

11 December 2015

Water Team – Pricing Framework Review
Essential Services Commission
Level 37
2 Lonsdale Street
Melbourne VIC 3000

Dear Water Team

Review of Water Pricing Approach

We welcome the Commission's request for further comments on its approach to water pricing for the 2018 water price review following its November workshop. We appreciated the opportunity to participate in the workshop and gained a better understanding of the various ideas that could be applied to future water pricing.

From the workshop, there were two main themes from the ideas presented. These were:

- ensuring customers are fully engaged in the development of price submissions and delivery of the outcomes; and
- incentivising water utilities to develop rigorous and robust price submissions, e.g. fast track status for water utilities passing various benchmarks established by the Commission.

We strongly support the first theme as we believe that customer driven outcomes are a necessity for any utility industry. In relation to the second theme, we believe that there is merit in further exploring options for incentivising water utilities.

We note that generally the ideas presented at the workshop supported the retention of the 'buildings blocks' method.

In our June 2015 submission to the Commission, we outlined our idea of rolling price determinations. Since that time, a number of regional urban water utilities have supported this concept. The concept involves a particular focus by stakeholders (water utility, customers and Government) on the baseline year, year 1 and final year of the rolling determination period:

- the baseline year - it is proposed that the current year be used as the baseline for the rolling price determination using nine months of actual results and three months of forecast results. This will significantly increase the focus on current year performance, as every year all parties will be seeking to ensure that any efficiencies will be passed on in the final year of the corporate plan and that any adverse changes in expenditure are not passed on unless there has been a material underlying change in costs;
- the first year of the five-year planning period – this will be the year on which budgets and performance plans will be set and, like now, will continue to be a key focus year; and

- the last year of the five-year planning period – this will be the extra year to be added under the rolling price determination concept and will require customer engagement on the outcomes to be achieved and a composite pricing outcome (previous four years plus pricing outcome for additional year).

To support the rolling determination concept, the Commission would need to set out its minimum requirements for a water utility's price submission proposal including:

- demonstration by the water utility of a thorough understanding of customers' needs;
- demonstrating proposed service standards meeting customers' needs;
- proposed benchmark expenditure that is efficient (including achievement of the nominated minimum efficiency factor for operating costs);
- Return of Capital that reflects asset lives; and
- Return on Capital that is consistent with the financial markets.

The approval process should be straight forward when water utilities have demonstrated they have met the requirements. This would then allow the Commission to allocate its resources to assess those water utilities that do not meet the minimum criteria. Throughout a year, the Commission should also have capacity to 'deep dive' on one or two matters that, due to both the Commission and water utilities' capacity constraints, do not get addressed in the current price determination process.

The rolling price determination arrangement would remove the large set piece price reviews at five-yearly intervals, which are resource intensive, and replace them with smaller mini annual price reviews.

In summary, we believe that there are four main possibilities from this concept:

- deeper customer and community engagement through the requirement for annual engagement;
- the Corporate Plan and price submission of each water utility are aligned with the key inputs and pricing outcomes being updated annually;
- annual 'deep dive' on a few regulatory issues by the Commission through a rolling program of reviews with the focus changing each year; and
- more productive and innovative industry with improved customer engagement and planning competencies and an annual focus on outcomes, costs and future prices.

If your team has any queries regarding the above, please contact Brett Mathieson, Manager, Regulation and Planning by email on Brett.Mathieson@yvw.com.au or by phone on 9872 2441.

Yours sincerely



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