

Customer engagement on prices for monopoly services

Research — Final Report
August 2012

No longer
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1 Executive summary

The Independent Pricing and Regulatory Tribunal of NSW (IPART) has recently reviewed the role of customer engagement in setting prices for monopoly services. In particular, we considered how we and the businesses we regulate can more effectively involve customers in price review processes to achieve better regulatory outcomes.¹ This report explains the key findings of the customer engagement review, and the decisions we have made as a result of it.

1.1 Overview of findings and decisions

While the scope of our consultations, research and analysis for the customer engagement review was broad, we found that the range of actions we can feasibly take to improve customer engagement and regulatory outcomes is quite narrow. This is largely due to the various legislation and terms of reference under which we make our pricing decisions. We concluded that the most feasible and effective approach is to provide a framework that:

- ▼ clarifies our expectations of regulated businesses in relation to customer engagement, and our undertakings on how we will engage with stakeholders for price reviews
- ▼ applies to the monopoly water businesses we price regulate only²
- ▼ focuses on these water businesses' proposals in relation to discretionary operating and capital expenditure and changes in price structure.

Many of the water businesses have well established, and we consider, good practice customer engagement programs.³ A number of the decisions of this report have been adopted by IPART previously⁴ and already implemented by a number of water businesses.⁵ As such, this document consolidates the outcomes of our customer engagement review and further clarifies our expectations.

¹ Throughout this report the term 'customers' includes households and, commercial and industrial, businesses.

² Water businesses we undertake price reviews for, and our decisions in this report apply to, include Sydney Water, Hunter Water, Gosford City Council, Wyong Shire Council, Essential Energy, Sydney Catchment Authority, State Water, and the Water Administration Ministerial Corporation.

³ Good practice customer engagement is discussed in Box 4.2.

⁴ IPART, *Guidelines for Water Agency Pricing Submissions – Guidelines*, April 2011.

⁵ See for example, Sydney Catchment Authority, *Submission to the Independent Pricing and Regulatory Tribunal – Review of the Operating License and Prices for the Sydney Catchment Authority 2011*, September 2011, p 62; CEPA, *Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay, A report for IPART*, June 2011, p 32 (State Water) and p 124 (Hunter Water).

Following the release of the Discussion Paper and stakeholder meetings, we reached the view that it is not practical for the framework to apply to our limited responsibilities in the regulation of retail energy suppliers' prices or the pricing of transport services. Separately, we undertake price reviews for local councils, however separate guidelines set out specific customer engagement requirements which we must consider in making pricing decisions.⁶

It is not reasonable for the framework to focus on assessment of any of the industry sectors' businesses' proposals for mandatory expenditure. This expenditure is necessary to meet either the businesses' legislative or regulatory obligations or a government directive. (Chapter 4 provides more information on the distinction between discretionary and mandatory expenditure.)

1.1.1 IPART's expectations of regulated water businesses in relation to customer engagement for price reviews

We consider that customer engagement can provide regulated businesses with valuable information about what service levels and service offerings their customers prefer, which they may not otherwise obtain due to the absence of competitive pressure. Therefore, it is good practice for such businesses to use customer engagement to inform the development of their pricing proposals to the regulator - particularly, their proposals on discretionary operating and capital expenditure (which can affect their discretionary service levels), and to a lesser extent, their proposals on changes to their price structure (which can affect their service offerings).

We restate our established position that the water businesses should be encouraged to accompany discretionary expenditure proposals with evidence of the customer engagement they have undertaken. Our views on the assessment of discretionary expenditure were most recently articulated in the April 2011 *Guidelines for Water Agency Pricing Submissions*. We also encourage water businesses to accompany their price structure proposals with customer engagement evidence. Most of the water businesses have well established customer engagement programs in place, as well as access to extensive consumer research. As such, we reached the view that most water businesses will be able to provide this evidence at a relatively low additional cost.

⁶ Division of Local Government, Department of Premier and Cabinet, *Guidelines for the provision of an application for a special variation to general income in 2012/13*, September 2011.

Accordingly, subject to the applicable legislation (eg, the *Independent Pricing and Regulatory Tribunal Act 1992* (IPART Act), and/or the terms of reference for the review) we may choose to include customer engagement as one of the matters we have regard to in determining water businesses' prices in future reviews. We have established a framework for customer engagement on prices reviews which comprises the decisions and undertakings below. Thus, we have made the following **decisions** to clarify our expectations of these businesses in relation to customer engagement:

- 1 Regulated water businesses are encouraged to provide evidence of the customer engagement they have undertaken in relation to their proposed discretionary expenditure. 15
- 2 Regulated water businesses are encouraged to provide evidence of the customer engagement they have undertaken on proposed changes to price structure. 15
- 3 Regulated water businesses are encouraged to undertake good practice customer engagement, as discussed in Box 4.2. 16
- 4 Regulated water businesses are encouraged to engage with their customers for price reviews early (that is, prior to submitting a price proposal). 18
- 5 Regulated water businesses must provide, along with their price proposal, a separate, short, plain English summary of their proposal that contains a clear statement of its customer impacts. 19

1.1.2 Clarifying how we will engage with stakeholders for price reviews

We found that the way regulators interact with their various stakeholders, including customers and customer representatives, is important to improve these stakeholders' capacity to participate in price reviews. Therefore, we have made the following **undertakings** on how we will engage with stakeholders in price reviews:

- 6 We will provide guidance to the regulated water businesses before the price review process begins to help them understand our expectations for customer engagement as it relates to our price review processes. 20
- 7 We will use our annual stakeholder workshops to assist stakeholders to build their capacity to participate effectively in price reviews. 21
- 8 We will upgrade our online submissions facility. We will expand our suite of communication channels with customers and the community. 23

We consider that this framework for customer engagement will continue to improve and target engagement processes, which will have a positive impact on our pricing decisions and may streamline the price review processes. It will allow us to make better informed decisions and also provides further clarification to the water businesses about how we assess discretionary expenditure and price structure.

1.2 Implementing the framework

As indicated above, we have clarified our customer engagement framework which sets out our decisions and undertakings. Our approach is not prescriptive. IPART in early 2011 adopted, and a number of the regulated water businesses have already implemented a number of the elements of this framework, as indicated above.

