



CHAMBER OF COMMERCE AND INDUSTRY
WESTERN AUSTRALIA

7 September 2007

Inquiry on Competition in the Water and Wastewater Services Sector
Economic Regulation Authority
P. O. Box 8469
Perth Business Center
PERTH WA 6849

Dear Sir or Madam,

Please find attached the Chamber of Commerce and Industry of Western Australia's (CCIWA) submission to the ERA's Inquiry on Competition in the Water and Wastewater Services Sector.

If you require any further information concerning this submission, please contact CCI's Senior Adviser – Industry Policy, Ms Jessica Shaw on 08 9365 7498.

Yours Faithfully,

Trevor Lovelle
Manager – Industry Policy

About CCI

CCI is the leading business association in Western Australia. It is the second largest organisation of its kind in Australia, with a membership of approximately 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private-sector businesses, but CCI also has representation in the not-for-profit sector and the government sector. Over 80 percent of members are small businesses, and members are located in all geographical regions of WA. Some 100 business associations are affiliated with CCI, expanding the organisation's representative coverage to more than 10,000 enterprises.

General Principles

CCI believes that markets are better than regulators at inducing efficient water use and welcomes this inquiry into competition in the water and wastewater services sector. Consistent with our long held views, we maintain private sector participation in the water and waste water industry can offer a number of benefits.

Enabling private suppliers to enter the market and sell the water they produce would, we believe create an incentive to invest in new infrastructure. While it is premature to be advocating disaggregation we believe there is scope for greater private sector involvement in water supply and wastewater disposal.

CCI considers there are a variety of alternative water supply sources, including desalination and water recycling, which can be provided if new market entrants are allowed to access waste water and supply water either directly to – or in competition with – Water Corporation. These sources are likely to be less dependent on climatic events, hence more reliable and private sector capital for major infrastructure construction can reduce the need to fund projects from the public purse.

Allowing broader participation in the water industry also enables companies with extensive water management expertise in other jurisdictions to apply their knowledge and innovative solutions in the WA context. Companies operating in other jurisdictions can also mobilise and relocate the skilled labour required to construct and manage water projects on either a temporary or permanent basis—especially pertinent given WA's current labour supply constraints. WA-based companies can also expand their operations and offer a range of new services to customers.

We understand that successful operating models exist, particularly in the UK, where the incumbent utility has sought support through outsourcing of functions or established capital delivery vehicles with private sector companies, to improve efficiencies, ensure output targets are achieved and to reallocate risk.

CCI believes the key is to identify and separate 'monopoly' and 'contestable' water industry activities, and allow market principles to apply accordingly.



Institutional and Legislative Arrangements to Ensure Effective Use of Competitive Supply Opportunities

If allowed to operate freely, a competitive water market should stimulate the development of new sources and encourage inefficient water users to either improve their water management practices or withdraw. For the market to operate effectively, however, a number of conditions must exist.

Consolidating Water Legislation

The legislative and administrative structures for water management must be firmly established, noting that water governance is currently conducted under a number of complex, overlapping and often outdated Acts. CCI has actively participated in the water law reform process and looks forward to the consolidation and streamlining of the various legislative schemes that currently govern water.

Removing Institutional Overlap

Inappropriate institutional overlap must be removed, with the roles of the various government agencies involved in water clearly articulated. We believe that planning and policy-making functions must be separated from water service provision. CCI supports the current legislative programme to formally establish the Department of Water in its own right and looks forward to the Department assuming the policy and planning functions currently performed by Water Corporation.

CCI considers that in the interests of successful market reform, consideration should be given to limiting Water Corporation's role to service provision. A model must be designed that provides a level playing field and removes cross subsidization. Specifically we believe that Water Corporation must not perform the policy-making and planning functions that could provide an unfair competitive advantage over other participants. In this respect we believe that consolidating and centralising planning and policy-making functions within the Department of Water would be beneficial.

Structuring the Water Market

CCI believes that private sector suppliers should be able to supply water to the market and compete on an equal footing. Companies must also be given access to waste water and be able to offer treatment services into the market. Mechanisms should be developed that facilitate the use of and access to groundwater on commercial terms, facilitating the entry of private-sector providers with an interest in waste water processing and aquifer recharge. Market entrants must also have access to the infrastructure required to deliver water to customers and draw waste water for re-processing.

Legislation, regulations, approvals and licensing processes must be clear and processes streamlined. Companies must be able to clearly identify the conditions they must meet in order to participate in the market. Procurement processes must be transparent and conducted independently. Currently, we believe considerable scope exists for conflicts of interest to arise where Water Corporation is simultaneously responsible for procuring and providing water sources.

