to report on its performance for each outcome are detailed on pages 48 to 51 of its price submission.

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

We considered its proposed set of outcomes for 2023–28 demonstrated an overall improvement in customer value and was consistent with the requirements of an ‘Advanced’ rating for the Outcomes element of PREMO. After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on Barwon Water’s outcomes.<sup>25</sup>

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

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

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

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

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

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

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

Barwon Water’s proposed service standards are the same as its service standards for the current regulatory period (with some wording changes to align with the updated Urban Water Industry Standard). The service levels proposed are the same, or in the cases of the average duration of

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<sup>25</sup> A submission from the Consumer Action Law Centre (CALC) commended all businesses for working closely with customers to develop their proposed outcomes set. Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2023.

planned water supply interruptions and average time to rectify a sewer blockage, an improvement on service levels for the current regulatory period.

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

These service standards and Barwon Water's targets until 2023 are set out in Appendix C.

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

### **3.4 Guaranteed service levels**

Our final decision is to adopt updated guaranteed service levels for Barwon Water as set out in Appendix D.

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

Barwon Water's proposed guaranteed service levels are set out on pages 53 and 54 of its price submission. As summarised in our draft decision, Barwon Water proposed to retain its existing four guaranteed services and to introduce a new guaranteed service level in relation to sewage spills. Barwon Water also proposed to continue to annually adjust its guaranteed service level rebates to reflect movements in the Consumer Price Index.

Our draft decision proposed to accept the guaranteed service levels proposed by Barwon Water on the basis that they had been developed with customers during its engagement.

The Consumer Acton Law Centre commented positively on Barwon Water's approach to increase the rebates associated with its guaranteed service levels (by adjusting annually for inflation).<sup>26</sup>

After releasing our draft decision, we identified an issue with Barwon Water's proposed guaranteed service levels. It proposed wording for the guaranteed service level relating to restriction and legal action that did not comply with the requirements of the Urban Water Industry Standard. We have therefore made a change to Barwon Water's wording of the mandatory guaranteed service level

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<sup>26</sup> Consumer Action Law Centre, Feedback on standard draft decisions: 2023 Water Price Review, 5 May 2023, p. 4.

relating to restriction and legal action, replacing the words ‘reasonable efforts’ (as proposed by Barwon Water), with ‘reasonable endeavours’ required in the Urban Water Industry Standard.<sup>27</sup>

On the basis of the above, our final decision is to adopt the updated guaranteed service levels outlined in Appendix D.

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

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<sup>27</sup> Clause 15.4 of the Urban Water Industry Standard specifies the requirements for reasonable endeavours.

## 4. Revenue requirement

The revenue requirement is the forecast amount a water business needs to deliver on customer outcomes, government policy, statements of obligations, and obligations monitored by technical regulators including the Environment Protection Authority Victoria and the Department of Health.<sup>28</sup> Along with forecast demand, it is an input to calculating prices.

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

Our final decision is to approve a revenue requirement of \$1,156.9 million.

Barwon Water proposed a revenue requirement of \$1,141.3 million over a 5-year period starting 1 July 2023. Our draft decision adopted a lower revenue requirement of \$1,137.9 million, mainly reflecting our proposed adjustments to forecast operating expenditure. Our final decision approves a revenue requirement of \$1,156.9 million (Table 4.1), which reflects our assessment of each element of the revenue requirement, including forecast operating and capital expenditure.

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<sup>28</sup> We met with officers of the Department of Energy, Environment and Climate Action, the Department of Health, and the Environment Protection Authority Victoria, to discuss their expectations of Barwon Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our final decision.

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

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	137.2	133.6	133.0	133.1	132.0	668.9
Return on assets	41.0	42.0	44.3	46.8	49.7	223.7
Regulatory depreciation	46.4	49.7	53.5	57.0	59.0	265.5
Non-prescribed offset of revenue requirement	-0.9	-0.3	-0.3	-0.5	-0.6	-2.6
Tax allowance	-	-	-	-	1.4	1.4
<b>Final decision – revenue requirement</b>	<b>223.7</b>	<b>224.9</b>	<b>230.5</b>	<b>236.4</b>	<b>241.5</b>	<b>1,156.9</b>

**Note:** Numbers have been rounded.

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

Barwon Water also updated its bulk water charges to reflect the latest information and, in response to our draft decision, updated its operating expenditure.

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

We received submissions in response to our draft decision which queried certain of the adjustments that we proposed in our draft decision however these submissions did not cause us to change our views on Barwon Water’s revenue requirement, those submissions and our views on the matters raised in those submissions are described in the relevant sections below.

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

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



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

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Barwon Water's proposed revenue requirement</b>	<b>221.6</b>	<b>224.2</b>	<b>228.1</b>	<b>231.0</b>	<b>236.3</b>	<b>1,141.3</b>
<b>B. Total adjustments proposed in our draft decision</b>	<b>3.7</b>	<b>-0.6</b>	<b>-2.0</b>	<b>-2.3</b>	<b>-2.2</b>	<b>-3.4</b>
Operating expenditure	3.5	-0.8	-2.2	-2.5	-2.4	-4.3
Return on assets	0.1	0.1	0.1	0.1	0.1	0.4
Regulatory depreciation	0.1	0.1	0.1	0.1	0.1	0.5
Tax allowance	-	-	-	-	0.1	0.1
<b>C. Draft decision – revenue requirement (C = A+B)</b>	<b>225.3</b>	<b>223.6</b>	<b>226.1</b>	<b>228.7</b>	<b>234.1</b>	<b>1,137.9</b>
<b>D. Total adjustments in our final decision</b>	<b>-1.6</b>	<b>1.2</b>	<b>4.4</b>	<b>7.7</b>	<b>7.4</b>	<b>19.1</b>
Operating expenditure	0.3	0.4	0.5	0.7	0.6	2.6
Return on assets	-1.9	0.8	3.8	7.0	10.1	19.9
Regulatory depreciation	-	-	-	-	-	-
Tax allowance	-	-	-	-	-3.4	-3.4
<b>E. Final decision – revenue requirement (E = C + D)</b>	<b>223.7</b>	<b>224.9</b>	<b>230.5</b>	<b>236.4</b>	<b>241.5</b>	<b>1,156.9</b>

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

## 4.1 Operating expenditure

Our final decision is to adopt a forecast operating expenditure of \$668.9 million for Barwon Water for the 2023–28 regulatory period.

