



By Email water@esc.vic.gov.au

12th February 2007

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

Dear Sean,

RE: Response to Essential Services Commission '2008 Water Price Review (Framework and Approach) Consultation Paper'

Western Water appreciates the opportunity to comment on the Essential Services Commission (ESC) 2008 Water Price Review (Framework and Approach) Consultation Paper.

Western Water is supportive of the overall content outlined in the Commission's Consultation Paper and will structure its Water Plan submission as outlined by the Commission. Specifically, Western Water is seeking to highlight concerns or request further clarification associated to the following issues raised in the Consultation Paper:

- Length of Regulatory Period
- Uncertainty/Unforeseen Events
- Materiality Threshold
- Service Standards
- Guaranteed Service Levels (GSL's)
- Annuities
- Incentives
- Tariffs
- New Customer Contributions (NCC's)

Length of Regulatory Period:

Western Water supports the principles behind a five year regulatory period however, due to the current drought situation and its associated uncertainty, would favour the shorter period of three years for this Water Plan. During a period of such uncertainty a longer regulatory period would provide increased challenges and a greater need for conservative estimates. The availability of a pass through for major projects under consideration from Government such as Central Region Sustainable Water Strategy (CRSWS) would be greatly supported as these represent a significant impost on some businesses.

Uncertainty/Unforeseen Events:

As suggested above, given the current climate the risk of uncertainty and unforeseen events is increased. If a price review is not available for such events then greater conservatism would need to be applied to estimates.

The availability of an adjustment mechanism would enable businesses to recover unforeseen events such as drought. The predominant event impacting on businesses during the first regulatory period is clearly the drought. Such an event has not only decreased revenue significantly but also, increased costs in areas of restriction management, supply of water and led to new, and a reprioritisation of a number of planned, capital projects.

If a price review mechanism is not available then Water Plans will need to be based on worse case outcomes.

Materiality Threshold:

Western Water assumes the current materiality threshold of the greater of 2.5% or \$1 million will continue to apply for Legislative change and suggests that this should also be applied to uncertainty and unforeseen events such as drought.

The “one size fits all” approach for both metropolitan and regional businesses ignores the increased difficulty of servicing regional areas that do not have alternative sources of supply and its associated risk.

Service Standards:

Western Water supports the Commission’s position that standards should reflect past service results. However, the impact of the drought on the number of additional breaks and bursts and therefore influence on response times should be considered. Customer feedback on these standards is essential. The standards, whilst being consistent throughout the business (ie do not vary by town) should reflect changing customer preferences and therefore should be business specific.

The application of service standards is appropriate for all customer groups including the non-residential and rural sectors.

Guaranteed Service Levels (GSL’s):

The feedback Western Water has received following consultation with its customer groups conducted in July 2006 does not support a move to the introduction of GSL’s. Our customers believe that resources paid out in GSL’s would be better used to fix the problem. However, they did support the notion of a Customer Service Gesture, although could not reach agreement as to its form.

If GSL’s were to be mandated, Western Water would support individual businesses being able to negotiate with their customers to determine the types of services to be guaranteed and the amount and type of payment. It also supports its application to both residential and non-residential customers as negotiated with customer representatives.

Annuities:

Western Water supports the use of the Regulatory Asset Value (RAV) approach for the rural sector as it provides a more transparent result. However, if the annuity method was permitted then the principles of calculation of the annuity such as class of assets, time period and capital cost assumptions should be set by the ESC. In any event, Western Water also supports increased consultation with bulk water suppliers, and increased transparency in the setting of bulk water prices with clearly defined tariff outcomes consisting of both fixed and variable components.

Incentives:

Western Water agrees that an efficiency carryover mechanism provides additional incentive for businesses to invest in efficiency measures. Many of the reasons the Commission gives for not applying such a mechanism to the first regulatory period are still likely to be relevant for the second regulatory period – the ongoing drought will continue to impact the quality of forecasts, ongoing operating costs will remain impacted by drought, priorities of operation and expenditure remain and can still change significantly depending on whether the drought lifts or worsens. These would all contribute to a likely complicated calculation of an efficiency carryover mechanism even in the second regulatory period.

Until an efficiency carryover mechanism is designed and implemented, an “S” factor adjustment is premature. The impost of such an incentive may actually work in the reverse and represent a “double edged sword” to some businesses.

Tariffs:

I. Rising Block Tariffs (RBT's)

Western Water will continue to apply Rising Block Tariff's to residential customers. Western Water has consulted with financial counsellors about the current levels for RBT's and they are supportive of the current structure and their continued use as long as hardship provisions are accessible to those in need. They accept the need for the price signal and believe the first step is “reasonable”. Western Water has implemented an effective hardship policy to support the introduction of RBT's to residential customers.

Applying a RBT's to non-residential customers is more difficult due to the variety of types of businesses involved and the difficulty in determining the level of discretionary use.

II. Rural

Western Water is keen to understand the impact that unbundling may have on its bulk water supply and costs. The move to a fixed and variable tariff is supported as this is more cost reflective. A greater customer consultation focus is encouraged.

III. Recycled Water

Western Water supports the Commission's recommended approach to pricing recycled water supplies.

