

## SUMMARY OF SUBMISSIONS TO THE TARIFF ISSUES PAPER

This document presents a summary of the submissions to the Essential Services Commission's "2013 Water Price Review – Tariff Issues Paper - July 2011". The summaries are presented for the convenience of interested parties but do not take the place of the actual submissions in terms of accuracy of content.

### **Western Water**

- Commented only on New Customer Contributions (NCC), where it noted that there is a direct relationship between NCC levels and Water and Sewerage tariff levels. Western Water's region will see significant growth which will require high levels of capital expenditure. NCC levels will be a key consideration in the recovery of part of the cost of new developments, with the balance from tariffs imposed on existing customers.
- As such, appropriate NCC charging can be used as a mechanism for mitigating the impacts of growth on customer tariffs, and the review of NCCs should not be considered in isolation of the issues associated with other water industry tariffs.

### **Wannon Water**

- Wannon Water considers that IBTs may have contributed to the significant reduction in average household water consumption in the current regulatory period.
- Sewerage tariffs – Wannon Water found that estimating the sewerage volume discharged was problematic, overly complex and subject to many assumptions which were difficult to explain to customers. As a result, Wannon Water had moved to a fixed sewerage service fee.
- The principles should include a primary statement that Water Corporation tariffs must be in accordance with the WIRO.
- If the State Government mandates a minimum percentage of water billing from the volumetric tariff – this would be inconsistent with the Commission's preference for LRMC. Direction will be needed on how this potential conflict is to be managed.

- Tariff innovation - there may be some merit in offering customers the opportunity to buy “green water” – (to purchase green power with which to supply water).
- Wannon Water is comfortable with the current individual price cap methodology given the stability of its water supply. Wannon Water would welcome the ability to move to a revenue cap if demand changed due to the loss of major industrial customers.
- Wannon Water is concerned that scarcity pricing has the potential to disadvantage the security of supply for customers who do not have the financial means to pay a higher tariff option to gain access to a more secure supply of water.
- For the next determination, it is unlikely that any customer would “take-up” a higher price tariff option to guarantee supply in times of scarcity. The concept of a customer paying to avoid restrictions would require some considerable understanding by the community.
- On innovation, the Commission should set the philosophy that the customer should not be disadvantaged, and nor should there be cross subsidises.
- Subject to the outcome of customer consultation, Wannon Water does not intend to offer tariff choice to water customers but might on billing frequency.
- If choice is to be provided, then the principle issues become: the tariff billing system and its ability to provide multiple options; customer understanding; and avoiding cross subsidies.
- An emerging issue for Wannon Water is the cost of localised sewerage systems servicing smaller communities and maintaining cross subsidies in order to mitigate price shocks.

## **Melbourne Water**

- Pricing principles - Melbourne Water considers there should be an additional principle relating to price structures providing incentives for the sustainable use of resources, assets and systems across all parts of the water cycle.
- Locational bulk water prices - locational usage headworks prices would result in significant differences across Melbourne. In relation to locational usage transfer prices, this could be explored in terms of prices for specific areas of Melbourne, rather than for specific retail water businesses.
- Volumetric bulk water prices - while the current usage component of the bulk transfer prices is determined with reference to LRMC, the remainder of the revenue is recovered through service (fixed) prices that are allocated based on forecast demand. Melbourne Water considers this approach is not inconsistent with the Productivity Commission’s approach of aligning prices with demand.

