



REVIEW OF THE RETURN OF UNREQUIRED DESALINATION PAYMENTS

November 2013



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CHAIRPERSON'S FOREWORD

In June 2012, the Minister for Water asked the Commission to provide oversight and independent verification of the return of all unrequired payments by water users to the metropolitan water businesses for the Victorian Desalination Plant. The unrequired payments occurred due to delays to the completion of the plant.

After commencing our role, we set out our expectation that businesses would return funds to customers in a way that was timely, transparent, and easy to understand. The amounts returned would include an adjustment for interest so that the businesses did not gain from holding unrequired payments. Further, we required the businesses to have procedures in place to address any concerns raised by customers about the amount or way the funds were being returned.

This report summarises the findings of an independent audit of the return of unrequired payments by the water businesses to their customers. The audit confirms that almost \$300 million—including more than \$23 million in interest—had been returned by the water businesses to their customers in the period to 9 September 2013.

As at 9 September 2013, a little over \$7 million (or 2.5 per cent of the total) was yet to be returned. Some of the remaining amount will be returned through the ongoing effects of the 2012-13 price freeze (as through to the end of September, some customers were yet to receive bills for water consumption in the period to 30 June 2013). The businesses have indicated the rest of the funds will be returned through a slight price reduction from January 2014.

The public response to the over-recovery of desalination funds by the water industry highlights the importance of placing customer interests at the forefront of business decision making. Returning the remaining funds as soon as possible must be a priority for the water businesses. We will report on this final 'true-up' in our annual 2013-14 water industry performance report.

Dr Ron Ben-David
Chairperson

1 INTRODUCTION

In 2009, the Essential Services Commission (Commission) authorised the maximum prices the water businesses could charge for the period to June 2013. For Melbourne Water and four water retailers – City West Water, South East Water, Yarra Valley Water and Western Water – these prices included a component for the desalination plant.

At the time, it was expected that the desalination plant would commence operation in December 2011. We authorised the water businesses to collect around \$230 million in 2011-12 and \$460 million in 2012-13 from their customers to pay for the plant. In other words, water prices approved in 2011-12 and 2012-13 included a maximum component of around \$690 million to cover costs associated with the desalination plant.

Because completion of the desalination plant was delayed, costs were lower than originally anticipated and the amount required over this period was substantially lower.

In June 2012, the Victorian Government and the water businesses announced a price freeze and a promise to return to customers any additional unrequired desalination payments with interest. As a result, 2012-13 prices for water, sewerage, trade waste and some recycled water services remained at 2011-12 levels.

The Minister for Water requested that the Commission oversee and verify of the return of all unrequired desalination payments to customers, including amounts for interest and inflation.

In 2012, the Commission set out a framework for monitoring the return of unrequired desalination payments.^{1,2} We specified that the return of funds should be transparent,

¹ Essential Services Commission 2012, Monitoring the return of unrequired desalination payments, July. Available at www.esc.vic.gov.au/Water/Return-of-the-Desalination-Over-Collection

timely, easy to understand, and that the businesses should not gain from holding the unrequired funds. We committed to verifying that the unrequired funds were returned to customers, focusing on the aggregate amount returned. Given the complexity of how desalination costs were spread across multiple tariffs and returned via the price freeze, we noted that it is extremely difficult to return to each customer the exact unrequired payments they contributed towards the desalination plant. Therefore, we also stated that there must be clear avenues for customers to have any disputes resolved about the amount or method of the return.

In September 2012, the Commission recommended the businesses include rebates on customer bills to speed up the return of funds to customers.³ The water businesses commenced returning funds via rebates on bills from February 2013. Unrequired desalination payments have also been returned to customers through:

- targeted reconciliations for large water users (mainly industrial customers)
- special circumstances payments (for example, to customers who contributed to desalination costs but had since moved out of the Melbourne area) and
- an adjustment to prices from 1 July 2013, which was allowed in the Commission's 2013 final price decision.

Since October 2012, the Commission has released four (quarterly) reports to provide an update on the return of unrequired desalination payments by the water businesses. These reports are available on our website (www.esc.vic.gov.au). In these reports, we noted our intention to audit the return of funds in 2013-14.

This report summarises the results of an audit of the return of funds by the water businesses. The audit was conducted by BDO for the Commission. The BDO report is available on our website.

