

# Southern Rural 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.

### An appropriate citation for this paper is:

Essential Services Commission 2023, Southern Rural Water final decision: 2023 Water Price Review, 23 June

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# Summary

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

In April 2023, we released our draft decision on the price submission Southern Rural Water submitted to us in September 2022.<sup>1</sup> The draft decision set out our preliminary views on Southern Rural Water's proposals and invited interested parties to make further submissions. We also held a public forum in May 2023. In addition to a response by Southern Rural 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 Southern Rural Water's response, we have made a price determination for Southern Rural Water.<sup>2</sup> The price determination sets out the maximum prices Southern Rural 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 Southern Rural 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, *Southern Rural Water Determination: 1 July 2023 – 30 June 2028*, 23 June 2023.

## **We have approved a revenue requirement of \$179 million over 5 years**

Our final decision approves a revenue requirement of \$179 million over the 5-year period starting 1 July 2023 (see Chapter 4).<sup>3</sup> This is \$9.9 million or 5.8 per cent higher than our draft decision, which mainly reflects our correction for the treatment of its non-prescribed storage operator charges (Section 4.1.1). This correction does not affect customer prices.

This revenue requirement will allow Southern Rural 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.

## **Prices will rise from 1 July 2023**

Price rises for each year of the regulatory period will be capped at inflation for the majority of Southern Rural Water's customers. Table A shows the estimated price change for 2023-24 (including inflation), for customers in each of Southern Rural Water's irrigation districts.

**Table A Estimated price changes – by irrigation district (2023-24)**

<b>Irrigation district</b>	<b>Price change</b>
Bacchus Marsh Irrigation District customers	7.0 per cent
Groundwater and Rivers customers	7.0 per cent
Macalister Irrigation District customers	8.6 per cent*
Werribee Irrigation District customers	8.1 per cent*
Latrobe bulk entitlement holders	8.6 per cent*
Werribee and Maribyrnong bulk entitlement holders	9.1 per cent*

\* calculated using Fisher equation

As noted below, most of Southern Rural Water's tariffs are regulated under a revenue cap. This means the revenue Southern Rural Water can earn is fixed at the start of the regulatory period, but customer prices may vary annually – within pre-defined limits – so the business can meet its revenue requirement. The prices determined for 2023-24 are fixed, noting later prices can vary within the constraints of its revenue cap.

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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.

## **Southern Rural Water has committed to delivering outcomes that reflect customer priorities**

Southern Rural Water plans to deliver the following outcomes for customers:

- Reliable water supply
- Sustainable water
- Great service
- Community value
- Fair and reasonable prices.<sup>4</sup>

Among the key initiatives to deliver on its commitments, Southern Rural Water will continue to modernise its assets in the Macalister and Werribee districts. In term of its bills and prices it will manage price paths for irrigation customers at or close to inflation. It will also help reconnect Aboriginal communities to water for cultural, economic, customary and spiritual purposes.

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

Our draft decision sought further information from Southern Rural 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, Southern Rural Water noted:

- Under its proposal more than 86 per cent of its customers will see price increases capped at changes in the consumer price index.
- It has not been immune to increasing costs, noting that while salaries are being managed in accordance with its existing enterprise agreement and the government's wages policy, overall labour costs are further increasing due to labour market shortages and higher skill requirements.
- A number of costs including IT, electricity and insurance are rising by more than changes in the consumer price index.

More information is available in Southern Rural Water's response to our draft decision.<sup>5</sup>

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<sup>4</sup> Southern Rural Water, 2023 water price submission, September 2022, pp. 60–65.

<sup>5</sup> Southern Rural Water, *submission in response to the Essential Services Commission '[business name] draft decision: 2023 water price review'*, 9 May 2023, pp. 2-3.

## **Tariff structures will generally remain the same, with some changes**

Consistent with our draft decision, our final decision approves Southern Rural Water's proposed tariff structures because they are broadly a continuation of its existing approach; where it has proposed changes, our reasons for approving the new tariff structures are detailed below.

While generally its tariff structures remain unchanged, we have approved its proposals to:

- introduce four new charges (pre-application fees, site visits, peer review fees and public advertising fees) as they are in line with pricing principles and will contribute to a sustainable revenue stream
- remove the 5 per cent price cap on bulk entitlement charges and calculate the charges in accordance with the bulk entitlement orders, as this will allow actual costs to be recovered and is based on pricing principles
- move bulk entitlement charges, recreation charges, charges related to its recycled water scheme and the Latrobe resource management fee from the schedule of rural prices to the list of miscellaneous charges as it reflects pricing principles.

For its form of price control, Southern Rural Water proposed to continue with:

- price caps for application fees, transfers and renewals
- pricing principles for recycled water charges
- a revenue cap for the remainder of its annual fees and charges.

Consistent with our draft decision, our final decision is to accept Southern Rural Water's proposed form of price control as it meets the requirements of our guidance and largely reflects a continuation of current arrangements, with the changes to bulk entitlement charges allowing a more effective mechanism to recover these costs.

## **We have rated Southern Rural Water's price submission as 'Standard' under the PREMO framework**

Consistent with our draft decision, our final decision is to rate Southern Rural Water's price submission as 'Standard' under the PREMO framework (Table B). This is the same as Southern Rural Water's self-rating.

Factors in support of Southern Rural Water's PREMO rating are that:


- it has overall, met its outcome commitments for the period to date
- it has improved its engagement from its 2018 price review through the introduction of an independently facilitated customer reference group, providing additional assurance that

customer preferences were considered at every stage of the development of its price submission<sup>6</sup>.

- also it has justified its forecasts for operating and capital expenditure
- its proposed targets for its outcome measures suggest an overall improvement in customer value.

While we agree with Southern Rural Water’s overall rating, we have adopted a rating of ‘Basic’ for the Management element of PREMO rather than the ‘Standard’ proposed by the business.

See Section 1.4 for an explanation of the PREMO framework and Chapter 7 for more detail on our assessment of Southern Rural 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
Southern Rural Water’s self-rating	Standard	Standard	Standard	Advanced	Standard	Advanced
Commission’s rating	Standard	Standard	Standard	Advanced	Basic	Advanced

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<sup>6</sup> We received a submission on Southern Rural Water’s engagement, and we have addressed this in Section 3.1 and Chapter 7.



# 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>7</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.<sup>8</sup>

Southern Rural 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>7</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>8</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>9</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 Southern Rural 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 Southern Rural Water, to inform their price submissions. The guidance set out how we would assess Southern Rural Water's submission against the matters we must consider under clause 11 of the WIRO. It also outlined our expectation that Southern Rural Water would comply with certain requirements and specified information that Southern Rural Water must provide to us when submitting its price submission.<sup>10</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 Southern Rural Water's maximum proposed prices it can charge for the prescribed services it provides.<sup>11</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>12</sup>



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

<sup>9</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>10</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>11</sup> This is a requirement of the WIRO, clause 14(a).

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

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

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

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
<ul style="list-style-type: none"> <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*, 26 October 2021, pp. 41–46.

