

Overall Comments on the 2013 Water Price Review Process

The ESC defines its role as assessing the Water Plans against the principles set out in the Water Industry Regulatory Order (WIRO) as stated in para 4 of Introduction to Summary of Regional Businesses Water Plans. I question as to when the public will be allowed/invited to review the appropriateness of the WIRO in light of the key role they play in the water price review process?

Sec 1.1 Proposed prices and impact on customer bills – The ESC notes that CWW, SEW and YVW have proposed a steep increase in water and sewerage prices in the first year followed by zero real increase over the remainder of the regulatory period in contrast to WW who proposed a smooth price path (with a little over 6% each year over the period). I question the financial effect of these different approaches. The high first year cost will continue as the base for all subsequent years and the actual percentage increases (zero real increase) will result in higher customer payments year on year than the smooth price path approach where the “minimum” payment is made year by year. This aspect is hidden in Tables 1 and 2 by listing only year 2013-14 (first) and showing 2017-18(final) together with the overall change and not the cumulative amounts paid by customers.

Contrast the way the way SEW shows Prices and Customer Impacts in Table 11-7 (p71 of SEW Water Plan) with Table 11.2 (p68) and ESC’s Tables 3a/3b and Table 1.

I have computed the difference in progressive annual cost of the two methods of charging using (a) constant bill for SEW and WW as shown in Table 1 and (b) using the *Estimated annual (real%) changes ESC weighted.....* from Table 3b. The SEW bill base of \$829 with SEW’s initial 34.9% increase results in initial annual payment of \$1118 and progressive payments of \$2236, \$3354, \$4472 and \$5590 in years 2,3,4 and5. With the same base and the smooth approach of WW the corresponding figures are: Year 1 \$881, \$935, \$992, \$1055 and Year 5 \$1130 with progressive payments being \$1816, \$2808, \$3863 and \$4993 in years 2, 3, 4 and 5. This results in a customer benefit of \$597 over the term with proportionate earlier benefits throughout the term.

The corresponding computation for WW bill base of \$956 with its smooth approach (Table 3b) of 6.1% etc shows Year 1 payment \$1016, Year 2 \$1078, Year 3 \$1145, Year 4 \$1217 and Year 5 \$1295 cumulative payment \$5751. Progressive payments would equal \$2094, \$3239, \$4456 and \$5751 for years 2, 3, 4 and 5. This contrasts with the high initial increase of 34.9% on the same WW bill base which would result in \$1289 Year 1 payment, and annually thereafter for a cumulative payment of \$6445 and progressive payments \$2578, \$3867, \$5156 and \$6445 in years 2, 3, 4 and 5. This would result in a customer detriment of \$694 over the term and markedly weighted against them in the earlier years.

These computations demonstrate the customer benefit of reducing the size of any price rise to the least and delaying its application to the latest time possible. Conversely they show the corresponding benefit to the businesses. They further highlight the difference between the gain/loss to both parties should the businesses exercise their power to arbitrarily determine the method of applying their increased charges.

It may be appropriate to remember that a reduction of say 10% in the value of capital needs to be offset by a gain of >11.1% (on the reduced capital) to return the value to the original figure even without compensating for the loss of purchasing value during the period the reduction applies.

Comments on Melbourne Water 2013 Water Plan

Sec 6.3: The passing on of the costs of the VDP is crucial to the extent of the price rises in the current plan and to subsequent plans. Why hasn't MW submitted their modelling on the multiple scenarios "*covering spreading a portion of the annual cost associated with a 0 GL water order for VDP over the life of the VDP asset itself (50 years)*"?

MW admits "*This would have the effect of lowering the initial price increase in the 2013 Water Plan period to some extent*", however they go on to claim "*it would leave Melbourne Water without enough cash flow to cover the annual contract payments*". Surely this is the nub of the issue. I maintain that MW should support these statements and open their assumptions to scrutiny by us the paying public. The principle behind a Public Private Partnership (PPP) should be to produce the least cost to the public and not some other result that in fact maximises the cost to the paying public.

Is the focus on cash flow before or after a dividend payment to the sole shareholder, the Government, which would be to the detriment of the ultimate shareholders – the public?

Surely the time has come when the value of PPPs should be reappraised and subject to public review before further commitments are made to ensure that the public interest is being properly achieved.

Given the different working lives of the various components of the VDP (27years/50 years/100years) surely some more appropriate method, in terms of lowering the initial slug, than recouping the cost over the shortest life, namely 27 years, should be the way to go! Why couldn't the various lives be accounted for independently and repaid accordingly? This approach would further help reduce the size of the initial impact on customers.

