

Your ref.

Our ref. 200/46

Contact: Gavin Hanlon (03) 5434 1231

29 July 2009

Dr Ron Ben-David
Chairperson
Essential Services Commission
Level 2
35 Spring Street
MELBOURNE VIC 3000

Dear Dr Ben-David,

Draft ESC Report of June 2009 on an Access Regime for Water and Sewerage Infrastructure Services.

Thank you for the opportunity to comment on the Draft ESC Report of June 2009 on an Access Regime for Water and Sewerage Infrastructure Services.

Attached is Coliban Water's submission on the key issues that relate to Coliban. I have also attached a copy of the Joint submission prepared by Central Highland Water and ourselves for the superpipe. This submission has been sent to you separately.

Yours faithfully

Gavin Hanlon
Managing Director

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ESC: Inquiry into an Access Regime for Water & Sewerage Infrastructure Services

Submission from Coliban Water

This paper provides a response from Coliban Water to the Draft Report published by the Essential Services Commission on its *Inquiry into an Access Regime for Water and Sewerage Infrastructure Services*.

Corporate Objectives

Coliban Water has recently reviewed its strategic direction and has stated through its Corporate Plan that its vision is:

To meaningfully contribute to improving living standards in our region.

And our mission is to focus on:

- *Engaging our communities and stakeholders to understand and meet their water cycle related needs*
- *Building, operating and maintaining sustainable water cycle infrastructure to meet the needs of our community*
- *Ensuring that improved services, increased standards of living and commercial viability are incorporated into our financial planning*
- *Actively contributing to the sustainability of the region*

This Vision and Mission are consistent with the intent of third party access, which is to improve community well being by encouraging innovation, increasing efficiency in water and sewerage provision and better meeting customers needs and preferences.

Support for Key ESC Proposals

Coliban Water therefore endorses the broad thrust of the proposals in the Draft Report on the proposed access regime. In particular Coliban Water welcomes:

- The value of third party access in promoting innovation and efficiency to better meet customers' needs;
- The proposal for the staged implementation of the new access regime, with a first stage establishing basic foundations that can later be built on (recommendation 3.1);
- The proposal for 'access commitments' as a workable first entry level approach (recommendation 3.2);
- The proposed coverage of the new regime to the whole of Victoria (recommendation 4.1);

- The focus of the regime on natural monopoly infrastructure facilities (recommendation 4.2);
- The nomination process whereby the incumbent infrastructure manager would propose priority infrastructure facilities for inclusion in the new access regime (recommendation 4.6);
- The proposal for a negotiation framework to promote mutually beneficial terms and conditions, with effective dispute resolution where required (recommendations 5.2 & 5.3);
- Recognition of the importance of access pricing in promoting efficient entry and use of infrastructure (recommendations 6.1 & 6.2);
- The value of functional separation between natural monopoly and potentially competitive activities. This will provide the platform for effective competition between all parties) provided adequate time is allowed for the exercise (recommendation 7.1);
- The importance of ensuring the robust protection of health, customers and the environment. The proposed new licensing regime will need to be effective in imposing clear obligations on new service providers and providing clarity on the interface with the incumbent provider (recommendation 8.1 - 8.5);
- That the ESC be appointed as the regulator of the new access regime. That is sensible given the existing role that the ESC plays in price determination and monitoring service provision (recommendation 9.1);
- The extension of the entitlements regime and trading to new and innovative sources of water (recommendation 10.2 & 10.3);
- The supplementary reform of legislation and licensing necessary to support this initiative (recommendations 10.4 - 10.8).

However, in welcoming the broad thrust and intent of the regime it is important to take full account of the complexity of the current delivery arrangements and to ensure that any proposals do not result in unintended perverse outcomes.

To enable the shared objectives to be realized we would like to offer the following comments, which identify areas and issues that will need to be considered in developing and implementing the new regime.