## 2. Our assessment of Southern Rural Water's price submission

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

- Southern Rural Water's price submission
- Southern Rural Water's presentation made directly to commissioners
- Southern Rural Water's responses to our queries and our draft decision
- our consultants' reports
- the views of participants in our public forum held on 1 May 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 Southern Rural 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. Southern Rural 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 6 April and 9 May 2023 and holding an online public forum on 1 May 2023. Themes raised during the forum included management of water flows and the effectiveness of Southern Rural Water's engagement under the PREMO framework. These matters are further discussed in Section 4.1.1 and Section 3.1 of this final decision.

Southern Rural 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>17</sup> In arriving at our final decision, we have considered Southern Rural Water's responses to our draft decision.

This paper sets out our final decision.

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

<sup>17</sup> All references to Southern Rural Water's price submission in this document refer to Southern Rural 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 Southern Rural Water has committed to over the regulatory period (Chapter 3).
- Establish Southern Rural 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 Southern Rural Water's financial position, which we have also had regard to.

Chapter 7 outlines our assessment of Southern Rural 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>18</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>19</sup>

Southern Rural 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>20</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>18</sup> This is a requirement of the WIRO, clause 9.

<sup>19</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*, 26 October 2021, p. 18.

<sup>20</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 Southern Rural 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:

- Southern Rural Water’s engagement with its customers in preparing its price submission (Section 3.1)
- whether Southern Rural Water has delivered on the outcomes it committed to for the current regulatory period (2018–23) and the customer outcomes Southern Rural Water is committing to for the next regulatory period (Section 3.2)
- Southern Rural Water’s service standards for the regulatory period (Section 3.3).<sup>21</sup>

### 3.1 Customer and community engagement

Our guidance required Southern Rural Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Southern Rural Water’s engagement.<sup>22</sup>

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

- began early and drew on insights gathered through ongoing engagement activities
- used a range of methods well suited to the context and was inclusive of the breadth of its customer base
- expanded its understanding of customer vulnerability and deepened its understanding of priorities of the Registered Aboriginal Parties of the lands it operates on
- covered matters that had a material impact on services and prices, including its investment priorities, service levels and performance measures, tariff reform options, and proposed price paths for each of its customer groups.

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<sup>21</sup> Guaranteed services levels are not applicable to rural water businesses and so are not addressed in this final decision.

<sup>22</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.

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

- managing price paths for irrigation customers at or close to inflation
- introducing new measures for reliable water supply and sustainable water
- merging its recycled water and river water products into a single tariff
- maintaining its existing expenditure on salinity and drainage services.

Our draft decision was to accept Southern Rural Water's 'Advanced' self-rating for the Engagement element of PREMO on the basis its engagement was highly robust and well suited to its operating environment and the context of the communities it operates across. Examples outlined in our draft decision included:

- that it built on established engagement with its three customer consultative committees and water forum and checked in with these groups at key points in its decision making process
- its wide engagement, which was supported by high quality materials clearly laying out the service price trade-offs customers could influence
- the level of stewardship it achieved through its high independently facilitated customer reference committee, and the assurance this group provided about how customer preferences were considered
- the strong endorsement it received from members of the customer reference group on the level of customer influence.

Feedback we received at the public forum and in written submissions raised concerns about the quality of Southern Rural Water's engagement on water flows, groundwater and environmental services.<sup>23</sup> A submission by People for a Living Moorabool reported an absence of community consultation by Southern Rural Water on environmental matters that inform its pricing submission. It noted Southern Rural Water's forum for consultation on ground water and rivers (its Groundwater and Rivers Forum) appeared to be entirely made up of customers, and no community representation.

Friends of Steele Creek sought Southern Rural Water establish a permanent presence in the Maribyrnong catchment to better support its engagement with the local community.<sup>24</sup>

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<sup>23</sup> People for a Living Moorabool, *submission to the Essential Services Commission 'Southern Rural Water draft decision: 2023 water price review'*, 9 May 2023.

<sup>24</sup> Friends of Steel Creek, *submission to the Essential Services Commission 'Southern Rural Water draft decision: 2023 water price review'*, 8 May 2023, p. 2.

Comments at the forum and in a written submission suggested that lack of representation of community was more consistent with a ‘Standard’ rating under the PREMO framework.<sup>25</sup>

Our framework promotes water business engagement with community in a number of ways.<sup>26</sup> In the case of Southern Rural Water’s, we agree with feedback that Southern Rural Water could have done more to engage with key community groups who hold a strong interest in environmental outcomes. We consider it could have done more to ensure these community groups had a reasonable fair opportunity to participate at a time it was developing its pricing proposals. Had it done so, Southern Rural Water may have been able to achieve the same high quality and meaningful engagement it achieved in other areas of its engagement.

We acknowledge Southern Rural Water’s commitment made during the public forum to improve its engagement with community groups, and feedback received at the forum that this improvement was underway.<sup>27</sup>

We recognise these perspectives raised by stakeholders and have weighed these against the significant factors in favour of an ‘Advanced’ rating and which we described in our draft decision and summarised above. Informing our draft decision was our assessment that Southern Rural Water had stepped up its engagement from its 2018 price review, including through the introduction of an independently facilitated customer reference group, the breadth of its overall engagement with customers, and the quality of its engagement materials.

Based on the above, our final decision is to accept Southern Rural Water’s self-rating of ‘Advanced’ for the Engagement element on PREMO. Further information on our PREMO assessment of Southern Rural Water’s price submission is included in Chapter 7 of this final decision.

## 3.2 Outcomes

In our draft decision, we agreed with Southern Rural 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.

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<sup>25</sup> Andrew Kelly, participant at the Essential Services Commission public forum on the Southern Rural Water draft decision, Water Price Review 2023, 1 May 2023. People for a Living Moorabool, *submission to the Essential Services Commission ‘Southern Rural Water draft decision: 2023 water price review’*, 9 May 2023.

<sup>26</sup> Our guidance requires water businesses to tailor their engagement to suit the content it is engaging on and the circumstances facing both customers and community. Among the criteria of our assessment of engagement is whether customers and others who are affected by the outcomes of the price submission were given reasonable and fair opportunity to participate. Our assessment includes the business’s justification for how it will address customer and community expectations that will not or cannot be met.

<sup>27</sup> John Forrester, participant comment, Southern Rural Water price review 2023 public forum, 1 May 2023; and Andrew Kelly, participant comment, Southern Rural Water price review 2023 public forum, 1 May 2023.

Southern Rural 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.

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

- Reliable water supply
- Sustainable water
- Great service
- Community value
- Fair and reasonable prices

Southern Rural Water's proposed measures and targets that it will use to report on its performance for each outcome are detailed on pages 60 to 65 of its price submission.

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 Southern Rural Water's outcomes.<sup>28</sup>

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

In response to our draft decision, Southern Rural Water amended its outcome measures and targets. We have worked with Southern Rural 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 Southern Rural 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.

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<sup>28</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.

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

Southern Rural 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 1.5 of the Water Industry Standard – Rural Customer Service (Rural 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 Southern Rural Water’s proposed service standards and the reasons that we considered they comply with the requirements of the Rural Water Industry Standard.