The statements "*alternatively*" the VDP "*would have to be funded through significant borrowings*" and "*which is counter to.....sound financial governance on behalf of the community*" belie the original basis upon which the Melbourne and Metropolitan Board of Works (MMBW) was funded. In effect the private profit which the Joint Venture Partners are taking from the VDP is being charged directly at the expense of the "community". Where are the savings going, will any share of profits from private operation of the plant be apportioned back to the community?

Sec 6.5: Will "*promoting cost reflective pricing*" extend to showing the extra price of desalination water as a separate line item on the consumer's quarterly bill? A separate line item on the bill is, in my view, the most appropriate way of showing the cost and give impetus to the need for water conservation. It will also clearly differentiate the cost of the two sources of water and help prevent the added costs being swallowed up and hence become less accountable. This failure was highlighted in the Return of Funds arising from the premature charging of VDP payments to customers.

Chap 7 Overview: MW acknowledges that "*The VDP costs fundamentally change Melbourne Water's cost profile*" and that some 13% of operating expenditures are effectively non-competitively (monopoly) priced. How can this sizeable sum be monitored and progressively contained over the life of the VDP in order to reduce the impact on customers?

Sec 7.1: The matter of alternative water sources was raised with respect to expenditures but was otherwise silent on extending the production and subsequent wider distribution of potable recycled water. The acknowledged high costs and public aversion associated with recycled water have been overtaken by the higher prohibitive costs of the VDP.

Sec 7.2: *“Mandating “third-pipe” use of recycled water for non-potable demands within households”* in the Cowies Hill and West Werribee area was noted and applauded, however, extended use of recycled water for non-potable purposes is too slow and further delays the upgrading of a significant proportion to potable standard and subsequent wide spread use. Thus a potentially cheaper source of potable water has seen supplanted by an extremely expensive reality.

Sec 7.4: *Capital Expenditure.* The lower than historical levels of capital expenditure as shown in Figure 7.1 have been distorted by the massive change to Operating Expenditure as shown in Figure 7.12 arising from the shift away from major capital works to the PPP method of functioning. Once again the risk of inappropriate haste or delay in planning and committing funds to projects needs to be controlled to preserve ongoing operations into the future.

Sec 8.3: *Return Of and On Assets.* It is noted that in determining Regulatory Asset Base (RAB) MW has changed away from ESC’s guidance. In my view the results of both the guidance and the proposed methods should be shown side by side to help better understand the impact.

Sec 8.3.2: *Regulatory Depreciation.* Table 8.7 shows Assumed asset lives for depreciating new capital expenditure. Where does the VDP asset fit? As the VDP is an operating expense item and it will presumably only come on to MW’s asset register after 27(?) years it doesn’t truly fit in this table, however, its components could be referenced for comparison purposes.

Sec 9: *Prices Overview:* I note that MW still persists with the claim that funds recovered early for the VDP are being returned to customers *“as soon as possible”* despite the fact that some funds are now still retained more than six months after collection! These types of statements could point to MW acting disingenuously towards its customers.

Sec 9.3.4: *Managing Uncertainty.* I agree the need to vary headwork water prices to reflect actual volume of desalinated water ordered in a given year with the provided that the price changes are accounted for as separate line items on customer bills. However, I would like further information on the possibility of VDP contract variations and provision for accommodating future changes in desalination costs associated with a 0 GL water order. It seems that the contract is inviolate when necessary and potentially variable when it suits (whom?).

Sec 9.5: *Alternative Water Source Pricing Principles.* I question the value of Table 9.11 for SEW and Eastern Irrigation Scheme (EIS) when the Proposed annual recycled water price is shown as a composite figure of Class A and Class C supply in unstated ratio. For comparison purposes surely separate prices for Class A and Class C as supplied to these customers would be of greater value in understanding the price ramifications.

Comments on South East Water’s Water Plan

Sec 11.1: *Price path and average bill change.* I note that two options were proposed for setting price paths namely Matched and Smoothed and that a series of focus groups were held to gauge

customer preference for their preferred price path and further that the results were fairly even. SEW reported that given customer feedback was not strongly in favour of one approach and that their preference was for a matched price path they decided to adopt a matched price path for 2013-18. This action exemplifies my contention (refer Initial comments above) that the matched price path preferentially benefits the business and will be of further benefit as CPI is applied throughout the following years.

