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3 June 2008

Mr Greg Wilson
Chairperson
Essential Services Commission
Level 2, 35 Spring Street
MELBOURNE, VIC 3000

Dear Greg,

Melbourne Water appreciates the opportunity to respond to the Commission's Draft Decision on prices for drainage and waterways services to apply over the 2008/09 to 2012/13 regulatory period.

Our response to the information on expenditures and prices requested by the Commission in the Draft Decision are attached.

Should you require further clarification or wish to discuss any aspects of the information provided, please contact Ben Furmage, Manager Pricing and Regulation on 9235 7210.

Yours sincerely

ROB SKINNER
MANAGING DIRECTOR

Cc: Will Guthrie, Department of Sustainability and Environment

Attachment 1

Response to the Essential Services Commission's Draft Decision on Melbourne Water's 2008 Waterways Water Plan

On the 16 May 2008, the Essential Services Commission (the Commission) released its Draft Decision in relation to prices for Melbourne Water's waterways and drainage services applying over the 2008/09 to 2012/13 period. In the Draft Decision the Commission requested Melbourne Water provide additional information in relation to expenditures and prices. This information is provided below.

Comments are also provided in relation to the Commission's proposal to reopen prices to reflect outcomes from its review of bulk water and sewerage prices and assessment of progress of planned activities against targets.

Expenditures

Draft Decision, Section 4.2

The Commission seeks further information from Melbourne Water on the take up projections of grants for waterway condition works on private land.

Melbourne Water Response

Table 1 outlines the actual and forecast Water Plan operating expenditures for Melbourne Water's grants program and equivalent take up projections.

Table 1: Actual and forecast operating expenditure for grants program

Financial Year	Water Plan ($)	Actual ($)	Variance ($)	Water Plan (No. Grants)	Actual (No. Grants)
2005/06	2,204,945	1,879,186	(325,759)	600	503
2006/07	2,104,945	2,117,770	12,825	575	507
2007/08	2,119,945	2,310,616*	190,671	580	765
2008/09	2,754,300	NA	NA	775	NA
2009/10	2,838,999	NA	NA	800	NA
2010/11	2,925,587	NA	NA	825	NA
2011/12	3,014,109	NA	NA	850	NA
2012/13	3,104,614	NA	NA	875	NA

*Forecast year end expenditure

As illustrated in Table 1, the number and total value of grants given to landholders and the community to undertake stream frontage improvement works has increased over the 2005 Water Plan period as a result of Melbourne Water raising community awareness of river health issues and building stronger community relationships. [1]

[1] Using the number of grants to gauge performance in meeting river health targets is problematic as the take up of a grant by a landholder with several kilometres of stream frontage could contribute an equal amount to the river health targets as a number of grants taken up by landholders with smaller stream frontages.

Melbourne Water has based its 2008 Water Plan forecast operating expenditures for the grants program on their projected contribution to riparian management (revegetation and weed control) and management agreement targets included in the Regional River Health Strategy - Addendum.

The forecast increase in the number of grants over the 2008 Water Plan period is due to expanding the grants program to landholders and community groups within Melbourne Water's extended boundary areas where there is a larger concentration of rivers and creeks. There is also a lower proportion of crown land in the extended area increasing the importance of effective engagement of private landholders in delivering improved stream frontage.

In developing forecast 2008 Water Plan expenditures to meet riparian management targets it has been assumed that 40% of land managers (private landholders, councils and community groups) with stream frontage will take-up grants across Melbourne Water's urban and rural areas. This assumption is consistent with guidance provided by the Department of Sustainability and Environment and aligns with the methodology used by Catchment Management Authorities across the State. Forecast expenditure growth to achieve this assumption is consistent with increases in take-up rates achieved over the 2005 Water Plan period.

Consultation to date in the extended areas indicates there is a strong commitment by the community to participate in the grants program. Due to the absence of a waterway management authority within the extended areas in the past, the community has developed a sense of ownership of waterways in their area and a willingness to improve their condition.

