

Water Reform in Victoria Independent pricing regulation and its outcomes for consumers

A report by the Consumer Action Law Centre

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Abbreviations

CLCV	Consumer Law Centre Victoria
COAG	Council of Australian Governments
CUAC	Consumer Utilities Advocacy Centre
DEFRA	Department for Environment, Food and Rural Affairs (UK)
DPC	Department of Premier and Cabinet (Vic)
DPMC	Department of Prime Minister and Cabinet (Cth)
DSE	Department of Sustainability and Environment (Vic)
ERA	Economic Regulatory Authority of Western Australia
ESC	Essential Services Commission of Victoria
ESC Act	<i>Essential Services Act 2001</i> (Vic)
ESCoSA	Essential Services Commission of South Australia
IPART	Independent Pricing and Regulatory Tribunal
LRMC	Long Run Marginal Cost
NWC	National Water Commission
NWI	National Water Initiative
OECD	Organisation for Economic Development and Cooperation
PIAC	Public Interest Advocacy Centre
PC	Productivity Commission
QCA	Queensland Competition Authority
VicWater	Victorian Water Industry Association
Water Act	<i>Water Act 1989</i> (Vic)
WI Act	<i>Water Industry Act 1994</i> (Vic)
WIRO	Water Industry Regulatory Order

Table of contents

Acknowledgments.....	ii
Abbreviations.....	lii
Executive Summary.....	1
Chapter One – Projects aims & overview.....	4
Chapter Two – Development of regulatory framework.....	9
Chapter Three – ESC price reviews.....	30
Chapter Four – Customer consultation.....	48
Chapter Five – Conclusion and recommendations.....	65
Bibliography.....	68
Appendix A – Maps of Victorian Water Businesses.....	72
Appendix B – Water Industry Regulatory Order.....	75
Appendix C – CoAG Communiqué extract on Water Policy.....	84
Appendix D – Questionnaire for Water Businesses.....	90
Appendix E – Community Consultation Questions.....	94

Executive Summary

Significant reform of the Victorian water sector has occurred over the last ten to fifteen years. More recently, reforms to the way in which water and wastewater services are priced have occurred – an independent regulator, the Essential Services Commission (the **ESC**), now sets prices to be charged by Victorian water businesses. Regulation relating to the pricing of water responds to a number of policy objectives. These objectives include:

- that the prices of services reflect their costs;
- that essential services are charged on a fair and affordable basis; and
- that prices encourage consumers to consume water sustainably.

These perhaps conflicting objectives are now resolved by the ESC, which has significant power and discretion in setting water prices and water tariff structures.

This report provides a consumer perspective about whether the independent regulation of water prices is achieving its objectives in Victoria, and the ways in which consumers are consulted in the price setting process. When the regulatory regime for water pricing was set up, consumer advocates were fundamental to ensuring the process was public so that pricing issues are exposed to public scrutiny (CLCV, 1996). By examining the outcomes of pricing regulation for consumers, this report similarly contributes to accountability in the sector. The report also makes a number of recommendations that aim to improve the public interest outcomes of the pricing regulation of water and wastewater services in Victoria.

In particular, this report finds that water businesses' consultation techniques have not been adequate throughout the first price reviews. This has significantly impinged upon the water price review process resulting in outcomes that benefit consumers. There are also recommendations about the regulatory framework, suggesting that the ESC be required to more actively take account of social and environmental factors in making pricing decisions, including those related to tariff structures. A summary of the recommendations follows.

Recommendation One: That the Victorian Government amend the regulatory framework for the pricing of water to require the ESC to more actively take account of social and environmental factors in making pricing decisions, including those related to tariff structures.

Recommendation Two: That any further moves to introduce market principles into the provision and/or pricing of water must be based on public interest outcomes (considering all social, environmental and economic implications) and involve robust community consultation.

Recommendation Three: That the Victorian Government and the ESC work with the water businesses (including industry bodies) to improve consultation processes and procedures. Consultation on water plans and pricing proposals, especially with low-income consumer and their representatives, is fundamental to robust and fair pricing determinations.

Recommendation Four: That the ESC prepare a guideline, in consultation with water businesses and stakeholders, to outline what is required for effective customer consultation, in the context of the preparation of Water Plans.

Recommendation Five: That the Government and the ESC undertake a comprehensive assessment of tariff structures and their impact on sustainable water consumption.

Recommendation Six: That the effectiveness of the inclining block tariff be independently assessed. This assessment should focus on:

- whether the first block is set at a level that ensures an essential water supply is affordable;
- whether measures to address affordability problems experienced by large households or other vulnerable groups are effective;
- whether the pricing structure has resulted in reduced water consumption; and
- if not, whether this can be addressed by amending the structure of the tariff (ie, levels of fixed and volumetric charges) or whether measures other than pricing should be used to promote sustainability.

Recommendation Seven: That the Government, the ESC and the water industry should further investigate alternative water pricing structures for industrial and commercial users that promotes water conservation.

Recommendation Eight: That the ESC consider direct price regulation for recycled water services rather than imposing only pricing principles, recognising it as an essential service and considering the benefits associated with its contribution to reduced use of potable water services.

Recommendation Nine: That the Victorian Government, the ESC and the water businesses investigate the potential effectiveness of a special tariff for consumers who are particularly vulnerable, such as very large families.

Recommendation Ten: That the ESC assess the adequacy of water businesses' hardship policies (including the adequacy of Government concessions) as part of its pricing determination in assessing Water Plans.

Recommendation Eleven: That the ESC introduce a Guaranteed Service Level payment where a water consumer is not treated in accordance with a business' hardship policy, as approved by the ESC

1. Project Aims & Overview

1.1 Background

In the mid 1990s, Victoria's water industry underwent significant restructuring. The provision of water services was largely corporatised, so that over 80 water providers became 20. This reform has had an impact on the price consumers pay for water, as well as the terms of service delivery. This report analyses changes to the way water is priced, and questions whether changes have brought about consumer benefit.

As part of the restructuring process (in conjunction with the privatisation of the energy industry), the Kennett Government established the Office of the Regulator-General, which later became the ESC.

On 1 January 2004, the ESC became the economic regulator for all water businesses in Victoria. This reform occurred as part of the Victorian Government's larger water reform white paper, *Securing Our Water Future Together*, which was launched by the Government in June 2004 (DSE, 2004). The white paper followed a detailed Green Paper released for public comment in mid-2003 (DSE, 2003). The white paper set out extensive reforms affecting the pricing of water for domestic consumers in metropolitan and regional urban areas:

- structuring water prices to reward conservation;
- ensuring that water prices recover the cost of delivering all water services; and
- funding initiatives that seek to promote the sustainable management of water and to address adverse impacts to the environment associated with its use.

1.2 The role of the Essential Services Commission

The ESC's regulatory responsibilities include:

- the approval and/or setting of prices to be charged by Victorian water providers;
- developing and monitoring codes of conduct; and
- reporting on the service provided by Victorian water providers.

The ESC has developed the Water Customer Service Code which specifies the standards and conditions of supply that urban water businesses must comply with in servicing customers (ESC 2005a) and is currently consulting on a Customer Service Code that will apply to rural consumers (ESC 2006a). The ESC has also developed a performance reporting framework which outlines the performance indicators that urban water businesses are required to measure and report (ESC 2004a). Public performance reporting contributes to the sector's "competition by comparison" regime. The ESC is also currently consulting on a performance reporting framework to apply to the rural water sector (ESC 2006b). This report, however, focuses on the ESC's price regulatory function, including the role of water businesses in developing water plans to meet the needs of consumers.

The ESC undertook its first price review during September 2004 to June 2005. The review set the prices for a period of three years from 1 July 2005 for most urban water consumers. The ESC's second price review, which set prices for two years from 1 July 2006, related to mostly the provision of water to rural users (farms, etc), although did cover some urban consumers in the north-west of Victoria. These price reviews have resulted in sustained above-CPI price increases for domestic water and sewerage services, as well as the implementation of new tariff structures. The ESC's next price review will set prices for all water consumers, urban and rural, for five years from 1 July 2008.

The ESC's regulation of water pricing responds to both state and federal government policies, including:

- the requirement that water businesses recover the cost of providing water services through water prices (full cost recovery);
- the need to promote conservation of water as a scarce resource; and

- an expansion in trade in water, which endeavours to achieve more profitable use of water and more cost-effective and flexible recovery of water to achieve environmental outcomes.

These policies indicate a distinct shift towards the commercialisation and marketisation of the provision of water in Victoria.

In this context, this report will consider the economic, environmental and social outcomes of the new regulatory framework for water, drawing on an analysis of the first regulatory price reviews. Integral to the price review framework is the way in which businesses consult with their customers – customer consultation justifies proposals for service standards and improvements, and ultimately pricing increases. By analysing the price reviews, the report will also examine ways in which consumer advocacy within the water sector can be improved, principally with respect to the upcoming price review.

1.3 The regulated Victorian water industry

The Victorian water industry is a monopoly industry – each water business is the exclusive supplier of services to a defined area of the state. The water sector is also known as a ‘natural monopoly’, which can be defined as a sector where more than one firm in the industry would mean wasteful duplication of costly capital facilities.

It is generally recognised that monopoly industries require regulation to avoid rent-seeking behaviour and that price regulation can eliminate (wholly or partly) the tendency of monopolists to under-allocate resources and to earn economic profits. Pricing regulation is integral, therefore, to ensuring water services are delivered in the public interest.

There is also an argument that as water services are essential to the interests of the public, the profits from the services should be kept in public hands. In Victoria, government ownership of the Victorian water businesses has been constitutionally protected to ensure continued public control of important water resources.¹

As outlined above, the Victorian water sector has undergone significant transformation in the past 10-15 years. Currently, the Victorian water sector, as regulated by the ESC, consists of the following:

- Melbourne Water, the wholesale water supplier to metropolitan Melbourne, providing bulk water and sewerage services to the

¹ *Constitution Act 1975 (Vic)*, s 97.

three retailers and a number of regional businesses and drainage services throughout Melbourne;

- three metropolitan water businesses,² supplying retail water and wastewater services to residential, commercial and industrial customers (the **metropolitan retailers**). The metropolitan retailers also undertake some sewage collection and treatment;
- thirteen regional-urban water businesses,³ providing water and wastewater services to customers within their respective regions (the **regional-urban businesses**). Unlike the disaggregated structure operating in Melbourne, these businesses are responsible for harvesting water and managing headworks, treating and delivering water for human use, treating and disposing of wastewater and retail functions.
- five rural water businesses,⁴ providing water services to the rural sector (the **rural businesses**). They are responsible for harvesting water and operating headworks, managing irrigation districts, supplying irrigation and stock and domestic water services to rural customers (that is, farms), supplying bulk water to some regional urban businesses, and administering diversion licences. Two of these businesses also provide water and wastewater services to regional urban customers as described above.⁵

Maps of the areas serviced by the various water businesses are at Appendix A.

This report focuses on the services of the metropolitan retailers and the regional-urban businesses. Although there is some discussion of the rural water price review in section 4, this report seeks to consider the impact of the regulation of the water sector upon domestic consumers. The focus remains, therefore, on the businesses that service those consumers.

² Yarra Valley Water, City West Water and South East Water.

³ Barwon Water, Wannon Water, Central Highlands Water, Coliban Water, Western Water, Goulburn Valley Water, North East Water, East Gippsland Water, Gippsland Water, South Gippsland Water, Westernport Water, GWM Water and Lower Murray Water.

⁴ Goulburn-Murray Water, Southern Rural Water, First Mildura Irrigation Trust, Lower Murray Water and GWM Water.

⁵ Lower Murray Water and GWM Water.

1.4 Overview of the report

The remainder of the report is structured as follows:

- Part 2 analyses in more detail the regulatory framework for water and wastewater price determination in Victoria. It also compares that framework with other Australian jurisdictions and the United Kingdom, and discusses some current policy reforms that impact upon the regulatory framework.
- Part 3 assesses the first Victorian price reviews undertaken by the ESC. The assessment examines whether the reviews:
 - are based upon clear and explicit customer consultation (that is, consumers understand and have contributed to proposals for service improvements and tariff structures);
 - result in pricing and tariff structures that contribute to sustainable water use; and
 - consider the impact of price increases on low-income and vulnerable consumers.
- Part 4 provides results from surveys with water businesses and other stakeholders about the levels and quality of customer consultation being undertaken by water businesses.
- Part 5 concludes the report with a range of recommendations to the Government, the ESC, water businesses and other stakeholders that aim to improve the operation of water and wastewater price determination in Victoria.

2. Development of Regulatory Framework

2.1 Overview from 1990s until present

Significant economic and structural reform of the Victorian water sector has been implemented over the last twenty years. In October 1993, the Victorian Government released a policy document, *Reforming Victoria's Water Industry – A Competitive Future*, which began a phase of structural reform of the industry (VG 1993). The Government's agenda sought a substantial overhaul of the Victorian water industry by introducing competition to drive efficiencies and by empowering customers to make choices about the services they require (VG 1994). 120 regional water authorities were reduced to around 20 and there occurred final separation of water authorities from local councils. In metropolitan Melbourne, Melbourne Water was divided into five separate entities – Melbourne Parks and Waterways, three retail businesses and Melbourne Water retained responsibility for headworks and sewerage treatment plants (VG 1995).

In 2004, the entire water industry was brought within the economic regulatory framework of the ESC. More recently, reform has occurred to various aspects of water management and planning (DSE 2004). This reform was driven by several key factors, such as the need to improve water and sewerage services by maintaining and improving infrastructure and the growing scarcity of water resources, resulting in an urgent need to promote the adoption of water conservation measures.

2.2 Role of regulation of water industry

An effective functioning modern economy and society depends on regulation (PC 2005).

Regulation involves the supervision and control by government of commercial activities in the interests of economic efficiency, fairness, health and safety. Regulation is most often described as required to address a broad range of economic ‘market failures’ that can occur in particular markets.⁶ However, the correction of market failure is not the only role of regulation. Governments also choose to regulate in order to achieve specific public policy objectives, including social and environmental policy goals. For example, the concessions framework in Victoria involves regulation specifically designed to achieve a social outcome.

In designing and administering regulatory regimes, government policy-makers and regulators draw on “best practice” regulation. The OECD (2005) endorses principles of good regulation as follows:

- transparency;
- accountability;
- targeted regulation;
- consistency; and
- proportionate regulation.

These are high-level principles only – it takes considerable effort to translate them into practical decisions on detailed regulatory policy, design and instruments. With respect to the water industry, competing objectives of regulation, as outlined below, complicate the regulatory project.

Recently, there has been increasing concern over the amount of regulation and the costs of compliance burdens on business. In 2005, the Federal Government launched a Taskforce on Reducing Regulatory Burdens on Business. The Federal Government (2006) has accepted many of the Taskforce’s recommendations, which aim to reduce the compliance burdens of regulation on business.

Rather than focus on the amount of regulation applying to water businesses, however, this report proceeds on the basis that the level and types of regulation should be based on what is effective in

⁶ For a review of the economic rationale of regulation, see Llewellyn (1998).

furthering the public interest. In particular, regulation of pricing should have an overarching objective of contributing to economic efficiency and consumer benefit. The focus, therefore, should be on what is in the “public interest” or what (if any) regulation effectively brings about outcomes that result in “consumer benefit”.

Consumer Action (and its predecessor, the CLCV) has long believed that the public interest is served by the maintenance of consumers’ access to essential services (CLCV 1996, 2004). That is, consumers should not be disconnected from supply due to incapacity to meet required financial obligations. Furthermore, the pricing of essential services should be equitable and fair, taking into account the need to maintain supply for vulnerable consumers as well as the importance of sustainable use of a limited resource.

Recommendations contained in this report focus on ensuring that the regulation of price reviews is done in a way so as to maximise consumer benefit, and ensuring the regulatory framework adequately assists low-income and vulnerable consumers.

The Committee for Melbourne’s Utility Debt Spiral Project (2004: 133) summarised the features of an effective social and economic regulatory framework for assisting vulnerable consumers as follows:

Table 1: From Committee for Melbourne's Utility Debt Spiral Project (2004).

Feature	Characteristics
Central government	Overall responsibility for determining social policy and funding arrangements Ensure accessibility of protections and assistance framework
Referral bodies	Independent, adequately resourced, efficient, accountable Effective communication and referrals between agencies
Support schemes	Dynamic, targeted, efficient (in administrative costs, timeliness), transparent, compassionate, responsive Efficient interface/interaction with practical/operational issues (eg, postal, welfare payment timing, etc)
Regulatory obligations	Dynamic/flexible (to accommodate changes in community expectations, needs, economic

Feature	Characteristics
	<p>climate, etc, over time)</p> <p>Regulatory design should ensure enforceable principles (<i>as distinct from detail</i>); the process should be regulated, rather than the outcome</p> <p>Deals transparently with costs</p> <p>Does not distort competitive markets or market objectives</p>
Retailer-customer interface	<p>Effective products, realistic payment options, accessible/understandable by special needs groups, early contact encouraged, information and referrals, retailer staff training/approach, efficient administration of support schemes/subsidies</p> <p>Creates incentives and opportunities for affected customers and interested welfare groups to participate in debates and development of regulations, processes, protocols and contracts that affect them</p> <p>Ready access to effective internal and external dispute resolution options</p>
Flexible structures and systems	<p>Structures and systems (and supporting regulatory frameworks) should be flexible to meet changing needs, given that any point in time, there may be significant variation in:</p> <ul style="list-style-type: none"> - the characteristics (and location) of groups in risk - the needs of different 'at risk' groups - the priority issues governments wish to address - society's capacity and willingness to fund support schemes for those at risk

While the above characteristics or objectives do not directly relate to regulation for pricing determinations, they provide a good overview of a regulatory regime that supports the public interest.

