



**Yarra Valley Water** | *a fresh approach*

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1 September 2011

Ron Ben-David  
Chairperson  
Essential Services Commission  
Level 2, 35 Spring Street  
Melbourne VIC 3000

Dear Ron

Yarra Valley Water welcomes the opportunity to respond to the Commission's Tariff Issues Paper for the 2013 Water Price Review. It is timely we re-examine tariffs because they have a profound influence on customer satisfaction. Our customers are very strong in their desire to have more control over their bills. We believe addressing customer's concerns regarding tariffs will improve their perception of value.

Attached is a detailed paper addressing the issues raised by the Commission, with an appendix containing our response to each of the questions posed in the Commission's paper.

If you have any further queries please contact Brett Mathieson, Manager Regulation and Planning on 9872 2441.

Yours sincerely

**Tony Kelly**  
**Managing Director**

***Response to the Essential Services Commission's  
"2013 Water Price Review - Tariff Issues Paper"***

*Yarra Valley Water - September 2011*



## YARRA VALLEY WATER

### RESPONSE TO THE ESSENTIAL SERVICES COMMISSION'S JULY 2011 TARIFF ISSUES PAPER

#### INTRODUCTION

##### Changing circumstances

Customers responded extremely well to the need to save water during the drought. A shift has occurred in water use behaviour and we believe customers place a higher value on water than in the past. However, with improved recent rainfall and commissioning of new supplies, customers are now faced with changing circumstances. We need to change tariffs to reflect these changing circumstances. Giving appropriate signals for supply and demand are still critical factors, but we must also recognise the effect that tariffs have on customer satisfaction and their perceptions of value.

##### Customer satisfaction is the key

The Commission has created a focus on value. Tariff structure is a critical input to customers' perception of value and their satisfaction with their utility. Our customer research shows that customers see the current system of charging as complex and it is poorly understood. The fixed charge part of the bill is seen to be 'too high'. Customers have stated a very clear preference for increasing the variable component of their bill.

##### Customers are interested in choice

Customers trust and respect their water utility which is seen to be more community oriented than other utilities. This is linked to high levels of satisfaction but customers are beginning to question why their water utility does not offer a greater range of options like other utilities do. They want the ability to make informed choices about their own usage through the provision of more information and stronger price signals. They want choice but not too much. They are wary of over-complicated tariffs that they experience with mobile phone plans, for example.

#### CONTEXT

*"In general, the regulatory framework does not change, however the technology, industry and economic context can change significantly."*

*Tariff Issues Paper p3*

We agree with the Commission's observation that the regulatory framework is generally fixed but the context is dynamic. The regulatory approach must recognise that dominant pricing objectives change. This highlights to us the need for a flexible approach by the Commission when carrying out its tariff approval remit within the regulatory framework. We believe the current framework is fit for purpose. This can be illustrated by our response to the ESC's 2007 Water Tariff Structures Review Issues Paper. We identified that tariffs "...are critical in managing the balance between supply and demand" which clearly reflected the circumstances at the time. The overriding concern was water conservation, because storage levels had dipped below 30% full, and tariff ideas were shaped to encourage water conservation. Since then, storage levels have recovered and climate-independent augmentations are being constructed. Customers now want tariff structures that will improve their satisfaction by giving

them more control over their bills and it has become clear that they have broader and more nuanced expectations of tariffs. Both these scenarios can be handled under the existing framework.

Tariff changes need to have regard to external factors. There are a number of industry reviews in progress, notably those by the Productivity Commission (PC) and the Ministerial Advisory Council for Living Melbourne, Living Victoria. As noted, the balance between supply and demand has improved and customers have become more aware of prices and pricing issues. All these factors may influence tariffs in the near future.

As well as meeting economic and policy objectives, it is important to consider the impact on customers in financial and satisfaction terms. Tariff changes that are imposed on customers have distributional effects where some see bill increases and some decreases, over which they have no control. Given that prices have not yet stabilised, the distributional effects may exacerbate possible price increases for some customers and leave others dissatisfied if they find they have less control over their bills.

