

# Coliban Water draft decision

2023 Water Price Review

12 April 2023



## Acknowledgement

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

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

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

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# Summary

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

This draft decision sets out our preliminary views on Coliban Water's price submission.<sup>1</sup> Our draft decision should be read together with Coliban Water's price submission.



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

## Coliban Water has committed to delivering outcomes that reflect customer priorities

Coliban Water plans to deliver the following outcomes for customers:

- Water quality and reliability
- Be easy to deal with
- Enhance the environment
- Regional prosperity
- Fair price.<sup>2</sup>

Among the key initiatives to deliver on its commitments, Coliban Water plans investments to renew and upgrade its infrastructure to meet compliance obligations, support reliable services for its customers, help to address future growth, and adapt to climate change. Coliban Water has also committed to improving performance on proactive customer notifications as part of a broader goal to enhance the effectiveness of its engagement with its customers.

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<sup>1</sup> Clause 16 of the Water Industry Regulatory Order 2014 requires the Essential Services Commission to issue a draft decision; Coliban Water's price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

<sup>2</sup> Coliban Water, 2023 water price submission, September 2022, p 89–93.

## **Our draft decision adopts a revenue requirement that will enable Coliban Water to deliver on its obligations and proposed outcomes**

Our draft decision is to adopt a revenue requirement that will allow Coliban 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.

Coliban Water proposed a revenue requirement of \$731.4 million over a 5-year period starting 1 July 2023. Our draft decision adopts a revenue requirement of \$727.4 million. The lower revenue requirement we propose to adopt reflects our initial views on Coliban Water's forecast operating expenditure.

Coliban Water's response must also address our preliminary views on its forecasts for regulatory depreciation, which are an input to the calculation of the revenue requirement. As set out in Section 4.5, our draft decision is to not accept Coliban Water's forecasts for regulatory depreciation.

## **For urban services, customer bills will increase in real terms under Coliban Water's proposal**

Coliban Water's price submission proposed an increase in (real) prices. Based on its price submission, the typical annual water and sewerage bill for a residential owner-occupier (with access to potable water) would increase from \$1,367 currently to \$1,393 in 2023-24, then increase to \$1,529 by 2027-28 (Table A). These estimates exclude inflation (they are in \$2022-23 terms).

Excluding inflation, bills for household tenants would increase from \$439 currently to \$448 in 2023-24, then increase to \$491 by 2027-28. Estimated annual water and sewerage bills for urban non-residential customers would also increase in real terms. On average, Coliban Water's price submission proposed a decrease in (real) prices for rural customers, indicated by estimated bill movements shown in Table A.

In response to our draft decision, Coliban Water must update its proposed prices to reflect our proposed changes to its revenue requirement (described below) and other matters raised in our draft decision. Its response may affect customer bill estimates. Estimated bills will also be impacted to reflect our updates for inflation and the cost of debt, following the release of our draft decision.

**Table A**      **Estimated typical water and sewerage bills (\$2022-23)**

	Average consumption (kL p.a.)	2022-23 (current)	2023-24	2027-28
Residential – owner occupier	192	\$1,367	\$1,393	\$1,529
Residential – tenant	192	\$439	\$448	\$491
Non-residential (small)	100	\$1,157	\$1,179	\$1,294
Non-residential (medium)	907	\$3,760	\$3,832	\$4,205
Non-residential (large)	2,000	\$7,291	\$7,430	\$8,153
Rural (modernised)	4,373	\$2,857	\$2,823	\$2,789
Rural (unmodernised)	3,146	\$1,851	\$1,829	\$1,807

### **In response to our draft decision, Coliban Water must consider the inflation environment and the impact on customer prices and bills**

Unlike some other water businesses, Coliban Water proposed to increase prices in real terms over the 2023–28 regulatory period. Coliban Water’s customer bills are currently among the highest in Victoria. Given this and given that since lodgement of its price submission it has become increasingly likely that a relatively high inflation adjustment will be incorporated into 2023-24 prices, Coliban Water must provide us with further information illustrating how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills (noting its price path proposed lower increases in earlier years).<sup>3</sup>

The March Quarter 2023 annual outcome for the consumer price index due for release in late April 2023, will be added to 2023-24 real prices.<sup>4</sup>

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall through 2023 and 2024.<sup>5</sup>

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<sup>3</sup> This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission, in considering the manner in which a regulated entity’s prices are to be calculated, determined or otherwise regulated, must have regard to whether prices provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

<sup>4</sup> Published by the Australian Bureau of Statistics (All Groups – Australia).

<sup>5</sup> The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (in annual terms) to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

Based on a forecast consumer price index change of around 6.7 per cent in annual terms, the typical annual residential owner occupier water and sewerage bill for a customer of Coliban Water will increase from \$1,367 currently to around \$1,459 in 2023-24, an increase of around \$92.<sup>6</sup>

For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.<sup>7</sup> Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Some high-cost growth areas specific to the water sector such as insurance and chemicals have been accounted for in uplifts to their opening base costs for the 2023–28 regulatory period.

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

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

Our draft decision is to approve Coliban Water’s proposed tariff structures, on the basis that they meet the criteria in our guidance and are a continuation of Coliban Water’s current approach, which its customers generally support.<sup>8</sup> Specifically, the tariff structures ensure a sustainable revenue stream and are simple to understand. Our review of Coliban Water’s proposed tariff structures is set out in Section 5.3.1.

Our draft decision is to accept Coliban Water’s proposed price cap form of price control (Section 5.2) including because it reflects a continuation of current arrangements, which we have previously approved. This means its maximum prices are fixed subject to updates for inflation and cost of debt, and any other price adjustments we approve in our price determination. We also propose to accept Coliban Water’s proposal to maintain the option to revert to a tariff basket form of price control during the regulatory period because this reflects a continuation of its current approach.

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<sup>6</sup> The annual rate to June 2023, as forecast by the Reserve Bank of Australia in its February 2023 Quarterly Statement on Monetary Policy. Note this estimated figure for 2023-24 is different to the figure in Table A because we have added an estimate for inflation.

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

<sup>8</sup> Coliban Water, 2023 water price submission, September 2022, p. 105 and 107.

## **Our draft decision rates Coliban Water’s price submission as ‘Standard’ under the PREMO framework**

Our draft decision is to rate Coliban Water’s price submission as ‘Standard’ under the PREMO framework (Table B). This is the same as the business’s self-rating of its price submission.

Key factors supporting this PREMO rating of ‘Standard’ include:

- Coliban Water has justified the substantive elements of its expenditure forecasts, including the prudence and efficiency of proposed capital expenditure.
- While concerns have been raised in submissions about its engagement with developers, we consider Coliban Water showed strong commitment to the outcomes of its engagement processes and influence of customers, including by adopting all recommendations of its deliberative community panel. It also provided evidence that participants in its engagement had a positive view of its approach to engagement and were supportive of its proposals.
- Coliban Water proposed an efficiency improvement rate for controllable operating expenditure over the next regulatory period of 1.4 per cent per year, one of the highest efficiency improvement rates of all businesses in the current price review.
- Coliban Water’s proposed targets for its outcome measures suggest an overall improvement in customer service levels. Coliban Water will continue to report annually to its customers on how it has performed against its outcome commitments, and it will continue engaging its customers on its outcomes at its annual regional advisory group forum.
- Coliban Water has also proposed to develop an online dashboard where customers can view more information on its performance against its outcome commitments which we consider will support its accountability to its customers.

Our preliminary view is that, while we agree with Coliban Water’s self-ratings of its price submission for the Engagement, Management and Outcomes elements of PREMO, we disagree with its self-ratings for Performance and Risk. In part, this reflects the increases in operating costs for 2021-22 above the benchmarks adopted at the 2018 review, and its aggressive approach to depreciation, which we consider has not been sufficiently justified.

Coliban Water’s price submission received a PREMO rating of ‘Advanced’ in the 2018 price review.

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



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



**Table B**      **PREMO rating**

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

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

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

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

## We invite feedback on our draft decision

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

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

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

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

**Table D** Specific topics we are particularly interested in stakeholder feedback on

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

### How to provide feedback and stay up to date

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

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

You can provide feedback by:

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

### Taking part in a public forum

We plan to hold a public forum on 1 May 2023. Forums provide an opportunity for interested parties to discuss key features of our draft decisions. Details of our public forums will be published on the Engage Victoria website.

### Provide written comments or submissions

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

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

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

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

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

## Submission and privacy statement

We encourage transparency in our review processes. It is our policy to publish all submissions to the 2023 water price review on the Essential Services Commission website unless the submitter has requested confidentiality. When we publish a submission, we will also include some details about the submitter (your name, not your address) unless the submitter has requested anonymity (does not want to be identified).

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

## Next steps

Activity	Indicative date
Public forum	1 May 2023
Closing date for submissions on our draft decision	12 May 2023
Release date for our final decision and price determination	June 2023

# 1. Our role and approach to water pricing

## 1.1 We are Victoria's independent economic regulator

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

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

Our review is of the prices that the 14 water businesses propose to charge customers for prescribed services from 1 July 2023.<sup>9</sup> The prescribed services include retail water and sewerage services, and bulk water and sewerage services delivered by the water businesses.<sup>10</sup>

Coliban Water provided a submission to us proposing prices for a 5-year period starting 1 July 2023. Our task is to assess the price submission using the legal framework and make a price determination that takes effect from 1 July 2023. The price determination will specify the maximum prices Coliban Water may charge for prescribed services, or the manner in which prices are to be calculated, determined or otherwise regulated. We will also issue a final decision that explains the reasons for our price determination.

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

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

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

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<sup>9</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>10</sup> The prescribed services are listed at clause 7(b) of the WIRO.

- the matters set out in section 33(3) of the ESC Act, which include the return on assets, relevant benchmarking and any other matters that the ESC considers relevant
- the matters specified in our guidance<sup>11</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 in this draft decision. Table 1.1 summarises the matters we must have regard to and groups them into themes.

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

If we consider the price submission has adequate regard for the matters in clause 11 of the WIRO and complies with our guidance, we must approve Coliban Water's proposed prices.<sup>12</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>13</sup>

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<sup>11</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

<sup>12</sup> This is a requirement of the WIRO, clause 14(b).

<sup>13</sup> This is provided for under the WIRO, clause 14(b)(i).

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

Economic efficiency and viability matters	Industry/business specific matters	Customer matters
<ul style="list-style-type: none"> <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 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 1995 (WI Act).

## 1.4 PREMO

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

### Box 1.1 PREMO

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

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

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

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

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

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



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>

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

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

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

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

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

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

We found Coliban Water's price submission generally presented clear and comprehensive information to support its proposals. Coliban Water also provided evidence that its overall engagement program sought to capture the main priorities and concerns of customers, and that it has taken this feedback into account (see Section 3.1 on customer engagement).

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



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

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

### 2.1 Draft decision paper outline

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

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

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

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

## 2.2 Regulatory period

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

We are required to set the term of the regulatory period over which a water business’s price determination will apply.<sup>16</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>17</sup>

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

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<sup>16</sup> This is a requirement of the WIRO, clause 9.

<sup>17</sup> For detail on the reasons for using five years as the default regulatory period, see: Essential Services Commission, *2023 water price review: Guidance paper*, p. 18.

## 3. Customer outcomes

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

This chapter:

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

### 3.1 Customer engagement

Our guidance required Coliban Water to engage with customers to inform its price submission. Our guidance also identified principles to guide Coliban Water’s engagement.<sup>18</sup>

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

- engaged early on its planning and considered internal engagement data from the past 10 years in developing its engagement program which ran from April 2021 to August 2022.
- used a range of online and in-person methods including phone calls, surveys, forums, focus groups, workshops, community events, a bill simulator and a 5-day deliberative panel.
- held inclusive engagement activities to hear from different customer groups including youth, traditional owners, customers experiencing financial vulnerability or family violence and the community groups that support them, land developers, business groups and councils.
- tailored its engagement methods to engage sensitively with its First Nations customers and Traditional Owners groups, with feedback from these groups provided to the deliberative panel and incorporated into one of the panel’s recommendations.
- engaged on matters that influence services and prices, such as intergenerational equity, drought preparedness, contribution to its community, the environment and support for customers experiencing vulnerability.

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<sup>18</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 20.

More detail on Coliban Water’s engagement is available in its price submission.<sup>19</sup>

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

- adopting all nine recommendations of its deliberative community panel<sup>20</sup>
- doubling support for customers experiencing vulnerability, and increasing education about services for customers experiencing hardship – in response to feedback from customers experiencing vulnerability and their support agencies, and its deliberative panel<sup>21</sup>
- purchasing water shares to help secure water supply during periods of drought – informed by a recommendation from its community panel and bill simulator responses<sup>22</sup>
- prioritisation of capital works for systems with poor water pressure to deliver improved performance– addressing feedback from customers regarding water pressure.<sup>23</sup>

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

Overall, our preliminary view is that Coliban Water has designed and delivered a robust engagement program that was well suited to the majority of its customers, and which was appropriate in the context of proposed real price increases over the 5 years of the regulatory period.

