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Director, Water and Local Government  
Essential Services Commission  
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By email: [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au)

Dear Mr Chow

**CUAC response to 2013 Water Price Review – Tariff Issues Paper**

The Consumer Utilities Advocacy Centre Ltd is an independent consumer advocacy organisation. It was established to ensure the representation of Victorian consumers in policy and regulatory debates on electricity, gas and water. In informing these debates, CUAC monitors grass roots consumer utilities issues with particular regard to low income, disadvantaged and rural consumers.

CUAC thanks the ESC for the opportunity to comment on the Tariff Issues Paper. The bulk of our submission follows the structure of the Issues Paper. However, we would also like to include some preliminary comments.

We note that the Issues Paper anticipates and devotes considerable attention to the introduction of ‘consumer choice’ in the form of tariff options. This will constitute a major change to the water sector and to consumers’ role within it. The extent of this change and consumer needs in relation to it should not be underestimated.

At this early stage and without more detailed information about water businesses’ proposals, it is difficult to offer specific comments on tariff options. Nonetheless, there are some general issues and principles that should be considered. In part, our positions on choice are informed by our work on the consumer experience of the competitive Victorian energy retail market. This work has shown that the complexity associated with choice can mean that the potential benefits

of choice are not realised by many consumers. It has also highlighted the critical importance of consumer information and education in an environment of choice.

Firstly, any choice strategy needs clear objectives, and the water business needs to identify and articulate what choice is intended to achieve. This articulation of objectives should include identification of who (specifically) will benefit and how. Water businesses also need to consider the potential impacts of choice (both positive and negative) on different consumer groups, including those who do not make an active choice. With a greater emphasis on consumer choice comes the requirement that consumers are given the information and tools needed to make appropriate choices. Businesses introducing choice will need a comprehensive consumer information and education strategy.

Finally, should the introduction of choice coincide with price increases as a result of desalination, businesses and government will also need to be aware of the potential for consumers to perceive these two changes as being related. Particularly if choice is implemented without clear objectives and comprehensive consumer information and education, and if average household bills continue to increase, there is a risk that choice reforms may not be well-received by the community.

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#### Proposed pricing principles

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On the whole, CUAC supports the proposed pricing principles set out in the Issues Paper, including the economically sustainable revenue principle, the subsidy free pricing and inefficient bypass principle.

#### **Tariff structure principles**

CUAC supports the tariff structure principles identified in the issues paper. We see the requirements for simple and understandable tariff structures as a particularly important consideration in this regulatory period as the ESC considers businesses' 'customer choice' proposals.

#### *Inclining Block Tariffs*

As CUAC has expressed previously, we do not oppose a move away from Inclining Block Tariffs. Nonetheless, before they make such a move, we would like to see more detailed analysis from businesses (who have the data to model changes) of the impact on different customer groups, including low-income consumers. In addition, we welcome the ESC's suggestion that it will look for evidence that water businesses moving away from IBTs have in place an adequate transition strategy.

## **Volumetric charge principle**

CUAC supports the general principle that the volumetric charge should have regard to marginal cost. At the same time, at this stage we oppose the introduction of scarcity pricing in relation to volumetric charges.

## **Customer focus principles**

CUAC strongly supports the ESC's proposed customer focus principles:

*Retail tariff and service offerings, and the form of price control, should have regard to:*

- *the ability of customers to understand the tariff and service offering and respond to price signals*
- *customers' preferences and needs in relation to service standards or new services*
- *the costs of implementing the tariff option, including administration and marketing costs*
- *price path stability*

We particularly welcome the discussion of the implications of these principles for proposed prices and the 2013 Water Price Review (p. 14).

### *Move away from two-part tariffs*

We strongly support the ESC's suggestion that businesses proposing a move away from a two part tariff consider the material impacts on different customer segments and identify options to manage any impacts. We also particularly welcome the suggestion that businesses liaise with government around the implications of tariff structure changes for concession design.

### *Price signals*

In CUAC's observation, much discussion of price signalling in water is heavily or exclusively theoretical in nature. While theoretical insights have an important role, there is also a need for consideration of how theoretical concepts translate into practice and, where possible, empirical analysis of the phenomena. We therefore support the ESC's suggestion that businesses' discussion of the likely customer response to tariffs should incorporate recognition of different customer types and the practical opportunities for, and barriers to, consumer awareness of and response to price signals.

### *Consumer understanding*

Consumer information and education will be particularly important for businesses seeking to introduce customer choice and we support the ESC's emphasis on the need for information about how businesses intend to facilitate customer understanding.

### *Market research*

The Tariff Issues Paper states that the ESC is interested in any research that investigates 'customer acceptance of possible tariff choices'. In this regard, we note that not all water sector market research meets high methodological standards and this should be considered when interpreting research findings. Key methodological issues for consideration include:

- sample representativeness and size
- question wording (is the language simple, clear and non-leading?)
- exhaustiveness of response options (were participants able to express the full range of preferences, including a lack of interest or possible preference for the status quo?)
- knowledge and understanding (were participants given sufficient information to enable a reasoned response?)