The relevance and application of these decisions to individual water price reviews will vary. We recognise that many water businesses have well established customer engagement programs and that in recent years businesses have sought to integrate these programs in the design and presentation of their pricing proposals. However, some room for future improvement remains.

We wish to work with the water businesses and other stakeholders to improve the link between the businesses' customer engagement programs and future price reviews.

We will continue work with the businesses before a price review begins. We will continue to encourage them to incorporate existing customer engagement information in their pricing proposals, and integrate customer engagement on proposed discretionary expenditure and changes to price structure in their existing consultation processes. We will also improve our own processes and communications strategy - including, for example, upgrading our online submissions facility to assist customers to participate more effectively in our price review process.

However, depending on the nature of each business' current engagement program implementing the framework may involve costs for both the water business and us - and cost will be a practical constraint on what will be feasible. In making our decisions and undertakings, we have aimed to ensure that they do not involve excessive costs or extend the time taken for price reviews. The decisions allow regulated businesses the flexibility to engage with customers in a manner that is proportionate to:

- ▼ the size of the business and the materiality of the customer impacts
- ▼ the type and number of the customers affected
- ▼ the relevance of the issues to the business.

1.3 Structure of this paper

The remainder of this report discusses the customer engagement review, and our framework in more detail:

- ▼ Chapter 2 provides the context for the review, including our rationale and approach for undertaking it
- ▼ Chapter 3 summarises the key points made by stakeholders in submissions to the Discussion Paper
- ▼ Chapter 4 explains our framework which comprises our final decisions and undertakings, and our considerations in making these decisions and undertakings
- ▼ Chapter 5 discusses the implications of our final decisions for future water price reviews and for IPART.

2 Our rationale and approach to the review

The following sections explain our rationale for undertaking the customer engagement review, and our approach to it.

2.1 Rationale

In a competitive market, customers can choose their supplier. This direct interaction between suppliers and customers gives businesses information for decisions about capital investments and the level of service that customers require. Monopoly businesses are often seen to be less driven by customer preferences due to the absence of competitive pressure.

An underlying problem for regulation is the information problem. That is, a regulator may not know as well as a service provider the relevant costs of the services provided, or the options for alternative service offerings. Similarly, the regulator does not know the preferences of customers as well as the customers do.

In a competitive market relevant cost and customer preference information is disclosed through the market. In a monopoly, a diverse group of customers may face a single supplier, and a limited number of common service offerings. In the textbook model, such a monopoly may, in theory, be tempted to over-price, under-supply, and offer the price/quality mix most convenient to it rather than the customers. In practice where a monopoly supplier faces a single or limited number of well-informed customers these problems may in some cases be resolved through negotiated contracts (eg, unregulated gas transmission pipelines with dominant users). This highlights the importance of negotiation and contracting costs. Where there are many customers these costs may limit the ability of customers to negotiate effectively.

This offers a different perspective on the role of the regulator. The regulator might be able to stand back and help the parties to negotiate agreements as would occur in a competitive market. Should this not be feasible a regulator could step in and to, the extent required, support an outcome that would occur in a competitive market.⁷

We understand that some important elements of an agreement between a regulated business and its customers are already written through mandatory requirements. Our focus is on the discretionary aspects of the price/service offering, since in a competitive market consumers are active participants.

The customer engagement review seeks to enhance the link between customer preferences and discretionary expenditure proposals for regulated businesses, which would likely occur in the absence of a monopoly service provider. The linking of customer preferences to discretionary expenditure is important when establishing the efficiency of proposed expenditure, and considering whether proposed expenditure is efficient is an important consideration for an economic regulator. Expenditure can be inefficient even if it is undertaken at low cost, if it cannot be established that consumers value the benefits obtained beyond the cost of the proposed discretionary expenditure.

Similarly, in a competitive market environment, a business is likely to have regard to its customers' views on the price structure of the products/services provided. Should a major restructuring of prices occur, it is likely that a business would undertake some kind of market research to test customers' acceptance of the change. In this context, we consider that it would benefit the regulated business to understand its customers' preferences, and we encourage regulated businesses to seek customers' views.

Successful engagement with customers before and during a price review can help customers better understand why and how they are charged for essential services and how they can have a say in determining future prices.

The increasing complexity of price submissions limits the ability of customers to engage in the process. Further, we may need to consider how the approaches used to communicate price review issues can be more effective. Our decisions and undertakings seek to improve the outcomes of our price reviews for customers by linking customer preferences to proposed discretionary expenditure through targeted, effective customer engagement.

The customer engagement review complements an increasing focus on customer service/engagement in the public sector. This focus is evidenced by the creation Customer Service Commissioner for the public sector.⁸

⁷ Biggar, D., *Public utility regulation in Australia: Where have we got to? Where should we be going?* ACCC/AER Working Paper Series, Working Paper No.4, July 2011, forward.

⁸ <http://www.nsw.gov.au/news/service-nsw-new-government-one-stop-shops-cut-queues-save-time>

2.2 Approach

We commenced the customer engagement review by engaging Cambridge Economics Policy Associates (CEPA) to review how other regulators and regulated businesses around the world approach customer engagement. We released CEPA's report on our website in July 2011.⁹ We held 4 workshops with regulators, regulated businesses, customer representative bodies and government, to discuss and receive feedback for stakeholders on the customer engagement options identified in the report.

We then developed a set of preliminary views of customer engagement, based on our consideration of the CEPA review and stakeholder feedback, which we outlined in a Discussion Paper released in February 2012.¹⁰ A summary of our preliminary view is attached in Appendix A.

We invited stakeholders to make submissions on the Discussion Paper and received 8 responses. We also held formal and informal meetings with regulated businesses and other stakeholders to provide them with further opportunities to express their views. We considered all submissions and feedback before making our decisions.

3 Submissions from stakeholders

In response to our Discussion Paper, we received submissions from the Energy & Water Ombudsman NSW (EWON), Action for Public Transport (NSW), Wyong Shire Council, State Water, the Small Business Commissioner, the Energy Retailers Association of Australia (ERAA) and Hunter Water.¹¹

All these submissions expressed support, to various degrees, for our preliminary view. For example, ERAA supported our view that customer engagement contributes to improved outcomes for the regulation of some monopoly businesses. However, it put the view that mandating evidence of customer consultation for the retail electricity industry is not appropriate because of the competitive nature of the industry, unlike other industries we regulate. Further, it noted that there is limited scope for effective consultation on the inputs that determine the retail component, compared to network businesses.¹²

⁹ CEPA, *Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay*, A report for IPART, June 2011.