We consider that Coliban Water’s engagement was representative of its diverse customer base including of First Nations people and people experiencing vulnerability. It tailored its engagement to suit customer circumstances and engagement preferences, including through meetings with local service providers to understand the needs of customers experiencing vulnerability.

Coliban Water sought to obtain guidance from its First Nations customers on how to best engage with them, including meeting separately with the different First Nations groups in its service area. This engagement was sensitive and appropriate, consistent with the expectations set out in our guidance. Coliban Water included as an appendix in its price submission, a letter of support from Traditional Owners group Dja Dja Wurrung recognising Coliban Water’s engagement with them before and during the preparation of the price submission.<sup>24</sup>

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<sup>19</sup> Coliban Water’s price submission is available on our website at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

<sup>20</sup> Coliban Water, 2023 water price submission, September 2022, p. 7.

<sup>21</sup> Coliban Water, 2023 water price submission, September 2022, p. 5.

<sup>22</sup> Coliban Water, 2023 water price submission, September 2022, p. 41.

<sup>23</sup> Coliban Water, 2023 water price submission, September 2022, p. 13.

<sup>24</sup> Coliban Water, 2023 water price submission, Appendix A, DJARRA (Dja Dja Wurrung Clans Aboriginal Corporation, 27 July 2022, p 2), September 2022.

Coliban Water offered customers multiple ways to participate throughout the engagement process including through the bill simulator survey, dedicated engagement activities with several groups representative of its customer base, and the deliberative community panel. A wide range of engagement channels were used to cater to its customers' engagement preferences and requirements, for example, its community draft decision was made available in an Easy English version in its dedicated feedback website.

Key aspects of Coliban Water's engagement were influential on the submission, as evidenced by feedback from its customer panel members who commented favourably on the alignment between their recommendations and the business's proposals, and by the supportive response to its community draft released for consultation.<sup>25</sup> Coliban Water included nine letters of support with its price submission, which generally commented favourably on the quality and appropriateness of its engagement.

We received a positive submission from the Consumer Action Law Centre regarding Coliban Water's financial support proposal that will impact customers experiencing vulnerability.<sup>26</sup> We agree and consider that support is critical, given Coliban Water's proposed real price increases.

We also received submissions from the Urban Development Institute of Australia and MG Estates raising concerns with Coliban Water's engagement process for new customer contributions.<sup>27</sup> Both submissions considered engagement was limited, occurred late and that not enough information was provided. Our guidance sets out engagement principles which, among other things, require businesses to provide participants in its engagement process with appropriate information, given the purpose, form and content of the engagement, and a reasonable and fair opportunity to participate as part of the process.<sup>28</sup> In giving effect to this principle, we would expect Coliban Water to tailor the materials and engagement approach to the level of sophistication of its various customer groups, and to address concerns of key stakeholders at a time this could influence the engagement process and outcomes; our preliminary view is that Coliban Water's engagement with developers in relation to new customer contributions should have been better tailored to their level of sophistication.

We considered this feedback in our assessment of Coliban Water's proposed new customer contributions (see Section 5.4 for more detail). We also considered it when assessing Coliban Water's overall engagement against our requirements for an 'Advanced' PREMO rating. We

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<sup>25</sup> Coliban Water, 2023 water price submission, September 2022, pp. 48-51.

<sup>26</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 9.

<sup>27</sup> Urban Development Institute of Australia, Submission to the Essential Services Commission 2023 water price review, 1 December 2022, p. 2; MG Estates, Submission to the Essential Services Commission 2023 water price review, 1 December 2022, pp. 11 and 12.

<sup>28</sup> Essential Services Commission, 2023 Water Price Review Guidance Paper, p. 20.

discuss this further in Section 7.1.3 on our PREMO assessment of Coliban Water's price submission.

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

## 3.2 Outcomes

### 3.2.1 Performance against outcome commitments 2018–23

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

A business's price submission should account for its actual performance against its outcome commitments for the current period, from 1 July 2018 to 30 June 2023.<sup>29</sup>

We consider Coliban Water accounted for its annual performance for each measure in its price submission. Table 3.1 lists Coliban Water's outcome commitments and includes its annual performance results as reported in its price submission and the period-to-date rating published in our 2021-22 Outcomes report.<sup>30</sup> The information in this table informs our assessment under the Performance element of PREMO, which is discussed in Chapter 7.

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<sup>29</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

<sup>30</sup> Coliban Water provided a period-to-date rating for the purpose of compiling our 2021-22 Outcomes report.

**Table 3.1 Business self-assessment of performance against Outcome commitments**

Outcome	2018-19	2019-20	2020-21	2021-22	Period to date <sup>a</sup>
Supply high quality water you can trust	Green	Amber	Green	Green	Green
Provide infrastructure and services to meet the needs of our customers now and into the future	Green	Green	Green	Green	Green
Reduce our environmental footprint and achieve a socially responsible, sustainable business for future generations	Green	Green	Green	Green	Green
Open and transparent with customers about affordable pricing, service disruptions and repairs	Amber	Amber	Green	Green	Green
Support the liveability in the region	Green	Green	Amber	Red	Red

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

Source: Essential Services Commission, Coliban Water's outcomes performance 2021-22, October 2022; Coliban Water, 2023 water price submission, September 2022, p 22.

Coliban Water considers it has achieved or exceeded its targets for 70 of its 108 measures reported over the first 4 years of the current regulatory period. Of these 108 performance measures, 16 (15 per cent) have been rated as amber 'close to achieving target' and 22 (20 per cent) as red 'failed to meet target' in the period to date.<sup>31</sup>

Notably, Coliban Water failed to meet its 'support the liveability in the region' outcome for the period to date. Coliban Water's outcomes reporting revealed that it had failed to meet its credit rating target in the 2021-22 reporting year, and debt repayment targets in some years. In its price submission, Coliban Water noted that changed investment priorities and updated risk analysis resulted in these targets not being achieved.<sup>32</sup>

<sup>31</sup> Essential Services Commission, Coliban Water's outcomes performance 2021-22, October 2022.

<sup>32</sup> Essential Services Commission, Coliban Water's outcomes performance 2021-22, October 2022; Coliban Water, 2023 water price submission, September 2022, p 22.



In the current regulatory period, Coliban Water published its performance prominently on the homepage of its website. It sought the views of its customers before finalising its annual traffic light ratings, via independently facilitated customer forums.<sup>33</sup>

Our draft decision is that we agree with Coliban Water's self-assessment that it has, overall, met its outcome commitments for the period to date.

### 3.2.2 Outcome commitments for 2023–28

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

- Water quality and reliability
- Be easy to deal with
- Enhance the environment
- Regional prosperity
- Fair price.<sup>34</sup>

Among the key initiatives to deliver on its commitments, Coliban Water plans significant investments to renew and upgrade its infrastructure to meet compliance obligations, support reliable services for its customers, help to address future growth, and adapt to climate change. Coliban Water has also committed to improving performance on proactive customer notifications as part of a broader goal to enhance the effectiveness of its engagement with its customers.

### 3.2.3 Our assessment of measures and targets

Coliban Water proposed a set of 19 measures and targets that it will use to report on performance across the 5 outcomes. These are set out on pages 89 to 93 of its price submission. Performance against these measures will inform our assessment during future price reviews.

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

- be relevant to, or be a reasonable proxy for, the delivery of the outcome they represent
- be measurable
- be clearly defined and unambiguous
- be easy for customers to understand
- have performance targets listed for each year of the regulatory period.<sup>35</sup>

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<sup>33</sup> Coliban Water, 2023 water price submission, September 2022, p 93.

<sup>34</sup> Coliban Water, 2023 water price submission, September 2022, pp. 89–93.

<sup>35</sup> Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 23.

Evidence provided by Coliban Water demonstrates that its measures and targets were developed in consultation with its customers, and that they are supported by its customers. It held customer forums in June 2022 to revise its outcomes and circulated a draft of its outcomes and measures for broader community feedback in July 2022. Its outcomes set was provided to its deliberative panel, which made nine recommendations that were all adopted by Coliban Water.<sup>36</sup>

Generally, we consider Coliban Water's intentions are clear, and its measures and targets will provide a sound basis to track performance and delivery against each outcome, once the matters we identified in our assessment have been addressed.

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

Coliban Water's proposed targets for its outcome measures suggest an overall improvement in customer value.

In its price submission, Coliban Water noted it will reprioritise investments to address underperformance against its outcomes, as part of the ongoing monitoring of its capital and operational investment programs. It also commits to addressing underperformance with its customers at its annual regional advisory forum and will modify its outcomes to respond to changing customer preferences and business priorities.<sup>37</sup>

Coliban Water will continue to report annually to its customers on how it has performed against its outcome commitments, and it will continue engaging its customers on its outcomes at its annual regional advisory forum. It will also develop an online dashboard where customers can view more information on its performance against its outcome commitments.<sup>38</sup>

On the basis that Coliban Water's proposal suggests an overall improvement in customer value and that its proposed outcomes appear to be supported by its customers, our draft decision is to accept Coliban Water's self-assessment of 'Advanced' for the Outcomes element of PREMO, which is discussed further in Chapter 7.

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

Service Standards are a common set of services applicable to all Victorian consumers required under clause 18.2 of the *Water Industry Standard – Urban Customer Service* (Urban Water Industry Standard) and clause 1.5 of the *Water Industry Standard – Rural Customer Service* (Rural

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<sup>36</sup> Coliban Water, 2023 water price submission, September 2022, pp. 7 and 87-88.

<sup>37</sup> Coliban Water, 2023 water price submission, September 2022, p. 93.

<sup>38</sup> Coliban Water, 2023 water price submission, September 2022, p. 93.

Water Industry Standard). Each water business must specify its own service levels against each of these service standards. Rather than performance measures, these service standards and corresponding service levels are the minimum level of service customers can expect to receive.

Coliban Water's service standards relating to reliability and faults can be found in its proposed service standards 2023–28 document.<sup>39</sup>

The service standards proposed by Coliban Water are substantially the same as those for the current 2018–23 regulatory period (with some wording changes required by the updated Water Industry Standard), with the exception of one service standard relating to average time taken to attend priority two water bursts. In relation to that service standard, Coliban Water proposed to set service levels for incremental improvement over a number of years to reflect customer preferences. Coliban Water has also provided the minimum water pressure as required by the Water Industry Standard.

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

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

Coliban Water was previously not required to provide rural service standards, however under clause 1.5 of the new Rural Water Industry Standards it must define service standards and specify targets in particular areas. Coliban Water did not provide proposed rural service standards with its price submission. We will work with Coliban Water to enable it to submit its proposed rural service standards to us with its response to our draft decision.

### **3.4 Guaranteed service levels**

Our draft decision is to accept Coliban Water's proposed guaranteed service levels.

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

Coliban Water's proposed guaranteed service levels are set out on pages 97 and 99 of its price submission. It has proposed to consolidate its guaranteed service levels by removing four guaranteed service levels, combining two, redefining four, and adding one new guaranteed service

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<sup>39</sup> Coliban Water, proposed service standards 2023–28, 21 February 2023.

level. The two sewer-spill guaranteed service levels will be combined with different rebates applying depending on if the spill lasts under an hour or if it lasts over an hour. Coliban Water's service standards describe a spill as an intrusion. The redefined guaranteed service levels include converting a rebate paid to the community for low pressure, to an individual rebate for affected customers.

The added guaranteed service level relates to customers experiencing a negative impact on living amenity due to construction works.<sup>40</sup> This reflects intensified construction works that will occur in the 2023–28 regulatory period.

In its submission the Consumer Action Law Centre stated that it was disappointing to see Coliban Water reduce the number of guaranteed service levels provided to customers.<sup>41</sup>

Coliban Water's changes to its guaranteed service levels were informed by customer engagement including customer forums in June 2022 during which customers considered which outcome measures should have associated guaranteed service levels, as well as the levels of its guaranteed service rebates.<sup>42</sup>

As a result of this consultation, Coliban Water has increased the amounts of the guaranteed service level rebates by approximately 10 to 15 per cent, except for the guaranteed service level rebate paid to the community related to a significant sewer spill to the environment, which has been reduced from \$20,000 to \$10,000.<sup>43</sup> In its consultation with customers, customers expressed the view that this rebate was an appropriate amount.

Our draft decision is to accept Coliban Water's proposed guaranteed service levels, on the basis that they have been developed with customers during its engagement. Final guaranteed service levels and rebates will be subject to our consideration of any feedback following the release of our draft decision.

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

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<sup>40</sup> Coliban Water, 2023 water price submission, September 2022, p. 98.

<sup>41</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 10.

<sup>42</sup> Coliban Water, 2023 water price submission, September 2022, p. 97.

<sup>43</sup> These amounts are in nominal terms, that is, they will not increase further with inflation.

## 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>44</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 Coliban 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 Coliban Water's PREMO rating (Section 4.4.2)
- establish a return of capital through a regulatory depreciation allowance (Section 4.5)
- establish a benchmark tax allowance (Section 4.6).

Our draft decision is to adopt a revenue requirement of \$727.4 million, which is lower than the \$731.4 million proposed by Coliban Water.

