



# Essential Services Commission

Pricing Framework Review

**Barwon Water – Supplementary Response**

Response Date: 11 December 2015

## Barwon Water response to Commission's Pricing Framework Review

Barwon Water would like to thank and congratulate the Commission on their consultation process to date on this important issue that will impact almost every Victorian. The opportunity to hear from leading regulatory experts at the recent Pricing Conference has been insightful and thought-provoking. Our response is provided with the hope that a fair and sustainable outcome is reached in time for the 2018 Price Submission.

Barwon Water has provided possible solutions to some of the identified improvement opportunities. These suggestions should however be interpreted as research topics for the Commission to consider given that Barwon Water does not have all the information to fully assess their effectiveness or other potential impacts to businesses, customers and other stakeholders.

### The pricing model

As per Barwon Water's initial submission in June 2015, we remain of the opinion that the building-block pricing model (the model) is able to achieve many regulatory objectives for pricing water and sewer services in Victoria. The main reasons for this conclusion are that the model:

- is well understood by the industry,
- inputs and their relationships with resulting prices are transparent,
- allows for scenario modelling to be undertaken and explained in relatively plain English to customers and other stakeholders,
- has a mechanism to adjust for unforeseen and uncontrollable events,
- identifies revenue requirements which take account of the financial health of the business;
- it requires inputs that most businesses have readily available from current financial systems and processes.

### Pricing model Improvement opportunities

Barwon Water's July 2015 submission identified a number of pricing model improvement opportunities that could be considered.

Improvement opportunity	Possible solution
The model adopts <b>static efficiency targets</b> that can limit incentives for improvement over the life of a Price Determination	These two points may be overcome by introducing efficiency sharing schemes for capital and operating expenditure.
It is difficult to accurately determine <b>efficient levels of expenditure</b> at a single window period, i.e. during the price submission process	Menu regulation could assist in achieving this objective but may prove too difficult to explain and implement in collaboration with customers and other stakeholders.

### Unsupported methodologies

Barwon Water does not believe that total-factor-productivity (TFP) and yardstick benchmarking methodologies would result in achieving the objectives of the review and the long-term interests of Victorian customers.

Results from benchmarking studies must take a significant amount of circumstantial data into consideration if an effective comparison is expected to be made. This would require much more data to be reported, compared to what is done currently, which would likely result in higher costs of regulation.

## Pricing framework administration

This section addresses a number of administrative aspects of the pricing process within a regulatory period.

In general, Barwon Water supports the current administration of the pricing process and believes that the annual CPI and price path adjustment process works well.

### Pricing framework Improvement opportunities

Barwon Water has identified a number of improvement opportunities to take into consideration which may improve the administration of the pricing process.

Improvement opportunity	Possible solution
<b>Cost of regulation</b>	Any changes in the pricing framework should not result in higher costs of regulation. Benefits and efficiencies from improvements should not be outweighed by increases in regulatory licence fees.
Significant resources spent each pricing period on <b>forecasting a weighted average cost of capital (WACC)</b> .	Water businesses could make an annual tariff adjustment to update the WACC with actual results, as is done with the annual consumer price index (CPI) adjustment.
The model adopts <b>static efficiency targets</b> that can limit incentives for improvement over the life of a Price Determination	The rolling price determination proposal, developed by Yarra Valley Water, may result in a more dynamic and resilient price determinations. Price submissions may also become less onerous if aligned with Corporate Plan submissions.  This could further incentivise efficient expenditure if combined with an efficiency incentive mechanism.
Excluding reputational, there is a <b>lack of incentives</b> to provide a thorough consulted and rationalised Price Submission given that audits and ESC investigation address any shortcomings	Incentives and clear criteria for businesses to be ‘fast-tracked’ for providing well consulted and robust Price Submissions would incentivise water businesses to prepare submissions that require less auditing and ESC resources to be approved.

## Customer consultation

Barwon Water considers the consultation process in the 2013 Price Submission was more informative rather than consultative or engaging.

After media advertising, the consultation for Barwon Water’s 2013 Price Submission resulted in Barwon Water and Commission staff significantly outnumbering the Geelong community representatives.

The outcome of these public forums was informative presentations being provided by Barwon Water and the Commission with comments from the community limited to only a few niche personal interests.

### Customer consultation Improvement opportunities

As noted in the ‘clarity of requirements’ section below, the Commission should provide a clear indication of the level of customer consultation expected from water businesses, e.g. collaboration with Customer Consultative Committee, a deliberative forum, focus groups for key issues and perception survey. This will ensure that Victorian customers do not pay for activities which will not yield significant benefits in the 2018 Price Submission process.

## Other considerations

Barwon Water would like to highlight a number of general points for the Commission to consider while finalising the review.

### Customer and business shocks

Barwon Water is of the opinion that any changes to the pricing approach should not result in price shocks to customers or financial shocks to water businesses.

It would be sensible to conduct impact assessments with water businesses when the Commission has narrowed the options down to something that may become the preferred approach.

### Timeframes

The Commission informed attendees of the Price Conference that the timeframes of the review have been pushed out resulting in the Guidance Paper release date moving from October to December 2016.

This shortens the window for customer consultation and engagement by two months, made even more difficult given that customers and consultants may not be available during the December and January holiday period.

An earlier release date for the Guidance paper would assist water businesses by providing more to undertake more effective customer consultation.

### Clarity of requirements

The discussion about 'fast-tracking' at the recent Pricing Conference from the UK guest presenters did not significantly elaborate on the criteria that would qualify a business to be 'fast-tracked'.

Barwon Water is of the opinion that it is important to clearly outline the 'fast-tracking' criteria so that water businesses can efficiently allocate resources. It would be against the review objective to implement an incentive mechanism that resulted in resources being unintentionally allocated in ways that do not contribute to increasing the likelihood of being 'fast-tracked'.