Operating expenditure – comprising both controllable and non-controllable expenditure – is a component of the revenue requirement. Our draft decision proposed to adopt a forecast operating expenditure of \$666.4 million for the 5-year period, which was \$4.3 million lower than proposed by Barwon Water.

Table 4.3 sets out our final decision on Barwon Water’s forecast operating expenditure, for the purpose of establishing the revenue requirement outlined in Table 4.1.

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	120.90	117.43	116.91	117.24	116.50	588.98
<b>Non-controllable operating expenditure</b>	16.30	16.16	16.11	15.83	15.55	79.96
Bulk services <sup>a</sup>	6.56	6.74	7.00	7.01	7.01	34.32
Environmental contribution <sup>b</sup>	9.27	8.96	8.66	8.36	8.08	43.34
Licence fees – Essential Services Commission <sup>c</sup>	0.19	0.18	0.18	0.18	0.18	0.91
Licence fees – Department of Health <sup>c</sup>	0.08	0.08	0.08	0.08	0.08	0.39
Licence fees – Environment Protection Authority <sup>c</sup>	0.20	0.20	0.20	0.20	0.20	1.01
<b>Final decision – operating expenditure</b>	137.20	133.59	133.03	133.07	132.05	668.94

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

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

Table 4.4 sets out the adjustments we have made to controllable and non-controllable operating expenditure for our draft decision, and since our draft decision. Details of our assessment and the reasons for our final decision adjustments are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).

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

**Table 4.4 Our adjustments to Barwon Water’s operating expenditure for our draft and final decisions**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Barwon Water’s proposed total operating Expenditure</b>	<b>133.38</b>	<b>133.94</b>	<b>134.67</b>	<b>134.86</b>	<b>133.82</b>	<b>670.67</b>
A1 – Our draft decision adjustments to controllable operating costs	3.17	-1.09	-2.56	-2.63	-2.52	-5.63
A2 – Our draft decision adjustments to non-controllable operating costs	0.31	0.33	0.40	0.18	0.10	1.32
<b>B. Draft decision – total operating expenditure</b>	<b>136.87</b>	<b>133.17</b>	<b>132.52</b>	<b>132.41</b>	<b>131.40</b>	<b>666.37</b>
<b>C. Final adjustments to controllable operating costs (C1)</b>	<b>0.29</b>	<b>0.31</b>	<b>0.33</b>	<b>0.35</b>	<b>0.37</b>	<b>1.64</b>
C1 – 2023-24 State Budget updates	0.29	0.31	0.33	0.35	0.37	1.64

Continued next page

**Table 4.4 (continued)**

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>D. Final adjustments to non-controllable operating costs (D1 + D2 + D3 + D4 +D5)</b>	<b>0.04</b>	<b>0.11</b>	<b>0.18</b>	<b>0.32</b>	<b>0.28</b>	<b>0.93</b>
D1 – Environmental contribution	-0.05	-0.09	-0.13	-0.16	-0.20	-0.62
D2 – Licence fees – Essential Services Commission	0.01	0.00	0.00	-0.00	-0.00	0.01
D3 – Licence fees – Department of Health	-0.14	-0.14	-0.14	-0.14	-0.14	-0.68
D4 – Licence fees – Environment Protection Authority	0.12	0.12	0.12	0.12	0.12	0.60
D5 – External bulk water charges – Melbourne Water	0.10	0.21	0.32	0.50	0.50	1.63
<b>E. Final decision – total operating expenditure (E = B + C + D)</b>	<b>137.20</b>	<b>133.59</b>	<b>133.03</b>	<b>133.07</b>	<b>132.05</b>	<b>668.94</b>

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

#### **4.1.1 Controllable operating expenditure**

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

- We considered Barwon Water’s proposal reflects an efficient baseline cost to forecast annual operating expenditure after removing \$3.1 million for non-recurring items, and \$0.4 million for more expensive water sourced through the Melbourne to Geelong Pipeline (which should come under bulk charges in non-controllable operating expenditure).
- Barwon Water had proposed an efficiency improvement rate of 2.0 per cent per year which is one of the highest when compared to other businesses in the current price review.
- The efficiency improvement rate is marginally lower than Barwon Water’s proposed average cost growth rate of 2.1 per cent per year over the next regulatory period, effectively delivering a small net increase to its controllable annual baseline operating costs in each year of the regulatory period.

- We considered Barwon Water’s forecast cost adjustment additions were prudent and efficient after:
  - removing the proposed \$1.9 million for readiness investigations for future major water supply, but allowing \$0.85 million for an additional resource to perform initial investigations
  - adding back \$13.0 million for scheduled non-recurring costs which were taken out of the baseline.
- There is evidence that Barwon Water has significantly tested its controllable expenditure requirements.

Barwon Water accepted our proposed adjustments to its controllable operating expenditure. We received submissions from stakeholders on our draft decision regarding Barwon Water’s controllable operating expenditure.