Coliban Water proposed a revenue requirement of \$731.4 million over a 5-year period starting 1 July 2023. Our draft decision adopts a revenue requirement of \$727.4 million (Table 4.1).

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<sup>44</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 Coliban Water in the regulatory period from 1 July 2023. We had regard to their views in arriving at our draft decision.

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
Operating expenditure	<b>88.90</b>	<b>88.54</b>	<b>88.11</b>	<b>88.34</b>	<b>88.75</b>	<b>442.64</b>
Return on assets	15.09	15.00	15.49	15.97	16.46	78.01
Regulatory depreciation	36.79	38.40	40.06	43.79	47.74	206.79
Tax allowance	0.00	0.00	0.00	0.00	0.00	0.00
<b>Draft decision – revenue requirement</b>	<b>140.78</b>	<b>141.94</b>	<b>143.66</b>	<b>148.10</b>	<b>152.96</b>	<b>727.44</b>

**Note:** Numbers have been rounded.

Table 4.2 summarises how our draft decision on Coliban Water’s revenue requirement (row D) differs to the revenue requirement proposed by Coliban Water in its price submission (row A). Where our draft decision differs from Coliban Water’s price submission in relation to a component of the revenue requirement, the adjustment we propose is shown in rows B and C of Table 4.2.

The adjustments relate to relatively minor changes we propose to Coliban Water’s forecast operating expenditure, and corrections to its bulk water tariff charges arising from our 2022-23 regulatory accounts review and approval process. Our draft decision also requires Coliban Water to justify the asset life it has proposed for calculating regulatory depreciation (Section 4.5).

Our final decision on Coliban Water’s revenue requirement will be based on the latest available information. Accordingly, as well as responding to our draft decision and providing an updated price schedule, Coliban Water must update its revenue requirement and prices to reflect our updates to estimates for the cost of debt and inflation, which we will advise in April 2023.

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

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Coliban Water’s proposed revenue requirement</b>	<b>141.78</b>	<b>142.60</b>	<b>144.94</b>	<b>149.09</b>	<b>153.02</b>	<b>731.43</b>
B. Operating expenditure	-1.01	-0.66	-1.28	-0.99	-0.01	-3.95
C. Return on assets	0.01	0.01	0.00	0.00	-0.06	-0.04
<b>D. Draft decision – revenue requirement (A + B + C)</b>	<b>140.78</b>	<b>141.94</b>	<b>143.66</b>	<b>148.10</b>	<b>152.96</b>	<b>727.44</b>

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

## 4.1 Operating expenditure

Our draft decision is to adopt a forecast operating expenditure of \$442.6 million, which is \$3.9 million or 0.9 per cent lower than proposed by Coliban Water.

Operating expenditure is a component of the revenue requirement. Coliban Water’s price submission provides detail on its forecast operating expenditure from page 73.

We assess both:

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

We engaged FTI Consulting to provide expert advice to inform our assessment of controllable operating expenditure. FTI Consulting’s report on its assessment of Coliban Water’s expenditure forecast is available on our website.<sup>45</sup>

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

<sup>45</sup> FTI Consulting, *Coliban Water – Expenditure Review for 2023 water price review*, February 2023.

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

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Controllable operating expenditure</b>	<b>80.64</b>	<b>80.38</b>	<b>80.11</b>	<b>80.47</b>	<b>81.01</b>	<b>402.61</b>
<b>Non-controllable operating expenditure</b>	<b>8.26</b>	<b>8.16</b>	<b>8.01</b>	<b>7.87</b>	<b>7.74</b>	<b>40.04</b>
Bulk services <sup>a</sup>	2.36	2.42	2.42	2.44	2.46	12.11
Environmental contribution <sup>b</sup>	5.57	5.41	5.25	5.09	4.95	26.26
Licence fees – Essential Services Commission <sup>c</sup>	0.10	0.10	0.10	0.10	0.10	0.49
Licence fees – Department of Health <sup>c</sup>	0.04	0.04	0.04	0.04	0.04	0.20
Licence fees – Environmental Protection Authority <sup>c</sup>	0.19	0.19	0.19	0.19	0.19	0.97
<b>Draft decision – operating expenditure</b>	<b>88.90</b>	<b>88.54</b>	<b>88.11</b>	<b>88.34</b>	<b>88.75</b>	<b>442.64</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.

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

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

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

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



**Table 4.4 Our proposed adjustments to Coliban Water’s proposed operating expenditure**

\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>A. Coliban Water’s proposed total operating expenditure</b>	<b>89.90</b>	<b>89.20</b>	<b>89.39</b>	<b>89.33</b>	<b>88.76</b>	<b>446.59</b>
<b>B. Our total proposed adjustments to controllable operating costs (B1 + B2)</b>	<b>-0.95</b>	<b>-0.62</b>	<b>-1.20</b>	<b>-0.88</b>	<b>0.13</b>	<b>-3.52</b>
B1 – Regulatory accounts reconciliation to baseline	0.19	0.19	0.19	0.19	0.19	0.95
B2 – End-of-term contract review	-1.14	-0.81	-1.39	-1.07	-0.06	-4.47
<b>C. Our total proposed adjustments to non-controllable operating costs (C1)</b>	<b>-0.05</b>	<b>-0.04</b>	<b>-0.08</b>	<b>-0.11</b>	<b>-0.14</b>	<b>-0.43</b>
C1 – Bulk charges adjustment	-0.05	-0.04	-0.08	-0.11	-0.14	-0.43
<b>D. Draft decision – total operating expenditure (D = A + B + C)</b>	<b>88.90</b>	<b>88.54</b>	<b>88.11</b>	<b>88.34</b>	<b>88.75</b>	<b>442.64</b>

**Notes:** Our proposed adjustments are the differences between our draft decision and what Coliban Water proposed in its price submission. Row A shows the total operating expenditure proposed by Coliban Water in its price submission. We have arrived at our draft decision (row D) by proposing the relevant adjustments to controllable operating costs and non-controllable operating costs shown in rows B and C (and itemised in rows B1, B2 and C1). Numbers have been rounded.

#### 4.1.1 Controllable operating expenditure

Coliban Water proposed a total forecast controllable operating expenditure of \$406.12 million over a 5-year regulatory period. For the reasons set out below, we propose to adopt a forecast operating expenditure of \$402.61 million for the 2023–28 regulatory period, which is \$3.52 million or 0.9 per cent lower than proposed by Coliban Water.

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

1. Establish a controllable operating expenditure baseline – the baseline comprises the efficient recurring costs from the last full year of data (2021-22) after non-controllable expenditure, one-off items are removed or normally occurring items are added in.
2. Apply a growth rate for operating expenditure for the regulatory period – assumed by Coliban Water to be 1.9 per cent per year.
3. Apply an annual cost efficiency improvement rate – assumed by Coliban Water to be 1.4 per cent per year.
4. Make adjustments for additional costs or cost saving expected in future years.

#### **4.1.1.1 Baseline controllable operating expenditure**

Coliban Water has proposed a controllable operating expenditure baseline of \$75.96 million after adding \$3.04 million to account for recurring operating expenditure that had not been incurred in 2021-22, and removing non-recurring costs linked to the coronavirus pandemic. Coliban Water's proposed baseline is \$9.32 million (or 14 per cent) higher than the benchmark figure of \$66.64 million of controllable operating expenditure for 2021-22 used for our 2018 price determination.

Since lodging its price submission with us, we identified that Coliban Water's forecast operating expenditure did not align with its regulatory accounts.

Coliban Water provided a revised financial model, increasing its operating expenditure baseline by \$0.19 million to align with its regulatory accounts. Based on these revised figures Coliban Water's operating expenditure baseline of \$76.14 million is \$9.51 million (or 14 per cent) higher than the benchmark figure from the 2018 price determination.

Our draft decision is to adopt the adjusted baseline controllable operating expenditure of \$76.14 million, because this aligns with Coliban Water's regulatory accounts.

Separately to the adjustment related to the regulatory accounts, our expenditure consultant requested substantiation of Coliban Water's proposed increase to its baseline year operating expenditure benchmark.<sup>46</sup> Coliban Water explained the increase was due to a number of factors including increases in maintenance activities to address asset failures, improving strategic resource planning, and transitioning its IT network to the cloud.

Our expenditure consultant verified these additional costs were recurring and found Coliban Water's substantiation of these costs to be reasonable. Accordingly, it recommended accepting

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<sup>46</sup> FTI Consulting, *Coliban Water – Expenditure Review for 2023 water price review*, February 2023, pp. 22-23.

Coliban Water's proposed baseline increase with no adjustments required. We reviewed Coliban Water's proposal and the advice from our expenditure consultant.

Given the above, we consider the adjusted figure of \$76.14 million reflects an efficient baseline cost to forecast annual operating expenditure for the purpose of our draft decision.

#### **4.1.1.2 Efficiency improvement and growth rate**

Coliban Water proposed an average efficiency improvement rate on its controllable operating costs of 1.4 per cent per annum. This is one of the highest rates proposed in the current price review and is above the average (around 1.3 per cent). Coliban Water expects to achieve its proposed efficiency improvement rate through as-yet-uncertain cost reductions in energy savings from capital expenditure, business transformation, reduced costs from digital metering, refined procurement approaches and platform renewals – resulting in \$21.8 million of efficiency savings over the next regulatory period.

The efficiency improvement rate is lower than Coliban Water's proposed average cost growth rate of 1.9 per cent per annum, effectively delivering a net annual increase to its controllable annual baseline operating costs in each year of the regulatory period. The increase in controllable operating expenditure per customer connection peaks in 2023-24, then there is a forecast general overall decline in the following years of the regulatory period.

Coliban Water has forecast its proposed average cost growth rate by combining the predicted higher growth rate of Bendigo with lower growth towns.

While there is a net annual increase to its controllable annual baseline operating costs, Coliban Water proposes to absorb both energy efficiencies and consequential energy increases arising from capital expenditure through the efficiency improvement rate and average cost growth rate.

#### **4.1.1.3 Cost adjustments**

Coliban Water has proposed additional forecast operating expenditure above the annual baseline, including:

- \$4.95 million for the Big Water Build to increase proactive maintenance and monitoring of sewer mains
- \$7.82 million for 'Resilient and Composable' activities such as end-of-term contract review, transformation foundations, and legislated superannuation increases
- \$3.70 million for 'Customer Experience' enhancements to expand its assistance program to provide direct support to customers experiencing vulnerability
- \$2.58 million for 'Digital Transformation' to achieve compliance with regulatory frameworks and execute its Digital Strategy to improve organisational processes.

The above costs represent an additional \$19.06 million over the regulatory period, or an average of \$3.81 million per annum.

Our expenditure consultant reviewed each of the proposed forecast variations above the baseline and requested further information from Coliban Water, including a further breakdown by individual cost item where required, along with documentation that supported the prudence and efficiency of each cost item.

Our consultant assessed each forecast variation against criteria for prudent and efficient operating expenditure and was mostly satisfied each item was appropriately costed and supported by internal documentation, which included evidence of its prudence and efficiency. It therefore considered that Coliban Water's proposed additions were mostly reasonable and only recommended one change to the Resilient and Composable activities step change listed above.

The Resilient and Composable activities step change is the largest proposed step change (\$7.82 million) and is comprised of:

- \$4.5 million for end-of-term contract review – to review and renegotiate five contracts that expire over the next regulatory period
- \$1.6 million for transformation foundations – to provide additional corporate resourcing to undertake workforce planning, and value stream analysis
- \$1.8 million to account for the superannuation guarantee minimum rate for employers increasing from 10 per cent in 2021-22 to 12 per cent by 2026.

Our expenditure consultant assessed this step change on its individual components and considered the \$1.6 million for transformation foundations and \$1.8 million to account for legislated superannuation increases to be justified, as Coliban Water had clearly explained the need to implement Horizon 2 of its Coliban of the Future transformation, and that the additional superannuation costs were required to comply with changed legislative obligations.

For the remaining \$4.5 million for end-of-term contract review, our expenditure consultant was not satisfied with the level of detail provided for how these costs were estimated or what activities would be undertaken. Because Coliban Water had already incurred costs of \$0.94 million against this initiative in its 2021-22 controllable operating expenditure baseline year which is subsequently included in the forecast operating costs for the next regulatory period, our consultant recommended the removal of this step change component as further justification for such a large step change had not been made by Coliban Water.

We have considered the advice from our expenditure consultant, and Coliban Water's proposal. and our preliminary view is that Coliban Water's approach to forecasting its operating expenditure is mostly consistent with the requirements of our guidance, except for the \$4.5 million step change that Coliban Water was not able to justify for its end-of-term contract review.

Our preliminary position is that we are satisfied that its proposed cost adjustments represent efficient controllable operating expenditure after removing the \$4.5 million step change for end-of-term contract review. In its response to our draft decision, we also request that Coliban Water explain how forecast increases in inflation will not cover increases in the superannuation guarantee levy. Further, we request that Coliban Water quantify the cost savings to customers delivered from its digital metering project rollout across the current period, and demonstrate how these savings are reflected in its financial model and passed through to customers.