2.3 Victorian water policy framework

As outlined above, in mid 2004, the Victorian Government released its White Paper on water reform, *Securing Our Water Future Together* (DSE 2004). The White Paper sets out extensive reforms affecting the

management of water in Victoria. Key initiatives in the White Paper included:

- A new Environmental Water Reserve, giving rivers a legal right to water for the first time;
- Long term assessments of water resources, which contributes to more forward-thinking water resource planning;
- Regional sustainable water strategies, which contribute to more integrated water resource management;
- A more flexible water market, which separates water shares from land;
- New water recycling projects, funded by “environmental contributions” from water businesses;
- Mandatory water efficiency measures for new houses and an extension of the Water Smart Homes and Gardens Rebates scheme⁷;
- A new water pricing system designed to reward water savers (applying to metropolitan Melbourne only); and
- Ensuring water prices enable businesses to recover their operating costs, capital expenditure to rehabilitate assets and the finance costs associated with new investment (full cost recovery).

The provision for “environmental contributions” responds, to some extent, to a need to recognise environmental externalities in water pricing; that is, the cost of water consumption to the environment of providing water services (DSE 2004: 129-30). However, instead of being based on the actual cost of water extraction to the environment, the environmental contributions are based on the water businesses’ existing revenues (5% for urban businesses and 2% for rural businesses). The Minister for Water is required to report annually on the expenditure of the environmental contributions, three months after the end of the financial year. The environmental contributions have contributed to increases in water prices for consumers.

⁷ The scheme encourages Victorians to use water more wisely by making water saving products more affordable. There are two main types of rebates being offered:

- A one-off rebate of \$30 per household for purchases of one or more products with a combined total of \$100 or more on eligible water-efficient products (such as mulch or compost, drip watering systems, tap timers, trigger nozzles or temporary grey water diverters).
- A core offer rebate ranging from \$10 for a AAA Water efficient shower rose, \$50 rebate on a Dual-flush toilet and between \$150 - \$500 rebates for rainwater and greywater tank systems.

The new pricing structure in the White Paper involved a new 'rising block' tariff structure for metropolitan Melbourne, where a higher price per kilolitre applies as consumption increases. Three blocks were proposed, with the first block of 40 kilolitres per quarter (set at the amount considered necessary for essential indoor use) being priced below the previous price. The next two usage blocks were priced to reflect more discretionary use. To ameliorate the potential detrimental impact price rises would have on low-income consumers, the Government increased and indexed concession entitlements. Water businesses were also required to implement a package to assist large households who might be disadvantaged (discussed further below). As outlined in part 4, these pricing structures have been maintained by the ESC price review for metropolitan retailers.

Many of the reforms proposed by the White Paper have now been introduced, with the *Water (Resource Management) Act 2005* (Vic) legislating many of the environment-related aspects of the White Paper. The *Water (Governance) Act 2006* (Vic), which implements a number of governance reforms, recently received royal assent.

2.4 Current framework for ESC price reviews

As stated above, the ESC became the economic regulator of the Victorian water industry on 1 January 2004. The ESC's role is set out in the *Essential Services Act 2001* (Vic) (the **ESC Act**) and the *Water Industry Act 1994* (Vic) (the **WI Act**). In addition, the ESC is guided by the Water Industry Regulatory Order 2003 (the **WIRO**), made under the WI Act by the Governor in Council. This framework gives the ESC broad power to regulate prices and customer service standards for certain prescribed water services across the entire Victorian water industry.

The primary objective of the ESC is to:

protect the long-term interests of Victorian consumers with regard to the price, quality and reliability of essential services.⁸

The ESC Act provides for a number of facilitating objectives:

⁸ *Essential Services Commission Act 2001* (Vic), s 8(1). A list of sub-objectives is provided for at section 8(2).

- to facilitate efficiency in regulated industries and the incentive for efficient long-term investment;
- to facilitate the financial viability of regulated industries;
- to ensure that the misuse of monopoly or non-transitory market power is prevented;
- to ensure that regulatory decision making has regard to the relevant health, safety, environmental and social legislation applying to the regulated industry;
- to ensure that users and consumers (including low-income and vulnerable customers) benefit from the gains from competition and efficiency; and
- to promote consistency in regulation between states and on a national basis.⁹

The WI Act states the objectives of the ESC in relation to the regulated water industry as:

- (a) wherever possible, to ensure that the costs of regulation do not exceed the benefits;
- (b) to ensure that regulatory decision making and regulatory processes have regard to any differences between the operating environments of regulated entities;
- (c) to ensure that regulatory decision making has regard to the health, safety, environmental sustainability (including water conservation) and social obligations of regulated entities.¹⁰

This framework enables the ESC to have significant influence over how water businesses operate within Victoria. In addition to setting or approving prices,¹¹ the ESC can also regulate standards and conditions of services as well as market conduct in relation to regulated services¹² and undertake performance monitoring.¹³

⁹ *Essential Services Commission Act 2001* (Vic), s 8(2).

¹⁰ *Water Industry Act 1994* (Vic), s 4C

¹¹ *Water Industry Act 1994* (Vic), section 4D and the Water Industry Regulatory Order 2003 (see further discussion below).

¹² *Water Industry Act 1994* (Vic), section 4E(1).

¹³ WIRO, clause 16.

Despite this, with respect to regulating the prices of water and sewerage services, the framework is relatively “light-handed”, that is, it gives the ESC power to oversee the implementation of water business management plans prepared by the businesses themselves (known as Water Plans), rather than prescriptive powers to set prices from the outset. The Water Plans set out water businesses’ proposed costs and prices for the regulatory period. The ESC can then approve those prices or set its own, but only where it finds that the water businesses’ proposals do not comply with the WIRO.

The WIRO provides that regulated water businesses must prepare Water Plans. The key role of the Water Plan is to clearly articulate and commit to a set of proposed outcomes and prices to be delivered over the regulatory period. As such, the Water Plan and the regulation of pricing do not just deliver proposed pricing outcomes, but informs the operations of water businesses more broadly over the regulatory period.

The Water Plan also provides a mechanism for businesses to resolve tradeoffs with customers, regulators and the Minister for Water. It states that the ESC must be satisfied that prices, or the manner in which they are determined, have been developed in accordance with the procedural requirements set out in Statements of Obligations issued to water businesses by the Minister for Water under sections 4I and 8 of the WI Act.¹⁴ Each water business’s Statement of Obligations provides that it must undertake effective consultation with customers on matters of concern to its customers that are to be included in its Water Plan. It is this consultation mechanism that will be examined in Part 4 of this report.

The WIRO also includes nine regulatory principles against which the ESC is required to assess prices. Principles 1 to 4 of the WIRO relate to the collection of sustainable revenue; principle 5 relates to investment efficiency. Principles 6, 7 and 8 relate to tariff design; principle 6 relates to tariff structure; principle 7 relates to equity, with explicit mention of low income and vulnerable customers; principle 8 relates to efficiency and sustainability; and principle 9 can be seen as relating to both revenue and tariff structures.

Table 2: WIRO Regulatory Principles

The WIRO includes a number of principles against which the Commission is required to assess prices. The WIRO states that prices must be such as to: ¹⁵

¹⁴ WIRO, clause 13.

¹⁵ WIRO, clause 14(1)(a).

1. provide for a sustainable revenue stream to the regulated entity that nonetheless does not reflect monopoly rents or inefficient expenditure by the regulated entity;
2. allow the regulated entity to recover operational, maintenance and administrative costs;
3. allow the regulated entity to recover expenditure on renewing and rehabilitating existing assets;
4. allow the regulated entity to recover a rate of return on assets as at 1 July 2004, with those assets valued in a manner determined by, or at an amount otherwise specified by, the Minister at any time before 1 July 2004;
5. allow the regulated entity to recover a rate of return on investments made after 1 July 2004 to augment existing assets or construct new assets;
6. provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users about:
 - the costs of providing services, including costs associated with future supplies and periods of peak demands and/or restricted supply;
 - choices regarding alternative supplies for different purposes;
7. take into account the interests of customers of the regulated entity, including low income and vulnerable customers;
8. provide the regulated entity with incentives to pursue efficiency improvements and to promote the sustainable use of Victoria's water resources; and
9. enable customers or potential customers of the regulated entity to readily understand the prices charged by the regulated entity for prescribed services, or the manner in which such prices are to be calculated or otherwise determined.

These regulatory principles require the ESC to balance a number of social, environmental and economic outcomes in setting prices. This gives the appearance that the discretion left to the regulator is considerable, but in fact, the ESC is largely reliant upon what is included in Water Plans to come to its decision. The discussion in Part 3 of this report will assess how the ESC has undertaken this balancing task.

2.5 Frameworks for regulating water pricing in other jurisdictions

Primarily due to policy reform promulgated by COAG which has guided lawmakers across jurisdictions, the framework for the pricing of water is

broadly similar across the various Australian states. While the processes involved and the level of regulatory oversight are variable, there are now generally independent regulators that regulate the water sector in each state.

2.5.1 New South Wales

In NSW, the Independent Pricing and Regulatory Tribunal (**IPART**) is the independent regulator of the water sector. IPART sets the maximum prices that can be charged for metropolitan water supply, wastewater and stormwater services, taking into account a range of factors. Importantly, IPART are required to indicate what regard it has had to each of these factors in reaching its determination or recommendation.

Table 3: IPART regulatory considerations

<p>In making determinations and recommendations, IPART is to have regard to the following matters:¹⁶</p> <ol style="list-style-type: none">1. the cost of providing the services concerned;2. the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of services;3. the appropriate rate of return on public sector assets, including appropriate payment of dividends to the Government for the benefit of the people of New South Wales;4. the effect of general price inflation over the medium term;5. the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers;6. the need to maintain ecologically sustainable development (within the meaning of section 6 of the <i>Protection of the Environment Administration Act 1991</i>) by appropriate pricing policies that take account of all the feasible options available to protect the environment;7. the impact of pricing policies on borrowing, capital and dividend requirements of the government agency concerned and, in particular, the impact of any need to renew or increase relevant assets;8. the impact of pricing policies on any arrangements that the government agency concerned has entered into for the exercise of its functions by some other person or body;9. the need to promote competition in the supply of the services concerned;10. considerations of demand management (including levels of demand) and

¹⁶ *Independent Pricing and Regulatory Tribunal Act 2001*, s 15(1).

least cost planning;

11. the social impact of the determinations and recommendations; and

12. standards of quality, reliability and safety of services concerned (whether those standards are specified by legislation, agreement or otherwise).

This framework allows IPART to consider the impact of pricing decisions on customers and make recommendations about the ways in which water businesses ameliorate negative impacts. These include considering social programs proposed by the water businesses. In a recent determination, IPART (2005) accepted Sydney Water's social program which includes:

- free residential retrofits for high water consuming households;
- pensioner rebates;
- extended payment arrangements;
- No Interest Loan scheme;
- Payment Assistance Scheme – vouchers provided to welfare agencies.

However, IPART stated that it was not convinced that these measures alone were sufficient to address the impact on vulnerable customers of the new two-tiered variable usage charge. It recommended that enhanced retrofits and a rebate scheme be available for specific households of six or more people (2005: 143). IPART also recommended that social programs be funded by Government as part of the Government's broader social program rather than directly by agencies through price increases.

2.5.2 South Australia

In South Australia, the essential services regulator, the Essential Services Commission of South Australia (**ESCoSA**), does not have specific power to regulate the water industry. However, ESCoSA has been instructed by the South Australian Treasurer on various occasions to carry out inquiries concerning the prices charged in the water sector.¹⁷ ESCoSA has then made recommendations to the Government in its setting of prices. ESCoSA's assessment of water prices is against

¹⁷ These are undertaken pursuant to section 35(1) of the *Essential Services Commission Act 2002* (SA).

the COAG pricing principles for water agreed to in 2004,¹⁸ as clarified by guidelines of the Standing Committee on Agriculture and Resource Management.¹⁹

This framework gives ESCoSA little scope to recommend anything other than whether the actual prices proposed by SA Water and set by the Government are in accordance with these principles. It cannot make recommendations about issues relating to demand management, customer consultation or service outcomes. Indeed, it has little power to recommend changes to tariff structure proposals (ESCoSA 2005).

2.5.3 Western Australia

Similar to ESCoSA in South Australia, the Economic Regulatory Authority (**ERA**) assesses water prices charged by water businesses in Western Australia only when directed to by the Treasurer.²⁰ Assessments are limited to the matters set out in the terms of reference for each assessment. In its first inquiry on urban water and wastewater pricing, the ERA (2005) proposed a number of pricing principles that should apply to the setting of water prices. A key principle proposed is that usage charges should be set at levels to reflect the estimated cost of developing new water resources to meet water demand. The inquiry also considered the social impact of price adjustments and made comments about concessions and uniform pricing policies.

2.5.4 Queensland

In Queensland, the Queensland Competition Authority (**QCA**) has a role in overseeing prices charged by monopoly water businesses. The QCA has not specifically assessed the prices charged to urban water consumers, and has not made other determinations relating to aspects of pricing including demand management and customer consultation. However, it has set pricing principles which are aimed to “achieve the objectives of monopoly price regulation” (QCA 2000). As the principles are to apply to a wide range of circumstances (infrastructure services, water allocations, domestic water usage), they are general.

¹⁸ Council of Australian Governments' Communiqué, 25 February 1994, Attachment A – Water Resource Policy, clause 3. This agreement is attached at Appendix C.

¹⁹ A committee of Department Heads/CEOs of Australian/State/Territory and New Zealand government agencies responsible for natural resource and agricultural policy issues.

²⁰ *Economic Regulation Authority Act 2003* (WA), s 34(1).

Table 4: QCA water pricing principles

The QCA considers that prices of water delivered to an end user should:

- be *cost reflective* – that is reflect the costs of providing the service and, where the demand for water exceeds its supply, potentially incorporate a resource value;
- be *forward looking* – in that they represent the least cost which would now be incurred in providing the requisite level of service over the relevant period;
- ensure *revenue adequacy* – the revenue needs of the business must be addressed where possible;
- promote *sustainable investment* – where the services are to be maintained into the future, the investor must be given the opportunity to enjoy an appropriate return on investment;
- ensure *regulatory efficiency* – the pricing method which minimises regulatory intrusion and compliance costs relevant to a particular circumstance should be adopted; and
- take into account matters relevant to the public interest.

2.5.5 Tasmania

In Tasmania, local councils (who provide water and wastewater services) are not subject to direct price regulation but are instead required to comply with guidelines for cost recovery. The guidelines, *Urban Water and Wastewater Pricing Guidelines*, are based on the *Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) Full Cost Recovery Guidelines*. The Tasmanian Government Prices Oversight Commission assesses water prices charged by local councils against these principles when directed to by the Minister for Finance.²¹ This process gives the regulator limited control over water pricing and/or other related outcomes. It has, however, made recommendations about community service obligations, cross-subsidies and councils' practices of providing free water allocations.

²¹ *Government Prices Oversight Regulations 1998 (Tas)*.

2.5.6 United Kingdom

In the United Kingdom, the Office of Water Services (**Ofwat**), the independent regulator for the sector, sets price limits pursuant to power granted to it under the *Water Industry Act 1991* (UK). This act was significantly amended by the *Water Act 2003* (UK). The primary duties of Ofwat are to:

- protect the interests of consumers (wherever appropriate by promoting competition);
- secure the functions of each water and sewerage company, as specified in the 1991 Act, are properly carried out; and
- secure that companies are able to finance their functions, in particular by securing a reasonable rate of return on their capital.

In carrying out these functions, Ofwat has a number of secondary duties to:

- promote economic efficiency;
- secure that no undue preference is shown, and there is no undue discrimination to customers, in the way that companies fix and recover charges. This means that a customer's bill should reflect the costs which the customer imposes on the system for a supply of clean water, disposal of dirty water and draining of surface water;
- secure that customers are protected as respects benefits that could be secured for them from the proceeds of any disposal of a company's protected land;
- protect customers' interests, including the quality of the service that they receive;
- ensure that transactions with associate companies are carried out at arm's length;
- ensure that each company maintains its accounts in a suitable form and manner;
- enforce the companies' duty (under the *Environment Act 1995*) to promote the efficient use of water by their customers; and
- contribute to the achievement of sustainable development.

In setting limits on water pricing, Ofwat is also provided with guidance from the Secretary of State (Department for Environment, Food and

Rural Affairs) about Government policies affecting water companies, and what it expects water companies to deliver. In the 2004 periodic review (covering a 5 year period until 2009), the Guidance raised issues relating to improvements to drinking water and the environment that the companies must deliver (DEFRA 2003-04). Government policies relating to affordability of water services must also 'be in place for new price limits' (DEFRA 2003-04).

UK Government policy on water affordability was informed by the Cross-Government Review of Water Affordability (DEFRA 2004) which was instituted after concern about the issue of over-indebtedness. Cost-effective pricing had meant that water was unaffordable for lower-income consumers and this was contributing to social and financial exclusion. Policies to address this problem include a 'vulnerable group tariff', which allows certain lower income consumers who need to use large amounts of water to have their metered bills capped.²² The tariff provides that such consumers would pay no more than the average bill for their area.

Following the Government response to the Review, the UK Government amended the tariff so that more consumers would be eligible.²³ Water companies are required to offer these tariffs to specified consumers. Work has also been undertaken by the Government and industry to better promote and target the vulnerable group tariff (DEFRA 2006).

2.6 National policy implications

As outlined above, the Victorian reforms are taking place in the context of other national reform initiatives that are aimed at changing the way in which water resources are managed. In 2004, COAG agreed to the *National Water Initiative (NWI)*, an agreement between the State and Federal Governments that provides the basis for economic reform of the management of water resources on a national basis.²⁴ The NWI builds on the 1994 COAG agreement.

²² Water Industry (Charges) (Vulnerable Groups) Regulations 1999 (UK).

²³ Water Industry (Charges) (Vulnerable Groups) (Amendment) Regulations 2005 (UK).