Submissions from Friends of Barwon and People for a Living Moorabool (PALM) both raised concerns with our draft decision adjustment to remove \$0.4 million per year for additional water from the Melbourne to Geelong Pipeline, noting the pipeline is important to return water to the Moorabool catchment in the context of the Central and Gippsland Region Sustainable Water Strategy (this concern was also noted by a participant at our public forum on our draft decision).<sup>29</sup> We have considered this and maintain the view expressed in our draft decision that our adjustment does not impact the operation of the pipeline, as we considered these costs are recouped by Barwon Water from customers via its non-controllable operating expenditure forecasts, reflecting Melbourne Water’s bulk water charges to Barwon Water.

Friends of Barwon and PALM both supported Barwon Water’s proposal for \$1.9 million over the period to conduct readiness investigations for future major water supply augmentation and questioned our adjustment, given the future impacts of climate change and demand on local water sources (this issue was also raised at the public forum on our draft decision).<sup>30</sup>

To clarify, our draft decision adjustment reflected Barwon Water’s own amended cost forecast for this work, when it revised its proposal after our consultant queried the costing methodology of the original proposal. Barwon Water’s revised proposal provides \$0.85 million over the period for an additional full-time resource to advance this work, noting additional project costs incurred during the period might be capitalised for recovery in the following regulatory period. Barwon Water did not submit further information on this cost item in response to our draft decision. Accordingly, and

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<sup>29</sup> Friends of Barwon, *submission to the Essential Services Commission ‘Barwon Water draft decision: 2023 water price review’*, 10 May 2023; People for a Living Moorabool, *submission to the Essential Services Commission ‘Barwon Water draft decision: 2023 water price review’*, 10 May 2023.

<sup>30</sup> Friends of Barwon, *submission to the Essential Services Commission ‘Barwon Water draft decision: 2023 water price review’*; People for a Living Moorabool, *submission to the Essential Services Commission ‘Barwon Water draft decision: 2023 water price review’*.

consistent with our draft decision, our final decision is that the revised proposal from Barwon Water reflects a prudent and efficient cost forecast for this work to proceed.

Friends of Barwon also supported the East Barwon River willow tree removal project.

A submission from Mary Lush raised concerns with our consideration of environmental sustainability.<sup>31</sup> We note that Barwon Water had already included projects such as the East Barwon River willow tree removal in its operating expenditure forecasts for the next regulatory period, which have been incorporated in to the expenditure benchmarks in our final decision.

The submission also raised specific issues relating to water sources and flows for Lorne. It is the responsibility of Barwon Water to manage water sources and flows – we do not have powers related to water management. Our guidance required that water businesses must propose a revenue requirement that provides them with sufficient revenue to efficiently meet its legislative, regulatory and policy obligations.<sup>32</sup> We are limited to assessing the expenditure proposed by a water business in its price submission. Further, the expenditure benchmarks we adopt to determine prices do not represent the amount that the water business is required to spend or allocate to particular projects or activities. Rather, it represents assumptions about the overall level of expenditure that we consider sufficient to operate the business and to maintain or improve services over the regulatory period. Barwon Water will determine how to best manage the allocation of its revenue and priority of its expenditure within a regulatory period.

The submission by Mary Lush also noted the General Environmental Duty and our recognition of broad environmental responsibilities. On this, and as noted above, water businesses are required to propose a revenue requirement that provides them with sufficient revenue to efficiently meet legislative, regulatory and policy obligations, which includes legislation and matters administered by the Environment Protection Authority Victoria (which includes the General Environmental Duty).

Following release of the 2023-24 Victorian State Budget on 23 May, we wrote to water businesses to provide them with an opportunity to update their cost forecasts, should they seek to claim any additional costs and reflect these in customer prices.<sup>33</sup>

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<sup>31</sup> Mary Lush, *submission to the Essential Services Commission 'Barwon Water draft decision: 2023 water price review'*, 1 May 2023.

<sup>32</sup> The Statements of Obligations (General) issued by the Minister for Water includes obligations on water businesses relating to management of water resources, minimising environmental impacts, and compliance with any Sustainable Water Strategy. Bulk water entitlements may also specify a range of conditions and obligations on water businesses that include rules about when, where and how much water can be taken, and obligations about releasing flows for environmental users, for example.

<sup>33</sup> Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023.

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

On the basis that Barwon Water's proposed controllable operating expenditure is consistent with our guidance, our final decision is to accept Barwon Water's revised forecast controllable operating expenditure of \$588.98 million (Table 4.3).

#### 4.1.2 Non-controllable operating expenditure

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

- Barwon Water had mostly followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission.
- We identified that Barwon Water's proposed bulk water charges to be paid to Melbourne Water were not consistent with our latest annual tariff approval for Melbourne Water in 2022. Barwon Water subsequently submitted a revised financial model with updated forecast bulk charges that increased the total non-controllable operating expenditure by \$1.3 million over the next regulatory period.
- We verified that Barwon Water's revised forecast bulk charges were consistent with our latest annual tariff approval and Melbourne Water's 2021 price determination.

We noted in our draft decision that we would update the forecast non-controllable operating expenditure for our final decision, and also adjust for the latest inflation and external bulk charges data.<sup>34</sup>

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

People for a Living Moorabool noted in its submission the apparent decrease in the environmental contribution across each year of the next regulatory period.<sup>35</sup> The annual environmental contribution levy for each business is set by the department to be flat in nominal dollars – that is, dollars of the day for each year, rather than indexed to inflation. Our price model and approved prices use a \$2022-23 base, and actual inflation is then added each year. We therefore need to deflate the nominal values by a forecast inflation figure, in anticipation of the inflation adjustment to

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<sup>34</sup> Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

<sup>35</sup> People for a Living Moorabool, *submission to the Essential Services Commission 'Barwon Water draft decision: 2023 water price review'*, 10 May 2023.

prices across the regulatory period. All else being equal, our approach does not result in businesses under-recovering the cost of the environmental contribution.