#### 4.1.2 Non-controllable operating expenditure

Our process for establishing non-controllable operating expenditure involves:

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

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

Coliban Water has proposed \$40.47 million in non-controllable operating expenditure over the 2023–28 regulatory period. This is a forecast decrease of \$2.01 million compared to the 2018–23 regulatory period, due to a \$0.80 million increase in external bulk charges, and a \$2.78 million decrease in the real value of the environmental contribution.

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

Since lodging its price submission with us, we identified that Coliban Water's proposed bulk water charges paid to Goulburn-Murray Water were not consistent with our latest annual tariff approval for Goulburn-Murray Water in 2022. Coliban Water subsequently submitted a revised financial model with updated figures for both Goulburn-Murray Water and GWMWater bulk water charges, which has reduced Coliban Water's proposed non-controllable operating expenditure by a further \$0.43 million over the next regulatory period to a total of \$40.04 million.

We have verified that Coliban Water's revised forecast bulk charges are consistent with Goulburn-Murray Water's 2020 price determination and will verify GWMWater's charges for the next regulatory period once a final decision is made for GWMWater's 2023 price review.

Accordingly, consistent with the reasoning in our guidance paper, our draft decision is to adopt the revised figure of \$40.04 million for Coliban Water's non-controllable operating expenditure.

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

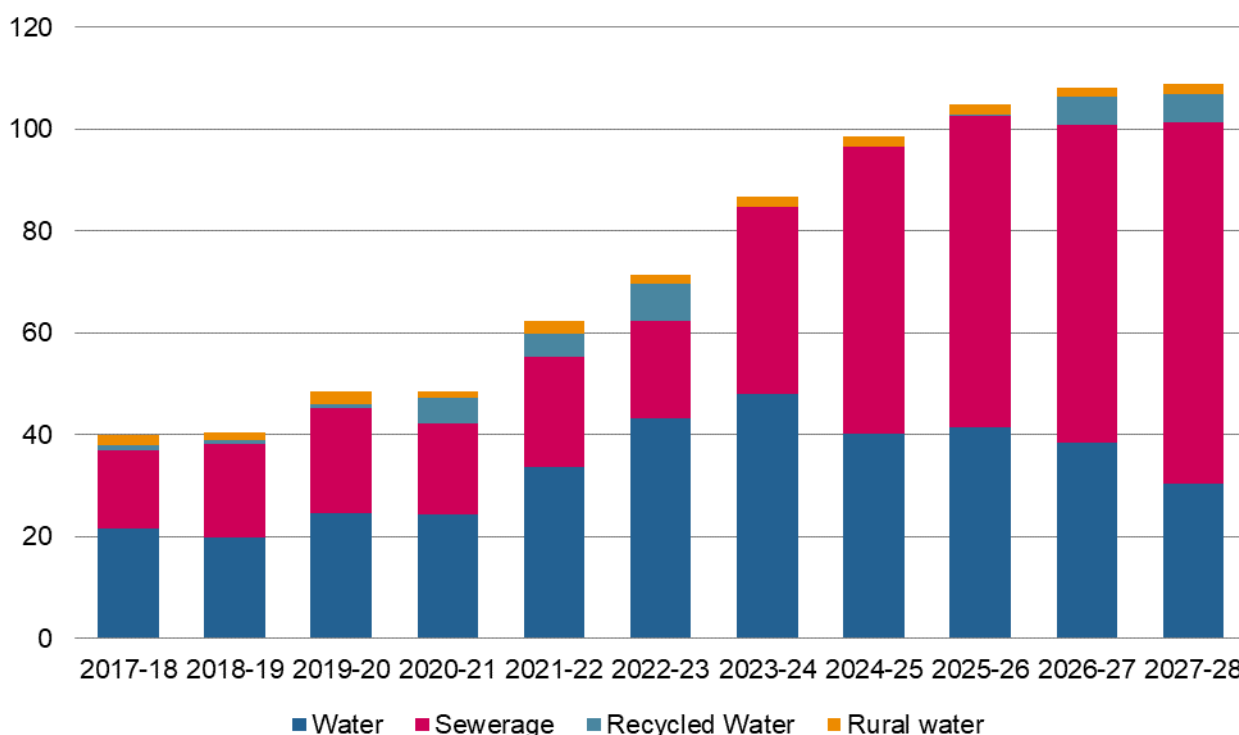
## 4.2 Capital expenditure

Our draft decision is to adopt a forecast capital expenditure of \$501.7 million, which is \$5.8 million or 1.1 per cent lower than proposed by Coliban Water.

Capital expenditure is an input to estimating the regulatory asset base, which is an input to the revenue requirement. Coliban Water’s forecast capital expenditure and supporting information is provided at pages 55 to 70 of its price submission.

Figure 4.1 shows Coliban Water’s actual gross capital expenditure for 2017-18 and the first 4 years of the current regulatory period (2018-19 to 2021-22) and forecast gross capital expenditure from 2022-23 to 2027-28. The first 5 years of actual expenditure shown in Figure 4.1 (2017-18 to 2021-22) is relevant to the calculation of the closing regulatory asset base discussed in Section 4.3.1.

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



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

We engaged FTI Consulting to provide expert advice to inform our assessment of capital expenditure. FTI Consulting's report on its assessment of Coliban Water's expenditure forecast is available on our website.<sup>47</sup>

#### 4.2.1 Actual capital expenditure

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

Over the period from 2017-18 to 2021-22, Coliban Water's gross capital expenditure was \$240.2 million, around \$23.8 million or 11 per cent higher than forecast. In net terms, capital expenditure was \$217 million, \$23.6 million or 12.2 per cent higher than forecast.

For 2022-23, Coliban Water proposed \$71.4 million in gross capital expenditure for 2022-23. This updated figure is above the benchmark of \$47.2 million approved for 2022-23 in the 2018 price determination, and largely reflects the early commencement of Coliban Water's Big Water Build program, discussed further below. However, consistent with our guidance, Coliban Water has only sought to include the benchmark allowance of \$47.2 million in its regulatory asset base forecast for 2022-23 (see Section 4.3.2).<sup>48</sup>

Coliban Water's price submission provided the following explanation of its increased actual capital expenditure it has incurred over the current regulatory period relative to its benchmarks:

- early commencement of the large infrastructure renewal and augmentation program, with additional expenditure increasing across the period, from \$24 million in 2018-19 to \$47 million in 2021-22, and \$55 million expected for 2022-23
- additional expenditure to meet environmental compliance obligations and minimise critical risks across sewer networks and treatment plants – this includes \$11.4 million reprioritised to expand the scope of major works at the Kyneton Water Reclamation Plant to reactively address compliance deficiencies following non-compliant discharges to the environment in 2019 and non-compliant discharge volumes at the Bendigo Water Reclamation Plant in 2022
- increased expenditure to address the risk of operational failure of the ageing assets due to poor condition and insufficient capacity, including costs exceeding \$1.3 million to remediate the collapse of a sewer pipeline in the Bendigo system in 2021

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<sup>47</sup> FTI Consulting, *Coliban Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023.

<sup>48</sup> While Coliban Water has provided its updated capital expenditure forecast of \$71.4 million for 2022-23, reflecting a more up to date forecast of its expected capital expenditure in this year, it has only proposed to include the figure of \$47.2 million in its regulated asset base. Coliban Water may seek to include a higher level of capital expenditure at the end of the regulatory period for this year, in line with our guidance.

- coronavirus pandemic related impacts, including customer growth requirements and global supply chain constraints.

Coliban Water's price submission details the immediate need for a large-scale renewal of its ageing assets. It acknowledges its previous deferral of capital works and reliance on ongoing operation of existing water and sewerage infrastructure beyond their design limits and expected life has affected its ability to meet customer service levels and maintain environmental compliance.

Coliban Water's price submission also reported on the status of its top 10 major capital projects which were consistent with the project timelines provided in its major capital projects report as at the end of June 2022.<sup>49</sup> Its price submission further identified the level of actual or forecast expenditure above or below the proposed budget for each project. As at September 2022, Coliban Water reported that, of the top 10 major projects proposed for the 2018–23 regulatory period, 2 have been completed, 2 are on schedule, and 1 is deferred to a future period. The remaining 5 are delayed, with 1 of these delayed projects expected to be completed in 2022–23. Coliban Water has stated:<sup>50</sup>

- Heathcote water reclamation plant compliance works were deferred, as the expected project outcomes were able to be achieved through the completion of Heathcote Water Treatment Plant upgrades.
- Strathfieldsaye water network augmentation is delayed and expected to be completed in 2022-23 under a lower cost solution.
- Western Bendigo water network augmentation has been delayed to prioritise higher risk projects given reduced customer complaints, and is expected to be completed in 2023-24.
- Digital customer metering rollout is delayed due to supply chain issues impacting the procurement of electronic hardware and is expected to be completed in 2023-24.
- Castlemaine water reclamation plant sludge handling upgrade is delayed to reprioritise projects that will address immediate risks of non-compliance, and is now expected to be completed in 2025-26.
- Bendigo water reclamation plant sludge processing upgrade is delayed to allow the reprioritisation of projects with an immediate risk of non-compliance, limited availability of consultants during the coronavirus pandemic and the need for an expanded scope, and is now expected to be completed in 2026-27.

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<sup>49</sup> Essential Services Commission, *Status of Major Projects Supplement: Outcomes report 2021–22*, 18 October 2022, pp. 7–9. Coliban Water's major projects are reported by the business as part of our annual outcomes reporting process, as part of its commitment to communicate the delivery of its major projects to its customers. The business's comments are not audited by the commission.

<sup>50</sup> Coliban Water, 2023 water price submission, September 2022, pp 17–19.



Coliban Water has delayed some projects in response to emerging risks during the regulatory period, including time-critical compliance requirements, changed project scopes or material supply chain issues. The delays span from 12 months to 36 months. Our expenditure consultant found good supporting information and reasonable explanations justifying Coliban Water’s increased capital expenditure and major capital program delivery performance over the current regulatory period.<sup>51</sup>

Our preliminary view is that Coliban Water has justified the prudence and efficiency of its actual capital expenditure incurred from 2018-19 to 2022-23, and its approach to capital reprioritisation in response to changed priorities and risks is reflective of appropriate capital program management.

Based on the above, we consider the actual capital expenditure Coliban Water has incurred from 2017-18 to 2022-23 is appropriate for the purpose of calculating its regulatory asset base (see Section 4.3.1).

#### 4.2.2 Forecast Capital Expenditure

Our draft decision is to adopt a forecast capital expenditure of \$501.7 million, which is lower than the \$507.5 million forecast proposed by Coliban Water.

We have reviewed Coliban Water’s proposed forecast capital expenditure and our draft decision is to adopt a forecast capital expenditure of \$501.7 million, which is \$5.8 million (or 1.1 per cent) lower than that proposed by Coliban Water.

**Table 4.5 Our proposed adjustments to Coliban Water’s proposed total forecast capital expenditure**  
\$ million 2022-23

	2023-24	2024-25	2025-26	2026-27	2027-28	Total
<b>Coliban Water’s – proposed total forecast capital expenditure</b>	<b>86.83</b>	<b>98.62</b>	<b>104.94</b>	<b>108.28</b>	<b>108.83</b>	<b>507.50</b>
Adjustments – Purchase of water shares	0.00	0.00	0.00	0.00	-5.78	-5.78
<b>Draft decision – total forecast capital expenditure</b>	<b>86.83</b>	<b>98.62</b>	<b>104.94</b>	<b>108.28</b>	<b>103.05</b>	<b>501.72</b>

**Note:** Numbers have been rounded.

<sup>51</sup> FTI Consulting, *Coliban Water: Review of Expenditure Forecasts – 2023 Water Price Review*, February 2023, pp. 32-35.

Coliban Water's price submission provided evidence that a large majority of its forecasts for capital expenditure are prudent and efficient. Coliban Water explained in its price submission that the significant increase in forecast capital expenditure is due to its ambitious program of investment to address compliance risks and renewals in the face of an ageing asset profile and poor asset conditions.<sup>52</sup> These issues have emerged following historical under-investment to meet growth under the business's previous strategy to defer augmentation to its infrastructure and run existing assets to their capacity and beyond. Coliban Water has already begun this program of increased investment in the current regulatory period.

Coliban Water has forecast \$335.4 million (66.1 per cent of its total capital expenditure forecast) on compliance and improvements in the next regulatory period.<sup>53</sup> Coliban Water also identified its assets are ageing and reaching the end of their useful life given its previous asset management strategy. Regarding the need for this expenditure, Coliban Water said:

We have deferred capital investment to pay down debt and deliver real price cuts. Low levels of capital expenditure are no longer sustainable, as evidenced by Coliban Water's conviction for breaches of the *Victorian Environmental Protection Act (2017)* in 2019 and our current low investment-to-asset value ratio. Many of our assets are operating at or beyond the limits of their design life, are in poor condition and have insufficient capacity. Our water and sewer networks need large-scale renewal, with some pipelines installed over a century ago, well beyond their expected life and critical to servicing many customers where the impact of failure would be unacceptable.<sup>54</sup>

We acknowledge this previous approach has resulted in Coliban Water now requiring a significant uplift in expenditure to ensure regulatory compliance is achieved, assets are maintained, and future customer growth can be sustained. We also note Coliban Water has consulted extensively with its customers on this, and has clearly communicated that its proposed investments and the resultant price impacts are a direct result of its previous strategy to defer investment.