## PROPOSED PRICING PRINCIPLES

*“Our proposed pricing principles are derived from the requirements in the WIRO and the Essential Services Commission Act and, flowing from the requirements of the Act, the principles for urban water tariffs set out in the National Water Initiative Pricing Principles...”*

*Tariff Issues Paper p8*

### The regulator’s role

The “propose-respond” model for regulating tariffs remains appropriate. Tariffs are a critical part of the relationship between a utility and its customers. It should be for the utility to formulate its tariffs based on economic and customer needs. The regulator’s role is to check whether or not tariff proposals are reasonable within the framework and would meet customer, government and utility objectives. It is not the regulator’s role to prescribe which tariff structures are acceptable. We recognise that this requires a careful balancing act by the regulator.

### Pricing principles should be general and not prescriptive

The Issues Paper states that the Commission is guided by the Essential Services Commission Act 2001, the Water Industry Act 1994, the Water Industry Regulatory Order and the National Water Initiative pricing principles. There is nothing in practice which suggests they do not contain adequate tools for regulating water utility prices. The important consideration is how the Commission applies its powers and the level of prescription it makes when interpreting the various principles.

We suggest that the Commission’s pricing principles should be general in nature. Many are general but some are prescriptive and reflect the Commission’s view of appropriate tariff structures. This would restrict the scope for the utility and its customers to reach a mutual agreement on tariffs to maximise satisfaction. The pricing principles from the independent experts at the Public Utility Research Centre (University of Florida) are widely recognised and accepted. They are a good example of general principles that provide clear direction without being prescriptive about the form that tariffs should take. We believe they capture the objectives of the guidance by which the Commission operates.

The principles are:

- Send price signals that encourage efficient use of services.
- Be simple to understand, facilitate convenience of payment and collection, and be acceptable to customers.
- Be free from controversy as to proper interpretation.
- Allow stable and predictable rates.
- Provide adequate revenue for investment and quality services.
- Allow stable and predictable revenues.
- Recognise positive and negative externalities.
- Fairly apportion the total cost of service.
- Avoid undue discrimination.
- Encourage innovation and respond to changes in supply and demand patterns.

### The Commission's proposed principles

*"Tariff structures, levels and the form of price control should ensure a sustainable revenue stream over the Water Price Review period."*

*Tariff Issues Paper p9*

We support the aim of sustainable revenue and that the form of price control is critical for ensuring that tariffs provide adequate revenue over time.

*"For each tariff class (that is, different tariff type), the revenue expected to be recovered should lie on or between an upper bound representing the stand alone cost of serving the customers in that class and a lower bound representing the avoidable cost of not serving those customers."*

*Tariff Issues Paper p9*

We agree that the revenue recovered from each class of customer should lie between stand alone and avoidable cost. We recognise that it is important to minimise possible subsidy between or within customer classes. Customers should broadly pay the cost of the service that is provided to them. We also recognise that cost reflective charges signal the value or otherwise of alternative investment in resources and supply.

*"Retailer Water Tariffs Structure - A two part tariff comprising a fixed charge and a volumetric component is preferred to recover a water business's revenue requirement from each tariff class."*

*Tariff Issues Paper p11*

We are concerned that the Commission's proposed tariff structure principles are prescriptive. Two part tariffs are reasonable in most circumstances but to prescribe them as principles could restrict the scope for innovation in tariffs. It may be appropriate to make a distinction between a utility's standard tariff for most customers and other tariffs which are aimed at specific customer needs.

We understand the rationale for a single block water volume charge but are cautious about moving to it too fast. We believe it should be a longer term objective to transition off the inclining block tariff. Our customer research suggests that customers are still attached to the water conservation message that additional blocks provide. This is incidentally supported by their reaction to scarcity pricing where there is a concern that a low price when storages are full would lead to water waste.

*"The volumetric charge should have regard to the relevant marginal costs."*

*Tariff Issues Paper p12*

The use of marginal cost as a reference for volumetric pricing is technically correct. However, it raises issues that will require further clarification from the Commission. Our recent estimates of long-run marginal cost suggest it will be lower than the existing volumetric charges for both water and sewerage. This has several implications. A move from the current price to one based on a lower long-run marginal cost will require higher fixed charges to recover adequate revenue. This will give customers even less control over their bills, contrary to the message from our customer research and feedback through our call centre. It may also be contrary to the Government's policy which calls for a 60:40 split between variable and fixed charges on the average bill.