Draft Decision, Section 4.2

The Commission seeks further information on the ability of Melbourne Water to deliver the targeted 10,000 rain gardens during the 2008 Water Plan period.

Melbourne Water Response

The objective of the 10,000 raingardens target included in Melbourne Water's Waterways Water Quality Strategy and Waterways Operating Charter is to enhance local government and community capacity to improve stormwater management through programs that encourage the installation of raingardens within established urban areas.

Achievement of the 10,000 raingardens target will require a combined effort by Melbourne Water, local government and the wider community.

Melbourne Water will implement programs that support the construction of raingardens on public and private land (including house lots and community venues). These programs will build on capacity enhancing programs that are already underway such as Raingardens in Schools Program and local government stormwater partnership programs.

For example, the City of Melbourne has recently agreed to a stormwater management target that is likely to result in about 500 raingardens being retrofitted into streetscapes over the next five years. Melbourne Water anticipates that agreement by other local governments to similar targets will make a significant contribution to the 10,000 raingardens target.

Another example is the pilot catchment scale river restoration projects which are likely to result in a significant amount of raingardens being built by the community. This Smart Water funded project being lead by Melbourne University (with some funding from Melbourne Water) offers stormwater treatment measures such as raingardens and rainwater tanks to residents to help manage stormwater at the allotment scale. Whilst in its early phase, it is likely to have over 50 raingardens installed by the community by June 2009. This pilot project is expected to be expanded out to other priority areas across Melbourne.

In addition, due to the integrated nature of Melbourne Water's stormwater quality improvement programs, rain gardens will be an important element of achieving other stormwater quality targets such as achieving a 70% improvement in local government's performance in delivering sustainable urban water management.

The raingarden target does not directly relate to the requirement that 10,000 individual raingardens be built within the community. Equivalence ratings will identify the treatment effectiveness of constructed raingardens. For example, a raingarden treating stormwater runoff from a large commercial car park has a greater impact on water quality than a raingarden attached to a single dwelling and therefore, would be assigned a number of equivalence units. This will enable a focus on projects that maximise the improvement in stormwater quality rather than focusing on delivering a numerical target.

Table 2 summarises the activities and forecast expenditures planned to meet the 10,000 raingardens target over the 2008 Water Plan period.

Table 2: Forecast operating expenditure to deliver 10,000 raingardens target over the 2008 Water Plan period

Program	**Water Plan ($)**
Raising awareness of stormwater water quality issues and management options and improve councils and the community's capacity to construct raingardens. This includes icon projects in the community and demonstrations such as promotions through nurseries and other landscaping industries	500,000
Develop design tools, websites and promotional material and incentive measures to assist implementation	400,000
Training for professionals and community groups in raingarden design and construction (eg. landscapers, plumbers, consultants, nurseries, supply industry, friends of groups, gardening clubs)	400,000
Funding rebates for the construction of raingardens, auditing and monitoring programs	400,000
Investigate appropriate treatment measures, design requirements and work with the local government and the plumbing industry to find ways of simplifying approval processes for installing raingardens	100,000
Total	**1,800,000**

Draft Decision, Section 4.2

The Commission seeks further information from Melbourne Water on the development of the definition of intolerable flood risk and its impact on expenditures.

Melbourne Water Response

The Melbourne region has 40,000 properties vulnerable to above floor level flooding from either riverine flooding or overland flows. It would require an estimated investment of at least $2.8 Billion to address the flood risks for every property. A review undertaken by the Victorian Auditor General [2] and stakeholder consultation has identified the need for more cost effective approaches to managing flood risks for these properties which would focus on reducing 'intolerable' flood risks and collaboratively managing residual flood risks through an appropriate mix of structural and non-structural solutions (e.g. integrated planning and education).

