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December 14, 2015

Water Team – Essential Services Commission
Attention: Marcus Crudden
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2 Lonsdale Street
MELBOURNE VICTORIA 3000

E-mail – water@esc.vic.gov.au

Dear Marcus,

REVIEW OF WATER PRICING APPROACH

Thank you for the opportunity to provide input into the Essential Services Commission Water Pricing Review. Several representatives of Wannon Water attended the recent Water Pricing Conference and found it educational and useful to hear the thoughts of the various contributors in person.

Consequently we are now more informed to provide input to the review process. There were a number of proposals, or aspects of proposals, that we believe could strengthen the pricing approach adopted by the Essential Services Commission (ESC), as well as those that may be more challenging to implement.

We provide our comments below in regards to individual pricing approaches or aspects/ themes discussed at the Conference.

Building Blocks Methodology

A number of the presentations over the two days included the building blocks methodology as the primary tool of the price setting process. We strongly agree that the building block methodology is an appropriate tool to initially establish the revenue requirement of a Corporation and that the use of secondary tools would be appropriate to enhance the process.

When consulting and gaining customer feedback, the building block methodology would be easier to communicate to customers as opposed to methodologies such as Total Factor Productivity. Also, the building block methodology has greater transparency to stakeholders by disclosing and calculating the different components of a Corporation's expenditure.



We are of the view however, that the return on the Regulatory Asset Base (RAB) component of the building blocks approach is not 'consumer friendly' when it comes to communication with customers. The Weighted Average Cost of Capital (WACC) is a complicated formula with many parameters involved. If this could be simplified, the building blocks approach would be far easier to understand. In addition, a return on the RAB with few parameters to be used as levers would be a favourable outcome from this pricing review process.

Fast Tracking/ Earned Autonomy/ Light Handed Reviews

A number of the ideas papers and presentations have raised the concept of earned autonomy, light handed regulation and fast tracking. We strongly support the integration of this into the price setting process.

The benefits of such an approach would include greater efficiency (for the ESC and the Corporation) and could be a mechanism to drive focus on particular areas, whether it is higher quality plans or increased consultation for example. The reputational benefit that could be earned by Corporations in achieving a fast tracked plan would also be a strong incentive.

If this approach were to be adopted, Corporations would require clear criteria on what would and would not earn autonomy, otherwise the benefits of such a process could be undermined. For example, if the process as proposed by Synergies were to be adopted, and a Corporation failed with its Type 1 status plan, then sufficient time would be required to then move to a Type 2 status plan. If sufficient time is not provided, then the quality of the Type 2 plan will be compromised, which would be an undesirable outcome for all.

The criteria to achieve a fast tracked plan/ autonomous plan and light handed review by the regulator would need to be clear, reliable and objective. If this is not the case, then the risk and uncertainty of achieving a fast tracked plan, may counter the benefit.

In addition, earned autonomy approaches that allow only a limited number of corporations the right to earned autonomy is problematic. It is our position that earned autonomy should be provided to all corporations that can achieve the defined benchmarks.

Rolling Price Reviews

We thought the proposal by Yarra Valley Water in regards to rolling price reviews was attractive for a number of reasons:

- The alignment with the Corporate Planning process and the continuous five year outlook
- Smoothing of workloads, and therefore resources, over the five year period, for both the Corporations and the ESC

- Provides an opportunity to develop stronger relationships between the ESC and individual Corporations
- The ability to adjust on an annual basis, key assumptions, such as WACC (or its alternative), customer growth rates and water volumes

We do acknowledge that adjusting assumptions on an annual basis would give customers less certainty over prices, but it would result in fairer prices year to year.

We would be very interested in further detail of how this approach might be implemented by the ESC and integrated with the building block methodology. The Corporate Planning process can be a period of high demand on the Corporations resources, so how the price review would integrate with this, as well as be completed in time to inform the Corporate Plan would be critical to its success.

Benchmarking

We do not agree with applying a benchmarking approach to set an efficiency improvement or adjustment to a Corporations revenue requirement.

There was much learning from the former Office of Living Victoria benchmarking review. From our perspective the biggest learning was that applying a set of benchmarks to all Corporations could potentially result in imbalanced outcomes for the majority of Corporations. The environments within which we each operate are too diverse for benchmarking to be successful, for example:

- Size of the customer base serviced
- The geographical area serviced
- The type of services provided/ customers serviced – urban customers only, rural customers/ rural water, remote and small towns, densely populated towns etc.
- The type of assets required to treat various types of water sources

If benchmarking was to be further considered by the ESC as part of the price setting process, we would want an opportunity to provide further input into this approach. More detail could be provided regarding:

- What data would be required to be collected and how,
- How the data would be compiled and adjusted to develop benchmarks that can be applied to all; and
- How the ESC would ensure that the data that is to be captured, is consistent from all Corporations.

The obligation to provide appropriate data, and therefore the detail a Corporation would need to go to, would likely offset the benefit of applying benchmarks for pricing purposes.

Unbundling/ Value Chain

Sapere Research Group proposed within their paper an unbundling/ value chain approach to setting prices. We agree with and support some of the benefits within this approach, such as the increased transparency with regard to the establishment of prices and the monitoring of performance across the different aspects of the Corporation.

Our concern with this approach is the increase in administration cost and time. While we currently collect some information that would allow the 'ring fencing' of some costs and assets, it would still require considerable work and refinement for it be able to be utilised for regulatory purposes.

With this in mind, our other concern is the lead time available to implement the relevant systems and processes, to inform a price setting process and then be able to manage and track performance. Given the limited time that we will have available leading into the next pricing period once the ESC's review is complete, we are not sure that such an approach would be achievable.

Customer Consultation/ Community Engagement

An overall theme throughout the conference was the importance of, and the increased focus on, customer consultation. We support this emphasis and contend that consideration be given to extending this concept to greater focus on "community engagement",

The International Association of Public Participation (IAP2) clearly outlines a spectrum of public participation¹ defining "Consultation" as "obtaining public feedback on analysis, alternatives and/or decisions". It is our contention, that it is more appropriate to "involve" stakeholders; that is to "work directly with the public throughout the process to ensure that public concerns and aspirations are consistently understood and considered". Therefore, using the word "engagement" rather than "consultation" suggests earlier and more ongoing involvement of stakeholders in the development of pricing determinations.

Given water can be considered a public good, we suggest consideration of using the word "Community" rather than "Customer" in order to recognise that whilst customers may be the primary stakeholder, that other stakeholders in the community should also have the opportunity to be involved in a conversation about what is valued within their communities in relation to water.

Finally we encourage the ESC to take up the verbal offer at the most recent IWA conference to engage with water corporations to develop a set of principles about community engagement in the lead up to the next pricing submission.

One method of customer engagement raised at the pricing conference was Customer Groups negotiating direct with Corporations. We do not believe this is an appropriate approach to customer engagement as it places too much power in the hands of some sub-categories of

¹ <http://www.iap2.org.au/documents/item/84>

customer groups (i.e. often those that have greater resources available to them and with stronger advocacy skills), over others (i.e. those with fewer resources and less able to advocate).

Thank you again for the opportunity to provide input into the Essential Services Commission Water Pricing Review. We look forward to the outcome of this stage of the process.

If any clarification or further information is required regarding the above, please don't hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A-Je/L' with a long horizontal stroke extending to the right.

**ANDREW JEFFERS
MANAGING DIRECTOR**