Western Water considers Class A recycled water supplies to new residential developments as a “third service” to these areas, and supports the establishment of a standard residential tariff. Pricing should be targeted at no more than the potable water supply.

Western Water believes recycled water tariffs should be structured similar to the overarching considerations for potable water services in that there should be:

- A fixed annual service tariff recognising the fixed costs for recycled water supplies (due to the close proximity of the two metered services – potable water and recycled water, some efficiencies are expected, and a lower fixed annual tariff than that applying to the water services should apply).
- A volumetric tariff based on usage giving the customer control over the amount of recycled water used and billed. Western Water is not planning to introduce RBT's for Class A recycled water supplies at this time. Whilst, volumetric tariffs will be capped

by Western Water to no higher than the first level of the potable water RBT, importantly costs of supplying recycled water are much higher than potable water supplies due mainly to regulatory requirements. In order to promote use of recycled water as a substitute for scarce potable supplies, and in recognition of the wider community benefit of this substitution, volumetric tariffs for Class A recycled water are capped accordingly and the remaining revenue requirement is met from Western Water's broader revenue base (potable water tariffs).

- Applicable NCC for recycled water services – refer specific comments on NCC's.

Western Water supports the continuation of the pricing principles approach to Class B, C & D recycled water supplies to unique (one-off) customers. The replacement of part of the reference in the recycled water pricing principles to “maximise revenue earned from recycled water services...” with “recovering the full efficient cost of supplying recycled water services...” is also seen as appropriate to apply for Water Plan 2008.

Western Water disagrees with the current treatment of return flows to rivers or groundwater systems from allocated waters not being considered recycled water. Western Water considers the environment to be the third party if recycled water is required by the waterway for environmental flows to be maintained to the river and therefore should be recognised accordingly.

IV. Miscellaneous services

Any changes should be by way of the establishment of pricing principles following consultation with the industry and should include a set of common definitions businesses could adopt. If these were not adopted it would be up to each business to explain (to Customers and the Commission) how their definitions differ.

Pricing should be cost reflective and as a result would lead to differences between businesses. Western Water does not see this as an issue as currently standard service charges for water, wastewater and recycled water vary between businesses. Western Water believes the pricing for miscellaneous services is already transparent except where the prices are “at cost plus admin fee”. In the latter case businesses should provide advice on likely cost without giving a firm quote (as the physical conditions are often unknown).

The introduction of new miscellaneous service charges should be confined to the commencement of a new regulatory period except in circumstances similar to those that trigger a price reset, or where a new service is being provided for the first time.

New Customer Contributions (NCC's):

I. Customer Contribution per lot charge for shared infrastructure – Water, Wastewater & Class A Recycled Water supplies.

An industry submission is being prepared and Western Water is supportive of an industry approach in an effort to reach a satisfactory outcome.

Western Water would also like to draw the Commission's attention to its reference on page 91 of the consultation paper with misleading suggestion to Western Water's tax position. The paper makes reference to “an estimate of tax attributable to new customer contributions that is greater than that forecast to be paid by the business as a whole. It estimates \$16.2 million in tax attributable to new customers over the regulatory period, which

is significantly higher than its total forecast tax payable for all customers of \$3.7 million.” The practicalities of the difference lie with the timing of tax payable as opposed to tax expense and the consumption of tax credits.

II. Recycled Water Assets

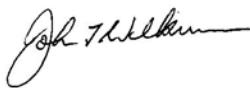
A NCC for Class A supplies is required to recover costs associated with the provision of increased infrastructure to service dual water supply areas. Typically, these areas are new with little or no established dual water supply infrastructure and require significantly higher infrastructure costs to establish, even when combined with potentially smaller diameter potable water mains in dual water supply areas.

Western Water strongly objects to the suggestion that all recycled water reticulation assets should be treated as shared distribution assets, and that the current ESC guidelines in this area referring to water mains of 150mm in diameter or less as “reticulation assets” is still appropriate. The low number of applications to shift from these guidelines, and even lower number of proposed dual water supply schemes suggests that the current guidelines are effective, and can accommodate unique developments such as those with dual water supplies.

It should be noted that new obligations may arise from implementation of the amended clause 56 of the Victorian Planning Provision that allows water businesses to mandate new development areas as dual water supply areas requiring installation of third pipe systems. As these provisions only took effect from the 9th of October 2006, Western Water advises the Commission that it is too early to determine the effect of this new provision on both the development industry and the water industry. At this time Western Water has been successfully working co-operatively with developers in our region to implement dual water supplies without relying on the mandate provided in clause 56. Should invoking the mandate place additional obligations on water businesses (for example directly funding all Class A recycled water reticulation within the mandated area), this would be contrary to funding principles established for similar services (eg declaration of development areas to be serviced for water and sewerage), and would negatively impact on the expansion of this important new water supply option that will reduce demand for precious drinking water supplies.

Once again, thank you for the opportunity to respond and provide feedback. If any further information or clarification is required please contact Vicki Pinder, Manager Regulation on 0403 154923.

Yours sincerely,



John Wilkinson
CHIEF EXECUTIVE