We have assumed the licence fees for the Department of Health and the Environment Protection Authority Victoria remain flat in real terms across the period.<sup>36</sup> For our Essential Services Commission licence fee, we have taken our forecast fee estimate schedule, which is based on the expected work program across the 2023–28 regulatory period (which is in nominal dollars) and deflated it into 2022-23 dollars to express the fee in real terms.<sup>37</sup>

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

We have increased Barwon Water’s forecast non-controllable operating expenditure by \$0.93 million across the 2023–28 period, resulting from the following adjustments:

- \$0.08 million decrease for licence fees after considering the latest information received from the relevant regulatory authorities
- \$0.62 million decrease for the environmental contribution to account for the latest data on inflation.
- \$1.63 million increase for external bulk water charges as revised by Barwon Water to reflect the Melbourne Water Bulk Charges for 2023-24.

Accordingly, after considering all submissions received in response to our draft decision and consistent with the reasoning in our guidance, our final decision is to adopt a revised non-controllable operating expenditure of \$79.96 million over the next regulatory period.

## 4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$549.4 million.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Our draft decision proposed to adopt a forecast capital expenditure of \$549.4 million for the 5-year period, as proposed by Barwon Water.

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<sup>36</sup> For the Safe Drinking Water Administration levy, we have used the 2021-22 value provided by the Department of Health and indexed it by the annual rate for fees in 2022-23 (1.75 per cent), as set out by the Department of Treasury and Finance’s cost recovery guidelines (<https://www.dtf.vic.gov.au/financial-management-government/indexation-fees-and-penalties>). We have applied the same approach to the 2021-22 licence fee provided by the Environment Protection Authority Victoria.

<sup>37</sup> These fees are yet to be determined by the Minister for Water.



The reasons for our draft decision were:

- Barwon Water demonstrated it has adopted a reasonable approach to developing its capital program, and that its capital expenditure forecasts are prudent and efficient.
- We considered the planned capital expenditure program is achievable, given Barwon Water's past track record delivering its capital expenditure program.
- Barwon Water has an appropriate approach for managing expenditure associated with uncertain projects, excluding an estimated \$111.7 million of project costs from its price submission where there is uncertainty in timing, cost, scope and benefits of capital expenditure under its 'customer pays later' proposal. We reiterate that Barwon Water will need to demonstrate the prudence and efficiency of these costs if they are incurred during the 2023–28 regulatory period, if seeking to include them in the regulatory asset base for the 2028–33 price review.
- We considered Barwon Water's approach to forecasting its capital expenditure is consistent with the requirements of our guidance.

We have considered all submissions in response to our draft decision. Our final decision is to adopt a forecast capital expenditure of \$549.4 million for the 5-year period (Table 4.6), as proposed in our draft decision and for the same reasons proposed in our draft decision. We consider this benchmark is consistent with our guidance and the principles in the Water Industry Regulatory Order (2014). Our final decisions on Barwon Water's forecast regulatory asset base (Table 4.6) and revenue requirement (Table 4.1) reflect this benchmark.

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

## 4.3 Regulatory asset base

A water business's regulatory asset base is the value of the business's assets for regulatory purposes.<sup>38</sup> The regulatory asset base is used to estimate the return on assets (discussed in Section 4.4) and regulatory depreciation (discussed in Section 4.5). Both the return on assets and regulatory depreciation are components of the revenue requirement.

Our guidance required Barwon Water to propose:

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

### 4.3.1 Closing regulatory asset base

Our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$1,548.6 million.

We update the regulatory asset base to reflect actual gross capital expenditure, less government and customer contributions, and asset disposals for the period from 2017-18 to 2021-22.<sup>39</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>40</sup>

Our draft decision adopted a slightly higher closing regulatory asset base than proposed by Barwon Water due to adjustments we made to reflect its approved regulatory accounts for 2021-22. In response to our draft decision, Barwon Water updated the closing regulatory asset base in its financial model to align with our draft decision and its approved regulatory accounts.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. Therefore, our final decision is to approve a closing regulatory asset base at 30 June 2022 of \$1,548.6 million (Table 4.5).

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<sup>38</sup> These values were set initially for the water businesses by the Minister for Water and are adjusted on an ongoing basis to account for new investments, asset disposals, depreciation and inflation.

<sup>39</sup> See Section 4.2 for a discussion of Barwon Water's capital expenditure.

<sup>40</sup> Net capital expenditure is calculated by deducting government and customer contributions from gross capital expenditure. Customer contributions reflect revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

**Table 4.5 Final decision – closing regulatory asset base (RAB)**

\$ million 2022-23

	2017-18	2018-19	2019-20	2020-21	2021-22
<b>Opening RAB 1 July</b>	<b>1,524.8</b>	<b>1,533.9</b>	<b>1,569.5</b>	<b>1,581.5</b>	<b>1,571.8</b>
Plus gross capital expenditure	76.0	91.1	86.1	77.4	59.8
Less government contributions	-	-	-	-	3.5
Less customer contributions	19.1	12.3	15.7	12.4	11.9
Less proceeds from disposals	8.4	0.9	13.3	26.9	18.0
Less regulatory depreciation	39.3	42.2	45.1	47.7	49.6
<b>Closing RAB 30 June</b>	<b>1,533.9</b>	<b>1,569.5</b>	<b>1,581.5</b>	<b>1,571.8</b>	<b>1,548.6</b>

**Note:** Numbers have been rounded.

### 4.3.2 Forecast regulatory asset base

Our final decision is to approve the forecast regulatory asset base as set out in Table 4.6.