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

These service standards and Southern Rural Water’s targets until 2028 are set out in Appendix C

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

## 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>29</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 Southern Rural 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 Southern Rural 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 \$179 million.

Southern Rural Water proposed a revenue requirement of \$175.6 million over a 5-year period starting 1 July 2023. Our draft decision adopted a lower revenue requirement of \$169.1 million reflecting the removal of some operating costs that are recovered through non-prescribed storage operator charges (Section 4.1.1), and minor changes to align with Southern Rural Water's approved regulatory accounts (Section 4.3). Our final decision approves a revenue requirement of \$179 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>29</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 Southern Rural 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 Southern Rural Water’s revenue requirement**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	29.2	28.6	26.7	27.3	26.2	137.9
Return on assets	2.8	3.3	3.6	4.0	4.3	18.0
Regulatory depreciation	4.8	5.6	5.8	6.4	7.1	29.6
Non-prescribed revenue offset of revenue requirement <sup>a</sup>	-1.5	-1.5	-1.1	-1.3	-1.1	-6.5
Tax allowance	-	-	-	-	-	-
<b>Final decision – revenue requirement</b>	<b>35.3</b>	<b>36.0</b>	<b>35.0</b>	<b>36.3</b>	<b>36.5</b>	<b>179.0</b>

**Note:** Numbers have been rounded. <sup>a</sup> Southern Rural Water’s activities from non-prescribed services are set out on page 100 of its price submission.

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 Southern Rural 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.

In response to our draft decision, Southern Rural Water provided an updated revenue requirement to reflect the updates to inflation and the cost of debt, as well as addressing issues identified relating to non-prescribed activities. Southern Rural Water also updated its forecast operating expenditure to reflect changes announced in the 2023-24 Victorian State Budget (see Section 4.1). The correction in our final decision for the treatment of non-prescribed storage operator charges is the main reason for the increase in the revenue requirement in our final decision, noting this adjustment does not affect customer prices.

During consultation on our draft decision, some submissions raised issues regarding water management including environmental water flows and sustainability, and appropriate funding for Southern Rural Water to undertake compliance and other activities supporting sustainability and environmental outcomes.<sup>30</sup> The submissions also noted concern about the proposal in our draft decision to reduce Southern Rural Water’s revenue requirement.<sup>31</sup> Similar themes were raised at the public forum we held on our draft decision for Southern Rural Water on 1 May 2023.

<sup>30</sup> People for a Living Moorabool, submission to the Essential Services Commission ‘Southern Rural Water draft decision: 2023 water price review’, 9 May 2023, and Friends of Steele Creek, submission to the Essential Services Commission ‘Southern Rural Water draft decision: 2023 water price review’, 8 May 2023.

<sup>31</sup> The reasons in our draft decision for our proposal to reduce Southern Rural Water’s revenue requirement were not related to funding for the business to deliver on its regulatory obligations.

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>32</sup>

The Statements of Obligations (General) 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.<sup>33</sup> 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>34</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 Southern Rural Water's expenditure proposals, that we consider is 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. Southern Rural Water will determine how to best manage the allocation of its

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<sup>32</sup> More information available at <https://www.water.vic.gov.au/planning/bulk-entitlements>.

<sup>33</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>34</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).



revenue and prioritise its expenditure within a regulatory period. This includes responding to its obligations related to environmental water and sustainability.

The adjustments to Southern Rural 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. Southern Rural Water’s proposed revenue requirement</b>	<b>34.5</b>	<b>35.3</b>	<b>34.3</b>	<b>35.6</b>	<b>35.8</b>	<b>175.6</b>
<b>B. Total adjustments proposed in our draft decision</b>	<b>-0.8</b>	<b>-1.0</b>	<b>-1.3</b>	<b>-1.6</b>	<b>-1.8</b>	<b>-6.5</b>
Operating expenditure	-0.8	-1.1	-1.3	-1.6	-1.9	-6.6
Return on assets	0.0	0.0	0.0	0.0	0.0	0.1
Regulatory depreciation	0.0	0.0	0.0	0.0	0.0	0.1
<b>C. Draft decision – revenue requirement (C = A+B)</b>	<b>33.8</b>	<b>34.3</b>	<b>33.0</b>	<b>34.1</b>	<b>34.0</b>	<b>169.1</b>
<b>D. Total adjustments in our final decision</b>	<b>1.5</b>	<b>1.7</b>	<b>1.9</b>	<b>2.2</b>	<b>2.5</b>	<b>9.9</b>
Operating expenditure	1.3	1.3	1.3	1.3	1.3	6.6
Return on assets	-0.1	0.1	0.3	0.6	0.9	1.7
Regulatory depreciation	0.3	0.3	0.3	0.3	0.3	1.5
<b>E. Final decision – revenue requirement (E = C + D)</b>	<b>35.3</b>	<b>36.0</b>	<b>35.0</b>	<b>36.3</b>	<b>36.5</b>	<b>179.0</b>

**Note:** Row A shows the total revenue requirement proposed by Southern Rural Water in its price submission. Row B shows the total difference between our draft decision and what Southern Rural 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 \$137.9 million for Southern Rural 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 \$131.4 million for the 5-year period, which was \$6.6 million lower than proposed by Southern Rural Water.

Table 4.3 sets out our final decision on Southern Rural 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>	<b>24.73</b>	<b>24.47</b>	<b>24.21</b>	<b>23.96</b>	<b>23.71</b>	<b>121.08</b>
<b>Non-controllable operating expenditure</b>	<b>4.46</b>	<b>4.14</b>	<b>2.44</b>	<b>3.33</b>	<b>2.49</b>	<b>16.86</b>
Bulk services <sup>a</sup>	1.21	1.21	1.21	1.21	1.21	6.04
Environmental contribution <sup>b</sup>	0.51	0.49	0.48	0.46	0.45	2.39
Licence fees – Essential Services Commission <sup>c</sup>	0.03	0.03	0.03	0.03	0.03	0.13
Licence fees – Department of Health <sup>c</sup>	0.00	0.00	0.00	0.00	0.00	0.01
Other non-controllable costs <sup>d</sup>	2.70	2.41	0.73	1.63	0.81	8.28
<b>Final decision – operating expenditure</b>	<b>29.19</b>	<b>28.61</b>	<b>26.66</b>	<b>27.28</b>	<b>26.20</b>	<b>137.94</b>

**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. <sup>d</sup> These costs refer to immediately recoverable capital works for Latrobe power companies.

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 adjustments are included in Section 4.1.1 (controllable operating expenditure) and Section 4.1.2 (non-controllable operating expenditure).

