

Final Determination: Coliban Water Application for Tariff Adjustment

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Bendigo, Victoria

This morning I have come to Bendigo to advise Coliban Water and its customers about the outcome of our review into its application to increase water prices.

Two years ago, the Essential Services Commission approved a five year price path for Coliban Water customers. This meant that we set prices for the five year period from 2008 to 2013 to reflect the costs faced by Coliban Water in delivering services to its customers. Tariffs were scheduled to increase each year to reflect the increasing costs of delivering reliable water services.

The reason for this approach is twofold.

First, it gives Coliban Water's customers some assurance about the future cost of receiving their water. We design the price paths so that they are gradual and don't bounce around from year to year. Customers can move forward with a degree of confidence without fearing an annual surprise in their water bills.

The second reason for our five yearly approach to setting prices is to give Coliban Water some certainty about the prices it can charge its customers. Knowing this, it can then get on with the business of delivering and improving services to its customers without worrying about the Essential Services Commission.

This is the approach we use with all water authorities in Victoria.

Providing customers and water authorities with some degree of certainty is self-evidently desirable. But, let's be clear, this is no mean task. Trying to forecast water supply and demand over a five year time horizon is fraught with difficulties — most notably, rainfall and run-off into local catchments.

For this reason, our five-year price decision back in 2008, included a clause that allowed water authorities to have their

prices reviewed under “uncertain and unforeseen” circumstances.

To be absolutely clear, this clause was not included so that water authorities could simply turn to the Commission for price increases whenever they were struggling to manage their costs.

We have made it clear that we would only consider reviewing prices — that is, the prices that customers are required to pay — under two conditions.

One, where a water authority finds itself in circumstances that were truly unforeseeable at the time of our last decision in 2008; and if they can satisfy us that this is indeed the case, then: Two, that they have done everything within their control to mitigate against the circumstances in which they find themselves.

The hurdle for assessment against these conditions is necessarily high. The Commission will not amend price determinations lightly.

If they have met these two conditions then and only then, will the Essential Services Commission consider reviewing their prices over the remaining years to 2013.

If we are satisfied that a review of prices is required, then another condition applies.

If truly unforeseen circumstances indeed dictate that prices need to be revisited during the five year period, then, as far as the Essential Services Commission is concerned, this should not be seen as a trigger for major price reform.

This is not to say that the Commission does not support price reform. But there is a time and place for everything. If a major reform of tariffs is to be pursued, then we believe that it should only be pursued as part of the *next* five year price setting process

— which is a very detailed exercise involving water authorities, their customers and the Commission.

In other words, when unforeseen circumstances require a review of prices *during* a five year pricing period, that review should look at the minimal possible adjustment to customer prices to address the problem at hand.

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This brings us to Coliban Water.

Before I continue with our decision, I just want to express my thanks to Coliban Water — under its Chairman, Mr John Brooke, and its Managing Director, Mr Gavin Hanlon — for their professionalism and for the quality of their application. They have undertaken thoughtful analysis, extensive consultation, and they have made difficult decisions where they have had to be made.

In March this year, Coliban Water submitted to the Essential Services Commission an application under the “uncertain or unforeseen events” clause that I have already described.

In short, due to the on-going low rain falls in this region and then even lower run-off from Coliban’s catchments, water restrictions have not been eased as Coliban Water, and the Essential Services Commission, had expected when we made our price decision in 2008.

This has resulted in some large financial losses for Coliban Water and undermined its financial viability.

Since we received Coliban’s application in March we have been analysing it very closely. We have worked with Coliban Water to understand their circumstances and I thank the board and management for their full and open cooperation over the last

couple of months. In addition, my staff and I travelled to Bendigo and Echuca a few weeks ago to meet with customers to assess their views about Coliban's proposals.

In making our assessment, we had to consider all those conditions that I outlined a moment ago:

- Were Coliban's circumstances truly unforeseeable at the time of our last decision in 2008?

If so:

- Has Coliban done everything within its control to mitigate against the circumstances in which it find itself?

If so:

- Is Coliban Water's financial position still untenable?

And finally, if so:

- Do Coliban's proposed price adjustments satisfy the condition that they be as minimal as possible in order to address the financial problem at hand?

The four criteria were used to assess Coliban Water's application for price increases.

First, we have satisfied ourselves that Coliban Water could not have foreseen, back in 2008, the circumstances in which it now finds itself. Run-off from local catchments continues to hit new lows that are historically unprecedented.

As well as reducing water available in its storages, this has increased the need for more water to be supplied via the Goldfields Superpipe and this in turn has placed very significant pressure on Coliban's capacity to treat that volume of water.

In response, Coliban has commenced an urgent upgrade of its treatment capacity. But in the meantime, restrictions have not been eased as was anticipated back in 2008.

Our second criteria was to ask: Has Coliban Water done everything within its control to limit the impact on its customers?

Again, we are satisfied that Coliban Water, has reviewed and revised its capital and operating expenditures in order to: (1) free up funding to support increased water treatment capacity; and (2) to minimise the impact on customer service standards.

Third, having done everything within its power to mitigate the impact of the unforeseen circumstances, does Coliban Water still find itself in a financially untenable position?

