

Wednesday, 5 May 2021

By email: water@esc.vic.gov.au

2021 Water Price Review
Essential Services Commission
Level 8, 570 Bourke Street
MELBOURNE VIC 3000

Dear Commissioners

Melbourne Water Draft Decision

Thank you for the opportunity to respond to the 2021 Water Price Review – Melbourne Water Draft Decision. This submission complements the presentation made by our Centre at the public forum for this Draft Decision, held on 22 April 2021, and provides comments on the following:

- The PREMO rating framework and engagement;
- Demand forecasts, particularly in the context of COVID-19;
- Desalination capitalisation; and
- The length of the regulatory period.

Overall, we broadly support the Commission's Draft Decision. In particular, we note that it sets prices at a level that would enable Melbourne Water to deliver key outcomes, including ensuring high quality drinking water and safe sewerage disposal and treatment, and contributing to Melbourne remaining liveable as it deals with the impact of climate change.

About Consumer Action Law Centre

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.



Opening remarks

Access to water is a basic human right.¹ All Victorians are entitled to a supply of water necessary for an adequate standard of living. Fundamental to this is that water services remain affordable for everyone, including low income and vulnerable consumers. The Commission reports that, in early 2021, more water customers are applying for utility relief grants and more customers are being supported through hardship programs² While, on average, water prices have come down slightly across metropolitan Melbourne in recent years, there remain some in the community that have difficulty making payments on their water bills.

The human impact of water prices should not be ignored, or under-stated. A report by VCOSS and RMIT University released August 2017 interviewed a single mum, Odette, who is forced to bathe her children on alternate days because “it’s just so expensive”.³ There are also fixed-income consumers that shower outside of the home or go to great lengths to carefully manage their water consumption and budgets yet still struggle to afford their water bills when they arrive. These are customers that we urge the ESC to keep in mind when assessing the pricing submissions put forward by Victorian water companies.

PREMO rating system and engagement

Consumer Action supports the Commission’s PREMO water pricing approach, as it provides incentives for water retailers to deliver outcomes most valued by customers. Since the establishment of this framework, we have observed water businesses taking greater effort in engaging with their customers and improving their productivity and performance. We have also observed prices moderate or even decline. We welcome the evaluation of the framework that finds that PREMO promotes long-term outcomes for Victorian consumers,⁴ and the outcomes reporting which rates the performance of businesses against their own commitments.⁵

The PREMO framework recognises that effective customer engagement is a proxy for consumer choice. In competitive markets, we rely on consumers to drive competition by making the best choices for their circumstances. However, in monopoly sectors like water, this choice is obviously constrained. As such, effective consumer engagement is necessary for legitimacy of the business plans and prices put forward by a business.

We recognise, though, that consumer engagement is difficult. While during the previous water pricing review for Victoria’s urban water retailers there were elements of good and better practice, it can be difficult to do engagement a way that overcomes behavioural biases, on both the business side and the consumer side. Consumers can experience a range of biases including projection bias (being influenced by their emotional state), optimism (e.g., being optimistic about their willingness to afford a cost that is a long way in the future), myopia (preference for current wellbeing over future wellbeing) and the focusing illusion (being concerned for something

¹ There have been many formal United Nations declarations over the years on the right to water, most recently in 2010 when the UN General Assembly recognised the human right to water and sanitation: Resolution A/RES/64/292. United Nations General Assembly, July 2010.

² See: <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/water-customer-support-during-coronavirus-pandemic>

³ VCOSS, Power Struggles, available at: <http://vcoss.org.au/documents/2017/08/POWER-STRUGGLES-2017.pdf>.

⁴ Farrier Swier, Victoria’s water sector: the PREMO model for economic regulation, April 2019, available at: <https://www.esc.vic.gov.au/water/how-we-regulate-water-sector/premo-water-pricing-framework>

⁵ See: <https://www.esc.vic.gov.au/water/sector-performance-and-reporting/water-business-outcomes-reporting>.

when you're asked to focus on it). Each of these will influence how a customer participates in engagement and may produce sub-optimal conclusions about consumer 'value'.

