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ISO 9001 / 14001 and AS/NZS 4801*

15 September 2011

Dr Ron Ben-David
Chairperson
Essential Services Commission
Level 2
35 Spring Street
MELBOURNE VIC 3000

Dear Dr Ben-David

Tariff Issues Paper

Please find enclosed the GWMWater response to the Essential Services Commission 2011, 2013 Water Price Review – Tariff Issues Paper, July 2011.

The 2013-2018 Water Plan presents many challenges for the water industry and to have these issues identified through the consultative processes at such an early stage will assist water businesses to prepare their Water Plans.

Should you have any queries specific to the GWMWater response these should be directed in the first instance to Mark Williams, Executive Manager Business Performance and Risk.

Yours sincerely

Jeff Rigby
Managing Director



ESC Tariff Issues Paper Specific Responses to Questions Raised

Section 3 - Proposed Pricing Principles

Questions - Proposed Pricing Principles

1. Do the proposed principles adequately address the WIRO and other relevant requirements in relation to pricing matters?
2. What amendments - changes or additions - are needed to ensure the principles are clear, useful and applicable in the 2013 Water Price Review?
3. Are there any other matters that we will need to consider in applying these proposed principles?

GWMWater Response

The proposed pricing principles do adequately address the requirements of the WIRO.

The only issue that is missing is any principle that related to the scarcity of the water resource and this is particularly the case in rural systems. The principles should also acknowledge the role of excess charges in capped systems as a way of regulating excess demand / consumption.

Clearer guidance could also be provided on what constitutes upper and lower bound pricing.

Section 4 - Form of Price Control

Questions - Form of Price Control

1. What tariff innovations could be proposed for the 2013 Water Price Review period?
2. What are the implications for the form of price control?
3. How will equity implications of tariff changes be managed?
4. Are there any significant cost forecasting uncertainties for water retailers, such as demand or variable bulk supply costs? If so, what are the appropriate mechanisms for managing these risks?

GWMWater Response

During the 2008-2013 GWMWater carried significant demand risk as a consequence of the water resource position that affected the region. In recognition of this GWMWater specifically requested a tariff basket inside a revenue cap as the form of price control. This request was also based on the need to continue with the progressive implementation of the tariff rebalancing that GWMWater was undertaking.

The ESC approved a hybrid price cap that constrained our ability to set prices relative to demand. The hybrid price cap was difficult to implement and made it extremely difficult to present any information relative to demand.

GWMWater was not as adversely affected by the reduced volumetric sales as it has a relatively low proportion of its revenue exposed to variable charges by industry benchmarks. Had this not been the case GWMWater would have experienced considerable risk to its commercial viability.

In the event that there is a push to have a greater proportion of the tariff based on volumetric charges as foreshadowed in the Living Victoria policy statement, this adds greater weight to a revenue cap / tariff basket. The alternative is a submission for higher prices to compensate for the demand risk assumed by the water business.

Section 5 - Tariff Structure and Design Issues

Questions - Bulk Water Tariffs and Transfer Charges

1. Can the current headworks charging structure be improved?
2. How will the structure of bulk water tariffs be affected by the desalination plant water resource?
3. Are there net benefits in introducing locational signals into bulk water charges?
4. Should the bulk transfer price be a two-part price or is there a case for alternatives such as a pure volumetric charge?
5. What are the benefits and implications of more differentiated bulk transfer charges and what options for them may be appropriate?
6. Should Melbourne Water establish separate charges for the headwork and the desalination plant or should they remain a single bulk water resource charge?

GWMWater Response

GWMWater has acknowledged that its headworks pricing structure can be improved and this can be achieved with the conversion of bulk entitlement to reflect the post pipeline water balance. The biggest challenge relates to any differential pricing for bulk water products that carry a different level of reliability.

There should not be any locational specific price signals that are based on cost. The only locational specific price signals developed should be based on a pass through of scarcity. These principles of scarcity should be achieved by having an efficient water market and pricing policies that uncouple bulk water costs and delivery costs.

Headworks costs tend to be fixed and this is justification for not having a fully volumetric charge. A two part tariff for bulk water is considered appropriate with some flexibility in the volumetric charge to reflective the principles of scarcity and or cost of water in the event that the additional water is 'manufactured water' from a desalination plant.