²⁴ Intergovernmental Agreement on a National Water Initiative between the Commonwealth of Australia and the Governments of New South Wales, Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory, available at <http://www.coag.gov.au/meetings/250604/index.htm#nwi>. Tasmania signed the agreement on 3 June 2005 and Western Australia on 6 April 2006.

A key policy goal in the 1994 COAG agreement was for water and wastewater prices to be set so businesses achieve full cost recovery, with prices set on a consumption basis and cost reflective. The NWI builds on this, and aims to establish best practice pricing and a consistent approach to the setting of prices and charges for water. Below is the extract from the NWI that relates to water pricing:

Table 5: National Water Initiative - extract

Best Practice Water Pricing and Institutional Arrangements

Outcomes

64. The Parties agree to implement water pricing and institutional arrangements which:
- i. promote economically efficient and sustainable use of:
 - a. water resources;
 - b. water infrastructure assets; and
 - c. government resources devoted to the management of water;
 - ii. ensure sufficient revenue streams to allow efficient delivery of the required services;
 - iii. facilitate the efficient functioning of water markets, including inter-jurisdictional water markets, and in both rural and urban settings;
 - iv. give effect to the principles of user-pays and achieve pricing transparency in respect of water storage and delivery in irrigation systems and cost recovery for water planning and management;
 - v. avoid perverse or unintended pricing outcomes; and
 - vi. provide appropriate mechanisms for the release of unallocated water.

Actions

Water Storage and Delivery Pricing

65. In accordance with NCP commitments, the States and Territories agree to bring into effect pricing policies for water storage and delivery in rural and urban systems that facilitate efficient water use and trade in water entitlements, including through the use of:
- i. consumption based pricing;
 - ii. full cost recovery for water services to ensure business

viability and avoid monopoly rents, including recovery of environmental externalities, where feasible and practical; and

- iii. consistency in pricing policies across sectors and jurisdictions where entitlements are able to be traded.

66. In particular, States and Territories agree to the following pricing actions:

Metropolitan

- i. continued movement towards *upper bound pricing* by 2008;
- ii. development of pricing policies for recycled water and stormwater that are congruent with pricing policies for potable water, and stimulate efficient water use no matter what the source, by 2006;
- iii. review and development of pricing policies for trade wastes that encourage the most cost effective methods of treating industrial wastes, whether at the source or at downstream plants, by 2006; and
- iv. development of national guidelines for customers' water accounts that provide information on their water use relative to equivalent households in the community by 2006;

Rural and Regional

- v. full cost recovery for all rural surface and groundwater based systems, recognising that there will be some small community services that will never be economically viable but need to be maintained to meet social and public health obligations:
 - a. achievement of *lower bound pricing* for all rural systems in line with existing NCP commitments;
 - b. continued movement towards *upper bound pricing* for all rural systems, where practicable; and
 - c. where full cost recovery is unlikely to be achieved in the long term and a Community Service Obligation (CSO) is deemed necessary, the size of the subsidy is to be reported publicly and, where practicable, jurisdictions to consider alternative management arrangements aimed at removing the need for an ongoing CSO.

The NWI also directs jurisdictions to undertake a number of actions in relation to demand management and the creation of water sensitive urban design.²⁵

In the context of the NWI, the Federal Government also established the National Water Commission (**NWC**). Its role is to:

- assess governments' progress in implementing the National Water Initiative (e.g. through biennial assessments of progress commencing in 2006–07);
- help governments to implement the National Water Initiative (e.g. by acting as lead facilitator on certain actions under the Initiative such as compatible registers of water entitlements and trades, and nationally consistent approaches to pricing), and
- administer two programmes under the \$2 billion Australian Government Water Fund—the Water Smart Australia and Raising National Water Standards programmes, including recommending projects for decision by the Australian Government.²⁶

The NWC has already undertaken the *2005 National Competition Policy Assessment of Water Reform Progress*. Previously, such assessments were carried out by the National Competition Council. This report assesses progress with implementing the 1994 COAG Water Reform Framework commitments, as modified and updated by the NWI, and new commitments in the NWI that were due for completion in 2004 and 2005. While the assessment showed that all jurisdictions have largely progressed the management of water resources in line with the 1994 COAG agreement, the NWC recommended a number of penalties in relation to a failure to open up interstate trade in permanent water entitlements. In relation to pricing, the assessments prioritised the requirement that water prices achieve full cost recovery in accordance with the NWI. In its assessment the NWC stated that although Victoria had made significant progress towards meeting its COAG commitments, it made a number of comments that indicate that this goal should be achieved in preference to other goals relating to social and environment outcomes.

Firstly, the NWC (2006: 3.35) noted that cross-subsidies exist in relation to backlog sewerage schemes. Costs associated with these schemes are identified in Water Plans but any shortfall in revenue recovered is recovered from the broader customer base. The NWC states that such cross-subsidies (and others relating to pricing of water to address

²⁵ *National Water Initiative*, cl 91 and 92.

²⁶ *National Water Commission Act 2004* (Cth), s 7.

affordability of access to water for essential purposes) may not be consistent with effective and efficient service provision. It suggests that cross-subsidies be removed and that the needs of specific customer classes be addressed through transparent community service obligations (**CSOs**). This approach does not recognise that the task of creating such transparent CSOs can be difficult, and that some consumers may be disadvantaged if cross-subsidies are removed.

Secondly, the NWC (2006:3.43) raised concerns with the 'environmental contribution' as a way of recovering environmental costs or externalities. It states that Victoria has not fully demonstrated the relationship between the levy and the environmental costs it addresses and that Victoria has not sufficiently demonstrated the extent to which the levy is used for resource management activities versus addressing environmental externalities. Again, the NWC appears to underestimate the difficulties in assessing environmental externalities and the extent to which the environmental contributions are addressing the concern.

The NWC's assessments indicate that it preferences the goal of "economic and efficient service provision" above other goals relating to social or environmental outcomes, despite the existence of all of these types of goals in the COAG agreement. Further, the NWC provides no basis for preferencing one policy goal over another. Future assessments by the NWC will be undertaken against the NWI (rather than the 1994 COAG reforms). This may increase the opportunity for the NWC to prioritise economic efficiency above other water policy goals. In preparation for future assessments, state governments have also prepared NWI Implementation Plans which have been accredited by the NWC.

With respect to pricing, the NWC is also developing guidelines to facilitate consistent approaches to urban water pricing (Australian Government 2006b: 3). It appears that these guidelines will focus on consumption based pricing and proceed based on a view that full cost pricing should ensure prices reflect different costs in providing water to different areas (although this approach is not mandated by the NWI).²⁷ This might be contrasted with the Federal Government's policy in relation to telecommunications, which includes obligations on Telstra to supply services to rural and regional areas at prices which are no higher than those charged in metropolitan areas.²⁸ The Victorian Government

²⁷ National Water Commission, Personal Communication, 21 July 2006.

²⁸ For more information, see

http://www.dcita.gov.au/communications_for_business/telephone_services/telstras_local_presence_in_regional_rural_and_remote_australia. It should be noted that the Australian Competition and Consumer Commission maintains that rental prices should be geographically de-averaged, to reflect the cost of service provision to different areas.

(DPC 2006) has also recommended that in developing national approaches to managing water security, national reform efforts should focus on, inter alia, water pricing reform.

While state and federal policies have brought about the marketisation of water supply in Australia, a recent discussion paper released by the Department of Prime Minister and Cabinet (DPMC 2006) marks a new shift. The paper examines the role of the private sector in the supply of water and wastewater services and suggests there are a number of potential benefits of private sector involvement in urban and rural water and wastewater services, including:

- additional sources of funding maintenance of existing infrastructure;
- investment in the renewal and replacement of water and wastewater services;
- creating competition, improved services and competitive pricing regimes;
- greater efficiencies in water delivery – particularly through new technologies;
- improved management and working practices;
- the attraction of new investment in water saving processes; and
- improved security for water users.

It also states that:

“Since the early 1990s sectors of the Australian economy, such as gas, electricity, transport and telecommunications have been opened up to private sector investment under National Competition Policy (NCP). Water has more common characteristics with some of these sectors than others. For example, water is seen as an essential commodity in a similar way as gas or electricity but dissimilar to other essential services like healthcare and education. Similarly, members of the public do not necessarily expect the supply of water, gas or electricity to be subsidised and, by and large, communities are more than capable of paying a price for these services which reflect the cost of delivery and ensures a fair return to the public or private utility that provides the service.”

These statements, despite not being supported by clear evidence, indicate a Federal Government preference to further reform of the water sector. Private supply of water and wastewater services gives further support to the need to have equitable, fair and accountable pricing policies for water. The release of this paper coincided with a new Office of Water Resources, located in the DPMC.²⁹ In January 2007, this office joined the environment department, which was renamed the Ministry of Environment and Water Resources. This new office also indicates increased Federal Government interest in water policy.

Recommendation One: That the Victorian Government amend the regulatory framework for the pricing of water to require the ESC to more actively take account of social and environmental factors in making pricing decisions, including those related to tariff structures.

Recommendation Two: That any further moves to introduce market principles into the provision and/or pricing of water must be based on public interest outcomes (considering all social, environmental and economic implications) and involve robust community consultation.

²⁹ Prime Minister, *Media Release: New Office of Water Resources*, 26 September 2006.

3. ESC Price Reviews

3.1 Assessing effective price regulation

The framework under which the ESC undertakes pricing determinations is outlined in Part 2. This part will examine the conduct of the first two pricing reviews, examining the scope of the reviews in bringing about outcomes that promote the public interest. Recognising that the pricing determinations are undertaken against all of the WIRO regulatory principles (taking into account the influence of other policy objectives), the following analysis will assess the extent to which the ESC's price regulation of water meets its social and environmental sustainability objectives, particularly WIRO regulatory principles six to nine. To do this, we have looked at three essential criteria:

- whether outcomes are based upon clear and explicit customer consultation (that is, consumers understand and have contributed to proposals for service improvements and tariff structures);
- whether outcomes result in pricing, tariff structures or other measures that contribute to sustainable water use; and
- whether outcomes consider the impact of price increases on low-income and vulnerable consumers.

These three criteria are all intended to occur in ESC water price regulation, and are the elements of the scheme that most clearly contribute to social and environmental outcomes. An analysis of the extent to which the determinations contributed to economically efficient

expenditure and investment decision-making and whether they achieve goals of full cost recovery is beyond the scope of this report.

Before analysing the reviews, the remainder of this section considers the criteria outlined above and analyses what should be considered in delivering a pricing determination that references those principles.

3.1.1 Customer consultation

Research literature on customer consultation suggests that citizen participation can vary along a continuum from empty rhetoric, manipulation and information at one end, to true partnerships and power sharing arrangements at the other. In this regard, the conceptual ladder put together by Armestein (1969) in the 1960s in the context of planning still rings true today. Armestein suggested that some degree of citizen power (and control) is needed in planning and governance, and that it is not the title of the Citizen Advisory Committee or Citizen Forum that is at issue, but the real degree to which power is redistributed through negotiation between citizens and power-holders.

A similar need to consult with stakeholders as the highest priority has also come through in the domain of corporate planning. Professor John Bryson (1995), one of the world's most respected public sector planning academics, says that if managers only have time to undertake one step in their corporate planning efforts, they should contact stakeholders and ask them how they are doing.

The Victorian Water Industry Association (VicWater 2003) has also recognised the benefits of consultation. VicWater suggests that consultation:

- extends the boundaries of people's knowledge;
- is ethical;
- is democratic;
- is efficient; and
- is required to meet regulatory obligations.

In the case of Victorian water businesses, robust customer consultation contributes not only to general corporate planning, but is integral to efficient and effective price determination that relies on service delivery and infrastructure planning. This is because the Victorian regulatory process requires businesses to propose prices that enable them to deliver the services required by consumers. Effective consultation with

consumers is of course required to determine what services consumers need and want.

3.1.2 Sustainable water use

Whether water pricing and tariff structures can contribute to sustainable water consumption is a contentious topic. It has been argued that water prices and tariff structures that aim to provide a signal for demand management can have unintended consequences (Wellsmore 2006). Proponents of this argument suggest that the varying objectives of tariff design (for example, improving demand management, achieving cost recovery and eliminating cross-subsidies) are not necessarily aligned. Furthermore, there are concerns that uniform tariff structures aimed at promoting sustainable water use can unfairly impact some households who have limited elasticity in their demand for water.

Nevertheless, it is a requirement of the ESC to consider whether water prices provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users about the costs of providing services, including costs associated with future supplies and periods of peak demands and/or restricted supply and choices regarding alternative supplies for different purposes.³⁰ This goal is primarily achieved through the designing of tariff structures (and to a more limited extent, through the overall cost of a consumer's bill).

3.1.3 Impacts on low-income and vulnerable consumers

In the context of policy reforms that require water to be priced at its full cost, the affordability of water and wastewater services is an important issue. For the individual, there is a human right to water which comprises a right to access sufficient clean water at an affordable price in order to meet basic human needs (CLCV 2005).

Considering this, a pricing determination must ensure that all consumers, regardless of income or geography, are able to retain supply without undue financial difficulty. For those who do experience hardship, there also needs to be effective programs in government and in companies to assist those consumers. Access means there must be mechanisms within the regulatory framework that ensure that consumers cannot be disconnected or restricted solely because they cannot pay, or refused connection because they are viewed as unattractive customers.

³⁰ WIRO, clause 14(1)(a)(vi).

In practical terms, this issue requires attention of a range of points in the regulatory process, including tariff levels, requirements relating to an obligation to supply and hardship policies.

3.2 Urban price review

3.2.1 Background

During 2004 and 2005, the ESC undertook its first review of the prices that regulated urban water businesses can charge for prescribed services. This involved a lengthy process of consultation with water businesses and other stakeholders, including other government regulators and consumers.

The process began in February 2004 with the release of *Consultation Paper No 1: Economic Regulation of the Victorian Water Sector* (ESC 2004b). A number of workshop discussion papers followed, including on issues such as pricing. In June 2004, the ESC released guidance to the water businesses on its assessment of Water Plans (ESC 2004c). This guidance provided details of what was to be included in Water Plans, but did not specifically provide guidance on customer consultation. With respect to pricing signals and pricing impact issues, the ESC stated that Water Plans should demonstrate:

- The ability of proposed tariff structures to change customer behaviour, such that customers are encouraged to better use water resources, with reference to demand elasticities and the ability of customers to change their behaviour in response to price; and
- Consideration of implementation and customer impact issues, including the costs of introducing new metering or billing arrangements and the impact of tariff structures on vulnerable and low income customers (ESC 2004c: 42).

In September 2004, 17 Victorian water businesses submitted detailed Water Plans to the ESC outlining key outcomes to be delivered for three years commencing 1 July 2005, revenue requirements and resulting prices.³¹ The ESC accepted public submissions on the Water Plans and a number of consumers and consumer organisations detailed their concerns in public submissions. The submission from CUAC and CLCV noted that:

³¹ Copies of Water Plans can be found on the ESC's website at:
<http://www.esc.vic.gov.au/water876.html>.

few of the Water Plans demonstrate an appropriate level of consideration of the social impacts of proposed price increases, or indicate that substantive consultation with customers regarding their capacity to pay for price increases has taken place.³²

In March 2005, the ESC released its Draft Decision. The water businesses and other stakeholders provided responses to the Draft Decision and in June 2005 a Final Decision was released. The result of the Final Decision was average real annual price increases between 0.5 and 8.4 per cent over three years. For owner-occupiers, this resulted in an increased annual bill of \$17 - \$62.³³

3.2.2 Customer consultation

Water Plans submitted by water businesses did not evince clear and robust customer consultation. Customer consultation is particularly required in relation to the assessment of service standards to be delivered by businesses – the regulatory framework provides revenue to the businesses at a level based upon customer preferences of service levels. Poor customer consultation means that the regulator is unable to determine what levels of service consumers want, and therefore what levels of revenue should be recoverable through prices.

In its Draft Decision, the ESC stated that it “intends to look more closely at the relationship between forecast expenditure levels and proposed service standards” and that businesses should “undertake more systemic research and consultation on the service standards to apply” (ESC 2005c: 10). The ESC noted it might also undertake research into customer consultation.

Similar comments were made in the ESC’s Final Decision (2005d: 7):

All of the businesses indicated having undertaken consultation with customers and committees about service levels during the development of their Water Plans. However, only a few businesses provided evidence of detailed customer consultation on whether proposed service levels are appropriate given historical performance; the standard of performance relative to other businesses; the common areas of customer complaints; the performance/failure rates of assets and the cost implications of improvements or

³² CLCV and CUAC,

³³ Owner-occupiers pay the following charges: water service charges, water usage charges, sewerage service charges, sewerage disposal charges and drainage charges (which is a fixed charge collected by retailers on behalf of Melbourne Water). Tenants generally only pay water usage charges and sewerage disposal charges.

reductions in service standard performance and customer willingness to pay.

The Commission recognises that the tight timeframe for this first review is likely to have provided limited opportunities for effective customer consultation on service delivery performance. However, for the next review, it expects all businesses to undertake systematic research and consultation with their customers on the service standards that should apply going forward and on the matters outlined above.

It is apparent that levels of customer consultation on service levels are poor at best, and need to be improved for the next regulatory price review. The ESC should more clearly identify types of appropriate customer consultation for the benefit of water businesses and their customers.

Where some water businesses did propose increasing service standards in their Water Plans, the ESC required evidence of customer preferences before accepting proposals. These were accepted primarily through the use of willingness-to-pay studies. Such evidence was also required where water businesses proposed projects relating to the recycling of water.

There are significant problems with the techniques used by businesses to determine customers' willingness to pay for service improvements or for water businesses to engage in environmental or social policies. Generally, this is undertaken through market research and then customer preferences are presented in a statistical fashion. Such analysis does not always take into consideration the views of different classes of consumers nor does it consider the differences in value attributed to different consumers.