Many of our customers also indicate that their primary reference point is the bill total. They compare it to an expectation based on recent bills and will only examine the constituent charges if the bill does not coincide with their expectation. Although a price based on marginal cost may provide a signal to customers, it is not certain that they will react to it (customers who choose a particular tariff may be more inclined to respond). It should also be remembered that customers receive the price signal after they have used the water because of the nature of the meter reading and bill cycle.

Our research indicates that most of our customers still expect their charges to provide a clear water conservation signal.

The use of marginal cost to set volumetric prices may constrain the scope for innovation in water and sewerage charges. For example, there may be support for a 100% volumetric tariff for low users who have felt that they do not benefit from lower bills regardless of how much water they use they avoid. The aim of the tariff would be primarily to improve customer satisfaction. Assuming total costs are correctly allocated to the target customers, it would meet other economic criteria such as falling between stand alone and avoidable costs. However, the use of marginal cost as a reference point could preclude such a tariff structure.

*"We think that the innovation required to develop customer choice does not lend itself to a uniform approach across all water businesses. However, we consider that large differences in the opportunities available to similar customers (but differentiated by their retailer) should be avoided in the early stages."*

*Tariff Issues Paper p14*

The Commission raises equity concerns about different opportunities for customers across the state. However, there would be a degree of unfairness if our customers want choice but are denied because of inactivity elsewhere. There may be a case for adopting a two speed approach depending on the degree of support by the customers of the individual utilities.

## FORM OF PRICE CONTROL

*“We would welcome broader consideration of the question of risk allocation between water customers and the owner of the water businesses, particularly given that assumptions on this underlie much of the discussion regarding the form of control and how uncertainty is managed within it.”*

*Tariff Issues Paper p18*

We recognise the need for a form of price control that manages a fair balance of risk between customers and the utility (and its shareholder). In terms of risk, however, tariffs are a secondary driver for price control, after demand.

From a tariff perspective, the flexibility to introduce tariffs is important. Under our current price cap, the start of the Water Plan period is the only practical window for introducing tariff changes. The forecasts on which the Water Plan is based start to unwind as the period advances. Although this may not be an issue on a wider scale because of “swings and roundabouts” it makes it difficult to introduce new tariffs or alter existing tariffs. Demands and revenues would need to be altered with consequential changes to price caps – essentially a reopening of the determination.

### **We are considering a revenue cap**

We proposed a revenue cap in previous Water Plans and are looking at its suitability for this Water Plan. For previous Water Plans the aim was to mitigate demand risk. Customer reaction to restrictions and water conservation was uncertain. The Commission has previously outlined the benefits of a revenue cap<sup>1</sup>:

- It removes the perverse incentive to sell more water when there is a need to maintain downward pressure on demand,
- It continues to provide incentives to manage costs efficiently,
- It allows for variability in revenue to be taken into consideration when setting tariffs, thus providing the business with greater certainty and stability,
- It gives customers sufficient (although not total) certainty regarding prices,
- It allows for the introduction of new tariffs during regulatory period, and
- It acknowledges that actual quantities may be different from those forecast and that neither the business nor its customers should be unduly penalised as a consequence.

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<sup>1</sup> For details see *Essential Services Commission, June 2008, ‘2008 Water Price Review, Goulburn-Murray Water Determination, 1 July 2008 – 30 June 2013’*.

We are exploring price control options that will be appropriate for changing supply and demand conditions and with the scope to change tariffs. We urge the Commission to be open-minded.

*“The implications of managing customer impacts from any significant tariff changes will need to be considered.”*

*Tariff Issues Paper p18*

The impact of our tariff proposals on customers is a crucial consideration. We are acutely aware that the distributional effects are critical and that we would need to make changes over time to minimise larger impacts. We would exercise caution if overall prices are to increase significantly because tariff changes can compound the impact for customers. Side-constraints may be reasonable if they are set clearly to manage the impact of change or introduction of tariffs. However, they need to be proportionate.

The Commission should also take account of customer impacts if it wishes utilities to move from their current tariff positions to a tariff that is aligned with the Commission’s view of cost reflective, marginal cost based charges.

