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Mr Graham Evans AO
Chair
Retail Water Sector
Victorian Competition and
Efficiency Commission
GPO Box 4379
Melbourne 3002

Dear Mr Evans

This submission is put forward by the Consumer Utilities Advocacy Centre Ltd (**CUAC**) and the Consumer Action Law Centre (**Consumer Action**) in response to the issues paper released by the Victorian Competition and Efficiency Commission and its inquiry into the reform of the metropolitan retail water sector.

The Victorian Council of Social Service (**VCOSS**) supports the views put forward in this submission.

CUAC is an independent consumer advocacy organisation which ensures the interests of Victorian electricity, gas and water consumers - especially low-income, disadvantaged, rural and regional and Indigenous consumers - are effectively represented in the policy and regulatory debate.

Consumer Action is a campaign-focused consumer advocacy, litigation and policy organisation. Consumer Action pursues a law reform agenda across a range of important consumer issues at a governmental level, in the media, and throughout the community and is dedicated to advancing the interests of low-income and vulnerable consumers.

We welcome the opportunity to provide comment to the Victorian Competition and Efficiency Commission inquiry. We support regular reviews of essential service delivery arrangements to ensure that they are being delivered in an efficient manner, which is least cost to consumers.

Access to water is an essential human right. It is also an integral part of the rural and regional economy and vital to the health of the environment. The long-term environmental, social and economic sustainability of this sector has therefore rightly become a high priority for Australian governments.

Our organisations have therefore welcomed the Government’s focus on consumers’ longer term interests in the White Paper and policy reform. We would be concerned at any move that weakens the focus on social and environmental outcomes.

As such, this Inquiry must not be the vehicle to consider privatisation of the metropolitan water retailers – any privatisation of the industry should only occur after full and open public debate. In any case, as outlined below, we would not support privatisation and believe the Victorian Government should remain responsible and accountable for the delivery of water services to Victorian consumers. Our more detailed comments are outlined below.

This submission focuses particularly on the interests of low-income and rural households. It addresses the key matters and issues for consumers raised by the Victorian Competition and Efficiency Commission Issues Paper.

Assessment of Industry Structure

This section highlights some of the key components within the current structure that we believe benefit end-users and should therefore be continued within a restructured metropolitan water sector model. These important elements include the facilitation of competition by comparison, the provision of hardship assistance packages, customer consultation, and performance reporting arrangements.

Competition by Comparison

We are of the view that competition by comparison has contributed to service improvements among the metropolitan water businesses. We believe that the competition by comparison component of the current retail structure has served as an impetus for service improvements and innovation. Although it would be impossible to prove a causal link between competition by comparison and recent initiatives and improvements by the water businesses, we know that the comparative information enables stakeholders to identify and compel underperforming businesses to make improvements. Without performance benchmarks, it would be near impossible to compel monopoly businesses to improve their service standards.

Assistance for Customers Experiencing Financial Hardship

In comparison with the regional water businesses, the Melbourne metropolitan water retailers, particularly Yarra Valley Water, have developed sophisticated consultation models and assistance programs for customers experiencing financial hardship. A range of initiatives have been developed, including flexible billing arrangements and the promotion of water efficiency measures (for example, through the Smart Homes Program). We recommend that a restructured metropolitan water sector model encourage and facilitate water businesses to continue to develop these types of initiatives. Hardship assistance programs play a vital role in ensuring that low-income and vulnerable consumers maintain access to supply.

The Committee for Melbourne has facilitated a large project involving the energy and water industry, government, regulators and consumer representatives to identify and examine potential means of ameliorating utility related hardship. The project concluded with the release of a set of guiding principles that utilities should use to support customers experiencing financial hardship¹. The project participants, including the metropolitan water businesses, agreed on four key principles that should be applied to hardship responses:

- Information provision – ensuring that information about the hardship policies is transparent and accessible.

¹ Committee for Melbourne, *Supporting Utility Customers Experiencing Financial Hardship – Guiding Principles*, The Utility Debt Spiral Prevention Project (April 2007)

- Operating protocols and engagement – ensuring that customers are treated with respect and that industry engages with external stakeholders.
- Comprehensive staff training – ensuring both extensive and ongoing staff training.
- An energy/water efficiency focus – promoting efficient usage as a way of reducing costs.

The metropolitan water businesses, and Yarra Valley Water in particular, were keen promoters of these principles as they had experienced the positive impact such policies have on their business practices.

