



Department of Industry and Resources
Government of Western Australia

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Inquiry on Competition in the Water and Wastewater Services Sector
Economic Regulation Authority
PO Box 8469
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Dear Mr Rowe

INQUIRY ON COMPETITION IN THE WATER AND WASTEWATER SERVICES SECTOR

Please find attached the Department of Industry and Resources submission to the ERA's Inquiry on Competition in the Water Sector.

If you would like to discuss any of the matters raised in the submission, please contact Derek Perez on 08 9222 0146.

Yours sincerely

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STATE DEVELOPMENT STRATEGIES

12 September 2007

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**Submission to the Economic Regulation Authority's
Inquiry into Competition in the Water and Wastewater
Services Sector**

12 September 2007

Department of Industry and Resources

Context

National Competition Policy and subsequent reports by the Productivity Commission have emphasised, that the introduction of competition is not an end in itself, but rather a means of achieving greater productivity, stronger incentives for innovation, lower costs and improved service, and so eventually to higher incomes. In determining the opportunities for introducing competition in the water industry it is important to be continually cognisant that the aim of competition is the achievement of these ends.

It is also important to stress that network water services are natural monopolies. That is, over a relevant range, they can produce increasing amounts of output at decreasing average cost. Consequently one firm can technically supply the entire market at a lower price than two or more firms. As such, it is inefficient to have more than a single firm in a region because this would lead to a higher average cost of supply. For such industries the main opportunities for the introduction of competition will be limited to greenfields developments, regions at the boundary between serviced areas and competition for the provision of the monopoly service itself.

In short, an efficient water industry does not lend itself, by its nature, to a competitive market structure. Having said this, opportunities do exist for the use of competitive mechanisms to achieve greater efficiency in the initial purchase of services and to some degree in the operation of aspects of the service (e.g. competition for retail services).

Competition *in* the market and *for* the market

It is useful to make a distinction between the one-off competitive processes characterising competition *for* the market and the ongoing competition that characterises competition *in* the market.

Competition *for* the Market

Competition for the market is a one-off form of competition where the successful bidder wins the right to become a regional monopoly service provider. This can create problems as the monopolist, once established, has increased bargaining power, enabling them to renegotiate terms. As a result there is always a need for appropriate regulatory oversight to ensure the monopolist does not exploit its monopoly status.

Examples of where competition for the market can have a role in the water industry include:

1. Competitive tendering for the provision of services to greenfields sites;
2. Competition for the management of existing infrastructure referred to as franchise bidding (Model used in South Australia and France); and
3. Competition between different product classes (Eg wastewater can be treated and used as a substitute for potable water across a range of activities); and
4. Third Party Access to existing infrastructure.

Competition *in* the Market

Competition *in* the market, or product market competition, is direct ongoing competition. The possibility of this form of competition would at first glance appear to challenge the view expressed above that the nature of networked water industries precludes the introduction of competition. In its strongest form you could envisage a situation where several water utilities use a single set of pipes to compete for customers in the same area. Although this possibility has been examined in the

literature¹ more realisable forms of competition *in* the market generally involve a form of retail competition. That is, those activities associated with the provision of customer services to water and wastewater customers.

Companies acting as water retailers would handle all the non-operational water and wastewater aspects of servicing customers. The new entrant water retailer would offer supply terms, take on customers and provide the entire range of customer service requirements including billing and payments, call handling, correspondence and marketing.

This form of direct competition 'in the market' may have some efficiency and customer service benefits, however given that the cost of the retail function of a water service provider is small relative to the total cost of providing the service it would seem unlikely that the benefit of duplicating retail services would outweigh its cost. Consequently, the remainder of this paper will focus on competition for the market.

1. Competition for the provision of services to a Greenfield site and the allocation of operating areas

As noted above, water services, because of their network structure, and the fact that the majority of capital costs are to be found in distribution pipes (large sunk costs), do not lend themselves to direct competition. That is, in general it is not viable to have two or more sets of pipes servicing a given geographic region. For this reason, once a service provider is established in an area it will become a monopoly provider. In these circumstances it is the role of regulators to ensure that the provider does not exploit its monopoly position.

In greenfield sites there is no pre-existing service. Consequently, the opportunity exists to seek 'competitive bids' for the provision of the service by allocating the operating licence to the preferred applicant. An example of this was the competitive process undertaken by the then Office of Water Regulation (OWR) for the Preston Industrial Estate. In a competitive bidding process, Aqwest won the right to provide the service over the Water Corporation and subsequently had its licensed operating area extended to include the Preston Industrial Estate.

¹ Foellmi R and Meister U; Working Paper No.115; Product Market Competition in the Water Industry; Voluntary Nondiscriminatory Pricing *Institute for Empirical Research in Economics University of Zurich Working Paper Series ISSN 1424-0459* (2002),

Another example, where a competitive process could have been followed was the provision of desalinated water in Dampier for the Burrup Fertilizer Project. In the case of Burrup Fertilizers a decision was made to have the Water Corporation provide the service rather than seek expressions of interest more generally. This was largely as a result of a need to ensure that proposed major industrial projects, to be served by the supply of desalinated water, were not delayed. In effect it was decided that the benefits of certainty of supply to an immediate development, and potentially a much larger industrial precinct, outweighed the benefits of a competitive process that may have delayed the projects.

