21 May 2013

By email: water@esc.vic.gov.au

Mr Marcus Crudden
Acting Director, Water
Water Team
Essential Services Commission
Level 37, 2 Lonsdale Street
Melbourne VIC 3000

Dear Mr Crudden,

Price Review 2013: Greater Metropolitan Water Business - Draft Decision

The Consumer Action Law Centre (**Consumer Action**), the Consumer Utilities Advocacy Centre (**CUAC**) and the Victorian Council of Social Service (**VCOSS**) welcome the opportunity to comment on the Essential Service Commission's (**Commission**) Price Review 2013: Greater Metropolitan Water Business—Draft Decision (the **Draft Decision**).

Opening Remarks & Summary

Our respective organisations have been active participants in the Commission's consultation on the Water Price Review 2013-2018, through written submissions and through our participation in the Commission's Water Reference Group and public forums on the water price review.

CUAC and Consumer Action made a joint submission on the Water Price Review 2013-2018 to the Commission on 25 January 2013 and an additional response to the supplementary information provided by Melbourne Water on 4 April 2013. VCOSS made a separate submission to the Commission on 26 February 2013. In CUAC and Consumer Action's joint submission, we expressed concern with the insufficient attention given to affordability issues in the water plans, and urged the Commission to ensure that there is an appropriate price path to ameliorate the impact of the proposed price increases and that the hardship support proposed by the water businesses is adequate to address the substantial price rises. VCOSS's submission emphasised the need for water businesses proposing steep pricing paths to commit to proactively helping customers by enhancing their hardship programs and payment processes to mediate those impacts and help vulnerable customers adapt to higher prices.

We note that the Commission has acknowledged these concerns and have made recommendations to address them in their Draft Decision. We welcome the Commission's overall approach articulated in their Draft Decision.

In summary our comments on the Draft Decision are as follows:

1. We are pleased that the Commission has:

    a. Examined the consumer impacts arising from the proposed price paths and increases, including their impacts on vulnerable and low income customers

    b. Examined the impact of tariff structures on customer groups, including the mix of fixed and variable charges

    c. Moderated the water businesses' proposed price increases

    d. Found cost savings in business costs leading to the proposed downward revision to the water businesses' proposed expenditure and revenue requirements

    e. Scrutinised the manner in which Melbourne Water has proposed to pass on the costs associated with the desalination plant to customers

2. We strongly support the Commission's Draft Decision in relation to the following:

    a. Allowing an additional $5 million for Yarra Valley Water (YVW), South East Water (SEW) and City West Water (CWW) to help them improve support for low income and vulnerable customers experiencing hardship

    b. Service standard targets and guaranteed service levels

    c. Reducing the forecast operating expenditure and capital expenditure, however, we ask that more transparency be provided to consumers about the level of operational expenditure that is actually government revenue

d. Reducing Melbourne Water's proposed waterways and drainage service price rise which was 14.1 per cent over the next five years, to 0.5 per cent over the same period

e. Increasing flexibility to reopen a determination where specific events are material

f. Requiring Melbourne Water to resubmit an alternative proposal for the recovery of the desalination security costs for further consideration, one which takes into account, the WIRO requirements and developed in consultation with water businesses, end-use customers and their representative bodies.

3. In addition, we are of the view that the Commission should:

    a. Set the WACC based upon the businesses actual cost of capital (given the fact that they are government-owned), rather than theoretically constructed private businesses

    b. Ensure that the pass through of desalination water order costs is effected in a consistent manner, so that customers understand the costs of their water use, and any pass through of costs should be included in usage charges

    c. Ensure that Melbourne Water capitalises as much of the desalination security payments as is possible, and undertake further analysis as to whether Melbourne Water can bear reduced net profits (or indeed net losses) so as to allow for higher capitalisation

    d. Outline for future regulatory periods what is required for Melbourne Water and water businesses in terms of consultation with their customers

Melbourne Water's Water Price Focus Group

We attended Melbourne Water's Water Price Focus Group on 10 May 2013. Melbourne Water presented their strategy on obtaining customer input on how the cost of the desalination plant should be recovered (over 27 years or 50 years), and the options they would be putting to customers for them to vote for their preference. Melbourne Water also explained the position they took in their initial Water Plan submission to the Commission and their current thinking on options they are exploring in response to the Commission's Draft Decision. We appreciate the time and effort put in by Melbourne Water in organising this, particularly within the tight time frames required and the fact that customer consultation has not been part of Melbourne Water's business practice in the past. We were given the opportunity for genuine exchange to better understand Melbourne Water's drivers and options under consideration.