To commence progress on addressing flood risks for affected properties, Melbourne Water has been assigned the target to reduce 10% of currently known intolerable flood risks by 2013 under the Waterways Operating Charter. The Operating Charter also identifies a 10-year goal to reduce currently known flood risk by 30% by 2018 and a long term aim to minimise all currently known intolerable flooding risks.

For the purposes of the 2008 Water Plan, intolerable flood risks have been identified based on consideration of the potential:

- Threat to life, health or safety
- Number of people/properties affected
- Environmental impacts
- Disruption to economic activity or public infrastructure.

Capital projects included in the 2008 Water Plan to meet the 2013 Waterways Operating Charter target (represents about 46% of total capital expenditure for the drainage and flood protection program) were identified and prioritised through an assessment of known high risk flood affected areas against the intolerable flood risk considerations mentioned above.

Priority projects for the 2008 Water Plan include Sandgate Avenue Drain, Fairfield Main Drain and Merrilands Drains which would receive a high priority on any reasonable interpretation of intolerable risk.

In addition to the priority projects, Melbourne Water has also identified a number of possible projects that would be required to address flood risks in other affected areas. However, further work is needed to prioritise these risks and refine the program of projects. Consequently, an allocation for flood mitigation works has also been included in the 2008 Water Plan and a detailed prioritised program of works will be identified when intolerable flood risk is further defined.

Enhanced capital planning and delivery mechanisms outlined in Melbourne Water's 2008 Water Plan will ensure timely delivery of these projects.

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[2] Victorian Auditor General, 2005, Managing Stormwater Flooding Risks in Melbourne

Table 3: Forecast capital and operating expenditure to meet the intolerable flood risk target

	2008/09 ($M)	2009/10 ($M)	2010/11 ($M)	2011/12 ($M)	2012/13 ($M)
Capital expenditure					
Sandgate Avenue Drain	4.5	12.4	4.0	0.0	0.0
Fairfield Main Drain	0.3	7.9	11.0	0.0	0.0
Merrilands Drain	0.0	0.1	0.0	1.0	0.0
Allocation – Flood mitigation works [1]	0.8	0.9	0.9	7.8	12.2
Total	**5.6**	**21.3**	**15.9**	**8.8**	**12.2**
Operating expenditure	**1.0**	**1.0**	**1.0**	**0.9**	**1.0**

[1] Includes mapping to determine flood extent

Table 4 outlines Melbourne Water's program to further define intolerable flood risk and develop a risk assessment model to facilitate more systematic consideration of flood risk factors and quantification of intolerable flood risk. Completion of the work on defining intolerable flood risk will enable Melbourne Water to prioritise the list of flood affected areas according to their 'flood risk'. Those areas assessed as having an intolerable flood risk will be investigated over the coming years for possible flood mitigation measures, either structural or non-structural.

The risk assessment model will also assist in prioritisation when the differences between possible flood mitigation projects are more marginal. The model and methodology will formalise the process for developing future Water Plan proposals.

Table 4: Program for developing intolerable risk assessment methodology

Date	Deliverable	Activity
April 2008	Draft tolerability assessment model	• Utilise results of RMIT research to adapt MWC Risk Management Matrix
May 2008	Targeted stakeholder consultation Local Government consultation	• Consult with representatives from DSE, OESC, VICSES, DHS, SIAV, IPWE, CMA Flood Managers, Waterways Advisory Group • Refine and circulate draft then conduct at least two workshops with local government representatives, 38 councils
June 2008	Market research	• Engage consultants to undertake market research with sample population of residents, (e.g. recently flooded, at risk but not flooded and not at risk) to improve understanding and categorise intangible risks
July 2008	Adoption of final model	• Further consultation around proposed final model • Testing and refinement of model based on consultation • Circulate proposed final model to reach agreed approach
August 2008	Quantification of impacts, determination of magnitude of intolerable flooding	• Apply model to Melbourne Water catchments
October 2008	Presentation to ESC on methodology	• Discuss proposed methodology and any material implications for proposed expenditures with ESC

Draft Decision, Section 4.2

The Commission seeks further information from Melbourne Water on the potential to smooth capital expenditure across the regulatory period, in particular for the drainage and flood protection program

Melbourne Water Response

In relation to the drainage and flood protection program, the lumpy nature of capital expenditure forecasts for the 2008 Water Plan period is driven by projects to meet new obligations in regards to reducing intolerable flood risks and undertaking works on business as usual assets to meet safety standards and comply with legislative requirements.