¹⁰ IPART, *Customer engagement on prices for monopoly services – Discussion Paper*, February 2012, pp 1-2.

¹¹ See our website (www.ipart.nsw.gov.au) for the submissions made on our Discussion Paper.

¹² ERAA submission to Customer Engagement Discussion Paper, 23 March 2012, p 1.

Action for Public Transport (APT)¹³ and Wyong Shire Council¹⁴ both supported the substance and conclusions of our Discussion Paper, but did not comment in great detail.

We note that there was also broad agreement with our preliminary view at the workshop we held on 2 March 2012 (which was for stakeholders that had participated in our previous workshops). Some of the stakeholders represented at this workshop (EWON, the Small Business Commissioner and Hunter Water) also made formal submissions.

The sections below summarise stakeholder comments on various aspects of our preliminary view and other issues raised in submissions.

3.1 Stakeholder support for a multi-layered approach engagement process

The Small Business Commissioner agreed strongly with our proposals to improve IPART's engagement processes. The Commissioner commented on each of the 7 engagement options from the perspective of small businesses.¹⁵

EWON supported our view that we should not advocate any particular engagement option. EWON also stated that oversight is necessary to ensure that the engagement strategy undertaken is properly assessed. Similarly, EWON agreed with our proposed use of new media (digital and social) to improve our communication with the public and households.¹⁶

Hunter Water stated that using new media would improve our communication with many customers and community members, but that such initiatives are a small part of an ideal engagement process. Like EWON, Hunter Water believes it is important that we consider those community sectors that do not source their information from new media. Developing new media communications can facilitate more constructive engagement but it should not be seen as an end point.¹⁷

¹³ Action for Public Transport (NSW) submission to Customer Engagement Discussion Paper, 22 March 2012, p 2.

¹⁴ Wyong Shire Council submission to Customer Engagement Discussion Paper, 23 March 2012, p 1.

¹⁵ Small Business Commissioner submission to Customer Engagement Discussion Paper, 29 March 2012, p 2.

¹⁶ EWON submission to Customer Engagement Discussion Paper, 23 March 2012, p 2.

¹⁷ Hunter Water submission to Customer Engagement Discussion Paper, 12 April 2012, p 10.

3.2 Cost benefit analysis (CBA) – mandated standards

State Water asked us to clarify whether the proposed requirement for regulated businesses to provide supporting cost benefit analysis applied to government-mandated service standards, particularly when the business is not responsible for setting the standards. State Water suggested the requirement for a cost benefit analysis could be placed on the agency imposing the mandated standards prior to setting them.¹⁸

Similarly, Hunter Water stated: “IPART needs to provide more clarity about its expectations for CBA of mandatory standards and how such analysis would integrate with the standards setting and regulatory process of all regulators.”¹⁹

Further, Hunter Water commented that more focus is required on the roles and responsibilities of regulators for customer engagement on price/outcomes trade-offs, especially when they determine service standards. Regulators could provide information on the likely impact on consumers of proposed regulations.²⁰

3.3 Consumer panels

While we did not propose establishing consumer panels, State Water suggested that we could take part in its Customer Service Committees, especially during the price review process.²¹

APT suggested that Transport for NSW should consider revamping its existing customer panels. APT believes that, under NSW legislation, all departments or authorities providing a service to the public are required to have a customer reference group. However, APT acknowledged the difficulty long-serving panel members may have in maintaining consistency with the views of the groups they represent.²²

¹⁸ State Water submission to Customer Engagement Discussion Paper, 20 March 2012, p 2.

¹⁹ Hunter Water submission to Customer Engagement Discussion Paper, 12 April 2012, p 4.

²⁰ Ibid., p 7.

²¹ State Water submission to Customer Engagement Discussion Paper, 20 March 2012, p 2.

²² Action for Public Transport (NSW) submission to Customer Engagement Discussion Paper, 22 March 2012, p 3.

3.4 IPART's role in customer engagement

The Small Business Commissioner strongly supported our proposals for capacity building, especially where it improves understanding of the impact of price proposals (price and service changes) on small business. The Commissioner noted that the needs of small business should be understood as they do not always accord with those of large businesses. The Commissioner is seeking 'follow up' with small business representatives to better understand the impact of price and service changes on small business.²³

Hunter Water commented that the Discussion Paper did not address the significant need for IPART to undertake widespread community education and capacity building around the price review process. Hunter Water believes capacity building should originate from regulators, not just utilities.²⁴ APT was critical of our lack of consultation on the annual review of transport "pricing paths".^{25,26}

3.5 Constructive engagement, consumer bodies and capacity building

Hunter Water supported constructive engagement whereby the community, customers, regulators, interest groups and the utilities jointly engage from an early stage in developing shared outcomes. Further, Hunter Water believes a peak utility consumer body in NSW, similar to the Customer Utility Advocacy Centre in Victoria, would complement existing interest groups in the engagement process. A peak consumer body can assist customers by disseminating information from utilities and by representing the general interest of consumers in price reviews.²⁷

²³ Small Business Commissioner submission to Customer Engagement Discussion Paper, 29 March 2012, pp 1-2.

²⁴ Hunter Water submission to Customer Engagement Discussion Paper, 12 April 2012, p 8.

²⁵ Action for Public Transport (NSW) submission to Customer Engagement Discussion Paper, 22 March 2012, p 2.

²⁶ APT also submitted that the Public Transport Ticketing Corporation, and the Opal Card, should come under IPART's scrutiny.

²⁷ Hunter Water submission to Customer Engagement Discussion Paper, 12 April 2012, pp 8-9.

