

12th August 2016



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

South Gippsland Water submission in response to Essential Services Commission (ESC) Position Paper – A New Model for Pricing Services in Victoria’s Water Sector May 2016

Thank you for the opportunity to provide a response and assist in shaping the future pricing model in the Victorian Water Industry.

South Gippsland Water welcomes and supports the review of the current pricing model and submits the following comments in relation to the position paper:

Customer Engagement

South Gippsland Water broadly supports the proposed approach to engagement with customers and stakeholders with respect to identification of the key matters of significance for customers. The process outlined will allow customers to identify more focused areas of interest resulting in a structure that provides the ability to influence areas that matter to them.

The Corporation has a number of comments in this regard:

- To engage and develop customer-centric standards, the corporation requires a level of confidence that the engagement process is able to influence the final proposal.
- Customer engagement features significantly in the PREMO assessment and the incentives provided to the corporation. In the absence of prescriptive criteria, will the scale of consultation be considered in the context of the size of the organisation and if so, how? For a smaller Corporation, undertaking a significant and comprehensive consultation process may outweigh the impact on price.
- Assume the consultation process resulted in the customer base preferring step changes in service levels and/or renewals of assets to avoid intergenerational transfer of costs. In these circumstances, would the proposed model allow such a price increase, especially in the context of other cost pressures, ie increasing regulator and/or shareholder requirements?

New Model

South Gippsland Water supports the continued use of the Building Blocks approach. Continuing to utilise this approach allows Corporations to apply a tested structure that has proven to work over recent years. Continued improvements in models provided by the ESC and information furnished by water corporations will result in better outcomes.

PREMO incentives

South Gippsland Water supports incentivising Corporations, and believes the model proposed is a good step towards this process. The following observations are offered:

- There are concerns that the "devil will be in the detail". For example, a non-prescriptive assessment of ambition allows a degree of flexibility, but if not applied in a transparent and accountable manner, could result in sub-optimal outcomes given the risk seems to be all downside to water businesses.
- Current South Gippsland Water analysis indicates a significant requirement for increased renewal spending to maintain current service levels and standards (subject to customer engagement), and extra costs relating to regulator/shareholder requirements. Can a water business actually be leading or ambitious in such circumstances? Indeed, would it want to have a higher cost of equity on top of higher prices due to the above?
- Consideration therefore needs to be given to an individual water business' particular circumstances, including current pricing (comparatively), infrastructure condition, economies/diseconomies of scale due to service demographics, etc.

Autonomy in Demand Forecasting

South Gippsland Water has concerns with respect to the proposal in Appendix B – Autonomy in Demand Forecasting. Careful consideration should be given to varied climatic conditions. This is particularly so during extremely dry years when water demand can significantly increase above and beyond those normal forecast demands. We believe it is appropriate to establish a revenue cap, however, careful consideration of the buffers needs to be applied due to the potential for extreme climate variability across the State. This could be informed by an analysis of historical forecasts and actuals.

In addition to a revenue cap, South Gippsland Water proposes a revenue floor be established, thereby creating a collar where price caps apply. Outside the collar, revenue would have a cap/floor level providing protection for both customers and businesses for extreme demand variations.

Additional General Considerations

Financial sustainability needs to be considered in more detail. The current model tends to drive corporations to debt to fund ongoing renewals and large infrastructure projects. A mix of debt and equity is good balance for any commercial corporation. However, there seems to be little consideration for the financial sustainability of regional corporations.

Service standards have generally been approved by the Commission based on historical performance and not considered holistically against cost drivers, customer preferences or compared to other Corporations. They are not specifically mentioned in the paper at all.

Yours Sincerely



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