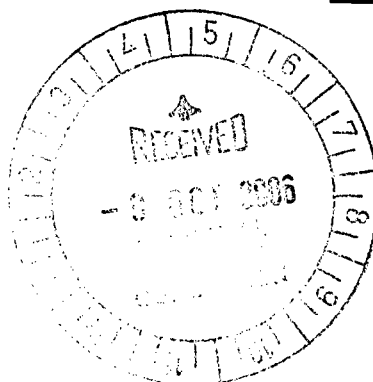


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Dear Sean

2008 Water Price Review Guidance on Water Plans

In September 2006 the Essential Services Commission (ESC) released its *2008 Water Price Review Guidance on Water Plans* (the Guidance Paper). Melbourne Water welcomes this paper and the guidance it contains, which will assist in preparing the draft 2008 Water Plan for submission in May 2007 and ultimately the final 2008 Water Plan in September 2007.

The following sets out Melbourne Water's comments in relation to those issues identified in the Guidance Paper, in particular its views on:

- Those issues the ESC intends to consult on over the next few months
- The proposed structure and content of the 2008 Water Plan.

Consultation issues

Identified issues

The ESC's Guidance Paper identifies a number of issues which will be the subject of consultation and further guidance. Melbourne Water supports further consultation on these issues. This said, Melbourne Water notes that some of the identified issues are interrelated and therefore consultation on these issues should occur at the same time. In particular, the following should be considered together:

- The length of the regulatory period and mechanisms for dealing with unforeseen or uncertain events
- Guaranteed service levels and S factors
- Tariff structures and miscellaneous charges.

Additional issues

In addition to the issues identified by the ESC, Melbourne Water also considers that the following should be the subject of consultation and further guidance:

- Measurement of productivity improvements and in particular the nature of supporting information that will be required to demonstrate efficiency (partial productivity ratios, total factor productivity analysis, etc)
- The framework that will be used to assess the prudence and efficiency of sustainability initiatives as well as how the ESC will take account of environmental and social considerations more generally.

Timing

It is noted in the Guidance Paper that a number of issues will need to be resolved before businesses submit their 2008 Water Plans, while other issues will be resolved as part of the price review process itself. In this regard, to ensure that Melbourne Water's draft 2008 Water Plan provides an appropriate basis on which to seek customer and community feedback, early guidance will be required from the ESC on the following issues:

- The length of the regulatory period (and therefore the mechanisms for dealing with new obligations, unforeseen / uncertain events)
- Tariff structures
- Classification of prescribed and non-prescribed services
- The framework that will be used to assess the prudence and efficiency of sustainability initiatives.

Structure and content of the 2008 Water Plan

Standardised format

The Guidance Paper notes that standardised Water Plans will assist customers and the ESC with clarity and understanding of the businesses' proposals. It further notes that standardisation will increase transparency and facilitate comparisons across businesses. Melbourne Water supports a standardised structure and approach to Water Plans but also notes the need for flexibility where appropriate, particularly given Melbourne Water's unique position in the water industry. For example, the different roles of Melbourne Water and the retail water companies will mean that the type and level of information provided to support demand forecasts will differ. Further, some flexibility will also assist in avoiding duplication or overlap between sections of the Water Plan.

Content

While Melbourne Water does not have any concerns in relation to the proposed structure of the 2008 Water Plan, some specific issues relating to the ESC's guidance on the content are discussed in the table below.

Content of the Water Plan

Issue	Comment	Page reference
Assessing outcomes from the 2005 Water Plan	An outcome based assessment is supported by Melbourne Water. Where inputs are considered the focus should be on the most significant projects and activities, in terms of their contribution to the revenue requirement.	Pg 7 – 9
New obligations under the Statement of Obligations	New obligations are defined to be those under the Statement of Obligations that take effect on or after 1 July 2008. As an alternative it is recommended that new obligations be defined as those taking effect on or after 1 July 2005 and not included in the ESC's 2005 Final Decision. This approach will facilitate clearer delineation of the drivers of new expenditure over the current Water Plan period. For example, Melbourne Water has had a number of changes to its Statement of Obligations which have involved significant expenditure over the current period Water Plan period and should not be considered in any comparisons of actual expenditure with the benchmarks included in the 2005 Final Decision.	Pg 12
Core service standards	Melbourne Water is mentioned twice in terms of core service standards, once in Box 4.1 in relation to urban standards and again in Box 4.3. It is suggested that Melbourne Water could be removed from Box 4.1.	Pg 15 – 17
Collection of data beyond the 2008 Water Plan period	As part of the financial templates that are associated with the 2008 Water Plan, information, and in particular operating expenditure information, needs to be collected for two regulatory periods. It is noted that the information for the second regulatory period (2013/14 – 2017/18) may need to include some simplifying assumptions.	Pg 21
Business as usual operating expenditure categories	In Box 5.1 there is duplication of some items such as licence fees and there appears to be some confusion between cost drivers (such as operations and maintenance) and activities (such as bulk water and sewerage services).	Pg 23
Flexibility around implementing strategies such as the Water Supply Demand Strategy and the Central Regional Sustainable Water Strategy	Where appropriate, the ESC expects the demand forecasts proposed in the 2008 Water Plan to be consistent with the Water Supply Demand Strategy and the Central Regional Sustainable Water Strategy. These strategies will guide the development of demand forecasts for the 2008 Water Plan, however, it is noted that going forward these strategies may evolve or be replaced. In this regard, mechanisms to deal with unforeseen or uncertain circumstances during the Water Plan period will be important.	Pg 31
Impact and likelihood of restrictions	The impact of restrictions is noted as a factor that needs to be taken into account in terms of demand management. The likelihood of restrictions should also be examined and factored into the analysis.	Pg 32 – 33

Issue	Comment	Page reference
Sewage demand forecasts – volume and load	Both volume and load information will need to be included in section 6.4.3.	Pg 34
Materiality of prescribed services	A further criteria that should be used to establish whether a service should be prescribed or not is its materiality in terms of contribution to the businesses' revenue requirement.	Pg 43 – 44

Next steps

Melbourne Water considers the Guidance Paper is an important first step in the 2008 Water Plan process. It looks forward to receiving further consultation papers on those issues outlined above and ultimately the ESC's guidance on these matters. An ESC timeline outlining when the ESC will consult on each of these matters would also assist timely and targeted industry participation.

Please do not hesitate to contact me, on 03 9235 7210, should you have any queries in relation to the above.

Yours sincerely



Ben Furmage
Manager, Pricing and Economic Regulation