3.6 Leveraging existing sources of information

In our Discussion Paper we proposed to encourage regulated businesses to incorporate existing consumer research into their pricing proposals. APT use the 131 500 Transport Infoline as an example of a currently available information source. This information is seen as useful “because the provider can see where the biggest problems are.”²⁸ Existing information on customers’ views may also be obtained from third party sources, for example, EWON submitted that we and regulated businesses could also use information from stakeholders such as themselves, which provides valuable information about customer issues.²⁹

4 Our considerations and final decisions

After considering the results of our research and consultations, we concluded that the most feasible approach for encouraging more effective customer engagement to improve regulatory outcomes was to provide a framework that clarifies our expectations of regulated businesses in relation to customer engagement, and our undertakings in relation to stakeholder engagement for price reviews. The sections below discuss our considerations on our customer engagement framework, which is comprised of our decisions and undertakings.

4.1 Our expectations of regulated water businesses in relation to customer engagement for price reviews

We consider that customer engagement is important for regulated businesses, as it provides them with information and insight into what service levels (above mandated) and service offerings (such as price structure) their customers prefer, which they might not otherwise obtain due to the absence of competitive pressure. Thus, we consider it is good practice for regulated businesses to use customer engagement to inform the development of their pricing proposals to the regulator – particularly, the elements that affect their service levels and offerings. Further, it is good practice to provide evidence of this customer engagement to the regulator to inform its decision-making. We consider that this approach would contribute to better regulatory outcomes, such as:

- ▼ better alignment between regulated service levels and prices and customer preferences
- ▼ helping customers understand better why and how they are charged for essential services

²⁸ Action for Public Transport (NSW) submission to Customer Engagement Discussion Paper, 22 March 2012, p 3.

²⁹ EWON submission to Customer Engagement Discussion Paper, 23 March 2012, p 1.

- ▼ more balanced regulatory decisions, based on better information and understanding of customer preferences.

While there is a competitive retail market in energy, price regulation remains for customers who have not chosen to enter into a market contract. It is not appropriate for the framework to apply to market contracts because retail energy suppliers operate in a competitive market.³⁰ With respect to the regulated prices, our regulatory framework together with competition in the market provide Standard Retailers with the incentive to set prices at cost reflective levels. Further, the legislative framework for our energy price determinations also does not expressly identify customer engagement as a factor to consider in determining prices.³¹ Additionally, at this stage we also do not consider that it is practical to apply the framework to public transport service providers.³² Separately, we undertake price reviews for local councils, however separate guidelines set out specific customer engagement requirements which we must consider in making pricing decisions.

We also recognise it is not appropriate for us to consider customer engagement in relation to all aspects of a regulated business' pricing proposal, particularly those expenditures required to comply with legislative or regulatory requirements. However, we consider it appropriate when expenditure is discretionary, because the link between this proposed expenditure and customer preferences is required to establish the efficiency of the proposed expenditure, an important task for an economic regulator.

Given the above, we have developed a framework that clarifies what we consider regulated businesses should be encouraged to do in relation to customer engagement for a price review and which:

- ▼ applies to the monopoly water businesses we price regulate, and focuses only on their proposals in relation to discretionary operating and capital expenditure and changes in price structure
- ▼ outlines our views on good customer engagement practices, including what approaches should be used, when it might occur, and how information should be presented to enhance its effectiveness.

³⁰ Our view is confirmed by the submission made by the ERAA, discussed on page 7 of this report.

³¹ However, if the *Electricity Supply Act 1995* (ie, terms of reference issued by the Minister under the Act) and *Gas Supply Act 1996* were to require us to consider customer engagement in making price determinations, then, we would need to consider this factor.

³² The NSW Government provides the majority of funding for transport. It is currently undertaking consultation on its master transport plan for the next 20 years including how these projects should be funded and paid for. The Government sees the importance of customer engagement and has planned extensive consultation as part of the development of its long term master plan. In addition, the NSW Government through its service contracts with transport operators determines service levels. IPART in determining fare levels ensures that passengers only pay for their fair share of efficient costs to deliver the level of services required by the service contracts. For these reasons, we have chosen not to include transport reviews in these requirements.

Note that this framework is **not** a prescriptive approach. While our water price reviews tend to follow a broadly consistent process, each review needs to take account of the specific context and issues that are relevant to that review. Therefore, the framework sets out **general** expectations on customer engagement for price reviews. The relevance and importance of these expectations will need to be considered on a review-by-review basis.

4.1.1 Framework applies to regulated water businesses and focuses on proposed discretionary expenditure and price structure changes only

As noted above the framework only applies to regulated water businesses. In addition, the framework focuses only on the water businesses' proposals in relation to discretionary expenditure and changes in price structure. Our established position, stated in the current *Guidelines for Water Agency Pricing Submissions* request that these businesses provide information on their customer consultation for price reviews.³³ Thus, this document consolidates the outcomes of our customer engagement review and further clarifies our previously stated expectations. In our Discussion Paper, we expressed a preliminary view that we should more clearly place an onus for customer engagement on regulated businesses.³⁴ However, we recognise that in recent years businesses have sought to integrate engagement programs in the design and presentation of pricing proposals, but some room for improvement remains.

In their submissions in response to this paper, Hunter Water³⁵ and State Water³⁶ questioned whether this was appropriate. They argued that regulated businesses should not need to consult their customers on expenditure that is largely driven by mandated service standards, which are set by the responsible authority. They put the view that this authority, not the businesses, should be responsible for consulting customers on these standards and their price implications.

We agree that the responsibility for customer engagement on regulated business expenditure depends on the driver of this expenditure (Table 4.1). In particular, we consider that when the expenditure is driven by a mandated service standard or government policy (**mandatory expenditure**), the responsibility for customer engagement rests with the proponent of the standard or policy (eg, the regulator or government policy unit). When it is driven by a regulated business' decisions to, for example, undertake a capital project to improve service levels beyond the mandated standard (**discretionary expenditure**), this responsibility rests with the business.

³³ IPART, *Guidelines for Water Agency Pricing Submissions – Guidelines*, April 2011, pp 7-10, 15.

³⁴ IPART, *Customer engagement on prices for monopoly services – Discussion Paper*, February 2012, pp 1-2.

³⁵ Hunter Water submission to Customer Engagement Discussion Paper, 12 April 2012, pp 1-4.

³⁶ State Water submission to Customer Engagement Discussion Paper, 20 March 2012, p 2.

