



31st August 2007

The Chairman
Inquiry on Competition in the Water and Wastewater Services Sector
Economic Regulation Authority
PO Box 8469
Perth Business Centre
PERTH WA 6849

by email: watercompetition@era.wa.gov.au

Dear Sir

Inquiry on Competition in the Water and Wastewater Services Sector

The Goldfields Esperance Development Commission (GEDC), as the peak regional organisation, would like to make the following comments on the issues paper "Inquiry on Competition in the Water and Wastewater Services Sector".

The nine Development Commissions spread throughout regional Western Australia, promote and coordinate the economic development of Western Australia's regions by working in close partnership with other State and Commonwealth Government bodies, local government, industry, business and community groups to ensure the regions develop in a positive and sustainable way for the future.

The objectives and functions of Development Commissions as defined in the Regional Development Commissions Act (1993) are to:

- Maximise job creation and improve career opportunities in the region,
- Develop and broaden the economic base of the region,
- Identify infrastructure services to promote economic and social development within the region,
- Provide information and advice to promote business development within the region,
- Seek to ensure that the general standard of government services and access to those services in the region are comparable to that which applies in the metropolitan area,

The efficient and reliable supply of an essential commodity such as water that meets required safety standards at a fair price to regional residents and businesses, directly affects four of the five above mentioned objectives. In this context the implications of the possible introduction of competition into the WA water industry, in whatever form or forms it may take, need to be carefully investigated and considered so as not to disadvantage any part of regional WA.

Yours sincerely

Robert Hicks
Chief Executive Officer

Current Government Policy

A search of recent literature and research on the subject of competition in the water and wastewater sector in Australia has shown it to be overwhelmingly concerned with the situation pertaining to capital cities and to a lesser extent, major urban centres. Rural and remote Australia figures marginally.

It is also worth noting that the State Government has given the following undertakings as per its Regional Development Policy:

- *The Government has firmly committed to the principle of uniform energy tariffs and water prices to ensure that the cost and availability of energy and water enhances regional Western Australia's economic competitiveness.*
- *Ensure that recommendations made by the Economic Regulation Authority fully consider the needs of regional residents and businesses.*¹

Differences Between Australian Rural and Urban Water Markets

When considering the “pros and cons” of introducing of competition into the WA water and wastewater services it cannot be assumed that the metropolitan and regional markets exhibit the same characteristics, and that the outcomes of changes introduced by competition will necessarily be the same.

The ERA has recognised this difference in the two markets by undertaking two separate inquiries into the pricing of water and wastewater in the country (2006) and urban areas (2004-5).

In a document produced by the Department of the Prime Minister and Cabinet entitled “*A Discussion Paper on the Role of the Private Sector in the Supply of Water and Wastewater Services*” (August 2006:6)² the variations between Australian rural and urban water markets are listed as being:

- Nature of supply
- Number of customers
- Pricing Structures
- History of private sector investment
- Third party access arrangements
- Importance of environmental flows

Water market differences need to be factored in when major changes to the current system are being contemplated.

¹ “Regional Development Policy 2003: Regional Western Australia – A Better Place To Live” p.33

² See Attachment 1

An Example of Private Sector Involvement in WA Water Industry

The GEDC believes that there is merit in new players coming into the market to fill a niche which the Water Corporation is either unable or unwilling to fill itself.

A good example of this approach is the proposal by United Utilities Australia (UUA) as part of a consortium, to build, own and operate a desalination plant in Esperance and a pipeline to transport potable water to Kalgoorlie-Boulder and possibly further north. Its business plan is to sell bulk water to the Water Corporation to supply residential and commercial customers. The UUA would sell potable water to interested mine sites. The project has been costed at \$400 million.

The GEDC supports this model as it would reduce water demands from Perth based sources. This demand is likely to increase as mining production increases in the region and with it, the need for additional potable water supplies. It would provide a better quality of water to the population of Esperance than is currently the case; and make the corridor between Esperance and Kalgoorlie-Boulder effectively “drought proof”. It also raises the distinct possibility of new ventures being established along the corridor that will help diversify the region’s economic base.

The GEDC regional economic modelling software shows that the direct local investment of over \$250 million expected from this project has a potential multiplier impact of over \$400 million which shared between construction, property, retail and almost all other industry sectors. The data also shows that the flow on benefit from the construction of the project alone will double with 200 persons being employed during this stage.

Other regional benefits would include:

- Reduction in the extraction and use of hypersaline water by the mining sector
- Increased regional water security with a climate independent source
- Increased utilisation of gas transmission and generating capacity at Esperance.

Costings associated with this project were the subject of an ERA inquiry³.