Melbourne Water also outlined their attempt to further engage with consumer opinion on their options. Again, we support this initiative; however, we did express concerns about the process which included the following:

1. The explanatory video provided to consumers was useful but still complex and would be difficult for consumers to absorb in the short period provided.

2. The pictorial boards were presented to provide consumers to further clarify Melbourne Water's options. However, we believe that some of the images used were potentially leading. For example, a picture of a broken piggy bank representing a budget deficit.

3. The pros and cons of debt levels and budget surplus/deficit were inadequately articulated for consumers to assess the full implications of the options.

4. They acknowledged that their focus group formation process was not able to guarantee appropriate representation of different demographic groupings; but their proposal to aggregate responses demographically (by socio-economic status, gender, age, etc.) and scale them up or down according to the demographic groupings' distribution in the wider community is statistically un-rigorous and potentially misleading.

The findings of any survey need to be considered alongside the data collection methods and for the reasons outlined above we consider that the outcomes of this case have been undermined. With regard to the difficulty in assisting consumers to understand complex issues in short time frames, we suggest that consultation on complex processes should be deliberative so that consumers can digest information on complex issues. We have argued this in the past in relation to consultation with consumers on water policy.

Our comments on the Draft Decision are detailed more fully below.

Prices & Customer Bills; Customer Support

We welcome the fact that the Commission has found efficiencies in expenditures that have allowed them to moderate the price increases which had been proposed by the water businesses in their Draft Decision.

We strongly support the Commission's proposal to allow an additional $5 million for the metropolitan businesses – CWW ($1 million), SEW ($2 million), YVW ($2 million), to assist low income and vulnerable customers manage the impact of the proposed price increases. The Draft Decision suggests that the additional expenditure is for the "first year of the period to review the existing hardship support programs." We suggest that the Commission exercise some flexibility as to when the additional expenditure is to be used by the metropolitan water businesses. Some customers may need hardship assistance and support in the later years as cost of living pressures builds up, rather than in 2013-2014.

The Draft Decision describes the various types of additional hardship assistance which CWW, SEW, YVW and WW have proposed. We note that the forms of assistance range from the more "basic" forms of hardship assistance such as payment plans, financial counselling and Centrepay (CWW) to more innovative measures such as the Hardship Relief Fund, Conservation Plumbing Scheme, Special Circumstances Customer Listing (SEW), Kildonan partnership, retrofit. Home visits (YVW) and Water Tight program, URG Supplementary Bonus, Household Size Relief Plan (WW). We recommend to the Commission, that CWW include some of the more innovative measures to complement the hardship assistance which has been articulated in the Draft Decision. Given the curtailment of Waterwise, it is noteworthy that some water businesses have included retrofits in their additional hardship assistance. We would also like to see retrofits available and accessible to more customers experiencing hardship and more water businesses offering them.

YVW invited us to a meeting on 1 May 2013 to canvass ideas on what other additional hardship assistance YVW could provide in view of the additional $2 million. We suggested the following, which is also of relevance to other water businesses:

- Personal line of credit for customers (allowing customers a personalised smooth price path)
- Debt waiver and incentives
- Shorter billing frequency
- Processes which make it easier for customers to arrange extensions (for example, calling a number to auto-arrange a payment extension without requiring the customer to speak to a customer service member)
- Ensuring that customers already in the hardship program are given additional support so they do not fall into more arrears when the price rise comes into effect
- Seize opportunities to have discussions with customers about water efficiency
- Monitoring customer (not just customers experiencing hardship) bill payments and flagging accounts where payments have been late (for example: a customer who pays two bills late may be experiencing payment difficulty)
- Training staff to be aware that a customer who calls about a "high bill" might actually be experiencing payment difficulty (they may not belong to the "traditional' low income and vulnerable category)

In addition to what has already been proposed by the water businesses, these are examples of additional hardship measures that we believe would be helpful in meeting the needs of the water businesses' customers. We agree that the Commission needs to monitor the water businesses' efforts in providing accessible support for their customers experiencing hardship and request that the Commission make such reports publicly available in the interest of transparency and accountability.