- Additionally, given the predominately fixed nature of Melbourne Water’s bulk water transfer system costs, Melbourne Water does not consider that a single usage price would be consistent with the Commission’s proposed pricing principles and the WIRO regulatory principles. Non cost-reflective prices could distort investment decisions.
- Current thinking on valuing the water resource and reflecting its scarcity in bulk water prices is evolving. Melbourne Water considers that further research into the practical application of this theory and whether its benefits outweigh its costs is needed before it can be implemented. This research should occur over Water Plan 3.
- Incorporating supply and demand side uncertainties in bulk water prices - at its full extent, the magnitude of cost variation due to desalination plant water orders (ordering nothing, as compared to ordering a full 150GL) presents a significant risk to Melbourne Water’s business viability, particularly over the 5 years of a regulatory period. Melbourne Water considers a flexible pricing approach will be required to ensure the uncertainty can be managed (both by itself and its customers). This will need to take into account the desalinated water ordering process, timeframes and requirements.
- The following options, individually or in combination are being considered further:
  - An annual pass through mechanism in which the variable portion of the desalination plant contract costs (that is, the portion of the contract payment based on the desalination plant water order) is passed on to Melbourne Water’s customers. This could be potentially subject to a materiality threshold.
  - A cumulative, end of regulatory period, pass through mechanism that accounts for changes in desalination plant’s water orders from the water orders forecast in the 2013 Water Plan and included in a regulatory determination. This could also be potentially subject to a materiality threshold.
- Unbundling of bulk water and sewerage price paths - in the 2013 Water Plan, unbundled price paths may be more appropriate to ensure that price increases are transparent at a product level. This benefit would have to be considered against the potentially competing objective of minimising price shocks to the end customer in any one product class.
- Waterways and drainage charges - Melbourne Water recognises the value of moving non-residential waterways and drainage charges to a more cost-reflective approach. Melbourne Water has investigated options for reform. A range of issues and challenges has been encountered, including the potential customer impacts. These primarily relate to a lack of complete and consistent data required to model the impacts of options. The complexity of these issues means that significant changes to non-residential waterways and drainage charges for the 2013 Water Plan are unlikely.

- Bulk recycled water - Melbourne Water broadly supports the Commission's and National Water Initiative's pricing principles. The exception to this is the National Water Initiative principle that states where there is a cost recovery gap this should be recovered with reference to all beneficiaries of the avoided costs and externalities. Melbourne Water currently recovers its cost recovery gap from sewerage customers on a polluter pays basis, in order to send signals to polluters about the benefits of improved sewage quality for recycled water. At this stage, Melbourne Water does not propose to change its current approach for the 2013 Water Plan

## **Coliban Water**

- The subsidy free pricing and inefficient bypass principle seems to be beyond the existing price approval considerations in the WIRO.
- In regards to rural pricing, it should be at the businesses' discretion as to how to allocate fixed costs as long as prices are set between avoidable and standalone costs.
- Coliban Water's customers wish to have more control over their water bill; variable prices may need to be greater than LRMC to accommodate customers' wishes and to ensure that tariff structures are in line with government policy.
- Price path stability reduces price shocks to customers. Any move away from IBTs should be accompanied by a clear transition strategy.
- Hardship policies play an important role in assisting low income and vulnerable customers and it is important businesses promote Government assistance, rebates and grants.
- The Commission should also consider the impact of tariff choices on different classes of customers. If low use customers are offered a different tariff, uptake of this will only occur if it results in an overall lower bill to them compared to the default tariff option.
- Revenue caps are useful to deal with variability.
- Coliban agrees that a standard two part tariff without IBTs will improve equity for large families who will no longer be paying the third tier price for water.
- There are no or few benefits in locational pricing in retail tariffs.
- Additional possible tariff options include community and green energy options.
- Three often cited constraints in offering tariff options are the businesses' billing systems, communication of tariff options and whether or not customers would like tariff options.

- Coliban does not charge a variable fee for sewerage for residential customers, thereby providing less complexity to residential sewerage tariffs.
- For simplicity purposes, residential recycled water prices should be set at some percentage of potable prices.
- The Customer Service Code could be adjusted to ensure that customers are aware of their cheapest tariff option, and it is the optimal tariff for them to choose.

## **South East Water**

### *Form of price control:*

- South East Water would consider a change from South East Water's current form of price control (individual price caps) to a weighted average price cap - provides flexibility in making individual price changes during the regulatory period.
- Given the level of uncertainty with desalination ordering and the associated variable charges, a pass through mechanism that adjusts for variable charges associated with the desalination plant has merit and needs to be explored.
- An investigation into an adjustment mechanism for significant under and over recovery of revenue due to sales variability should be undertaken.

### *Tariff structures and design levels:*

- Does not support different volumetric charges for bulk resource costs according to the bulk supply point for a retailer.
- Water and sewerage bulk charges must reflect the need to establish prices for new access seekers to Melbourne Water's infrastructure.
- Sewage disposal charge is not easily understood by residential customers given the complexity of its calculations.
- Currently reviewing their tariff strategy for recycled water.
- Tariff strategy is comprised of developing a default set of tariffs with choice tariffs remaining as optional for customers.