Table 4.1 Relationship between the driver of regulated business expenditure and responsibility for customer engagement

Driver of expenditure	Mandatory service standard	Government policy	Discretionary service standard
Definition	Expenditure required to meet specific service standards for current and future customers	Expenditure required to meet a policy objective	Expenditure for projects that provide services not mandated, go beyond the standard, or anticipate a future change in standards/policies
Responsibility for customer engagement	Regulator / proponent of standard	Government policy unit	Regulated business

Source: IPART.

We analysed mandated standards when we amended Hunter Water’s and Sydney Catchment Authority’s operating licences in 2012. This process was open to public comment (issues paper, public hearing) and subject to targeted consultation, and included a cost benefit analysis on the proposed variations which was included in previous licence variations. We could have considered additional customer engagement, and will seek to improve our processes where possible, but we consider our engagement was proportionate to the proposed variations. Mandated expenditure related to other regulators/authorities is a matter for these entities since they must comply with their own legislative obligations. Consultation by these entities occurs within their legislative obligations and not with regard to our processes. Nevertheless, we have written an Information Paper which, in part, discusses how we intend to engage more with environmental regulators, and addresses potential implications for price reviews.³⁷

We also consider that it is desirable for regulated water businesses to engage with their customers about proposed changes to their service offerings, particularly changes to price structure (such as the balance between the fixed service charge and variable usage charge). We consider that this can lead to benefits such as improved customer understanding of such changes. This is borne out by recent experience in the recent State Water and Sydney Water (trade waste) price reviews.³⁸

Further, we consider that the water businesses are best placed to engage with their customers on their proposals for discretionary expenditure and changes to price structure, because they:

- ▼ know their customers better than us or other regulators
- ▼ have experience in undertaking customer research and can use existing engagement activities to include views on issues relevant to price reviews.

³⁷ IPART, *Addressing environmental issues in IPART’s price determinations – Information Paper*, July 2011.

³⁸ We recognise that the particular engagement approaches used in these reviews may not be appropriate for all price reviews, as the customers number of affected by the changes was relatively small.

Given the above, our framework concentrates on proposed discretionary expenditure and price structure changes only. Box 4.1 discusses what we mean by discretionary expenditure to more clearly distinguish it from mandatory expenditure.

Decisions

- 1 Regulated water businesses are encouraged to provide evidence of the customer engagement they have undertaken in relation to their proposed discretionary expenditure.
- 2 Regulated water businesses are encouraged to provide evidence of the customer engagement they have undertaken on proposed changes to price structure.

Box 4.1 What is discretionary expenditure?

Discretionary expenditure is generally expenditure above and beyond, or outside the expenditure required to comply with legislative or regulatory requirements.

The distinction between discretionary or mandatory expenditure can sometimes be uncertain. Our issues paper for the 2012 review of Sydney Water's prices provides information on how we considered discretionary expenditure for that review.^a However, as stated elsewhere in this report, customer engagement on discretionary expenditure should be considered on a review-by-review basis.

Regulated businesses generally have a business case for proposed expenditure. The following questions may provide businesses with some additional guidance on discretionary expenditure that could inform a business case:

- ▼ Is performance currently at or below the standard?
- ▼ How will the expenditure change this?
- ▼ What are the regulatory consequences of not undertaking the proposed expenditure?

These questions, which are examples only and **not** an exhaustive list, may assist businesses when considering if proposed expenditure is discretionary.

There may also be other discretionary items, which are outside legislative or regulatory requirements, such as a business' decision to become carbon neutral.

^a IPART, *Review of prices for Sydney Water Corporation's water, sewerage, stormwater and other services - Issues Paper*, June 2011, p 60.

4.1.2 Framework provides guidance on good customer engagement practices

This section of the report outlines our views on good customer engagement practices, including what approaches should be used, when it might occur, and how information should be presented to enhance its effectiveness. These views are intended as guidance to the water businesses.

What customer engagement processes should be used?

Our Discussion Paper included an indicative list of customer engagement approaches that regulated businesses could potentially use to demonstrate customer engagement on proposed discretionary expenditure and changes in price structure.³⁹ We consider that the effectiveness of each potential approach is likely to vary by water business and customer group. Therefore, we consider that the businesses should choose the customer engagement approach they consider will be most effective for their situation.

We also consider that the approach they choose should be **proportional** to the potential customer impact of the proposed discretionary expenditure or price structure changes.⁴⁰ Further, we encourage businesses to undertake good practice customer engagement, having regard to the costs of engagement. Box 4.2 sets out our thoughts on good practice in customer engagement.

Decision

- 3 Regulated water businesses are encouraged to undertake good practice customer engagement, as discussed in Box 4.2.

We are aware that the water businesses currently undertake well established and extensive customer engagement. For example, Hunter Water has both a Consultative Forum and Customer Panel,⁴¹ and Sydney Water undertakes large-scale studies such as the Sentiment Monitor and Customer Values surveys, with output from these surveys used as background information in its submission to the 2012 price review.⁴²

The businesses' customer engagement approaches also vary considerably. For example, those serving a small number of motivated and resourced clients may use different engagement options (eg, committees and workshops) than those with a larger proportion of small retail customers (eg, random surveys or logged customer calls to call centres).

³⁹ IPART, *Customer engagement on prices for monopoly services – Discussion Paper*, February 2012, pp 13-23.

⁴⁰ Proportional means the cost of the engagement should be consistent with the cost of the proposed change and its impact on total customer bills.

⁴¹ CEPA, *Regulated monopoly service providers and customer views, preferences and willingness to pay*, A report for IPART, June 2011, pp 120-126.

⁴² Sydney Water submission on Review of prices for Sydney Water Corporation's water, sewage, stormwater and other services, 16 September 2011, pp 15-24.

The businesses' customer engagement approaches can also vary across customer groups. For example, Sydney Water is likely to use different approaches for engaging with its trade waste customers and small retail customers.⁴³ Hence, the approach used, and possibly the time required, to undertake any engagement is likely to vary given the nature of the proposal and the customer group affected. The framework leaves it to the regulated business to decide the most appropriate approach.

In the short term, businesses are encouraged to use **existing** information from customer engagement for price proposals wherever possible. For example, they may use information gathered from existing customer attitude surveys or from customer feedback telephone numbers. However, for significant changes to service provision or price structure, it may be necessary and appropriate to use dedicated customer engagement.