Last year the Auditor-General noted that Coliban Water's financial health is not as robust as it ought to be.

The Commission is confident that Coliban Water has the capacity to rebound reasonably strongly if the right course of action is taken. We are confident that Mr Brooke and Mr Hanlon are taking that course of action.

Nevertheless, a significant problem remains for the coming financial year, 2010-11. Under the existing tariff structures, Coliban Water will make another loss next year. This comes on top of large deficits last year and this year. To put it another way, Coliban Water will need to borrow more money next year just in order to keep its doors open.

Reflecting the material fall in demand below original projections and a weak financial outlook for 2010-11, the Essential Services Commission has found in favour of Coliban Water's request for

a “reopening” of its water pricing structures in the current regulatory period.

We have accepted that prices will need to increase to address Coliban’s unforeseen circumstances.

This brings me to the fourth condition. Are the price adjustments proposed by Coliban Water as minimal as possible in order to address the problem at hand?

In this case, we do not find fully in favour of Coliban’s proposal.

While we acknowledge the extensive research and analysis undertaken by Coliban Water in developing its innovative pricing proposal, we consider it goes too far — given that this is a mid-period review, rather than a whole new five year price schedule.

Coliban’s application made a strong case for changes to its tariff structure. But as I have said, there is a time and place for more extensive tariff reform. Today is not the time.

The Commission will consider the more substantial proposals as Coliban Water develops its next five year Water Plan.

We have therefore decided on a slightly different approach from the one proposed by Coliban Water, though wherever possible we have sought to keep in line with their objectives.

In setting prices we have adopted the following principles.

First, we need to prevent Coliban Water from going deeper into debt just in order to keep the doors open. In other words, we need to ensure it returns to cash surplus in 2010-11.

Second, we have attempted to meet the expectations of Coliban Water and its customers by shifting more of the average water bill on to variable charges and less on to fixed supply charges. Or to put it another way, over the next three years, customers will have increasingly greater control over their water bills.

Third, we need to stay as true as possible to the five year endpoint for prices, that is, we want to remain as true as possible to the prices we have already committed to for 2012-13. We want to remain as true as possible to that commitment for customers in Coliban's Central and Northern zones.

When combined, the outcome for customers from applying these three principles is as follows.

First, we have brought forward, by two years, the scheduled increases in water tariffs. In other words, the prices that were scheduled to kick-in in 2012-13 will now come into effect from 1 July this year. However, they will then remain unchanged for the next three years (other than minor adjustments for inflation).

Second, we have reduced the fixed access charge for water by 5 per cent in 2010-11. There will be another 5 per cent reduction in 2011-12. This will have two benefits. First, it will offset some of the increases in the variable tariffs; and second, it will give customers will have greater control over their water bills. We know this is something that Coliban's customers want.

In keeping with Coliban's application, we have not adjusted prices for sewerage and variable charges for rural customers.

So what does this mean for households?

A household consuming 170 kilolitres of water per year in Coliban's Central price zone, which includes Bendigo, can expect its annual bill from Coliban Water to be around \$897 in 2010-11. This is about \$110 higher than the corresponding bill

this year and about \$50 higher than had we not agreed to increase prices in response to Coliban’s application.

Residential customers in Coliban’s Northern-Rivers price zone, which includes Echuca, will see their annual bill rise by around \$56 dollars to \$740. This is about \$15 higher than the previously scheduled fee increase.

I need to stress that by 2012-13 water and sewerage bills will be no higher than they would have otherwise been had we not agreed to re-open prices as requested by Coliban.

Under Coliban Water’s proposal, household bills would have ended-up \$10 to \$20 higher in 2012-13.

Comparison of water and sewerage bills

Central pricing zone

	2009-10	2010-11	2011-12	2012-13
ESC 2010 Determination	788	897	912	932
Coliban proposal	788	879	921	941
ESC 2008 Determination	788	848	894	933

Northern pricing zone

	2009-10	2010-11	2011-12	2012-13
ESC 2010 Determination	683	740	754	774
Coliban proposal	683	746	777	797
ESC 2008 Determination	683	726	753	776

It is worth noting that customers of Coliban Water will continue to have among the lowest water and sewerage bills in the State. By way of comparison, the corresponding household in Ballarat will be paying more than \$1,000 in 2010-11.

Nevertheless, a price increase can, and will, have adverse impacts for some customers.

The Essential Services Commission requires that all water businesses, including Coliban Water, have in place measures that provide assistance to customers if they are having difficulty paying their water bill.

The Commission has received assurances from Coliban Water that it will continue to provide support – including through providing alternative payment arrangements – to customers who are finding it difficult to pay their water bills.

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I want customers of Coliban Water to know that we do not relish the opportunity to announce price increases. We do so reluctantly and as a last resort. But customers can be confident that Coliban Water has done everything possible to control its costs and continue to deliver against its service standards.

But I also have one final reminder to Coliban Water.

Price re-openers are a two-edge sword and the Essential Services Commission will be monitoring Coliban Water's financial position very closely over the next three years.

If we consider that the higher tariffs that we announced today result in unwarranted profits, then we will initiate another price review in order to return some of those profits to customers in the form of lower prices.

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