## **Westernport Water**

### *Forms of price control:*

- Support an 'individual price cap' model.
- Support the use of revenue caps for their business.

*Bulk water tariffs and transfer charges:*

- Currently working with Melbourne Water to develop pricing principles and a cost allocation framework for the metropolitan water bulk entitlement holders.

*Retail tariffs:*

- Supports a two part tariff structure with a fixed charge and a single volumetric charge.
- Do not support the introduction of innovative tariffs structures based on location or water quality – do not believe that ‘scarcity’ based tariffs would be appropriate.
- Supports setting fixed sewerage charges for residential customers.
- For recycled water, supports a two part tariff structure that is priced to promote the use of recycled water as a substitute for potable water.
- Does not support a move to a charge based on property size for waterways and drainage charges.
- Does not support offering “customer choice” tariffs.

**John Holland (Southern Region)**

- John Holland’s Southern Region operations have sensitivity to the pricing mechanisms used for potable, non potable and trade waste.
- The requirement of a minimum of Class A water for the majority of construction activities significantly restricts viability of options such as recycled water, borehole extraction, rainfall harvesting and treated storm water.
- Until such time as the use of non potable (specifically Class A) water becomes competitive with potable water it is difficult to imagine how an industry wide shift to more sustainable water sources such as recycled water will be achieved.
- Trade Waste charges are generally based on industry averages, not the specific construction site discharge – there is very little financial incentive to increase the quality of water discharged to sewer, a cost which is no doubt born elsewhere in the system.

## **Murtoa Showyards Recreation Reserve and Murtoa Golf Club**

- Concerned with the price of water to rural communities for recreation purposes.
- The pricing regime favours recreational lakes and not recreation reserves or golf courses.
- Water to community facilities such as recreational grounds and golf clubs should be offered at a price significantly less than \$830/ML – it should be around \$300/ML (the price to lakes is \$45/ML).
- There should be an increase in the price as the amount of water use increases above the basic requirements.
- The lost revenue could be recouped by a levy on all rate payers or by water sales program.

## **Consumer Utilities Advocacy Centre**

- Any choice strategy needs clear objectives, and the water businesses need to identify and articulate what choice is intended to achieve.
- 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 related.
- Would like to see analysis of the result of moving away from IBTs - what will be the impact on different customer groups, including low-income consumers.
- Oppose the introduction of scarcity pricing in relation to volumetric charges.
- Not all water sector market research meets high methodological standards and this should be considered when interpreting research findings.
- Concerned that 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 – a price cap does not offer this incentive.
- Favours smoothing approach to the translation of variable bulk water costs into retail tariffs – minimising variability for consumers.
- Giving consumers the choice between ‘pass through’ and ‘smoothed’ retail tariffs would introduce substantial complexity for consumers and should be closely scrutinised against the ‘customer focus’ principles set out in the Issues Paper.
- Retailer tariffs should use the postage stamp approach to distribution cost recovery – for reasons of equity, administrative simplicity and consumer understanding.

- 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.
- 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.
- Sewerage is unmetered and inelastic in demand – there is little benefit to the use of a two-part sewerage tariff.
- For those proposing tariff choices – businesses should clearly identify administration and implementation costs of tariff choice.
- Do not want reforms that will increase the complexity facing consumers.
- Should greater choice be made available to consumers – this would need to be accompanied by consumer information and education.
- Where tariff choices are made available, a default tariff should be in place to allow consumers to avoid making a choice if they choose to do so.
- If tariff option packages are approved, the Commission must review the Customer Service Codes in light of the change.

### **Victorian Council of Social Service (VCOSS)**

#### *Pricing principles:*

- VCOSS are not opposed to flat or other types of tariffs that are compatible with the suite of pricing principles. They agree that the critical test for a proposed tariff structure is that it has a clear rationale, its impacts on different types of customers have been analysed, and – where it differs markedly from its predecessor – an appropriate transition strategy is in place.
- VCOSS does not support scarcity pricing and does not believe dynamic price signalling can overcome the inherent demand inelasticity of most customers.
- VCOSS supports the proposed customer focus principles. Tariff structure proposals should consider impacts on different types of customers and have some basis in broad customer consultation.



