

29 July 2005

Mr Lyndon Rowe  
Chairman  
Economic Regulation Authority  
197 St Georges Terrace  
Perth WA 6000.

Emailed to [watersubmissions@era.wa.gov.au](mailto:watersubmissions@era.wa.gov.au)

Dear Mr Rowe,

**Submission from United Utilities Australia Pty Ltd ("UUA") in response to the EKP Draft Report**

United Utilities Australia Pty Ltd ("UUA") wishes to formally respond to the draft report of the Inquiry into the Cost of Supplying Bulk Water to Kalgoorlie-Boulder that was issued by the Economic Regulation Authority ("ERA") on 30 June 2005 ("Draft Report").

We set out our comments on the Draft Report for your consideration below.

**Executive Summary**

This document details key concerns of UUA in relation to:

- The analytical framework chosen for use in the Draft Report is not the most appropriate for the circumstances of the project
- Even within the framework used, the report's negative conclusion is not warranted
- The 6% difference between costs and benefits is well within the margin of error, given the uncertainty associated with the main variables
- The benefits to mines from switching to potable water are significantly understated – correction of this error alone produces net project benefits
- The assumption of Water Corporation avoided cost is overly dependent on acceptance of Water Corporation assertions, particularly in relation to the costs of the G&AWS under conditions of growth
- The Draft Report neglects important public policy considerations germane to ERA's task, in particular the desirability of introducing a competitive alternative to Water Corporation's monopoly.

UUA believes that additional information it is supplying to the ERA in this and associated documents provides the evidence required to revise the conclusion of the Draft Report.



## Introductory Comments

The Goldfields Water Supply Project proposed by UUA (“**Project**”, also referred to by the ERA as “EKP”) is at pre-feasibility stage, and as you are aware UUA has indications of firm interest in the purchase of water from a number of mines located in the Kalgoorlie-Boulder region, including public statements from Goldfields Australia, the owner of the St Ives mine at Kambalda, and Mincor. Demand for water now seems likely and we are pleased the ERA has accepted a rising demand profile over the long term as the basis for its analysis.

However, there is an intrinsic variability in the underlying cost assumptions used by the ERA. On this basis, a finding of costs outweighing benefits by 6% seems to be well within the margin of error of the base data. Of particular concern is the accuracy of the future estimates of the cost to upgrade the G&AWS.

The case for the Project is strategically simple, based upon:

- (a) constrained supply from the G&AWS to meet suppressed demand in the Goldfields
- (b) the advantages of releasing that demand for the benefit of the Perth area
- (c) the need to diversify water sources in Western Australia and
- (d) the benefit in both financial terms and economic development outcomes in replacing public funding of the G&AWS upgrades with private funding of the project.

These are, we believe, compelling strategic arguments. They are supported by the economic arguments.

From an economic perspective, and on the basis of data UUA has made available to the ERA, UUA is of the view that by comparison with the delivery of water to the Kalgoorlie-Boulder region from Perth, the delivery of water to the same region from Esperance (the essence of the Project) is a more economically viable option for addressing this region's continuing and growing water needs. On that basis, UUA seeks further clarification from the ERA regarding the accuracy of the economic data upon which the ERA reached the conclusions stated in the Draft Report, and, if appropriate, an assessment of the relative accuracy of the Net benefit/ cost finding relative to the assessed accuracy of the input data.

UUA proposed an ‘economic option’ approach to the evaluation of the economic development benefits of, the Project, which in our view clearly demonstrates the economic development benefits the Project will bring to the Goldfields-Esperance region.

## **Comments on the method adopted by the ERA and presented in the Draft Report**

In our view, the ERA's approach to the EKP does not meet the broader requirements of Government as requested by the Treasurer in his Terms of Reference in assessing the value of the Project to the State of Western Australia, and we do not believe that the conclusions drawn in the Draft Report provide a decision framework to assist Government in deciding whether to support the Project into further development.





The two projects considered by the ERA in the context of the EKP are not, in our view, comparable. For example, Water Corporation proposes an incremental increase to water supply, over a 15 year period, whereas the Project will provide the same level of water supply within a three year period. Further, the Project addresses the water supply needs of the Kalgoorlie-Boulder and Esperance regions, whereas Water Corporation's proposal does not. For these and other clear differences between the two projects, it is not appropriate in our view to decide better economic viability and community benefit on the basis of a direct cost comparison. Other factors should most certainly be considered. It is noted for example that by proceeding to its next stage the project has the potential to unlock suppressed demand – this cannot happen otherwise.

The method proposed by UUA, consisting of a carefully constructed G&AWS comparator and an economic option diagram, remains the most appropriate to respond to the issues under consideration by the ERA, in the view of UUA.

However UUA intends to submit additional information within the methodological framework formally issued by the ERA on 22<sup>nd</sup> July 2005. UUA believes this will support a revised conclusion that the project should proceed.