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

Our draft decision was to not accept Barwon Water's proposed forecast regulatory asset base for the period 2023-24 to 2027-28 due to adjustments we proposed to its closing regulatory asset base. Our draft decision proposed a forecast regulatory asset base that reflected our adjustments to Barwon Water's proposed closing regulatory asset base. In response to our draft decision, Barwon Water accepted these revised forecasts and updated the forecast regulatory asset base in its financial model to align with our draft decision.

Table 4.6 sets out our final decision on Barwon Water's forecast regulatory asset base from 1 July 2023, which is the same as that outlined in our draft decision.<sup>41</sup>

<sup>41</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

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

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

**Table 4.6 Final decision – forecast regulatory asset base (RAB)**

\$ million 2022-23

	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Opening RAB 1 July</b>	<b>1,548.6</b>	<b>1,553.7</b>	<b>1,612.6</b>	<b>1,652.3</b>	<b>1,693.0</b>	<b>1,723.2</b>
Plus gross capital expenditure	68.5	122.9	106.6	108.0	101.1	110.8
Less government contributions	0.5	3.4	2.9	-	-	-
Less customer contributions	10.9	13.3	13.4	13.6	13.6	13.5
Less proceeds from disposals	2.9	0.9	1.0	0.2	0.2	0.2
Less regulatory depreciation	49.1	46.4	49.7	53.5	57.0	59.0
<b>Closing RAB 30 June</b>	<b>1,553.7</b>	<b>1,612.6</b>	<b>1,652.3</b>	<b>1,693.0</b>	<b>1,723.2</b>	<b>1,761.4</b>

**Note:** Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our final decision approves Barwon Water’s proposed 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.<sup>42</sup>

Our draft decision accepted Barwon Water’s forecast for customer contributions because it was consistent with past outcomes and was calculated on a reasonable basis.

<sup>42</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water business’s water, sewerage or recycled water networks.

After considering all submissions received in response to our draft decision, and for the reasons set out above, our final decision approves the benchmark revenue from customer contributions proposed by Barwon Water and as set out in Table 4.6.

## 4.4 Rate of return

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

### 4.4.1 Cost of debt

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

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

In May 2023, we provided Barwon Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.<sup>43</sup> This reflects the rise in borrowing costs over the past 12 months. Barwon Water used this updated value to recalculate its revenue requirement.

For the above reasons, our final decision adopts the updated figures for the benchmark cost of debt as set out in Table 4.7.

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

**Table 4.7 Final decision – 10-year cost of debt**

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

**Note:** Numbers have been rounded.

<sup>43</sup> These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

## 4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.5 per cent in real terms, which reflects Barwon 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 Barwon Water's PREMO rating. As outlined in our guidance, the return on equity we adopt depends on a water business's self-rating and whether we accept that rating.

Our guidance included a matrix proposing the return on equity we would adopt, based on the combination of the business's self-rating and our rating.<sup>44</sup>

Barwon Water rated its price submission as 'Advanced'. Based on this PREMO self-rating, Barwon Water proposed a real return on equity of 4.5 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as 'Advanced'.<sup>45</sup>

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

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

Therefore, our final decision is to adopt Barwon Water's proposed return on equity of 4.5 per cent per year, reflecting our final decision on the overall PREMO rating of its price submission (see Chapter 7).

## 4.4.3 Long term inflation forecast

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

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

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<sup>44</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

<sup>45</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

calculated was 3.5 per cent.<sup>46</sup> All businesses adopted this amount to calculate prices in their responses to our draft decision. We checked this estimate again for our final decision, based on the method below.

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

Estimates we have adopted for each year of the 2023–28 regulatory period under the ‘RBA geometric mean’ approach are set out in Appendix E. Using the ‘RBA geometric mean’ approach we estimate an inflation rate of 3.8 per cent.<sup>47</sup>

For the ‘bond breakeven’ approach, we estimate a 5-year average rate of 3.3 per cent, with the estimates adopted for each year of the 2023–28 regulatory period also set out in Appendix E.<sup>48</sup>

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

However, to manage the risk that inflation falls well below our forecast, our price determinations include a provision that allows for a reconsideration of the inflation forecast adopted, if inflation falls below 2.5 per cent by 2026-27.<sup>49</sup> The updated inflation estimate, if needed, would be based on a 5-year averaging period.

## 4.5 Regulatory depreciation

Our final decision is to adopt a forecast regulatory depreciation as set out in Table 4.6.

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

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<sup>46</sup> The inflation rate adopted in our draft decision was 3 per cent.

<sup>47</sup> We have decided to use a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>48</sup> Similar to the ‘RBA geometric mean’ approach, we have adopted a rate of 7 per cent for 2023-24, because it is consistent with the rate used to inflate 2023-24 prices in our price determination.

<sup>49</sup> With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.

As indicated in our draft decision, Barwon Water’s forecast for regulatory depreciation was calculated using a straight-line depreciation profile, which is our preferred approach.<sup>50</sup> However, due to adjustments we proposed to its forecast regulatory asset base, our draft decision did not accept Barwon Water’s forecast regulatory depreciation.

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

We received no submissions from other stakeholders on this issue.

On that basis, our final decision is to approve the updated forecasts provided by Barwon Water in its response to our draft decision as they were calculated in a manner consistent with our guidance (see Table 4.6 in Section 4.3.2).

## 4.6 Tax allowance

Our final decision is to adopt a forecast tax allowance of \$1.4 million for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement.

Our draft decision adopted a forecast tax allowance of \$4.8 million over the 5-year period, which was slightly higher than the \$4.7 million proposed by Barwon Water and which reflected that we had adopted a lower revenue requirement than what Barwon Water had proposed. We required Barwon Water to provide an updated tax allowance forecast in its response to our draft decision.