Our expenditure consultant requested selected documents from Coliban Water as a representative sample to demonstrate its asset management processes and justification for its capital expenditure program. Based on the sample of documents reviewed, our consultant's workshop with the business and Coliban Water's responses to further questions, our consultant found that Coliban Water has a robust approach for developing project scope, the timing of works and cost

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<sup>52</sup> Coliban Water, 2023 water price submission, September 2022, p. 55.

<sup>53</sup> Coliban Water noted in its returned financial model that a number of its proposed capital projects have multiple drivers. For example, projects allocated as an Improvements/Compliance driven project may also include expenditure to ensure the business can meet future customer growth.

<sup>54</sup> Coliban Water, 2023 water price submission, September 2022, p. 60.

estimates.<sup>55</sup> We note it is proposing a relatively large increase in its capital program at a time of rising input costs.

Coliban Water has forecast \$205 million of capital expenditure on its top 10 major projects in the next regulatory period. Our consultant reviewed business cases and supporting information for all 10 major projects proposed by Coliban Water.

Our consultant found that the information provided on each project was detailed and provided strong justification for the projects and associated expenditures. Our consultant recommended no adjustments to Coliban Water's forecast capital expenditure for its top 10 major projects.<sup>56</sup> We agree with our consultant's view as we consider that, for the purposes of our draft decision, the prudence and efficiency of the expenditure has been justified, consistent with our guidance.

Our consultant also reviewed four of Coliban Water's major capital programs: Water Reclamation Plant Renewals, Water Main Renewals, Purchase Water Shares, and Sewer Network Renewals. Our consultant found there was strong justification for all four major programs reviewed, and that the water reclamation plant, water main, and sewer network renewal programs were well prioritised and appropriately targeted given the levels of asset and service risk observed.

However, our consultant recommended an adjustment to the Purchase Water Shares program, which includes expenditure to purchase additional permanent water share entitlements across Coliban Water's system to address water security risk. This is expected to ensure Coliban Water has enough water supply to service its forecast customer base as population growth continues and climate change impacts existing water resources over time. While our consultant considered this program is well justified as the most efficient way to secure water supply against these emerging issues, it considered that the uncertainty in timing for both customer growth and climate impacts warranted a forecast adjustment. Our consultant recommended retaining the permanent water share purchases proposed for 2023-24 and 2026-27, but deferring the \$5.8 million proposed for 2027-28, the final year of the regulatory period, into the beginning of the 2028–33 period. We will then be able to review this expenditure in our 2028 price review. We agree with our consultant's assessment that this is an appropriate approach to address the timing risk on behalf of customers, especially considering the very large capital program and the end-of-period timing.

Our preliminary view is that the planned capital expenditure program proposed by Coliban Water is ambitious but necessary for Coliban Water to undertake given its past strategy of deferring major

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<sup>55</sup> FTI Consulting, *Coliban Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, pp. 36-38.

<sup>56</sup> FTI Consulting, *Coliban Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p 40.

works, the current condition of its ageing infrastructure, and its level of non-compliance and environmental risk exposure.

Our expenditure consultant reviewed the business's capacity to deliver on its large forecast capital program, and considered the information reviewed provided confidence Coliban Water will have the proper processes in place to deliver the program within the regulatory period. However, our consultant also noted that given the large program proposed by Coliban Water, any additional capital projects the business proposes to undertake in the next regulatory period would likely have significant impacts on the business's ability to deliver the program it has proposed in its price submission.<sup>57</sup>

Outside of the projects it has discussed under its uncertain and unforeseen events mechanism, Coliban Water has not specifically identified any projects it has excluded where there is uncertainty in timing, cost, scope and benefits of capital expenditure. For any additional capital expenditure in the 2023–28 regulatory period that Coliban Water proposes to include in the regulatory asset base at the end of the regulatory period, it should note the following:

- Coliban Water will need to demonstrate the prudence and efficiency of these costs if they are incurred during the 2023–28 regulatory period if seeking to include them in the regulatory asset base for the 2028–33 price review.
- Deviations from forecasted capital expenditure during the 2023–28 regulatory period will form a key part of our assessment of the Performance element of PREMO at the next price review.

Coliban Water has identified an upper bound figure of approximately \$500 million dollars tied to a number of capital projects it has not included in its capital expenditure forecast, that it considered were uncertain to occur in the next regulatory period or would only be initiated if certain events triggered a need to conduct the project. The upper bound figure equates to another capital program approximately the same size of the capital program being assessed for inclusion in pricing. The specific projects listed by Coliban Water under its uncertain and unforeseen events mechanism were not put forward by Coliban Water as part of its capital program, and they were not reviewed by our expenditure consultant to assess the prudence and efficiency of the associated expenditure. Our expenditure consultant considered that given the size and cost of the projects discussed under this mechanism, it would be necessary for a relevant project to undergo a review of its prudence and efficiency before any associated costs were passed on to customers.<sup>58</sup> Coliban Water's proposed uncertain and unforeseen events mechanism is discussed in more detail in Section 5.5.

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<sup>57</sup> FTI Consulting, *Coliban Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 38.

<sup>58</sup> FTI Consulting, *Coliban Water: Review of expenditure forecasts - 2023 Water Price Review*, February 2023, p. 38.

Our draft decision is not to accept the \$5.8 million proposed purchase of additional water shares for 2027-28 for the reasons specified above. But for this proposed adjustment, we have reviewed Coliban Water's proposals and advice from FTI Consulting and our preliminary view is that Coliban Water's approach to forecasting its capital expenditure is consistent with our guidance.

Based on the above, our draft decision for total gross capital expenditure is to not accept Coliban Water's proposed benchmark, and instead adopt a benchmark of \$501.7 million over the 5-year period, reflecting the \$5.8 million adjustment for additional water shares in the next regulatory period (Tables 4.5 and 4.7).

The benchmark that we propose to adopt for Coliban Water does not represent the amount that Coliban 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 Coliban Water's revenue requirement, we are not requiring the business to remove that project. Coliban 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>59</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 Coliban 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.

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<sup>59</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.

### 4.3.1 Closing regulatory asset base

Our draft decision is to not accept Coliban Water's closing regulatory asset base.

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>60</sup> This helps to ensure prices reflect the actual net expenditure of a water business.<sup>61</sup>

Coliban Water's proposed closing asset base at 30 June 2022 is provided at pages 71 and 72 of its price submission.<sup>62</sup>

We compared Coliban Water's actual net capital expenditure for 2017-18 to 2021-22 with the forecast used to approve maximum prices for the period from 1 July 2018. Typically, if a water business's net capital expenditure was more than 10 per cent above the forecast, we consider the business's justification for the additional expenditure before including it in the closing regulatory asset base. We consider this approach is reasonable given capital expenditure can be 'lumpy' in nature.

Coliban Water's net capital expenditure over the period from 2017-18 to 2021-22 was \$217.0 million. This is \$23.6 million or 12 per cent higher than the forecast used to approve maximum prices for the period from 1 July 2018. We reviewed the net capital expenditure over this period and our preliminary view is that it was prudent and efficient (refer to Section 4.2.1).

We consider Coliban Water calculated its closing regulatory asset base in accordance with the requirements of our guidance. However, our review of Coliban Water's 2021-22 approved regulatory accounts identified some necessary adjustments to its customer contributions which affect its closing regulatory asset base. Because of these adjustments, the closing regulatory asset base we have adopted for our draft decision is slightly higher than proposed by Coliban Water.

For this reason, our draft decision is to not accept Coliban Water's proposed closing regulatory asset base for 30 June 2022 of \$573.2 million, and instead adopt a figure of \$573.5 million.

Table 4.6 sets out our draft decision on Coliban Water's closing regulatory asset base at 30 June 2022.

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<sup>60</sup> See Section 4.2 for a discussion of Coliban Water's capital expenditure.

<sup>61</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.

<sup>62</sup> Available at [www.esc.vic.gov.au](http://www.esc.vic.gov.au).

**Table 4.6 Draft 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>539.8</b>	<b>552.8</b>	<b>549.5</b>	<b>553.5</b>	<b>558.0</b>
Plus gross capital expenditure	40.0	40.5	48.6	48.5	62.5
Less government contributions	0.7	0.0	0.0	0.0	2.6
Less customer contributions	3.9	4.8	3.3	3.7	4.1
Less proceeds from disposals	3.2	3.6	4.9	2.6	1.4
Less regulatory depreciation	19.3	35.4	36.5	37.7	38.9
<b>Closing RAB 30 June</b>	<b>552.8</b>	<b>549.5</b>	<b>553.5</b>	<b>558.0</b>	<b>573.5</b>

**Note:** Numbers have been rounded.

#### 4.3.2 Forecast regulatory asset base

Our draft decision is to not accept Coliban Water's proposed forecast regulatory asset base.

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

Based on our proposed adjustments to Coliban Water's closing regulatory asset base (Section 4.3.1), forecast capital expenditure (Section 4.2.2) and our draft decision to not accept Coliban Water's proposed new customer contributions (Section 5.4), our draft decision is to not accept Coliban Water's proposed forecast regulatory asset base.

Table 4.7 sets out an indicative forecast regulatory asset base reflecting our draft decision on Coliban Water's closing regulatory asset base and forecast capital expenditure, noting that the forecast customer contributions and regulatory depreciation may change, subject to Coliban Water's response to our draft decision.<sup>63</sup> As outlined in Section 4.3.2.1, in response to our draft

<sup>63</sup> Our guidance required water businesses to provide an estimate of the components of their regulatory asset base for 2022-23. This was so we could assess the opening asset base for 1 July 2023. Our guidance noted that where the 2022-23 forecasts for net capital expenditure (gross capital expenditure less government and customer contributions) is lower than the forecast benchmark for that year in its 2018 price determination, the lower amount must be used. The estimates for 2022-23 will be confirmed at the price review following the 2023 water price review. Essential Services Commission, *2023 water price review: Guidance paper*, p. 38.

decision, Coliban Water must provide updated justification and estimates for its forecast customer contributions and regulatory depreciation.

Our assessments of the components of the forecast regulatory asset base are outlined in different sections of this draft decision paper as follows:

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

**Table 4.7 Draft 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>573.5</b>	<b>572.1</b>	<b>611.4</b>	<b>659.7</b>	<b>711.3</b>	<b>760.9</b>
Plus gross capital expenditure	47.2	86.8	98.6	104.9	108.3	103.1
Less government contributions	1.3	0.0	0.0	0.0	0.0	0.0
<i>Less customer contributions<sup>a</sup></i>	<i>5.3</i>	<i>8.6</i>	<i>9.8</i>	<i>11.1</i>	<i>12.8</i>	<i>14.8</i>
Less proceeds from disposals	1.7	2.2	2.2	2.2	2.2	2.2
<i>Less regulatory depreciation<sup>b</sup></i>	<i>40.3</i>	<i>36.8</i>	<i>38.4</i>	<i>40.1</i>	<i>43.8</i>	<i>47.7</i>
<b>Closing RAB 30 June</b>	<b>572.1</b>	<b>611.4</b>	<b>659.7</b>	<b>711.3</b>	<b>760.9</b>	<b>799.2</b>

**Note:** Numbers have been rounded. <sup>a</sup> Forecast customer contributions are subject to Coliban Water's response to our draft decision on its new customer contributions, and our consideration of its response. These forecasts are indicative only (see Section 4.3.2.1). <sup>b</sup> Regulatory depreciation is calculated based on the opening regulatory asset base of the given year. Therefore, regulatory depreciation forecasts are indicative only and may change in response to any changes to the indicative customer contributions forecasts shown.



### 4.3.2.1 Customer contributions

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

Revenue from customer contributions is deducted from gross capital expenditure so it is not included in the regulatory asset base.<sup>64</sup>

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

Further, Coliban Water's forecasts for customer contributions in the financial model and the new customer contributions model do not match (Section 5.4).

For the purposes of calculating the regulatory asset base and revenue requirement in our draft decision, we have adopted Coliban Water's proposed customer contributions forecasts based on its financial model. However, Coliban Water must update its customer contribution forecasts in response to our draft decision and must ensure that the forecast customer contributions in the financial model and new customer contributions model reconcile.

## 4.4 Rate of return

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

### 4.4.1 Cost of debt

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

Our guidance required Coliban Water to use estimates of the cost of debt provided by the commission to estimate its revenue requirement. Coliban Water used the cost of debt values we specified to calculate its revenue requirement. For this reason, as set out in Table 4.7, our draft decision is to accept the cost of debt proposed by Coliban Water, noting that the cost of debt estimates will be updated following the release of the Australian Bureau of Statistics March Quarter 2023 consumer price index.

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<sup>64</sup> Revenue from new customer contributions reflects revenue earned from new connections made to the water business's water, sewerage or recycled water networks.

