

17 March 2015

Water Team
Essential Services Commission
Level 37
2 Lonsdale Street
Melbourne VIC 3000

Dear Sir/Madam

Consultation Paper on Proposed Approach to Melbourne Water's 2016 Water Price Review

We welcome the release of the Commission's Issues Paper on its proposed approach to undertaking Melbourne Water's 2016 water price review.

Our customer research indicates that lower water prices is the most important aspect of customer satisfaction – refer Appendix 1 for further details. As Melbourne Water's bulk water and sewerage charges comprise 57% of the water and sewerage components of our typical customer's bill, the outcomes from this price review will have a major impact on whether customer satisfaction can be maintained or improved. Given this preference by our customers, a desired outcome from the price review is to have a price path for the next regulatory period which provides reductions in water and sewerage prices to our customers. The potential capitalisation of part of Melbourne Water's desalination security payments (to recognise the 50 year life of the infrastructure rather the 27 year contract term) together with a lower weighted average cost of capital provide the foundations for achieving this result.

This is the first time there has been a two-year gap between Melbourne Water's and the metropolitan retail water utilities' price reviews. We welcome this initiative as it provides an opportunity for greater involvement of the retail water utilities and the community in Melbourne Water's price review process, which has been challenging in the past due to concurrent price reviews. We believe that this two-year gap should remain for future price reviews to enable this important engagement to continue.

In relation to the Commission's processes for Melbourne Water's water price review, we will actively participate including responding to Melbourne Water's price submission and the Commission's draft decision. We are currently participating, on behalf of our customers, in Melbourne Water's consultation process to develop its price submission and, to date, we have found Melbourne Water's process to be constructive.

We believe the Commission's suggestion of a deliberative forum involving our customers to consider Melbourne Water's approach to the recovery of its desalination security payments is an appropriate approach to consideration of this matter. As indicated in the Commission's Issues Paper, we used this approach in developing our 2013-18 Water Plan and found it to be an extremely beneficial with key insights derived through a six hour forum with a cross-section of residential customers. The services received from water utilities are generally not top of mind for most customers so forums such as these provide the opportunity to more deeply explore the services provided and trade-off decisions in relation to service and price. Given that "end-use customers" are customers of Yarra Valley Water, we would be pleased to facilitate this deliberative forum with our customers with the support of Melbourne Water.

We note the Commission is proposing to use the building blocks pricing methodology for Melbourne Water's price review process and we support the use of this cost-based approach. Moreover, we note that the Commission is planning to undertake a review of the price setting methodology to be used in future price reviews from April 2015 to October 2016 and we look forward to participating in this review.

In relation to timelines, we believe that the final determination needs to be finalised by end May 2016 rather than 15 June 2016 to enable implementation of the new prices for our customers (allowing for system changes to implement revised prices and drafting customer communications). Given this, we believe that the planned dates for the Commission's draft decision and submission of Melbourne Water's final price submission should be brought forward by three weeks.

Finally, we note the Commission's preliminary comments on the requirements for Boards to drive efficiencies within the regulatory period which are then delivered to customers through lower prices at each price determination. In particular, we note the Commission's comment:

"In coming months, the Commission will seek to engage with Boards of all water businesses to ensure that there is a common understanding of the roles and responsibilities of the Commission and the businesses so customers receive services that they are willing to pay for at the lowest possible long-term cost".

We agree with the intent of the Commission's proposal and look forward to meeting with the Commission on this matter.

The attached Appendix 2 contains our responses to the six questions contained in the Issues Paper.

If your team has any queries regarding the above, please contact Brett Mathieson, Manager, Regulation and Strategy by email on Brett.Mathieson@yvw.com.au or by phone on 9872 2441.