In response to our draft decision, Barwon Water provided an updated forecast for its tax allowance that reflected changes to its revenue requirement. The updated estimate of Barwon Water’s tax liability is \$1.4 million, which is around \$3.4 million lower than we adopted in our draft decision (Table 4.2).

We consider Barwon Water’s updated estimates were calculated in a manner consistent with our guidance.

After considering all submissions received in response to our draft decision, and for the reasons set out above, our final decision adopts a forecast tax allowance of \$1.4 million for the 5-year regulatory period, as set out in Table 4.1.

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<sup>50</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.



## 5. Demand, tariffs and prices

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

### 5.1 Demand

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

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

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

In response to our draft decision, Barwon Water explained that its approach to demand forecasting included more datapoints than updated Victorian Government population and dwelling growth estimates – and has a closer alignment to actual property growth. It also noted that growth rates appear to align between its forecasting approach and the Victorian Government estimates. Further, Barwon Water's response said it had not noted any changes in demand per property. Accordingly, it proposed to continue to use the forecasts adopted in its price submission.

We accept Barwon Water's reasons and consider its demand forecasts were estimated consistently with the requirements of our guidance. Accordingly, our final decision is to accept Barwon Water's demand forecasts.

### 5.2 Form of price control

Our final decision is to approve Barwon Water's price cap form of price control.

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

After considering all submissions received in response to our draft decision, and for the reasons set out above, our final decision approves Barwon Water's proposed price cap form of price control.<sup>51</sup>

## 5.3 Tariff structures and prices

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

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

### 5.3.1 Tariff structures

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

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>52</sup> This recognises water businesses are often best placed to consider the interests of customers in designing tariffs, and that existing tariff structures have been developed over time to deal with a variety of local circumstances.

Our draft decision was to accept Barwon Water's proposal to retain its existing tariff structures, including:

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

For recycled water tariffs, Barwon Water proposed the following changes:

- a new tariff for Class B recycled water from the Portarlington Water Reclamation Plant
- transitioning to uniform tariffs to deliver Class C recycled water to customers from several smaller water reclamation plants

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<sup>51</sup> We note our determinations allow water business's flexibility to apply to change from a price cap to a weighted average price cap or tariff basket within a regulatory period.

<sup>52</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

- a single charge for the recycled water Class C at Bannockburn Water Reclamation Plant – which will mean either the same or lower prices for most customers, but an increase from \$97 to \$109 for some customers.

In our draft decision, we considered the two-part structure for water services will promote the efficient use of services and will send these customers a signal about the costs of their water use. We also considered that a two-part tariff structure is easy to understand and is an approach that is commonly applied in other states and territories.<sup>53</sup>

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

The Consumer Action Law Centre noted that the water businesses in our current review have generally proposed no changes in their tariffs, particularly the balance between fixed and variable charges. The Centre supported this outcome, given the impact on tenants when more weight is assigned to variable charges.<sup>54</sup> We consider that Barwon Water’s proposal retains such a balance.

At our public form on Barwon Water’s draft decision, a participant sought price signals that better reflects the true value of water, and consideration of inclining block tariffs. Similarly, a submission suggested that under the current price, there is precious little incentive to reduce water consumption.<sup>55</sup> This stakeholder had no objection to a price rise.

On these matters, we consider the two-part tariff structure proposed by Barwon 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.<sup>56</sup> We also consider two-part tariff structures are easy to understand. Further, there are trade-offs that need to be considered with inclining block tariff structures. For example, they can impact dwellings with larger numbers of occupants who may have little ability to reduce consumption. Moreover, quarterly billing periods means the bills alerting customers to consumption crossing over inclining block consumption thresholds are generally received well after the high consumption occurs, so the price signal to reduce consumption is weak.

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<sup>53</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>54</sup> Consumer Action Law Centre, *Feedback on standard draft decisions: 2023 water price review*, 5 May 2013, p.2.

<sup>55</sup> Mary Lush, *submission to the Essential Services Commission ‘Barwon Water draft decision: 2023 water price review’*, 1 May 2023.

<sup>56</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

Given Barwon Water's proposed tariff structures are a continuation of its current approach, and meet the requirements of our guidance, our final decision is to approve Barwon Water's proposed tariffs structures.

### 5.3.2 Prices

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

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

Following our draft decision, Barwon Water proposed revised prices that reflect the updates to our inflation and cost of debt estimates, and to bulk water charges (See Section 4.1). Barwon Water's revised prices also reflect changes to its revenue requirement as a result of its response to our draft decision and to changes announced in the Victorian State Budget (See Section 4.1).

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

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

From 2024-25, for major water and sewerage tariffs for residential and non-residential customers, prices will decrease by around 0.9 per cent per year, excluding inflation. Note that bills for residential tenants will be impacted by the progressive removal of a bill rebate over the 2023-28 regulatory period.

**Table 5.1 Final decision – water prices**

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Variable (\$/kL)	2.3635	2.3421	2.3209	2.2999	2.2791
Fixed (\$/year)	143.29	141.99	140.71	139.43	138.17
<b>Non-residential</b>					
Variable (\$/kL)	2.3635	2.3421	2.3209	2.2999	2.2791
Fixed (\$/year)	143.29	141.99	140.71	139.43	138.17

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

**Table 5.2 Final decision – sewerage prices**

\$ 2023-24

	2023-24	2024-25	2025-26	2026-27	2027-28
<b>Residential</b>					
Fixed (\$/year)	619.74	614.14	608.58	603.07	597.61
<b>Non-residential</b>					
Variable (\$/kL)	2.1035	2.0844	2.0656	2.0469	2.0283
Fixed (\$/year)	374.98	371.59	368.23	364.90	361.59

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

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

In making our price determination, we must have regard to whether Barwon Water’s prices take into account the interests of customers, including low income and vulnerable customers.<sup>57</sup>

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

- its tariffs reflect efficient costs for delivering services

<sup>57</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

- its tariffs were informed by an extensive customer engagement program, including with customer support agencies who represent customers experiencing vulnerability
- its proposed increase in the financial assistance available to customers through its customer support programs, including for renters who experience difficulty paying bills as the Transitional Rebate Adjustment is removed
- its proposal to increase in access to customer support through upgrades to its contact centre and investment in staff training.