## **TARIFF STRUCTURE AND DESIGN**

### **Bulk charges**

*“The charges associated with the desalinated water resource will need to be reflected in bulk water charges and take account of the desalination plant’s variable and uncertain cost structure.”*

*Tariff Issues Paper p21*

Our main concern with Melbourne Water’s bulk tariff is the uncertainty of the quantum of water that we will order from the desalination plant in any given year. The short-run cost we face could be materially different from our assumption about bulk water costs. This applies equally to orders that are greater or less than the assumption leading to higher or lower costs. As noted in our discussion of the form of price control, this could be managed by a revenue cap with a cost pass-through or adjustment for desalinated water costs.

Other bulk water costs are an issue for us when the short-run cost of bulk water exceeds the revenue that has been locked in for five years by our price caps. These factors suggest a case for aligning tariffs to the supply position but it may be premature while Melbourne still has a pooled entitlement for retailers.

We would prefer that the price for harvesting and storage is separate from the charge for desalinated water. This would allow scope for a cost pass-through or adjustment for the cost of desalinated water within the price control mechanism. The order for the water for the financial year beginning on 1 July is scheduled to be completed by early in the preceding April. This should allow the Commission to examine the change in bulk water costs in time for the start of the charging year.



*“We note that the Productivity Commission considers that all transmission costs should be recovered through a volumetric price and not a two-part tariff because this better reflects the underlying costs. This prompts us to raise the question of the appropriateness of Melbourne Water’s bulk transfer charges.”*

*Tariff Issues Paper p23*

There may be benefits in introducing locational signals into bulk charges. We would welcome clear price signals on constraints and opportunities to lower cost for customers.

The Commission notes that the PC considers that transmission costs should be apportioned entirely on a volumetric basis. There may be some merit in this approach to address some issues with the cost allocation between retailers for bulk transfer charges. If one retailer removes demand for bulk water (and transfer) by creating a new resource (or through demand management), the customers of other retailers also carry some of the cost because the cost avoided by the first retailer is reapportioned on to the others. This happens even if the customers of the other retailers do not increase their demand. We recognise that customers get some benefit through an implied increase in security of supply but the cost should be proportional, otherwise sub-optimal investment decisions can be made without facing the full consequence.

### **Distribution costs**

*“Currently the water retailers and most regional water businesses recover their distribution system costs on a postage stamp basis; that is, retail tariffs do not reflect any differences in costs of the distribution system by time or by location.”*

*Tariff Issues Paper p26*

The Commission asks if retail tariffs should signal differences in distribution costs. We agree with the PC which considers that distribution costs are driven by customer numbers rather than volumes of water and wastewater and are best recovered as a fixed charge per connection<sup>2</sup>. We also note with interest the Commission’s suggestion that differences in distribution costs not reflected in developer charges should be reflected in retail tariffs. From our perspective, it is too late to consider differentials in distribution costs once the infrastructure is commissioned and in use. It is not clear why other customers should pay for material shortfall which should be recovered in advance through developer charges.

We seek clarification on the Commission’s view on locational price signals. The Commission suggests that locational signals that reflect cost differences should be considered. Locational signals within a retailer’s area may create further dissatisfaction as postage stamp pricing unravels. Locational price signals would also be inconsistent with the current approach to developer charges where location driven costs are not considered.

We recognise that locational signals may be integral to third party access. If this is the rationale behind the Commission’s views it may be premature. We have no concerns about third party access but would prefer for a framework, including licencing, to be in place before advancing along this path. If we received an application for access before then, we would negotiate with the third party over price. The Commission could arbitrate if there is no agreement.

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<sup>2</sup> Productivity Commission “Australia’s Urban Water Sector draft report” April 2011 Page 167

## Two-part tariffs are appropriate for the default tariff but moving to a single block is premature

*“As reflected in our proposed pricing principles, we prefer a two-part retail water tariff because of its efficiency properties, simplicity, and consistency with the National Water Initiatives pricing principles.”*

*Tariff Issues Paper p26*

We recognise that a two-part tariff is probably the most suitable form for a utility’s default tariff and acknowledge that a single block water volumetric part is broadly desirable. We would be concerned, however, if the Commission pressured for a move from the three block volumetric part to a single block too soon. Our concern is based on the potential distributional impacts and customers’ attachment to the perceived water conservation message. Our customer research indicated that customers have a preference for two blocks, the first being for “efficient” use and the second, higher block to discourage inefficiency. Some customers recognised that this would vary depending household size. It may take some time for the broader customer base to accept a move to one block which may cause some dissatisfaction.

