

Office of Water Strategy

Submission to Economic Regulation Authority

Draft Report on Urban Water and Wastewater Prices

Overview

As part of its commitment to the achievement of a comprehensive long-term State Water Policy and Plan, the Office of Water Strategy (OWS) thanks the Authority for the opportunity to comment on the draft report on Urban Water and Wastewater Prices. The OWS believes the independent advisory role of the Authority to the government is important in the context of water and regulatory policy setting in Western Australia. The Office would also like to have the opportunity to have input in the final report recommendations on 12 August 2005.

This submission will open with some general comments about the Authority's process in conducting the inquiry and then address some of the specific issues raised in the draft report.

Authority's Process in Conducting the Inquiry

The OWS notes that the ERA's current "Inquiry into Urban Water And Water Charges" is the first independent comprehensive review of urban water and wastewater charges in Western Australia. The Office understands a further inquiry into rural and regional charges for water services is likely to be the subject of a future inquiry by the ERA.

In making its suggestions on a future consultation process of future ERA inquires, the Office takes into account the tight timetable in which the Authority was given to make its final recommendations to Government and that the Economic Regulation Authority was established on 1 January 2004. In contrast the Independent Pricing and Regulatory Tribunal in New South Wales (a multi-utility economic regulator) has been established and conducted inquiries for more a decade.

The initial process to inform the Authority's pricing recommendations was outlined in the Issues Paper published in June 2004.

The Authority was to:

- call for submissions on the matters in the terms of reference and Issues Paper by 3 September 2004).
- publish a Methodology Decision Paper published in October 2004 calling for submissions from service providers on their recommended prices .
- invite members of the public to comment on the service providers' submissions.
- publish a Draft Report will be published by 18 March 2005 presenting the initial findings of the inquiry and calling for further public submissions
- hold public forums in Perth, Bunbury and Busselton to discuss the Draft Report.
- publish the final The Final Report by 12 August 2005.

The OWS believes that the process outlined in the Issues paper provided an opportunity for relatively open and transparent process to inform the Authority's recommendations. The approach also satisfied the Terms of Reference of the inquiry provided to the Authority by the Government.

However the OWS would have favoured a public hearing to be undertaken prior to release of the Draft Report. A public hearing has the advantage of providing a more formal rigor to the review of the service provider's pricing submissions. It allows the Authority to interact with invited agencies to question assumptions made in the submissions for the public record. Public Hearings prior to release of Draft Reports are part of the inquiry process of well-regarded agencies such as IPART in NSW and the Productivity Commission.

The Office believes that the less formal public forums in Perth, Bunbury and Busselton after the release of the Draft Report do provide some form of a secondary forum for the public consultation approach.

The Office of Water Strategy notes that that the Authority provided a notice of amendment on 1 December to the initial process published in the Issues Paper. The amendment was related to the public release of the service provider's submissions.

"This amendment to the timeframe means there will be insufficient time to seek public comment on these submissions from service providers prior to the issuing of the Draft Report by the Authority due 18 March 2005. The submissions from service providers will therefore be made public at the time of the release of the Authority's Draft Report"

The Authority did not publicly consult with stakeholders on the amended timetable and the notice was released after the previously outlined due date for public release of the water agencies submissions.

The Office of Water Strategy believes there is good merit in allowing the public opportunity to read and comment on the water agencies pricing submissions prior to the release Draft Report. It provides the public with important information

on the underlying cost structures and assumptions on future cost pressures in a more comprehensive form than other publicly available information, such as the Statements of Corporate Intent and the State Government's Budget Papers. The release of the water agencies submission could then have been an easily accessible input into public submissions to the draft report.¹

The Office of Water Strategy has concerns over the lack of clear recommendations in the report. Rather, the report presents key findings. In effect the Draft Report reads like a second issues paper. This would make it very difficult for members of the public to respond to the draft report in order to affect the final report.

It is not clear from the Authority whether the Final Report is to differ significantly from the draft report and provide some firm recommendations to Government on the prices and price structures for urban water and wastewater services. This will make it more difficult to implement any of the key findings of the Authority's final Report.