According to the State Budget (2013-2014), the water concession cap will only be indexed by CPI. The concession amount is significantly less than the proposed increase in water prices. The consequence is that concession households will, in effect get a larger water price rise than other households. For instance, VCOSS modelling estimates that not increasing the cap on the water concession will give concession households price rises 30 to 50 per cent higher than non-concession households. For concession household with typical water usage, this amounts to a 26 to 37 per cent price rise instead of 17 to 25 per cent. As mentioned in Consumer Action's and CUAC's joint submission in January 2013, we would like to see the Commission, in maintaining its focus on consumer impact and affordability, make a formal recommendation to the State Government to review concessions as part of its water plan review.

Service Standards & Guaranteed Service Levels

We broadly support the Commission's intention to approve all but one of the service standard targets proposed by the metropolitan water businesses. We also support the Commission's request for further information from the businesses where deviations are not sufficiently justified. For example, we support the Commission's Draft Decision to not approve Yarra Valley Water's proposed deviations in relation to attendance of bursts and leaks as they were not sufficiently justified.[1]

However, as stated in Consumer Action's and CUAC's joint submission of January 2013, whilst we support the five year benchmarking for standards, in our view the regulatory regime should continually encourage business to improve service standards and efficiencies over time, rather than continuing to meet the average five year standard.

We also support the Commission's Draft Decision that water businesses maintain their guaranteed service level schemes (**GSLs**) for the third regulatory period. In our view GSLs are important in providing redress for customers who receive poor service, whilst providing incentives for business to improve services. We note again, however, that water businesses should increase the amount of payments over time, to ensure that they do not lose their relative value and encourage the Commission to reconsider whether the GSL levels remain appropriate.

Revenue Requirement

We strongly support the Commission's efforts in investigating and rigorously analysing the water businesses proposed operating and capital expenditure.

Operating Expenditure (except desalination costs)

In terms of operating expenditure, we welcome the Commission's proposal to reduce controllable operating expenditure by around $181m. In particular, the Draft Decision's reduced forecast labour and energy costs as well as the requirements around productivity and efficiency. We agree that it is incumbent on water businesses to expend no more than is efficient or necessary on operating costs, and that incentives to improve productivity and encourage good performance should thus be built into pricing determinations.

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1 Essential Services Commission, *Price Review 2013: Greater Metropolitan Water Businesses - Draft Decision,* p 31.

We understand that some of the water businesses may seek to challenge the Commission's Draft Decision on operating expenses, particularly as it relates to labour costs and the proposed efficiency dividend. We support the Commission's position to limit all wage increases to CPI from the expiry of current enterprise bargaining agreements, and for rigorous limiting of sub-contractor labour costs. We also support the approach taken by the Commission in imposing a productivity hurdle, resulting in a downward productivity adjustment for Melbourne Water, CWW and SEW. In preparing its final decision, we ask the Commission to consider the extent to which water businesses have been able to limit operating expenditure to that proposed by the Commission in previous regulatory periods.

We note that a not insignificant amount of operating expenditure relates to government licensing fees, for example, the environmental contribution, Department of Health safe drinking water fees, Environmental Protection Authority licence fees and Commission licence fees. We believe that there should be more transparency around the level of these fees for consumers, so that consumers understand how much of their water bill is comprised of government levies.

Capital Expenditure

We strongly support the Commission's Draft Decision to lower capital expenditure of the water businesses for the next regulatory period. We agree that expenditure should not be allowed where the Commission does not consider that the business is likely to deliver against its time lines or where there is a lack of justification or insufficient supporting documentation.