After considering all submissions received following our draft decision, we have not changed our views expressed in our draft decision on how Barwon Water has addressed the interests of low income and vulnerable customers.

### 5.3.4 Other services

Barwon Water has confirmed its proposed tariffs for trade waste and miscellaneous services are calculated in accordance with the pricing principles referenced in our guidance. Given this, our final decision is to approve Barwon Water's proposed tariffs for trade waste and miscellaneous services.

## 5.4 New customer contributions

Our final decision is to accept Barwon Water's proposed new customer contributions and its 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 and designated by the water business. The purpose of standard new customer contributions is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.<sup>58</sup> Negotiated charges allow water businesses and developers to negotiate a site-specific arrangement where standard charges are not fair and reasonable or where a new connection is outside the areas eligible for standard charges.<sup>59</sup>

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<sup>58</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

<sup>59</sup> Essential Services Commission, *New customer contributions: explanatory note*, December 2013, p. 3.

Our draft decision considered that Barwon Water’s proposed new customer contributions complied with the requirements of our guidance and therefore proposed to accept Barwon Water’s proposal to:

- increase the standard water supply charge by 9.9 per cent for greenfield contributions and 9 per cent for infill contributions in 2023-24, with no further increases in real terms for the last 4 years of the regulatory period<sup>60</sup>
- reinstate standard new customer contributions for sewerage connections to reflect increased capital expenditure in sewerage services<sup>61</sup>
- continue applying area-specific water and sewerage charges for the Fyansford growth area, by contracts established under its negotiated new customer contributions framework<sup>62</sup>
- continue applying its negotiated new customer contributions framework.

We consider that Barwon Water has implemented its new customer contributions consistent with our guidance.

After considering all submissions received following our draft decision, and for the reasons set out above, our final decision is to approve Barwon Water’s proposed new customer contribution charges. We wish to highlight that, to the extent necessary, the new customer contribution framework allows water businesses and developers to negotiate new customer contribution in lieu of using the standard new customer contributions.

Regarding Barwon Water’s proposed negotiated new customer contribution framework, our draft decision accepted the framework. After considering all submissions received in response to our draft decision, our final decision remains the same as our draft decision. Our final decision is to accept Barwon Water’s negotiated new customer contribution framework because it is consistent with the requirements of the guidance.<sup>63</sup>

If there is a dispute between a developer and a water business (whether in relation to a standard or negotiated new customer contributions), developers may use the dispute resolution offered by a water business as part of its new customer contribution negotiating framework. In addition,

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<sup>60</sup> A development is considered infill if it can be serviced by existing infrastructure and does not trigger the need for a capacity upgrade.

<sup>61</sup> Barwon Water, *2023 water price review: Supporting Paper 7 - NCC tariff structure and prices*, 30 September 2022. The standard new customer contributions for sewerage connections had been removed from the 2018–23 regulatory period due to reduced capital expenditure.

<sup>62</sup> Barwon Water proposed to keep these charges unchanged in real terms during the 2023–28 regulatory period.

<sup>63</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 59.

developers may follow the Water Act 1989 process to object and seek internal review by the water business, and to pursue unresolved matters through the Victorian Civil Administrative Tribunal.<sup>64</sup>

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

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

#### **5.4.1.1 Current issues**

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

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

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

#### **5.4.1.2 Next steps**

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

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

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<sup>64</sup> Water Act 1989, section 271.



## 5.5 Adjusting prices

Our final decision is to approve Barwon Water's proposed price adjustment mechanisms.

Our draft decision accepted Barwon Water's proposed price adjustment mechanisms in relation to uncertain and unforeseen events.

Our draft decision proposed an adjustment mechanism that allows prices to change in response to changes in Melbourne Water's bulk water charges in order to support consistency across businesses. This mechanism was not initially proposed by Barwon Water in its price submission as its goal is to keep prices as low as possible and simplify the adjustment mechanisms.<sup>65</sup>

In its response to our draft decision, Barwon Water accepted our proposal, noting that it may choose not to pass the full impacts of changes through to customers if they result in higher customer prices.<sup>66</sup>

After considering all submissions received following our draft decision, our final decision approves Barwon Water's proposed price adjustment mechanisms, including in relation to Melbourne Water's bulk charges on the basis that they are generally a continuation of current arrangements, and otherwise satisfy the requirements of our guidance.

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<sup>65</sup> Barwon Water, 2023 water price review submission, 30 September, p. 90. This refers to Barwon Water's general proposal for its form of price control.

<sup>66</sup> Barwon Water, *submission in response to the Essential Services Commission 'Barwon Water draft decision: 2023 water price review'*, 8 May 2023, p. 4.

## 6. Financial position

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

In approving prices, we must have regard to the financial viability of the water industry.<sup>67</sup> We interpret the financial viability requirements under the *Essential Services Commission Act 2001* and the Water Industry Regulatory Order (2014) to mean that the prices we approve should provide a high level of certainty that each water business can generate sufficient cash flow to deliver on its service commitments, including financing costs arising from investments to meet service expectations.

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

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<sup>67</sup> WIRO clause 8(b)(ii) and ESC Act s.8A(1)(b).