Consultation

Customer consultative committees and other formalised liaisons between the water companies and stakeholders serve as effective and ongoing mechanisms to ensure continuous improvement to the water businesses service delivery.

In a study undertaken by the Consumer Action into water reform in Victoria and outcomes for consumers², it was found that the nature and content of customer consultation varies considerably among water businesses. The study noted that many water businesses were unclear about how consultation was undertaken with low income and disadvantaged consumers and their representatives. This is an important aspect of effective consultation models as low-income and disadvantaged consumers are likely to have special needs in relation to water and wastewater services. The study found that:³

“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”.

It has also been our experience that price reviews have been conducted without adequate customer consultation. As argued in the Consumer Action research report:⁴

“[I]t 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”.

We strongly believe that guidance should be provided to water businesses in developing consultative mechanisms that offer informed and representative input. Effective consultation with low-income and vulnerable consumers and their representatives is not only integral to improved affordability and access (through hardship programs), but is also a vital element to the development of price-service proposals.

Performance Reporting, Auditing and Accountability

Transparency and public reporting contribute to informed consumer advocacy, which in turn enhances the regulator’s decision-making processes. Robust performance reporting and regulatory audits are crucial to tools to detect and highlight service deficiencies.

We strongly believe that, under a restructured metropolitan water sector, water authorities should be required to report on a range of indicators to:

- demonstrate compliance with Customer Service Codes and other regulatory requirements;
- enable performance assessments of hardship policies and programs; and
- ability to meet environmental objectives.

² Consumer Action Law Centre, *Water Reform in Victoria – Independent Pricing Regulation and its Outcomes for Consumers*, (March 2007), p. 58. Available at <http://www.consumeraction.org.au/publications/policy-reports.php>

³ *Ibid*, p. 58.

⁴ *Ibid*, p. 64.

Comprehensive, and regularly reviewed, performance indicators are essential to detect and address systemic issues and to assess regulatory compliance.

Framework for Comparing Different Structures

We appreciate the Commission’s proposal to compare different structures and relative merits of available options using clearly articulated criteria.

To adequately assess different industry structures, we believe that the Commission should acknowledge that the water sector is largely a natural monopoly. A monopoly is a sector where more than one firm in the industry would mean wasteful duplication of costly capital facilities. Such an acknowledgment leads to the conclusion that increasing competition into the water industry involves tradeoffs – on the one, productive efficiencies can result from economies of scale provided by monopoly service provision; while on the other, dynamic and productive efficiency gains may be achieved through increased competition. The criteria to compare different structures, therefore, will be key to resolving tradeoffs between choosing between different industry structures.

Recognising this, we support the inclusion of all the suggested indicators to develop a relevant and appropriate framework for the water industry. Nevertheless, we feel that three of these criteria should receive prominence and remain integral to any preferred structural solution. The criteria we prioritise below are integral to ensure the structure will advance the public interest.

First, we recommend that the Commission prioritise improvements in service outcomes as an additional and important indicator. In our view, regulatory processes should encourage businesses to improve service outcomes for consumers. In the first price review, the Essential Services Commission (ESC) developed service standards relating to levels of consumer complaints as well as customer service. We believe these could be extended to include social and environmental obligations of water retailers. Setting out clear service standards in the context of a price determination encourages the businesses to achieve those outcomes and improve services for consumers. We believe that any proposed structure for the Victorian water industry should enable regulatory processes to incentives improved service outcomes for the benefit of consumers.

Second, fairness and equity of pricing outcomes must be another key consideration. This criterion is particularly important in relation to the provision of water services to low-income or other disadvantaged consumers. Consumers are often made vulnerable due to an intersection of various factors, including: inadequate income; inefficient appliances and poor quality housing; household types and personal circumstances and external factors such as tariff structures and geographical factors. Considering this, the Commission must necessarily be conscious of the specific issues by which low-income and vulnerable consumers are affected.

As previously stated, water is a basic human right, comprising a right to accessing clean water at an affordable price in order to meet basic human needs. As such, it is necessary to consider what would be required to ensure that Victorian consumers are able to enjoy this right.

