

Involving customers in the economic regulation of water: the Victorian and South Australian contexts

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The Essential Services Commission Act (Victoria) does not envisage any particular role for customers in economic regulation

- The ESC Act instructs ESC to have regard to several factors and authorises the ESC to “*regulate a prescribed price for prescribed goods and services in any manner the Commission considers appropriate*”.
- The Act does not envisage any particular role for customers in economic regulation, indeed it does not oblige the ESCV to consult with customers in setting prices, although it does not preclude consultation or customer involvement. ESC Act does however require ESCV to develop a charter of consultative practice to guide its own consultations.
- However, the Statement of Obligations (issued by the Minister for Water to the water companies) obliges the companies to consult with customers to develop their price submissions.

The Water Industry Act does not promote or preclude consumer engagement but the Order under the Act does require consumer interests to be taken into account

- Like ESC Act, Water Industry Act does not place obligation on ESCV to consult with customers. However it does not preclude customer involvement or consultation.
- Revised Water Industry Regulatory Order (WIRO) establishes a regulatory process whereby the water companies propose prices (or revenues) and the Essential Services Commission then decides whether to accept their proposals.
- WIRO has specific instructions in respect of the prices that the ESCV determines:
 - prices should be easy for customers to understand,
 - should provide signals about the efficient costs, avoid price shocks where possible and
 - take into account the interests of customers, including low income and vulnerable customers.
- WIRO also requires the ESCV to explain to the companies how it expects them to consult with customers.

ESC provides comprehensive guidance on the customer consultation it expects from water companies ...1/2

- ESCV has provided increasingly comprehensive guidance to water companies on its expectations for customer consultation. For example, in the latest review underway (Melbourne Water) ESCV suggests:
 - Melbourne Water must consult with customers during the development of its price submission but the manner in which Melbourne Water consults will be for it to determine so that it is “effective”, “fit-for-purpose” and “meaningful”.
 - Melbourne Water must consult with residential and non-residential customers on matters where they will have a particular interest. This includes waterways and drainage services and prices, and the time profile for the recovery of its desalination security payments.
 - Melbourne Water’s price submission must demonstrate that it has consulted with customers and other interested parties, and provide information on how their views have been addressed in its submission.
 - Melbourne Water’s price submission must (for each proposed service outcome), identify whether it reflects a government obligation, or a customer need (demonstrated via cost benefit analysis, evidence of customer willingness to pay, or similar).

ESC provides comprehensive guidance on the customer consultation it expects from water companies ... 2/2

- Where the proposed service outcome reflects a customer need, Melbourne Water is required to explain:
 - how consultation with customers (including retail businesses for Melbourne Water's water and sewerage services, and residential and non-residential customers for waterways and drainage services) has informed the proposed service outcomes.
 - provide evidence of customer willingness to pay for that standard of service (for example, via a willingness to pay study or similar evidence),
 - provide a description of how Melbourne Water consulted with customers, and a summary of the views received from customers, and
 - describe how views received from customers were taken into account in determining the time profile for recovering the desalination security payments.
- For price changes of more than 10 per cent for any tariff in any year, Melbourne Water is required to describe the relationship between the cost of service provision and the proposed price; explain how customers were consulted and what they said in response.

In Victoria, customer groups are constrained in their ability to participate

- Customer groups commended ESCV's increasing focus on customer engagement and the efforts made by some water companies to engage with customers. They were less complimentary about other companies likening, in some cases, consumer engagement to "gathering yes-men around the table to have a sandwich".
- Customer groups often found themselves inundated with requests to engage with water companies but often did not have the resources to respond to the invitations.
- Aggregate expenditure by consumer groups on water regulation is (we estimate) circa \$150-250K per year.
- None of the customer groups have access to technical assistance and as far as we know they have not ever commissioned legal, engineering, economic or accountancy advice in the course of their water customer advocacy work. They do not consider that they have the expertise needed to assess the companies' efficiency.
- All of the groups we spoke to said that resource constraints meant they had limited ability to critique the technical information put before them or actually engage in the technical content of issues. This meant that consultation often reduced to "tick-a-box" rather than substantive engagement.

Observations on consumer engagement aspects of relevant law in South Australia

Water Industry Act (2012)

- ESCOSA to establish Consumer Advisory Committee and to consult with CAC (at ESCoSA's discretion)
- SA Treasurer may make Pricing Order and ESCOSA must observe. Pricing Order could cover:
 - Policies or other matters ESCOSA must have regard to;
 - Parameters, principles or factors Commission must adopt;
 - Any other matter.

Essential Services Commission Act (2002)

- Primary objective of economic regulation is protection of consumers' interest;
- In making a price control decision, ESCoSA to have regard to much the same set of factors as ESCV;
- ESCoSA's draft price control decision not necessarily to be made public (at Commission's discretion);
- No specific requirement to consult with consumers in setting price control.

ESCoSA's Consumer Advisory Committee

- ESCoSA convenes a Consumer Advisory Committee to assist it in engagement and consultation;
- CAC covers broad range of consumer groups, including general consumers, business, primary production, local government, the environment and the elderly;
- CAC Members required to consult with their constituency;
- CAC members not required to reach consensus on issues or make binding group decisions or submissions; CAC is advisory, final decision-making rests with the Commission.
- Quarterly meetings; membership drawn through public advertisement; two-year appointments.
- Grants for members of the CAC to undertake research, programs and activities that will assist ESCoSA in protecting the long-term interests of South Australian consumers of essential services.
- Publication of any research pursuant to these grants, at ESCoSA's discretion.