Large scale flood mitigation projects (Sandgate Avenue Drain and Fairfield Main Drain) planned to meet intolerable flood risk targets will be constructed in developed urban areas using large diameter pipes and/or retarding basins. The pipes are generally placed under existing road infrastructure which results in significant impacts on the local community through traffic disruption, inconvenience and noise. Although the planned works have been divided into stages, where feasible, there is a need to deliver the projects within a reasonable timeframe to suit the construction technique (e.g. tunnelling, pipe jacking, open trench) and to minimise the impact on the local community. It is unlikely that Melbourne Water would be in a position to meet its 2008 Water Plan target in relation to reducing intolerable flood risks if the timeframes for the delivery of these two projects was pushed back.

In developing the 2008 Water Plan, portfolio risk assessments undertaken on the condition of drainage assets identified a number of capital works required to meet safety standards included in Melbourne Water's Statement of Obligations and to meet Water Plan outcomes relating to 'no instances of asset failure that result in significant flooding, damage, disruption or personal injury'. Capital works identified over the 2008 Water Plan period to meet these requirements include:

- Works to replace and refurbish ageing infrastructure in the Patterson Lakes Development which will be funded by special drainage prices applying in the area. Melbourne Water has consulted with local resident committees in relation to the level of works required and their timing and is currently working with the committee on developing appropriate funding arrangements
- Staged remedial works to improve the capacity of retarding basin spillways and removal and/or modifications of drains discharging into Port Phillip Bay from beach outlets which pose a safety hazard
- Improvement/stability works for drainage channels, levee banks and retarding basins that have reached the end of their useful life and a program of land rehabilitation works to comply with biodiversity legislative requirements.

Melbourne Water has phased these projects over the 2008 Water Plan period according to asset condition and associated safety risks and expenditures have been smoothed where appropriate.

Draft Decision, Section 4.2

The Commission seeks further information from Melbourne Water on the impact of changes to payroll tax, land tax and WorkCover premiums announced in the recent State Budget.

Melbourne Water Response

Table 5 outlines the impact of State Budget changes to payroll tax and land tax on Melbourne Water's forecast 2008 Water Plan operating expenditures.

The change in payroll tax from 5.05% to 4.95% has a very small impact ($0.10M) on Melbourne Water's forecast operating expenditures for the period as payroll tax accounts for a small proportion (5%) of total labour costs.

Although reductions were made to land tax rates in the State Budget, the level of land tax forecast to be paid over the 2008 Water Plan period has increased due to higher land valuations received subsequent to Melbourne Water's 2008 Water Plan submission.

In regards to WorkCover, Melbourne Water is a self insurer for workplace injury claims and does not pay WorkCover premiums to the Victorian WorkCover Authority. Therefore, changes to WorkCover premiums will have no impact on Melbourne Water's expenditures.

Table 5: Impact of State Budget changes to payroll and land tax on 2008 Water Plan operating expenditures

	2008/09 ($M)	2009/10 ($M)	2010/11 ($M)	2011/12 ($M)	2012/13 ($M)	Total ($M)
Payroll tax – Water Plan	0.87	0.88	0.87	0.89	0.89	4.40
Payroll tax – Revised	0.85	0.86	0.85	0.87	0.87	4.30
Difference	**(0.02)**	**(0.02)**	**(0.02)**	**(0.02)**	**(0.02)**	**(0.10)**
Land tax – Water Plan	1.70	1.87	2.02	2.16	2.31	10.06
Land tax - Revised	2.42	2.64	3.01	3.31	3.69	15.06
Difference	**0.72**	**0.77**	**0.99**	**1.15**	**1.38**	**5.00**

Draft Decision, Section 4.2

The Commission may also review other components of the drainage and waterways expenditure during its review of Melbourne Water's bulk water and sewerage prices, including an assessment of progress of planned activities against targets.

