

2 August 2016

Marcus Crudden
Director, Water
The Essential Services Commission
Level 38, 2 Lonsdale Street
MELBOURNE VIC 3000

Dear Marcus

New model for pricing water services in Victoria – Position Paper

South East Water welcomes the opportunity to provide a response to the Essential Service Commission's review of its approach to water pricing position paper. South East Water broadly supports the approach outlined in your position paper to develop greater financial and reputational incentives for water businesses to deliver what their respective customers value. The following outlines some key areas we believe need to be considered in the next stage of the review and we would appreciate the opportunity to work with you in the further development of the ESC's new approach to pricing.

PREMO Assessment framework

Clear guidelines - Development of clear guidance on what constitutes a leading, ambitious, standard or basic submission for businesses to understand what they are targeting as they develop their submissions and undertake their own self-assessment. We understand the ESC has already commenced work towards developing these guidelines. Further worked examples may also help support the guidance as there may be a number of combinations which may result in each PREMO rating.

Individual assessment of price submissions – We consider that businesses should be assessed individually rather than in comparison with other businesses, as it should be possible for businesses to demonstrate their PREMO ranking based on their own customer engagement which will be specific to individual businesses. Additionally not all price review processes across Victoria would be undertaken at the same time and there would not always be other price submissions to compare against.

Weighting the PREMO assessment – Whether elements of the PREMO assessment criteria will be weighted higher than others, or would each element be evenly weighted. Alternatively, based on customer engagement outcomes, could the weighting or areas of focus be proposed

by the business in their price submission. For example, a business may set far reaching targets for some measures and not others, or take on more risk through demand forecasts but maintain current service outcomes.

Current customer outcomes – How will the ESC’s assessment against the PREMO criteria take into account services that businesses are currently offering to customers. Businesses may be delivering the outcomes customers’ value and their customers may not want to move significantly from some or all of the outcomes and service levels they are currently getting, or not willing to pay for service improvements. In this case could a business still be considered ambitious or leading or will businesses need to make a significant change in customer outcomes from the current period for a rating higher than standard.

PREMO in future regulatory periods – How will the model work in future regulatory periods and will businesses need to continue to provide greater stretch targets in the following regulatory period and continue to outperform to maintain an ambitious or leading rating, or could the rating last for longer than one regulatory period. In setting customer outcomes we also consider that businesses and the ESC will need to ensure they are taking account the long term interest of customers and not aim to provide short term benefits but poor long term outcomes.

Risk assessment and price control – South East Water supports the ESC’s proposed approach to include an assessment of the risk that businesses shares with customers as part of its incentive framework. We note that the ESC has proposed an autonomous demand model as an alternative price control mechanism in its position paper. We consider that the autonomous demand as a price control mechanism needs further development and that price adjustments should be symmetrical when actual sales are below forecast not just above. South East Water also believes that the ESC should continue to allow flexibility in businesses proposing its price control, rather than determining a price control for all businesses. The ESC could assess a businesses’ proposed price control, demand forecasts and tariff structures as part of its overall risk assessment. The ESC’s risk assessment would then determine whether a more detailed review of demand forecasts is required.

Customer Engagement – South East Water supports the ESC’s proposed customer engagement principles and the framework for assessing customer engagement outlined in the position paper. We consider that engagement needs to focus on the areas where water businesses have discretion to change based on what customers value and want businesses to prioritise. We also note that the level of engagement with customers will vary across the various aspects of the price submission outcomes that are tested and at various phases of the price submission development process. We also concur with the ESC’s views that customer engagement should be ongoing, and not cease post the price review process. Continuous engagement may mean that customer requirements will continue to evolve. Given this, the framework should have the flexibility to cater for changing customer priorities within a pricing period, and businesses should not wait for the next pricing period to meet customer expectations.

Customer outcomes and measures – We support the ESC’s proposed approach for businesses to set outcomes and measures based on their own customers’ preferences. In this revised approach to setting performance measures will the ESC allow business to develop new measures that the ESC or the business doesn’t currently monitor or will all new proposed measures require some form of historical data to allow for the setting of service level targets.

Penalty for ESC down-grading self-assessment – We consider that given the 2018 price review will be the first time businesses will self-assess their price submissions against the PREMO

criteria, that the cost of equity penalty resulting from the ESC down-grading a self-assessment could be reduced in this first review.

Performance against proposed outcomes with customers

South East Water supports the focus of future performance monitoring on the outcomes proposed in their price submissions. We also support flexibility in the framework to allow for changes in outcomes and measures, due to customer changing customer expectations, and potential for changes to PREMO ratings during a pricing period. We also agree that a mid period review should be the exception and consistent with the current framework, there should be a materiality threshold to require changes during the period. However if the ESC is going to make adjustments for actual performance either during or at the end of the regulatory period, the ESC should clearly identify the parameters around failure or outperformance that would trigger review of a PREMO rating. For example, would the assessment be based on all measures or only those measures that are deemed more significant than others, will it be based on a range below or above the agreed targets, and what would be the number of measures that failed or outperformed (and the frequency of failure or outperformance) that would trigger a review.

Fast-tracking and review process

South East Water supports the ESC streamlining the review of price submissions that are aligned to customer expectations and have robust management processes, and for ESC price reviews to focus only on areas that require a greater level of scrutiny. Consideration could also be made to provide a material incentive for businesses to achieve a fast-tracked price submission.

Regarding the ESC review process we also consider that businesses could be notified of the ESC's PREMO review as part of the initial review process, prior to the draft decision, particularly if the ESC does not agree with the businesses' self-assessment. This would give businesses the opportunity to respond or provide additional information or revise their approach to address any issues identified by the ESC.

We would be happy to have further discussions and to continue to work with you and your team on your approach to water pricing review.

Yours sincerely,



Chris Feil
General Counsel, Strategy & Governance