In our view, capital expenditure should only be included in the current price plan where:

- It is clear that it will be completed within this time period
- There is clear customer need for the project or
- There is government policy that supports its approval.

As we noted in Consumer Action's and CUAC's joint submission of January 2013, we do not believe that further supply augmentation is warranted at a time when such significant expenditure is occurring in relation to the desalination plant. As the desalination plant is causing prices to increase significantly for consumers, any further increase should be deferred unless absolutely necessary.

Financing Capital Investments

We support the Commission's Draft Decision to require the water businesses to use net capital expenditure forecasts approved for the second regulatory period in its regulatory asset base for the third regulatory period. A number of water businesses proposed to include 2012-13 net capital expenditure amounts above their determination forecasts—such an approach can incentivise the businesses to delay capital works until the last year of a regulatory period. Even if capital works were not delayed in the second regulatory period (and we have no knowledge as to whether they were or not), this is an important regulatory principle to ensure businesses are not unduly benefited by the capital allowances approved in previous regulatory periods.

We offer broad support for the Draft Decision's adoption of a weighted average cost of capital (**WACC**) of 4.2 per cent. However, we note the water businesses are all government owned and are able to take advantage of cheaper cost of financing compared to privately owned businesses. For example, we note that the Victorian Government is currently AAA rated and its bond rates are listed as between 3.1 and 4.09 per cent. The Commission states that the cost of capital for a government owned utility is typically set on the same basis as a privately owned utility to ensure competitive neutrality. Water businesses in Victoria are monopoly businesses, and do not have opportunity to compete. We believe that cost of capital should be assessed based on real costs of capital, not on substituted values based on hypothetical private competitors.

We note, further, that there is a not insignificant difference between the WACC recommended by the Independent Pricing and Regulatory Tribunal (**IPART**), and the WACC of 4.7 per cent that the Commission is proposing to approve.[2] We would ask the Commission to more clearly demonstrate the basis upon which a lower WACC can be justified for the NSW business.

Demand

In light of the Commission's assessment, we support the Commission's Draft Decision requiring water businesses to resubmit forecasts to account for updated bounce back modelling and consultation following their Draft Decision.

Form of Price Control

We consider that, in general, tariff baskets and revenue caps carry increased risks for consumers versus price caps, as they give increased scope for businesses to alter prices and unexpectedly increase the financial burden on particular customer segments (for e.g. those that use a particular service disproportionately, in the case of tariff baskets) or all customers (in the case of revenue caps). Tariff baskets and revenue caps should thus be accompanied by adequate consumer protections.

In this vein, we support the proposed rebalancing constraints of 3 per cent and 2 per cent per annum for SEW and YVW, respectively, as promoting price path stability, reducing price shocks, and reducing the price risk for consumers.

We welcome the Commission's Draft Decision requiring water businesses to consult customers whenever they propose a change to the form of price control. Water businesses should consult meaningfully with their customers if they propose to move to a hybrid form of price control or propose price changes that result in a material tariff change, and provide evidence of such consultation and a statement on customer impacts and how they intend to address these impacts, to the Commission.

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2 Independent Pricing and Regulatory Tribunal, *Draft Determination No. 4 Hunter Water Corporation* (March 2013).

Bulk Water & Sewage

We support the Commission's proposal for Melbourne Water to revise their proposed pricing strategy to incorporate a more cost reflective price structure (for bulk water and sewage) given the Commission's proposed reduction of Melbourne Water's revenue in the Draft Decision to minimise cross subsidies.

Retail Water Service Tariffs

Inclining Block Tariffs

In the Draft Decision, the Commission has proposed to approve the metropolitan water businesses' proposal to retain their three tier inclining block Tariff (IBT), while remaining of the view that a simple two-part tariff with a single variable charge may be a more efficient approach. The Commission has acknowledged that the joint consumer survey (by CWW, SEW and YVW) results were not as conclusive as the businesses had argued, that GA's research 2012 report suggested some openness to shifting from the three tier-IBT, and that this option had not been explored further by water businesses.

