

How are water prices established in Victoria?

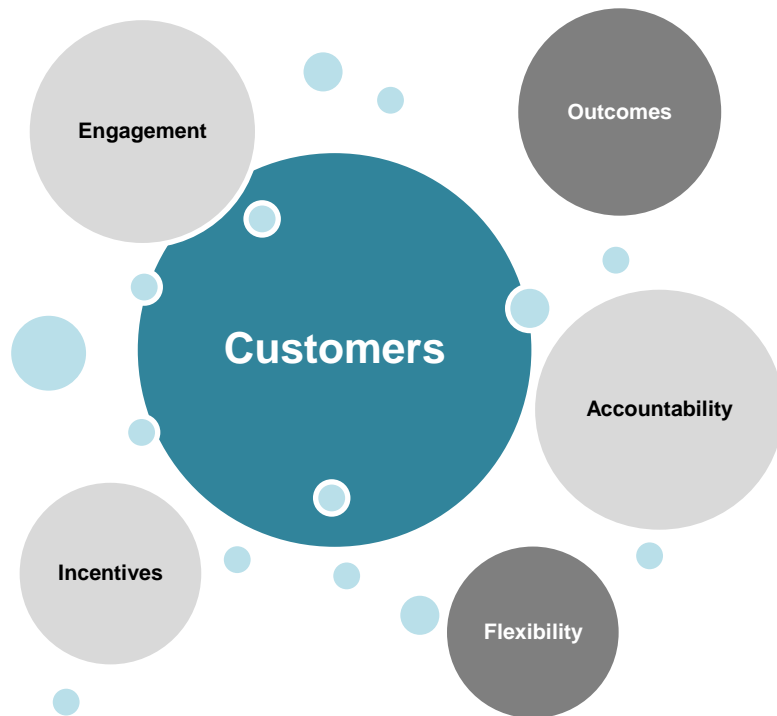
The Essential Services Commission regulates the prices and service standards of Victorian water businesses. We periodically assess prices put forward by water businesses in their price submissions.

In October 2016, we released our new Water Pricing Framework and Approach paper to complete our review to identify the best approach for Victorian water pricing, which involved extensive consultation with the Victorian water businesses and other stakeholders. We consider the new approach will deliver better outcomes for Victorian water customers, with strong incentives for water businesses to put forward better quality price submissions reflecting their customers' expectations, and offering great value for the prices proposed.

What are the key features of the new framework and approach?

Our new approach is built on three key mechanisms:

- Engagement:** *Customers* are now central to a water business's price submission. Businesses need to *engage* with customers to understand their concerns, priorities and preferences so their price submissions can be expressed in terms of the *outcomes* valued by their customers.
- Incentives:** The new PREMO *incentive* framework rewards businesses that deliver outcomes sought by customers, manage risks on behalf of their customers, and deliver services efficiently. A business's return on investment now varies with the level of the business's ambition in delivering outcomes valued by customers. In addition, businesses putting forward clear and concise price submissions may receive a simplified assessment and a 'fast-tracked' pricing decision, through our new *flexible* approach.
- Accountability:** Businesses will have greater autonomy, however with this comes greater *accountability*. They will be responsible for discovering and responding to their customers' preferences. Businesses will be accountable to their customers for delivering the outcomes set out in their price submissions, annually reporting their performance and whether they have delivered on expectations, along with an explanation for any performance shortfalls and how these will be addressed.



What is the PREMO incentive framework?

A price submission will be assessed and rated based on the five PREMO elements: **P**erformance, **R**isk, **E**ngagement, **M**anagement and **O**utcomes (further detail over page). A business will receive a different return on its investment depending on whether its price submission is rated as having a **leading**, **advanced**, **standard** or **basic** level of ambition (the PREMO rating) in terms of customer value.

The ambition of a price submission reflects the extent to which a water business has challenged itself to meet all of its statutory and regulatory objectives while delivering the outcomes and prices customers value. It is a measure of the value customers will receive from their water business. A more ambitious price submission will propose targeted services and outcomes at lower prices, for example. This is achieved through better customer engagement, efficient management practices and rigorous self-examination.

The new approach encourages price submissions to reflect a 'best offer', by requiring businesses to first self-assess their level of ambition before we conduct our own, independent review using the same PREMO criteria.

What does PREMO seek to assess?

The five elements of PREMO are individually assessed to inform an overall price submission rating (a PREMO rating of leading, advanced, standard or basic). The assessment focuses on:

Performance	• Has the business delivered on its commitments to customers?
Risk	• Has the business sought to appropriately manage risk on behalf those best placed to bear it?
Engagement	• How effective was the business's customer engagement? • How have customer needs been taken into account?
Management	• Has the business justified the efficiency gains factored into forecast controllable costs?
Outcomes	• Do the proposed service outcomes represent an improvement, the status quo, or a lessening in service standards? • Are these in alignment with customer views?

What is meant by customer engagement and outcomes?

Our new approach recognises that each business is much better positioned than the regulator to determine what its customers and community expect and need from their water business, and how best to interact with its customers.

Businesses are free to develop the **form, content** and **timing** of their own engagement strategies, having regard to established practices, such as those available from IAP2*.

Given the water businesses operate in different environments across the state, customers can be confident that outcomes will be tailored to their unique needs and preferences.

Each business will propose a set of outcomes that reflect the value customers will receive from prices. Each outcome will include measurable service outputs and deliverables, and any associated service targets that will demonstrate achievement.

A business will report annually to its customers on its performance against the outputs and deliverables for each outcome. Ongoing engagement will enable businesses to adapt their outcomes as customer needs and preferences change.

*International Association for Public Participation

How are prices established under the new framework?

1. Businesses *undertake* customer engagement to discover customer preferences and establish service outcomes valued by customers.
2. Businesses *prepare* price submissions, including the forecast costs to deliver the proposed outcomes and how these translate into prices for customers.
3. Businesses *provide* their price submissions and PREMO rating self-assessments to us for review.
4. We *review* price submissions with a flexible approach that reflects the quality and strength of each submission, and assign our own PREMO rating for each business. We release a draft decision for consultation before approving maximum prices for the next financial year.
5. We both *monitor and report* on the performance against the outcomes. We may adjust the return on investment and prices where a business consistently fails to deliver the promised outcomes.

Implementing the new approach

Our new flexible assessment approach will recognise businesses that propose improved outcomes for customers and that present clear, well-justified price submissions. If we are satisfied that a price submission does not require further scrutiny, the submission will be **fast-tracked** through the review process, and the business can receive its draft decision and also the final decision ahead of the others. These water businesses can focus on their customers and service delivery, rather than responding to regulatory scrutiny.

Indicative timeline for implementing PREMO and the resulting new prices from 1 July 2018.

Guidance paper
November 2016

Submission
September 2017

**Fast-tracked
draft decision**
December 2017

Draft decision
March 2018

**Fast-tracked
final decision**
May 2018

Final decision
June 2018