Southern Rural Water
Managing Water. Serving Communities.

8 November 2016

Water Team – Pricing Approach Review
Essential Services Commission

RE: ASSESSING AND RATING PREMO PRICE SUBMISSIONS

Thank you for this further opportunity to contribute to the Commission's review of its water pricing approach.

As outlined in our previous submission, we commend the Essential Services Commission on the genuine engagement with the industry throughout this process, and we support the principle of incentives introduced through the PREMO model.

In relation to the assessment tool, there are two aspects within the risk element that we have some concern with - guaranteed service levels and capital estimation. These are discussed below. More generally, we note that the risk element links ambition levels to fixed standards. This seems at odds with the other PREMO elements, which generally link ambition levels to improvements on past performance (or possibly to relative industry performance).

Guaranteed Service Levels (GSL)
Table 3.4 requires that, to achieve a standard assessment, we have a GSL scheme that reflects the main service concerns and priorities of customers.

Without debating the merits of a GSL scheme, we note that this is not something we currently have, and so if we were to make a price submission today, we would necessarily be limited to a "basic" assessment.

By way of context, our existing services measures are averages across customer groups. The partly modernised nature of our delivery systems means that the service received by some customers is consistently well below the average, and below what we consider as acceptable standards. Whilst modernisation is improving this situation, it will continue to exist into the next regulatory period.

This creates a challenge in proposing a GSL scheme. We could be faced with a choice between setting very low service standards, which will be meaningless for most customers, or alternatively setting service standards at a level we can't

88 Johnson Street
Maffra Victoria, 3860
Post Office Box 153
Maffra Victoria, 3860
Phone 1300 139 510
Fax (03) 5139 3150
srw@srw.com.au
www.srw.com.au
DX 217245
ABN 70 801 473 421

guarantee for all customers, and accepting that we will need to make regular GSL payments and therefore increasing general prices to provide for these payments.

An alternative is to introduce differential pricing to reflect the different service levels that customers receive. In prior consultation there has been no support for this model, but it is something we can retest with customers for this price submission.

We can engage with customers on the possibilities and preferences for GSL schemes or differential pricing, and to reflect this in our submission. Our concern is that without modernisation being completed across our business, the service level differentiation is too great to warrant the introduction of such a scheme at this time.

Capital estimation

We note the requirement that we “can demonstrate rigorous probability analysis that can be independently replicated, to support project costs with contingency allowances that have no less than 50% probability of exceedance”.

We see this is an onerous requirement which could add significantly to our capital planning costs. Our reading of this would mean having a monte-carlo analysis for each project – which requires specifying statistical variability of major inputs and running a scenario model and documenting it all. In practice, this is typically done this for very large projects – to get a better understanding of uncertainty and the dominant inputs.

Moreover, this requirement appears to mix two project costing concepts. An exceedance probability relates to the probability of a project exceeding a cost estimate. Project contingency is not a probabilistic tool – but rather a framework to reflect uncertainty based on experience and judgement combined with confidence on scope, rates and quantities.

Aside from the cost of undertaking probability analysis for projects, we also reinforce our feedback through the last price review that a 50% probability of exceedance was not consistent with treasury guidelines for major projects.

Industry Comparison

In several parts of the document, there are references to industry comparison or comparison with peers. This is valid and useful for the urban water sector where there are three similar metropolitan retailers and several regional urban businesses largely providing the same services.

This is problematic for the rural water sector where there very few industry peers across our three primary businesses – irrigation, headworks and unregulated rivers and groundwater licencing and compliance. A recent benchmarking study undertaken by Marsden Jacob highlighted this issue.

Scoring

In response to the specific request for feedback on the proposed scoring system, we support the alternative scoring method proposed by the Commission. We note that the commission states that the proposal is a “high level” and we believe further guidance is necessary to ensure that the proposed terminology makes clear how an assessment should be made. For example, providing guidance on how reasonably confident differs from satisfied, or confident from very confident.

Furthermore, we suggest that it may also be appropriate to consider, within the scoring framework, the *extent* to which a submission meets a level of ambition (or exceeds a lower level of ambition). Our understanding is that the proposed scoring will rate the level of confidence that a business *fully* meets the requirements of a given level of ambition. Given the wide increments between ambition levels, providing for some subdivision would give less scope for minor differences in assessment to result in different ratings between the business and the ESC. This could be included within the definitions of proposed confidence levels, or could be expressed as either an additional or alternative dimension.

We would be interested in discussing these concepts further with Commission staff.

Thank you again for the opportunity to contribute to this review, and we look forward to continued engagement.

Yours sincerely,

CLINTON RODDA
Managing Director