Melbourne Water Response

In its Draft Decision the Commission notes that, in consultation with its customers, Melbourne Water is free to determine its own expenditures priorities in light of changing circumstances and to pursue innovation and efficiencies that enable it to out

perform the cost assumptions. This said, the Commission also notes that it may review components of the drainage and waterways expenditure, other than corporate overheads, during its review of Melbourne Water's bulk water and sewerage prices. This would include an assessment of progress against targets.

Melbourne Water considers that incentive based regulation works best by allowing businesses to manage within a regulatory period the expenditures determined by the Commission as being prudent and efficient. This enables the business to reprioritise expenditures as necessary and to benefit from efficiency and innovation initiatives. While recognising the benefits of within period expenditure reviews for uncertain projects or new obligations, Melbourne Water does not consider there are benefits from further reviewing expenditures already determined as efficient. Such reviews will certainly diminish any incentives to implement efficiency initiatives.

However, should the Commission decide to review drainage and waterways expenditures at the same time it reviews Melbourne Water's bulk water and sewerage prices, such a review should only be triggered when total overall actual expenditures are significantly greater those determined by the Commission. Setting a review threshold that is triggered when expenditures are greater than those determined by the Commission would ensure that incentives to implement efficiency incentives are maintained. Only reviewing expenditures that are significantly greater than those allowed enables business to manage their expenditures, including across years within the regulatory period.

Prices

Draft Decision, Section 7.2.3

The Commission seeks further information from Melbourne Water on the impacts of introducing fixed charges/prices for residential customers within a shorter timeframe.

Melbourne Water response

As outlined in Melbourne Water's 2008 Waterways Water Plan, residential customers receive a wide range of social, recreational, economic and environmental benefits from the provision of regional services which includes flood protection for households and community assets (e.g. roads) and higher quality waterways. These benefits are broadly available to all residential customers who live, work or travel within the catchment and can be considered to be essentially uniform for all residential customers. Consequently, Melbourne Water has proposed to introduce a single fixed price based on the average cost of providing services to residential customers as a proxy for the benefits received and costs incurred by this group.

As property values result in a large distribution of prices paid by customers, moving residential customers to a single fixed price results in prices increasing for some customers and decreasing for others. Without phasing these impacts could be material with disproportionate increases/decreases for some customers.

In developing the 2008 Waterways Water Plan, Melbourne Water consulted on the option to introduce a single fixed price for residential customers from the 1 July 2008.

Whilst stakeholders were supportive of customers receiving similar services paying similar prices, concerns were raised in regard to the size of the 'one-off' increase required to move customers on the minimum to the average cost and feedback was received that Melbourne Water should phase-in the increases over the regulatory period to manage the impact on customer bills.

In light of the consultation feedback and the significant customer impacts associated with introducing a fixed price from 2008/09, Melbourne Water has proposed to transition minimum paying customers to the average cost over a 5 year period. This process will see a gradual increase for customers paying the minimum price while prices for customers with high property values will be maintained in real terms until 2012/13 when all customers will move to the average cost of the service.

Draft Decision, Section 7.2.3

The Commission seeks further information from Melbourne Water on its longer term strategies for reforming non-residential waterways and drainage charges/prices.

Melbourne Water response

Melbourne Water's broader long-term strategy for reforming waterways and drainage prices is to move away from using property values and to introduce a charging structure that more effectively:

- Reflects the extent to which different customer sectors impact on, or benefit from waterways and drainage services
- Achieves a higher level of transparency and customer understanding
- Takes account of customer impacts relative to some other options
- Provides an adequate and stable level of revenue to maintain services at an agreed standard
- Delivers significant implementation and administration cost savings.