Further, due to the varying degrees of consumers' awareness, understanding and biases, research into customer preferences that produces monetary-based outcomes might not present a full and fair understanding of a customer group's views on a particular issue. Research suggests that efforts to quantify costs in monetary terms by identifying a trade-off between the selected benefit (service improvement, environmental protection) and economic goods and services for which price tags are already attached do not necessarily bring about clear results. For example, Martin O'Connor (2000) argues that due to an "observed plurality of motivations and justifications" (i.e. in terms of value statements expressed in people's overall lifestyle choices, in their attachments to place of life and work, in their commitments to family, tradition and community, in their political activity

and goals of justice, and so on) there is an “irreducible basis for enquiry into value”. Put plainly, this means that because different customers and different customer groups value services and benefits differently, it is next to impossible to satisfactorily identify consumers’ willingness to pay for service improvements.

Recognising this, research into customer preferences and willingness-to-pay must be viewed as sociological as much as economic, and recognise the difficulties in putting fixed values on service improvements and environmental or social outcomes. More qualitative sociological research may well find that low-income residential consumers may be less willing to pay (primarily due to a lesser capacity to pay) than more well off residential consumers.

This does not mean that research into customer preferences cannot be useful and is unimportant. However, rather than being used just to determine people’s preferences in “commodity” terms of price for goods and services, it can be used as a “reciprocal learning process where both the researchers and the interviewees might come to appreciate more about the range of perspectives that may be brought to bear on the valuation problem” (O’Connor 2000). Considering this, it appears that the ESC should promote customer consultation and customer research on preferences that is substantive and rigorous, including elements of raising both consumers’ and water businesses’ awareness and understanding of the issues involved, before accepting business proposals that will increase costs substantially. There is significant scope for the ESC to work with water businesses to improve such customer consultation processes.

Recommendation Three: That the Victorian Government and the ESC work with the water businesses (including industry bodies) to improve consultation processes and procedures. Consultation on Water Plans and pricing proposals, especially with low-income consumer and their representatives, is fundamental to robust and fair pricing determinations.

Recommendation Four: That the ESC prepare a guideline, in consultation with water businesses and stakeholders, to outline what is required for effective customer consultation, in the context of the preparation of Water Plans.

3.2.3 Sustainable pricing and tariff structures

Changes in the final prices paid by households for their water bills may have an impact upon their demand for water, although there is no clear evidence to prove this yet (cf Wellsmore 2006). The ESC's final decision increased prices from 0.5 per cent to 8.4 per cent per annum for the three year period. The table below details the total revenue and average annual price increases approved by the ESC.

Table 6 – ESC Final Decision on total revenue and average annual price increases (real)

	Total revenue 2005-06 to 2007-08 \$ million	Average annual price increase Per cent
Melbourne Water	1,474.8	2.1
City West	691.3	2.2
South East	1,019.1	2.0
Yarra Valley	1,101.3	1.8
Barwon	276.2	5.3
Central Highlands	122.2	4.8
Coliban	135.6	4.4
East Gippsland	44.0	5.1
Gippsland	162.5	4.7
Glenelg	17.6	3.6
Goulburn Valley	111.2	4.7
North East	88.9	2.6
Portland Coast	18.9	8.4
South Gippsland	43.0	7.8
South West	56.4	5.2
Western	100.8	0.5
Westernport	31.6	3.6

It is difficult, however, to conclude that price increases of this magnitude contribute to reduced demand for water.

Throughout the water price review, the ESC emphasised the importance of setting variable prices with reference to estimates of the long run marginal cost (**LRMC**) of supply. The ESC states this “is consistent with

providing incentives for sustainable water use by allowing customers to balance the relative costs and benefits of consuming water” (ESC 2005b: 1). In economic terms, LRMC reflects the cost of meeting an incremental change in demand assuming all factors of production can be varied. LRMC comprises the sum of marginal operating costs and the marginal capital costs associated with bringing forward (or delaying) planned increases in capacity (such as a new reservoir or additional transfer system infrastructure) in order to meet an increase in forecast demand. LRMC based prices are useful for signalling the long term implications of consumption decisions.

There are obvious problems with relying on LRMC estimates in setting prices that contribute to sustainable outcomes. For example, LRMC pricing may encourage increased water consumption as it essentially requires usage charges to decrease as additional units are consumed. This is contrary to the ESC preference for inclining block tariffs (see further below). There is also considerable uncertainty about the ways in which LRMC should inform tariff design, and little guidance has been provided by the ESC. Rather than focusing on LRMC estimates, therefore, an analysis of approved tariff structures may be more appropriate – tariff structures arguably play a more important role in influencing water demand than marginal prices.

Summarising tariff structures and the impact upon sustainable water use is also a difficult task. Many factors impact upon water use, including levels of restriction, information provision and the use of water saving appliances. In order to fully understand the scope for tariff structures to impact upon sustainable water consumption, a comprehensive assessment of those tariff structures must be undertaken. Such an assessment is beyond the scope of this report.

Recommendation Five: That the Government and the ESC undertake a comprehensive assessment of tariff structures and their impact on sustainable water consumption.

(a) Residential tariffs

In their Water Plans, eight businesses proposed to charge residential customers on the basis of an inclining block tariff structure. The metropolitan retailers had been charging customers on such a structure since October 2004 as a result of the White Paper policy changes. Six businesses proposed to levy a flat usage based variable charge. In the

case of residential sewerage services, some business proposed to levy fixed and usage charges whilst others proposed only a fixed charge.

The ESC supported the imposition of inclining block tariffs, noting that:

Inclining blocks are often justified on the basis that they send strong conservation signals to large water users. They can be used to target discretionary water use by setting the second block high enough to exclude most customers' non-discretionary water use (ESC 2005c: 169).

However, the ESC also approved tariffs that were based on flat usage variable charges but did not approve Westernport Water's seasonal charge. By approving these water tariffs, the ESC agreed that the prices provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users (criterion 6 from WIRO).

Clearly, then, very different tariff structures can each satisfy the ESC's criterion. The ESC gives no explanation as to how this can be the case. In reality, little analysis has been done on the effectiveness of different tariff structures on demand management, hence it is difficult for the ESC to meet its regulatory obligations.

In summary, it is again difficult to conclude whether the residential tariff structures, including inclining block tariffs, contribute to sustainable water use without further analysis.

Recommendation Six: That the effectiveness of the inclining block tariff be independently assessed. The assessment should focus on:

- whether the pricing structure has resulted in reduced water consumption; and
- if not, whether this can be addressed by amending the structure of the tariff (ie, levels of fixed and volumetric charges) or whether measures other than pricing should be used to promote competition.

(b) Non-residential tariffs

The inclining block tariffs approved by the ESC do not apply to non-residential urban consumers (ie, industry). South East Water proposed

an inclining block tariff for non-residential consumers, which was not approved (ESC 2005d: 97-8), and the ESC amended the proposal to a flat per kilolitre charge. The ESC stated that it is more difficult to identify the consumption levels that are consistent with discretionary and non-discretionary water use for commercial and industrial customers, given the large variations in water use and range of activities undertaken (ESC 2005d: 98). For example, a food or beverage manufacturer might be expected to use relatively more water than a clothing manufacturer. It might be inequitable to assume they both have the same level of non-discretionary water use.

This approach is misconceived, as commercial and industrial users do not have a human right to water to meet basic human needs as individuals do. There is no such thing as 'non-discretionary' water use for business users - business users consume water as an input into their business, whose aim, ultimately, is to stay alive only in the sense of continuing to make profits.

The pricing of water in a manner that does not make concessions for different business types might be considered an effective means of achieving economically efficient outcomes, by encouraging water to be used by those businesses that use it most efficiently or for the most value, namely those businesses that can afford the price of water as an input into their products or services either because they use comparatively little water or because the end product is valuable enough that consumers are prepared to pay a price that includes the cost of the water input. This might not merely encourage water-intensive individual businesses to be replaced by water-efficient businesses, but water-intensive industries to be replaced by water-efficient industries.

In any case, tariff structures should encourage industry to use water efficiently rather than focus on the level of total water use by industry. The Government has indicated it intends to work with water businesses and industry to explore alternative pricing options to encourage sustainable use by industry (DSE 2006: 50). The ESC has stated that one option might be for water businesses to offer price discounts to business users who decrease their water use or discharge below some predefined level as an incentive (ESC 2006e: 62-3). Another way might be to develop different tariff structures for different types of non-residential customers, based on water consumption characteristics.

The investigation into alternative ways to charge industry use of water is commendable and should be extended. It is inequitable for residential

consumers to bear the burden of tariff structures aimed at reducing water use alone.

Recommendation Seven: That the Government, the ESC and the water industry should further investigate alternative water pricing structures for industrial and commercial users that promotes water conservation.

(c) Non-price conservation policy tools

It should be noted that the ESC did acknowledge that prices and tariff structures are not the only mechanism to achieve conservation outcomes, by pointing to:

- use of other demand management tools to complement or reinforce incentives for conservation (for example, targeting particular customers with high use by undertaking water audits) or by providing financial incentives to encourage more water efficient practices (such as rebates for water efficient appliances and rainwater tanks).
- restrictions or regulation of the use of water supplies, particularly where water is scarce and other demand management initiatives (including efficient prices) are insufficient to address supply shortages (ESC 2005d: xv).

It is of course essential that pricing and tariff structures are not the only policy tool available to affect consumer's demand for water. Indeed, it has been argued that community-wide water restriction policies are a more equitable measure as they can isolate particular water-using practices that are clearly discretionary (Reidy 2005: 55). The Government has also introduced a "name and shame" policy for industrial and commercial consumers of water. New legislation provides that the names, location and involvement in water conservation programs of the top 200 water users for each water business must be publicly reported.³⁴ Non-price measures to reduce water consumption may in fact be more successful than pricing tools.

³⁴ *Water Industry Act 1994* (Vic), s 77A.

(d) Recycled water

The WIRO mandates that the ESC be satisfied that pricing structures provide incentives for sustainable use of water by providing appropriate signal to water users about choices regarding alternative supplies for different purposes.³⁵ The way in which recycled water is priced can contribute to sustainable outcomes, as consumers may be encouraged to use recycled water rather than regular potable water.

In the ESC's final decision, it imposed only light-handed regulation in relation to recycled water prices, rather than setting a maximum price. It proposed a set of pricing principles for recycled water – prices set by water businesses must be consistent with these principles:

- maximise revenue earned from recycled water services having regard to the price of any alternative substitutes and customers' willingness to pay;
- cover the full cost of providing the service; and
- include a variable component (ESC 2005d 102-3).

It is unclear how the imposition of these pricing principles can encourage sustainable water use by encouraging consumers to choose to use recycled water. In fact, the decision seems to go to lengths to ensure that there are no cross-subsidies between the prices charged for potable water and the prices charged for recycled water.

It should be noted that the penetration of access to recycled water is extremely limited in Victoria (ie, it is limited to a small number of "third pipe" estates). However, the Government is now mandating recycled water projects on a number of residential estates.³⁶ With ongoing drought, such mandated projects are likely to continue. For the residents of these estates, recycled water will become an essential service and consumers need to be protected from abuses of monopoly power in terms of prices, pricing policies and standard of services. Users who are required to enter into a contractual arrangement for the supply of recycled water are captive customers of the water agency in the same way as customers of potable water and sewerage monopolies (PIAC 2006). Pricing principles are unlikely to be adequate protection, due to difficulties for consumers in determining whether uneconomic prices are being charged, and the limited oversight role of the ESC. An

³⁵ WIRO, clause 14(a)(vi)(B).

³⁶ Minister for Water, Press Release – First Mandatory Recycled Water for Melbourne, 15 January 2007.

alternative approach may be to set a maximum tariff that considers the social and environmental benefits of access to recycled water services.

Recommendation Eight: That the ESC consider direct price regulation for recycled water services rather than imposing only pricing principles, recognising it as an essential service and considering the benefits associated with its contribution to reduced use of potable water services.

3.2.4 Consider the impact on low-income and vulnerable consumers

While the ESC's final decision does in some areas discuss the impact of its determination on low-income and vulnerable consumers, it does not deal with affordability issues in a robust and clear way. For example, in the ESC's analysis of Goulburn Valley Water's prices and tariff structures, it noted:

While the Commission recognises that increasing water charges may nevertheless impact on customers who are experiencing financial hardship, it notes that welfare policies are a more appropriate instrument for dealing with hardship and disadvantage in the community. Keeping water prices artificially below the cost of supply for all customers is an inefficient measure for addressing welfare objectives and is inconsistent with the efficiency and sustainability objectives of the Government's White Paper. (ESC 2005d: 96)

This statement is at odds with the regulatory principle requiring the ESC to take into account the interests of low-income and vulnerable consumers³⁷ which mandates it to consider more fully the impact of water charges on customers experiencing financial hardship. In fact, it indicates that the ESC did not meet its obligations under WIRO regulatory principle seven. While the ESC should consider Government efficiency and sustainability objectives as set out in the White Paper, it is required not to merely analyse hardship and affordability issues as something left to 'welfare policies'. As water is an essential service and access to affordable water can be considered a basic human right (CLCV 2005), water pricing has important social impacts and should not be analysed in merely economic terms.

³⁷ Water Industry Regulatory Order 2003 (**WIRO**), clause 14(a)(vii).

Many consumers do not benefit from welfare policies, including available concessions. The move to inclining block tariffs (**IBTs**) in the metropolitan water sector has resulted in some water consumers who have an inelasticity of demand (such as large families) paying higher water bills. The Public Interest Advocacy Centre (**PIAC**) has found that large and low-income households have a more limited capacity to reduce their water consumption compared to other high usage households in New South Wales (PIAC 2004). In approving tariff structures, therefore, the ESC should have regard to varying household structures and the impact approved tariff structures might have upon those households' ability to afford their water bills.

In its draft decision on water pricing for the Sydney Water Corporation (**Sydney Water**), IPART assessed the range of measures in operation that aim to mitigate the impact of price increases on customers (IPART 2005a: 117-8). While suggesting that customer-impact mitigation is primarily the responsibility of the State Government as part of its broader social policy, IPART was concerned to ensure that Sydney Water also had appropriate measures in place to assist financially disadvantaged customers who have difficulty paying their bills. IPART assessed the range of social programs administered and suggested areas for improvement and noted the need to balance customer needs with providing a simple cost-effective process. In Victoria, measures which may assist consumers with water bills include Government concessions, the Neighbourhood Renewal Energy Taskforce program³⁸ and water industry water conservation schemes such as the large family assistance package.³⁹ An assessment of these measures was not undertaken by the ESC in the recent price review. However, it would be valuable to do so.

The ESC also did not consider or promote the allowance of "social" tariffs, that is, tariffs that exempts certain customers from paying the full cost of their water supply. One example might apply where large families whose usage brings them into a higher or more expensive block tariff be shielded from the additional charges (CLCV 2005: 26). Another might be based on the UK's vulnerable group tariff, discussed at part 2.5 above. The fact that the regulatory framework does not allow for

³⁸ Neighbourhood Renewal's Energy Task Force is a joint program of DHS and the Sustainable Energy Authority of Victoria which aims to improve energy efficiency in low-income households. See <http://www.neighbourhoodrenewal.vic.gov.au/OOH/Web/nrwSite.nsf/doclookup/housing?opendocument>.

³⁹ For more information, see <http://www.yvw.com.au/yvw/YourHome/AccountInformation/PaymentAssistance/>.

such innovative measures to address the needs of low-income and consumers is a particular failing.

In response to water affordability problems, the ESC has implemented a requirement for all water businesses to implement a hardship policy. Following research undertaken by CLCV (2006) about the effectiveness of such policies, the ESC (2006) has also undertaken a review of water businesses' hardship policies. The ESC review made a number of recommendations, including requiring businesses to:

- better document their existing hardship policies;
- consider best practice examples to improve the effectiveness and targeting of hardship programs;
- make greater use of Government's hardship assistance scheme;
- look to integrate business hardship policies with community agencies in their areas.

The ESC will also pursue improvements in the regulatory and monitoring framework for water hardship policies, including:

- inserting a definition of hardship into the Customer Service Code;
- requiring water businesses to include hardship policies on their website; and
- requiring business to provide information to hardship customers.

While the ESC did not specifically recommend it, there is also scope for hardship policies to be assessed or enforced through the water price review process. One way could be to require businesses to include details and costings of their hardship policy or program in Water Plans, to be assessed by the ESC. Another is through the creation of a Guaranteed Service Level (**GSL**) scheme. A GSL payment could be mandated where a customer is not treated in accordance with the requirements of its hardship policy. This would also encourage water businesses to comply with their hardship policy obligations, similar to the operation of the wrongful disconnection payment for energy.⁴⁰ The ESC has acknowledged the usefulness of GSL schemes, noting the underlying objective to provide an incentive for businesses to address the incidence of inferior service performance (ESC 2006e: 30).

⁴⁰ Pursuant to energy legislation, consumers are entitled to a payment of \$250 per day where an energy retailer disconnects them in contravention of the Energy Retail Code.

Recommendation Six (cont): That the effectiveness of the inclining block tariff be independently assessed. The assessment should (also) focus on:

- whether the first block is set at a level that ensures an essential water supply is affordable;
- whether measures to address affordability problems experienced by large families or other vulnerable groups are effective.

Recommendation Nine: That the Victorian Government, the ESC and the water businesses investigate the potential effectiveness of a special tariff for consumers who are particularly vulnerable, such as very large families.

Recommendation Ten: That the ESC assess the adequacy of water businesses' hardship policies (including the adequacy of Government concessions) as part of its pricing determination in assessing Water Plans.

Recommendation Eleven: That the ESC introduce a Guaranteed Service Level payment where a water consumer is not treated in accordance with a business' hardship policy, as approved by the ESC.