CCI maintains that market forces should play a greater role in determining when new water sources should be developed. There is perhaps scope for some form of capacity market to be developed, analogous to the capacity market for electricity, whereby forward projections for water demand are made either via or by the Department of

Water and a transparent independent procurement process then conducted to ensure sufficient supply.

For such a structure to work, CCI believes that there needs to be a conceptual shift in water procurement. Currently, water supply is considered in terms of “sources” such as desalination plants, aquifers, dams, rivers, treated wastewater, etc. instead of being considered in terms of “volumes” of water or the provision of water “services”. If water supply were reconceptualised, Government would seek a volume of water or supply service. It would then be left to the market to devise the most innovative, cost-effective solutions to provide that water. Companies should be able to bid their solutions into an independently operated procurement process, with financial viability and economic efficiency determining which service should be selected.

Similar to water supply, waste water treatment should also be considered a service. Once a need for waste water treatment has been identified, the Government should again enter the market and seek a solution. The private sector should be allowed to innovate and provide that solution in the most cost-effective manner possible.

If a proponent can provide a water supply or waste water service, and has obtained all necessary approvals, the actual source should be immaterial since economic drivers should determine which option among a range is selected.

Barriers to Competitive Procurement

CCI considers that the current structure of the water industry is not conducive to greater competition for reasons enunciated below

1. Regulatory complexity

Private sector proponents have attempted to develop water supply projects in WA in the past, but have experienced a lack of regulatory clarity. Approvals processes are often complex and opaque, with multiple agencies involved in regulating the industry. Some proponents have experienced extreme frustration when it appears that agencies have refused to make decisions or have been unsure of the extent of their powers under the overly-complex regime.

The removal of regulatory complexity is a prerequisite to delivering value for money assets and attracting private-sector participation. CCI strongly recommends that a more streamlined approvals process be developed. Better communication across and between Government and regulatory agencies is also required.

2. Inappropriate institutional overlap

The current blurring of planning and policy-making roles between the Water Corporation and the Department of Water can undermine private proponent's confidence in the procurement process.

Water Corporation's extensive industry knowledge and role as the “gate-keeper” to industry involvement can be seen as a barrier to participation. Industry participants perceive a lack of transparency and a heightened level of sovereign risk in the water procurement process (exacerbated by the recent Binningup Desalination Plant process).

There are concerns that political expediency may drive water procurement decisions. For the market to function efficiently and effectively, potential market entrants must have confidence in the transparency and veracity of the decision

making process. Proponents must be able to rely on the predictability of structures and institutions.

3. Water Pricing

In order to attract and facilitate private sector involvement in the water market, water pricing mechanisms should be developed so that the price of water reflects its scarcity value and actual cost. Price signals would then operate to allocate water to its most efficient uses.

Transparent pricing and cost analysis for the water supply chain is also vital, with any cash payments or subsidies between Water Corporations' divisions made apparent, otherwise potential market entrants will find it difficult to determine business viability. Water transportation costs would be an example of critical information that should be made available to prospective entrants.

Constraints on the Use of Water Trading as a Source of Bulk Water

CCI believes that market forces should operate to allocate resources where they are most valued. Efficiency demands that the scarce resources we have at our disposal are put to their most productive possible uses.

CCI is opposed to any measures that assign water resources for favoured customers, impose more stringent reuse or other regulations on some clients than others, or treat some service providers (including self-providers) less favourably than others. All users must pay the costs of the resources they use while all water providers should be free to trade their water as they see fit.

There should be no constraints on the use of water trading, however, appropriate mechanisms should be in place to avoid cartelling, water hoarding and general anti-competitive behaviour. Furthermore, the State water planning process must be clearly understood and its impact on trading made clear.

Ensuring Efficient Service Provision in Uneconomical Areas

Governments have a legitimate concern to protect the interests of potentially disadvantaged consumers in the market for some essential goods and services. Government's involvement generally entails ensuring that all members of the community have the opportunity to access essential goods and services and in many cases also ensuring that they can afford to access them.

CCI acknowledges that equity issues need to be addressed in remote and regional areas where the cost of providing water can be higher than in the Perth metropolitan region. In this context, CCI also acknowledges the importance of Community Service Obligation (CSO) payments.

The financing of the CSO should be equitable, transparent and achieved in a way that has the least impact on competition and economic efficiency. The CSO should be provided in the form of a subsidy provided to an operator or water supplier. Access to subsidies should be contestable, with contracts awarded to those operators able to fulfil the government's CSO at the lowest cost. Where subsidies are provided to operators in non-contestable markets (such as in remote or regional areas where

monopoly suppliers may exist), they should be audited carefully and reviewed regularly.