I like the clarity in Table 11.2 in which *Proposed residential water and sewerage tariffs 2012-13 to 2017-18 (1 January 2013 dollars)* (p68) are presented, however, it would have been even better if the table contained the footnote “A one-off price increase in 2013-14 before inflation followed by no real price changes from 2014-15 onwards (excluding CPI)” (ref Sec 11.4).

Sec 11.6: Customer Impacts. Again I appreciate the clarity of the statement “If there is an order of 50 GL of water from the VDP, then the average household bill will increase by approximately \$12 from \$1,136 to \$1,148 per annum”.

Sec 8.1: Ordering water from the desalination plant – annual price adjustment. Table 8.1 shows *Incremental price and bill impact if water from the desalination plant is ordered* and I question why the indicative annual bill increase ratio does not match the order of water ratio? It appears that the greater the order quantity the greater the price /GL (3x volume leads to 4x dollar bill increase).

Sec 6.2: Demand – Current period outcomes. The variations in period volumes are significant and undoubtedly have a significant impact on revenue projections, however, “the uptake of high efficiency products and embedded behaviour responses and structural changes in outdoor water use” should be encouraged and not cause for regret. How this trend can be better integrated into this and future water plans still needs to be resolved –possibly by way of supplementary reviews when the variation falls outside preset levels.

Sec 2.1: Engagement. The plan shows Table 2.1: *Summary of customer feedback on (SEW) draft Water Plan.* SEW’s final Water Plan proposal is to retain the current three tiered approach with a reduction in the price differential between the second and third tiers. I support this action as it appears a fair balance between sustainability, cost recovery and demand stabilisation issues.

Sec 8.3: Other unforeseen events. I support SEW’s approach to include a mechanism in the price determination to ensure that events outside their current understanding can be adequately be dealt with. This approach would lessen the unnecessary need to bolster expenditure estimates, and hence revenue collection, to cover remotely possible events although the consequence is somewhat less rigidity in the final determination.

Sewage disposal charge. SEW proposes to alter the Residential Sewage Disposal Charge (SDC) from a seasonal variation charge to a set 75% of potable water supplied. They claim that this approach will not change the bill amount for most customers. My records show that in 5 of the last 6 years my SDC ranged between 61.4% and 69.4% with the average overall of 65.2%. I would consider that this would not be untypical, and that a 10% increase in sewage volume would result in an increase of \$28 pa for an average customer based on 2013-14 sewage disposal charge.

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2013 Water Price Review			Addendum 1				
Comparison of Price Path Methods							
Basis	Matched (Proposed)			Smoothed			
Retailer	South East Water						
Increase	34.9% (2)		Rate (2)				
2012-13	\$829 (1)			\$829		Match exceeds Smooth(4)	
	Annual payment	Progressive Payment		Annual Payment	Progressive Payment	Difference Annual	Difference Progressive
2013-14	1118	1118	6.30%	881	881	237	237
2014-15	1118	2236	6.10%	935	1816	183	420
2015-16	1118	3354	6.20%	992	1808	126	546
2016-17	1118	4472	6.30%	1055	3863	63	609
2017-18	1118	5590	6.40%	1123	4986	-5	604
Total (\$)	5590	5590		4986	4986	604	604
Notes/source							
(1) ESC Summary Table 1 -Indicative owner occupier							
(2) ESC Summary Table 3b -Estimated annual (real%) price change							
(3) All figures exclude CPI (ie at 1 Jan 2013 dollars - constant price)							
(4) Matched method payments exceed smoothed method payments in every year bar Year 5							
Basis	Smoothed (Proposed)			Matched			
Retailer	Western Water						
Increase	6.10%			34.90%			
2012-13	\$956			\$956		Match exceeds Smooth(4)	
	Rate (2)	Annual payment	Progressive Payment	Annual Payment	Progressive Payment	Difference Annual	Difference Progressive
2013-14	6.30%	1016	1016	1289	1289	273	273
2014-15	6.10%	1078	2094	1289	2578	211	484
2015-16	6.20%	1145	3239	1289	3876	144	628
2016-17	6.30%	1217	4456	1289	5156	72	700
2017-18	6.40%	1295	5751	1289	6445	-6	694
Total		5751	5751	6445	6445	694	694
Notes/source							
(1) ESC Summary Table 1 -Indicative owner occupier							
(2) ESC Summary Table 3b -Estimated annual (real%) price change							
(3) All figures exclude CPI (ie at 1 Jan 2013 dollars - constant price)							
(4) Matched method payments exceed smoothed method payments in every year bar Year 5							