### **Comments on the Draft Report**

**The negative view of the Project in the Draft Report is unsafe and unsound.** This conclusion was reached on the basis of a 'net cost' of \$56 million associated with the Project. The smallness of this 'gap' is emphasised by comments in both ERA's recent report on water and wastewater charges and the recent Allens Consulting Group report on source water costs, both of which pointed to evidence of systematic underestimation bias, of the order of 10-11%, in Water Corporation project costings. The meeting between UUA and the Water Corporation on 22<sup>nd</sup> July, held at the specific request of the ERA, further supports the UUA view that the long term capital investment plans related to the G&AWS are very approximate. These effects are made even more important given that UUA is willing to underwrite its delivery risk and that Water Corporation is unable to underwrite its, because it is Government-owned.

**UUA commercial position:** We note that the ERA Act vests with the ERA the power to investigate competition issues. The Draft Report is in part based on assumptions about the commercial arrangements that might exist between the Water Corporation and UUA should the Project succeed, that do not reflect a consideration of competition issues. UUA has not yet entered negotiations with Government into the terms of a mandate to proceed with further Project development. Its reason for seeking a mandate from the Government, rather than relying solely on commercial negotiations with Water Corporation, is because of fundamental impediments we see to a soundly based outcome emerging from such negotiations.

**The demand for water:** We note from the Draft Report that ERA accepted the UUA demand estimates and profile as a basis for its data and the subsequent analysis. The demand profile published in the Draft Report and which we understand was used in the analysis was created principally for the comparator tool to allow UUA to more accurately estimate the increased costs of supplying more water via the G&AWS. This created an unintended difficulty for the ERA analysis. We have provided substitute data to the ERA in a separate document.



**Water pricing:** the Draft Report suggests that the Water Corporation should pay no more than the avoidable cost of bulk water in Kalgoorlie. This does not reflect the payments of Government to the Water Corporation for the same services, worth \$33 million per annum plus the avoidable cost. UUA accepts the basic avoidable cost calculation framework in the Draft Report. However, the analysis by ERA fails to take into account the additional, quantifiable cost advantages resulting from risk transfer to UUA, including removal of technology, process, delivery and operational risk which would result from the Project.

**Cost/ benefit:** UUA will separately submit material which demonstrates a clear positive net benefit from the Project.

**Regional development:** Section 9.3 of the Draft Report does not address regional development. The Draft Report only represents the possible commercial costs and benefits to potential bulk water purchasers, and as such restricts the extent of benefits and costs that undoubtedly would accrue if this Project proceeded. It is our view that these benefits far outweigh the costs. We are advised a number of community groups and organizations will make direct submissions to the ERA on this point.

The concern of the ERA that growth in the Goldfields will be to the detriment of other regions in WA does not seem to be supported by any evidence, and is presumably an argument for regional economic development to be a low priority for Government.

**Reliance upon the Water Corporation for information:** on page 22 of the Draft Report, the ERA makes clear its decision to rely upon the Water Corporation for critical information, without reference to other interested parties (including UUA). In our view, given that:

- Water Corporation is a monopoly (ref. ERA Act, section 26);
- Water Corporation has been given access to UUA's data on 20<sup>th</sup> April 2005, giving the Water Corporation a clear advantage; Water Corporation has not fully revealed its internal information relating to the cost of upgrading G&AWS;
- Water Corporation's position may be influenced by the fact that should the Project proceed, it will be a commercial party to the arrangements,

and in order to ensure procedural fairness prior to publishing its final report, the ERA is requested to provide other interested parties the same opportunity, namely access to the information provided by Water Corporation and an opportunity to make submissions in light of such information.

### **Incremental expansion of the G&AWS**

UUA was unaware that prior to release of the Draft Report the Water Corporation had advised the ERA of its claimed ability to extend the capacity of the G&AWS to 77 MLD **without cost penalty**. No evidence for this claim is presented in the Draft Report and no information to support it has been released by ERA. We suggest that caution is required in relation to this claim. A document provided by the Water Corporation at the April 20 workshop presented an incremental cost model of 70MLD, but without supporting evidence.



UUA prepared its comparator on the reasonable expectation that if demand increased in a 'step change' then the G&AWS would need to be duplicated. This view was formed on the basis of information received confidentially from third parties. Subject to any evidence to the contrary, in UUA's view such an expectation remains more probable.

In order to support its claim, and justify reliance on that claim by the ERA, UUA believes that the Water Corporation must provide evidence to support its claim, and inform ERA and other interested parties how it would meet demands equivalent to those being met by the Project. The information which should in our view be provided includes the Notional Cost Model and technical data on the G&AWS.

In addition, if the Water Corporation cannot, or will not, meet economic development requirements in the Goldfields then this should also be reflected in the analysis of the ERA.

#### **Concluding remarks and requests**

UUA requests assistance from the ERA in obtaining information to verify the claims of the Water Corporation relied upon by ERA in the Draft Report. Further, in our view the Water Corporation should be requested to release detailed information to justify its position and that ERA should perform an independent evaluation of the Water Corporation data.

UUA will separately submit papers on cost-benefit analysis and on avoidable cost to the ERA to assist with further analysis. UUA cannot provide analysis beyond this without a debriefing by ERA and access to working papers.

If you have any questions concerning this submission, please contact Graham Dooley, our Managing Director, or myself.

Yours sincerely,

A handwritten signature in blue ink that reads 'Phil Endley'. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

**Phil Endley**  
Project Manager – Goldfields Water Supply Project