Revenue requirement

The operating expenditure that we have adopted for Southern Rural Water does not represent the amount that Southern Rural 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 Southern Rural 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. Southern Rural Water’s proposed total operating expenditure</b>	<b>29.16</b>	<b>28.60</b>	<b>26.66</b>	<b>27.31</b>	<b>26.24</b>	<b>137.97</b>
A1 – Our draft decision adjustments to controllable operating costs <sup>a</sup>	-1.24	-1.24	-1.23	-1.24	-1.25	-6.20
A2 – Our draft decision adjustments to non-controllable operating costs	-0.05	-0.07	-0.08	-0.10	-0.11	-0.41
<b>B. Draft decision – total operating expenditure</b>	<b>27.86</b>	<b>27.29</b>	<b>25.35</b>	<b>25.97</b>	<b>24.88</b>	<b>131.36</b>
<b>C. Final adjustments to controllable operating costs (C1 + C2)</b>	<b>1.32</b>	<b>1.32</b>	<b>1.31</b>	<b>1.32</b>	<b>1.33</b>	<b>6.61</b>
C1 – Non-prescribed storage operator charges	1.24	1.24	1.23	1.24	1.25	6.20
C2 – 2023-24 State Budget updates	0.08	0.08	0.08	0.08	0.08	0.40

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)</b>	<b>0.00</b>	<b>-0.01</b>	<b>-0.00</b>	<b>-0.01</b>	<b>-0.01</b>	<b>-0.03</b>
D1 – Environmental contribution	0.00	0.00	-0.00	-0.00	-0.01	-0.01
D2 – Licence fees – Essential Services Commission	-0.00	-0.01	-0.00	-0.01	-0.01	-0.03
D3 – Licence fees – Department of Health	0.00	0.00	0.00	0.00	0.00	0.01
<b>E. Final decision – total operating expenditure (E = B + C + D)</b>	<b>29.19</b>	<b>28.61</b>	<b>26.66</b>	<b>27.28</b>	<b>26.20</b>	<b>137.94</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 disaggregated in rows C1 and C2 and D1 to D3) 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.

<sup>a</sup> Table 4.4 of our draft decision included an 'Annual productivity saving reconciliation' adjustment to controllable operating expenditure at row B2, which netted out to a very minor change across the period. These numbers did not actually represent an adjustment to Southern Rural Water's proposed operating expenditure, but a correction within its price submission financial model where its forecast operating expenditure did not reconcile across different sections of its financial model. There was in fact no change to these forecast figures resulting from our draft decision correction, and the total operating expenditure figures at row D in Table 4.4 in the draft decision are correct. The figures in Row A1 in our final decision show the corrected figures from rows B1 and B2 in our draft decision.

#### 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 Southern Rural Water's proposal reflected an efficient baseline cost to forecast annual operating expenditure after removing \$1.24 million of non-prescribed storage operator charges from its proposed 2021-22 baseline controllable operating expenditure, consistent with the approach taken in our 2018 final decision. However, we invited Southern Rural Water to provide further information on the revenue and costs associated with these non-prescribed storage operator charges, including proposing alternative treatments within our financial model.
- We identified that Southern Rural Water's financial model was inconsistent in its presentation of its forecast controllable operating expenditure in different sections of the model. While the totals across the 5-year period matched, the annual figures varied due to differing treatments of its annual productivity saving. This was subsequently corrected in a revised financial model

submitted by Southern Rural Water, consistent with the methodology set out in our guidance. There was no net change to its forecast arising from this correction.

- Southern Rural Water had not proposed any additional forecast operating expenditure above the annual baseline. Rather, Southern Rural Water had proposed an efficiency step change reduction of \$4.27 million over the regulatory period, or an average reduction of \$0.85 million per year.
- There is evidence that Southern Rural Water has significantly tested its controllable expenditure requirements.

In its response to our draft decision, Southern Rural Water provided further information on the treatment of its non-prescribed storage operator charges, clarifying these charges reflect the costs and revenues associated with government-owned water shares and environmental entitlements held by the Victorian Environmental Water Holder. Storage operator and bulk water services provided in relation to these water shares and entitlements are not prescribed services under the Water Industry Regulatory Order and are not regulated under the Water Industry Regulatory Order.<sup>35</sup> Services and charges in relation to these shares are negotiated between Southern Rural Water and the government. Services and charges in relation to environmental entitlements held by the Victorian Environmental Water Holder are set out in environmental entitlements and are also negotiated between the parties. Southern Rural Water has proposed, and the commission accepts, that costs and revenues from the services provided in relation to environmental entitlements should be treated the same as government-owned water shares.

Southern Rural Water proposed a clear and consistent approach for presenting these activities within our pricing model and the annual regulatory accounts.<sup>36</sup> It proposed that, for the purposes of both its price submission and its regulatory accounts:

- costs and services associated with government-owned water shares and environmental entitlements would be included in total controllable operating expenditure, and therefore within the benchmark forecast established for our final decision
- the prescribed revenue requirement would exclude costs and services associated with government-owned water shares and environmental entitlements

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<sup>35</sup> Storage operator and bulk water services are defined in clause 5 of the Water Industry Regulatory Order to mean 'a service provided by a regulated entity in connection with the provision of a supply to a regulated entity. The Victorian government is not a regulated entity as defined in the WIRO. The Victorian Environmental Water Holder is also not a regulated entity as referred to in the definition of these services in the WIRO. Services provided to the Victorian Environmental Water Holder EWH in relation to environmental water entitlements is also not a 'retail water service' as defined in the Water Industry Regulatory Order. Water under these entitlements is provided to the environment and not to a person as referred to in the definition of a 'retail water service' in the Water Industry Regulatory Order.

<sup>36</sup> Southern Rural Water, *submission in response to the Essential Services Commission 'Southern Rural Water draft decision: 2023 water price review'*, 9 May 2023, pp. 1-2.

- costs and services associated with government-owned water shares and environmental entitlements would be charged to the government and the Victorian Environmental Water Holder as non-prescribed revenue.

The approach proposed by Southern Rural Water in its response to our draft decision ensures other water customers do not contribute to the costs of the services in relation to government owned water shares and environmental entitlements.

Consistent with the approach noted above, and Southern Rural Water's response to our draft decision proposing to include the associated \$1.24 million of costs, we have added these costs back into the 2021-22 baseline controllable operating expenditure specified in our draft decision, and verified that the corresponding amount has been removed from Southern Rural Water's revenue requirement for the next regulatory period.

We agree with Southern Rural Water's proposed approach because:

- it gives a consistent and full account of operating costs for the storage facility, for easy comparison from year to year and across the regulatory period
- the revenue received for non-prescribed services is treated as non-prescribed revenue, effectively reducing the revenue requirement and ensuring prescribed customers do not incur these costs – we have verified this is the case in Southern Rural Water's financial model.

For these reasons, we accept Southern Rural Water's proposal to include \$1.24 million in the 2021-22 baseline relating to non-prescribed storage operator charges. Southern Rural Water provided updated figures for controllable operating expenditure reflecting this treatment and also our draft decision to remove \$0.01 million from its proposed baseline for 2021-22.<sup>37</sup> The inclusion of non-prescribed storage operator charges increases the controllable operating expenditure forecast across the 2023–28 regulatory period by \$6.2 million compared to the amount we adopted for our draft decision.