*Tariff structure and design issues:*

- VCOSS does not support the pass-through of variable bulk water costs at the retail level and considers that water businesses are well placed to smooth locationally variant costs into postage stamp pricing.
- VCOSS supports inclining block tariffs (IBTs) but is not opposed to flat tariffs, so long as complementary measures to address social equity and affordability are appropriately designed.
- VCOSS has qualms about some possible innovative tariff offerings and believes that water, like energy, is a relatively low-engagement product and most households have little interest in having to choose between numerous product offerings.
- VCOSS believes that the fixed and (where applicable) volumetric retail sewerage charges should be incorporated into the fixed and volumetric water supply charge

*Customer choice:*

- VCOSS is not convinced that Victorian households want choice in their water supply arrangements. The evolution of the competitive energy market over the last decade suggests that while direct competition can bring (relatively) lower prices for some, increased choice often leads to customer confusion.
- VCOSS supports a default tariff made available to all customers in a class. Forcing a choice on customers would likely lead to poor outcomes for some customers who do not have the capacity or inclination to choose the most appropriate tariff for their circumstances.
- Alternative tariffs should be subject to approval by the Commission with regard to the pricing principles, balanced with other considerations as outlined in section 6.4 of the issues paper.
- Any move toward tariff choice would do well to implement learnings from the privatised energy market. The issues paper identifies the key areas that need to be addressed:
  - Information provision – including clear information on how the tariffs work as well as terms and conditions.
  - Facilitating decision-making – including an appropriate method for customers to assess the cost impact of alternative tariffs against each other and against their existing tariff, using their real consumption data.
  - Switching – including the process by which switching occurs (ensuring explicit informed consent is obtained and minimising the potential for billing errors), mandating an appropriate cooling off period, and limiting entry and exit costs.

## City West Water

*The volumetric charge for water and sewerage:*

- Volumetric prices currently charged by CWW are above marginal cost, and may in fact be substantially higher in some cases.
- CWW supports the proposal to move away from their current inclining block tariffs and the sewerage disposal charge.
- Issues to consider when moving away from IBTs:
  - the impact this restructure will have on some customers
  - the conflict this restructure may have with the desire by customers and government policy that a large proportion of the bill is made up of variable charges.

*The degree of uncertainty in the next regulatory period:*

- The next five year regulatory period will see a far greater level of uncertainty than the previous period due to:
  - the costs of desalinated water, which directly affect bulk water prices from Melbourne Water
  - uncertainty around demand in an unrestricted environment.

*Form of price control:*

- CWW is currently subject to individual price caps that are set for the entire regulatory period and adjusted annually for inflation.
- CWW's current form of price control provides certainty to customers.
- CWW proposes that an alternate price control to the currently one is preferable for the next regulatory period. This alternate price control could address the issues of the:
  - uncertainty of the annual desalination costs and
  - the demand uncertainty when pricing is above marginal cost.
- Given the level of uncertainty with desalination ordering and the associated variable charges, a pass through mechanism that adjusts for variable charges associated with the desalination plant has merit and needs to be explored.
- CWW proposes consideration be given to a price control that adjusts prices each year after the actual demand for the previous year is known.
- CWW also suggests that if adjustments led to price shocks for customers it may be able to be phased over a number of years.

## **PACIA (Plastics and Chemicals Industries Association)**

*On Trade Waste Agreement Fees, PACIA submitted the following:*

- PACIA recommends ... that a company should not be penalised with higher renewal fees for having a more complex trade waste discharge when the discharge is consistent from one agreement to the next. If the trade waste agreement does not change as there is no change to the discharge, there is no valid reason to charge a greater amount in the renewal fee. It is valid to charge a greater amount in renewal fees only when there is a change to the composition of the discharge, and work is then required to assess the risk.

## **Grampians Wimmera Mallee Water (GMMW)**

*Proposed pricing principles:*

- GMMW supports the pricing principles but suggests a principle relating to water scarcity with some acknowledgement of the role of excess charges in capped systems as a way of regulating excess demand.

*Form of price control:*

- GMMW is currently subject to a hybrid price cap that constrains its ability to set prices relative to demand.
- GMMW would like a revenue cap and tariff basket if a greater proportion of tariff's are based on volumetric charges or alternatively set higher prices to offset the risk borne by the water businesses.