Consumer Action and CUAC, have as noted in the Commission's Draft Decision, expressed our views in detail on tariff structure (IBTs, fixed and variable) in our January 2013 joint submission. The Commission's findings as outlined in the paragraph above, supports the need for more research on tariff structure, as previously recommended by Consumer Action and CUAC. It is unlikely that there will be sufficient time for further research into tariff structures for this regulatory period. However, in anticipation for the next regulatory period, the Commission and water businesses should undertake further research on how the current tariff structure can be improved, including modelling the impacts of alternative tariff structures such as the one and two part IBT, and variations to the proportion of fixed and variable charges on a customer's bill, for different households (including seniors, low income, owner occupier, and tenant occupier households).

Connection Based Charging

We are pleased that the Commission has, in response to Consumer Action's and CUAC's joint submission of January 2013, acknowledged the need for water businesses to communicate the changes in relation to connection-based charging to affected customers. In addition to this, water businesses should also alert customers to any support and payment options that may be available to help them manage the change.

Customer Choice

We welcome the Commission's Draft Decision regarding customer choice as it addresses the matters Consumer Action and CUAC had raised in their January 2013 joint submission. We support the Commission's Draft Decision, requiring YVW to provide regular updates on the progress of their opt-in 100 per cent variable price customer trial and publishing the results of the trial. We are also supportive of SEW and CWW undertaking targeted research including similar customer trials as proposed by YVW and consulting with their customers on choice.

Recycled Water

While the water businesses' have proposed a two-part tariff (fixed and variable) for residential recycled water tariffs, they peg their prices differently. YVW and SEW peg the variable water variable charge at 85 per cent of the first tier potable water prices. (YVW for the regulatory period 2013-18. However, for SEW, from 2014-15, the price will move according to "cost drivers"). CWW and WW price the variable recycled water price to their respective first tier potable water price.

While we understand that there are different considerations in relation to the supply of recycled water, we are concerned that there is no price certainty for SEW residential customers on recycled water for 2014-18 who might end up paying more. The results of the joint customer research study (by SEW, YVW and CWW) indicated that 39 per cent of customers indicated a preference that recycled water be priced at a lower price than the first tier potable water price. 37 per cent indicated a preference that recycled water be priced at the same price as the first tier potable water price.[3]

We ask the Commission to clarify with SEW how they have considered the customer research study outcomes in their proposal to base their pricing of residential recycled water on their "cost drivers" for 2014-18.

New Customer Contributions (NCCs)

We support the Commission's approach regarding NCCs as articulated in the Draft Decision (p 249-250). The need for a "sensible balance to exist between full cost-reflectivity and having standardised new connection charges apply across greater Melbourne, provided benefits outweigh costs." This approach takes into consideration the cost of servicing different areas (greenfield areas and brownfield areas).

Adjusting Prices

Reopening Mechanism

We are of the view that mechanisms to reopen determinations to adjust price during the regulatory period are an important consumer protection in the case of an unforeseen event affecting pricing. We agree with the Commission that the over collection of desalination payments during the current regulatory period exposed *"an undesirable inflexibility in the Commission's ability to adjust prices within a regulatory period"*.[4]

We are strongly supportive of the Commission's proposal to depart from the current mechanism regarding unforeseen events that requires a broad consideration of all factors influencing a business' costs and revenues. We are pleased to see that the Commission intends

3 Essential Services Commission, *Price Review 2013: Greater Metropolitan Water Businesses - Draft Decision,* p 200-201.

4 Id p 265

to increase flexibility to reopen a determination where specific events are material.[5] In our view, any such mechanism must be reasonably responsive, to ensure that consumers are not adversely affected where an unforeseen event causes overpayment by customers.

Proposed Adjustment Factors for Desalination Costs

We broadly support the Commission's assessment that the pass through of desalination cost changes via adjustment factors for changes in security costs and water orders sends appropriate price signals to customers regarding the cost of desalinated water.[6]

However, we note that CWW, SEW and YVW all propose inconsistent approaches to adjusting prices in response to changes in costs relating to the desalination plant.[7] We are concerned that this inconsistency will confuse customers or cause them to question whether they are being treated fairly. We consider that the pass through of desalination costs must be effected in a consistent manner, so that customers understand the costs of their water use, and can adjust their usage in response.