Publicly available information from customer groups could be another avenue to explore to obtain customer views. As EWON discussed in its submission, businesses and regulators could make better use of existing information from stakeholders such as itself, to obtain valuable information about customer issues.⁴⁴

In our view, regulated businesses should be able to better **integrate** customer engagement on price reviews into existing practices. We consider that this should not significantly increase their costs.

4.1.3 When should customer engagement occur?

Customer engagement that informs a price proposal is best undertaken as early as possible – for example, at the strategic planning stage. This allows customers to have genuine input into the development of the services, for example by explaining their needs and preferences. If engagement only occurs at a later stage, they may only be able to provide feedback on services that have already been developed.

Customer engagement may also be taken in the price proposal preparation stage – for example, to test customers' willingness to pay. Ideally, this engagement will be part of a continuous process started in the strategic planning stage. However, even if the process hasn't been started that early, it is still preferable that regulated businesses engage their customers on their price proposal before it is submitted.

⁴³ That is, in the case of Sydney Water's trade waste customers, seeking agreement with an organised and known group of customers is possible compared to a large number of unknown retail customers consisting of households and small businesses. Thus, obtaining views, rather than agreement, using random surveys of small retail customers is possibly the most appropriate approach in this instance.

⁴⁴ EWON submission to Customer Engagement Discussion Paper, 23 March 2012, p 1.

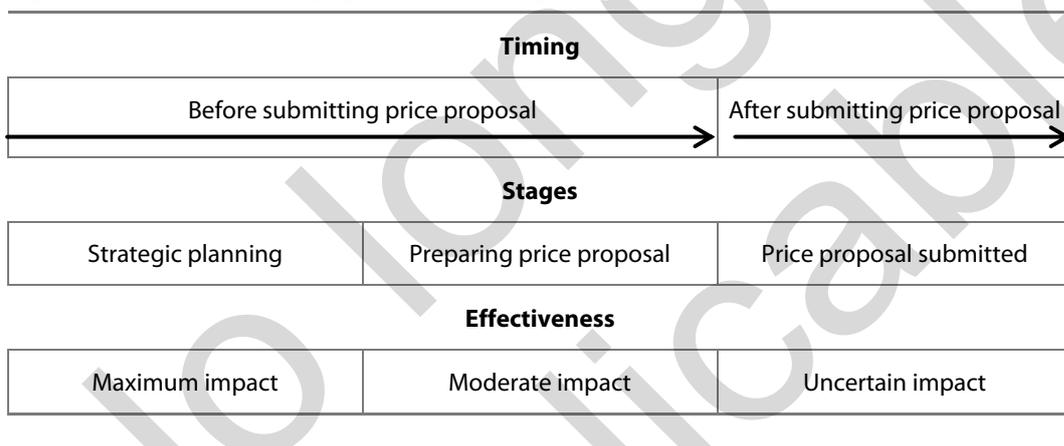
Customers or customer representative groups generally take part in our price reviews after we receive a regulated business' price proposal. We consider that customer engagement at this stage of the process is less effective because customers' views do not inform the development of the proposal.

Recent examples of customer engagement by water businesses include:

- ▼ State Water has used output from its Customer Service Committees when developing its last price submission to us for the 2010 price review.⁴⁵
- ▼ Hunter Water has commenced engaging with its customers prior to submitting its price proposal for the price review currently underway.⁴⁶

Figure 4.1 shows the various stages when customer engagement may be undertaken and their relative effectiveness.

Figure 4.1 Customer engagement – timing, stages and effectiveness



Decision

- 4 Regulated water businesses are encouraged to engage with their customers for price reviews early (that is, prior to submitting a price proposal).

4.1.4 How should information be presented to enhance customer engagement?

How information is presented to stakeholders, such as customers or their representatives influences the degree of customer engagement. All stakeholders in our October 2011 workshops agreed that the size and current presentation of price proposals make it difficult for non-specialist readers to participate in the price review process.

⁴⁵ CEPA, *Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay, A report for IPART*, June 2011, p 146.

⁴⁶ <http://surveys.insyncsurveys.com.au/surveys/HWCStakeholderResearch2012>.

Therefore, we consider that to improve customer engagement and input into the price review process, the water businesses must provide with their price submission a short plain English (that is, non-technical) summary of this submission. The Public Interest Advocacy Centre (PIAC) made a similar recommendation to us in its submission to our CEPA report.⁴⁷

This summary document should be readily understood by a broad audience including, for example, a business' customer base, customer representative bodies and other non-specialist interest groups. Importantly, it must include a clear statement of the price proposal's impact on customers. In addition, it should cover the **entire** submission, rather than be specific to proposals on discretionary expenditure and changes to price structure.

Useful examples of customer impact statements for businesses to consider include our facts sheets on electricity retail prices⁴⁸ and Sydney Water's price review for households.⁴⁹ However, businesses are best placed to understand their submission and must decide themselves how to prepare this document.

Decision

- 5 Regulated water businesses must provide, along with their price proposal, a separate, short, plain English summary of their proposal that contains a clear statement of its customer impacts.

4.2 Our undertakings in relation to stakeholders for price reviews

We found that the way regulators interact with their stakeholders - including regulated businesses, customers and their representatives, the community, and government agencies - is important to improve these stakeholders' capacity to participate in price reviews, and thus ensure customer views are reflected in price outcomes. Therefore, we have made a range of undertakings on how we will engage with stakeholders in price reviews from this point onwards. Section 4.2.1 is specific to our interactions with regulated businesses for water price reviews. Section 4.2.2 and 4.2.3 discuss IPART's approach on how we undertake customer engagement across **all** of our price reviews.

⁴⁷ PIAC submission on CEPA's Customer Engagement report, 30 August 2011, p 6.

⁴⁸ IPART, *Changes in regulated electricity prices from 1 July 2012 - Fact Sheet*, June 2012.

⁴⁹ IPART, *Prices for Sydney Water's customers in single dwellings - Fact Sheet*, June 2012.

4.2.1 Our dealings with regulated water businesses

Customer engagement is unlikely to be the same across all price reviews, given that the water businesses sometimes face issues that are unique to their business or a particular time period. Therefore, the businesses may want some guidance from us about options for customer engagement for a particular review. In line with our normal practice for price reviews, we will be available to discuss customer engagement issues with the water business, if requested, on a review-by-review basis.⁵⁰ We could also provide some guidance by asking the water businesses to include their consultation strategies in their submissions.

