

### REVIEW OF MELBOURNE WATER PRICE SUBMISSION

In October 2015, Melbourne Water submitted its price submission to the Essential Services Commission (the Commission) for assessment.

The price submission sets out the prices that Melbourne Water proposes to charge for its bulk water, sewage treatment, recycled water and waterways and drainage services for a five year period 1 July 2016 – 30 June 2021.

The Commission’s assessment of Melbourne Water’s price submission is set out in our draft decision. In forming our draft decision, we considered: Melbourne Water’s price submission; submissions from interested parties and a public forum; and reports prepared by expert consultants, Deloitte Access Economics and Incenta Economic Consulting.

### REVENUE REQUIREMENT – DRAFT DECISION

The Commission proposes a revenue requirement of \$7 763 million for the period 2016-17 to 2020-21, \$92 million (or 1.2 per cent) lower than proposed by Melbourne Water (Table 1).

This draft decision reflects our assessment of the efficient costs of delivering services. The revenue approved in our draft decision will allow Melbourne Water to deliver safe and reliable wholesale water and sewage services, and meet service commitments in waterway health, flood protection and stormwater management.

The lower revenue requirement approved in our draft decision reflects:

- a \$112 million reduction to forecast operating expenditure, mostly reflecting the Commission’s view on Melbourne Water’s energy costs
- a \$355 million reduction in Melbourne Water’s forecast capital expenditure, reflecting reduced or deferred capital programs
- our financial assumptions (cost of capital and tax) which had an upward impact of around \$60 million.

We note that the proposed revenue requirement on an average annual basis is around 7.9 per cent lower than in the current regulatory period. The reduction incorporates savings identified during Melbourne Water’s 2014 efficiency review. Some of the cost savings proposed by Melbourne Water and reflected in our draft decision have already been reflected in end-use customer bills in metropolitan Melbourne via a residential water bill rebate delivered in 2014 and 2015 (metropolitan water retailers also undertook an efficiency review and contributed to the rebate)

The impact of our decision on end-use customer bills will depend on how Melbourne Water responds to our draft decision.

**Table 1. Revenue requirement – Melbourne Water proposed and draft decision (\$m 2015-16)**

	2016-17	2017-18	2018-19	2019-20	2020-21	Total
Melbourne Water proposed revenue	1 560	1 576	1 588	1 570	1 561	<b>7 855</b>
Draft decision revenue	1 509	1 533	1 560	1 575	1 586	<b>7 763</b>

## TARIFF STRUCTURE – DRAFT DECISION

### • **Bulk Water and Sewerage Tariffs**

Melbourne Water proposed a shift from a fixed and variable water headworks tariff to a fully fixed tariff for each metropolitan water retailer and some regional water businesses to reflect the government's bulk entitlement reform in 2014. We propose to approve the shift in structure of the headworks tariffs.

Melbourne Water also proposed a shift in tariffs from a fixed and variable water transfer to a single variable tariff common across all retailers. We view that a single variable tariff will be easier to understand and there is broad support among the water retailers for the changes.

We have approved a mechanism that allows Melbourne Water to adjust its prices upward to reflect the costs of desalination water orders. The current determinations for the metropolitan water retailers allow them to pass on the costs of water order to end-use water customers.

### • **Waterways and Drainage Tariffs**

Our draft decision approves Melbourne Water's proposed waterways and drainage tariffs for residential and rural customers. Melbourne Water proposed to transition all non-residential customers from a charge rate linked to property value to a flat charge (all but the largest 50 non-residential customers by revenue). Melbourne Water did not propose either a maximum tariff or a method for determining tariffs for the largest 50 non-residential customers. While we support a move away from property based charge, we could not form a view on the cost reflectiveness of the proposed tariffs, or the extent to which the tariffs have regard to the Water Industry Regulatory Order 2014. Our draft decision is to not approve Melbourne Water's proposed reforms to non-residential waterways and drainage tariffs.

We did not approve a proposed new Patterson Lake Marina tariff as maintenance costs covered by the tariff are the subject of a private contract.

## OPERATING EXPENDITURE – DRAFT DECISION

Melbourne Water proposed operating expenditure of \$4 691 million for the period 2016-17 to 2020-21. Melbourne Water's operating costs mainly reflects expenditure on labour, energy, maintenance and treatment to underpin delivery of its wholesale water and sewage and waterways and drainage services. The Commission proposes operating expenditure of \$4 578 million, which is \$112 million (or 2.4 per cent) lower than the total proposed by Melbourne Water. The main reasons for the reduction is our assessment of Melbourne Water's energy costs.

The operating expenditure that we have adopted for Melbourne Water does not represent the amount that it is required to spend or allocate to particular operational, maintenance and administrative activities.

It represents assumptions about the overall level of expenditure (to be recovered through prices) that we consider sufficient to operate the business and to maintain services over the regulatory period.

Melbourne Water proposed to capitalise (that is, treat a proportion of operating costs as capital expenditure for pricing purposes) \$20 million per annum of its forecast annual desalination security payments over the 2016-17 to 2020-21 period. We propose to approve the capitalisation amounts for the desalination security payments. This has the effect of lowering prices for end-use customers. Melbourne Water is invited to provide more information on opportunities for capitalisation of the desalination payment given our draft decision on capital expenditure and finance costs, and views in submissions to the Commission from retail water businesses and some consumer groups.

## CAPITAL EXPENDITURE – DRAFT DECISION

For the period 2016-17 to 2020-21, Melbourne Water proposed capital expenditure of \$2 672 million. The proposed expenditure reflects projects such as upgrades to sewage treatment plants, renewal of aging infrastructure to ensure service continuity and flood protection works.

The Commission propose capital expenditure of \$2 316 million. This is \$355 million (or 13.3 per cent) lower than proposed by Melbourne Water.

In our view, our draft decision would allow Melbourne Water to deliver its service commitments.

## RESPONDING TO THIS DRAFT DECISION

We invite comments from interested parties on our draft decision. The Commission will consider those comments before making its final decision for new maximum prices to be in place by 1 July 2016.

Interested parties can provide feedback on this draft decision in two ways:

### • Come to a public meeting

We will hold a public forum in April 2016.

The forum will provide an opportunity for interested parties to understand and comment on the key features of this draft decision.

We will publish details of the forum on our website:  
[www.esc.vic.gov.au](http://www.esc.vic.gov.au).

### • Provide written comments or submissions

Written comments or submissions in response to this draft decision are due by 26 April 2016.

We would prefer to receive them by email at [water@esc.vic.gov.au](mailto:water@esc.vic.gov.au).

Or by mail to:  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne VIC 3000