3.3 Rural price review

This report has not considered in detail the rural water price review undertaken by the ESC during 2006. This price review approved the revenue required for the rural water businesses, which primarily provide irrigation services to farmers. Nevertheless, for the purposes of the current report, similar concerns were expressed throughout the review regarding the adequacy of customer consultation. In its final decision, the ESC stated:

The Commission also accepts that the consultation arrangements associated with the price reviews can be improved and the respective roles of the Commission and the water businesses need to be better defined. The Commission believes that the processes can be improved by:

- more direct consultation between customers and the Commission during the regulatory period. This will allow the Commission to have a better understanding of customers' needs prior to the price review commencing;
- greater consultation between water businesses and their customers prior to preparing their draft Water Plans; and
- improving customer awareness of the role of the Commission and the price review process more generally (ESC 2006d: 36).

The following sections of this report present the results of research into customer consultation. It is hoped that this presentation can assist the development of customer consultation techniques for future price reviews.

4. Customer Consultation

4.1 Need for better customer consultation

As outlined above, both the ESC and a number of consumer advocates have lamented the poor customer consultation in the first price reviews. So as to contribute to better customer consultation in future price reviews, this report surveyed water businesses about their current customer consultation techniques and also a number of consumer advocates about such consultation. This section of the report presents the results of those surveys.

4.2 Surveys with water businesses

The survey provided to water businesses covered a range of areas, including:

- how the business consults;
- mechanisms for engaging with customers;
- whether consultative mechanisms result in changes to the business; and
- continuous improvement.

A copy of the survey used is attached at Appendix D. The survey was provided to all metropolitan retailers and regional-urban water authorities. Nine water businesses responded to the survey. Businesses that responded were:

- Westernport Water;

- South Gippsland Water;
- South East Water;
- Gippsland Water;
- City West Water;
- Western Water
- Wannon Water;
- Melbourne Water;
- GWM Water.

Coliban Water and Barwon Water refused to participate in the survey. Despite a number of requests, Central Highlands Water, Goulburn Valley Water, North East Water, Yarra Valley Water, Lower Murray Water and East Gippsland Water did not respond. Survey responses are outlined below. These are provided to identify best practice consultation techniques as well as to identify areas for improvement.

4.2.1 City West Water

City West Water has a Community Engagement Policy and also consultation guidelines that are used in partnership with its Policy.

City West Water consults with its customers via its Customer and Community Engagement Committee (**CCEC**), its Community Liaison Committee (**CLC**) and by means of its customers contacting its call centre or customer relations team. The CCEC has representation from householders, industry, community groups, the Open Garden Scheme, the Combined Pensioners' Association, Local Councils, Local MPs and Environment Victoria. Both the CCEC and CLC have Terms of Reference and all positions have a position description. The committee structures are reviewed every two years. An independent chair conducts the meetings.

The CLC is the businesses' environment consultative and engagement mechanism. The CLC meets quarterly to discuss environmental impacts of the business, including sewer spills, trade waste spills, water extraction from the environment, laying of pipes in new estates and existing infrastructure.

City West Water consults with low-income and disadvantaged customers directly through its trained call centre and credit management team as well as its customer relations team.

Customer input informs City West Water's work in a range of areas, for example in the establishment of its hardship policy, development of a special needs program and policy and through input into its Sustainability Report. In addition, customer complaints provide input into operational improvements and process changes. City West Water consults on its Water Plan through its consultative committees. It sees customer support to new initiatives as integral to approval by the ESC. City West Water sees consultation on willingness to pay as a critical path for investigation in the development of pricing strategies.

City West Water is undertaking a comprehensive review of its current consultative processes through developing new guidelines. It does not see any barriers to effective consultation, noting the effective support from the wider organisation.

4.2.2 Gippsland Water

Gippsland Water has a Communication Strategy identifying the consultation processes in place. It also relies on VicWater's *Working Together: A Guide to Consultation for Victorian Water Businesses* for its consultation processes.

Gippsland Water uses a range of mechanisms to ensure the view points of customers are considered in its operations, including consultative committees, focus and reference groups, independent market research, liaison meetings with regulators and large customers, community presentations, customer newsletters, mail outs, education programs and its website. Gippsland Water undertook specific customer consultation in the updating of its Customer Charter.

Gippsland Water advertises for Expressions of Interest to participate in committees. It tries to ensure that membership is representative of the demographics of the regions and includes significant stakeholders. There is an independent chair of the meeting and the Public Affairs Manager facilitates the meeting. Membership is for a three year term. Agendas are determined in consultation with the chair of the committee. Following any consultation process, Gippsland Water analyses the outcomes of the consultation, identifies any issues which require action and then implements an appropriate strategy to address the issue. Feedback from customer consultation was taken into account and addressed in the Water Plan. Whilst the draft Water Plan was made available for public comment, comments received by Gippsland Water were primarily from the regulators and government. Notwithstanding this, Gippsland Water undertakes to take into consideration any

legitimate concerns expressed by customers in the development of the final Water Plan.

Gippsland Water reviews its Communication Strategy quarterly to determine the progress of implementation. This is reviewed and amended annually to ensure any improvements or opportunities identified throughout the year are addressed. Gippsland Water sees the major barriers to effective customer consultation to be tight time frames placed on it by external stakeholders.

4.2.3 GWM Water

GWM Water has a detailed Community Engagement and Marketing Plan which includes information about how it consults with customers. GWM Water has 8 customer advisory groups, with over 100 customers involved in the groups.

Membership of advisory groups is drawn from the customer base, usually through public announcements or by nomination from key stakeholder groups, such as the Victorian Farmers' Federation, environmental groups, catchment management authorities and local government. The role of these customer advisory groups is to provide advice to the board and to act as a barometer of customer needs and expectations. Each group generally meets 3 to 4 times a year.

GWM Water also has a number of special purpose committees to address specific issues and also a project based consultative program in relation to particular projects.

Low-income and disadvantaged groups are not directly targeted by GWM Water but are represented by the broad membership of various customer consultative committees. These groups are also captured through annual information booths throughout the region and other regional events attended by GWM Water.

All outcomes and feedback received from the above consultative mechanisms will feed into the development of the Water Plan. Draft plans are regularly presented to meetings of the various customer advisory groups, seeking comment and feedback. Meeting of special pricing committees (who draw their membership from major customer advisory groups) will also be held on an as-needed basis to provide input in development of the Water Plan. Customer Advisory Groups have been also been actively involved in the development of service standards and the customer charter.

GWM Water is also undertaking a review of the structure of the customer advisory group framework. This review is aimed at better reflecting the main user groups, minimising duplication and improving efficiencies. GWM Water sees its diverse customer groups (irrigation, urban, groundwater, domestic and stock) and small communities spread out over large geographic areas as the primary barrier to effective customer consultation. Furthermore, the need to educate customers about the regulatory environment so that they can provide informed advice presents as a difficulty.

4.2.4 Melbourne Water

As a water wholesaler, Melbourne Water works with its customers, the retail water businesses, to ensure efficient, sustainable services are provided to the community. General feedback to the community is provided on a regular basis through publications and on Melbourne Water's website. For major projects, Melbourne Water conducts consultation specific to the project.

In relation to its responsibility for waterways and drainages, Melbourne Water consults with the community through a range of committees and workshops. These include the Waterways Advisory Committee, which meets four to six times a year, and whose membership includes representatives from Melbourne Water, the Department of Sustainability and Environment, EPA Victoria, local government, Catchment management authorities and Environment Victoria. Members of committees are selected to ensure an appropriate mix of specialist skills, representation of key stakeholder groups and community interest relevant to the purpose of the committee. Customer consultative committees have agreed terms of reference and performance is reviewed periodically.

After seeking feedback from committee members or specific residents or groups potentially impacted by its activities, Melbourne Water incorporates specific suggestions if they are feasible. Depending upon the nature of the engagement undertaken, feedback has resulted in all project managers being trained in community consultation.

Melbourne Water consults with the public on its Water Plan through the ESC approval process. It also consults with its customers, the retail water businesses, to propose service standards and outcomes in its Water Plan.

Melbourne Water regularly undertakes reviews of its stakeholder relationships. Community committees are reviewed annually. All

projects requiring community consultation are evaluated at the project's conclusion.

4.2.5 South East Water

South East Water adopts VicWater's *Working Together: A Guide to Consultation for Victorian Water Businesses* as its policy regarding customer consultation. It also has a separate Marketing and Communications Plan.

South East Water consults with its customers through Customer Advisory Committee and Environment Advisory Committee. It also undertakes a number of surveys – call centre follow-up surveys, satisfaction surveys and willingness to pay surveys. In addition, it has a range of direct communication channels such as newsletters, brochures, media, website, displays and sponsorships.

The Customer Advisory Committee consists of “regular” customers with the exception of a commercial customer representative and a representative from Good Shepherd Youth and Family Services. In appointing members, South East Water considers a mix of customer types in terms of age, location and interest. The Committee is independently chaired, and most meetings are attended by the Managing Director, General Manager Customer Services and General Manager Regulation. The Committee also provides feedback directly to South East Water's board. Membership of the Committee and the Terms of Reference are reviewed every few years.

The Environment Advisory Committee is used to consult with customers in environmental issues. South East Water also invites key environmental stakeholders on tours to highlight the way in which South East Water is managing specific environmental issues. South East Water also publishes a number of reports (eg, Annual Report, Environment Report, Water Quality Report, Environment Improvement Plan) that detail its impact on the environment.

South East Water consults with representatives of low-income and vulnerable consumers through its partnership with Good Shepherd Youth and Family Services. In addition to providing financial counselling services for South East Water customers, Good Shepherd provides input to the ongoing maintenance of policies for customers in hardship. Good Shepherd also provides training to South East Water's call centre, credit management and priority plumbing services staff in relation to dealing with customers in hardship.

South East Water undertakes market research regarding customer preferences for tariff change to feed into the Water Plan. This research also guided the overall target levels of service in the Water Plan, including the introduction of guaranteed service level payments. South East Water state that the next Water Plan will involve greater customer consultation.

South East Water evaluates each of its programs involving customer consultation. It sees the main barrier to a good understanding of customer wants and perceptions of South East Water to be the time and cost associated with obtaining detailed, thorough research. A co-operative approach between the industry, the regulator and community groups would assist this process considerably, particularly in developing joint research programs.

4.2.6 South Gippsland Water

At the time of surveying, South Gippsland Water did not have a defined policy/procedure for customer consultation, but it was under review. It did state that it has engaged high levels of customer consultation and that support and encouragement has been received to process from the senior management and board.

South Gippsland Water has a range of customer consultation methods, including phone surveys, project groups, workshops/meetings, individual interviews, website feedback, correspondence and general enquiries. It also has a customer consultation list, which is a key source of contacts to participate in consultative programs. These include representatives of low-income and disadvantaged groups. South Gippsland Water offers to compensate all such representatives for expenses incurred in attending workshops.

South Gippsland Water does not have a standing consultative committee, but instead has project or task driven consultation committees. It states that this project consultation brings about direct tangible changes to work processes as requested by consultation groups. Interestingly, South Gippsland Water states that it is unsure whether customer consultation in relation to the Water Plan influences the ESC in its decision-making. It was not clear as to how its customer consultation impacts on its Water Plan.

South Gippsland Water reviews its consultation procedures through debriefs of consultation projects, reviews of 'best practice' within and outside the industry. It also shares information on techniques, procedures and practices with neighbouring water businesses.

South Gippsland Water sees that the main barrier to effective customer consultation is customer interest. However it sees project based consultation as extremely popular and participation has been good.

4.2.7 Wannon Water

Wannon Water has internal and external Community Engagement Policies. It consults with its customers by means of its Customer Engagement Committee, specific project monitoring committees, annual satisfaction surveys and by invitation to submit a response to draft strategic and policy documents.

The Customer Engagement Committee has an independent chair and is serviced by a senior officer and has secretarial support. The Committee develops an annual work plan and focuses on strategic customer issues. Members are identified as having a commitment to working within the Committee's framework, a keen interest in water industry issues relevant to the south-west region and the ability to represent the community or particular customer segment views.

The Customer Engagement Committee also considers environmental issues and compliance.

Under its Community Engagement Policy, if a matter is deemed to affect a low-income or disadvantaged group, then the matter would be raised with that group. However, there has been little contact by groups or organisations that represent low-income or disadvantaged groups.

In relation to its Water Plan, Wannon Water will raise tariff structures and other aspects with its Customer Engagement Committee, it will place a draft on its website and invite comments from customers, it will issue media releases relating to key customer issues and it will use its regional newsletter to convey important customer information. It will engage customers on tariff structure design and service levels (including guaranteed service level payments).

The Customer Engagement Committee has reviewed hardship and complaints processes and will also provide input into water tariff design. Project monitoring committees have provided feedback on proposed processes for community consultation and also assisted in avoiding negative community relations.

Wannon Water's process and procedures for customer consultation have recently been reviewed. Evaluation of current processes and

procedures will be the subject of future analysis. Wannon Water sees the main barriers to effective customer consultation as time constraints on representatives to address issues on a voluntary basis, low number of responses from the community in general when invited to make submissions and lack of local community groups taking an active interest in water issues.

4.2.8 Western Water

Western Water outlines its customer procedures and policies in its Policy Manual. It has three community reference groups, and a Customer Advisory Committee. It also institutes special purpose community reference groups for major projects and has regular forums with other stakeholders (ie, financial counsellors and real estate agents).

Members of committees “self-nominate”, but Western Water do try to ensure the groups represent the demographic characteristics of the area. A staff member coordinates the groups and members are surveyed about their participation every two years. Western Water uses a balanced scorecard to measure the success of customer groups by the number of issues raised and resolved each meeting.

The community reference groups and the Customer Advisory Committee meet with the board annually to assist with developing Western Water’s strategic plan. Prior to developing the Water Plan, it had a full day workshop with stakeholders and also had focus groups on the pricing proposal. Such consultation resulted in a reduction of inclining block tariff thresholds. Customers did not support a change from tri-annual to quarterly billing or the introduction of guaranteed service levels, and these proposals were not included in the Water Plan. Western Water’s main consultation on issues relating to low-income and disadvantaged groups is through its links with local financial counsellors. It holds 6-monthly forums with financial counsellors which cover a range of issues. When inclining block tariffs were introduced, it formed a working group with financial counsellors to develop hardship packages.

Western Water reviews its consultation procedures through biannual performance evaluations. It sees the main barriers to effective consultation as getting new members to join its group. However, it notes board and management support of customer consultation processes.

4.2.9 Westernport Water

Westernport Water has detailed its customer procedures and policies in a Customer Engagement Strategy and Customer Consultative Panel Strategy. Westernport Water also has a relationship with a local financial counsellor who has previously served on the Customer Consultative Panel. Other mechanisms to engage customers include regular media releases, advertising and the account newsletter.

Westernport Water has a Customer Consultative Panel made up of 9 customers who meet monthly. Members are based on a submission of Expression of Interest process and final selection is based on a number of factors including skills and expertise, permanent or non permanent resident status and where they are located within the region to ensure a broad representation of customers within the group. A member is selected as Chair of the Panel.

Customer Satisfaction Surveys are undertaken annually, and a Customer Service Survey is undertaken with customers who have contacted the Customer Service team. There are also ad-hoc surveys on topics such as Water Plans and pricing, water restrictions and the regional sustainable water strategies. After each survey reporting, the process and outcome are evaluated.

Westernport Water has memoranda of understandings with local environment and landcare groups, which involve shared projects, promotion of best practice, a sustainability seminar series, development of information sources and sharing of resources. Westernport Water is also documenting its impact on the environment to identify action areas and to see a reduction in its environmental footprint in future years.

Customer consultation has resulted in amended Permanent Water Savings Measures being approved by Government in 2005. Approval required demonstration that customer consultation had been undertaken. The Customer Consultative Panel also contributed to Westernport Water's tariff structure for the first price review. It agreed that step tariffs would have disadvantaged permanent residents and favoured the majority non-permanent residents, proposing instead a fixed single year round tariff.

Westernport Water states that the main barriers it faces to effective customer consultation include timeframes set by other stakeholders.

4.2.10 Discussion

The water businesses that responded to the survey should be congratulated. Their participation demonstrates that they respect the principles of accountability and transparency that should apply in the context of essential service delivery.

The survey results demonstrate that the nature and content of customer consultation is variable among water businesses. While all businesses that responded have policies that deal with consultation and consumer engagement, their degree of detail was mixed.

The survey results were particularly unclear about how customer consultation is undertaken in relation to Water Plans. Considering that the Water Plan is the primary method by which levels of service and prices paid by consumers are determined, it is unsatisfactory for water businesses not to incorporate clear and robust community consultation into their Water Plan development process.

Many survey responses also did not clearly indicate how consultation was undertaken with low-income and disadvantaged consumers and their representatives. Low-income and disadvantaged consumers are likely to have special needs in relation to water and wastewater services, including access to hardship policies. Businesses who did specifically engage low-income and disadvantaged consumers were more likely to understand the issues facing such consumers and actively promote their assistance programs.

4.3 Customer representative survey results

As part of this report, telephone surveys and discussions were undertaken with a range of customer representatives. These surveys aimed to obtain an understanding of customer representatives' dealings with water businesses, in particular in relation to customer consultation issues and in relation to pricing. A total of 20 interviews were undertaken with representatives including financial counsellors, representatives from Consumer Affairs Victoria and members of water businesses customer consultative committees. A copy of the questions asked is included at Appendix E.

It is recognised that the sample of customer representatives is quite small and, as such, it is difficult to generalise the findings in relation to the quality of water businesses' customer consultation techniques. Furthermore, due to the small number of available respondents, not

every water business was surveyed. Nevertheless, the following results provide some insight into the experiences of consumer representatives with local water businesses.

4.3.1 Results of the consultation

(a) Experience with local water businesses

Most financial counsellors interviewed had experience with negotiating with water businesses on behalf of their customers. About half of the interviewees said that negotiating with their local water business was not difficult.

“Gippsland Water are quite easy to deal with regarding payment plans. It’s good that they now offer Centrepay”.

“We have a very strong relationship with Yarra Valley Water – there are generally no problems”.