**Table 4.7 Draft decision – cost of debt**

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

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

#### 4.4.2 Return on equity

Our draft decision is to adopt a return on equity of 4.1 per cent, which reflects Coliban Water’s PREMO self-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 Coliban 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>65</sup> We reviewed the return on equity values in the matrix in mid-2022 given the change in market conditions that has occurred since we published our guidance in October 2021. We consider that the values in our matrix reflect the medium-term real rates of return.<sup>66</sup>

Coliban Water rated its price submission as ‘Standard’. Based on this PREMO self-rating, Coliban Water proposed a return on equity of 4.1 per cent per annum. This reflects the maximum return rate allowed in our guidance for a price submission rated as ‘Standard’.<sup>67</sup>

<sup>65</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 42-43.

<sup>66</sup> We will continue to monitor market conditions and may amend the return on equity matrix values to reflect any changes to the medium-term outlook prior to releasing our final decision. We have had regard to the return on equity adopted by interstate regulators in the following publications: Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of WaterNSW’s rural bulk water prices*, 9 September 2021; Independent Pricing and Regulatory Tribunal NSW, *Final Report - Review of prices for Sydney Water*, June 2020; Essential Services Commission of South Australia, *SA Water’s water and sewerage retail services: 1 July 2020 - 30 June 2024*, Price Determination, 1 July 2020; Queensland Competition Authority, *Final report - Seqwater bulk water price review 2022–26*, March 2022; Queensland Competition Authority (QCA), *Final report - Rural irrigation price review 2020–24, Part A: Overview*, January 2020; Office of the Tasmanian Economic Regulator, *Final report - Investigation into TasWater’s prices and services for the period 1 July 2022 to 30 June 2026*, May 2022.

<sup>67</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 42.

As outlined in Chapter 7, our draft decision is to agree with Coliban Water's PREMO self-rating and adopt its proposed return on equity.

## 4.5 Regulatory depreciation

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

Regulatory depreciation is a component of Coliban Water's revenue requirement and is also an input to calculating the regulatory asset base. Coliban Water's forecast regulatory depreciation was calculated using a straight-line depreciation profile.<sup>68</sup> We noted in our guidance that we prefer this approach. We also specified that estimates and profiles for depreciation should reflect reasonable assumptions about asset life.<sup>69</sup>

Coliban Water has proposed an asset life of around 16 years for existing assets, similar to the rate it proposed at the 2018 water price review. Coliban Water's proposed asset life for the 2023–28 regulatory period reflects a recommendation from its deliberative panel for modest price increases now to ensure future prices remain sustainable in support of intergenerational equity.<sup>70</sup>

In our 2018 draft decision for Coliban Water, we did not accept its assumptions about asset life as a basis for calculating depreciation under the straight-line method.<sup>71</sup> We considered Coliban Water had not provided sufficient justification for halving its asset life assumption for the purpose of calculating regulatory depreciation using a straight-line approach.

In its response to our 2018 draft decision, Coliban Water noted that it sought to achieve a smoother price path reflecting customer preferences for stable prices bills, and to recover depreciation amounts deferred from its 2013–18 regulatory period. It also noted that its depreciation forecast was not premised on halving asset lives. On this basis, our final decision in 2018 accepted Coliban Water's forecast regulatory depreciation.<sup>72</sup>

In terms of Coliban Water's proposal for the 2023–28 regulatory period, our preliminary view is that Coliban Water has not justified why 16 years reflects a reasonable assumption about asset life, consistent with the requirements of our guidance.

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<sup>68</sup> For the period from 2022-23 to 2027-28, Coliban Water proposed a regulatory depreciation of \$247.1 million.

<sup>69</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 39.

<sup>70</sup> The underlying assumption is that current customers should pay for a relatively higher proportion of the assets than future customers as current customers benefit more from the assets than future customers. Hence, per unit prices for current and future customers would be relatively constant. Coliban Water, 2023 water price submission, September 2022, p. 71.

<sup>71</sup> Essential Services Commission 2018, *Coliban Water draft decision: 2018 Water Price Review*, 28 March, p. 26.

<sup>72</sup> Essential Services Commission 2018, *Coliban Water final decision: 2018 Water Price Review*, 28 March, p. 24.

Nor do we consider that Coliban Water has sufficiently justified that its assumption for asset life will best achieve intergenerational equity as compared to alternative assumptions.

Our preliminary view is that Coliban Water's approach means today's customers will pay more than an efficient cost of providing services than will future customers, which runs counter to objectives associated with intergenerational equity and the efficiency objectives of the Water Industry Regulatory Order 2014.

Accordingly, our draft decision is to not accept Coliban Water's proposed forecasts for regulatory depreciation.

In forming this view, we have also considered that:

- Coliban Water's assumed asset life of 16 years for existing assets is around 30 years less than the average adopted by regional Victorian businesses on average, for the 2023–28 regulatory period (around 47 years)
- Coliban Water's assumed asset life is around 14 years lower than the next lowest asset life proposed by a water business in the current price review
- the context for the 2018 and 2023 water price reviews are different, most notably in terms of the real price increases proposed by Coliban Water in this review and likely high inflation being added to 2023-24 real prices and customer bills, compared to the real price reductions it proposed in 2018.

In its response to our draft decision, Coliban Water must propose an asset life for existing assets of at least 30 years (the next lowest asset life assumption proposed by a water business in the current review).

Alternatively, it must provide more information to justify its approach to regulatory depreciation using the straight-line method and its assumptions about asset life or propose and justify an alternative approach that is consistent with our guidance.

For the purposes of our draft decision we have adopted an assumed asset life of 16 years for existing assets, and Coliban Water's response to the matters above will inform our final decision. The regulatory depreciation estimates adopted for our draft decision are shown in Table 4.7 in Section 4.3.2.

## 4.6 Tax allowance

Our draft decision is to accept Coliban Water's proposed forecast of no tax allowance for the 2023–28 regulatory period.

The tax allowance is a component of the revenue requirement. Coliban Water has proposed no tax allowance in its revenue requirement for the 2023–28 regulatory period as it will not be required to pay tax during the 2023–28 regulatory period.

Our draft decision is to accept Coliban Water's forecast as it was calculated consistently with the method required by our guidance.<sup>73</sup>

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<sup>73</sup> Essential Services Commission, *2023 water price review: Guidance paper*, pp. 47–48.

## 5. Demand, tariffs and prices

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

### 5.1 Demand

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

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

Coliban Water's demand forecasts are set out at pages 82 to 86 of its price submission and are also included in its financial model.

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

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

### 5.2 Form of price control

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

Our guidance indicated we would have particular regard to whether a business proposed to continue its existing form of price control or introduce a new form of price control.<sup>74</sup>

Coliban Water proposed a price cap form of price control as set out on page 100 of its price submission. Under its proposal, Coliban Water will reserve the option to revert to a tariff basket during the regulatory period. This is the same as its current approach. Under the price cap form of price control, maximum prices for each prescribed service for the 2023–28 regulatory period are determined at the start of the regulatory period. Adjustments to account for movements in inflation (measured by the consumer price index published by the Australian Bureau of Statistics), return on assets and any approved pass-through mechanisms will be made during the regulatory period.

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<sup>74</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 50.

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

- it is the same as its current approach, which we have previously approved
- it provides sufficient revenue to cover the forecast efficient costs of providing services and for Coliban Water to deliver on any health, safety and environmental obligations
- it provides Coliban Water's customers with price certainty
- it is easy to explain to customers
- it is easy to verify that proposed prices comply with the determination requirements
- demand risk is more efficiently managed by Coliban Water than by its customers
- it is otherwise consistent with the requirements of our guidance.

Our draft decision is to accept Coliban Water's proposal to reserve the option to revert to a tariff basket during the regulatory period because it is the same as the current arrangement provided for in Coliban Water's 2018 price determination. This allows flexibility for the business to propose changes to prices, within certain constraints, within the regulatory period if it is sufficiently justified.

### 5.3 Tariff structures and prices

Our draft decision is to accept Coliban Water's proposed tariff structures.

Coliban Water's proposed tariffs are set out at pages 105 to 111 of its price submission.

Our draft decision does not approve prices for each tariff. Prices will need to be updated by Coliban Water to reflect our draft decision on the revenue requirement and updates to inflation and cost of debt estimates prior to our final decision. They may also need to be updated depending on our further review of its new customer contributions and depreciation. Our draft decision considers proposals related to tariff structures, the price path proposed, and any submissions on the level of prices or bills.

#### 5.3.1 Tariff structures

As outlined in our guidance, we have provided the water businesses with a large degree of discretion to decide on individual tariff structures.<sup>75</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.

Coliban Water proposed to maintain its existing tariff structures, except for its proposed changes to new customer contributions and trade waste charges and its proposal to add metering and installation charges to the schedule of prices.

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<sup>75</sup> Essential Services Commission, *2023 water price review: Guidance paper*, p. 51.

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

Coliban Water also proposed to continue to provide customers in Elmore with a discount on their annual wastewater access fees in recognition that the town will receive a lower level of service than other towns.

The Concerned Waterways Alliance recommended that we encourage all water businesses to adopt tiered water use tariff structures, or at the very least to justify why they have rejected this approach.<sup>76</sup> We consider that 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 is to accept Coliban Water's proposed tariff structures, on the basis that they are generally a continuation of Coliban Water's current approach and otherwise meet the criteria in our guidance and because Coliban Water's customers generally supported its existing tariff structures.<sup>77</sup>

Our preliminary view is that the two-part tariff structures proposed by Coliban Water for its water services and for non-residential sewerage services, will promote efficient use of these services. The two-part tariff structure sends customers a signal about the costs of their water use and is an approach that is commonly applied in other states and territories.<sup>78</sup> We also consider two-part tariff structures are easy to understand.

### 5.3.2 Prices

Under Coliban Water's proposal, prices will be higher in real terms.

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

Based on recent inflation outcomes and market expectations, the annual outcome for the March Quarter 2023 consumer price index is likely to be relatively high, noting the rate is expected to fall

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<sup>76</sup> Concerned Waterways Alliance, submission to water price review 2023, 1 December 2022, p. 5.

<sup>77</sup> Coliban Water, 2023 water price submission, September 2022, p. 105.

<sup>78</sup> Includes the tariffs of Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.



through 2023 and 2024.<sup>79</sup> For the 2023–28 regulatory period, we have assumed an inflation rate of 3 per cent per year, which is significantly lower than near-term inflation expectations.

Many of the drivers of higher inflation (such as fuel, food and travel) are not major cost items for water businesses. Considering this, Coliban Water’s proposal for increasing prices in real terms over the 2023–28 regulatory period, and the priority placed by customers on affordability, we are seeking further information from Coliban Water in response to our draft decision on how it intends to address the impacts of relatively high inflation on its proposed prices and customer bills for 2023-24.<sup>80</sup>

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

In response to our draft decision, Coliban Water will need to propose updated prices to reflect our draft decision on its revenue requirement. This includes any changes arising from our review of new customer contributions and regulatory depreciation.

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

In making our price determination, we must have regard to whether Coliban Water’s prices take into account the interests of customers, including low income and vulnerable customers.<sup>81</sup>

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

- improving access to government support (the Utility Relief Grant scheme) through faster turnaround times for its processing of the applications (applications submitted to government within 2 days)
- doubling the existing budget (to \$570,000) to support customers experiencing financial hardship.
- investing to raise awareness of customer support programs.

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<sup>79</sup> The latest (February 2023) Reserve Bank of Australia Quarterly Statement on Monetary Policy forecast the consumer price index to change (over the year) to around 4.8 per cent by December 2023 and 3.2 per cent by December 2024.

<sup>80</sup> This is relevant to clause 11(d)(ii) of the Water Industry Regulatory Order 2014 which states that when making a price determination, the commission must have regard to principles that the manner in which a regulated entity’s prices are to be calculated, determined or otherwise regulated, should provide signals about the efficient costs of providing prescribed services to customers (either collectively or to an individual customer or class of customers) while avoiding price shocks where possible.

<sup>81</sup> Water Industry Regulatory Order 2014 clause 11(d)(iii).

Coliban Water also proposed not to increase its Minor and Medium trade waste charges given concerns for non-residential customers experiencing hardship as a result of the coronavirus pandemic.

The Consumer Action Law Centre acknowledged Coliban Water's doubling of its hardship assistance and noted that direct investment in hardship support is critical.<sup>82</sup>

As noted in Section 3.1, Coliban Water's price submission was informed by engagement that was inclusive for customers more likely to experience vulnerability, and who are more likely to be adversely affected by the proposed price path. Coliban Water also engaged with and supplied in its pricing submission letters from community agencies supporting its proposed assistance to customers experiencing vulnerability.

We note Coliban Water received a number of submissions that supported its proposed price increase, with an understanding of the infrastructure needs, the increased support for vulnerable customers, and the work needed to increase water security for Kyneton and Trentham.<sup>83</sup>

#### 5.3.4 Unique services

Coliban Water's unique services are set out at pages 108 to 112 of its price submission. Coliban Water proposed to introduce a Medium trade waste category to better manage these customers. For the 2023–28 regulatory period, the tariffs for Medium trade waste customers are proposed to be aligned with existing Minor trade waste customers. Coliban Water also proposed to introduce five new trade waste non-compliance charges to incentivise compliance, and to include scheduled metering and installation charges in its tariffs.