Ideas to strengthen customer engagement (in Victoria):

1. Customer Advocates' Advice Centre

- If customers are to be more seriously engaged in the development of economic regulation they will need to be appropriately resourced.
- Consideration might also be given to the establishment of a “customer advocate advisory centre” to strengthen the technical assistance available to customer advocates.
 - Small permanent staff; responsible for compiling and publishing information that customer advocates are likely to find useful. This could include information on prices, tariffs, regulated revenues, water company expenditure, industry profits, regulated asset values, quality of supply and service information. The centre might also be able to provide or procure research on relevant regulatory issues.
 - Focussed only on providing technical assistance rather than itself representing customer interests to companies, regulators and other parties.
- Funding for such an advisory centre – and indeed funding to strengthen the customer groups themselves – may come from the ESCoSA, the industry via a levy or from Government or perhaps some combination of all three.

Ideas to strengthen customer engagement: 2. Would a Consumer Challenge Panel be useful?

- Australian Energy Regulator's CCP has two duties:
 1. To act as a "critical friend" to the AER, based on the Panel's view of customers' interests;
 2. To advise the AER on its view of how the companies have consulted with customers.
- CCPs were used by Ofwat and Ofgem.
- Not obvious to us that a challenge panel would be helpful: perhaps preferable for customer groups to engage directly with the ESC about how they feel that they have been consulted and about the extent to which companies responded to their concerns, than for this to be filtered through another advisory body.

Ideas to strengthen customer engagement (in Victoria):

3. Greater interaction between ESCV and customer groups

1. ESCV's approach, similar to Australian Energy Regulator's, is to provide guidelines on how companies should interact with customer groups, and leave the companies to it.
2. Experience of this approach in energy regulation in Australia is not encouraging: consumer groups recognise greater efforts that some companies have made, but most seem to feel that customer engagement has not been meaningful.
3. Conversely in GB, customers seemed to support the water and energy companies' business plans but the regulators rejected the plans.
4. Deeper interaction between ESC and customer groups may help to ensure that each can communicate to the other what they consider to be important.

Ideas to strengthen customer engagement (In Victoria):

4. Provide incentives for companies to obtain their customers' support

- Both Ofwat and Ofgem offered prospect of “fast tracking” some companies through regulatory process if customers supported the company’s proposals. A few companies were fast-tracked and although customer engagement was a factor in this, it does not seem to have been the main factor;
- Since advantageous terms promised to the fast-tracked companies would in fact be paid for by their customers some questioned whether the outcomes were entirely in the interests of customers.
- Incentive to engage are likely to result in greater effort to secure customer support. But if the customer groups are not adequately equipped to drive a suitably hard bargain, then such incentives may not be in customers’ interests.

Ideas to strengthen customer engagement:

5. Direct negotiation: many possibilities

Nature of the negotiation	Scope of the negotiation	Role of regulator
Informal negotiation	Small number of specific items	Full detailed review in parallel
Formal negotiation	Parts of the plan	Review of remaining parts of plan
Structured process with formal agreement	Whole plan with exceptions on efficiency and WACC	Review of efficiency and WACC only
Negotiated settlement with contract	Whole plan	Only intervene if negotiations fail

Source: Frontier Economics, July 2015. *The potential for direct negotiations for price setting in the water sector in England and Wales.* A report prepared for Wessex Water, July 2015.

Ideas to strengthen customer engagement:

5. Direct negotiation: Issues for consideration

- **Scope of the matters to be negotiated:** May be advantageous to start with limited scope for settlement – say service targets, tariff structures, major projects (or aspects thereof). Given inexperience and possible reservations by companies, customer groups & regulator, narrowing the scope of negotiation may enhance the prospect of agreement between companies and customer groups.
- **Process:** ESCoSA would need to take the lead in establishing process but important that ESCoSA consults with the parties to the negotiation in developing process to be followed.
- **Customer representation:**
 - How is the range of customer interests to be represented or taken into account and how will different customer representatives will be coordinated and decisions made?
 - Arrangements for the legal form of the customer entity, membership, responsibilities, voting rights and so on would need to be established.
 - The Scottish Water Forum, with an independent chairman and the members appointed jointly by the regulator, the company and the main customer body, with a specified remit and process, provides one model that might be studied further.

Ideas to strengthen customer engagement:

5. Direct negotiation: Issues for consideration

- **Equipping customers:**
 - Customer groups suggested to us that they were reticent about settlements since they did not feel sufficiently skilled or adequately resourced to negotiate with the water companies.
 - Resources will be needed to fund the operation of a customer forum and in ensuring technical assistance to the forum so that it can feel able to hold its ground in negotiation.
 - ESCoSA staff may provide some of this technical assistance? Notwithstanding support from the ESCoSA, customer groups may also wish to have access to technical assistance that they are able to direct.
 - Part of the process may involve deliberative forums, juries, willingness to pay studies and similar approaches that would involve engagement with customers and not just customer representative groups.

Ideas to strengthen customer engagement:

5. Direct negotiation: Issues for consideration

The regulator's role

- Settlements in Scotland, Ontario, Florida, Alberta and federally in the United States points to the role to be played by regulators in setting up the arrangements, structuring and managing processes and providing customers with technical assistance. To implement negotiated settlements in South Australia, we would expect ESCoSA would take the lead in:
 - Facilitating establishment of a customer forum;
 - Establishing scope & process for negotiation;
 - Ensuring customer participation is funded;
 - Providing technical assistance (or ensuring its provision by others) to customer forum;
 - Explaining how it would treat settlements presented to it (and what it would do if settlement is not achieved).