Another key objective of Melbourne Water's long-term strategy includes developing charging structures that take account of the relationship between waterways and drainage services and other elements of the water cycle (e.g. stormwater). Melbourne Water's long-term strategies include investigating the potential to use prices to promote incentives for more sustainable and efficient outcomes.

In developing its 2008 Water Plan, Melbourne Water undertook a two year investigation which included extensive stakeholder consultation and detailed review of a number of alternative charging methodologies (e.g. fixed prices, catchment based prices, council based prices). This combined with work undertaken as part of Melbourne Water's 2005 Water Plan resulted in a staged reform process being proposed.

The first stage focused on residential customers (representing 89% of the customer base), introducing rural prices in response to customer feedback and introducing prices to Melbourne Water's extended operating area where services have been provided since 2005.

A feature of non-residential customers (ranging from cafes, to shopping centres and factories) is their diversity in terms of their contribution to Melbourne Water's costs (e.g. a customer's contribution to the quantity and quality of stormwater run-off), the benefits they receive (e.g. the level of foregone earnings as a result of flooding) and the prices they currently pay. Prices based on property values also mean that similar customers (e.g. café owners) in different locations can pay very different prices. This diversity means that current prices are not cost reflective and any price reform will have potentially significant customer impacts.

Therefore, to allow appropriate consultation on both the nature of the prices and its implementation, Melbourne Water proposed not to introduce a new basis for charging on 1 July 2008. Melbourne Water is however committed to moving to an improved basis for charging that is simpler, more cost reflective and ideally supports improved stormwater use.

Melbourne Water has not proposed introducing a single fixed price for non-residential customers in line with reform proposals for other sectors since, unlike other sectors, the impact on and benefit received from services is not uniform across customers. Levying a fixed price would unfairly apportion a greater level of costs on smaller customers. For example, a single fixed price based on the current average non-residential customer bill would see a bakery owner in the outskirts of Melbourne paying the same as a department store in the central business district.

A more cost reflective and equitable alternative charging structure was investigated by Melbourne Water involving differentiating between customers based on their land areas and level of imperviousness as a proxy for the quantity and quality of stormwater runoff. Although this charging structure better reflected the cost impact on Melbourne Water's services by different customer types, the resulting change in customer bills would still have been significant due to the large distribution in prices currently paid by customers.

In addition, stakeholder consultation resulted in the investigation of taking up 2006 property values as a basis for non-residential prices. The analysis indicated that while the use of 2006 property values would result in fewer extreme customer impacts it would see increased bills for more than two thirds of customers and in some cases the impacts would still be very large. Further, administering current values is expensive as values would need to be acquired on every revaluation (estimated to be $2M every two years). Impacts on customer bills would also be experienced each time property values were updated resulting in ongoing price volatility.

Given the extent of customer impacts under the alternative charging structures investigated, Melbourne Water proposes to retain its current charging arrangements for the non-residential sector.

This will help ensure that customers are no worse off in the interim while further work takes place over the 2008 Water Plan period to develop an alternative basis for charging that is consistent with Melbourne Water's long-term objectives, manages customer impacts and is acceptable to Government and customers.

Although Melbourne Water does not propose to move away from property valuation based prices for the 2008 Water Plan period, it does propose that the minimum price be increased in 2008/09 to reduce the amount of property based prices and to establish a higher base price upon which future tariff reforms can take place. Analysis undertaken to date demonstrates the difficulty in reforming prices with the minimum paid by customers being so low.

A higher minimum price also reflects the greater cost impact many non-residential customers have on services as compared to residential and rural customers. Increasing the minimum from $55 to $77 [3] (in real terms) in 2008/09 would result in the number of non-residential customers paying the minimum increasing from around 14% to approximately 23%.

Melbourne Water has a firm commitment to reform non-residential prices in a timely fashion and aims to complete the analysis and consultation required to develop an acceptable charging basis and manage customer impacts (through appropriate phase-in mechanisms) within the 2008 Water Plan period. Melbourne Water will involve the Commission in this process and proposes that the Commission apply an appropriate price control method to enable commencement of the reform process within the 2008 Water Plan period.