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### Form of price control

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We have concerns that a revenue cap form of price control creates an incentive for businesses to under-forecast demand and over-collect revenue in the first year of the period. Contrastingly, a price cap does not offer this incentive.

### **Managing customer impacts**

We welcome the ESC's emphasis on managing the customer impacts from any significant tariff changes and would support the use of side constraints to minimise price shocks.

### **Form of price control criteria**

CUAC supports the criteria for the most appropriate form of price control identified in the Issues Paper (p. 18). We note that greater uniformity across businesses in the form of price control has the potential to minimise the complexity and costs of administration.

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### Tariff structure and design issues

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With regard to tariff structure changes, CUAC supports the ESC's intention to scrutinise the transition strategy (including identification and management of anticipated customer impacts) and to expect evidence of substantial customer consultation (p.20).

## **Retail water tariffs**

### *Uncertain bulk variable costs*

The Issues Paper notes that some regional urban water authorities purchase water on the rural water market, with implications for certainty and risk. CUAC favours a ‘smoothing approach’ to the translation of variable bulk water costs into retail tariffs, minimising variability for consumers. We support the ESC’s view that over time, customers should pay only the efficient variable bulk costs and not any unspent allowances.

The Issues Paper notes that a water business with uncertain variable bulk costs may propose that customers be able to choose between a ‘pass through’ and ‘smoothed’ retail tariff (p. 25). In our view, such a choice strategy would introduce substantial complexity for consumers and should be closely scrutinised against the ‘customer focus’ principles set out in the Issues Paper.

### *Signalling differences in distribution costs*

CUAC thinks it appropriate to signal differences in distribution costs in developer charges. With regard to retailer tariffs, however, we generally favour a postage stamp approach to distribution cost recovery, for reasons of equity, administrative simplicity and consumer understanding.

### *Two-part tariffs*

For the same reasons outlined in the Issues Paper, CUAC supports a two-part retail water tariff structure but believes the ESC should consider and approve alternative structures should they be aligned with the pricing principles and supported with robust analysis.

### *Approach to innovations in retail tariffs*

CUAC welcomes the ESC’s emphasis on the need for provision of ‘comprehensive and easily understandable’ consumer information to accompany proposals for innovation and choice in retail tariffs. In particular, we would like to see businesses give consideration to how low-income and vulnerable consumers might be proactively helped to choose the best option for them, such as through:

- incorporation of tariff choice assessment into hardship programs;
- access to personalised advice over the telephone; and
- targeted promotion to concession card holders and customers on instalment plans.

### *Concessions and low-income and vulnerable consumers*

CUAC also welcomes the ESC's direction to businesses to identify the potential impacts of tariff structure changes on low income and vulnerable consumers. Businesses' modelling should show that the proposed tariffs do not, on balance, disadvantage low-income and vulnerable consumers relative to other customer segments. Businesses proposing substantial changes to retail tariff structures should carefully consider how their proposed tariffs will interact with concessions, and identify any suggested changes to concession design.

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## Sewerage tariffs

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### **Retail sewage disposal charges**

Given that sewerage is unmetered and, moreover, the likely inelasticity of demand for sewerage services, CUAC sees little benefit to the use of a two-part sewerage tariff. This tariff structure is complex and confusing for consumers. We would therefore favour a move to a single fixed sewage disposal charge for Melbourne residential consumers.

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## Tariffs and customer choice

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Broadly, CUAC agrees with the ESC's thinking on the evaluation of customer choice proposals (p. 38). We have further comment to make on the evaluation of these proposals.

### **Costs clearly identified alongside assessment of likely take-up**

For those proposing tariff choices, CUAC would like to see businesses clearly identifying administration and implementation costs of tariff choice. These should then be considered alongside a realistic assessment of the likely take-up of choice. In this regard, we note that market research survey responses may overstate the actual willingness and motivation of consumers to make choices on water products, services and tariffs. One recent study surveyed consumers on their willingness to switch supplier for a saving of \$5 per week on various goods and services including banking, electricity and superannuation. Respectively, 28 per cent, 27 per cent and 21 per cent of respondents reported that they would 'definitely' switch under these circumstances, yet actual switching rates are much lower than this: about 3 per cent per year for banks and 3 to 6 per cent per year for superannuation.<sup>1</sup>

There are several possible explanations for these discrepancies. A likely factor is that, while answering a question in a survey is simple, active exercise of choice incurs search costs. 'Social desirability bias', where survey respondents inaccurately report behaviours and opinions that are generally considered acceptable or positive,<sup>2</sup> may also play a role.

These issues should be borne in mind when interpreting market research survey results on tariff options. While an individual may indicate during a survey that they would choose a hypothetical

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<sup>1</sup> Citi Australia (2010) *Evidence versus emotion: How do we really make financial decisions?* The Australia Institute: Canberra, p. 11-12.

