

24 February 2016

Dr Ron Ben-David  
Chairman, The Essential Services Commission  
Level 38, 2 Lonsdale Street  
MELBOURNE VIC 3000

20 Corporate Drive  
Heatherton VIC 3202  
Locked Bag 1  
Moorabbin VIC 3189  
Telephone +61 (03) 9552 3000  
Facsimile +61 (03) 9552 3001  
[southeastwater.com.au](http://southeastwater.com.au)

Dear Ron

### **Review of Melbourne Water's 2016 Price Submission**

South East Water welcomes the opportunity to provide input into the Essential Service Commission's review of Melbourne Water's 2016 price submission. Our response not only represents South East Water's views but also reflects the desire of our customers for more affordable bills. The following outlines some key points for consideration in your review of Melbourne Water's price submission.

**Customer engagement** – South East Water is pleased with and supports the increased focus on customer engagement throughout the development of Melbourne Water's price submission. However, more ongoing engagement and collaboration with retail businesses is required throughout the regulatory period, particularly on their growth and asset management planning activities, not just at the time of developing a price submission.

**Tariff structures** – South East Water has worked closely with Melbourne Water on the development of its proposed tariff structures and supports its proposal to set water headworks prices based on bulk water entitlements. However, this will result in a significant increase in the fixed component of our bulk charges from Melbourne Water, which will increase the revenue risk associated with fluctuations in demand. South East Water supports Melbourne Water proposed bulk sewerage prices, which aims to provide clearer signals and minimise the adverse cost impact of wet weather events.

**Capitalisation of desalination water security payments** – South East Water supports the approach taken by Melbourne Water to engage customers to ascertain their views on the capitalisation of desalination security payment costs. We agree that the response by customers to the principle of capitalising desalination costs was mixed between supporting the spreading of costs over the 60 year life of the asset and paying for it over the 27 year period of the contract. However, it is unclear why capitalisation amounts of only \$0, \$20 and \$40 million were tested with customers. Had a broader range of potential capitalisation amounts been tested, which would deliver more material upfront customer bill savings, we believe customers may have provided a different response.

**Weighted Average Cost of Capital** – We note Melbourne Water's proposal to calculate the cost of debt using a trailing average and that any change to the WACC methodology will likely set a precedent for future price reviews for all Victorian businesses. We therefore consider

that any consideration of change to the WACC methodology should be considered as part of the ESC's broader pricing framework review, and should include extensive consultation with all Victorian businesses.

**Capital Expenditure** – There has been a reasonable level of engagement with retail businesses by Melbourne Water on its capital expenditure program, and we are supportive of investment at Eastern Treatment Plant (ETP), however remaining projects are addressing risk which is difficult to assess. We also have some concerns with the overall size of Melbourne Water's capital expenditure program and its impact on customer bills, given it is projected to be higher than current levels of expenditure. South East Water has also some concerns with the level of risk appetite Melbourne Water is exhibiting (other than with ETP), and that it may be overly conservative in its approach to risk. To better understand Melbourne Water's capital expenditure program we would like to understand the service level/price trade off of Melbourne Water's capital expenditure program. For example, if Melbourne Water were to reduce its expenditure by \$100 million over the next five years, what would be the impact on service levels in terms of additional risk.

**Operating expenditure** – South East Water supports Melbourne Water's pursuit of operating expenditure efficiencies to help drive down customer bills. However, we are concerned that its overall operating expenditure does increase, particularly in the latter years of the regulatory period, well above the two per cent productivity hurdle set by the ESC.

We also note that while Melbourne Water did receive some customer willingness to pay for its current renewable energy costs, we consider it needs to be tested as part of a more comprehensive study which tests willingness to pay for a range of new service levels, compared with current levels of service. We therefore consider the ESC should assess the efficiency of the renewable energy expenditure as part of business as usual expenditure.

We would be happy to have further discussions with you and your team regarding Melbourne Water's price submission.

Yours sincerely,



Kevin Hutchings  
**Managing Director**