## 7. PREMO rating

PREMO is an incentive mechanism that links the return on equity used to calculate a water business’s revenue requirement to that business’s level of ambition expressed in its price submission. Our guidance required Barwon Water to self-assess the level of ambition of its price submission for each element of the PREMO mechanism and arrive at an overall self-rating.<sup>68</sup> We required Barwon 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 Barwon Water to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control, and tariffs.

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

### 7.1 Our PREMO assessment of Barwon Water’s price submission

Our final decision is to rate Barwon Water’s price submission as ‘Advanced’ under PREMO, which is the same as Barwon Water’s self-rating.

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

**Table 7.1** PREMO rating

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

<sup>68</sup> This is the first price review we have done where the rating has been based on all five elements of PREMO. In our 2018 price review, our PREMO assessment was against only four of the elements — Risk, Engagement, Management and Outcomes.

After considering submissions received in response to our draft decision, our final decision is to agree with Barwon Water's proposed overall PREMO self-rating of 'Advanced'. This rating is reflected in the return on equity we have approved for Barwon Water (see Section 4.4.2).

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

In summary, the following matters support Barwon Water's self-rating of its price submission as 'Advanced':

- Barwon Water has generally met (or is on track to meet) its outcome commitments in the current regulatory period.
- Barwon Water has demonstrated accountability for not meeting some of its targets under the performance incentive mechanism it adopted at the 2018 water price review.
- Barwon Water's engagement provided its customers with a high level of influence on its proposals, including through its 2-year deliberative process undertaken to develop its long-term strategy 'Water for our future', the recommendations from which were incorporated into proposed outcomes.
- Barwon Water proposed one of the highest efficiency improvement rates for controllable operating expenditure over the next regulatory period (2 per cent), contributing to price reductions (excluding inflation).
- Barwon Water identified \$111 million of uncertain capital expenditure it had excluded from its prices under its 'customer pays later' proposal – these project costs will be carried by the business and included at the end of the regulatory period if they are incurred.
- While the financial model Barwon Water provided with its price submission needed some corrections to reflect its approved regulatory accounts, we found its submission generally was well presented and of a high standard.
- Most targets indicate Barwon Water will deliver improved service outcomes in the 2023–28 period, which along with a proposed reduction in (real) prices, indicates that customer value will be improved.

## Appendix A – Submissions received on draft decision

Name or organisation	Date received
Mary Lush	1 May 2023
Consumer Action Law Centre	5 May 2023
Barwon Water	8 May 2023
Friends of Barwon	8 May 2023
People for A Living Moorabool	9 May 2023
Registered Accommodation Association of Victoria	26 May 2023

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

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

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

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.<sup>69</sup> Our draft and final decisions provide further information on where we have considered our guidance, and Barwon Water’s compliance with our guidance, in making our price determination.<sup>70</sup>

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

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

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

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

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

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

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<sup>69</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>70</sup> Essential Services Commission, *Barwon Water draft decision: 2023 water price review*, 30 March 2023; Essential Services Commission, *Barwon Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable Barwon Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>71</sup>

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

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

We have had regard to this matter in Chapter 6.

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

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

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<sup>71</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.



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

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

## **Industry specific matters**

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

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

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

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

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

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

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

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

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

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

- indicative bills paid by customers in other jurisdictions in Australia<sup>72</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>73</sup>
- tariff structures applied by water businesses throughout Australia<sup>74</sup>
- the regulatory rate of return set by other regulators.<sup>75</sup>

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

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

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

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

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

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

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<sup>72</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

<sup>73</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>74</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>75</sup> Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW's rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water's water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

## Customer matters

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Appendix B – Commission’s consideration of legal requirements

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

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

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

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

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

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

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

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

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

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

## **Other matters**

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

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

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

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

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>76</sup>

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>77</sup>

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

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

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

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<sup>76</sup> Essential Services Commission 2016, *Water Pricing Framework and Approach, Implementing PREMO from 2018*, October, pp. 11–13.

<sup>77</sup> 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.<sup>78</sup>

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<sup>78</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.

## Appendix C – Service standards

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

### Water service standards – excluding flow rates

Service standard	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of unplanned water supply interruptions a customer may experience in any 12-month period	5	5	5	5	5
Average time taken to attend bursts and leaks (priority 1) (minutes)	27	27	27	27	27
Average time taken to attend bursts and leaks (priority 2) (minutes)	43	43	43	43	43
Average time taken to attend bursts and leaks (priority 3) (minutes)	226	226	226	226	226
Average duration of unplanned water supply interruptions (minutes)	125	125	125	125	125
Average duration of planned water supply interruptions (minutes)	165	165	165	165	165

### Water service standards – flow rates

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



## Sewerage service standards

Service standard	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of sewer blockages a customer may experience in any 12-month period	3	3	3	3	3
Average time to attend sewer spills and blockages (minutes)	53	53	53	53	53
Average time to rectify a sewer blockage (minutes)	150	150	150	150	150
Maximum time taken to contain a sewer spill (minutes)	300	300	300	300	300

## Appendix D – Guaranteed service level scheme

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

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

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

### Barwon Water’s guaranteed service level scheme

Service level obligation	Payment (\$)
We will not restrict water supply or take legal action against a customer prior to taking reasonable endeavours to contact the customer and provide information about help that is available if the customer is experiencing difficulties paying a bill	404
No more than five unplanned water supply interruptions per customer per year	88
No more than three unplanned sewerage service interruptions to a customer’s property per year	88
No more than two sewer spills on a customer’s property per year	675
No incidence of sewage spills inside a residential customer’s built premises, caused by Barwon Water or a failure in Barwon Water’s system(s)	1,000

Note: These payment amounts are expressed in \$2022-23. Barwon Water indicated at page 54 of its price submission that it will annually adjust these payment amounts to reflect movements in the Consumer Price Index to ensure they do not decline in real terms.

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

### Inflation – annual estimates (per cent)

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