“The metro water businesses have good attitudes towards low-income and vulnerable consumers. A greater recognition of people in hardship results in people paying their bills”

“I’ve never had a bad experience with Lower Murray Water when negotiating payment plans, generally they are happy as long as the client is making a fair attempt to make regular repayments to reduce their debt. Lower Murray Water are also part of the Centrepay scheme which is a great success with our clients”.

“I have a direct contact within GWM Water and that makes negotiation easy”.

Others had not had good dealings in negotiating payment plans.

“Actually, it is generally quite difficult to negotiate with East Gippsland Water. Although I haven’t had many instances of having to deal with them”.

“Dealing with Coliban Water on behalf of clients is not always easy – you have to tell them what to do; they are not overly forward in offering their services”.

“It can be difficult to get hold of the person you want to speak with and they are not always easy to deal with. They do not always know about concessions and utility relief grants, but they are usually ok when putting together payment plans”.

“Coliban Water need more understanding about issues relating to hardship – they were lagging in adopting a hardship policy and they don’t make it known to customers they have a hardship policy. They should be more proactive”.

“I have experience of working with tenants – I find that sometimes water service costs are being charged to tenants when it should be the landlord.”

Consultations also indicated that the ability to have positive outcomes depended upon having a direct contact within the organisation. One customer representative described in detail a partnership arrangement between her service and the water business.

“Previously, South East Water employed a person to work with their customers identified as having financial difficulties. This process worked reasonably well, but there was a realisation that the business did not have the expertise to deal with a range of customers issues. Because of this we developed a “partnership model” whereby we would work together by providing direct casework to clients identified through South East Water, provide training for South East Water staff, provide support into policy development and also cultural change/understanding. The financial counselling offered is a broad service, not just with respect to water debt. Good Shepherd provide referrals to the South East Water internal hardship scheme where they have some funding to replace leaking taps, install dual flush toilets, water saving shower heads etc”.

This arrangement enables the respective organisations to work effectively together

*(b) Dealing with the Energy and Water Ombudsman (Victoria)
(EWOV)*

While most interviewees did not have experience in dealing with EWOV, two respondents had made complaints to EWOV on behalf of consumers.

“I’ve had two major cases against them at EWOV – bills over \$3,000. In both cases, the interest charged on overdue accounts was larger than the amounts owing. EWOV helped negotiate the removal of interest and a reduction in the bill. Now, East Gippsland Water waive the interest component if a customer enters an agreement to pay.”

“I’ve only had one matter gone to EWOV – where Gippsland Water had moved the meter so that a problem area of the pipe was now the customer’s responsibility. The debt ended up being shared by a capital grant, Gippsland Water and the consumer”.

EWOV statistics show relatively low levels of consumer complaints in relation to water businesses. From 1 January 2006 until 30 June 2006,

there were 675 cases, compared with over 8,000 for the energy industry.⁴¹ The low level of complaints to EWOV may suggest that water businesses are generally able to negotiate effectively with consumers and their representatives, without recourse to an independent conciliator. Alternatively, it may also suggest a low level of knowledge about EWOV among water consumers.

(c) Restriction / legal action

In line with performance reporting of the ESC, reports of restrictions and legal action for non-payment were generally very low. Data from the ESC shows that for most businesses, restrictions and legal actions were applied to less than 0.5 per cent of consumers (ESC 2006f). This indicates water businesses are addressing affordability matters through other means, such as instalment plans or through other ways.

“East Gippsland Water do not commonly use restriction and legal action, but they do use threatening letters of demand”.

“I’ve only had one case of a client’s supply being restricted. That was because they put their head in the sand and it was restricted for 12 months”.

“Coliban Water often threaten legal action, and pass along debts to collection – it happens when the customer doesn’t contact Coliban Water or a financial counsellor – the threat is needed so that Coliban Water gets a response from the customer”.

“Lower Murray Water are very good at sending out reminder notices and making every attempt to encourage customers to set up repayment arrangements to avoid any need for legal action. They refer customers to our service if needs be, and we will assist clients with assessing how much they can afford”

“South East Water have very few restrictions and legal actions against non-paying customers”.

“There are very few restrictions undertaken by GWM Water – GWM Water will attempt to deal with customers and put them on a payment plan”.

It should be noted that the ESC performance report concluded that water businesses were not uniform in their dealings with issues relating to affordability, including in relation to restrictions and legal actions for non-payment (ESC 2006f). It noted that regional businesses had comparatively higher levels of restrictions and legal actions, and that some businesses in particular had high levels. This finding led to the ESC’s (ESC 2006c) review of water businesses’ hardship policies.

⁴¹ EWOV, Resolution 22, October 2006.

(d) Consultation processes

Disappointingly, many of the customer representatives did not feel that water businesses had acceptable consultation policies and procedures. In particular, a failure to consult with representatives of low-income and vulnerable consumers (such as financial counsellors) was evident in a number of areas.

“I’ve never been consulted by East Gippsland Water. I’m not even sure if they have a customer committee”.

“I’m not aware of Gippsland Water customer committees or consultation – I’m never invited”.

Others, however, praised their water businesses’ customer consultation.

“Yarra Valley Water have very effective customer consultation processes. We have a representative on its customer consultative committee. They also meet with financial counsellors each year to get feedback”.

“I’m a member of Lower Murray Water’s Customer Consultative Committee – my experience so far has been great, at our meetings all members and people in attendance have a chance to bring up any issues they themselves or members of the public may have. They are very interested in hearing our views and concerns, and in return they are very open and honest when discussing matters with us”.

“As a member of GWM Water’s customer consultative committee, I believe it is a good 2 way – a good opportunity to comment on what the organisation is thinking and a good opportunity to feedback things I have heard around the community. The CCC doesn’t necessarily tell GWM Water what to do, but can modify how it does things”.

“Our previous team leader was on Coliban Water’s customer committee, but there hasn’t been an opportunity for a replacement. I think it’s a body that is worthwhile to get an understanding of what they are doing, but I doubt it has much input into the business”.

Consultation is clearly an area where there can be improvement. This is outlined further in the discussion section below.

(e) Water prices

Most customer representatives had not noticed the price increases in 2005 that resulted from the first price review. Others who noticed price

increases suggested that they can be handled by effective hardship policies and other measures to address affordability issues.

“I haven’t noticed any increase in water prices – bills are pretty minimal for renters. However, there are some new towns being connected to a sewerage system. This has increased their bills markedly as they now have to pay sewerage disposal costs. This impacts upon low-income earners, and can make their bills unmanageable”

“We haven’t noticed higher water prices since the price review”

“I’ve not noticed any increases in water debts since the change in prices. Centrepay has made payments easier to manage for consumers”.

“Yes, prices have been increasing. This affects tenants who don’t want to water their gardens and landlords then claim it’s a tenant’s responsibility and seek compensation”.

“Increased water prices hasn’t been a major problem as a large number of customers’ debts are waived where affordability problems are assessed, giving these clients a ‘new start’”

(f) Other issues

Customer representatives raised a range of other important issues relating to the application of concessions programs and other measures that address issues faced by low-income and vulnerable consumers. The selection below demonstrates the importance of customer consultation to ensure that consumers and consumer advocates are aware of business operations and services that are available. Improved communication between water businesses and consumer representatives can help ensure that water services are provided in the most efficient and fair manner possible.

“A common problem is in relation to applying for capital grants. You are required to waste water to show there is a leak (increase in usage) to get the grant – this is counter-intuitive”.

“Previously there was a problem that the water business would not apply concessions retrospectively. This has been changed now by DHS”.

“One issue is that Centrepay doesn’t accept payments less than \$10 per fortnight. This means that some clients get ahead of their debt and means they have to stop and start payments”.

“The Large Households Assistance Package – many consumers wrote back very upset by the implication that they were high water users, and it meant that the program was a failure. They should

change the way they market it or maybe promote it through financial counsellors, so that they can access it on behalf of their customers”.

4.3.2 Discussion

The issues raised by consumer survey respondents varied, and indicated minimal consumer understanding of the price review and Water Plan process. This conclusion accords with the ESC’s comments that the water businesses have engaged in little consultation with consumers and consumer representatives. It appears that where individual advocates have good relationships with individual staff members of water businesses, their concerns are often acted upon quickly and appropriately. However, it is clear that with current levels of customer consultation, price reviews are not being conducted with adequate input regarding the interests of consumers and the public generally.

Poor consultation also suggests that water businesses are not obtaining information or understanding the practical effects of their practices and policies on consumers. For example, customer representatives may give useful input into programs such as the Large Households Assistance Package and Centrepay. Other issues raised by consumer survey respondents suggest the following:

- a need for systematic response to customer complaints and queries in water businesses (resolution should not rely on knowing the correct person to speak to);
- that regional water businesses need to improve the way in which they deal with hardship issues; and
- that consultation processes need to be improved, especially in relation to low-income and vulnerable consumers.

5. Conclusion and Recommendations

This report concludes that while the framework for water price regulation has the potential to produce outcomes that are in the public interest, a lack of robust community consultation within the water price review process can inhibit the ability of the process to achieve its objectives. The report also concludes that insufficient analysis has been undertaken or reported during price reviews regarding impacts on disadvantaged and vulnerable consumers.

As stated at the introduction, the objectives of water price regulation are in some senses conflicting. Enabling water businesses to recover the costs of providing water services (and obtaining a return on investments) may sometimes conflict with the objective of providing affordable water services. In turn, they may both conflict with the objective of encouraging sustainable water consumption. The task of the ESC to manage these conflicting objectives is difficult. However, clear and coherent consultation with consumers about how the process is managed and undertaken and impacts on different customer groups has the potential to ensure price regulation achieves its objectives.

The fact the regulatory framework for water pricing includes requirements relating to customer consultation is promising. However, it is clear that consultation needs to be improved – this report has found that water businesses' consultation techniques have not been adequate throughout the first water price reviews. It is hoped that the comparison of water businesses' consultation techniques will encourage improved consultation for future water price reviews.

Recommendation One: That the Victorian Government amend the regulatory framework for the pricing of water to require the ESC to more actively take account of social and environmental factors in making pricing decisions, including those related to tariff structures.

Recommendation Two: That any further moves to introduce market principles into the provision and/or pricing of water must be based on public interest outcomes (considering all social, environmental and economic implications) and involve robust community consultation.

Recommendation Three: That the Victorian Government and the ESC work with the water businesses (including industry bodies) to improve consultation processes and procedures. Consultation on water plans and pricing proposals, especially with low-income consumers and their representatives, is fundamental to robust and fair pricing determinations.

Recommendation Four: That the ESC prepare a guideline, in consultation with water businesses and stakeholders, to outline what is required for effective customer consultation, in the context of the preparation of Water Plans.

Recommendation Five: That the Government and the ESC undertake a comprehensive assessment of tariff structures and their impact on sustainable water consumption.

Recommendation Six: That the effectiveness of the inclining block tariff be independently assessed. This assessment should focus on:

- whether the first block is set at a level that ensures an essential water supply is affordable;
- whether measures to address affordability problems experienced by large households or other vulnerable groups are effective;
- whether the pricing structure has resulted in reduced water consumption; and
- if not, whether this can be addressed by amending the structure of the tariff (ie, levels of fixed and volumetric charges) or whether measures other than pricing should be used to promote sustainability.

Recommendation Seven: That the Government, the ESC and the water industry should further investigate alternative water pricing structures for industrial and commercial users that promotes water conservation.

Recommendation Eight: That the ESC consider direct price regulation for recycled water services rather than imposing only pricing principles, recognising it as an essential service and considering the benefits associated with its contribution to reduced use of potable water services.

Recommendation Nine: That the Victorian Government, the ESC and the water businesses investigate the potential effectiveness of a special tariff for consumers who are particularly vulnerable, such as very large families.

Recommendation Ten: That the ESC assess the adequacy of water businesses' hardship policies (including the adequacy of Government concessions) as part of its pricing determination in assessing Water Plans.

Recommendation Eleven: That the ESC introduce a Guaranteed Service Level payment where a water consumer is not treated in accordance with a business' hardship policy, as approved by the ESC

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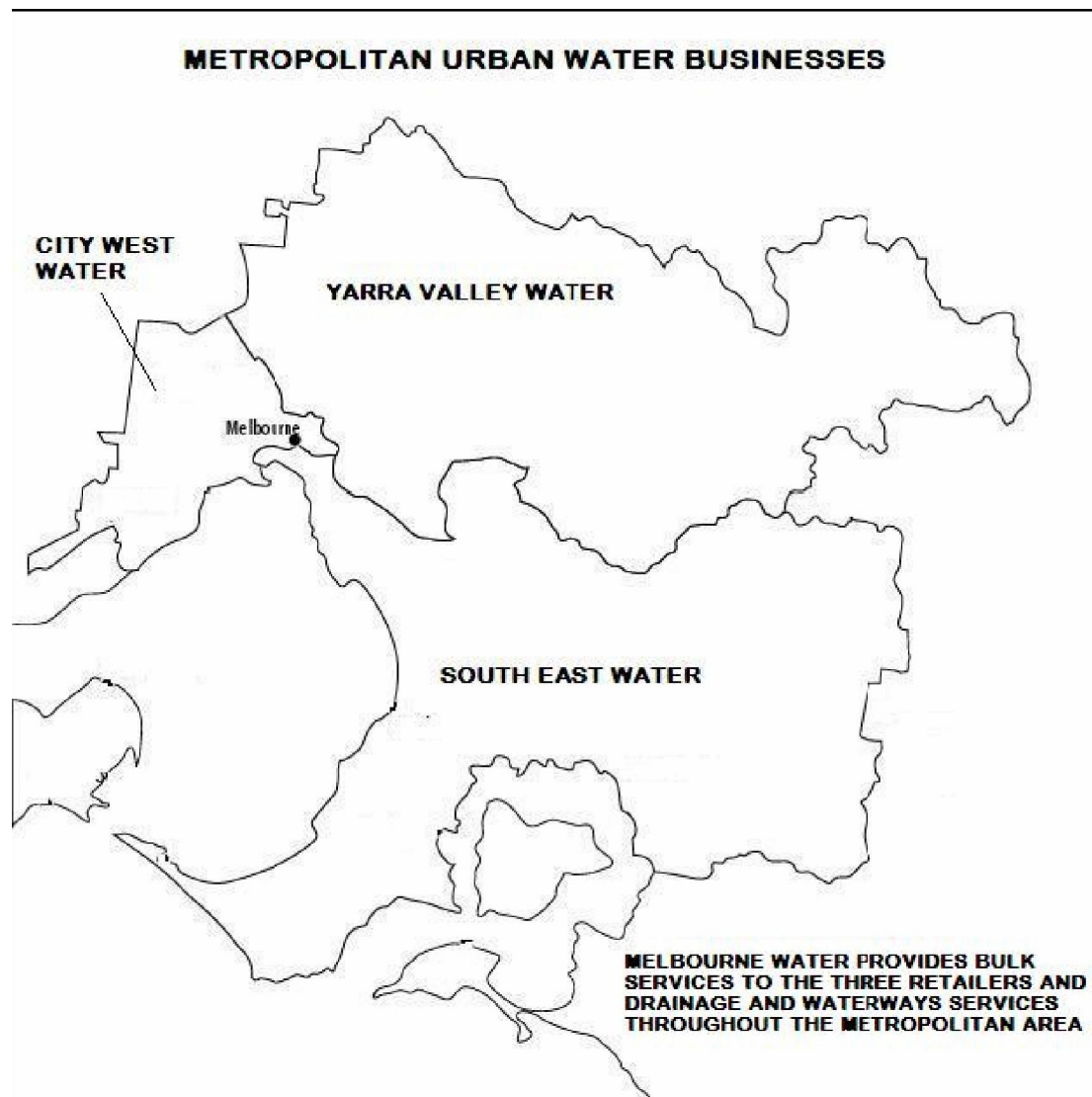
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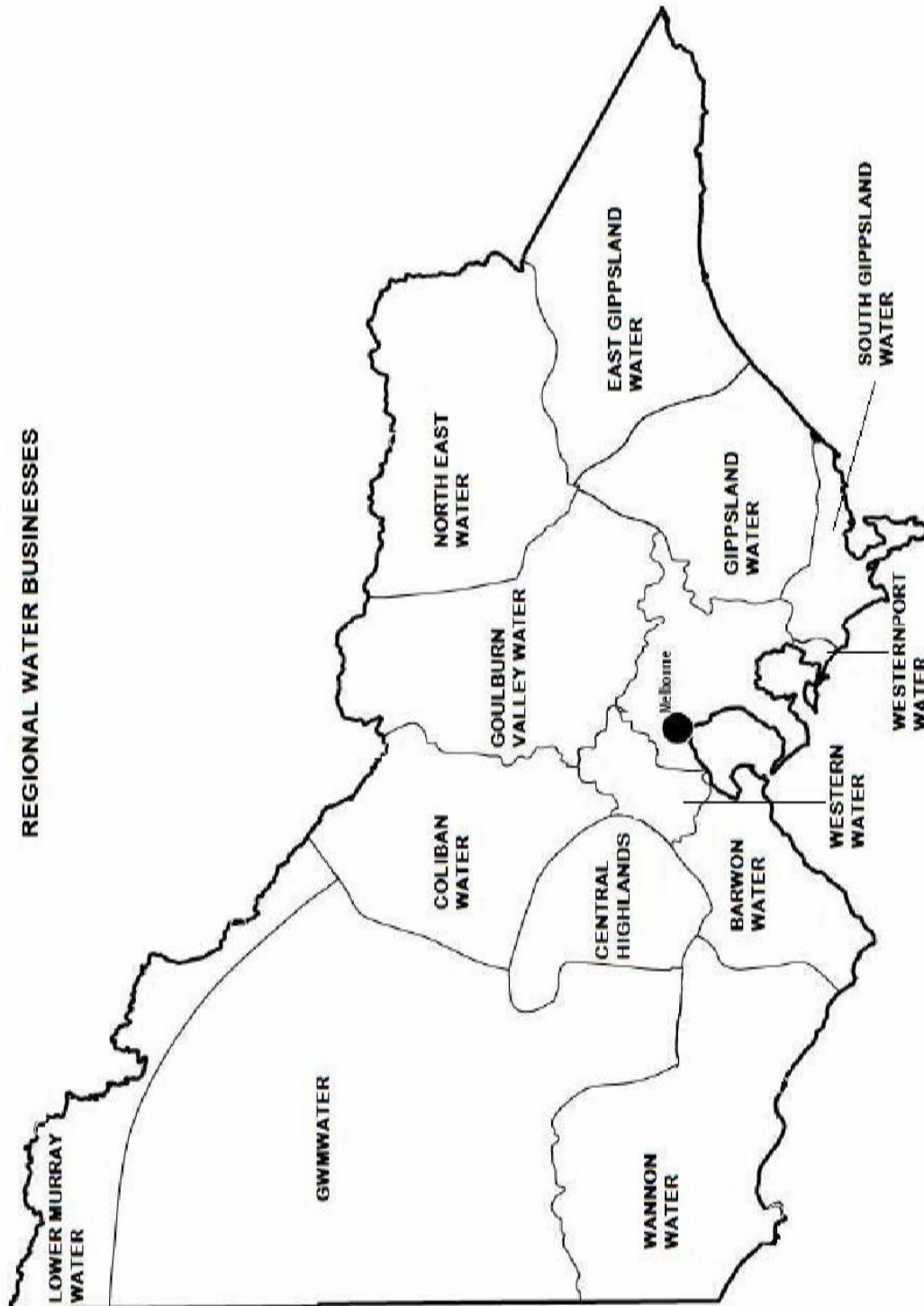
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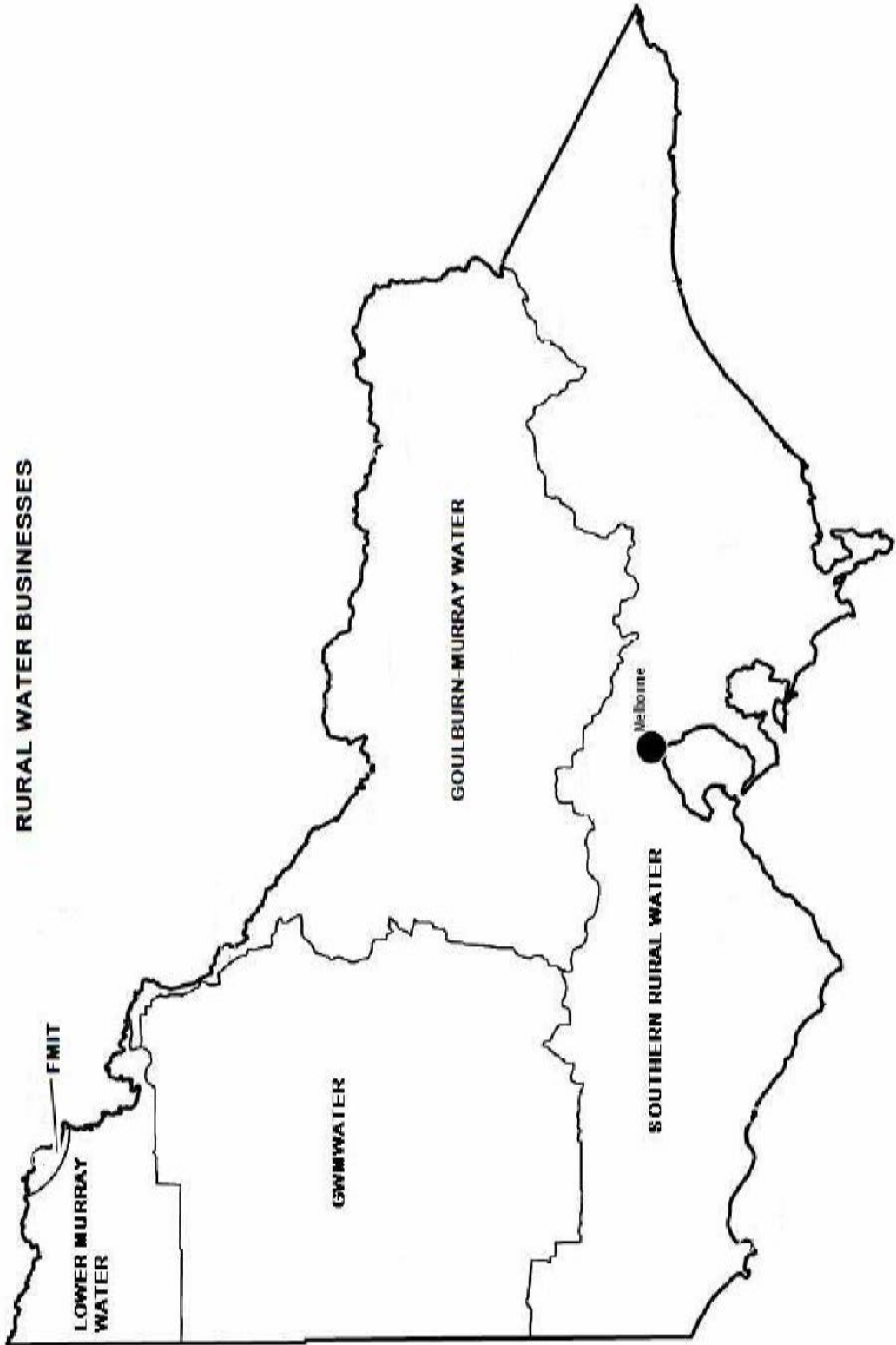
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Appendix A