This means the controllable operating expenditure benchmarks for 2023–28 will include the full cost of operating these water storages. We reiterate that the services provided to government-owned water shareholders remain non-prescribed, and their charges must match the costs incurred on their behalf.

We also received a submission from People for a Living Moorabool that raised concerns about the impact of private dams on the Moorabool catchment. People for a Living Moorabool consider that a surge in the number and size of private dams over the last decade is having a significant impact on

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<sup>37</sup> Our draft decision on controllable operating expenditure also differed from the amount proposed by Southern Rural Water in its price submission, as our draft decision removed an annual productivity saving of \$0.01 million as an adjustment to Southern Rural Water's proposed baseline for 2021-22. Southern Rural Water accepted this adjustment and our final decision retains it.

the extent of inflows into the Moorabool River.<sup>38</sup> It considered this is detrimentally impacting the environmental and consumptive values of Moorabool River water, and also presents a challenge for sustainable water resource management and use. People for a Living Moorabool questioned whether Southern Rural Water has sufficient funding for the next regulatory period to manage, monitor and enforce compliance of potentially unauthorised private dam construction and enlargement within the Moorabool catchment.

In our draft decision, we noted that the revenue requirement proposed in a price submission must provide water businesses with sufficient revenue to meet all of its legislative, regulatory and policy obligations. This includes obligations to monitor water theft and extraction levels insofar as they relate to prescribed services in the WIRO.

Southern Rural Water is responsible for regulating certain types of private dams across southern Victoria. These are private dams built on a waterway. The *Water Act 1989* requires landowners to obtain a licence to construct, alter, repair, or decommission these types of private dams.<sup>39</sup> Certain types of large private dams that are not constructed on waterways also require a licence.<sup>40</sup> Southern Rural Water has responsibility to issue such licences as a delegate of the Minister for Water. It considers these licencing activities are prescribed services for the purposes of the WIRO and are subject to price regulation by the commission.

Smaller private dams, often referred to as stock and domestic dams, currently do not need a licence if they are not on a waterway and are smaller than the large private dams referred to above.<sup>41</sup> Activities undertaken in relation to these types of private dams are not considered a prescribed service for the purposes of the WIRO, and are not subject to price regulation by the commission.

Under the *Water Act*, Southern Rural Water is obliged to monitor and enforce private dam licensing requirements. Under a Letter of Expectations for 2023-24 issued by the Minister for Water, Southern Rural Water is required to apply a consistent, transparent and risk-based approach to managing all its compliance and enforcement activities.<sup>42</sup>

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<sup>38</sup> People for a Living Moorabool, *submission to the Essential Services Commission 'Southern Rural Water draft decision: 2023 water price review'*, 12 May 2023.

<sup>39</sup> Section 67 of the *Water Act 1989*.

<sup>40</sup> These types of dams are currently private dams that are: (a) 5 metres high at the wall with a capacity of 50 megalitres or more; (b) 10 metres high at the wall with a capacity of 20 megalitres or more; and (c) 15 metres high at the wall, regardless of capacity.

<sup>41</sup> <https://www.water.vic.gov.au/water-for-agriculture/taking-and-using-water/private-dam-licensing>.

<sup>42</sup> On 9 March 2023, the Minister for Water issued a Letter of Expectations to Southern Rural Water. This letter is intended to inform the development of Southern Rural Water's corporate plan for the forthcoming financial year and each of the four following financial years. It sets out the Minister for Water's expectations of Southern Rural Water in

Southern Rural Water funds its compliance activities in relation to licencing, including in relation to licenced private dams, through the licence fees it receives. As part of its price submission, the business has committed to the investment of a further \$200,000 per year for all its compliance activities. This was approved in our draft (and final) decisions.

As noted above, 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 (relating to prescribed services). Our final decision approves a revenue requirement, based on Southern Rural 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.

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>43</sup>

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

After considering all submissions received in response to our draft decision, on the basis that Southern Rural Water's updated controllable operating expenditure is consistent with our guidance, our final decision is to adopt a forecast controllable operating expenditure of \$121.08 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:

- Southern Rural Water had partially followed the approach set out in our guidance paper to forecast its non-controllable operating costs in its price submission, but had increased the environmental contribution in 2022-23 and held this flat in real terms rather than nominal terms for the next regulatory period.
- We requested Southern Rural Water to further explain why the proposed \$8.28 million immediately recoverable costs for Gippsland power company works are classified as non-controllable operating expenditure rather than capital expenditure.

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relation to 8 priority areas to be planned for and reported on in Southern Rural Water's corporate planning processes. The Letter of Expectations is publicly available but is not currently published anywhere. A copy of this can be obtained from Southern Rural Water.

<sup>43</sup> Victorian Government, *Budget papers '2023/24 State Budget papers'*, 23 May 2023.



In its response to our draft decision, Southern Rural Water advised that it operates Lake Narracan and Yallourn Weir on behalf of the Gippsland power companies who are the sole entitlement holders. Southern Rural Water also explained that its role is effectively that of a facilities manager, with all relevant expenditure associated with the ongoing operations and maintenance of these dams immediately recoverable from the entitlement holders.<sup>44</sup> We accept this explanation, which confirms these costs should not be treated as capital expenditure incurred by Southern Rural Water, nor as controllable operating expenditure. Accordingly, we consider that it is appropriate that these costs are treated as non-controllable operating expenditure, with a corresponding revenue stream from Gippsland power companies.

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>45</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.

We have assumed the licence fees for the Department of Health remain flat in real terms across the period.<sup>46</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>47</sup>

We have reduced Southern Rural Water's forecast non-controllable operating expenditure by \$0.03 million across the 2023–28 period, resulting from the following adjustments:

- \$0.02 million decrease for licence fees after considering the latest information received on the Department of Health and Essential Services Commission licence fees. We understand that Southern Rural Water has previously been charged an immaterial licence fee of under \$2,000 per year by the Department of Health.

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<sup>44</sup> Southern Rural Water, *submission in response to the Essential Services Commission 'Southern Rural Water draft decision: 2023 water price review'*, 9 May 2023, p. 3.

<sup>45</sup> Non-controllable costs are those that cannot be directly or indirectly influenced by a water business's decisions.

<sup>46</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>).

<sup>47</sup> These fees are yet to be determined by the Minister for Water.

- \$0.01 million decrease for the environmental contribution to account for the latest data on inflation.

Accordingly, consistent with the reasoning in our guidance paper, our final decision is to adopt a revised non-controllable operating expenditure of \$16.86 million over the next regulatory period.

## 4.2 Capital expenditure

Our final decision is to adopt a forecast capital expenditure of \$125.1 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 \$125.1 million for the 5-year period, as proposed by Southern Rural Water.

The reasons for our draft decision were that:

- Southern Rural 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 Southern Rural Water's past track record delivering its capital expenditure program.
- We considered Southern Rural 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 \$125.1 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 Southern Rural 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 Southern Rural Water does not represent the amount that Southern Rural 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 Southern Rural Water's revenue requirement, we are not requiring the business to remove that project. Southern Rural 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>48</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 Southern Rural 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 \$71.7 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>49</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>50</sup>

Our draft decision adopted a closing regulatory asset base of \$71.7 million at 30 June 2022. This was more than the \$71.2 million proposed by Southern Rural Water in its price submission due to adjustments we made to Southern Rural Water's capital contributions and proceeds from disposals to align with 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 \$71.7 million (Table 4.5).