However, the businesses should not rely on us for technical advice on customer engagement options. Box 4.2 sets out our thoughts on good customer engagement.

Box 4.2 Characteristics of good customer engagement

Some broad principles:

- ▼ customers are engaged on their preferences (strategic planning)
- ▼ customers are engaged on their willingness to pay (proposed spending)
- ▼ engagement considers the wider context of customers' budgets
- ▼ engagement is proportionate to the materiality of the proposed change.

In principle, customer engagement by regulated businesses should be:

- ▼ transparent – what was done, how it was done and what it means must be clear
- ▼ representative – there should be a representative sample of the views of relevant customers
- ▼ unbiased – the engagement should be impartial and not be misleading or leading
- ▼ quantifiable – for consistent and objective analysis.

Customer engagement tools/methods need to be robust and should represent good practice for the approach chosen by the business. External peer review may be used when it assists to ensure robustness of approach. For example, consultation may be undertaken by a qualified person taking into account good practice, such as a member of a professional body like IAP2 or AMSRS.

Note: IAP2 is the International Association of Public Participation Australasia and AMSRS is the Australian Market and Social Research Society.

Source: IPART; Ofwat, *Involving customers in price setting – Ofwat's customer engagement policy statement*, April 2011, p 14.

Undertaking

- 6 We will provide guidance to the regulated water businesses before the price review process begins to help them understand our expectations for customer engagement as it relates to our price review processes.

⁵⁰ For example, we currently discuss issues surrounding discretionary expenditure, for example, in our quarterly meetings, as well as on an ad hoc basis if regulated businesses contact us.

4.2.2 Our dealings with customers or their representatives

The ability of customers, customer representative bodies and interest groups to adequately participate in the price review process partly depends on their understanding of regulatory issues and process. Stakeholders have suggested that we need to continue to engage with customers and their representatives to build their capacity to respond effectively to our price reviews.⁵¹

We will continue to have annual stakeholder workshops and various informal meetings with interest groups on topics such as the regulatory environment or our building block methodology. It may be possible to use these existing channels to build the capacity of customers, their representatives and interest groups.

Feedback from stakeholders that participated in previous annual stakeholder workshops has generally been positive. Further, stakeholder submissions to our Discussion Paper indicate that capacity building to assist customers is widely supported.

Undertaking

- 7 We will use our annual stakeholder workshops to assist stakeholders to build their capacity to participate effectively in price reviews.

Peak utility consumer body

As noted in Chapter 3, Hunter Water believes there is scope for a peak utility body in NSW similar to the Consumer Utilities Advocacy Centre (CUAC) in Victoria. This body could represent the general interest of consumers and act as a catalyst for capacity building with consumers.⁵² However, funding for such an organisation is not discussed in Hunter Water's submission. CUAC receives funding support from Consumer Affairs Victoria.⁵³

In NSW, PIAC undertakes this type of role, although its advocacy scope is broader. The NSW Department of Trade and Investment, Regional Infrastructure and Services provides funding for PIAC's consumer advocacy program in the area of electricity, gas and water.⁵⁴

A new or existing peak utility body, if it is government funded, is a matter for government to decide given its priorities and budgetary constraints.

⁵¹ Pers. Comm., customer representative and EWON workshop, October 2011.

⁵² Hunter Water submission on Customer Engagement Discussion Paper, 12 April 2012, p 9.

⁵³ www.cuac.org.au/about/about.

⁵⁴ www.piac.asn.au/about-us/who-funds-piac/who-funds-piac.

Other issues raised by stakeholders

The Small Business Commissioner discussed 'follow up' with small businesses as they do not have the resources to undertake detailed research. While we do not have a formal 'follow up' process, we undertake ongoing consultation with stakeholders, and we provide staff contact details for stakeholders.

Separately, PIAC recommended that we coordinate consultation periods internally.⁵⁵ Consumer groups are involved in multiple regulatory reviews, hence it becomes difficult to dedicate resources to adequately respond to each review. PIAC acknowledged our efforts to assist stakeholders, such as combining the recent SCA operating licence and price reviews.⁵⁶ Further, we provide a water newsletter that informs stakeholders on future reviews and consultations, which assists planning.⁵⁷ However, reviews occur when required and are based on the individual merits of the process, such as resources available and links to other reviews.

4.2.3 Our dealings with the community

We use a variety of approaches to communicate the reasons behind our decisions. Our communication strategy (for example, stakeholder plans) is considered on a review-by-review basis, which is prudent given the differences between our reviews.

We release statements to the media for selected reviews, we have moved to simpler fact sheets and regularly hold informal meetings with stakeholders explaining our issues papers or other reports. We are actively trying to communicate with the community about our processes but acknowledge that we can improve, for example, use technology better:

- ▼ Customer representative bodies and government agencies asked whether we could provide a document or an online submission portal that highlights significant issues or key drivers of price changes and allows for a simpler submission process.
- ▼ Digital and social media is growing in importance, as highlighted in the NSW Government ICT Strategy 2012.⁵⁸ It may be useful to consider these media in addition to traditional methods to broaden our audience. EWON and Hunter Water in their submissions believe that new media communications should be part of a suite of approaches, not the only approach, as discussed in Chapter 3.

⁵⁵ PIAC submission to CEPA's Customer Engagement report, 30 August 2011, p 8.

⁵⁶ Ibid., p 7.

⁵⁷ www.ipart.nsw.gov.au/Home/Industries/Water/Water_Newsletter_-_April_2012.

⁵⁸ www.services.nsw.gov.au/ict.

Traditional means of communication and engagement

We usually produce issues papers, draft and final reports and fact sheets for reviews. Over time we have improved these documents by targeting questions to various stakeholder groups and changing the layout. We also write letters and emails to stakeholders and meet with stakeholders, formally (for example, workshops, roundtables and hearings) and informally, on issues regarding our reviews.

We have also undertaken our own research by surveying the community's use of electricity, water and gas usage every few years. This information is used to identify the household characteristics that drive consumption of services we regulate. These periodic surveys and follow-up research are a form of customer engagement which may provide valuable information for our price review process.

