

11 December 2015

Water Team – Pricing Framework Review
Essential Services Commission

RE: REVIEW OF WATER PRICING APPROACH

Thank you for this further opportunity to contribute to the Commission's review of its water pricing approach.

Previously we have provided background on rural water management in Victoria, to ensure that the particular context of rural water is recognised within the regulatory model. We also outlined particular issues in managing risk and uncertainty within the regulatory process. Our focus is not on whether our prices should reflect a certain set of costs (as expressed by the building block model), but rather how the regulatory process operates, and in particular to ensure that the process is efficient, and respects our engagement with customers.

We are particularly interested in the concept of fast tracking, and also in looking at greater alignment between our regulatory process and our annual Corporate Plan process.

Fast tracking

The concept of fast-tracking was considered in a number of the papers commissioned by the ESC from independent regulatory experts.

We believe that this principal is sound, if applied in the context of the Victorian Water Industry. We believe that fast tracking is appropriate where an authority can demonstrate close engagement with customers, meeting or exceeding plans from the previous plan, delivering service outcomes better than target (or benchmarks where available) and proposes a plan that continues that approach and performance.

We consider that is consistent with Southern Rural Water's aims – given our close engagement with customers, our pricing outcomes, and our focus on returning value to customers.

Our prices at the end of Water Plan 2 were between 5% and 18% lower than we had forecast in our Water Plan, and we are realising further savings within the current

regulatory period. We have agreed with some customer groups to return value through lower prices, while for other customer groups we have agreed to reinvest the savings in service improvement projects – effectively offsetting future price increases.

We feel that if the ESC is satisfied that our proposal for the next water plan that fast tracking could be considered for our business.

We consider fast tracking a better fit for the Victorian Water Industry – particularly rural corporations - than other incentives. For example, our goal is to improve value for customers – either through improved service or maintaining or reducing prices – or both. Providing us with a financial reward would not add value as we don't return profits or dividends to a shareholder – except in terms of customer value. Any financial reward would just be returned to customers creating a circular transaction.

Aligning the regulatory process with the annual Corporate Plan

Since our first Water Plan, we have attempted to operate under regulation with minimal change to our planning and pricing processes. We have been regulated under a revenue cap (for the most part), and we have continued to set prices annually in consultation with our customer committees. Our annual process includes updating our regulatory asset base for works delivered and reforecasting our capital expenditure budgets, as well as recalculating an appropriate rate of return based on market conditions. We document our annual budgets and prices within our Corporate Plan.

We note that the WIRO requires the ESC to set the term of each regulatory period. Whilst the existence of a fixed regulatory period provides a baseline and point of reference for our annual plans, which can be useful, it also presents some challenges. There is the obvious cost of preparing a Water Plan, but also, some of our most significant pricing decisions have been subject to business cases for government funding which have been unresolved at the time of preparing our business plan. We are also conscious of the overlap with our Corporate Plan, and the challenges in reconciling our annual Corporate Plan with our Water Plan, as well as issues in later years where we are forecasting future prices and financial outcomes in our Corporate Plan which are well beyond the current regulatory period.

We are interested in exploring the possibility of using our Corporate Plan as a pricing submission. This could mean a greater focus on regulatory matters within the first Corporate Plan of each multi-year regulatory period. Alternatively, it could mean adopting a one year regulatory period. With fast tracking, or a price monitoring approach, this could represent a lower regulatory cost than the current model, given that we already submit prices annual for approval, and we already prepare an annual Corporate Plan with a 5 year outlook.

We would be interested in exploring these concepts further in conversation with Commission staff, with a view to developing a more thorough proposal for how a model might operate in practice.

Thank you again for the opportunity to contribute to this review, and we look forward to continued engagement throughout the review.

Yours sincerely,



CLINTON RODDA
Managing Director