1. Business Efficiencies

As a natural monopoly Coliban Water recognized the importance of being lean and efficient a number of years ago. To this end, Coliban Water competitively tendered out the majority of its operations to ensure that the business is as economically efficient as possible. This model also assisted in the management of risk and gave CW access to international expertise in the delivery of high quality services.

These contracts range in time frames from 5 to 20 years and have fixed and volumetric components.

A number of these contracts, particularly the Echuca treatment plant PPP and the Bendigo Treatment Plan BOOT both are for substantial periods of time. Careful consideration will need to be given to the contractual impacts of introducing third party access.

To cater for this, it is acknowledged that different costing methodologies will be necessary for different pieces or parts of the distribution system.

2. The Social Contract with Smaller Communities

The report inquiry states on page 17 that “ *it seems likely that some opportunities for providing innovative water sewerage services will suit small, specialized businesses seeking to enter the industry*”.

This may raise a serious issue for Coliban Water.

Like most other regional water corporations, Coliban Water has a number of supply systems and some 49 towns in its area.

There a number of towns in our region that could be seen as profitable as stand-alone entities. There are also a number of other towns that are currently ‘subsidised’ to ensure that water services can be supplied at a reasonable price and that our “social contract” with the community is maintained.

The social contract with smaller “unprofitable” towns must be incorporated into the calculation of costs, as a third party could easily “cherry pick” the profitable towns and leave the smaller “unprofitable” towns. This would either load additional costs unfairly onto the remainder of the customer base or require substantial further funding from government to maintain the minimum standards of service.

Further to this, as Coliban Water is vertically integrated, subsidisation also occurs between the functions such as sewage and supply. This further enables Coliban Water to meet its social contract with smaller communities.

This may warrant further consideration being given to establishment of Universal Service Obligations to protect customers.

3. Environmental Levy

Coliban Water currently pays a 5% environmental levy to government. This is intended to reflect the environmental costs associated with maintaining catchment health.

Our regional processes are now at the point that we could articulate the catchment values that are important from a water services perspective, the risks to these values and works/maintenance required to maintain these values.

These costs should be incorporated into the assessment of total costs to better reflect the real cost of water. That total cost needs to be accounted for in calculating the access price for new entrants.

4. Access promotes greater customer choice, with innovative water and sewage services that better reflect customer needs and preference.

The draft report refers to the greater customer choice and innovative water services that will be promoted by the access regime. Coliban Water supports this contention from its own practical experience.

Coliban Water trialed a pilot Urban Water Trading Scheme, which allowed community groups, Councils and businesses affected by the current water restrictions to buy water in the market and then access our infrastructure to transport that water to their premises 'at cost'. Customers had to demonstrate that they were either providing a public good or that they were severely impacted by the restrictions.

This pilot scheme anticipates the protocols and dynamics of third party access.

A recent audit of the pilot scheme shows that this was an outstanding success. The audit provides strong evidence of the demand for this facility, with the scheme generating major benefits across outcomes including business viability, maintenance of sporting and social facilities and wider social and aesthetic outcomes. The approach therefore clearly offers greater customer choice and provides an innovative service that better meets customer needs.

A number of customers have since contacted us and asked for access to the scheme to ease the impact of drought. Clearly there are limits to how many customers could access the scheme as ultimately the scheme could be seen to run counter to the broader water restrictions policy in the region. Indeed, the scheme is only possible because of the differences between the water regimes in place in the urban and rural sectors – with urban

water customers, subject to socialised water restrictions, able to reduce the impacts of those restrictions by accessing the commercialised water markets that apply in the rural sector.

This approach raises the question of equity. It has been argued by some that it is inequitable and unethical to allow people to have as much water as they can afford (or the system can supply) as it implies that only the rich will have water for discretionary use.

It must be recognised that water represents a complex product with both public good attributes and commodity characteristics. The non-discretionary uses (essential human needs) can be seen as a moral good, while the discretionary uses (for gardens, pools etc) should be capable of being satisfied through market mechanisms.