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<sup>48</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>49</sup> See Section 4.2 for a discussion of Southern Rural Water's capital expenditure.

<sup>50</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>49.4</b>	<b>61.2</b>	<b>72.4</b>	<b>91.1</b>	<b>73.6</b>
Plus gross capital expenditure	35.7	53.8	29.8	15.7	10.5
Less government contributions	17.5	27.6	3.7	21.7	4.6
Less customer contributions	0.6	9.5	1.7	0.4	0.6
Less proceeds from disposals	0.8	1.3	0.4	5.0	0.6
Less regulatory depreciation	5.1	4.3	5.2	6.0	6.6
<b>Closing RAB 30 June</b>	<b>61.2</b>	<b>72.4</b>	<b>91.1</b>	<b>73.6</b>	<b>71.7</b>

**Note:** Numbers have been rounded.

### 4.3.2 Forecast regulatory asset base

Our final decision is to adopt a 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 adopted a forecast regulatory asset base that was higher than proposed by Southern Rural Water, mainly due to our proposed adjustments to its closing regulatory asset base.

In response to our draft decision, Southern Rural Water revised its financial model to reflect our adjustments to its closing regulatory asset base. The change to its regulatory depreciation resulted in a decrease of \$1.5 million in the forecast regulatory asset base over the regulatory period, compared to the forecast that we adopted in our draft decision.

Table 4.6 sets out our final decision on Southern Rural Water's forecast regulatory asset base from 1 July 2023.<sup>51</sup>

<sup>51</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

Our final decision on Southern Rural 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>71.7</b>	<b>102.8</b>	<b>129.3</b>	<b>141.3</b>	<b>148.5</b>	<b>158.5</b>
Plus gross capital expenditure	53.8	48.4	25.3	16.8	19.6	15.1
Less government contributions	12.1	13.8	4.4	0.4	-	-
Less customer contributions	2.7	2.5	2.5	2.5	2.5	2.5
Less proceeds from disposals	0.8	0.8	0.8	0.8	0.8	0.8
Less regulatory depreciation	7.0	4.8	5.6	5.8	6.4	7.1
<b>Closing RAB 30 June</b>	<b>102.8</b>	<b>129.3</b>	<b>141.3</b>	<b>148.5</b>	<b>158.5</b>	<b>163.1</b>

**Note:** Numbers have been rounded.

#### 4.3.2.1 Customer contributions

Our final decision is to accept Southern Rural Water’s forecasts for revenue from customer contributions, which is the same as that proposed by Southern Rural Water.

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>52</sup>

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.

<sup>52</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water business’s; water, sewerage or recycled water networks.

Unlike urban water businesses, where customer contributions to capital are mostly a result of standard new customer contribution charges, Southern Rural Water does not generate contributions from customer contribution charges.

For Southern Rural Water, customer contributions represent the expected proceeds from the sale of created water entitlements in the Macalister Irrigation District. We reviewed Southern Rural Water's forecast customer contributions and consider that they have been estimated in a manner consistent with our guidance.

After considering all submissions received in response to our draft decision, our final decision is the same as our draft decision. For the reasons set out above, our final decision is to accept Southern Rural Water's forecasts for customer contributions as set out in Table 4.6.

## 4.4 Rate of return

In establishing the return on assets component of Southern Rural Water's revenue requirement, we have applied a rate of return to Southern Rural 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 Southern Rural Water to calculate its revenue requirement.

Our draft decision approved the cost of debt proposed by Southern Rural 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 Southern Rural Water with an updated cost of debt value from 3.75 per cent to 6.76 per cent for 2022-23.<sup>53</sup> This reflects the rise in borrowing costs over the past 12 months. Southern Rural 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.

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<sup>53</sup> These updated figures were based on data from Treasury Corporation Victoria on the actual trailing average cost of debt for 2022-23.

**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.

#### 4.4.2 Return on equity

Our final decision is to adopt a return on equity of 4.1 per cent in real terms, which reflects Southern Rural 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 Southern Rural 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>54</sup>

Southern Rural Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Southern Rural Water proposed a real return on equity of 4.1 per cent per year. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.<sup>55</sup>

Our draft decision adopted Southern Rural 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 Southern Rural Water’s overall PREMO rating remains the same as our draft decision. Therefore, our final decision is to adopt Southern Rural Water’s proposed return on equity of 4.1 per cent per year, reflecting our final decision on the overall PREMO rating of its price submission (see Chapter 7).

#### 4.4.3 Long-term inflation forecast

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

<sup>54</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

<sup>55</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

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

In addition to updating our estimate for the cost of debt, in May 2023 we also updated businesses on our long-term inflation forecast. We advised businesses that the long-term inflation rate we calculated was 3.5 per cent.<sup>56</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>57</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>58</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>59</sup> The updated inflation estimate, if needed, would be based on a 5-year averaging period.

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<sup>56</sup> The inflation rate adopted in our draft decision was 3 per cent.

<sup>57</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>58</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>59</sup> With inflation measured by the Australian Bureau of Statistics Consumer Price Index – all groups.



## 4.5 Regulatory depreciation

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

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

As indicated in our draft decision, Southern Rural Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile and in a manner consistent with our guidance.<sup>60</sup> However, due to adjustments we proposed to its forecast regulatory asset base, our draft decision did not accept Southern Rural Water's forecast regulatory depreciation. Our draft decision on Southern Rural Water's forecast regulatory depreciation reflected the asset lives proposed by Southern Rural Water but was based on our draft decision on its forecast regulatory asset base.

In response to our draft decision, Southern Rural Water accepted our adjustments to regulatory depreciation resulting from our changes to the forecast regulatory asset base, but also identified that the regulatory depreciation figures we adopted in our draft decision did not appear to be based on the most recent data provided by the business. The updated forecast provided by Southern Rural Water corrected for this.

Our final decision is to accept the updated regulatory depreciation figures because they were calculated in a manner consistent with our guidance.

As a result, the forecast regulatory depreciation we have approved in our final decision is \$1.5 million higher over the 5-year regulatory period than the amount we adopted to calculate the revenue requirement in our draft decision.

## 4.6 Tax allowance

Our final decision is to adopt Southern Rural Water's forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Our draft decision was to accept Southern Rural Water's proposed forecast of no tax allowance for the 2023–28 regulatory period as it was calculated consistently with the method required by our guidance.<sup>61</sup>

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision accepts Southern Rural Water's tax allowance as set out in Table 4.1.

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<sup>60</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 39.

<sup>61</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 47–48.

## 5. Demand, tariffs and prices

Once Southern Rural 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 Southern Rural Water's demand forecasts.

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

In our draft decision, we proposed to accept Southern Rural Water's demand forecasts as we considered they were estimated in a manner consistent with the requirements of our guidance.