Questions - Retail Tariffs

1. What are the implications of increased variability and uncertainty in bulk water costs for retail tariff structures and levels?
2. What are the efficient options for managing this uncertainty and meeting other WIRO objectives and the pricing principles?
3. Are there net benefits in reflecting differences in distribution system costs by time or location in retail tariffs?
4. Are there any factors that would support a water business's default retail water tariff not being a two-part tariff?
5. What approach should we take to innovations to default tariff offerings?
6. Are businesses in a position to be able to offer choice to water customers?
7. What constraints are there in offering a choice in water tariffs?

GWMWater Response

The most significant issue confronting water businesses of increased variability in tariffs is the predictability of demand.

There has been a significant behavioral shift by customers that has also been affected by local harvesting and conversions at the customer level. Water businesses do not have sufficiently robust data about this support a more targeted approach to demand forecasts. The risk here is that water businesses will seek prices that compensate for demand uncertainty. This risk could be overcome by having a revenue cap as the form of price control to ensure that water businesses are less exposed to volume risk.

Retail or distribution tariffs should not be differentiated on cost and certainly not based on issues of distance. Uniform prices are easier to explain to customers and should only be based on differing levels of service.

There are however defensible arguments for time and/or reasonable prices where these are accessing unused capacity and/or avoiding additional cost to upgrade the system. In the case of GWMWater some of the differential prices established relate to seasonal off peak opportunities. The rural pipeline service also has elements of avoidance of peak day demand with the specific requirement that customers receive water into storage. The challenge for water businesses in this area relates to the level of transparency it can provide to support the cost basis of these tariffs.

GWMWater has an excess charge on its rural pipeline systems that reflect the relative scarcity in the system to service customers. Customers can avoid the excess charge by acquiring additional water in the market. This demonstrates that there is some scope for innovative tariffs that have their origins some principles that have their origins in the effective and efficient regulation of the water delivery systems.

Customers should be able to select a tariff that is more appropriate for their situation and water businesses should work with customers to explore these options. Water businesses may not be in a position to implement these at the moment but should be looking for tariffs that not only provide choice but also promote efficiency. A revenue cap and tariff basket will provide greater scope for businesses to explore these options in between the current five year regulatory resets.

Questions - Sewerage and Trade Waste Tariffs

1. Does the structure of Melbourne Water's bulk sewerage charges need to be reviewed?
2. Does the structure of the Melbourne water retailers' sewage disposal charges provide the right balance between efficiency, and the ability of customers to respond, simplicity, and equity?
3. Are there any issues with regional urban water businesses' sewerage tariffs?
4. Do trade waste disposal charges provide the right balance between efficiency, and the ability of customers to respond, simplicity, and equity?

GWMWater Response

Any volumetric component in the sewerage charge for residential and commercial users is difficult to explain and therefore inherently in conflict with one of the fundamental principles of the WIRO.

Trade waste charges are an effective mechanism for promoting efficiency and ensuring that water businesses receive a waste stream that is most usable (reusable).

Questions - Recycled Water

1. Are any changes required in the approach to determining recycled water prices having regard to the experience in the last Price Review period, the proposed pricing principles, the WIRO Regulatory Principles or the NWI pricing principles for recycled water and storm water?
2. The principles developed for recycled water pricing as part of the 2008 Water Price Review remain relevant.

GWMWater Response

Where these systems are part of communal schemes there are opportunities to consider a water market with pass through of scarcity principles to encourage customers to take water in wetter seasons and better reflect its value in drier seasons.

Section 6 Customer Choice

Questions Tariffs and Customer Choice

1. Should the Commission allow water businesses to offer customers choice in tariff offerings?
2. If so, is the Commission's proposal to regulate only default tariffs supported?
3. What role should the Commission play with respect to alternative tariffs offered by water businesses?
4. If tariff choice is introduced, what aspects of consumer protection would need to be introduced or enhanced?

GWMWater Response

Water businesses should not be precluded from offering tariffs that provide customer choice.

In the event that tariffs are developed that provide greater customer choice there may need to be an adjustment to the customer code to effectively regulate. The administration against the code it is assumed would remain the domain of EWOV.