## Sewerage charges

*“The bulk sewerage structure appears consistent with the proposed pricing principles; it appears to provide appropriate signals to the water retailers and other parties, for example to guide investment decisions in sewage treatment plants Melbourne Water’s approach to setting the volumetric charges appears consistent with the proposed pricing principles.”*

*Tariff Issues Paper p28*

For bulk sewerage charges, there should only be a change to their structure if there is a strong cost case and a clear benefit. From a retailer perspective, cost allocation for bulk charges is more important. Trade waste bulk charges carry a similar concern and new or varied charges should have a fair assessment of the cost of introducing and policing changes compared to the benefit in terms of reduced pollution risk. The impact on customers also needs to be managed and a conversation with customers before proposing new charges is very necessary to explain why it is needed. We have received feedback from trade waste customers that they get frustrated because a charge is introduced and billed but treatment is not built.

*“The Productivity Commission has also noted that it is unlikely that the demand for domestic sewage services can be influenced by price to the same degree as demand for water overall.”*

*Tariff Issues Paper p29*

The key issue with retail sewerage charges lies with the sewage disposal charge (SDC). Our customers commonly misinterpret the SDC as a fixed charge, if they recognise it at all. There is also a view that customers have no control over the volumes they discharge, and they are not metered, so it is not appropriate to charge on a volumetric basis. Volume is a cost driver for treatment so it may be appropriate to provide some volumetric signal. We have previously argued that it could be combined into a single volumetric charge with water so that customers get a unified signal about use of water and

sewerage services. The remainder would be recovered as a fixed charge which is in line with customer expectations.

## Recycled water

*“During the last price review, the metropolitan retailers proposed to maintain a two part tariff for third pipe recycled water services with a variable charge pegged to the first tier price of potable water... customer submissions argued that the businesses’ pricing proposals provide customers with little incentive to use recycled water and that recycled water should be subjected to a great degree of cross subsidy to promote its uptake.”*

*Tariff Issues Paper p32*

We believe that recycled water should not automatically be cheaper than potable water because it is seen by some as an inferior quality product. In some regards we believe it is superior to potable water because it is unrestricted<sup>3</sup> and creates a higher degree of utility for many customers. They have not had to remodel their gardens to cope with drought and restrictions for example. In addition, on a standalone cost basis, recycled water is more expensive than potable water. We understand that in some areas there may be quality issues, such as colouration, that prevent customers realising the full benefits of recycled water. In these cases a price adjustment may be appropriate.

## TARIFFS AND CUSTOMER CHOICE

### We propose to offer choice to customers to improve their satisfaction

*“The themes of customer choice and a stronger customer voice are common to many current water discussions... While there are many aspects of customer choice, the ability of customers to choose from a range of alternative tariffs is one possibility.”*

*Tariff Issues Paper p36*

We have made public our view that customers may benefit from a choice of tariff options in addition to the standard tariff. We are aware of some dissatisfaction with existing tariffs and believe that choice would improve overall customer satisfaction if properly introduced. Because our aim is customer satisfaction, we are well aware of the need to make the process as transparent as possible for our customers, both those who choose and those who remain on the standard tariff.

### Initial consultation indicates support for choice

*“We would expect and encourage the retail water businesses to consult closely with each other and with customers.”*

*Tariff Issues Paper p36*

We are examining the scope for including a limited number of optional tariffs in our Water Plan. We have discussed our idea of offering optional tariffs with various stakeholders, including customer

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<sup>3</sup> Recycled water has advantages even under Permanent Water Saving Rules such no restriction on the times that watering systems can be used and use for hosing paved areas.

groups, the ESC, academics and the Government. A press article<sup>4</sup> noting our concept indicated that a notable proportion of customers reacted positively to the idea. We carried out subsequent qualitative market research. Our market research consultant held four group discussions covering a cross-section of our residential customer base. The headline results are:

- There is limited understanding of our existing charges and customers tend to look at the bottom line (in the short-term we will start to address this by implementing improvements to bill content and formats),
- Customers feel strongly they have little ability to influence their bills because of fixed charges (which some take to include the sewage disposal charge). This is consistent with feedback through our call centre,
- There is little financial incentive to save water,
- Choice is perceived positively, particularly if it captures “pay for what you use”, but customers are wary if it introduces complexity,
- There is a preference for a variable water, fixed sewerage tariff but caution over size of fixed sewerage charge (view that it penalises smaller households),
- There was not much support for a special for large households option,
- There is some support for an optional unrestricted tariff (at a higher price) but concern over fairness and a perceived poor water conservation signal,
- A scarcity tariff based on dam-level divides opinion, customers feel either it’s a good idea or are worried about variability and perceived poor water conservation signals,
- Community and environmental tariffs are nice ideas but there is little willingness to pay for these and a sentiment that these areas should be funded through other routes.

### **Next steps**

We will use this research to guide our thinking on tariffs and intend to carry out further research for the Water Plan. We agree that it may be appropriate to test some concepts further through pilots.

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<sup>4</sup> The Age, Melbourne, 22 September 2010, p1.

## YARRA VALLEY WATER RESPONSE TO THE ESSENTIAL SERVICES COMMISSION JULY 2011 TARIFF ISSUES PAPER

QUESTION	RESPONSE
<b>Proposed pricing principles</b>	
Do the proposed principles adequately address the WIRO and other relevant requirements in relation to pricing matters?	<ul style="list-style-type: none"> <li>• We are comfortable with the principles that are consistent with the WIRO e.g. sustainable revenue stream, bounded cost basis.</li> <li>• However, some of the proposed principles are prescriptions e.g. suggested two-part tariffs.</li> <li>• We seek clarification of the Commission's interpretation of cross subsidy points and adherence to LRMC. Some stricter interpretations may restrict the scope for reasonable tariff innovation.</li> <li>• There should be a differentiated approach for default and optional tariffs with a tighter standard for the default.</li> </ul>
What amendments – changes or additions – are needed to ensure the principles are clear, useful and applicable in the 2013 Water Price Review?	<ul style="list-style-type: none"> <li>• Interpretation and application of the principles are critical – innovation and customer satisfaction should be given consideration as well as economic factors.</li> <li>• The current framework provides the Commission with adequate powers.</li> </ul>
Are there any other matters that we will need to consider in applying these proposed principles?	<ul style="list-style-type: none"> <li>• The Commission's principles may conflict with Government policy/objectives and customer preferences.</li> <li>• Long-run marginal cost may not be a practical benchmark in all circumstances. Customers' primary signal is the total charge on the bill, followed by the proportion of variable charge. It should also be remembered that the signal is ex-post so customers receive it after the service has been used. This gives a dampened response to price.</li> </ul>
<b>Form of Price Control</b>	
What tariff innovations could be proposed for the 2013 Water Price Review period?	<ul style="list-style-type: none"> <li>• We are on the record as supporting choice.</li> <li>• We are further exploring the views of our customers and other stakeholders before making specific proposals.</li> </ul>

QUESTION	RESPONSE
What are the implications for the form of price control?	<ul style="list-style-type: none"> <li>• We proposed a revenue cap mechanism in previous Water Plans. We are examining suitable price controls for this Water Plan, including the suitability of a revenue cap.</li> <li>• The correct form of price control is important for the fair risk allocation between the business and our customers</li> <li>• Demand risk is the main factor that needs to be managed through the price control mechanism. Tariffs are a contributory factor.</li> <li>• Price caps do not provide the flexibility to introduce tariffs within a pricing period.</li> </ul>
How will equity implications of tariff changes be managed?	<ul style="list-style-type: none"> <li>• We are sensitive to the impact of our tariff proposals on our customers.</li> <li>• All tariff changes need to consider the impact on customers. Where they are significant the change needs to be implemented over time.</li> <li>• We will not make significant changes when prices are increasing significantly. They compound the impact for some customers.</li> <li>• Side-constraints are a mechanism that is reasonable when they are set to manage the impact of change or the introduction of tariffs. However, they need to be proportionate to the price.</li> </ul>
Are there any significant cost forecasting uncertainties for water retailers, such as demand or variable bulk supply costs? If so, what are the appropriate mechanisms for managing these risks?	<ul style="list-style-type: none"> <li>• This is a general concern but new tariffs and any dislocation between bulk prices and retail tariffs increase risk.</li> <li>• Forecasting risks are significant and are magnified by price caps and the 5-year lock-in of prices and revenue. There is an asymmetric risk because the restrictions downside outweighs the swings and roundabouts of weather driven changes to demand.</li> </ul>
<b>Bulk water tariffs and transfer charges</b>	
Can the current headworks charging structure be improved?	<ul style="list-style-type: none"> <li>• Our preference is to separate storage/harvesting charges from the cost of desalinated water.</li> </ul>
How will the structure of bulk water tariffs be affected by the desalination plant water resource?	<ul style="list-style-type: none"> <li>• We believe that a cost pass-through or adjustment mechanism for desalinated water may be appropriate.</li> </ul>
Are there net benefits in introducing locational signals into bulk water charges?	<ul style="list-style-type: none"> <li>• Welcome clear price signals on constraints and opportunities to lower costs for customers.</li> </ul>

