

9 May 2008

Mr Sean Crees
Director Regulation (Water)
Essential Services Commission
Level 2
35 Spring Street
MELBOURNE VIC 3000

Dear Sean,

Please find attached South East Water's response to your 2008 Water Price Review Draft Decision for Regional and Rural Businesses. South East Water understands that the Commission's Draft and Final Decisions in relation to miscellaneous, developer and recycled water charges will apply to the metropolitan retailers. South East Water has made comments in relation to these issues as well as other aspects of the Commission's Draft Decision that could reasonably be expected to impact on a similar decision for the metropolitan retailers, in the future.

Most importantly, South East Water is aware that the Commission expects to deliver its Final Decision in mid June 2008. In order to facilitate the development of customer communication messages and material plus allow necessary changes to billing systems to be implemented, South East Water would encourage the Commission to deliver its Final Decision as soon as possible.

Should you require any information in addition to the attached, please feel free to contact me on 9552 3725 or ian.johnson@sewl.com.au.

Yours sincerely



Ian Johnson
General Manager, Regulation

South East Water Response to:

2008 Water Price Review

Regional and Rural Businesses Water Plans 2008-2013 – Draft Decision

May 2008

Introduction

South East Water appreciates the clarity provided by the Commission's decision in relation to the likely outcomes for establishing miscellaneous charges, new customer contributions and residential recycled water prices for 2008/09, as well as the process for the Department of Sustainability and Environment (DSE) to confirm the general price increases for South East Water for 2008/09.

South East Water understands that due to a number of factors, the Commission's final decision in relation to the Regional and Rural Businesses Price Review is not expected until mid June 2008. South East Water requests that the Commission endeavour to make known its final decision as soon as possible in order to provide retailers with sufficient time to inform customers and make the necessary changes to billing systems. South East Water has been contacted by a number of customers wishing to understand the nature of the 2008/09 price increase for miscellaneous and developer charges and South East Water would like to be able to provide as much notice as possible, in the interests of customer service.

South East Water would like to take this opportunity to address issues raised in the Draft Decision that either apply directly to the metropolitan retailers or are issues where a decision by the Commission could reasonably be expected to impact on a similar decision for the metropolitan retailers, in the future.

Miscellaneous Charges

South East Water is strongly supportive of the Commission's proposed approach to approve a core set of miscellaneous charges only, with the remainder set by the retailer, subject to pricing principles.

South East Water does however question the practicality of determining the charges that make up the core list on the basis of revenue contribution only, and believes that the benchmark of 75% of miscellaneous charges revenue is too high. South East Water originally proposed to submit for approval a set of charges that represented high volume items, were services of a fundamental nature or contributed significantly to revenue. South East Water's view is that the Commission should take into account the individual circumstances of each business and the reasons behind the charges proposed when determining whether their core services list is appropriate.

The core list of South East Water proposed services is as follows:

- 20mm meter fee
- Information Statements
- Application fee for single house connections
- Sewer location plan fee
- Removal and testing of 20mm meters
- Restoration of supply (after withdrawal)
- Build over easement
- Trade Waste Application fee

The Commission should also recognise that some miscellaneous services (eg chargeable works for repairs to hydrants etc) are charged on an actual cost basis. These one off services make up a significant proportion of revenue. South East Water expects to find it difficult to make up a list of core services which account for 75% of revenue, without including items charged at actual cost.

Recycled Water

South East Water accepts the Commission's proposed changes to pricing principles, and considers it particularly important that the Commission acknowledges that recycling projects are undertaken on the basis that they contribute to both potable replacement and recycling targets imposed on retailers as well as the achievement of supply/demand balance. When considering whether the price applied to a recycled water project is appropriate, South East Water expects that the Commission should consider the attainment of supply/demand balance on a long term basis. For example, South East Water has mandated the installation of dual pipe reticulation systems in a number of areas expected to be developed as new residential

estates. These are the estates that for geographic reasons provide the most efficient opportunity to undertake potable substitution and waste minimisation. Therefore, in order for it to be cost effective, recycled water reticulation needs to be installed at the time the development is constructed, regardless of the immediate supply/demand balance.

South East Water remains supportive of the Commission's proposal to approve and publish a tariff for residential third pipe recycled water customers, while retaining the use of pricing principles for non-residential third pipe and all other recycled water customers. South East Water has connected a number of third pipe residential customers during the current regulatory period and is expecting to connect many more during the next period. Standards of service provided to residential customers are generally consistent and in order to give future customers a degree of certainty, a published price is seen to be of benefit.