Draft Decision, Section 7.2.3

The Commission seeks further information from Melbourne Water on the costs, benefits and customer impacts of the two options identified in the Draft Decision to address the inconsistency of approach in non-residential prices between the existing and extended areas.

Melbourne Water response

Melbourne Water agrees in principle with comments included in the Commission's Draft Decision that customers receiving the same level of service should pay the same price or incur prices that are calculated in the same manner. However, Melbourne Water does not support the implementation of either of the options identified by the Commission as this principle must be balanced in the short term against the customer impacts resulting from applying a consistent approach, customer understanding of the charging basis and whether it facilitates implementing future reforms or results in avoidable price volatility.

These considerations are discussed below in the context of the two options identified in the Commission's Draft Decision.

[3] Reflects Melbourne Water's revised Water Plan price proposals incorporating refinements sent to the Commission on the 30 April 2008 and a Weighted Cost of Capital of 6.1% as per the Commission's Draft Decision

Option 1: Increase the minimum charge/price for non-residential customers at a faster rate over the regulatory period and moving all customers to fixed charges from 2012/13 in line with the reforms for residential customers.

Under this option, non-residential customers would transition to an average fixed price of approximately $476 in real terms over the 2008 Water Plan period in line with reforms for residential customers.

Phasing in a fixed price over the regulatory period would result in increasing the minimum price by about $100 each year from 2009/10 for around 25% of customers within the existing and extended areas. Property values would be retained for customers who currently pay above the minimum in the existing areas until the transitional arrangements are complete in 2012/13. As the majority (96%) of revenue is collected from customers currently paying above the minimum, prices for these customers would decrease by about 8% in real terms over the regulatory period as additional revenue is recovered from customers on the minimum.

Aside from the significant customer impacts associated with introducing a fixed price, Melbourne Water does not support introducing a single fixed price for the non-residential sector on the basis that the impact on and benefit received from services is not uniform across customers. As discussed above, levying a single fixed price would unfairly shift the revenue burden to smaller customers and apportion fewer costs to customers that have a greater impact on services. For example, a fixed price would see an oil refinery pay the same amount as a small shop even though it has a larger impact on services in terms of the quantity and quality of stormwater runoff.

Option 2: Using property values to calculate drainage charges/prices on a consistent basis in both existing and extended areas while further reforms are undertaken.

Under this option, prices for non-residential customers within the extended areas would be calculated by multiplying the same rate in the dollar applying in the existing areas to the 1990 Net Annual Value of the customer's property, subject to a minimum price.

In developing its 2008 Water Plan proposals for customers in the extended areas, Melbourne Water sought to balance broader equity considerations arising from the application of a consistent charging basis with the potential impacts on customer bills, the degree to which customers would understand the basis for their price and whether it facilitates implementing future reforms or results in avoidable price volatility. These considerations reflect consultation feedback received from stakeholders and the community within the extended areas which require that the basis for charging for new services should be readily understood by customers and that the impacts on customers be taken into consideration.

Adopting a property valuation basis for charging customers in the extended areas would result in a very large distribution of prices. To minimise price shocks for customers, large prices would need to be phased in over a number of regulatory periods to help manage the impact on customer bills.

These phase-in arrangements would not only create inconsistencies in property based customer prices between the existing and extended areas over the 2008 Water Plan period, but could result in large fluctuations in customer bills when reforms are introduced in the 2013 Water Plan period. In addition, introducing property values in the extended areas will further complicate the reform of prices for non-residential customers as it would further increase the level of customer impacts.

Unlike the existing areas where customers are familiar with Melbourne Water's property valuation based prices, customers in the extended areas receiving services and paying prices for the first time are unlikely to understand a price that is based on the 1990 dollar value of their property which is based on Net Annual Value as opposed to Capital Improvement Value used to calculate their local council rates. Introducing property values is these areas, is likely to result in customer confusion and be difficult to explain.