QUESTION	RESPONSE
Should the bulk transfer price be a two-part price or is there a case for alternatives such as a pure volumetric charge?	<ul style="list-style-type: none"> <li>We would be pleased to explore alternatives, as this could feed through potential retail tariff offerings</li> </ul>
What are the benefits and implications of more differentiated bulk transfer charges and what options for them may be appropriate?	<ul style="list-style-type: none"> <li>In Melbourne, if one utility removes demand for bulk water (and transfer) by creating a new resource (or demand management), the customers of other utilities pay for it. We recognise that these customers get some benefit (through improved overall security of supply) but the cost should be proportionate, otherwise inappropriate investment decisions can be made without facing the full consequence.</li> <li>We do not see benefit in differentiating the bulk transfer charges in the Melbourne system. There is benefit in different prices for transfer where there are constraints in the system which allows the industry to explore options to optimise the system at lowest community cost.</li> </ul>
Should Melbourne Water establish separate charges for the headwork and the desalination plant or should they remain a single bulk water resource charge?	<ul style="list-style-type: none"> <li>To ensure we receive an appropriate price signal, we would prefer that the price for harvesting and storage is separate from the charge for desalinated water. This would provide us with better signals to optimise the system. It would also allow us to pass-through or adjust for the cost of desalinated water within the price control mechanism.</li> </ul>
<b>Retail tariffs</b>	
What are the implications of increased variability and uncertainty in bulk water costs for retail tariff structures and levels?	<ul style="list-style-type: none"> <li>The cost of desalinated water and how the price control mechanism allows for the variability is a concern. A revenue cap would allow for an adjustment for changes in bulk water costs.</li> </ul>
What are the efficient options for managing this uncertainty and meeting other WIRO objectives and the pricing principles?	<ul style="list-style-type: none"> <li>The form of price control is fundamental to managing the risks created by uncertainty.</li> <li>As above, a revenue cap with side constraints that manage price shocks meets the objectives of the WIRO and the Commission's proposed pricing principles.</li> </ul>
Are there net benefits in reflecting differences in distribution system costs by time or location in retail tariffs?	<ul style="list-style-type: none"> <li>We are not sure that the benefits for most customers would outweigh other effects like creating "boundary" cost differences (customers on different sides of the street paying different charges).</li> <li>It may have a role to play for large customers on dedicated networks and could create scope for tailored tariffs.</li> <li>The best opportunity to make locational signals is through developer charges before the infrastructure is created.</li> </ul>