² Essential Services Commission 2012, Opinion report – Return of Additional Desalination Payments, September. Available at www.esc.vic.gov.au/Water/Return-of-the-Desalination-Over-Collection

³ Essential Services Commission 2012, Opinion report – Return of Additional Desalination Payments, September. Available at www.esc.vic.gov.au/Water/Return-of-the-Desalination-Over-Collection

2 REVIEW SUMMARY

The Commission appointed BDO to verify that collectively, City West Water, South East Water, Yarra Valley Water and Western Water, have returned all unrequired desalination funds to customers. This required the verification of:

- the total amount that should have been returned to customers (which includes an adjustment for interest to ensure that the businesses did not gain from holding the unrequired funds)
- whether the total amount that should have been returned has been returned to customers, and if not, any remaining amount to be returned to customers

BDO conducted an audit process with each water business that included:

- site visits with each business
- reviews of billing and accounting systems
- discussing with management the process to monitor the return of funds
- sampling water bills to verify return processes and
- cross checking data with other sources of information (including the performance report audit).

For more information on the audit approach see the BDO report, which is available on our website.⁴

In their review, BDO noted that the retailers had returned \$295.1 million to customers as at 9 September 2013. This represents 97.5 per cent of the \$302.5 million that BDO has verified as the amount that should be returned. A residual of \$7.3 million was yet to be returned at 9 September 2013, based on the BDO review.

⁴ BDO 2013, Final Review of Desalination Return of Funds by Water Businesses, October

Table 2.1 sets out the amounts verified by BDO.

TABLE 2.1 AGGREGATE RETURN OF DESALINATION FUNDS

Current at 9 September 2013

	Amount (\$m)
Revenue associated with desalination for 2011-12 and 2012-13 (with actual demand and pre-price freeze prices)	686.9
Less desalination payments for 2012-13	408.2
Plus interest	23.7
Total to be returned	302.4
Total that has been returned (at 9 September 2013)	295.1
Total remaining to be returned	7.3

The BDO report shows that the businesses used different rates to calculate customer rebates. This reflects the varying impacts of the amount returned by the 2012-13 price freeze by each water business (the amount returned through the price freeze was dependent on customer water use, which varied by business).

In our September 2012 Opinion Report, we noted the difficulty in estimating a rebate, given the decision to implement a price freeze. We set out a suggested approach in the Opinion Report. The businesses have broadly followed this approach.

BDO’s review identified instances where special circumstances payments⁵ (for example, payments to customers who have moved out of the Melbourne area) were calculated incorrectly by City West Water, Yarra Valley Water and Western Water, although the amounts in question were immaterial. BDO identified that only Yarra Valley Water and Western Water had some instances of returning too little to customers—we expect these two businesses to address these audit findings.

⁵ The special circumstances payments account for a very small proportion of the amount returned (0.05 per cent).

3 NEXT STEPS

The BDO review of the return of unrequired desalination payments found that the businesses were yet to return almost \$7.3 million to customers at 9 September 2013. Some of the remaining small amounts will be returned through the ongoing effects of the 2012-13 price freeze, as some customers will receive bills after 9 September that include a component for consumption in the period to June 2013.

The businesses have indicated to the Commission that they will return the additional funds through lower water prices. City West Water, South East Water and Yarra Valley Water will return the final unrequired desalination amounts through lower water prices from January 2014, and Western Water will do the same from February 2014. The businesses prefer a reduction to prices rather than a rebate as:

- There is a possibility that businesses will pass on a desalination refinancing benefit from early 2014 through lowering prices.
- There is a very small amount to return per customer, and the cost of administering billing adjustments for a rebate could outweigh the benefit relative to returning funds via a price reduction.

To ensure the businesses do not gain from holding the unrequired desalination funds, the businesses will need to include an adjustment for interest in the remaining amount returned. Depending on the impact of the price reduction, around \$200 000 will be returned to account for interest on the unrequired funds held by the water businesses (as at 9 September 2013).

The Commission will conduct a follow up review to check that remaining funds have been returned in accordance with the businesses stated intent as part of its annual 2013-14 water industry performance report. We expect the businesses to maintain records to facilitate our follow up review. We also expect businesses to maintain dispute resolution processes to address any customer concerns about the amount of

funds returned or the way in which they were returned. If customers have any queries about the return of funds, in the first instance, they should contact their water retailer.

City West Water – Website: www.citywestwater.com.au

Phone: 131691

South East Water – Website: www.sewl.com.au

Phone: 131694

Yarra Valley Water – Website: www.yvw.com.au

Phone: 131721

Western Water – Website: www.westernwater.com.au

Phone: 1300 650 425