In keeping with this principle of efficiency, we agree with the Commission that customers who benefit from a service pay for the costs of providing that service.[8] In relation to the desalination security cost, however, we consider that not all customers will benefit equally: low-use customers require less capacity to meet their needs than high-use customers, and thus receive a lesser benefit from the option to produce water in times of supply restraint. We therefore consider that any pass through of costs should be included in the usage charges rather than service charges, reflecting the differentiated benefits customers gain from the desalination plant and allowing them to make efficient decisions based on price signals relating to their usage.

To the extent that consumers with lower water usage are disproportionately consumers with lower incomes, an equal adjustment factor for security costs would also be regressive and, we consider, undesirable.

Options for Treatment of Desalination Plant

We strongly support the Commission requiring Melbourne Water to resubmit its pricing proposal for its desalination security payments[9] to demonstrate that it has taken into account the requirements of the WIRO and consulted consumers and water businesses. Our further response to the Commission of 4 April 2013 strongly advocated for Melbourne Water to be required to be more transparent about its proposals relating to desalination security payments, so we very much welcome this requirement.

In terms of the financing of the desalination plant security payments, we are of the view that the Commission should focus on minimising price increases for customers, both absolutely (to

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5 Ibid
6 id p 269
7 id p 271
8 id p 275
9 id p 273

provide the lowest possible bills) and relatively (to promote price path stability and avoid bill shock). We therefore believe that Melbourne Water should capitalise as much of the security payments as possible without jeopardising its financial stability. In consideration of the principles of equity and efficiency we also believe Melbourne Water and the water retailers should spread the cost of the desalination plant across customers for the estimated life of the plant of 50 years.

We note that Deloitte has assessed that Melbourne Water would be able to capitalise up to 20 per cent of its annual security payments for the desalination plant and remain financially viable.[10] Even the lower capitalisation rate of 15 per cent would result in annual savings for customers varying between $4 and $35,[11] compared with the prices under the current Commission's Draft Decision with no capitalisation of costs. Whilst, on the face of it this may not appear as a significant saving, for a low income consumer who budgets daily, even a saving of $10 is significant in reducing their financial stress.

We also believe that it is efficient and equitable that the costs of the desalination plant should be spread across the customers who will benefit from the plant over its estimated 50 year life. In a meeting with Melbourne Water, it was suggested that paying off the plant over 27 years would mean that future generations were not 'burdened' with debt. In our view, this is not a fair characterisation of the issue. Instead, the Commission should consider the equitable principle that customers who benefit from a service pay for the costs of providing that service. Capitalisation of some of the plant costs does not mean that future generations are paying for today's debt, rather they will be paying their fair share for the benefit that the plant is providing (that is, it is available to provide water during times of supply restraint).

Matching the benefits and costs of a service over time is also an efficient way of paying for services—those that benefit from the service see the actual cost of that service, thereby influencing consumption decisions at that time. The initial proposal from Melbourne Water would have meant inconsistent price signals for consumers, as consumers for the next 27 years would bear the costs of services provided in years 27 to 50. This would create an inter-temporal price distortion by raising prices for 27 years then lowering them for 23, leading to sub-optimal, inefficient consumption and investment decisions not reflective of the true cost of water provision and security.

