

Contact: Stephen Walker

15 June 2015

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

By email: water@esc.vic.gov.au

Attention: Mr Marcus Crudden

Dear Mr Crudden

RE: REVIEW OF WATER PRICING APPROACH

Thank you for the opportunity to make this submission to the Commission's Review of Water Pricing Approach. Cardno has worked in the Victorian water sector for many years and we are committed to the ongoing success of the sector in providing effective and efficient water and sewerage services to customers.

This submission is based on:

- our experience working with water utilities and the Essential Services Commission in Victoria
- our experience working across Australia with water utilities and most state and territory economic regulations
- the experience of our team in other regulatory frameworks, including in other countries.

In this submission we discuss a small number of areas that we consider are positives of the current approach to price regulation, as well as some opportunities for improvement.

Benefits of a multi-faceted approach

We have experience in providing expert advice to the Essential Services Commission, and other Australian economic regulators, on the prudence and efficiency of the capital and operating expenditure plans put forward by water utilities. In assessing these expenditure plans, we employ a multi-faceted approach that considers:

- The governance framework of the business
- The business processes used to develop the expenditure plans
- Benchmarking using partial indicators
- Analysis of long term expenditure trends and variances and performance (service levels) of the entity

- Detailed review of a sample of projects.

We consider that this multi-faceted approach is necessary to adequately assess expenditure forecasts. While each approach in isolation has shortcomings, when taken together, they provide a detailed and complete view of the expenditure plans. For example, a process review provides assurance that a utility has the capability to deliver on its plans but is unable to answer the question of whether specific expenditure items are justified. Similarly, benchmarking and trend analysis may provide guidance as to the whether the level of expenditure proposed is historically high or low or relatively high or low, but cannot convey whether this is by design and if the specific items proposed represent sound investments or otherwise.

Therefore, we consider that any changes to the approach to water pricing should retain this multi-faceted approach for assessing expenditure. Similarly, we do not consider that one approach in isolation, such as productivity measurements or a yardstick, would provide sufficient assurance to customers.

This multi-faceted approach should also consider longer term financial sustainability issues to ensure that any short-term efficiency gains do not compromise longer term financial sustainability of the entity.

Importance of benchmarking data

As noted above, in performing expenditure reviews to inform price regulation, we undertake benchmarking using partial indicators. For this activity, we use the National Performance Reporting (NPR) data set. This data set has recently become the responsibility of the Bureau of Meteorology following the cessation of the National Water Commission. The Victorian water sector is fortunate in having a data set that is more comprehensive than the NPR and that is subject to annual audit. We consider that the Essential Service Commission's performance reporting data set is invaluable to price regulation and that this data should continue to be collected and be subject to audit.

While outside of the Commission's control, we believe that there would be significant benefit in the NPR data set being refined to provide more support to price regulation and there being greater scrutiny on the submitted data. Improving the NPR data set would be of benefit to the Victorian water sector by providing more comparator agencies, particular for Melbourne Water and the metropolitan distribution-retail businesses.

Value of asset management

The regulatory framework for the Victorian water sector currently makes only limited reference to the discipline of asset management. This is through the Statement of Obligations and through the Commission's requirement that capital expenditure proposed by water utilities be supported by "well developed asset management planning".

There is significant alignment between asset management and the objectives of economic regulation; both seek to ensure that asset owners provide service to customers efficiently. With the publication of the international series of standards on asset management, ISO55000, in 2014, there is now a globally recognised and industry accepted approach to asset management. This standard takes a whole-of-business approach to the management of assets. We consider that the Commission should place greater emphasis on the importance of asset management in any future regulatory approach given that infrastructure investment and operating costs have the greatest impacts on water pricing.

We wish you success in completing this review.

Yours sincerely



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