<sup>2</sup> Rajenda Nargundkar (2010) *Marketing Research: Text and Cases*, McGraw-Hill: New Delhi, p. 49.

tariff or service option from a list, this cannot be taken as meaning that the consumer would, in a real life situation, necessarily seek out and select that option.

## **Consumer information and education**

CUAC has some trepidation about reforms that will increase the complexity facing consumers. While choice often brings benefits, it also requires people to make increasingly numerous and complex decisions. Increased complexity may be worthwhile or even necessary in some circumstances, but government, regulators and business should avoid creating complex choices which are out of proportion to both the potential benefits of an individual's optimal choice, and to consumers' motivation, knowledge and resources to navigate such choices.

We note, for example, that some of the tariff examples the ESC has identified in Box 6.1 contain fairly complex concepts such as scarcity value and supply security. Some of the options would require additional conditions to prevent customers from moving on and off different tariff types. These concepts and conditions would need to be clearly and simply explained to consumers.

In our view, for this regulatory period, water businesses seeking to introduce tariff choice should limit the number of tariff options to a small number while ensuring that these options are easy to compare to each other, and have clear benefits for different, identifiable consumer types.

Should greater choice be made available to consumers, this will need to be accompanied by consumer information and education, and we welcome the ESC's emphasis on this in the Issues Paper. The research on consumer information and education suggests that to be effective, consumer education needs to:

- go beyond simple provision of print and audio-visual materials;
- integrate various strategies (such as mass media, face-to-face communication, incentives, and integration with existing events, services etc.); and
- use messages designed or customised to meet the needs of different groups.<sup>3</sup>

Importantly, consumer information and education strategies must take into account the particular needs of disadvantaged consumers, including those with low literacy skills and those for whom English is not their first language. For these consumers, the literature suggests that information is often most effectively conveyed interpersonally.<sup>4</sup> For this reason, we suggest that businesses information and education strategies should include information dissemination to community services that work with low-income consumers, including financial counsellors and emergency relief providers. CUAC's research report *Consumers and smart meters: Delivering*

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<sup>3</sup> Flowers, Rick et al (2001) *What is Effective Consumer Education?: A literature review*, Commissioned by the Australian Securities and Investments Commission, Centre for Popular Education, University of Technology Sydney: Sydney, p. 30-38.

<sup>4</sup> *Ibid*, p. 36-7.

*information to non-government organisations, while focused on electricity smart meters, contains relevant discussion and recommendations.*<sup>5</sup>

### **Default tariff**

CUAC is strongly of the view that where tariff choices are made available, a default tariff should be in place. This will mean those customers who do not wish to exercise choice, or who have difficulty choosing, can avoid doing so. At the same time, the continued availability of a default option will allow businesses to more accurately gauge customer interest in alternative tariff options (and in the act of choosing itself). This information on choice take-up will in turn be useful for other businesses considering introducing tariff options in future regulatory periods.

### **The ESC's role**

CUAC agrees with the ESCs initial assessment that tariff options relating to customer preferences for risk allocation are likely to require more ESC involvement than those relating to additional service choice (such as an environmental tariff). However, it does not follow from this that the ESC regulate only the default tariff ('Questions', p. 39). Particularly during the first regulatory period in which choice is to be introduced, we see the close attention of the ESC as an important safeguard for consumers.

Similarly, CUAC understands that different tariff options are likely to satisfy the various pricing principles in the WIRO to different extents, and that therefore, the ESC may not apply the same weighting to each of these principles for each tariff option (other than the default). Nonetheless, we see it as necessary that, as well as assessing individual tariff options, the ESC consider the package of tariff options as a whole against the WIRO principles. For example, while the ESC might approve a high-price, high security tariff that is unlikely to be in the interests of low-income consumers, it should only approve a package of tariff options that includes a tariff or tariffs that is in the interests of low income and vulnerable consumers. The ESC will also need to consider any possible impacts of take-up of a particular tariff option on other consumers.

### **Consumer protection**

The Tariff Issues Paper notes that the introduction of customer choice will require additions to the customer protection framework. If tariff option packages are approved, we see a need for the ESC to review the Customer Service Codes in light of this change. In particular, changes might be needed regarding:

- the frequency of meter readings and estimations (4.2, 4.3)
- content of bills and presentation of charges (4.5, 4.6)
- payment difficulties and hardship provisions, e.g.

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<sup>5</sup> Consumer Utilities Advocacy Centre (2010) *Consumers and smart meters: Delivering information to non-government organisations*, CUAC: Melbourne.



- additional requirement that businesses assist customers in hardship programs to choose the most appropriate tariff;
  - ability of customers experiencing unanticipated hardship or payment difficulties to move off a high-cost tariff;
  - Policies, practices and procedures to respond to enquiries in relation to tariff options (12.1)
  - Provision of usage/billing history information to consumers to facilitate choice (12.7)
  - Content of customer charters (15)
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Please do not hesitate to call Caitlin Whiteman, Policy Advocate, or myself on (03) 9639 7600 should you require further clarification of points raised in this submission.

Yours sincerely,



Jo Benvenuti  
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