Coliban Water has confirmed its proposed tariffs for trade waste and miscellaneous services, which includes its proposed metering and installation charges, are calculated in accordance with the pricing principles referenced in our guidance. We sought further information from Coliban Water regarding its proposed trade waste non-compliance charges and, in response, Coliban Water confirmed that the charges were supported by its trade waste customers.<sup>84</sup>

The Concerned Waterways Alliance recommended that all water businesses should spell out how their pricing mechanisms can be used to avoid pollution and harm.<sup>85</sup> Coliban Water's quality-based

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<sup>82</sup> Consumer Action Law Centre, submission to water price review 2023, 30 November 2022, p. 9.

<sup>83</sup> Coliban Water received letters of support from: DJARRA (Dja Dja Wurrung Clans Aboriginal Corporation); City of Greater Bendigo Youth Council; City of Greater Bendigo; Be.Bendigo; Salvation Army; Coliban Water Rural Customer Advisory Group; City of Greater Bendigo and its Farming and Agribusiness Advisory Committee; Hepburn Shire Council (CEO); and the Macedon Ranges Shire Council (CEO). These letters are included in Appendix A of Coliban Water's price submission, which is available on our website.

<sup>84</sup> Coliban Water, 2023 water price submission, September 2022, p. 108.

<sup>85</sup> Concerned Waterways Alliance, submission to water price review 2023, 1 December 2022, p. 3.

trade waste charges have been put in place to incentivise trade waste customers to limit their trade waste discharges.

## 5.4 New customer contributions

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

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

Coliban Water's proposed new customer contributions are set out at pages 103 to 113 of its price submission. Coliban Water proposed using a model based on average incremental cost to estimate its new customer contributions rather than the net incremental cost approach it has used in the past.<sup>86</sup>

Coliban Water proposed to:

- increase its new customer contributions for water services from \$1,790 to a capped \$3,144 per lot (a 76 per cent increase) and for sewer services from \$1,790 to a capped \$4,453 (a 149 per cent increase) between 2022-23 and 2027-28
- phase in the new customer contributions until it reaches the \$3,144 cap per lot for water services and \$4,453 cap for sewer services in 2027-28<sup>87</sup>
- continue to set the new customer contributions for recycled water services at 50 per cent of the new customer contributions for water services causing these to also increase by 76 per cent between 2022-23 and 2027-28
- provide an annual rebate to wastewater new customer contributions if its wastewater growth capital expenditure falls materially short of proposals
- provide a discount to developers who are required to fully fund a pump station to service their own development.

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<sup>86</sup> The average incremental cost approach calculates the new customer contribution charge by dividing the capital and operating cost of a growth area by the number of connections in that area. The net incremental cost approach applies the incremental revenue less incremental cost to estimate the new customer contribution charge.

<sup>87</sup> Coliban Water set the phased new customer contributions by increasing water and wastewater services by 20 per cent each from 2022-23 to 2023-24. It then proposed a price path of 10 per cent increase annually for water services and 20 per cent annually for wastewater services from years 2 to 5 of the 2023–28 regulatory period.

Coliban Water put forward three reasons for using the average incremental cost approach, namely, that it will address:

- risks associated with the recent development boom across the towns serviced by Coliban Water
- the issue of inadequate cost reflectivity
- a perceived lack of transparency in the rationale and calculation of existing new customer contributions.<sup>88</sup>

We consider the net incremental cost approach outlined in our guidance, and previously adopted by Coliban Water, also enables water businesses to address risks associated with changes in development, allows for cost reflectivity and is transparent, and that these issues can be flexibly dealt with by applying that approach.<sup>89</sup> Further, water businesses have the flexibility to negotiate different charges for different developments or growth areas as circumstances may require.

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

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.<sup>90</sup>

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

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<sup>88</sup> Coliban Water, 2023 water price submission, September 2022, p 103-104.

<sup>89</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, pp. 59-60.

<sup>90</sup> Essential Services Commission, 2023 water price review: Guidance paper, p. 59.

### 5.4.1 Fair and reasonable costs

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

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

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

Coliban Water has not provided us with sufficient information to enable us to be satisfied that it has implemented the average incremental cost approach according to the Water Act section 268(3).

We also consider that Coliban Water's methodology to allocate costs to new customer contributions is unclear:

- it has not provided any policy documentation on how shared capital expenditure for water and sewer upgrades have been included in new customer contributions.
- it is unclear how Coliban Water has allocated its capital expenditure to growth.
- costs appear predominantly in the Bendigo catchment, however charges are applied equally across regions.

### 5.4.2 Incremental infrastructure and associated costs

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

Our preliminary review of Coliban Water's allocation of growth capital expenditure to new customer contributions has found that the forecast costs may not be reasonable and appropriately attributed to developers. In response to our draft decision, we require Coliban Water to provide further information on how it has allocated its capital expenditure to new customer contributions.

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

#### **5.4.2.1 Transparency and justification of proposed transition to cost reflective pricing**

We understand that Coliban Water's proposed charges do not reflect the average incremental costs in its pricing model. Instead Coliban Water has opted to cap charges below the relevant costs and phase in its implementation to minimise price shocks. Coliban Water explained that the proposed capping below cost and phased implementation was a response to feedback from the development community.<sup>91</sup> Coliban Water has not provided us with any explanation of its proposed transition plan to achieve fully cost-reflective pricing or a justification of this transition plan.

The Consumer Action Law Centre sought closer scrutiny of those price submissions that do not address decreasing cross subsidies, and said that it wants to see all users, particularly builders and developers, pay the full costs of their water use.<sup>92</sup> Builders and developers generally recover the new customer contributions from home buyers, hence buyers will face the higher charges. Existing customers may partly benefit from developments funded by new customer contributions too.<sup>93</sup>

We require Coliban Water to provide us with sufficient information about its transition plan to enable us to make a final decision about whether Coliban Water's proposed transition is appropriate.

#### **5.4.2.2 Proposed structure of new customer contributions**

Coliban Water proposed to maintain its postage stamp approach to new customer contributions based on its engagement with developers since 2017.<sup>94</sup> It noted that region-specific new customer contributions would be higher in Maiden Gully and Strathfieldsaye compared to central regions. Coliban Water did not provide us with enough information to assess how Coliban Water distinguished between infill and greenfield growth areas and its reasons for not proposing charges to reflect this distinction. We cannot verify if Coliban Water's capital expenditure is reasonably attributed between multiple drivers and catchments.

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<sup>91</sup> In response to our request for information, Coliban Water provided engagement materials outlining developers' support of the capped new customer contributions.

<sup>92</sup> Consumer Action Law Centre, Initial Feedback: 2023-28 Water Price Review, 30 November 2022, p. 5.

<sup>93</sup> Historically, customers have never fully paid for the regulatory asset base as it was originally set below cost for pricing purposes. Hence, existing customers have benefitted from a cross-subsidy of the total cost of the regulatory asset base. Developer contributions reduce the regulatory asset base and therefore the prices of water and sewerage services paid for by the general customer base.

<sup>94</sup> Coliban Water, Response to request for information, 19 December 2022.

We published Coliban Water's new customer contribution models on our website for public consultation.<sup>95</sup>

In response to our draft decision, Coliban Water must explain how it considered setting new customer contributions that distinguish between infill and greenfield growth areas and its reasons for not proposing charges to reflect this distinction.

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

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

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

As noted above, we require further information from Coliban Water on the allocation of its assets between its pricing model and new customer contributions model as we are not satisfied that capital expenditures are appropriately allocated to the new customer contributions model.

On the information provided to us, we are also unable to reconcile the new customer contributions revenue included in the new customer contributions with the financial model from 2023-24 to 2032-33.<sup>96</sup>

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

### **5.4.4 Avoidable costs of connection and standalone costs of connection**

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

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<sup>95</sup> Essential Services Commission, Coliban Water's price submission, accessed on 27 February 2023, <https://www.esc.vic.gov.au/water/water-prices-tariffs-and-special-drainage/water-price-reviews/water-price-review-2023/coliban-water-price-review-2023#tabs-container2>.

<sup>96</sup> The customer contributions revenue in the financial model do not match with estimated customer contributions using the calculated, capped and proposed new customer contribution charges and the corresponding connection numbers set out in the new customer contributions model by service.

Coliban Water has not provided any evidence that the cap on its proposed new customer contributions has not caused the new customer contribution to fall below avoidable cost.

Accordingly, Coliban Water has not provided us with sufficient information to enable us to be satisfied that it has met this pricing principle.

In response to our draft decision, we require further information from Coliban Water on how the proposed cap on new customer contributions complies with the above pricing principle.

#### **5.4.5 Engagement and transparency matters raised by stakeholders**

The Urban Development Institute of Australia and MG Estates raised concerns about Coliban Water's price submission in relation to an inadequate level of engagement, lack of detailed information including in relation to calculations and methodology, cost allocation, treatment of shared/upsized assets and number of lots and sequence for the roll out of subdivisions.<sup>97</sup> They sought public disclosure of the inputs and methodology used to estimate standard new customer contributions and its negotiating framework.

Coliban Water provided a further submission to us in January 2023 in response to the issues raised by MG Estates.<sup>98</sup> Our review identified that Coliban Water's engagement with developers commenced in mid-2021 and involved workshops with follow up surveys but that there was minimal information provided about the proposed average incremental cost methodology.<sup>99</sup>

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

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

#### **5.4.6 Next steps**

In response to our draft decision in relation to new customer contributions, Coliban Water must:

- provide further information to enable us to assess if growth related costs have been appropriately attributed between new customer contributions and charges paid for the general customer base

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<sup>97</sup> Urban Development Institute of Australia, Submission Water Price Review, 1 December 2022; MG Estates, Submission of MG Estates Pty Ltd, 1 December 2022.

<sup>98</sup> Coliban Water, Response to the submission of MG Estates, 12 January 2023.

<sup>99</sup> Coliban Water, 2023 water price submission, September 2022, pp. 49-50. In a further submission in January 2023, Coliban Water also advised that its augmentation plan for each town is available on its website. Coliban Water, Response to request for information, 20 February 2023.



- explain its transition plan towards achieving full cost reflectivity for each service including the timeframes of this plan and provide reasons for adopting this transition plan and its timing
- set out how it proposes to fund any shortfall in revenue from new customer contributions, compared to the estimated costs of providing the service
- explain how it considered setting new customer contributions that distinguish between infill and greenfield growth areas and its reasons for not proposing charges to reflect this distinction
- information regarding how its proposed cap on new customer contributions has not caused the contributions to fall below avoidable costs
- ensure that its proposed new customer contribution charges and connection numbers by service reconcile between its new customer contributions model and financial model.

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

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

#### **5.4.7 Negotiated new customer contributions framework**

Coliban Water provided us with its negotiating framework for negotiated new customer contribution contracts and published it on its website.<sup>100</sup> As noted above, we are still assessing the proposed average incremental cost approach used by Coliban Water to calculate negotiated new customer contributions. For this reason, our draft decision is to not accept Coliban Water's proposed framework for negotiated new customer contributions.

### **5.5 Adjusting prices**

Our draft decision is to accept Coliban Water's proposed price adjustment mechanisms.

Coliban Water's proposed price adjustment mechanisms are set out at pages 101 to 103 of its price submission. It proposed to:

- continue to apply annual changes to benchmark cost of debt adjustments to tariff categories including trade waste charges
- retain the existing price adjustment mechanisms in relation to uncertain and unforeseen events.

Coliban Water has identified a number of uncertain or unforeseen events and approaches to manage these events prior to seeking a re-opening of its determination. For example, Coliban

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<sup>100</sup> Coliban Water NCC Negotiating Framework Revision March 2022.

Water proposed to rebalance its capital expenditure program in the first instance, where appropriate, or to fund the project through increased debt. We sought further information from Coliban Water, and it confirmed that it was only seeking to list a number of potential triggers that may re-open the determination and not seek to include these capital expenditure items as ‘uncertain’ events in its determination. This is further discussed above in Section 4.2.

Our draft decision accepts Coliban Water’s proposal to retain the existing price adjustment mechanisms in relation to uncertain and unforeseen events and to apply annual changes to benchmark cost of debt adjustments to a revised set of tariffs in the 2023–28 regulatory period because it is consistent with the requirements outlined in clause 11 of the Water Industry Regulatory Order 2014.<sup>101</sup>

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<sup>101</sup> WIRO clause 11(d)(ii).

## 6. Financial position

We have reviewed key indicators of Coliban Water's financial performance and our preliminary view is that Coliban 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>102</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.

Coliban Water's price submission and the supporting financial model provided estimates for key indicators of financial performance. These estimates were based on Coliban Water's assumptions about its revenue and expenditure. We have reviewed the key indicators of financial performance and our preliminary view is that we consider Coliban 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>102</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 Coliban 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>103</sup> We required Coliban 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 Coliban Water to consider its level of ambition in relation to matters covered in its price submission, such as proposals related to operating and capital expenditure, the form of price control, and tariffs.