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 Southern Rural Water's demand forecasts because they were estimated consistently with the requirements of our guidance.<sup>62</sup>

### 5.2 Form of price control

Our final decision is to accept Southern Rural Water's proposed hybrid revenue cap form of price control.

Our draft decision accepted Southern Rural Water's proposal to retain a hybrid revenue cap form of price control. This includes some minor changes to current arrangements, which we considered in line with our pricing principles and consistent with the requirement of our guidance.

After considering all submissions received in response to our draft decision, for the above reasons, our final decision confirms our draft decision and approves Southern Rural Water's hybrid revenue cap form of price control.

### 5.3 Tariff structures and prices

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

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<sup>62</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 47-48.

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

### 5.3.1 Tariff structures

Our final decision is to accept Southern Rural 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>63</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 Southern Rural Water's proposal to retain its existing tariff structures with the following changes:

- the introduction of four new charges – pre-application fees, site visits, peer review fees and public advertising fees – to address historic under-recovery of costs associated with applications as they are in line with pricing principles and will contribute to a sustainable revenue stream<sup>64</sup>
- modification of its bulk entitlement charges and its Latrobe resource management fee
- moving its bulk entitlement charges, recreation charges<sup>65</sup>, Latrobe resource management fee and its charges relating to its recycled water scheme from the schedule of rural prices to the list of miscellaneous charges.

In our draft decision, we also accepted Southern Rural Water's proposal to remove the 5 per cent price cap that currently applies to its bulk entitlement charges and calculate charges in accordance with the various bulk entitlement orders, which are based on a cost reimbursement model, as this will allow actual costs to be recovered and is based on pricing principles.

We considered Southern Rural Water's proposed tariffs will allow it to recover revenue sufficient to cover efficient costs.

For the reasons set out above in relation to the proposed changes, and because the balance of the proposed tariff structures are a continuation of its current approach, our final decision is to approve Southern Rural Water's proposed tariffs structures.

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<sup>63</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 51.

<sup>64</sup> Southern Rural Water stated in its price submission that it will not apply these charges without knowledge and consent of customers.

<sup>65</sup> Note that these charges are not prescribed services under the Water Industry Regulatory Order 2014, and as such, the commission does not have the power to set maximum charges for them. Prior to our draft decision, we considered information provided by Southern Rural Water on how it allocates costs between headworks (a prescribed service) and recreational facilities (a non-prescribed service) in the Blue Rock Reservoir, Cowwarr Weir and Lake Glenmaggie areas. We reviewed Southern Rural Water's approach and consider it to be reasonable.

### 5.3.2 Prices

Our final decision is to accept Southern Rural Water’s proposed prices.

Our draft decision recognised that Southern Rural Water is best placed to consider the interests of its customers in designing tariffs. In our draft decision, we indicated that Southern Rural Water would need to demonstrate how it has considered the impacts of inflation on its forecast expenditure in 2023-24, and additionally propose updated prices to reflect our draft decision on its revenue requirement.

In response to our draft decision, Southern Rural Water outlined the impact of inflation on its forecast expenditure and its approach to passing through changes in the consumer price index to customers. Southern Rural Water also provided an updated revenue requirement in response to our draft decision, but as the main reason for the change was related to the treatment of non-prescribed storage operator charges, no adjustment was required to customer prices.

Our final decision is to approve Southern Rural Water’s proposed prices because they have been calculated in a manner consistent with our guidance. Table 5.1 shows the estimated price change for 2023-24, for customers in each of Southern Rural Water’s irrigation districts.

Our price determination for Southern Rural 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).

**Table 5.1 Estimated price changes – by irrigation district (2023-24)**

Irrigation district	Price change
Bacchus Marsh Irrigation District customers	7.0 per cent
Groundwater and Rivers customers	7.0 per cent
Macalister Irrigation District customers	8.6 per cent*
Werribee Irrigation District customers	8.1 per cent*
Latrobe bulk entitlement holders	8.6 per cent*
Werribee and Maribyrnong bulk entitlement holders	9.1 per cent*

\* calculated using Fisher equation

As noted in Section 5.2, our final decision approves a revenue cap form of price control. The majority of Southern Rural Water’s annual charges will continue to be subject to a revenue cap. This means the revenue Southern Rural Water can earn is fixed at the start of the regulatory period, but customer prices may vary annually – within pre-defined limits – so the business can

meet its revenue requirement. The prices determined for 2023-24 are fixed, noting later prices can vary within the constraints of its revenue cap.

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

In making our price determination, we must have regard to whether Southern Rural Water's prices take into account the interests of customers, including low income and vulnerable customers.<sup>66</sup>

As outlined in our draft decision there is evidence that Southern Rural Water has sought to address the interests of low income and vulnerable customers because Southern Rural Water proposed to cap prices to inflation for more than 86 per cent of its customers, and prices are directly aligned with proposed expenditure. Southern Rural Water identified through its engagement that its customers, who are predominantly commercial entities, value the profitability of their own operations over affordability (meaning that they may be willing to pay more to receive a water supply more suited to their needs). We accept that Southern Rural Water's proposed prices will allow the business to deliver on the outcomes agreed with its customers.

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

### **5.3.4 Other services**

As indicated in our draft decision, Southern Rural Water has confirmed that its proposed tariffs for recycled water and miscellaneous services are calculated in accordance with the pricing principles referenced in our guidance.

After considering all submissions received in response to our draft decision, for the reasons set out above, our final decision accepts Southern Rural Water's proposed tariffs for recycled water and miscellaneous services.

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<sup>66</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

## 5.4 Adjusting prices

Our final decision is to accept Southern Rural Water's proposed price adjustment mechanisms.

As indicated in our draft decision, Southern Rural Water did not propose any changes to its current price adjustment mechanisms.

Our final decision is to accept Southern Rural Water's proposal to continue its existing price adjustment mechanisms as they satisfy the requirements of our guidance and are a continuation of its existing approach.

## 6. Financial position

We have reviewed key indicators of Southern Rural Water's financial performance and consider that Southern Rural 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 Southern Rural Water's prices. We have assessed that under our final decision, Southern Rural 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 Southern Rural 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 Southern Rural 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 Southern Rural 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 Southern Rural Water's price submission. As outlined in our guidance, the combination of Southern Rural Water's self-rating and our rating has determined the return on equity we have adopted to calculate Southern Rural Water's revenue requirement in our final decision.

### 7.1 Our PREMO assessment of Southern Rural Water's price submission

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

Southern Rural 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 Southern Rural Water's price submission.

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<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.



**Table 7.1**      **PREMO rating**

	Overall PREMO rating	Performance	Risk	Engagement	Management	Outcomes
Southern Rural Water’s self-rating	Standard	Standard	Standard	Advanced	Standard	Advanced
Commission’s draft decision rating	Standard	Standard	Standard	Advanced	Basic	Advanced
Commission’s final decision rating	Standard	Standard	Standard	Advanced	Basic	Advanced

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

After considering submissions in response to our draft decision, our final decision is to agree with Southern Rural Water’s proposed overall PREMO self-rating of ‘Standard’ for the reasons set out below. This rating is reflected in the return on equity we have approved for Southern Rural Water (see Section 4.4.2).