A Third Party Access Regime

CCI believes that, whilst potential exists for competition both upstream and downstream in the water market, the same cannot be said for the naturally monopolistic water transportation infrastructure.

CCI does not advocate the privatization of the current water distribution assets. We consider it is appropriate and in the public interest for this infrastructure to remain in public ownership at this time. CCI considers, however, that a third party access regime allowing private sector suppliers to distribute water either through a bulk supply contract with Water Corporation, or direct to individual customers should not be discounted. Private sector operators with an interest in utilising waste water should also be able to access state-owned networks.

Without such a third party access regime, lengthy and costly litigation could ensue. CCI is concerned to avoid a situation similar to that recently witnessed in NSW where Services Sydney had to resort to protracted legal action to obtain a Declaration under Part IIIA of the *Trade Practices Act 1974* to gain access to Sydney Water's sewerage transmission and interconnection network.

A state-based regime that is fair, robust, will minimise delay and clearly articulate water quality standards is preferred. Under this arrangement the tariff structure should be transparent and CCI recommends that an industry regulator should be responsible for regulating access to water and waste water distribution infrastructure. In this respect we strongly recommend that the Economic Regulation Authority should perform this role, similar to the Authority's roles in the regulation of gas, rail and electricity infrastructure.

Trading & retail competition

CCI considers that trading and retail competition could become viable if upstream competitive reform is achieved in the water market.

Water providers may wish to sell their water direct to customers through bilateral trading mechanisms, which could be viable where non-potable or treated wastewater can be traded for use in industrial processes. Providers may also see commercial opportunity in directly retailing potable water to industrial, commercial or residential customers.

We consider that if new water retailers or retailers currently selling other utility services are able to purchase bulk water from suppliers and on-sell to consumers, considerable efficiency gains may also be made. Retailers may be positioned to 'bundle' services for water, electricity and/or gas together, giving consumers the option of consolidating their utility bills.

Ultimately the decision to bilaterally trade or retail water should be a commercial decision. Whilst the argument is sometimes mounted that metering cycles and billing systems could be problematic, fundamentally, if a company is willing and able to design appropriate structures, they should be afforded the opportunity to enter the market. Proponents should assess the financial viability of a trading or retailing scheme, including determining the costs of metering and billing, and reach a

commercial decision regarding whether to participate. Appropriate licensing regimes would need to be established to facilitate this.

CCI strongly supports the establishment of mechanisms that would allow the private sector to trade or retail water if commercial opportunities existed. CCI acknowledges, however, that an assessment of the benefits and costs of implementing such an arrangement should be undertaken.

Relevant Issues not Identified in the Issues Paper.

The discussion paper raises the possibility of developing a disaggregation process similar to the electricity model, but does not specifically model a regional component. CCI believes there are opportunities for separating out regional water and wastewater services. A centralised procurement process for service provision could be possible for entire (and possibly also discrete) markets. This issue perhaps warrants further attention.

Areas of Particular Attention

CCI recommends that the Authority should consider the regulatory and institutional structures that would allow a market to exist and competitive forces to develop across the entire water supply chain. The establishment of a competitive water market may require ring-fencing or disaggregating areas of Water Corporation's activity to allow the private sector to compete on an equal basis. Water Corporation's planning and policy-making functions should also be removed and placed squarely with the Department of Water. The Authority should particularly consider developing more transparent procurement models.

When considering the potential costs of an industry restructure, it is important to keep the long term benefits of competitive reform firmly in mind since transitional costs may create a sense of failure. There must be a strong commitment to and investment made in beneficial change. CCI firmly believes that the short term costs of reform are outweighed by the long term price and efficiency savings that will flow to the entire community and the range of innovative solutions that can be introduced into Western Australia's water management framework.

Conclusion

The critical objective of the water market reform process should be to ensure safe, efficient, effective and sustainable water supply that is in the public interest. Fundamentally, WA needs a market structure that will support the State's continued economic development and ensure that environmental and social needs are met.

WA needs the right sources, the right technology, at the right time and for the right price. CCI believes WA's water and waste water services industry can be improved by allowing greater private sector participation, thereby encouraging the development of a diverse range of sources and innovative solutions. CCI's Senior Adviser – Industry Policy, Jessica Shaw, would be willing to provide further information regarding this submission. Ms Shaw can be contacted on 08 9365 7498 or Jessica.Shaw@cciwa.com

Yours Faithfully,

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