We understand that the Water Corporation, provided the purchase unit cost is acceptable, has no philosophical issues with being a “foundation customer” of UUA and purchasing bulk water from it. The Water Corporation is a practitioner of alliance contracting and works closely with the private sector through its competitive tendering process.

³ “Final Report - Inquiry on the Cost of Supplying Bulk Potable Water to Kalgoorlie-Boulder” ERA (October 2005)

Western Power as a Case Study in Disaggregation

In examining various competition models for the water industry, we would like to comment on the disaggregation model based on the GEDC's experience with Western Power in the provision of the upgrade of power infrastructure to the town of Ravensthorpe.

In April 2006 the Government's Western Power Corporation, which until then had been a vertically integrated electricity utility, was disaggregated into four entirely separate corporate business entities, to open the electricity market to wider competition:

Western Power Networks (trading as Western Power) – was made responsible for the ownership and operation of the SW electricity grid (known as the SWIS - south west interconnected system) which connects generators of all types to consumers' installations.

Horizon Power - responsible for the ownership and operation of what were previously Western Power's remote electricity supply systems (including some local generation facilities), and the retailing of electricity to customers, in most towns of the far north of the State, the Pilbara and Esperance.

Synergy - responsible for the retailing of electricity to what were previously Western Power's customers in the SWIS.

Verve Energy - responsible for ownership and operation of what were previously Western Power's power stations connected to the SWIS.

Western Power is an electricity networks corporation owned by the Western Australian Government and is accountable to the Minister for Energy. As a statutory corporation, established by the Electricity Corporations Act 2005, it makes commercial decisions based on regulations.

Western Power's operations are guided by regulations, codes and legislation. The major regulators being the Economic Regulation Authority (ERA), Office of Energy, Energy Safety and the Independent Market Operator (IMO).

For many years the GEDC has sought, in conjunction with the Ravensthorpe Shire, a fair and equitable solution to Ravensthorpe's inadequate and unreliable power supply. Part of the problem is that Ravensthorpe "sits" at the edge of the SWIS (being 270 km from the nearest zone substation at Katanning) and experiences frequent "brown-outs". Capacity demands have also increased due to a large degree to the economic "knock-on-effects" of BHP-Billiton's large Ravensthorpe Nickel Project (the company generates its own power through diesel fuelled generators).

Western Power has installed temporary generators to help cope with existing power demands, until a permanent solution is provided towards the end of 2008.

However the charges being fore-shadowed under Western Power's new proposed Distribution Headworks Scheme to connect new residential and commercial customers is proving to be very contentious; as it will be a strong dis-incentive to investing in the town as compared to other parts of WA.

The following extract explaining the proposed Distribution Headworks Scheme is taken directly from Western Power's Distribution Headworks Contributions Policy document entitled "Distribution Headworks Scheme (Proposed)" (2007:3).

"This Scheme is proposed to operate within the Western Power Capital Contributions Policy and is designed to provide for customer contributions for capacity enhancements to the existing HV three-phase rural distribution system throughout the SWIS. Capacity refers to the ability of the existing HV three-phase distribution feeder network to deliver the required electrical capacity to customers as electricity demand increases over time.

Contributions are required for this work because the investments in rural and regional areas do not generally meet the 'new facilities investment test' (NFIT) requirements defined in section 6.56 of the Code, or the 'alternative option test' defined in section 6.41 of the Code. The Scheme allows for the equitable sharing of those contributions between all new customers, including customers seeking upgrades to existing connections.

The headworks charges will not apply in metropolitan and other inner areas of the SWIS, because it is more likely that investments in those areas will meet the NFIT. This is because the network tariff revenue from new customers in those areas is more likely to be sufficient to recover the cost of network capacity enhancement. In general, new connections at a distance less than 25 km from zone substations do not attract net capital contributions (after new revenue offset). Consequently, this Scheme does not apply to connection applications within 25 kms of zone substations. Zone substations are located throughout the Perth metropolitan area but are also located in many major country towns (such as Albany, Bunbury, Geraldton, Narrogin), and consequently developments in those towns are not affected by this Scheme.

Where this Scheme applies, the contribution so determined provides the only contribution required with respect to distribution headworks, when required as a result of or in connection with a connection application – whether before or after the construction of the works required with respect to the connection application.

On the other hand, this Scheme does not provide for any contribution that may be required with respect to the costs related to the new or upgraded connection assets. These contributions are determined separately in accordance with the provisions of the Code and/or the Capital Contributions Policy. The Scheme applies to customers with potential loads less than 1000 kVA. For loads in excess of 1000 kVA Western Power will individually assess the application under the provisions of the Capital Contributions Policy.

This is because in areas remote from major population centres, loads of that magnitude can have a significant impact on the network, which can be disproportionate in cost to the amount that would be recovered as a headworks charge.”