South East Water believes that its existing residential recycled water pricing policy (a volumetric charge equivalent to the lowest potable price and a service charge less than the standard residential potable water charge) satisfies the requirements of the Commission's pricing principles. South East Water will also apply pricing principles for non-residential customers in third pipe developments

New Customer Contributions

Process for Determining Brought Forward Charges

While South East Water has not experienced any significant difficulties with the existing methodology for determining brought forward charges, South East Water is of the view that a scale of charges could be of value. The main source of conflict in relation to brought forward charges relates to developers disputing the number of years a development has been brought forward. Whilst a scale of charges may solve some of these issues, there will still be scope for disagreement where a development is close to one of the change points in the scale.

South East Water would prefer that if a scale of charges is to be introduced, the years align closely to the Urban Development Program, which is the primary tool used to determine brought forward charges. Therefore, if a change is to be considered then South East Water would recommend the following scale:

- 0-2 years = zero
- 3-5 years = 25%
- 6-10 years = 35%
- 11-15 years = 50%
- >15 years = 70%

While South East Water remains strongly supportive of the concept of bring forward charges in order to ensure that assets are developed in an efficient and least cost manner, recently announced planning changes need to be taken into consideration. Developers need to be aware that brought forward charges still apply on the basis of the Urban Development Program in place at the time of development of the Water Plan, or South East Water will need to accelerate planning for asset construction in growth areas resulting in significant cost increases.

In addition, South East Water has previously noted that the process of managing brought forward applications could be significantly improved if South East Water was able to issue developers with brought forward charges. In all cases, developers would have a right of appeal to the Commission where the developer was not in agreement with the water business' assessment. Substantial time and labour savings could be made for the Commission, developer and water business if an administrative process did not need to be followed when all parties are already agreed.

VicWater Proposal for Scheduled Charges

South East Water remains supportive of the VicWater proposal to levy new customer contributions on the basis of lot size, as an indicator of water use and efficiency. However, it is recommended that the Commission use the most recent version of the VicWater proposal and prepare any changes to codes or guidelines at the time of making the final determination to ensure that all retailers are able to apply the new charges in a consistent manner and to establish clear expectations within the development industry. This would involve further clarification of the treatment of new non-residential customers.

South East Water would also prefer the Commission to retain a scheduled maximum charge for recycled water, as proposed by VicWater. This scheduled charge would provide developers with greater certainty in relation to the most they could be charged and provide retailers with the flexibility to charge a lesser amount when the full amount is not justified.

South East Water does not expect to charge the maximum amount in most circumstances and has already had a \$500 charge for recycled water approved by the Commission for the current financial year. As a result of the approval of this charge, developers have been advised, a number of contracts entered into and offers made on this basis. To move away from this position now will leave developers uncertain about how developments with recycled water will be charged in future and may impeded the implementation of third pipe schemes.

Finally, South East Water has provided developers with three months notice of previous price changes. South East Water would expect to follow this practice in the current circumstances, subject to the Commission accepting

the reduced revenue resulting from these charges as part of South East Water's Water Plan.

Allocation of Costs for Reticulation Assets

South East Water is unsure whether the Commission is attempting to address the situation where a developer pays for reticulation assets that are also used by a neighbouring developer or whether the Commission is attempting to address the inequity that results from the first developer in an area paying to bring forward the construction of shared assets, which are subsequently used by another developer. South East Water would like to see more detailed scenarios and examples of what is being proposed in order to be able to make a more detailed submission.

If the Commission is referring to shared reticulation assets, South East Water is of the view that the Commission would achieve improved outcomes from giving further consideration to the application of the definition of shared versus reticulation in special circumstances, than attempting to implement additional administrative burden.

If the Commission is considering a return to the previous process of charging for basic size, South East Water could potentially adopt a process that required each developer to contribute to the construction of shared assets on the basis of the minimum size required for their development. This may require the first developer to pay for the minimum size pipes with South East Water paying for additional capacity which would be recouped from later developers.

Ultimately, South East Water recommends that consistency across regulatory periods and developers' ability to understand the process and anticipate potential costs should be the key criteria used in making an assessment of whether a change to the methodology for classifying reticulation assets is warranted.