Melbourne Water accepts there would be inconsistencies in the short term by introducing a fixed price for non-residential customers in the extended areas and continuing the use of property values within the existing areas. However, it considers that broader considerations in terms of customer impacts, customer understanding and implications for further reform outweigh consistency considerations in the interim.

The transition measures proposed in Melbourne Water's 2008 Water Plan will ensure there is greater consistency between customer prices within the existing and extended service areas, further reduce reliance on property values and ensure that customers are no worse off while further analysis takes place over the regulatory period on developing a charging basis that can be uniformly applied across all non-residential customers.

Draft Decision, Section 7.3

The Commission seeks confirmation on whether Melbourne Water's proposes to retain its pricing principles for calculating drainage developer charges/prices over the regulatory period.

Melbourne Water response

In its 2008 Waterways Water Plan, Melbourne Water indicated that a number of reforms have been or are in the process of being implemented to improve the robustness of development service schemes.

The Commission requests that Melbourne Water confirm whether or not the reforms require any amendments to the current pricing principles for calculating developer prices in order to be implemented.

The reforms are either designed to improve expenditure and land development forecasting accuracy or are of a procedural nature to better manage the administration of schemes.

Therefore Melbourne Water confirms the current pricing principles for calculating developer prices as per the 2005 Water Plan will continue to be applied over the 2008 regulatory period without amendment.

Draft Decision, Section 7.4

The Commission seeks further information on the costs it expects to incur in providing diversion services and the revenue it expects to receive under the proposed prices included in the 2008 Waterways Water Plan.

Melbourne Water response

Diversion prices are set to recover the costs for services related to billing and collections and monitoring and enforcing customer compliance with licence conditions. These costs include:

- Direct operating costs of service provision (including labour, materials, maintenance)
- Allocation of corporate overheads that can be directly attributed to diversion services (including accommodation, accounts receivable, information technology hardware)
- Capital costs associated with the renewal of meters and upgrading information technology systems to meet monitoring and reporting requirements.

Table 6 outlines the total operating and capital expenditure forecast over the 2008 Water Plan period for diversion services.

Table 6: Forecast operating and capital expenditure

	2008/09 ($M)	2009/10 ($M)	2010/11 ($M)	2011/12 ($M)	2012/13 ($M)
Operating expenditure	0.6	0.6	0.7	0.7	0.7
Capital expenditure	0.05	-	0.1	0.1	0.1

The increase in forecast expenditures over the 2008 Water Plan period is due to additional costs incurred to meet changes in water resource management requirements along with new initiatives to improve customer service. These include:

- Contributing to the creation of a State-wide register for water entitlements and collection of an environmental water reserve contribution from water users under the State Government's White Paper
- Additional labour to more effectively manage customer compliance and enforcement with license requirements and to manage emerging requirements for licensing stormwater diversions in accordance with the CRSWS
- Implementing technology to improve the level of information customers receive on their metered water levels and status on restrictions or bans on extracting water, and to meet the Commission's requirements in relation to performance reporting

- Implementation of Streamflow Management Plan requirements in regards to monitoring water flows.

The building block approach has been used to establish the revenue requirement for diversion services which includes a return on existing assets. Table 7 outlines the rolled forward regulatory asset base used to calculate prices for diversion services.

Table 7: Rolled forward regulatory asset base

	2008/09 ($M)	2009/10 ($M)	2010/11 ($M)	2011/12 ($M)	2012/13 ($M)
Opening RAB	0.58	0.57	0.51	0.55	0.58
Plus Gross Capital expenditure	0.05	-	0.10	0.10	0.10
Less Regulatory depreciation	0.06	0.06	0.06	0.07	0.08
Closing RAB	0.57	0.51	0.55	0.58	0.60

A copy of the templates used to calculate diversion prices will be provided to the Commission for information purposes.