As discussed in the *Water: Access, Affordability and Sustainability Report*⁵ there are a range of issues that may arise if water is unaffordable. The report highlights that some consumers who cannot afford to pay their utility bills (including gas, electricity and water) divert spending from other essential expenses, including food, rental payments, clothing or school fees. It draws attention to possible increases in debt, either through the household accumulating debts to a water business or accessing credit (often at a high cost) from other sources to pay a bill. Other outcomes noted in the same report include financial stress, which leads to rationing usage of water to a level that is lower than is required to preserve adequate standards of health and sanitation. In our view, a truly affordable water supply is one in which consumers not only maintain an unrestricted

⁵ Consumer Law Centre Victoria and Environment Victoria, ‘*Water : Access, Affordability and Sustainability – Issues Paper*’, (2003) p21.

connection to a water service but do not need to reduce their spending on other essential goods and services, limit their usage below the level of an essential water supply or service large amounts of debt in order to remain connected to an unrestricted supply.

Finally, we urge the Commission to place a high priority on environmental outcomes. We maintain that it is essential to protect our catchments and ensure that the structural works proposed in the Government's *'Our Water Our Future: The Next Stage of the Government's Water Plan'* do not gravely impact upon the environment. However, we also believe that environmental outcomes should include consideration of sustainability more broadly, including consideration about how reform will contribute to inter-generational equity, in terms of water conservation and the expected costs relative to this contribution. There is a subtle difference between this and environmental outcomes, which aim primarily to ensure that the way that the service is undertaken is not detrimental to the environment. For example, a model may produce positive environmental outcomes (e.g. a reduction in pollution levels) but fail to contribute to the water demand/supply imbalance.

Alternative Structures

A key concern to us in relation to a potential restructuring of the water sector is that any new structure must be aligned with the broader public policy objectives and ensure that basic principles are retained to protect and promote consumer interests. Broadly speaking, these principles can be categorised under access to supply, quality of supply and governance.

Access to supply

Any new model must ensure that consumers have access to affordable water services. Water pricing is the key to ensure consumers can afford the water supply they require, while government concessions and hardship policies are secondary. For that reason water prices can not be deregulated for domestic users. Water services are too essential to households to allow for price setting to occur outside the regulatory domain.

In addition to pricing, fair and reasonable contractual terms and conditions promote consumer access and affordability. Regulatory tools, such as Customer Service Codes, ensure that customers' rights and responsibilities are clear and that *both* customers and suppliers interests have been looked after. Without such sector specific regulation, water suppliers may develop contractual terms and conditions (i.e. in terms of billing arrangements) that decrease consumers' ability to pay (i.e. by being forced on shortened collection cycles).

Furthermore, provision of hardship assistance is crucial for those customers who are unable to pay for their water consumption despite price regulation and Customer Service Codes. Due to the detrimental impact of water supply restrictions on households, hardship policies must be retained and kept under regulatory oversight.

Finally, arrangements to solve disputes between businesses and their customers must be in place. We view the service provided by external dispute resolution schemes such as the Energy and Water Ombudsman Victoria (EWOV) as an essential component of an industry structure designed to protect and promote consumer interests. In addition to an external dispute resolution scheme the regulatory arrangements should ensure that water businesses have adequate internal dispute resolution mechanisms in place. We believe it is in both the customers and industry's interest to ensure that disputes are adequately and efficiently dealt with – and the more businesses are able to solve disputes internally the better service they are providing their customers.

Quality of Supply

It goes without saying that a key imperative for any water industry structure is to ensure that the quality of the water supply meets public health standards. It is important that the design of the regulatory framework ensures that the monitoring and maintenance of the water quality is not jeopardised by competing demands. Stringent regulation and possible license requirements are usually regarded as possible barriers to market entry. However public health and environmental issues in relation to the water supply must always override potentially sub-optimal market design solutions.

Governance

Key governance issues for any retail water sector model include the appointment of an independent economic regulator. Price setting and service levels should always be determined by an independent regulator mandated to conduct reviews in a transparent and accountable manner. These regulatory functions must continue to be independent from the government of the day.

In addition to determining price and service levels, an independent regulator must have the mandate to undertake market performance reviews. Key features of performance monitoring have been outlined above and include aspects such as compliance with regulatory arrangements (i.e. codes and mandatory schemes) and the businesses' service delivery performance (in comparison to reliability targets) and provision of hardship assistance. Furthermore, we recommend that a Guaranteed Service Level Scheme is in place to drive performance as well as compensating consumers experiencing poor service levels.