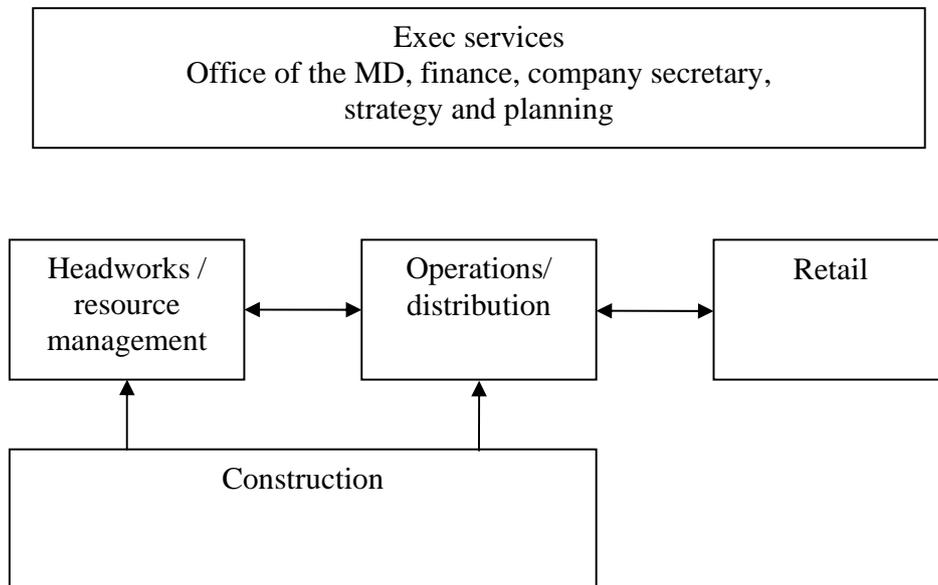
Pricing mechanisms should enable the consumer to have confidence that:

- the moral good is being provided for,
- those that want to conserve water are rewarded for it and
- those that want to have discretionary use pay the full cost.

5. Functional Separation

Functional separation will be a necessary part of the implementation of a third party regime. However, it is important to recognise that functional separation within any organization will necessitate the review of strategy, business systems and skill sets as they are all interrelated. This process is likely to take in the order of 12 months as opposed to 6 months recommended in recommendation 7.1. To complete this exercise properly will require a substantial investment, and it would appear that these costs have not been catered for.

Functional separation may mean the separation into the following broad framework.



With the potential for an increase in the number of retailers it becomes essential for the legislation to clearly articulate who has the responsibility to delivery water (ie a wholesaler would only have an obligation to deliver water if is available) and who has the responsibility to supply water (eg such as the current obligations on regional corporations to ensure that communities do not run out of water).

With the potential for multiple retailers it will be essential that there is no ambiguity as to who has these explicit responsibilities.

6. Establishing a legal framework for an access regime

Section 3.2.4 acknowledges that there is a need for the legislative change to enable third party access.

This should also encompass a establishing the framework for the “supplier of last resort”. Should a third party provider fail or there are parts of the community that could potentially miss out on the opportunities that third party access could bring, legislation is required to ensure there is adequate protection.

7. Staged implementation

Competition requires that all players are able to operate on an equivalent basis, the proverbial ‘level playing field’. That applies equally to the incumbents as to the new entrants. Many of the water corporations are not free to compete on equal terms with possible competitors as they are not viable financial entities.

Coliban Water has held preliminary discussion with the ESC and government regarding the impact that the drought is having on its financial position. This has led to an increase in its costs and a reduction in its revenues in comparison with the assumptions underlying the recent price determination. Current water charges do not generate sufficient revenues to meet standard financial measures of viability.

Coliban Water has stated through its corporate plan that it would like to explore reopening this pricing with a view to ameliorating the impacts of drought on business viability.

Coliban Water welcomes the proposed third party access regime and in particular the proposed stage implementation, however, it is of critical importance that this does not hold up discussions regarding reopening of pricing, and that any competitive challenge does not exploit the current financial situation.