

ESC's current approach to price reviews

Essential Services Commission
Water Pricing Conference

9 November 2015



Objectives

1. Highlight some aspects of the ESC's current process
2. Summarise the ESC's approach to determining regulated revenues
3. Highlight some issues

Role of ESC

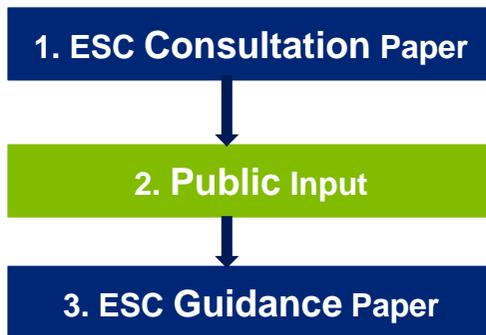
| Decision maker | Ministerial reference | Statutory document | Legislative requirement | Regulatory approach |
|----------------|-----------------------|--------------------|-------------------------|---------------------|
| ESC | | ✓ | | Deterministic |
| ACCC | | | ✓ | Deterministic |
| ERA | ✓ | | | Recommendatory |
| ESCOSA | ✓ | | ✓ | Deterministic |
| ICRC | ✓ | | ✓ | Deterministic |
| IPART | | | ✓ | Deterministic |
| QCA | ✓ | | | Price monitoring |

The price review process

Process

Approach

Issues



- Manner of regulating prices
- Approach & methodology
- Content of price submission
- Timing
- Expectations on customer consultation

ESC Outputs

| Decision | Approach discussion (e.g. seminars or paper) | Issues paper (s) | Guidance paper | Summary of business proposal | Draft determination (or equivalent) | Final determination (or equivalent) |
|-------------------------------|--|------------------|----------------|------------------------------|-------------------------------------|-------------------------------------|
| ESC 2013 water price review | ✓ | | ✓ | ✓ | ✓ | ✓ |
| ACCC - State Water 2014 | | ✓ | ✓ | ✓ | ✓ | ✓ |
| ERA - Water Corporation 2012 | | ✓ | | | ✓ | ✓ |
| ESCOSA - SA Water 2013 | ✓ | ✓ | ✓ | | ✓ | ✓ |
| IPART - Sydney 2012 | | ✓ | ✓ | | ✓ | ✓ |
| ICRC - ACTEW Water 2013 | ✓ | ✓ | ✓ | | ✓ | ✓ |
| QCA - QUU and Unitywater 2013 | | | ✓ | | ✓ | ✓ |

Approach

- Historically used building block approach
- Price cap or revenue cap
- Now, no constraints on regulatory approach

Process

Approach

Issues

WACC x RAB

+

Depn of RAB

+

Opex

+

Tax

Approach

| Process | Approach | Issues |
|---------|----------|--------|
|---------|----------|--------|

- WACC based on CAPM approach
- Approach to opex:
 - Consultant review
 - Base plus change, where justified
 - No efficiency carryover mechanism
 - GSL payments
 - Efficiency factor

| | Equity Beta | Post tax real WACC |
|---------------------|----------------|--------------------|
| ESC 2013 | 0.65 | 4.5 |
| ESCOSA 2013 | 0.8 | 4.5 |
| IPART (Hunter) 2013 | 0.7 (midpoint) | 4.6 |



$$\begin{aligned} \text{Efficient spend} &= \text{Baseline} \\ &\times \\ &(1 + \text{customer growth \%}) \\ &\times \\ &(1 - \text{efficiency factor \%}) \end{aligned}$$

Benchmarking

- Focus on own cost
- But benchmarking important

| Cost item | Benchmarking metrics |
|----------------|---|
| IT | Cost per employee, cost per customer |
| Energy | Cost per kWh, change in kWh |
| Chemicals | Cost per kL, change in cost |
| Labour | Cost/employee, No employees per 1000 customers, EBA increases |
| Administration | Total admin cost/customer, corporate cost/customer, billings and collection cost/customer |
| Capital costs | Contingencies %, Unit rates, change in unit rates, renewals spend/customer |

Other approaches

- Rate of return
- Total factor productivity
- Indices
- Benchmarks/yardsticks
- Price monitoring

Other approaches

| Criteria | Building blocks | Rate of Return | TFP | Index | Yardstick | Price monitoring |
|---|-----------------|----------------|-----|-------|-----------|------------------|
| 1. Incentives for efficient investment | ● | ● | ● | ● | ● | ● |
| 2. Incentives to reduce costs (while maintaining/improving service standards) | ● | ● | ● | ● | ● | ● |
| 3. Effort required by regulator | ● | ● | ● | ● | ● | ● |
| 4. Burden on regulated entity | ● | ● | ● | ● | ● | ● |
| 5. Risk to business viability | ● | ● | ● | ● | ● | ● |
| 6. Complexity/transparency | ● | ● | ● | ● | ● | ● |
| 7. Predictability/certainty | ● | ● | ● | ● | ● | ● |

In summary

- Deterministic
- Structured approach
- Appeal mechanism
- WIRO
- Less influenced by Government
- New flexibility in approach
 - More matters 'up for grabs'
 - More flexibility
 - No longer one size fits all