Apportionment of costs

We welcome and support the inquiry's focus on fair and equitable apportionment of costs. As stated above, access to affordable water services is a basic human right, and all future and current consumers should equitably bear the responsibility for delivering that service. We are concerned, nonetheless, that principles used by Governments to apportion costs across society have disadvantaged a significant number of consumers.

In 2004, building upon a 1994 Council of Australian Governments (COAG) agreement on Water, Australian Governments including the Victorian Government agreed to the National Water Initiative (NWI). These agreements set up a framework for how costs should be apportioned across water consumers. The NWI promoted 'best practice water pricing', to promote economically efficient and sustainable use of water resources and infrastructure assets. The NWI states that best practice water pricing includes enabling businesses to achieve full cost recovery, with prices set on a consumption basis and cost reflective. We are concerned that the way these principles have operated has meant that there has not been fair and equitable apportionment of costs. We are particularly concerned about how these principles impact upon the interests of households, especially larger sized households and low income and disadvantaged consumer groups.

We agree that user pays pricing principles can promote economic efficiency and the sustainable use of water resources. However, such principles do not adequately consider the fair and equitable distribution of costs among customers. For example, the National Water Commission (NWC) is developing guidelines to facilitate consistent approaches to urban water pricing. These guidelines appear to be focused on consumption based pricing and advocates a view that full cost pricing would ensure prices reflect different costs in providing water to different areas.

Additionally, the NWC has previously noted its opposition to cross-subsidies. This includes any cross-subsidies to address affordability of access to water for essential purposes, on the basis that cross-subsidies are inconsistent with effective and efficient service provision. The NWC suggests 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.

We believe that the primary focus to any method of cost apportionment should be the achievement of equity across all current and future consumers. Price increases in essential water and waste water services impact on entire communities. As such, price distribution should not be associated with geographic proximity or accessibility, instead horizontal equity should apply. Achieving equity and accessibility should be the Government's focus, and in achieving this, appropriate tariff structures and concession frameworks need to be strengthened. New ways to ensure delivery of basic service to low income and other vulnerable consumers must be explored as a priority.

We recognise that current tariff structures and concession frameworks can help manage the distributional impacts of cost recovery principles. We need to highlight certain issues that have not been addressed through the current model of cost recovery. These issues include:

- Intergenerational equity implications from current users paying for underinvestment and sub-optimal resource management from past generations;
- That user pays principles create a one dimensional approach to asset cost recovery mechanism available from public investment in infrastructure. Namely, freeing up discretionary income (as infrastructure costs are absorbed in public investment and not recovered through price increases) for alternative goods and services spending, creating flow public revenue and benefits to other sectors of the economy and government.
- That increasing charges on users already constraining consumption creates contradictory signals - essentially punishing users for exhibiting the 'correct' behaviour.
- The inefficiency and negative impact that price increases have on administering and delivering concession frameworks, as opposed to using public money collected through existing (presumably) efficient tax channels. Essentially the concession framework becomes a duplication of revenue reallocation that should already occur through the tax system.

It is our view that the Commission should take into account these considerations when exploring the best ways of apportioning costs of water service delivery and infrastructure.

Governance Arrangements

As stated above, we support regular reviews of essential service delivery arrangements to ensure that they are being delivered in an efficient manner, which is least cost to consumers.

Despite this, the width of this review is unclear. The issues paper states that the Commission intends to review the structure of the three water retailers and not the wholesaler, Melbourne Water. It is unclear whether and how the Commission intends to form a strategy for improving water service delivery arrangements by reviewing only part of Melbourne's water industry, especially when most of the supply related cost pressures are related to the wholesale supply of water (in particular, the Government's plan to build a desalination plant). While there may be some administrative savings by amalgamating the three water retailers, we are yet to see any evidence that such savings will go even part way to offset cost increases by the proposed supply augmentation.

As outlined earlier, we feel that the current structure of retailers, by encouraging competition by comparison, has improved decision making in the water businesses and been complementary to the efficient functioning of the water industry.

Ownership and Accountability

We continue to support the fact that, in Victoria, government delivery of water services is constitutionally protected. The existing ownership structure of Melbourne’s water retailers ensures government responsibility for the delivery of water services, which in turn ensures government accountability for the provision of the service to all consumers.