Maps of Victorian Water Businesses







Appendix B

Water Industry Regulatory Order

As amended as at 25 October 2005.

The Governor in Council makes the following Order:

GENERAL

1. Title

This **Order** is called the Water Industry Regulatory Order 2003.

2. Commencement

This **Order** comes into operation on 1 January 2004 and remains in force until it is revoked.

3. Authorising Provision

This **Order** is made under section 4D(1)(a) of the **Act**.

4. Purpose

The purpose of this **Order** is to provide a framework for economic regulation by the **Commission** for services provided by the **regulated water industry** by:

- (a) specifying which goods and services are to be prescribed goods and services in respect of which the **Commission** has the power to regulate prices;
- (b) declaring which goods and services are to be declared goods and services in respect of which the **Commission** has the power to regulate standards and conditions of service and supply;
- (c) specifying the approach to be adopted by the **Commission** in regulating the price of prescribed goods and services;
- (d) specifying particular matters to which the **Commission** must have regard in exercising its powers and functions under this **Order**;
- (e) conferring on the **Commission** certain functions in relation to monitoring, performance reporting and auditing; and
- (f) conferring on the **Commission** certain functions in relation to dispute resolution.

5. Definitions

In this **Order**, unless the contrary intention appears the words and phrases have the meanings given to them in Schedule 1.

COVERAGE

6. Prescribed Services and Declared Services

(a) The following services supplied by or within the **regulated water industry** are declared services in respect of which the **Commission** has the power to regulate standards and conditions of service and supply:

- (i) **retail water services**;
- (ii) **retail recycled water services**;
- (iii) **retail sewerage services**;

- (iv) **storage operator and bulk water services;**
- (v) **bulk sewerage services;**
- (vi) **bulk recycled water services;**
- (vii) **metropolitan drainage services;**
- (viii) **irrigation drainage services;**
- (ix) **connection services;**
- (x) services to which **developer charges** apply; and
- (xi) **diversion services.**

(b) The following services supplied by or within the **regulated water industry**, with the exception of those provided by the First Mildura Irrigation Trust, Gippsland and Southern Rural Water Authority, Goulburn-Murray Rural Water Authority, Grampians Wimmera Mallee Water Authority and Lower Murray Urban and Rural Water Authority, are specified as prescribed services in respect of which the **Commission** has the power to regulate prices:

- (i) **retail water services;**
- (ii) **retail recycled water services;**
- (iii) **retail sewerage services;**
- (iv) **storage operator and bulk water services;**
- (v) **bulk sewerage services;**
- (vi) **bulk recycled water services;**
- (vii) **metropolitan drainage services;**
- (viii) **irrigation drainage services;**
- (ix) **connection services;**
- (x) services to which **developer charges** apply; and
- (xi) **diversion services.**

(c) The following services supplied by the First Mildura Irrigation Trust, Gippsland and Southern Rural Water Authority, Goulburn-Murray Rural Water Authority, Grampians Wimmera Mallee Water Authority and Lower Murray Urban and Rural Water Authority are specified as prescribed services after 1 July 2006 in respect of which the **Commission** has the power to regulate prices:

- (i) **retail water services;**
- (ii) **retail recycled water services;**
- (iii) **retail sewerage services;**
- (iv) **storage operator and bulk water services;**
- (v) **bulk sewerage services;**
- (vi) **bulk recycled water services;**
- (vii) **metropolitan drainage services;**
- (viii) **irrigation drainage services;**
- (ix) **connection services;**
- (x) services to which **developer charges** apply; and
- (xi) **diversion services.**

(d) Nothing in this **Order** is to be taken as precluding services that come within one of the categories of service identified in paragraphs (a), (b) and (c) being regulated, whether as to price, standards and conditions of service and supply, in a different manner from either other services that come within that same category or other services that come within a different category.

REGULATORY PERIOD

7. Regulatory Period

(a) The first **regulatory period** shall be:

- (i) for the First Mildura Irrigation Trust, Gippsland and Southern Rural Water Authority, Goulburn-Murray Rural Water Authority, Grampians Wimmera Mallee Water Authority and Lower Murray Urban and Rural Water Authority, the 2 year period commencing on 1 July 2006; and
- (ii) for all other regulated authorities, the 3 year period commencing on 1 July 2005.

(b) Except in the case of the first **regulatory period**, the **Commission** must set the term of each **regulatory period**.

REGULATORY APPROACH

8. Decision in relation to prices

Before the commencement of a **regulatory period**, the **Commission** must:

- (a) approve all of the prices which a **regulated entity** may charge for **prescribed services**, or the manner in which such prices are to be calculated or otherwise determined, as set out in the **regulated entity's Water Plan**, until the commencement of the next **regulatory period**; or
- (b) specify the prices which a **regulated entity** may charge for **prescribed services**, or the manner in which such prices are to be calculated or otherwise determined, until the commencement of the next **regulatory period**.

For the avoidance of doubt:

- (c) a decision of the **Commission** under paragraph (a) or (b) is a determination for the purposes of the **ESC Act**.

9. Approval of prices

The **Commission** must give the approval referred to in clause 8(a) if it is satisfied that the prices which the **regulated entity** may charge for **prescribed services** or the manner in which they are to be calculated or otherwise determined (as set out in the **Water Plan**):

- (a) were developed in accordance with the **Procedural Requirements**; and
- (b) comply with the relevant **Regulatory Principles**.

10. Specifying prices

The **Commission** may only specify prices, or the manner in which such prices are to be calculated or otherwise determined, under clause 8(b) if a **regulated entity**:

- (a) fails to deliver to the **Commission** a **Water Plan** within the time specified for such delivery in the **Statements of Obligations** that has been issued to that **regulated entity**; or
- (b) after considering the **Water Plan** and any variations to it made after the issue of the Commission's draft decision in relation to the **Water Plan**, the Commission is not satisfied that the prices which the regulated entity may charge for prescribed services or the manner in which they are to be calculated or otherwise determined:
 - (i) were developed in accordance with the **Procedural Requirements**;
and
 - (ii) comply with the relevant **Regulatory Principles**.

11. Draft decision

Before making a decision under clause 8, the **Commission** must issue a draft decision which either:

- (a) proposes to give the approval referred to in clause 8(a); or

(b) proposes to refuse to give the approval referred to in clause 8(a) and specifies the reasons for the **Commission's** proposed refusal (which may include suggested amendments to, or action to be taken in respect of, the **Water Plan** that, if adopted or taken, may result in the **Commission** giving that approval) and the date by which a **regulated entity** must resubmit a revised **Water Plan** or undertake such action as to ensure compliance.

12. Information

In order to be satisfied that prices, or the manner in which such prices are to be calculated or otherwise determined:

- (a) were developed in accordance with the **Procedural Requirements**; and
- (b) comply with the relevant **Regulatory Principles**, the **Commission** may require the regulated entity to provide additional information in support of its **Water Plan**.

PROCEDURAL REQUIREMENTS AND REGULATORY PRINCIPLES

13. Procedural Requirements

In order to be satisfied that prices, or the manner in which such prices are to be calculated or otherwise determined, have been developed in accordance with the **Procedural Requirements**, as required by this **Order**, the Commission must be satisfied that the regulated entity has observed the procedural requirements as set out in the **Statement of Obligations**.

14. Regulatory Principles

(1) In order to be satisfied that prices, or the manner in which such prices are to be calculated or otherwise determined, comply with the **Regulatory Principles**, as required by this **Order**, the Commission must be satisfied that:

(a) the prices contained in the **Water Plan** as those which the **regulated entity** proposes it be permitted to charge for **prescribed services** over the term of the **Water Plan**, or the manner in which the **Water Plan** proposes that such prices are to be calculated or otherwise determined, must be such as to:

(i) provide for a sustainable revenue stream to the **regulated entity** that nonetheless does not reflect monopoly rents and or inefficient expenditure by the **regulated entity**;

(ii) allow the **regulated entity** to recover its operational, maintenance and administrative costs;

(iii) allow the **regulated entity** to recover its expenditure on renewing and rehabilitating existing assets;

(iv) allow the **regulated entity** to recover:

(A) a rate of return on assets as at 1 July 2004 that are valued in a manner determined by, or at an amount otherwise specified by, the **Minister** at any time before 1 July 2004;

(B) all costs associated with existing debt incurred to finance expenditure prior to 1 July 2006, in a manner determined by the Minister at any time before 1 July 2006;

(v) allow the **regulated entity** to recover a rate of return on investments made after 1 July 2004 to augment existing assets or construct new assets;

- (vi) provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users about:
 - (A) the costs of providing services, including costs associated with future supplies and periods of peak demands and or restricted supply; and
 - (B) choices regarding alternative supplies for different purposes;
 - (vii) take into account the interests of customers of the **regulated entity**, including low income and vulnerable customers;
 - (viii) provide the **regulated entity** with incentives to pursue efficiency improvements and to promote the sustainable use of Victoria's water resources; and
 - (ix) enable customers or potential customers of the **regulated entity** to readily understand the prices charged by the **regulated entity** for **prescribed services**, or the manner in which such prices are to be calculated or otherwise determined;
- (b) the expenditure forecasts contained in the **Water Plan** must reflect the efficient delivery of the proposed outcomes contained in the **Water Plan** and take into account a planning horizon that extends beyond the term of the **Water Plan**.
- (2) The **Regulatory Principles** in clause 14(1) do not apply to the regulated entities referred to in clause 7(a)(1), if clause 14A applies."

14A. Rural Sector Regulatory Principles for the First Regulatory Period

For the first **regulatory period** for the entities referred to in clause 7(a)(i), in order to be satisfied that the manner in which prices are to be calculated or otherwise determined complies with the **Regulatory Principles** in paragraphs (a) and (b) of this clause as required by this **Order**, the Commission must be satisfied that:

- (a) the prices contained in the **Water Plan** as those which these authorities propose to be permitted to charge for **prescribed services** over the term of the **Water Plan**, or the manner in which the **Water Plan** proposes that such prices are to be calculated or otherwise determined, must be such as to:
 - (i) provide for a sustainable revenue stream to the regulated entity that nonetheless does not reflect monopoly rents and or inefficient expenditure by the authority;
 - (ii) allow the regulated entity to recover its operational, maintenance and administrative costs;
 - (iii) allow the regulated entity to recover its expenditure on renewing and rehabilitating existing assets, either by classifying the expenditure as maintenance, recovering a renewals annuity, or borrowing and recovering the cost over time;
 - (iv) allow the regulated entity to recover:
 - (A) a rate of return on assets as at 1 July 2004 that are valued in a manner determined by, or at an amount otherwise specified by the Minister at any time before 1 July 2004; or
 - (B) all costs associated with existing debt incurred to finance recent expenditure prior to 1 July 2006, in a manner determined by the Minister at any time before 1 July 2006;

- (v) allow the regulated entity to recover a rate of return on investments made after 1 July 2004 to augment existing assets or construct new assets;
 - (vi) provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to **urban water users** about:
 - (A) the costs of providing services, including costs associated with future supplies and periods of peak demands and or restricted supply; and
 - (B) choices regarding alternative supplies for different purposes;
 - (vii) take into account the interests of customers of the regulated entity, including low income and vulnerable **urban water users**;
 - (viii) provide the regulated entity with incentives to pursue efficiency improvements; and
 - (ix) enable customers or potential customers of the regulated entity to readily understand the prices charged by the regulated entity for **prescribed services**, or the manner in which such prices are to be calculated or otherwise determined;
- (b) the expenditure forecasts contained in the **Water Plan** must reflect the efficient delivery of the proposed outcomes contained in the **Water Plan** and take into account a planning horizon that extends beyond the term of the **Water Plan**.

REGULATION OF SERVICE QUALITY

15. Specifying standards and conditions

The **Commission** may specify standards and conditions of services and supply with which a **regulated entity** is obliged to comply in connection with the provision by it of **declared services**:

- (a) by approving standards and conditions of services and supply which a **regulated entity** has included in its **Water Plan**; or
- (b) by specifying standards and conditions of services and supply in a **Code** issued under section 4F of the Act; or
- (c) by any combination of the means specified in paragraphs (a) and (b).

MONITORING, PERFORMANCE REPORTING AND AUDITING

16. Performance Monitoring and Reporting

The **Commission** has the function of monitoring and reporting publicly on the performance of the **regulated water industry**.

