

4 November 2016

Water Team – Pricing Approach Review
Essential Services Commission
Level 37, 2 Lonsdale St
MELBOURNE VIC 3000

By email
water@esc.vic.gov.au

Dear Water Team

RE: Submission: Assessing and rating PREMO price submissions

Thank you for the opportunity to provide feedback on the proposed PREMO model as described in the above paper. Central Highlands Water wishes to record its appreciation to the ESC regarding your consultative process regarding the development of the new pricing framework which has provided sufficient opportunity for review and contribution.

In response to the current consultation paper, Central Highlands Water generally supports the overall model and makes the following observations which may help strengthen the approach.

General observations

The distinction is quite clear regarding the expectations between a 'Standard Submission' and an 'Advanced Submission'. However the distinction is less clear between an 'Advanced Submission' and a 'Leading Submission'. This is characterised by the following:

- The size of the required improvement is described as '*significant*' to a '*very significant*' (Outcomes and Management). The definition of the size of the required improvement hinges on the interpretation of one adjective: 'very'.
- No clear distinction regarding Engagement practices
- Difficult to ascertain when a water business can confidently self-assess as a 'Leader' (Outcomes and Management) as the rest of the industry will also be improving so it is not possible to identify and beat a moving (and unknown) target.
- For this reason it is also important to retain the proposed element under Outcomes on Table 3.1: *The business proposes outcomes that are well ahead of the industry average or past performance (measured by reference to output targets)*. We believe it is important to retain the option to demonstrate proposed improvements on the water business's current service levels in order to meet this criteria.

While this approach does provide flexibility for the business to interpret and state its case, the difficulty is that the assessment becomes subjective for the business and in turn its submission will be subject to a subjective evaluation process by the ESC. If the two perspectives of subjectivity align, then one assumes the assessment will be favourable, but if the two perspectives do not align (and due to the asymmetry of available information to both the water business and the ESC), then the self-assessment is at greater risk to be downgraded.

While still wishing to support the flexibility that the new approach offers, Central Highlands Water suggests the addition of the opportunity of a pre-submission discussion with the ESC to provide a 'sense check' if the proposed submission is generally of the level of ambition being sought.

Pricing outcomes

The Advanced submission appears to contain contrary expectations regarding pricing outcomes. Under 'Management', the expectation is that 'customer prices do not increase'. (This is assumed to be net of CPI). However, under 'Risk' the expectation is that the business 'reduces prices'. In this instance it is not clear if a submission self-assessed as 'Advanced' would need to demonstrate a price reduction or not.

Risk

The Risk component of the model under 'Advanced' appears to be more prescriptive than other components and it is difficult to see where value is being added in several areas. For example:

- *'The business has attained accreditation to these ISO standards' (ISO 31000 Risk and ISO 55000 Asset Management)*
 - The requirement of actual accreditation is beyond the expectation as required by the current *2015 Statement of Obligations*. While Central Highlands Water meet the expectations of these standards we do not believe there is additional business benefit in seeking third-party accreditation which would potentially cost several hundred thousand dollars.
 - It would be perhaps more appropriate if the model suggested accreditation to customer service related standards, as customer interests are at the heart of the PREMIO model, for example accreditation to *ISO 10002 Customer Satisfaction and Complaints Handling* and accreditation to the *International Association for Public Participation (IAP2)* spectrum for customer involvement.
- *'The water business has had its financial position reviewed by an independent credit ratings agency.'*
 - Water businesses already have independent credit ratings made through the State Government and we are unsure what an additional credit rating at the cost of approximately \$50,000 would achieve.

The above components and the statements under 'Advanced' and 'Leading' regarding price reductions through better risk management indicate that the ESC believe water businesses are charging excessive risk premiums. In order to meet the expectations of the 'Advanced' or 'Leading' category, Central Highlands Water believes a stronger and more specific case needs to be made regarding the correlation between risk management and prices.

Scoring method

Central Highlands Water prefers the alternative scoring system for a PREMO rating as proposed by the ESC. We note that the graded scoring system relates to the 'degree of confidence' which supports our observations that the assessment process is essentially a subjective one.

Summary

Central Highlands Water believes the new PREMO model is a step in the right direction to placing customers at the centre of investment and performance decisions by water businesses.

However, as this is the first experience with the new model (and noting its central assessments are largely subjective) Central Highlands Water encourages the ESC to provide some latitude in its assessment and to also take into account the overall intent of the *whole of the submission* in relation to the self-assessed level of ambition.

This would mean (for example) that despite the submission perhaps not meeting one or more particular elements, the overall submission and proposed position of the water business is clearly 'Advanced' or 'Leading' in relation to its previous position.

Thank you again for the opportunity to provide input into the consultative process.

Yours sincerely,



Paul O'Donohue
Managing Director