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

### 7.1 Our PREMO assessment of Coliban Water's price submission

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

Coliban 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 proposed ratings following our assessment of Coliban Water's price submission.

**Table 7.1** PREMO rating

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

<sup>103</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.

Our preliminary view is that we agree with Coliban Water’s proposed overall PREMO self-rating of ‘Standard’. This is reflected in the return on equity we propose to approve for Coliban Water (see Section 4.4.2). We have formed this view after reviewing Coliban Water’s proposed self-rating for each of the five PREMO elements, with a summary of our assessment provided below.

### 7.1.1 Performance

For the 2023 price review, a business’s rating for the Performance element of PREMO is based on a combination of its overall PREMO rating at its most recent price review, and its level of performance based on achievement of outcomes (related to service targets and performance against expenditure benchmarks set at the previous price review) and customer sentiment.<sup>104</sup>

As noted in Section 3.2, we agree with Coliban Water’s self-assessment that it has, overall, met its outcome commitments for the period to date. In supporting the robustness of its self-ratings, Coliban Water published its performance assessments prominently on its website and sought the views of its customers before finalising its self-ratings.

In terms of customer perceptions, Coliban Water’s results on the commission’s survey of customer sentiment – covering measures of overall satisfaction, value for money, trust, and reputation in the community – generally improved over the regulatory period. In our most recent survey (January 2023) Coliban Water generally ranked among the lower performing businesses across most measures, but ranked around mid-table for trust.<sup>105</sup>

Coliban Water’s controllable operating costs during the current regulatory period are forecast to be higher than the benchmark established at the 2018 water price review (Section 4.1.1).

In 2021-22 (the last available year of audited results), its expenditure was around 14 per cent higher than the benchmark adopted at the 2018 water price review (compared to the industry average of around 9 per cent. While we accept that some costs have increased in the current regulatory period, we consider that businesses should still seek to manage and reprioritise costs closely having regard to the price review benchmarks.

Our draft decision is to not accept Coliban Water’s self-rating of its price submission as ‘Advanced’ for the Performance element of PREMO. While meeting its outcome commitments, the increase in its controllable operating costs above the 2021-22 benchmark set in 2018 for its controllable operating costs, is among the highest of all businesses in the current price review.

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<sup>104</sup> As set out in Essential Services Commission, *2023 water price review: Guidance Paper*, October 2021, pp. 74-75. Guiding questions are set out on page 45.

<sup>105</sup> The commission’s customer perception survey results are available on our website. See <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/how-customers-rate-their-water-business#tabs-container2>.

On this basis, and taking into account the above, we consider Coliban Water did not meet performance expectations in the current regulatory period, and as such our draft decision proposes a rating of ‘Standard’ for the Performance element of PREMO.

### 7.1.2 Risk

The Risk element of PREMO is assessed against guiding questions focused on the appropriate allocation of risk (so that customers don’t pay more than they need to), and the business’s proposed guaranteed service level scheme (including that it provides incentives for the business to deliver valued services efficiently).<sup>106</sup>

Our draft decision is to not accept Coliban Water’s self-rating of its price submission as ‘Standard’ for Risk, and instead adopt a rating of ‘Basic’.

We consider Coliban Water has not justified the adoption of a relatively aggressive approach to depreciation, evident in its proposed 16-year life for existing assets which has the effect of raising customer prices in the 2023–28 regulatory period and lowering prices at some later time.

This is in the context of Coliban Water proposing relatively large real price increases over the 2023–28 regulatory period, at least in part to address what it has described as a historical under-investment to meet its compliance obligations.

Our preliminary view is that Coliban Water’s proposed approach to depreciation would mean customers in the near term would be paying more than they need to.

### 7.1.3 Engagement

The Engagement element of PREMO is assessed against guiding questions such as the form, timing, and nature of matters engaged on by the water business, and the influence of engagement on proposals. We also consider the extent to which a business has undertaken inclusive engagement, including with First Nations people and those experiencing vulnerability.<sup>107</sup>

Generally, we found Coliban Water’s engagement to be at a high level, involving activities that were inclusive and well suited to the context it was engaging in, which included real price increases over the regulatory period. Coliban Water was able to achieve high quality and meaningful engagement across a range of its engagement methods, particularly among customers experiencing vulnerability and Traditional Owners.

However, for its engagement with developer stakeholders, we consider that engagement methods and materials should have been better tailored to their level of sophistication, to support

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<sup>106</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 45.

<sup>107</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 45.

stakeholders to provide meaningful feedback prior to a pricing submission being made to us. For an 'Advanced' submission, we would also expect stronger endorsement of its engagement process by stakeholders, along with greater alignment between a business's proposals and the preferences and interests elicited in its engagement program. Although most stakeholders strongly endorsed Coliban Water's engagement process, as described above in Section 3.1, developer stakeholders expressed some concerns.

When forming our preliminary view, we have considered the issues in relation to developer engagement in the context of an engagement program that in other areas was well designed and delivered. We have considered the overall level of customer influence Coliban Water was able to achieve, including by adopting all recommendations of its deliberative community panel. We also considered the overall customer endorsement, which was strong in relation to its other engagement activities.

For the above reasons we have formed the preliminary view to accept Coliban Water's 'Advanced' self-rating for the Engagement element of PREMO.<sup>108</sup>

#### 7.1.4 Management

The Management element of PREMO is assessed against guiding questions that cover matters such as the efficiency of proposed expenditure and prices, the quality of the business's submission and supporting information to justify proposals, and evidence that there is senior-level ownership and commitment to the proposals contained in the submission.<sup>109</sup>

In support of its self-rating of 'Standard' for the Management element of PREMO, as noted in Section 4.1.1, Coliban Water proposed an efficiency improvement rate for controllable operating expenditure over the next regulatory period of 1.4 per cent per year, one of the highest efficiency improvement rates of all businesses in the current price review.

We received submissions from MG Estates and the Urban Development Institute of Australia, which disagreed with Coliban Water's 'Standard' self-rating for the Management element of PREMO.<sup>110</sup> As noted in Section 5.4, our draft decision proposes to not approve Coliban Water's proposed new customer contributions, as our preliminary view is that it has not provided sufficient information or justification in a number of areas.

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<sup>108</sup> Urban Development Institute of Australia, Submission Water Price Review, 1 December 2022; MG Estates, Submission of MG Estates Pty Ltd, 1 December 2022.

<sup>109</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 45.

<sup>110</sup> Urban Development Institute of Australia, Submission Water Price Review, 1 December 2022; MG Estates, Submission of MG Estates Pty Ltd, 1 December 2022.

Based on advice from FTI Consulting, we have also tested Coliban Water's assumptions for forecast operating and capital expenditure, and our preliminary view is that except for some relatively small adjustments, they reflect efficient expenditure.

We consider Coliban Water's financial model contained no substantive errors and was consistent with its written submission. Its price submission was well presented and clearly linked the outcomes of its engagement to planned outcomes and expenditure. The Coliban Water Board has also attested to the accuracy of the information contained in its submission, as required by our guidance.

Accordingly, our draft decision is to accept Coliban Water's self-rating of its price submission as 'Standard' for Management.

### 7.1.5 Outcomes

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

- the alignment of proposed outcomes with customer priorities and expenditure forecasts
- whether the proposed outcomes are measurable
- the processes established to measure performance and report to customers.<sup>111</sup>

As noted in Section 3.2, our preliminary view is that Coliban Water has provided evidence that demonstrates its outcome measures and targets were developed in consultation with its customers, and that they are supported by customers. It held customer forums in June 2022 to revise its outcomes and circulated a draft of its outcomes and measures for broader community feedback in July 2022. Its outcomes set was provided to its deliberative panel, from which nine recommendations were made and incorporated.

Coliban Water's proposed targets for its outcome measures suggest an overall improvement in customer service levels. Coliban Water will continue to report annually to its customers on how it has performed against its outcome commitments, and it will continue engaging its customers on its outcomes at its annual regional advisory group forum.

Coliban Water will also develop an online dashboard where customers can view more information on its performance against its outcome commitments which we consider will support its accountability to its customers.

Accordingly, our draft decision is to accept Coliban Water's self-rating of its price submission as 'Advanced' for the Outcomes element of PREMO.

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<sup>111</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021, p. 45.



## Appendix A — Submissions received

Name or organisation	Date received
Anonymous	7 October 2022
Consumer Action Law Centre	30 November 2022
Concerned Waterways Alliance	1 December 2022
MG Estates	1 December 2022
Urban Development Institute of Australia	1 December 2022
Concerned Waterways Alliance	21 December 2022

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

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

Below, we describe how we apply the mandatory factors and where we have done so in our draft decision for Coliban 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>112</sup> We have had regard to the matters specified in our guidance in reaching our preliminary view. Our draft decision provides further information on where we have considered our guidance, and Coliban Water’s compliance with our guidance, in reaching our preliminary view.

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

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

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

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

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

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

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<sup>112</sup> Essential Services Commission, *2023 water price review: Guidance paper*, 26 October 2021.

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

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

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

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

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

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

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

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

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

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

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

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

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

- A 10-year trailing average approach to estimating the benchmark cost of debt (see Section 4.4.1).
- A regulatory rate of return that we consider will enable Coliban Water to recover borrowing costs associated with its investment in services, and generate a return on assets.<sup>113</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 draft decision, we have had regard to the extent Coliban Water has demonstrated its forecasts reflect efficient costs to deliver services valued by customers, and to deliver on relevant legislation and relevant health, safety, environmental and social obligations.

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

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

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<sup>113</sup> The regulatory rate of return is comprised of the cost of debt and the return on equity.

- Our assessment of tariffs (Section 5.3).

## **Industry specific matters**

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

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

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

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

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

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

Our draft decision provides for Coliban 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>114</sup>
- operating and capital expenditure costs per connection throughout Australia<sup>115</sup>
- tariff structures applied by water businesses throughout Australia<sup>116</sup>
- the regulatory rate of return set by other regulators.<sup>117</sup>

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

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

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

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

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

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

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<sup>114</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*, February 2022.

<sup>115</sup> Bureau of Meteorology, *National performance report 2020-21; urban water utilities, part A*.

<sup>116</sup> Includes Icon Water, Sydney Water, Hunter Water, Central Coast Council, Power and Water Corp, Urban Utilities, Unity Water, SA Water and TasWater.

<sup>117</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 draft decision involved consideration of this factor:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- Our consideration of customer engagement (Section 3.1)



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

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

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

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

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

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

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

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

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

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

## **Other matters**

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

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

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

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

We consider that our pricing approach helps to address market power and information asymmetries relating to the water businesses. Our PREMO water pricing approach provides incentives for a water business to provide its “best offer” to customers in its price submission. This is described in further detail in a report we released in 2016.<sup>118</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>119</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>118</sup> Essential Services Commission 2016, Water Pricing Framework and Approach, Implementing PREMO from 2018, October, pp. 11–13.

<sup>119</sup> Essential Services Commission, 2023 water price review: Guidance paper, p. 2.

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

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

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

- Implementing a price review process so that water businesses may receive streamlined price reviews if they submit a high quality price submission. This reduces the costs of regulation for water businesses and the commission.
- Focusing our assessments of price submissions on the materiality of proposals to customer interests (including low income and vulnerable services), including in terms of price, bill and service impacts.
- Designing our guidance so we minimise the compliance costs for water businesses. Our guidance noted that much of the information required in price submissions should be readily available to water businesses as it would be relevant for other purposes such as corporate planning and project prioritisation and justification.<sup>120</sup>

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<sup>120</sup> Essential Services Commission, 2023 water price review: *Guidance paper*, p. 2.

## Appendix C – Average incremental cost methodology and the Water Act

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

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

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

To take into account the benefit to a connecting property relative to the benefit to other properties, a new customer contribution charging regime must determine how much a connecting party should pay upfront versus what will be paid through ongoing charges.<sup>121</sup> Ongoing charges are paid by both the connecting party and all other customers via inclusion in the regulatory asset base.

The water business undertakes this task by deciding:

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

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

This regulatory price setting and cost recovery task can be done through the incremental costs minus incremental revenues calculation required in the current new customer contribution guidance,<sup>122</sup> applied in conjunction with a building block approach that only adds net capital expenditure (that is, gross capital expenditure less contributions) into the regulatory asset base.

It is also possible to do this task by applying the benefits assessment at a planning stage. When setting standard new customer contributions, a water business can determine what costs relate to new connections and what relate to existing customers, and then direct the costs accordingly to new customer contributions and the regulatory asset base (or regulated operating expenditure

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<sup>121</sup> Ongoing charges are paid by both the connecting party and all other customers via inclusion in the regulatory asset base.

<sup>122</sup> Essential Services Commission, Estimator Guidance – New Customer Contributions (September 2012); see also Essential Services Commission, Explanatory Notes – New Customer Contributions for The Victorian Water Industry (9 December 2013) and Essential Services Commission, 2023 water price review: Guidance paper, 26 October 2021, p. 59.

allowance). By ensuring that the calculation of the building block revenues accounts for this view of relative benefits and does not double count the cost recovery, the equivalent regulatory outcome can be achieved.

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

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