Western Power conveyed to this Commission, in April 2007, the following points pertaining to the Proposed Distribution Headworks Charge (DHC) in the context of its impact upon regional centres, such as Ravensthorpe, which are located many kilometres from their zone substations.

“The DHC is designed to:

- (i) Provide a funding approach (that the Economic Regulatory Authority and the Department of Treasury and Finance support) for network reinforcement in situations where the revenue stream from new customers is insufficient to offset the reinforcement cost;*
- (ii) Correct the current approach, which is to charge up-front the first-mover developer(s) with full capital contribution required to make reinforcement work economically viable;*
- (iii) Ensure that the user-pays principle applies with all new users of the infrastructure contributing their fair share to the cost of new infrastructure;*
- (iv) Be cost effective to allow for better decision-making by the development industry and government;*
- (v) Minimise cross-subsidisation, and*
- (vi) Minimise the final cost to developers, whilst adhering to the principles enshrined in the regulatory regime and our Act.*

*In the case of Ravensthorpe, the cost of reinforcement is much higher than for many other towns because of the distance from the nearest bulk supply point (substation). **The principles espoused above lead to a much higher DHC for a development in Ravensthorpe than for a development close to a substation.....As mentioned above, Western Power acknowledges that the DHC at Ravensthorpe will be high under the proposed approach.**” (our emphasis)*

In fact the State Government has recently announced that a rebate will be provided to offset headworks charges in locations where headworks charges are greatest. While this will provide some relief, the GEDC believes that this proposed policy favours parts of WA over others, and will influence investment decisions. Towns like Ravensthorpe will be placed at a distinct disadvantage compared to those centres much closer to a zone substation.

Concluding Observations

This case study has been quoted at some length so as to highlight the considerable challenges that the Goldfields-Esperance Region confronts in addressing essential infrastructure requirements at a time when it is experiencing an ongoing minerals boom. The pressure on infrastructure will continue to increase.

Based on the Western Power experience, the GEDC is concerned that while introduced competition into the water and wastewater sectors may well prove to be of benefit to parts of WA, it will prove detrimental to those further away from the main population centres.

The provision of infrastructure requires long term planning eg we understand that the Water Corporation plans to a timeframe of 25 to 50 years. It has responded much better through its planning processes to the implications of climate change, as compared to its counterparts in other parts of Australia. The Water Corporation still maintains a significant presence in major regional centres in terms of staff who work and live there.

If new entrants are to be allowed into the water industry it is important that licence conditions contain provisions that ensure an adequate level of R&D and water conservation measures. The same legislative regime should be applicable to all players performing similar functions and providing similar services.

The issues of uniform tariffs and Community Services Obligations (CSO) were part of an inquiry undertaken by the ERA in 2006.⁴ The Commission supports the policy of uniform pricing based upon the need for transparency in the method used for determining water prices. It also supports CSO payments being provided to all water service providers in Western Australia and not just to the Water Corporation.

In concluding this submission, the Commission wishes to draw to the Authority's attention the comprehensive report entitled "*Competition Policy And Reforms In The Public Utility Sector*"⁵ produced in 1999. Although the report is eight years old and some of the recommendations have been acted upon, we believe that many of its recommendations are still salient to the ongoing debate on the role of competition in the provision of essential services. This is particularly so with reference to those recommendations pertaining to the State's regions and the impact of competition policy.⁶

⁴ "Final Report: Inquiry on Country Water and Wastewater Pricing in Western Australia" ERA (June 2006)

⁵ "Competition Policy And Reforms In The Public Utility Sector" Standing Committee of the Western Australian Legislative Assembly on Uniform Legislation and Intergovernmental Agreements (1999)

⁶ See Attachment 2

ATTACHMENT 1

The involvement of the private sector in water is dependent on, amongst other matters, the ability to make commercial returns in the target market. Water, at least in urban settings, has the characteristics of a large, reliable market with growing demand for the service – which is attractive to investors. Table 1 summarises some of the other key characteristics of rural and urban water markets in Australia.

