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Dear Marcus

Approach to Water Pricing Review

South East Water welcomes the opportunity to provide input into the Essential Service Commission's review of its approach to water pricing. South East Water notes there has been a number of consistent themes raised through your review to date. The following outlines South East Water's current views under those key areas.

Customer engagement

South East Water supports a focus on ongoing and more meaningful customer engagement to inform water businesses' decision making. In the development of price submissions we consider that the ESC should provide some broad parameters around what it would expect from water businesses. This could include guidance on:

- Extent of the pricing submission that requires customer engagement on – eg, the whole submission or just sections that requires engagement with customers
- Level of engagement, ie demonstration of collaboration, with some broad guidance on approaches without being prescriptive of how engagement is undertaken
- Level of flexibility around changing performance targets should customer preferences change within a regulatory period.

Output incentives framework

As outlined in our previous submission, South East Water supports the development of greater incentives for businesses to deliver the outcomes which meet their customer's expectations. This is consistent with recommendations made in the conceptual papers commissioned by the ESC and with the approach undertaken in the regulation of the UK water industry. This could be enhanced through businesses developing one or more of the following incentives:

- Reputational – ESC performance monitoring could primarily focus on performance against the targets that were agreed to with customers. Ultimately this performance reporting to customers could be undertaken by the water business. The reputational incentive would be for businesses to achieve or outperform against performance targets agreed with its

customers. We also consider that the set of comparative performance measures that are common to all businesses could be reduced to a small number of core service standards that are focused on customer outcomes, including customer satisfaction

- Financial Rewards and Penalties – water businesses could also propose financial rewards and or penalties for overachieving or underperforming against agreed output delivery measures. This being if there is sufficient evidence that there is a potential benefit to the customer from increased performance. The benefit to customers for delivering the improved performance would need to outweigh the financial reward to businesses.

Financial rewards or penalties for meeting or not meeting agreed targets could include:

- A material financial amount agreed to with customers if an output target is met or not met – this may be tied to funding allowed for in relation to provision of that service or some other agreed amount
- Alternatively, businesses could agree performance targets and expenditure targets that would be built into prices. If businesses outperform their operating expenditure forecasts and meet or outperform service levels they could retain operating expenditure savings for 5 years, or be penalised if they do not deliver on agreed outcomes due to reasons within control of the water business
- A Revised/Expanded GSL scheme, which is aimed at compensating customers who are not receiving minimum standards, could be revised to align with new output measures.

Fast tracking and a more streamlined price review process

As noted in our previous submission South East Water supports further investigation into developing a more streamlined price review process and potentially a framework for fast tracking. For this to be effective we consider the ESC would need to establish a clear framework and criteria for a fast-tracked price review and what the material benefits of achieving a fast-tracked price submission to a water business. We also consider that the criteria would need to be provided early enough through the price submission guidance process to enable businesses to assess which approach they take in developing its price submission. Businesses which are proposing to meet the ESC criteria could then be able to demonstrate their compliance through a more streamlined price submission document. As suggested by a number of the conceptual papers, to achieve fast-tracked price review, we agree that a threshold criteria could be set on a number of key elements such as:

- Customer engagement on agreed outcomes
- Actual performance levels
- Agreed price path with customers based on projected outcomes.

The ESC could periodically assess its criteria and continue to evolve to ensure the water businesses are continually incentivised to meet customer expectations and deliver efficient outcomes. The ESC could also consider setting criteria for what requirements would warrant regulatory intervention to re-evaluate a water business fast-tracked status.

We also support exploring greater flexibility in the timing of price reviews. This could include allowing greater flexibility for businesses to propose price changes if they wish to seek a change to controllable costs built into prices during a regulatory period, while also allowing straight pass through of uncontrollable cost changes. This may enable streamlined price reviews for individual businesses that are focused on specific elements that are outside the

price determination or the ESC's threshold criteria. Businesses would need to justify why they cannot meet the ESC threshold criteria, eg customers are willing to pay for a greater level of service or a specific outcome that requires an adjustment to prices. Ultimately if businesses are meeting the ESC's threshold criteria there may be less emphasis on set regulatory periods and price reviews are only required at times when the ESC's threshold criteria is not being met.

We would be happy to have further discussions with you and your team on your approach to water pricing review.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'C. Feil', written in a cursive style.

Chris Feil
General Counsel, Strategy & Governance