*Tariff structure and design issues:*

- GMMW acknowledges that its headworks pricing structure can be improved. Headworks costs are generally fixed, hence a two part tariff for bulk water is considered appropriate.
- GMMW does not support locational signals based on cost but does support them based on scarcity.
- The most significant issue confronting water businesses related to increased variability is demand uncertainty.
- GMMW see revenue caps as a way to ensure that water businesses are less exposed to volume risk from demand uncertainty.
- GMMW does not support cost based locational signalling, however does support seasonal peak/off peak pricing.
- GMMW does support customer choice and mentions that a revenue cap and tariff basket will provide businesses greater scope to explore customer choice.

- Volumetric sewerage charges conflict with the WIRO as they are difficult to explain to customers.
- Trade waste charges are an effective mechanism for promoting efficiency and ensuring that water businesses receive a waste stream that is most usable.
- GWMW believes that the recycled water principles developed for the 2008 Water Price Review remain relevant.

*Customer choice:*

- GWMW supports water businesses having the ability to offer customer choice.
- If customer choice tariffs are developed GWMW thinks that there may need to be an adjustment to the customer code to effectively regulate.

## **Barwon Water (BW)**

*Proposed pricing principles:*

- BW is comfortable with the pricing principles as proposed by the Commission.

*Form of price control:*

- BW's current form of price control is 'individual price caps' which, integrated with long-term water supply and financial sustainability planning, can avoid 'price shocks' and provide price stability.
- The biggest risks for water businesses are managing climate variability, customer demand and bulk water purchase costs.

*Tariff structure and design issues:*

- In terms of bulk water, BW would like the continuation of the current obligatory buy back arrangement by Melbourne Water which effectively constitutes a "pay as you go" volumetric charge which results in BW paying a combined fixed and volumetric charge in the form of a higher volumetric charge for water as it is used.
- BW would not support bearing any additional costs of increasing MW's pool size due to metropolitan demand increase as BW will increase water supply sources locally before increasing its entitlement.
- BW has a two part tariff and does support a pricing option for passing on the higher costs of purchasing water in drought periods for those customers that wish to use the water.
- BW has already removed its residential volumetric sewerage tariff but supports volumetric tariffs for businesses.

- BW has no major issues with the recycled water tariffs, however, strongly supports recycled water sources being part of the total integrated water resource planning system.

*Customer choice:*

- BW considers the ability to offer tariff choices such as a customer choosing to pay more for water supplied by green power or paying more in time of drought to secure water supply and not be impacted by restrictions, would be difficult to adopt during this regulatory period.

## **Yarra Valley Water (YVW)**

*Proposed pricing principles:*

- YVW supports most of the principles but not the overly prescriptive ones, such as suggesting a two part tariff.
- YVW believe that the marginal cost reflective volumetric tariff principle is too prescriptive and contrary to government policy regarding the ratio of fixed to volumetric charges.

*Form of price control:*

- YVW recognise the need for a form of price control that manages a fair balance of risk between customers and the utility (and its shareholder). In terms of risk, however, tariffs are a secondary driver for price control, after demand.
- YVW consider a revenue cap to be more appropriate than a price cap
- Tariff structure and design issues:
  - In terms of bulk water, YVW believe that a revenue cap would mitigate the risk from uncertainty around bulk water purchases.
  - YVW would also prefer that desalinated water charges are separate from storage and collection charges.
  - YVW considers that there may be benefits in introducing locational signals into bulk charges.
  - YVW thinks that locational signals should be sent through developer charges rather than tariffs.
  - YVW suggests that a two part tariff should be the default tariff but IBTs should remain an option as a customer choice
  - YVW supports the inclusion of a volumetric sewerage component to the volumetric water charge and maintaining a separate fixed charge for sewerage.

- YVW believe that recycled water should not automatically be cheaper than potable water because it is seen by some as an inferior quality product. In some regards YVW believe it is superior to potable water because it is unrestricted and creates a higher degree of utility for many customers.
- YVW has already removed its residential volumetric sewerage tariff but supports volumetric tariffs for businesses.
- YVW has no major issues with the recycled water tariffs, however, strongly support recycled water sources being part of the total integrated water resource planning system.

*Customer choice:*

- YVW suggest that customers may benefit from a choice of tariff options in addition to the standard tariff.
- YVW are aware of some dissatisfaction with existing tariffs and believe that choice would improve overall customer satisfaction if properly introduced.