Stakeholders at our customer representative and EWON workshop in October 2011 suggested we should produce short social and environmental impacts statements as part of our price decision.⁵⁹ Currently, we discuss the social impacts of our price reviews by showing the effect of price changes on typical customer bills in the final report. The impacts on the environment are also discussed in our reports, where relevant, for example, in the 2012 Sydney Water price review.⁶⁰ We consider social and environmental impacts as some of the matters we have regard to under section 15(1) of the IPART Act.

Our communication strategy, however, needs to be proportionate to the materiality of the proposed change being considered.

Undertaking

- 8 We will upgrade our online submissions facility. We will expand our suite of communication channels with customers and the community.

5 Implementation of the framework and its implications for stakeholders

The framework outlined in this paper has some potential implications for the regulated water businesses and IPART. The sections below outline these implications, and also discuss from when the framework will apply.

⁵⁹ IPART, *Customer engagement on prices for monopoly services - Discussion Paper*, February 2012, p 36.

⁶⁰ IPART, *Review of prices for Sydney Water Corporation's water, sewage, stormwater drainage and other services - Final Report*, June 2012, p 186.

5.1 Implications for regulated water businesses

As noted above, the water businesses already undertake well established customer engagement, and have access to extensive consumer research. A number of the decisions of this report have been adopted by us previously and implemented by a number of regulated water businesses. Further, we recognise that in recent years businesses have sought to integrate their engagement programs in the design and presentation of their pricing proposals. However, some room for improvement remains. As such, we reached the view that most water businesses should be able to meet the expectations set out in the framework without adding significantly to their regulatory compliance costs.

For example, in the short term, they could use information gathered from their existing consultation processes to demonstrate customer engagement for price reviews. In the medium to long term, they could extend or adapt their consultation processes so they gather more direct customer feedback on price proposals. We note that none of the submissions we received on the Discussion Paper from regulated business raised cost as an issue.

The water businesses' price proposals are already accompanied by relevant evidence on their expenditure and other proposals. In the future, where a proposal includes discretionary expenditure and/or price structure changes, relevant information about their customer engagement activities and results should form part of this evidence base (see Box 4.1). This will enable us to make better informed decisions and improve the prospects of the proposals on discretionary expenditure and changes to price structure being accepted. It may also result in a more streamlined process, as we should not need to seek further information about such proposals and provides clarification to businesses about how we assess discretionary expenditure and price structure.

In making water price determinations, we consider a range of factors, set out in section 15(1) of the IPART Act, and the weighting of these factors for the purpose of our decision-making varies from review to review. Similarly, the way in which we take account of customer engagement evidence will be determined on a review-by-review basis. However, we consider that submissions would benefit from including relevant customer engagement evidence that demonstrates that discretionary expenditure is prudent, efficient, and considers consumers' overall willingness to pay.

As Section 4.1 discussed, this framework sets out our general expectations of the water business in relation to customer engagement, not a prescriptive approach. Thus, the application of the framework is likely to vary from review to review – for example, depending on the particular issues and price proposal involved.

5.2 Implications for IPART

Our undertakings to improve customer engagement in price reviews mean that we will need to spend time on customer engagement tasks in preparation for and during a price review. That is, in preparation for a price review, we will spend time with regulated water businesses to explain our expectations and, in general for all price reviews, preparing our own engagement plan. Further, during a review, for all price reviews, we need to put into place our engagement processes which we consider appropriate for a review. While better engagement processes are likely to have a positive impact on our decision-making they may impose a cost on us or regulated businesses. This will depend on the nature of the current engagement program of each business implementing the framework. Cost will be a practical constraint on what is feasible. In making these decisions and undertakings we have been concerned to ensure that they do not involve excessive costs or extensions of the time taken for price reviews.

5.3 When the framework will begin to apply

The decisions outlined in this report will apply from the date of release of this report. After the next water price review, we will evaluate how the framework worked and review our decisions as necessary. In our view, the improvement of customer engagement for price reviews will be a continuous process, and we and the water business will need to continuously seek to better understand and reflect the views of the customers of regulated water services. For reviews about to commence, we have provided advanced guidance given the time required for regulated businesses to prepare for a price review.

No longer
applicable



No longer
applicable

Appendices

No longer
applicable

A Discussion paper preliminary view

This appendix details our preliminary view as presented in our Discussion Paper.⁶¹ That is:

- ▼ Customer engagement is useful for businesses in delivering services that customers want and are willing to pay for.
- ▼ Customer engagement can be done at different levels and is most effective as part of ongoing strategic planning by regulated businesses.
- ▼ We do not advocate any particular engagement option. It is the responsibility of the regulated businesses to choose options that fit their particular circumstances and to ensure the customer engagement is robust, cost effective and relevant to decisions on service levels and prices.
- ▼ Regulated businesses should demonstrate that they have adequately consulted their customers in developing their price and service proposals.
- ▼ Regulated businesses should consult with their consumers about service standards and price/service trade-offs before submitting a price proposal. Evidence of this should be provided with the price proposal.
- ▼ Regulated businesses should provide us with a plain English version of their price and service proposal aimed at consumer representatives and average households.
- ▼ We understand that regulated businesses may need guidance regarding engagement. We are willing to discuss this early in the review process.
- ▼ When assessing pricing submissions, we will take into account evidence of customer support for the proposal and any other factors we consider relevant.

We consider that regulated businesses are best placed to engage with their customers because they:

- ▼ know their customers better than us
- ▼ have experience in undertaking customer research
- ▼ can expand existing engagement activities to include views on issues relevant to price reviews.

⁶¹ IPART, *Customer engagement on prices for monopoly services - Discussion Paper*, February 2012, pp 1-2.

We prefer that businesses choose the most effective form of engagement as the effectiveness of different forms is likely to vary between industries and customer groups.

We also recognise that IPART can improve the engagement process by:

- ▼ creating a pro-forma online submission document with plain English explanations for the main cost drivers to enable easier response by stakeholders
- ▼ giving regulated businesses clear guidance early in the determination process to ensure they understand our requirements regarding the customer engagement to be undertaken
- ▼ improving our use of digital and social media to communicate and consult with stakeholders
- ▼ continuing capacity building with interested and relevant parties.

No longer applicable