Yours sincerely



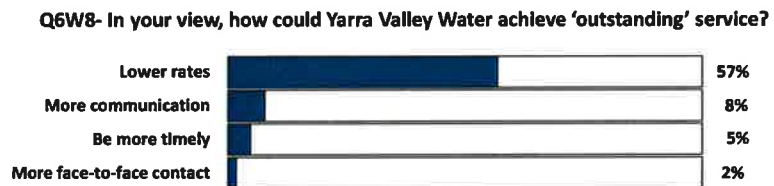
Pat McCafferty
Managing Director

Our customer research

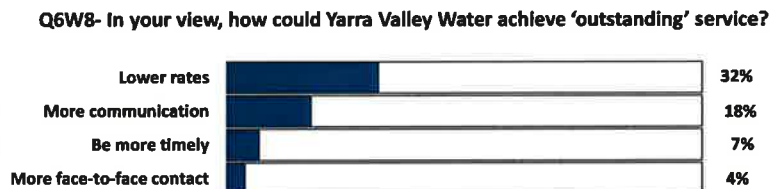
Our recent customer research shows that lower prices (i.e. rates) is the most significant factor which would drive achievement of 'outstanding' customer service – refer chart below.

LOWER PRICES KEY TO OUTSTANDING SERVICE

Brand Monitor – General Customer Base



Service Evaluation Monitor – customers with recent service interaction



n=233

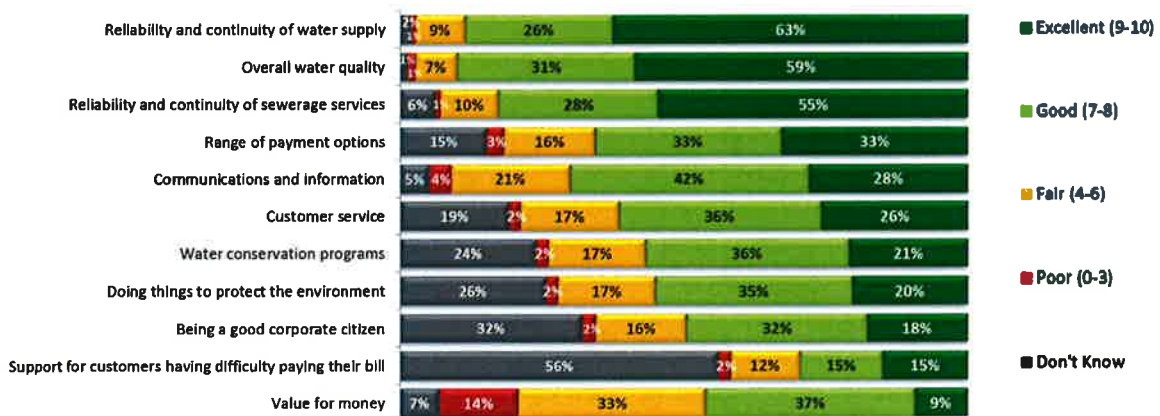
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In this recent research, value for money for our services was ranked the lowest performing attribute.

VALUE FOR MONEY LOWEST PERFORMING ATTRIBUTE

Key Performance Attribute Ratings (Ranked by 'Excellent' Ratings)



9

Base: All respondents, (n= 571 for Wave Two).
Q4. Thinking generally, how do you rate the following aspects of Yarra Valley Water

Source: Elasticity Study June '14
Newgate Research



Responses to questions in the Commission's Consultation Paper on Proposed Approach to Melbourne Water's 2016 Water Price Review

The Commission seeks ideas on any improvements to our application of the building block methodology for Melbourne Water's 2016 water price review.

We support continuation of the cost-based building blocks methodology for Melbourne Water's price review. We note that the Commission is planning to undertake a review of the price setting methodology to be used in future price reviews from April 2015 to October 2016 and we look forward to participating in this process.

We welcome the two-year gap between Melbourne Water's and the metropolitan retail water utilities' price reviews. This initiative provides an opportunity for greater involvement of the retail water utilities and the community in Melbourne Water's price review process, which has been challenging in the past due to concurrent price reviews. We believe that this two-year gap should remain for future price reviews to enable this important engagement to continue.