Accountability in its traditional meaning reflects the public nature of ownership, control and provision of essential services. According to a recent research report by Monash University, accountability has been at the heart of modern democratic processes, and has been a core criterion of the social contract binding governments and citizens together. It notes that as far as consumers are concerned, the existence of accountability in the provision of essential services has been important from two perspectives:

- it is crucial for governments to be held accountable for their policy decisions and actions relating to the provision of essential services, especially in terms of price and availability; and
- more recently, consumers have also put a high priority on service providers being accountable to individual customers, especially those who are most vulnerable to changes in the market.

In recent times there have been changes to the nature of accountability. As with the Victorian water industry, Governments have corporatised essential service entities that then operate in an environment not too dissimilar to that of privatisation, but under government ownership. These corporations have had to balance two competing goals: maximising profits, and protecting the public interest. Brown argues that corporatisation is therefore underpinned by the notion that a publicly owned corporation can function with autonomy. Brown suggests that while this in theory ‘requires independence from traditional Ministerial or ‘political’ lines of control’, the reality is slightly more complex⁶. A popular reason for corporatisation is to break the direct ministerial control in order to increase efficiency.

We continue to strongly support ministerial accountability in relation to the Victorian water industry. Whatever structure is proposed, Victorian consumers will continue to expect a certain level of service delivery from the Victorian Government.

Apart from being accountable, we feel that any discussion on governance structures, or changes to the existing service model, needs to bear in mind public interest outcomes. We note that the federal and state government policies have shown a persistent interest in privatisation of water supply and services.

We believe that this is not the appropriate process to privatise the Victorian water industry. Any further marketisation of the industry should take into consideration all social, environmental and economic implications of doing so while involving active community consultation.

Government obligations on water businesses

The Statements of Obligations issued by the Minister for Water are focused on increasing efficiency and effective water resource management. We are supportive of the obligations placed upon water businesses in the statements and consider them necessary guidance for the appropriate management of the water retailers. For example, the statements place an obligation to establish and maintain community engagement committees to consult with the community and other stakeholders on a regular basis. We view community consultation, if conducted appropriately, can provide water businesses with better guidance for future decision-making.

⁶ Brown, A.J. (2003), ‘Halfway House or Revolving Door? Corporatisation and Political Cycles in Western Democracy’, in Michael J. Whincop (ed.), *From Bureaucracy to Business Enterprise – Legal and Policy Issues in the Transformation of Government Services*, Aldershot: Ashgate, pp. 9-25

Nonetheless, we feel that some of the obligations are too broad, and do not give sufficient guidance from Government. For example, the statements provide that water retailers were to prepare supply-demand strategies to develop the best mix for demand measures and supply options for urban water systems. While we support such strategies, they should be developed in close collaboration with Government and other policies that impact on essential service delivery.

This is particularly true in relation to demand side measures – we believe that the Government should ensure that all consumers should have access to conservation assistance. Some policies and programs designed to reduce water demand are inappropriate for tenanted households, or require upfront investment (even with rebate), that is prohibitive for many low-income households. We would like the Commission to recommend more specific guidance on some elements mentioned in the statements of obligation.

Obligations on water businesses in relation to setting prices

We continue to believe that the ESC is guided by contradicting principles when it is required to assess and set water prices. For example, the ESC is required to abide by government policy that directs:

- a. water businesses to recover the cost of providing water services (full cost recovery);
- b. the promotion of sustainable water use and conservation of water as a scarce resource; and
- c. consideration of price impacts on low-income and vulnerable consumers.

We support all these goals, but note that their implementation requires significant trade-offs. Achieving this is complex, and requires a holistic view of the social, environmental and economic implications of water service delivery.

We continue to be concerned that the ESC focuses primarily on economic, rather than social or environmental outcomes. For example, in its first review of water prices, the ESC did not appropriately assess how water prices impact on consumers. It stated:

“While the commission recognises that increasing water charges may nevertheless impact on customers who are experiencing 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 is an inefficient measure for addressing welfare objectives and is inconsistent with efficiency and sustainability objectives.”

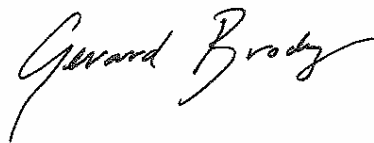
This statement indicates that the ESC places more importance on principles of efficiency and sustainability, rather than it does on affordability, despite it being required to assess all of them.

If you wish to discuss any matters raised in this submission, please contact either James Henshall, Consumer Utilities Advocacy Centre (03) 9639 7600 or Gerard Brody, Consumer Action Law Centre on telephone (03) 9670 5088.

Yours sincerely



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