Table 1: Variations between Australian rural and urban water markets

	Rural Water Market	Urban Water Market
Nature of supply	Supply is driven by variability in climate and rainfall and in some irrigation districts by the capacity of the irrigation system.	Supply is driven by variability in climate and rainfall as dams are the main source of water. Demand is influenced by seasonal variations and population growth.
Number of customers	Discrete customer base which uses low cost water supplies for irrigation and stock and domestic uses.	A large and differentiated customer base, including households, commercial and industrial users. There is generally a capacity to pay relatively high prices for water.
Pricing structures	The NWI requires a move to lower-bound ⁷ pricing which may be difficult to achieve.	The NWI requires a move to upper-bound ⁸ pricing which is being delivered by major urban utilities. A move to upper-bound pricing by non-metropolitan utilities may create opportunities for greater private sector involvement.
History of private sector investment	On farm private investment aimed at water use efficiency will continue to be required. There is also a need for increased investment in water supply infrastructure to the farm gate.	A recent history of private sector investment through the delivery of capital works programs and the outsourcing of operations and maintenance by water utilities.
Third party access arrangements	There appears to be limited third party access arrangements although an expansion in water trading may change this situation.	Third party access opportunities appear real across a range of areas, including the recycling of water and in servicing new sites.
Importance of environmental flows	Investments are required in infrastructure to increase efficiency and meet environmental needs. In the past, governments and water users have contributed according to their capacity to pay.	Urban water utilities are required to comply with environmental flow requirements. Yields from catchments can be reduced to meet these requirements.

⁷ *Lower bound pricing* – the level at which to be viable, a water business should recover, at least, the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes (not including income tax), the interest cost on debt, dividends (if any) and make provision for future asset refurbishment or replacement. Dividends should be set at a level that reflects commercial realities and stimulates a competitive market outcome. (NWI 2004)

⁸ *Upper bound pricing* – the level at which, to avoid monopoly rents, a water business should not recover more than the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes provision for the cost of asset consumption and cost of capital, the latter being calculated using a weighted average cost of capital. (NWI 2004)

ATTACHMENT 2

Recommendations

The Standing Committee in accordance with its brief to provide Parliament with an effective mechanism to scrutinise intergovernmental agreements and legislative schemes and after considering the impact of National Competition Policy on Western Australian public utilities has made the following recommendations -

Recommendation One

That the Government develops a strategy of public information and consultation before it proceeds with the privatisation of public utilities.

Recommendation Two

That where a substantial Government asset is to be sold that this be achieved, where possible, by public float with preference given to Western Australian investors.

Recommendation Three

That consideration be given to the establishment of an independent energy industry regulator.

Recommendation Four

That because of the infrastructure requirements and the range of subsidies that are required, for the most part, the government retain water services in public ownership.

Recommendation Five

That the accounting and funding of community service obligations be made open and subject to scrutiny.

Recommendation Six

That the Public Accounts and Expenditure Review Committee should examine community service obligations in Western Australian public service delivery.

Recommendation Seven

That private sector service providers who provide services on behalf of the Government be subject to the same administrative law provisions as the public sector.

Recommendation Eight

That the Government consider reforming public and private laws to ensure that a contractor's decisions and actions are reviewable as if they were performed by a government agency, if they are performed on behalf of the Government.

Recommendation Nine

That the Government introduce processes for contracts with contractors who provide services previously provided by the public sector, that require the contractors to provide sufficient information to allow proper Parliamentary scrutiny of the contract and its management.

Recommendation Ten

That when contractors provide services previously performed by the public sector, that the Government require those contractors to provide sufficient information to enable the Auditor General to carry out a performance audit of the contractors performance under the contract.

Recommendation Eleven

That the Government provide a commitment to ensure a free flow of information where government services have been privatised and outsourced.

Recommendation Twelve

That the powers of the Auditor General be extended to ensure proper scrutiny of privatised and outsourced functions.

Recommendation Thirteen

That the Government consider the establishment of a Regulator General to investigate and resolve complaints about contractors who deliver services on behalf of the Government.

Recommendation Fourteen

That the Government consider whether it is practicable for recipients of services formerly provided by the Government and now provided by a private sector provider to obtain information under the Freedom of Information legislation.

Recommendation Fifteen

That the Public Accounts and Expenditure Review Committee undertake a review of the contracting out and outsourcing of services and functions previously undertaken by the public sector.

Recommendation Sixteen

That the Government constantly review the implementation of National Competition Policy reforms and address any adverse affects in Western Australia particularly in rural and regional areas.

Recommendation Seventeen

That the Government implement measures to ensure that the export sector of the Western Australian economy benefits from the implementation of National Competition Policy.

Recommendation Eighteen

That the Government as part of the National Competition Policy, reform government business enterprises, by restructuring them and making them compete with private businesses as well as monitoring prices where the government business retains a monopoly.

Recommendation Nineteen

That the Government undertake an educative role on the nature of National Competition Policy, specifically the nature of the reforms relating to the extension of the *Trade Practices Act 1974*, review of anti-competitive legislation, the restructure of public monopolies, the introduction of competitive neutrality, third party access to essential facilities and prices surveillance of government businesses.

Recommendation Twenty

That any commercial enterprise of Government be subject to the scrutiny of the Auditor General to ensure that the balance sheets of the business reflect the true costs of operations.