Uncertainty

Major Projects

South East Water supports the Commission's attempt to provide additional measures to deal with uncertainty, particularly in the context of potential climate change and the large number of infrastructure projects that are currently proposed. However, South East Water considers that the best way to deal with these projects is to build into the price determination their most likely cost and timing, and then make adjustments during the period, once confirmed. In this way customers are able to build into their forward plans the

most likely cost for the five year period. Should the projects be completely omitted from the determination until they are confirmed, customers will commence the period with price expectations that will always be lower than what will eventuate. In some cases, customers are making decisions about investments in water conservation that are based on expectations of future price increases. These private investments may not be made, if future price assumptions are significantly understated.

South East Water recommends that the Commission extend this pass through provision to projects that are not currently known, but may be mandated at relatively short notice during the regulatory period. South East Water also expects that should Melbourne Water successfully apply to the Commission for an adjustment to account for either a known but not yet finalised or an unknown project, the metropolitan retailers' price determinations will be automatically reopened.

Demand

South East Water supports the Commission's proposal to allow within period volume adjustments but would encourage the Commission to express beforehand the degree to which forecasts need to vary from actual volumes or revenues in order to trigger a change. The possibility of a later adjustment should also not be used as justification to make adjustments to retailer's initial demand forecasts to the point where they no longer represent the most likely outcome.

Carbon Trading

South East Water is also supportive of allowing a within period adjustment to account for any necessary adjustments to costs associated with a carbon emission trading system, when one is introduced.

Demand Forecasts

The Commission has commented on the impact of inflow scenarios on demand for water and has concluded that forecasts should be based on average weather.

It is important to understand that the metropolitan retailers' demand forecasts are not based on inflow scenarios. Forecasts are built up on the basis of customers' expected end uses in average seasonal conditions, along with the impacts of potential changes to those patterns that are forecast to occur, eg third pipe recycling projects, changes associated with improved appliance efficiency or government policy. These forecasts are then adjusted to take into account the impacts on customer behaviour of the likely level of water

restrictions. Expectations about restriction levels going forward are based on analysis undertaken by Melbourne Water.

South East Water has also developed its demand forecasts in the context of history and with reference to obligations imposed by Government. The recent experience of stage 3A water restrictions in metropolitan Melbourne has now provided a valid reference point for estimation of the impact of restrictions generally and the likely take up and impact of initiatives such as the showerhead program pursued by retailers in response to the requirements of the Central Region Sustainable Water Strategy (CRSWS).

South East Water remains committed to achieving all mandated demand reduction requirements/targets (such as those contained in the CRSWS), until these requirements are changed by Government.

Expenditure

South East Water supports the Commission's endorsement of a 1% per annum productivity improvement assumption (excluding new obligations and fixed costs such as licence fees). While South East Water will continue to strive to exceed this figure, a 1% pa improvement from the current day base is a reasonable assumption going forward, subject to the outcomes of the industry review which may deliver further savings through a future shared services model.

South East Water also expects that the Commission will accept real cost increases (either operating or capital) where there is evidence to support them ie. electricity costs and labour rates.

Form of Price Control

As noted by the Commission in its Draft Decision, South East Water had a tariff basket form of price control approved at the time of the last price determination. This determination has allowed South East Water to make minor adjustments to its tariffs on an annual basis in order to implement its long term tariff strategy. It is South East Water's view that that the ongoing use of this form of price control would be of benefit as it would:

- Provide businesses with a means of responding to the actual impact of variations in sales volumes;
- Allow businesses to use price as a mechanism to impact sales volumes in the period prior to supply augmentations coming on line; and

- Make further adjustments should any proposed tariff structural changes unduly impact on customers or fail to achieve their objectives.

The method for rebalancing tariffs during the regulatory period as described by the Commission in its Draft Decision amounts to a mini price review. The concept of a tariff basket was intended to allow small adjustments to tariffs (with limited increases to ensure individual customers are not adversely impacted), without the need to undertake additional extensive consultation programs, impact modelling and applications for approval.

South East Water recommends that, subject to further guidance from the revised Water Industry Regulatory Order, the Commission continues to make provision for businesses to request a tariff basket form of price control. In South East Water's case, the past three years experience should be taken into account and on the basis that there has not been adverse customer feedback in relation to rebalancing, this practice should be allowed to continue.