The Office of Water Strategy recommends that the Authority consider amending its inquiry process for future references to be more transparent and clear in the level of public consultation it undertakes. The Office of Water Strategy regards the inquiry processes of the Productivity Commission and the IPART as good models to consider for future references for inquiries from Government.

Response to Findings

Scarcity Value of Water

The authority states that the Government should delay the construction of the desalination plant while considering the viability of the South West Yarragadee as an alternative water supply.

"The Authority is of the view that consideration should be given to postponing desalination, which would allow time for the environmental assessment of South West Yarragadee to be completed. Subject to environmental approval, South West Yarragadee would provide customers with a cheaper source of water"

The OWS believes that the Authority has not taken into account the Government's commitment on 29 July 2004 to build a desalination plant that will operational in October 2006.

¹ The simultaneous release of the Service Provider's pricing submissions and Authority's draft report may place constraints on the public to fully evaluate and provide comment to the Authority's Final Report.

The Government had called for expressions of interest on and the contract awarded and publicly announced on 14 April 2005. Recommending that the Government delay the construction of the desalination plant would raise possible sovereign risk concerns for investment in the state. Furthermore construction of the plant would be underway by the time of the final Report by the Authority is due to be on 12 August 2005.

Desalination is one of the seven platforms in a 'Security through Diversity' strategy the Government has embarked on to ensure a sustainable water supply for the state.

Postponing the desalination plant, as the authority notes, would increase from the probability of a total sprinkler ban from 8 per cent to 17 per cent in 2006-07. The authority also notes that consumer preferences for the increased buffer from a total sprinkler ban should be taken into account when weighing up the benefits of lower prices. However the report makes no attempt to quantify the trade-off between an increase risk of sprinkler bans and lower water prices.

Demand Management

In relation to the per capita targets set by the State Water Strategy for the Water Corporation the Authority

"considers that the Corporation's target of restraining demand to 155 kL per capita by 2012 may be optimistic, given that the Corporation plans to either remove sprinkler restrictions or ease restrictions to three days per week from 2006/07 onwards."

The Office of Water Strategy believes that, as we are at an early stage in relation to demand management policy and there are major initiatives in relation to reuse and water trading, this observation is premature. The OWS would also like to see whether there is a longer-term structural change in demand for water since the imposition of water restrictions in 2001/02

Revenue Requirements

The Office understands that Regulatory Asset Value (RAV) has the most significant impact on average price for services, as it tends to drive three quarters of a water business' revenue requirement. Changes in the RAV from year to year are increased by net capital investment and decreased depreciation. Therefore, under the Building Blocks approach adopted by the Authority, changes in revenue required by the water service providers can be largely affected by changes in capital and operating efficiencies.

The Office of Water Strategy notes that, despite a slight difference in the Regulatory Asset Value (RAV) calculation between the Authority's estimate and

the Water Corporation's submission, the Authority accepted the Water Corporation's proposed RAV of \$9,100 million.

Although the Authority notes (under certain gearing assumptions) the practical minimum regulatory asset value could be as low as \$3,500 million, implying a reduction in average prices by about 30 per cent. The Office of Water Strategy agrees with the Authority that would have significant impacts on the financial structure of the Corporations and returns to the Government in dividends.

The Water Corporation's submission proposes to set base prices and escalate these prices with inflation. Over the four-year period commencing 2005/06 and finishing in 2008/09, the Corporation has proposed 'across the board' price increases equal to the consumer price index (CPI). In addition the Water Corporation propose to increase by 13.5 per cent in 2006/07 to recover the cost of the desalination plant. And in 2008/09 a further 2.1 per cent increase is proposed to finance the cost of purchasing water savings from Harvey Water.

In Response the Authority argues that the Water Corporation could achieve a reduction in revenue requirements.

"through identified opportunities for reductions in operating costs (particularly staffing costs) and a change in the source development programme that brings forward the development of the South West Yarragadee Aquifer and postpones development of the desalination plant. These initiatives could give rise to reductions in revenue requirements and average prices of approximately 2.8 per cent and 0.9 per cent, respectively, for the period to 2008/09."