QUESTION	RESPONSE
Are there any factors that would support a water business's default retail water tariff not being a two-part tariff?	<ul style="list-style-type: none"> <li>• Customer impacts are the most important consideration, whether moving to or from a two-part structure.</li> <li>• Customer impacts are also important for changes within the two-part tariff such as moving from a multi-step inclining block tariff to a single step.</li> <li>• Customer preferences and support are also important. For example, our customers indicate a preference for two blocks, the first being for "efficient" use.</li> </ul>
What approach should we take to innovations to default tariff offerings?	<ul style="list-style-type: none"> <li>• The important factor is the objective of the tariff which should capture customer preferences, impacts and the underlying economics.</li> </ul>
Are businesses in a position to be able to offer choice to water customers?	<ul style="list-style-type: none"> <li>• We are in a position to offer choice. We would undertake specific system changes, customer service training, billing alterations and customer communication to ensure that customer satisfaction is increased through a new tariff. We would not offer choice without certainty that our systems are able to support the initiative.</li> </ul>
What constraints are there in offering a choice in water tariffs?	<ul style="list-style-type: none"> <li>• Possible constraints include the extent of price rises, customers and stakeholder support for specific tariff options. Customers want choice which is why we engaging with stakeholders to find the best way to achieve this.</li> </ul>
<b>Sewerage and trade waste tariffs</b>	
Does the structure of Melbourne Water's bulk sewerage charges need to be reviewed?	<ul style="list-style-type: none"> <li>• There should only be change if there is a strong cost case and the benefit is clear.</li> <li>• Industrial customers value certainty and need time to adjust to changes in trade waste parameters in particular.</li> </ul>
Does the structure of the Melbourne water retailers' sewage disposal charges provide the right balance between efficiency, and the ability of customers to respond, simplicity, and equity?	<ul style="list-style-type: none"> <li>• The residential sewage disposal charge creates confusion for our customers, many of who believe it is a fixed charge. There is also an issue about the ability of most customers to influence their sewerage bills, regardless of the price signal. This was also noted by the Productivity Commission<sup>1</sup>.</li> <li>• We are exploring options for residential sewerage charges including elimination of the sewage disposal charge.</li> </ul>
Are there any issues with regional urban water businesses' sewerage tariffs?	NA

<sup>1</sup> Productivity Commission "Australia's Urban Water Sector draft report" April 2011 Page 161




QUESTION	RESPONSE
Do trade waste disposal charges provide the right balance between efficiency, and the ability of customers to respond, simplicity, and equity?	<ul style="list-style-type: none"> <li>We have no major concerns beyond fair assessment of the cost of introduction and policing of load charges (including the impact on customers) versus the benefit</li> </ul>
<b>Recycled Water</b>	
Are any changes required in the approach to determining recycled water prices having regard to the experience in the last Price Review period, the proposed pricing principles, the WIRO Regulatory Principles or the NWI pricing principles for recycled water and storm water?	<ul style="list-style-type: none"> <li>The average cost of recycled water is higher than potable water. The proposal that recycled water should be cheaper than potable may fall foul of cost reflection principle (even with the benefits for overall security of supply).</li> <li>Recycled water customers have a higher level of utility because their supply is effectively unrestricted. They have not had to make changes to their gardens to cope with drought, for example.</li> <li>We understand that in some areas there may be quality issues, such as colouration, that prevent customers realising the full benefits of recycled water. In these cases a price adjustment may be appropriate.</li> </ul>
<b>Waterways and drainage charges</b>	
Is there a need to further reform waterways and drainage charges and, if so, what options exist for further reform that better reflects the underlying cost characteristics of waterways and drainage services?	NA
Are there efficiency benefits in more cost reflective waterways and drainage charges, in particular for non-residential customers?	NA
What are the practical administrative and equity considerations?	NA

QUESTION	RESPONSE
<b>Tariffs and customer choice</b>	
Should the Commission allow water businesses to offer customers choice in tariff offerings?	<ul style="list-style-type: none"> <li>• We are on the record as supporting customer choice for tariffs</li> </ul>
If so, is the Commission's proposal to regulate only default tariffs supported?	<ul style="list-style-type: none"> <li>• We support the Commission focusing on default tariffs.</li> <li>• Optional tariffs will still require regulatory oversight but it is clearly in the utility's interest to ensure that optional tariffs achieve the critical objective of increasing customer satisfaction. Regulation will be more on the customer service and implementation side than financial protection.</li> </ul>
What role should the Commission play with respect to alternative tariffs offered by water businesses?	<ul style="list-style-type: none"> <li>• Our objective is to improve customer satisfaction. Lighter handed regulation on choice is more appropriate.</li> </ul>
If tariff choice is introduced, what aspects of consumer protection would need to be introduced or enhanced?	<ul style="list-style-type: none"> <li>• We are happy to engage with the Commission on the form and role of regulation. We believe regulation will be more about contract terms and market behaviour in the longer run.</li> <li>• Because our aim is customer satisfaction, we are well aware of need to make everything as painless as possible for our customers, both those who choose and those who remain on the default.</li> </ul>



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