The Commission's Issues Paper has raised the matter of existing cross-subsidies between sewerage services to water services and waterways and drainage services to both water services and sewerage services (page 26). We have not been aware that economic cross-subsidies existed between these services. We are aware that Melbourne Water has had a separate building block for its waterways and drainage services but we are not aware of separate building blocks for the water services and sewerage services. We look forward to Melbourne Water and the Commission clarifying the extent of these cross-subsidies. If cross-subsidies exist between the three services, we support the Commission's principle that these should be transparent and every endeavour should be made to reduce or eliminate them over time, subject to being able to manage any customer impacts.

The Commission seeks views on how the WIRO principle on "price shock" should be interpreted for Melbourne Water's 2016 water price review.

For Melbourne Water's price review, we are not expecting any price shocks. We believe that price shocks need to be avoided and, if necessary, transition arrangements put in place. For instance, we have as part of our revenue cap price control restricted price increases to 2% per annum after CPI and any desalination order adjustments with any price reductions passed immediately through to our customers.

The Commission is interested in receiving views on areas where Melbourne Water may provide customers with an increased ability to influence its proposals, and how Melbourne Water might go about this. For instance, a deliberative customer forum may be well suited for Melbourne Water to receive end-use customer input on its approach to the recovery of its desalination security payments.

In relation to the Commission's processes for Melbourne Water's water price review, we will actively participate including responding to Melbourne Water's price submission and the Commission's draft decision. We are currently participating, on behalf of our customers, in Melbourne Water's consultation process to develop its price submission and, to date, we have found this process to be constructive.

We note the Commission's suggestion of a deliberative forum involving our customers to consider Melbourne Water's approach to the recovery of its desalination security payments and believe that this is an appropriate approach to consideration of this matter. As indicated in the Commission's Issues Paper, we used this approach in developing our 2013-18 Water Plan and found it to be an extremely beneficial with key insights derived through a six hour forum with a cross-section of residential customers. The services received from water utilities are generally not top of mind for most customers so forums such as these provide the opportunity to more deeply explore the services provided and trade-off decisions in relation to service and price. Given that "end-use customers" are customers of Yarra Valley Water, we would be pleased to facilitate this deliberative forum with our customers with the support of Melbourne Water.

The Commission seeks views on any other issues the Commission should focus on, and include in our guidance, as part of Melbourne Water's 2016 price review.

We see the key matters to achieve best value services for our customers in this price review being:

- Melbourne Water undertaking best practice customer engagement including closing the loop through feeding back to stakeholders the reasons for decisions – we are encouraged by the level and intent of Melbourne Water's engagement thus far.
- A deliberative forum (or forums) facilitated by the metropolitan urban water utilities, and supported by Melbourne Water, involving a cross-section of the urban water utilities' water and sewerage customers considering Melbourne Water's approach to the recovery of desalination security payments.
- The Commission determining an appropriate weighted average cost of capital resulting in lower customer prices.

The Commission seeks views from stakeholders on any information that may assist us in reviewing the efficiency of Melbourne Water's proposals. This could include any benchmarks or indexes relevant to our assessment of its forecast expenditure.

We note the comment in the Commission's Staff paper accompanying the report by Economic Insights on Victorian Urban Water Utility Benchmarking, 31 July 2014, that "*Melbourne Water was not included in the study as there are no comparable businesses against which its productivity performance can be benchmarked*" (page 4). Given the lack of comparable peers in Australia for benchmarking Melbourne Water, alternative approaches involving benchmarking of partial factors or bottom up scrutiny of expenditure proposals are likely to be required. We look forward to Melbourne Water providing this information.

Stakeholders are invited to provide feedback on the proposed steps and timelines for the price review.

We believe that the final determination needs to be finalised by end May 2016 rather than 15 June 2016 to enable implementation of new prices for our customers (allowing for system changes to implement revised prices and drafting customer communications). Given this, we believe that the planned dates for the Commission's draft decision and submission of Melbourne Water's final price submission should be bought forward by three weeks to 19 February 2016 and 15 October 2015 respectively.