### 7.1.1 Engagement

In response to our draft decision, we received feedback from stakeholders which sought improvements in how Southern Rural Water engages with community impacted by its services and questions whether it had earned its ‘Advanced’ PREMO rating.

We have considered the observations made by People for a Living Moorabool in its submission and at the public forum held in May 2023.

As highlighted in our guidance, we agree that water businesses should engage with the community or parts of the community in the development of its price submission.<sup>69</sup> We agree with the People for a Living Moorabool, that Southern Rural Water can improve its engagement with key community groups in the development of its pricing proposals. We have considered this alongside the significant factors in favour of an ‘Advanced’ rating and we do not consider that it is appropriate to downgrade Southern Rural Water’s rating. As indicated earlier, Southern Rural Water stepped up its engagement from its 2018 price review, including through the introduction of an independently facilitated customer reference group, the breadth of its overall engagement with customers, and the quality of its engagement materials.

We remain of the view, as set out in our draft decision; that Southern Rural Water’s price submission engagement demonstrated a step up in its engagement and is appropriately rated as

<sup>69</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p.20.

‘Advanced’. We expect that any future step up would include more expansive engagement with community on environmental outcomes relevant to its pricing submission.

### 7.1.2 Management

Southern Rural Water’s response to our draft decision noted that it welcomed the commission’s overall assessment of its price submission as ‘Standard’ but sought reconsideration of the commission’s rating of the Management element of PREMO as ‘Basic’.

It pointed to aspects of its submission that supported its Management self-rating as ‘Standard’, such as its justification for the prudence and efficiency of proposed expenditure that are reflected in its prices, commitment to cost efficiency, and senior level ownership of the submission. We agree these factors support its overall PREMO rating and promote good outcomes for customers.

Southern Rural Water’s response to our draft decision also stated that a principal area of concern in the commission’s assessment appeared to be the treatment of non-prescribed costs.

Southern Rural Water’s response to our draft decision explained that it considers that its treatment of certain costs as non-prescribed costs was not an error but was the result of uncertainty and inconsistency regarding how non-prescribed costs have been treated in previous price submissions and regulatory accounts and in its price submission for this price review. This matter is discussed in more detail in Section 4.1.1, and we agree with Southern Rural Water’s observation that this was not an error.

Following the release of our draft decision, Southern Rural Water has worked with us to clarify and resolve the treatment of these non-prescribed costs. The business has worked proactively and cooperatively to address this issue and more generally since the release of our draft decision.

We also acknowledge the overall quality of Southern Rural Water’s proposal for its customers which we have reflected in our agreement with its proposed self-rating of ‘Standard’ for its price submission.

However, the treatment of the non-prescribed costs noted above was one factor in our decision to adopt a rating of ‘Basic’ for the management element of PREMO, which also included some changes to the model issued by the commission, and time taken to resolve queries associated with the regulatory accounts. We agree with the business’s observation in its response to our draft decision that these matters were relatively minor and did not have a material impact on pricing. However, we note that changes to the model can impede our review process these issues did take time for us to explore and resolve, adding to the complexity of our review process. Accordingly, our final decision is to rate the Management element of PREMO as ‘Basic’, consistent with our draft decision.

### 7.1.3 Other matters

We consider that the following matters support the rating of Southern Rural Water's price submission as 'Standard':

- we agree with Southern Rural Water's self-assessment that it has, overall, met its outcome commitments for the period to date
- Southern Rural Water's delivery of major projects compares favourably to other water businesses
- Southern Rural Water has justified its forecasts for operating expenditure and capital expenditure
- Southern Rural Water's proposed targets for its outcome measures suggest an overall improvement in customer value.

## Appendix A – Submissions received on draft decision

Name or organization	Date received
Consumer Action Law Centre	5 May 2023
Friends of Steele Creek	8 May 2023
People for A Living Moorabool	9 May 2023
Southern Rural Water	9 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).

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.

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

In addition to the mandatory factors set out below, clause 11 of the WIRO requires the commission to have regard to the matters specified in the commission’s guidance.<sup>70</sup> Our draft and final decisions provide further information on where we have considered our guidance, and Southern Rural Water’s compliance with our guidance, in making our price determination.<sup>71</sup>

Note: all chapter and section numbers referenced below refer to our final decision for Southern Rural 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>70</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>71</sup> Essential Services Commission, *Southern Rural Water draft decision: 2023 water price review*, 6 April 2023; Essential Services Commission, *Southern Rural 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 Southern Rural 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 Southern Rural Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>72</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 Southern Rural 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>72</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 Southern Rural 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 Southern Rural 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>73</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>74</sup>
- tariff structures applied by water businesses throughout Australia<sup>75</sup>
- the regulatory rate of return set by other regulators.<sup>76</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 Southern Rural Water’s proposals, including through submissions and public meetings.

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<sup>73</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

<sup>74</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>75</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>76</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 Southern Rural 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 Southern Rural 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 Southern Rural 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 Southern Rural 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)

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- 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 Southern Rural 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 Southern Rural 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, Southern Rural 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>77</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>78</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>77</sup> Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

<sup>78</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, 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>79</sup>

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<sup>79</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, 26 October 2021, p. 2.

## Appendix C – Service standards

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

### Southern Rural Water’s service standards

	2023-24	2024-25	2025-26	2026-27	2027-28
Applications that do not require public notification completed within:					
• allocation trades, divide a water share (days)	3	3	3	3	3
• licence transfers (on sale of land), water share transfers, information statements, subdivisions (days)	7	7	7	7	7
• farm dam licences, take and use licences (days)	60	60	60	60	60
Maximum time to respond to correspondence or a complaint (days)	10	10	10	10	10
Water is delivered	On agreed day	On agreed day	On agreed day	On agreed day	On agreed day
Maximum disruption time in the Macalister Irrigation District	10 consecutive days	10 consecutive days	10 consecutive days	10 consecutive days	10 consecutive days
Maximum disruption time in the Bacchus Marsh and Werribee Irrigation Districts	3 consecutive days	3 consecutive days	3 consecutive days	3 consecutive days	3 consecutive days
Bulk Entitlement orders delivered	On agreed days	On agreed days	On agreed days	On agreed days	On agreed days

Continued next page

## Southern Rural Water's service standards (continued)

	2023-24	2024-25	2025-26	2026-27	2027-28
Maximum number of days water cannot be supplied due to high salinity ( $\leq 1,800$ ) or blue green algae in the Werribee Irrigation District	5 consecutive days	5 consecutive days	5 consecutive days	5 consecutive days	5 consecutive days
Minimum amount of new permanent water shares offered for sale in the Macalister Irrigation District	1000ML per annum	1000ML per annum	1000ML per annum	1000ML per annum	1000ML per annum
Maximum time properties are inundated after a 1:50 rainfall event in the Macalister and Werribee Irrigation Districts	24 hours	24 hours	24 hours	24 hours	24 hours



# Appendix D – 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