To do engagement well in the context of regulatory price determinations, we consider it requires reaching either 'collaborate' or 'empower' categories within the public participation spectrum created by the International Association for Public Participation.⁶

Some forms of customer research fall short of these standards. In particular, we are not convinced that 'willingness-to-pay' surveys are always effective, particularly if the goal is to set a price. Willingness-to-pay (WTP) or willingness-to-accept (WTA) studies are a crude proxy for welfare. The theory around these studies is perhaps most secure when consumers are asked how much they are willing to pay for a good with which they are familiar, such as food or clothing. It is far less secure when consumers are asked to pay for a good whose actual effects on their lives are unfamiliar, unclear, or ambiguous. In such cases, WTP or WTA may amount to a stab in the dark. Estimating the value of services that are paid for through bills charged in arrears, quite independent from consumption decisions (like water), involve similar challenges. That said, we consider these sorts of studies may be helpful in signalling consumer preferences (i.e., preference for A over B).

While we have not examined the Melbourne Water willingness-to-pay survey for the waterways and drainage charges in detail, we note the consultant report commissioned by the Commission which raised concerns.⁷

We support the Commission's PREMO rating for Melbourne Water's pricing proposal (Standard)—we agree that it is difficult to rate a pricing proposal as Advanced where it proposes increases to both operational and capital expenditure (capex is forecast to increase significantly compared to the prior period). Adopting a Standard rating means that consumers save in terms of the proposed return on equity, particularly given the regulatory asset base is set to increase. We consider that it should only be appropriate to have a higher return of equity if a pricing proposal demonstrates consumer value, such as through reductions in overall expenditure.

Demand forecasts

In its pricing proposal, Melbourne Water incorporated demand forecasts based on 2019 population level forecasts. The Commission's Draft Decision finds that while given the opportunity to amend demand forecasts due to the impact of COVID-19, Melbourne Water chose not to make any adjustments.

During the preparation of its pricing proposal, Melbourne Water told us that potential lower population growth means that there are less customers to distribute its costs across, and therefore there would be higher prices if it adopted reduced population forecasts based on COVID-19. Melbourne Water said that it would bear the revenue risk on behalf of customers should growth rates be below forecast.

We note with concern, however, that the Draft Decision states that (post submission of the pricing proposal) Melbourne Water noted it would be unlikely to absorb, in full, the much higher revenue risk should growth be closer to the state forecasts of population. Moreover, we consider that with lower population forecasts, Melbourne Water could reconsider its capital expenditure and whether projects can be deferred. This should

⁶ See: <https://iap2.org.au/resources/spectrum/>

⁷ See: <https://www.esc.vic.gov.au/water/water-prices-tariffs-and-special-drainage/water-price-reviews/melbourne-water-price-review-2021#tabs-container2>.

ensure that costs are not unnecessarily imposed on consumers. As such, we support the Commission's Draft Decision relating to demand forecasts.

Desalination capitalisation

Consumer Action has long supported spreading the cost of the desalination plant across the actual asset life rather than the 27-year lease period. We consider such an approach contributes to inter-generational equity and is in the long-term interest of consumers. In particular, such an approach keeps today's bills more affordable by spreading the cost over the useful life of the plant. As such, we broadly support Melbourne Water continuing to capitalise a proportion of the annual security payments over the regulatory period, though we recognise the rate of capitalisation may vary from period to period depending on other financial factors.

We note that the Commission's Draft Decision proposes to oppose Melbourne Water's proposal of capitalising a shortfall in payments from previous years. As we understand it, the concern is that such capitalisation 'catch-up' payments are not aligned with the principle of intergenerational equity.

We note that the Commission's Draft Decision results in higher operational costs in the current period, which will be charged to consumers through higher bills, so we are reticent about this position. Furthermore, we presume that given Melbourne Water proposed additional capitalisation, this approach does not affect its financial viability. As such, we query whether it should be opposed by the Commission if it lowers bills for customers for the remainder of the desalination plant life. On the issue of inter-generational equity, we reiterate that it is important to spread the costs of the desalination plant over its life so as to contribute to the affordability of bills today. In this context, should the Draft Decision be upheld in the Final Decision, we urge the Commission to explain more clearly how it is in the long-term interests of consumers not to accept Melbourne Water's proposal.

Regulatory period

Finally, we support the Commission's Draft Decision to have a three-year regulatory period rather than a five-year period. We agree that the outlook is uncertain, particularly in the wake of COVID-19, and that a shorter period would provide greater flexibility to adjust prices as appropriate (including downwards).

Please contact me on [REDACTED] or at [REDACTED] if you would like to discuss this submission further.

Yours faithfully,

CONSUMER ACTION LAW CENTRE



Gerard Brody
Chief Executive Officer