17. Auditing

The **Commission** has the function of carrying out audits in relation to:

- (a) the compliance of **regulated entities** with the standards and conditions of service and supply specified by the **Commission** in any Code or set out in their **Water Plans**, and the systems and processes established by the **regulated entity** to ensure such compliance;
- (b) the reliability and quality of information reported by **regulated entities** to the **Commission** and the conformity of that information with any specification issued by the **Commission**; and

(c) the compliance of **regulated entities** with obligations imposed in any **Statement of Obligations** issued to them in respect of the management of their assets.

In the case of any such audits:

(d) the Commission may decide the scope and frequency of such audits provided that such audits are not conducted more frequently than once in any given **financial year**;

(e) conducted pursuant to paragraph (c), the **Commission** must include in that audit any matters requested by the **Minister**.

18. Audits requested by Minister

The **Minister** may request the **Commission** to audit the compliance of a **regulated entity** with such obligations as are identified by the **Minister** and as are imposed on that **regulated entity** under the **Statement of Obligations** that is issued to it, in which case the **Commission** must carry out that audit in accordance with that request.

19. Publication of audit results

The **Commission** must publicly report on the results of all audits conducted under clause 17 or 18.

DISPUTE RESOLUTION

20. Disputes between regulated entities

In such circumstances as the **Commission** determines, the **Commission** has the function of facilitating the resolution of a dispute in relation to prices and standards and conditions of service and supply provided for in an agreement between two **regulated entities** to supply **storage operator and bulk water services, bulk sewerage services** and **bulk recycled water services**. The **Commission** may carry out this function by requiring mediation or arbitration or by any other means the **Commission** considers appropriate.

Dated: 16 December 2003

SCHEDULE 1

DEFINITIONS

In this **Order**:

"**Act**" means the Water Industry Act 1994;

"**business day**" means a day on which banks are open for general banking business in Melbourne, not being a Saturday or a Sunday;

"**bulk recycled water service**" means a service provided by **Melbourne Water** in connection with the provision of a supply of recycled water;

"**bulk sewerage service**" means a service provided by **Melbourne Water** in connection with the conveyance, treatment and disposal of wastewater for a **regulated entity**;

"**Code**" means a code under section 4F of the **Act**;

"**Commission**" means the Essential Services Commission established under the **ESC Act**;

"**connection service**" means the connection of a serviced property to a water supply system or sewerage system;

"**declared services**" means the services described in clause 6 of this **Order**;

"**developer charges**" means:

- (a) contributions to the cost of works imposed under sections 27, 28 and 29 of the **Act**;
- (b) contributions to the costs of works imposed under Division 6 of Part 13 of the **Water Act 1989**; and
- (c) contributions to the cost of drainage works imposed under section 269A of the **Melbourne and Metropolitan Board of Works Act 1958**;

"**diversion service**" means a service provided by a **regulated entity** in connection with the management, extraction or use of groundwater or surface water;

"**ESC Act**" means the Essential Services Commission Act 2001;

"**financial year**" means a year ending 30 June;

"**irrigation drainage services**" means a service provided by a **Rural Water Authority** in connection with the removal and disposal of run-off from irrigation;

"**Melbourne Water**" means the Corporation as that term is defined in Melbourne Water Corporation Act 1992;

"**metropolitan drainage service**" means a service provided by **Melbourne Water** in connection with the performance of its functions under Part X of the Melbourne and Metropolitan Board of Works Act 1958;

"**metropolitan retail water company**" means:

- (a) City West Water Limited (ACN 066 902 467);
- (b) South East Water Limited (ACN 066 902 547); or
- (c) Yarra Valley Water Limited (ACN 066 902 501);

"**Minister**" means the Minister administering the **Act**;

"**Order**" means this Water Industry Regulatory Order 2003;

"**prescribed services**" means the services described in clause 6 of this **Order**;

"**Procedural Requirements**" means the procedures referred to in clause 13 of this **Order**;

"**Regional Urban Water Authority**" has the meaning given in section 4A of the **Act**;

"**regulated entity**" has the meaning given in section 4A of the **Act**;

"**regulatory period**" means a period over which a decision of the **Commission** under clause 8 of this **Order** is to apply;

"**Regulatory Principles**" means the principles set out in clause 14 and 14A of this **Order**;

"**regulated water industry**" has the meaning given in section 4A of the **Act**;

"**retail recycled water service**" means a service provided by a **regulated entity** in connection with the provision of a supply of recycled water;

"**retail sewerage service**" means a service provided by a **metropolitan retail water company** or by a **Regional Urban Water Authority** in connection with the removal, treatment and disposal of sewage and **trade waste**;

"**retail water service**" means a service provided by a **regulated entity** in connection with the provision of a supply of water to a person other than a **regulated entity**;

"**Rural Water Authority**" has the meaning given in section 4A of the **Act**;

"**Statement of Obligations**" means a Statement of Obligations issued by the **Minister** under section 41(2) or section 8(1) of the **Act**;

"**storage operator and bulk water service**" means a service provided by a **regulated entity** in connection with the provision of a supply of water to a **regulated entity**;

"**trade waste**" means any waterborne waste (other than sewage) which is suitable, according to the criteria of a **regulated entity**, for discharge into the **regulated entity's** sewerage system;

"**urban water users**" means customers who receive an urban water service from Grampians Wimmera Mallee Water Authority or Lower Murray Urban and Rural Water Authority;

"**Water Plan**" means a water plan that is required to be delivered to the **Commission** by **regulated entity** under a **Statement of Obligations**.

Appendix C

Council of Australian Governments' Communiqué – Water Resource Policy, 25 February 1994

In relation to water resource policy, the Council agreed:

1. that action needs to be taken to arrest widespread natural resource degradation in all jurisdictions occasioned, in part, by water use and that a package of measures is required to address the economic, environmental and social implications of future water reform.
2. to implement a strategic framework to achieve an efficient and sustainable water industry comprising the elements set out in (3) through (8) below;
3. in relation to pricing:
 - a. in general -
 - i. to the adoption of pricing regimes based on the principles of consumption-based pricing, full-cost recovery and desirably the removal of cross-subsidies which are not consistent with efficient and effective service, use and provision. Where cross-subsidies continue to exist, they be made transparent;
 - Queensland, South Australia and Tasmania endorsed these pricing principles but have concerns on the detail of the recommendations,
 - ii. that where service deliverers are required to provide water services to classes of customer at less than full cost, the cost of this be fully disclosed and ideally be paid to the service deliverer as a community service obligation.
 - b. urban water services -
 - i. to the adoption by no later than 1998 of charging arrangements for water services comprising an access or connection component together with an additional component or components to reflect usage where this is cost-effective;
 - ii. that in order to assist jurisdictions to adopt the aforementioned pricing arrangements, an expert group, on which all jurisdictions are to be represented, report to COAG at its first meeting in 1995 on asset valuation methods and cost-recovery definitions; and
 - iii. that supplying organisations, where they are publicly owned, aiming to earn a real rate of return on the written-down

replacement cost of their assets, commensurate with the equity arrangements of their public ownership.

- c. metropolitan bulk-water suppliers -
 - i. to charging on a volumetric basis to recover all costs and earn a positive real rate of return on the written-down replacement cost of their assets.
- d. rural water supply -
 - i. that where charges do not currently fully cover the costs of supplying water to users, agree that charges and costs be progressively reviewed so that no later than 2001 they comply with the principle of full-cost recovery with any subsidies made transparent consistent with 3(a) (ii) above;
 - ii. to achieve positive real rates of return on the written-down replacement costs of assets in rural water supply by 2001, wherever practicable;
 - iii. that future investment in new schemes or extensions to existing schemes be undertaken only after appraisal indicates it is economically viable and ecologically sustainable;
 - iv. where trading in water could occur across State borders, that pricing and asset valuation arrangements be consistent;
 - v. where it is not currently the case, to the setting aside of funds for future asset refurbishment and/or upgrading of government-supplied water infrastructure; and
 - vi. in the case of the Murray-Darling Basin Commission, to the Murray-Darling Basin Ministerial Council putting in place arrangements so that out of charges for water funds for the future maintenance, refurbishment and/or upgrading of the headworks and other structures under the Commission's control be provided.
- e. groundwater –
 - i. that management arrangements relating to groundwater be considered by Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ) by early 1995 and advice from such considerations be provided to individual jurisdictions and the report be provided to COAG;

4. in relation to water allocations or entitlements:

- a. the State Government members of the Council, would implement comprehensive systems of water allocations or entitlements backed by separation of water property rights from land title and clear specification of entitlements in terms of ownership, volume, reliability, transferability and, if appropriate, quality;

- b. where they have not already done so, States, would give priority to formally determining allocations or entitlements to water, including allocations for the environment as a legitimate user of water;
 - c. in allocating water to the environment, member governments would have regard to the work undertaken by ARMCANZ and Australian and New Zealand Environment and Conservation Council (ANZECC) in this area;
 - d. that the environmental requirements, wherever possible, will be determined on the best scientific information available and have regard to the inter-temporal and inter-spatial water needs required to maintain the health and viability of river systems and groundwater basins. In cases where river systems have been overallocated, or are deemed to be stressed, arrangements will be instituted and substantial progress made by 1998 to provide a better balance in water resource use including appropriate allocations to the environment in order to enhance/restore the health of river systems;
 - e. in undertaking this work, jurisdictions would consider establishing environmental contingency allocations which provide for a review of the allocations five years after they have been determined; and
 - f. where significant future irrigation activity or darn construction is contemplated, appropriate assessments would be undertaken to, inter alia, allow natural resource managers to satisfy themselves that the environmental requirements of the river systems would be adequately met before any harvesting of the water resource occurs;
5. in relation to trading in water allocations or entitlements:
- a. that water be used to maximise its contribution to national income and welfare, within the social, physical and ecological constraints of catchments;
 - b. where it is not already the case, that trading arrangements in water allocations or entitlements be instituted once the entitlement arrangements have been settled. This should occur no later than 1998;
 - c. where cross-border trading is possible, that the trading arrangements be consistent and facilitate cross-border sales where this is socially, physically and ecologically sustainable; and
 - d. that individual jurisdictions would develop, where they do not already exist, the necessary institutional arrangements, from a natural resource management perspective, to facilitate trade in water, with the proviso that in the Murray-Darling Basin the Murray-Darling Basin Commission be satisfied as to the sustainability of proposed trading transactions;
6. in relation to institutional reform:-
- a. that where they have not already done so, governments would develop administrative arrangements and decision-making processes to ensure an integrated approach to natural resource management;

- b. to the adoption, where this is not already practised, of an integrated catchment management approach to water resource management and set in place arrangements to consult with the representatives of local government and the wider community in individual catchments;
 - c. to the principle that, as far as possible, the roles of water resource management, standard setting and regulatory enforcement and service provision be separated institutionally;
 - d. that this occur, where appropriate, as soon as practicable, but certainly no later than 1998;
 - e. the need for water services to be delivered as efficiently as possible and that ARMCANZ, in conjunction with the Steering Committee on National Performance Monitoring of Government Trading Enterprises, further develop its comparisons of inter-agency performance, with service providers seeking to achieve international best practice;
 - f. that the arrangements in respect of service delivery organisations in metropolitan areas in particular should have a commercial focus, and whether achieved by contracting-out, corporatised entities or privatised bodies this be a matter for each jurisdiction to determine in the light of its own circumstances; and
 - g. to the principle that constituents be given a greater degree of responsibility in the management of irrigation areas, for example, through operational responsibility being devolved to local bodies, subject to appropriate regulatory frameworks being established;
7. in relation to consultation and public education:
- a. to the principle of public consultation by government agencies and service deliverers where change and/or new initiatives are contemplated involving water resources;
 - b. that where public consultation processes are not already in train in relation to recommendations (3)(b), (3)(d), (4) and (5) in particular, such processes will be embarked upon;
 - c. that jurisdictions individually and jointly develop public education programs in relation to water use and the need for, and benefits from, reform;
 - d. that responsible water agencies work with education authorities to develop a more extensive range of resource materials on water resources for use in schools; and
 - e. that water agencies should develop, individually and jointly public education programs illustrating the cause and effect relationship between infrastructure performance, standards of service and related costs, with a view to promoting levels of service that represent the best value for money to the community;
8. in relation to the environment:

- a. that ARMCANZ, ANZECC and the Ministerial Council for Planning, Housing and Local Government examine the management and ramifications of making greater use of wastewater in urban areas and strategies for handling stormwater, including its use, and report to the first Council of Australian Governments' meeting in 1995 on progress;
 - b. to support ARMCANZ and ANZECC in their development of the National Water Quality Management Strategy, through the adoption of a package of market-based and regulatory measures, including the establishment of appropriate water quality monitoring and catchment management policies and community consultation and awareness;
 - c. to support consideration being given to establishment of landcare practices that protect areas of river which have a high environmental value or are sensitive for other reasons; and
 - d. to request ARMCANZ and ANZECC, in their development of the National Water Quality Management Strategy, to undertake an early review of current approaches to town wastewater and sewage disposal to sensitive environments, noting that action is underway to reduce accessions to water courses from key centres on the Darling River system (It was noted that the National Water Quality Management Strategy is yet to be finalised and endorsed by governments.);
9. in relation to water and related research, member governments would:
- a. give higher priority to the research necessary to progress implementation of the strategic framework, including consistent methodologies for determining environmental flow requirements; and
 - b. to greater coordination and liaison between research agencies to more effectively utilise the expertise of bodies such as the Land and Water Research and Development Corporation, the Murray-Darling Basin Commission and other State and Commonwealth organisations;
10. in relation to taxation:
- a. that a sub-committee of Commonwealth and State officials, established by the Working Group on Micro-economic Reform, meet to discuss taxation issues of relevance to the water industry with a view to reporting, through the Working Group, to the Council within 12 months;
 - b. to support water-related taxation issues being examined in the proposed Industry Commission Inquiry into Private Sector Infrastructure Funding; and
 - c. to accept any future consideration of tax compensation payments involving the water industry being dealt with through the Commonwealth-State Working Group established at the July 1993 financial Premiers' Conference; and
11. in relation to recommendations (3) through (8):

- a. that the Working Group on Water Resource Policy would coordinate a report to the Council for its first meeting in 1995 on progress achieved in implementing this framework including reductions in cross-subsidies, movement towards full-cost recovery pricing in urban and rural areas and the establishment of transferable water entitlements; and
- b. that as part of the monitoring and review process, ARMCANZ, ANZECC and, where appropriate, the Murray-Darling Basin Ministerial Council and the Ministerial Council for Planning, Housing and Local Government, would report annually over the succeeding four years, and again at its first meeting in 2001, to the Council of Australian Governments on progress in implementing the various initiatives and reforms covered in this strategic framework.

Appendix D

Questionnaire for Water Businesses

The Consumer Law Centre Victoria (**CLCV**) has received funding from the Consumer Utilities Advocacy Centre (**CUAC**) to undertake a research project that investigates the impacts of independent regulation of the Victorian water industry on Victorian consumers. The model of regulation involves the Essential Services Commission (**ESC**) regulating prices, service standards and market conduct for 20 water authorities providing bulk and retail water and waste water services to all of Victoria's urban and rural irrigation customers. The project will analyse the effectiveness of the ESC's regulation of the Victorian water sector and its impact on Victorian water consumers, with the aim of improving outcomes for consumers.

We would appreciate it if you could assist us by answering some questions. The questions aim to obtain information about how water businesses consult with customers. In particular, we are interested in the consultative mechanisms that are used and how they impact upon water businesses' work and outputs.

How do you consult?

- a) How does <water business> consult with its customers?

- b) Does <water business> have defined procedures and policies regarding customer consultation? Can you provide a copy of <water business>'s policies relating to customer consultation?

- c) Can you provide information about <water business>'s policies on consulting with low-income and disadvantaged customers or their representatives? Are such customer groups directly targeted in consultation methodologies?

What are your mechanisms for engaging with customers?

- a) What are your mechanisms for engaging with customers? How are you engaging with customers in the Water Plan process?

- b) If you have a customer consultative committee, how are different customer groups represented?

- c) How are customer consultative committees managed? (ie, how are they overseen, how are they reviewed?)

- d) What are your mechanisms for engaging with customers on issues related to <water business>'s impact on the environment? What do you see as <water business>'s impact on the environment?

How have your consultative mechanisms resulted in changes?

- a) How do your consultative mechanisms result in changes to <water business>'s work and outputs?

- b) How does customer consultation on the draft Water Plan impact on the development the final Water Plan provided to the Essential Services Commission?

- c) How does customer consultation impact on proposed price increases and tariff structures proposed as part of the Water Plan?

- d) How does customer consultation impact on the level of service provided by <water business>? (eg, the timeliness of complaint resolution, the offering of Guaranteed Service Level payments)?

Continuous improvement

- a) How are customer consultation processes and procedures reviewed and evaluated?

- b) What do you see as the main barriers in your organisation to effective customer consultation (eg, budgetary allowance, management involvement, guidance on consultation from the ESC)?

Thankyou for participating.

Appendix E

Community Consultation Questions

1. What is your experience with your local water business?
2. What are your experiences with negotiating with the local water business on behalf of clients?
3. What are your experiences with making complaints to EWOV on behalf of aggrieved water consumers?
4. Are you aware whether your local water business charges interest on outstanding accounts?
5. What is your experience of the local water business with respect to dealing with customers in financial difficulty? Do they commonly restrict and/or engage in legal action?
6. Have you noticed any changes in water business debts in your casework since the last price review (prices came into effect 1 July 2005)?
7. To your knowledge, does your local water business invite local consumer advocates to participate in business consultations (for example, on local customer committees, or in the ESC Water Plan process)?
8. What are your experiences of being involved in water business consultations? Do you believe that your participation resulted in any changes in the water business?
9. What resources would you require to be able to engage in effective consultation with your local water business?
10. Do you have much experience or knowledge about the economic regulation of the Victorian water industry? Do you believe that social and environmental factors should be considered in the regulation of price and service standards?