We understand that Melbourne Water will resubmit its proposal and propose to capitalise a portion of the desalination costs. We welcome this, but note that Melbourne Water proposes to do so at a far lower proportion than in the analysis undertaken by Deloitte and the Commission. In doing so, Melbourne Water seems overly focused on maintaining a theoretically optimal, overly risk-averse financial position at odds with its role as a bearer of risk on behalf of its customers, and a government-owned entity operating for community benefit. This is exemplified in its determination to retain a budget surplus at all costs (as well as its insistence on using the terms 'profit' and 'loss' to refer to a surplus and a deficit). It is not clear to us why Melbourne Water cannot bear a smaller surplus ('reduction in net profit') or even a small

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10 Deloitte Touche Tohamatsu, *Desalination Capitalisaton Scenarios,* p. ii

11 Essential Services Commission, *Price Review 2013: Greater Metropolitan Water Businesses - Draft Decision* p. 283

budget deficit ('net loss') for the first few years of the desalination plant, and why it considers that the Commission's Draft Decision must necessarily produce a budget surplus ('net profit') each year of the regulatory period (and thereafter). As far as we understood it, the analysis of capitalising a larger proportion undertaken by Deloitte and Commission was undertaken on the basis that it is revenue neutral to Melbourne Water over the life of the plant—therefore it would not necessarily impact its financial viability. Given this, and the balancing that needs to be undertaken in assessing Melbourne Water's needs and customer needs, we encourage the Commission to ensure that the level of capitalisation is significant to ensure equitable and efficient outcomes for consumers.

A key role of utilities such as Melbourne's water businesses is to shoulder risk on behalf of consumers. It appears to us that the lesser the proportion of the desalination costs that are capitalised, the greater financial risk is borne by today's customers compared to Melbourne Water. A greater proportion of capitalisation would mean that Melbourne Water would carry more risk through taking on debt. In our view, Melbourne Water as a government-owned water business with low debt costs is better placed to do this compared to households.

We welcome the Commission's work exploring approaches for Melbourne Water to recover its desalination security costs over time,[12] but consider that, whichever approach is taken, the Commission should provide a smooth price path for customers to limit bill shock, and ensure the peak payment over the 50-year period is as low as possible. We believe it is appropriate that Melbourne Water play a role in re-profiling customer costs over time (while still fully recovering those costs), as it has greater capacity to cope with revenue-expenditure fluctuations and shortfalls than customers, especially low-income and vulnerable customers.

Finally, we strongly recommend that for future regulatory periods, the Commission calls for greater consultation by the water businesses with consumers before proposals are made.

We encourage Melbourne Water to engage with consumers and consumer organisations on an ongoing basis and in a pro-active manner. For regulatory decisions to be made that are in the long term interests of consumers, it is important for regulated businesses to consult openly, transparently and fully with consumers and representatives throughout the process. Our organisations are keen to work with Melbourne Water on their consumer engagement strategy. CUAC is currently undertaking a research project on best practice consumer engagement which involves the development of best practice guidelines which will be relevant to government, regulators, and businesses including Melbourne Water.

Prior to finalising this submission, we were contacted by YVW with an alternative proposal for dealing with Melbourne Water's desalination expenditure. In essence, it involves increased contributions by Melbourne Water to hardship programs in lieu of capitalisation. We understand that the amount provided by Melbourne Water would be $4m over the regulatory period. After giving due consideration, we have decided to maintain our position on capitalisation (outlined in our submission) as we believe that capitalisation is appropriate in order to share the costs fairly over households that will benefit from it thereby aligning value and cost more reflectively.

[12] id, S.21.6

YVW's proposal relies substantially on Melbourne Water's customer focus group results. We have highlighted the significant concerns we have around this process, and consequently, the reliability and validity of their findings. We also note that the scenarios outlined by Deloitte involved capitalising between zero and 45 per cent, but that capitalising at 15 per cent would mean an average of $98m per annum capitalised over the regulatory period—a significantly greater amount to be returned to customers compared to YVW's proposal. Of course, the additional funds in the YVW proposal are much more targeted to those most in need than the capitalised funds – and we agree that the greatest risk of the price rises is on those who are vulnerable to financial hardship. However this does not obviate the obligation on Melbourne Water to allocate infrastructure costs fairly over its entire customer base. Thus we contend that it is appropriate for Melbourne Water to both capitalise as required to pass costs through equitably over the life of the desalination plant, and provide additional funds for retailers to better support customers in hardship.

Thank you for the opportunity to participate in the Commission's consultations on the Water Price Review 2013-18. If you have any questions on the submission, please do not hesitate to contact the undersigned signatories.

Yours sincerely,

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