



22 April 2016

Water Team – Pricing Framework Review  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
MELBOURNE VIC 3000

Dear Sir/Madam

## Price Review 2016: Melbourne Water – Essential Services Commission Draft Decision

The Consumer Utilities Advocacy Centre (CUAC) and the Consumer Action Law Centre (CALC) welcome the opportunity to comment on the Essential Service Commission's (Commission) Price Review 2016: Melbourne Water Draft Decision (**Draft Decision**).

Our respective organisations have been active participants in the Commission's consultation on the Melbourne Water Price Review for the period 2016/17 – 2020/21.

We would like reiterate our strong support for the following initiatives:

- Wholesale charges for water and sewage services which are expected to decrease for 2016/17 and thereafter only increase in line with inflation;
- Residential customers' waterways and drainage charges which will only increase with inflation.

We expect these measures will lead to a meaningful reduction in overall prices for consumers across the period.

### Victorian Desalination Plant

We support the Commission's draft decision calling for Melbourne Water to *"provide further information on opportunities for capitalisation of desalination security payments"*. As stated in our previous submissions, increased capitalisation of desalination payments across the life of the asset improves intergenerational equity and better reflects the "user pays" principle

across the estimated 60-year life of the plant. Limiting repayments to the first 27 years of the life of the plant also has the effect of an inter-temporal price distortion, whereby the consumer pays higher rates in the short term and lower rates in the long term. This leads to sub-optimal, inefficient consumption and investment decisions not reflective of the true cost of water provision and security. We recognise that 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 than are households.

While Melbourne Water have outlined the findings of the views of consumers voiced in forums and sourced through different formats, we request that Melbourne Water outline how it determined to capitalise \$100 million in desalination security payments over the period based on these views.

We also support the Commission's decision that Melbourne Water should not be allowed to recover amounts for regulatory depreciation for any desalination security payments treated as capital. We agree with the Commission's view that depreciating desalination security payments should commence only once Melbourne Water takes over ownership of the plant in 2039.

#### Rate of Return

We support the Commission's position to reject Melbourne Water's proposed trailing average approach to estimate the regulatory allowance for the benchmark cost of debt, because it does not better meet the requirements of the Water Industry Regulated Order than the current on-the-day method. We take the view that Melbourne Water's proposed approach which locks in "gains" through its proposed trailing average debt series is inappropriate when considering the weighted average actual cost of debt is lower across the past 10 years. Adopting a trailing average benchmark cost of debt based on a theoretically constructed private business during the global financial crisis would have the effect of increasing prices based on inefficient costs.

We agree with the Commission that there is merit in a trailing average to estimate the cost of debt to "*reduce price volatility through annual updates to the rate of return, as opposed to an update every three or five years*", and support the suggestion that Melbourne Water submit a revised trailing average approach to estimate the cost of debt.

#### Demand

We would like to draw attention to the intention of the Victorian State Government to "reactivate the Target 155 water savings campaign".<sup>1</sup> We query the extent to which the Commission has taken the effect of this policy into its demand forecast and the flow on effects for consumers given the revenue requirement.

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<sup>1</sup> Department of Premier and Cabinet, *Government Provides Water Storage Certainty*, 6 March 2016, [accessed online at]: <http://www.premier.vic.gov.au/government-provides-water-storage-certainty-2/>

Thank you for the opportunity to provide feedback on the Commission's draft decision. If you have any queries on the submission, please do not hesitate to contact the undersigned.

Yours sincerely,



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