

## Response to the ESC's *A New Model for Pricing Services in Victoria's Water Sector*

*Westernport Water*

25 July 2016

Westernport Water welcomes the opportunity to submit to the Essential Services Commission (ESC) on its new model for pricing water services in Victoria.

Westernport Water supports the principles the ESC have used to prepare its new pricing model, including:

- Support for ongoing, meaningful engagement with customers;
- Adoption of a trailing average cost of debt approach to more accurately reflect financing costs;
- Application of incentive mechanisms to improve service levels and drive innovation in the industry; and
- Support for a flexible approach to pricing that balances the needs of all of our customers in the short and long term.

Furthermore, Westernport Water asks the ESC to consider the following areas when finalising its approach:

**Assessment of customer engagement** - Westernport Water supports the increased autonomy and flexibility to create a customer driven pricing proposal that demonstrates value to customers relative to the community's needs. Genuine customer engagement that creates an authorising environment for customers to contribute and shape the pricing submission can be achieved in different ways. Westernport Water asks the ESC to consider the quality of engagement as opposed to its scale, giving consideration to the resources available to each water business.

**Cost of equity matrix** – Westernport Water provides the following feedback for further consideration and clarification:

*Long term interest of customers.* The current definitions of the business categories encourage, promote and reward change. For example, a 'leading' business is described as a pricing submission that proposes a step change in proposed outcomes, controllable costs or both, and where customer engagement has heavily influenced the business' proposal.<sup>1</sup> We would like the ESC to consider the long term interest of customers in these definitions. The current definition may create perverse incentives for businesses to achieve short term higher financial returns to the detriment of the long term interests of customers. The definitions provided also do not consider the achievements of the business over the previous regulatory periods to reduce controllable expenditure and provide improvements in customer services. Westernport Water would like the definition to consider the sustainability of change and how it protects customer interests in the long term.

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<sup>1</sup> Essential Services Commission (2016). *Water Pricing Approach Proposal*.



*Creation of league tables.* Westernport Water supports mechanisms to foster competition amongst businesses. However, whilst drawing comparisons between businesses can be healthy when seeking further understanding of practices and approaches, it can be damaging if it is used as a basis for assessment. For example, infrastructure investment is often a function of the age and type of assets as opposed to how well the business is performing.

*Estimates of the cost of equity.* Westernport Water would like to further understand how the estimates of the cost of equity were calculated. Our understanding is that the cost of equity over the previous regulatory periods has been over 4.5 per cent. The current estimates for the cost of equity in the matrix are as low as 3.90 per cent. This also raises a question of how the financial viability of the water business will be taken into account with these estimates.

*Self assessment.* Westernport Water notes that the current cost of equity matrix has a 'basic' business receiving a cost of equity amount of 4.1 per cent. It would be better for a 'basic' business to self-assess as 'ambitious' or 'leading', where the lowest cost of equity amount it could receive would be 4.3 per cent and 4.1 per cent respectively.

*Language.* The language used for self-assessment carries negative connotations and may unduly influence a water business' decision. Westernport Water suggests that 'standard' and 'basic' could be changed to 'emerging' and 'complying' to address this issue.

**Risk management assessment** - Risk management in the ESC's 'PREMO' model relates to ensuring the risk is allocated to those who have the means and capacity to manage that risk. We view a risk held by our customers as a risk of ours. Risk management should be viewed as balancing the risk between customers and the business, rather than how much risk the business holds or has transferred to customers. If risk is not addressed and balanced appropriately it may result in inequity across customer groups.

Once again, Westernport Water would like to express its gratitude to the ESC for its willingness to engage in further discussion and looks forward to learning more.

Yours sincerely

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Managing Director