The Office acknowledges the importance of the Authority identifying cost efficiencies that could be achieved by the water service providers. However the OWS is concerned that in its Draft Report findings, the Authority may be entering into a debate with the Government on source development. Particularly by arguing to bring forward development of the South West Yarragadee Aquifer while its viability is still being considered by Government and postponing construction the desalination plant (as stated previously in the submission)

Also, the OWS is concerned regarding the assumptions in achieving operating efficiencies by cutting staff in regional areas. The OWS would seek clarification in the Authority's assumptions regarding staff numbers in its final report.

Environmental Externalities

The Authority agrees in principle with the introduction of a resource management charge, however has reservations regarding its practical application.

"The Authority is of the view that it would be reasonable to pass on to customers those resource management costs that are directly attributable to current consumption activities. The cost of repairing damage caused by supply decisions made in the past should be funded by government"

The Office of Water Strategy notes that the Government has commissioned a Statewide Irrigation Review and this review is in its final stages. The Office would like to see how Government receives the recommendations before considering its position to the charge. The Office is also concerned that any introduction of the charge should be congruent with how much the charge is passed on to consumers in terms of higher water charges.

Pricing Reform

The Report argues that the Water Corporation should replace its five block-inclining tariff with either a flat rate usage charge or a two block-inclining tariff to more reflect long-run marginal cost prices.

*"The existing five block inclining tariff would be replaced with a single flat rate usage charge, set equal to the approximate LRMC of \$1.00 per kL." Or
The tariff is structured such that customers using up to 600 kL are charged at LRMC (\$1.00 per kL), while customers using more than 600 kL are charged \$1.50 per kL for their usage"*

At average consumption levels consumers would experience a small increase in charges (\$12 for a flat rate approach and \$6 for a two block approach). It is argued in the report that either of these approaches would be simpler and bring the tariff structure into line with other States.

The Office of Water Strategy is still in the process of forming a position. However believes that the structure of tariff should:

- be efficient and cost reflective,
- equitable to consumers, particularly low-income households and
- be simple to follow and administer.

The OWP does accept that there may be some complexity with current five step tariff approach. However it is important to note that states that had previously adopted a flat consumption charge are considering moving towards two-step or multi-step tariff structures

In its final report, the ERA should give further consideration to the equity impacts of the proposed tariff options. In particular the impacts of re-balancing the fixed charge to pensioners who receive up to 50% rebate on the fixed charge and up to 25% on the variable charge.

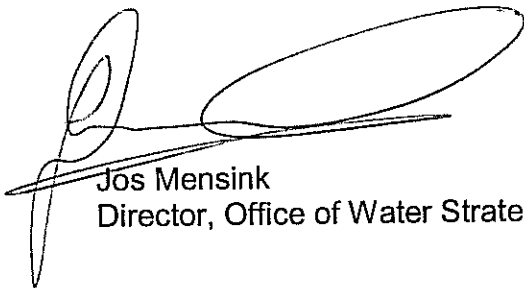
It is unclear whether the proposed tariffs structures take into account the costs of the desalination plant to meet the required revenue. If it is the case that the Authority has not adjusted revenue required to be inclusive of desalination costs, it would have underestimated the fixed charge in its rebalancing options.

In terms of wastewater charges the OWS does not favour moving away from property based charges without due consideration to the distributional impacts of the change.

Summary

The Office of Water Strategy believes that the Economic Regulation Authority's Draft Report into Urban Water and Wastewater Charges in Western Australia goes part of the way in addressing the terms of reference to provide the Government with recommendations for urban water and wastewater charges.

The Office of Water Strategy is very interested in contributing to the inquiry process and therefore has offered some comments in regard to the process and key findings of the Draft Report. The OWS looks forward to working the Authority on matters it has raised in this submission and any other matters that need clarification before the Authority makes its final recommendations to Government by 12 August 2005.

A handwritten signature in black ink, consisting of a large, stylized 'J' followed by a long horizontal stroke and a large oval shape.

Jos Mensink
Director, Office of Water Strategy