Dallyelup Case Study

Although the basis for undertaking a competitive process for a greenfield site (new operating area) is to obtain the best outcome for consumers, it does not follow that any competitive process will lead to such an outcome. For example, the competitive process undertaken by the previous OWR for the provision of services to Dallyelup Estate (referred to in the ERA Issues Paper page 24) resulted in the Water Corporation bidding to provide the service at a significantly reduced headworks charge (50 percent of the standard headworks charge) in order to undercut Aqwest (whose standard headworks charge was lower than that of the Water Corporation). It is likely the main beneficiary of this was the developer who received an improved bottom-line on selling the lots. Some of the benefits may have been passed on to land purchasers, however it is more likely that this process resulted in a net loss of revenue to Government and no increased benefit to consumers.

This example also highlights the need for regulatory authorities or those responsible for the facilitation of competitive processes to establish the appropriate rules for the competitive process.

It should be noted that once a provider has won the right to provide the service, and develops its infrastructure, it will then be providing the service as a monopoly provider. As such, although competition may (or may not) lead to beneficial outcomes in selecting a provider, it does not guarantee the efficiency of the provider once it is established, as the possibility of subsequent entry into the same market is extremely

small. As such, once established (given the licence to supply a specific operating area) the continued efficient operation of a service provider relies on the existence of an appropriate regulatory system that will ensure efficient pricing and appropriate levels of service.

Limitations to Competition for Greenfield Sites

Although running a competitive bidding process for a greenfield site represents an opportunity to introduce new players into the State water industry, the viability of the project, as a stand-alone service, must also be taken into consideration in awarding a service provider a licence to provide. This is usually undertaken as part to the ERA's licensing process (s.23 Water Service Licensing Act 1995).

Despite initially meeting the requirements of s.23, Nilgin Services Company did not maintain its assets, and as a consequence the Water Corporation was required to take over the scheme, with a significant Community Service Obligation (CSO) payable from the Government.

The Nilgin Scheme was given approval to operate by the Water Authority in 1980, long before a separate regulatory (licensing) regime was established in Western Australia, and as such was not an example of a competitive bidding process or a failure of the licensing system. It does however highlight the problems that may occur when licensing small private service providers. Further, unlike the Water Corporation, Nilgin did not have access to CSOs and found it difficult to sustain its operations from its small revenue base. This suggests the need for a broader Government policy on the provision of CSOs and subsidies if new market players are to attempt to enter the market on an equal basis. This issue is in part being addressed in the proposed new *Water Services Bill*, which will for the first time make CSOs, at least in principle, available to all service providers. However, the legislation only provides the capacity for CSOs to be provided; appropriate structures will need to be established within government to administer any CSO regime.

Cherry-Picking

Current State Government policy requires the Water Corporation to charge for its services using uniform headworks charges and to apply a uniform pricing policy (except in the case of major industrial consumers). This can lead to the possibility for

'cherry-picking' of operations that are cheaper to provide by new service providers, and eventually to the average charge across the State increasing. This can occur for existing services as well as greenfields developments.

In the cherry-picking scenario it is open for competitors to the Water Corporation (or the Water Boards) to undercut the Water Corporation for the provision of services in areas, by charging less than standard charges. This will occur in situations where the actual cost of provision is lower than the revenue that can be generated by charging at the average charge required under uniform charging policy.

The problem of cherry-picking is not insoluble. However, as noted above, it raises questions as to the basis on which competition for greenfield sites should be undertaken in a uniform charging regime. In the case of country operations, which are essentially loss making, competition could occur on a cost basis. That is, the provider requiring the lowest CSO from Government (the relationship of Water Corporation finances to State finances, discussed further below, makes this assessment more complicated than it superficially appears).

However, 'cherry-picking' is not as significant a problem as is sometimes claimed. This is because the margins made by service providers on the sale of water services are relatively small. Consequently, any investment requires large customer volumes to be viable. It is also important to realise that the cherry-picking argument does not apply to major industrial consumers which are charged at full economic cost. For example, the opportunity could exist to have a competitive process for water provision on the Burrup Peninsular or in the Goldfields (e.g. United Utilities). Although any new provider would need to demonstrate the benefits to the State and the community of being granted a licence to provide.

2. Competition for the Management of Existing Infrastructure

Most examples of competition are based on the notion of an existing supplier facing entry from an alternative provider based on new infrastructure being constructed. An alternative option, and one used in South Australia, is for the State (or local regional authority) to own the assets (business) and to tender the management of the business to an experienced water service provider. In this case the bidding process is for the right to manage the State's business.

For example, in 1996 the South Australian Government awarded United Water a 15-year contract to manage and operate the metropolitan Adelaide water and wastewater systems on behalf of SA Water. United Water is a consortia of three companies:

- Veolia Water - the world's largest water services company and is the water division of Veolia Environment.
- Thames Water - the UK's largest water company, providing water and wastewater services to 13 million people in Southern England and 43 million people worldwide.
- Halliburton KBR - a leader in engineering, planning and project management in the Asia Pacific region.

Again, as with the case of greenfield sites, a regulatory structure is essential to monitor the performance of the appointed manager. SA Water's contract with United Water sets strict performance targets for customer service based on response times to *water mains bursts and other problems*

3. Competition at the boundary between two existing service providers

At the geographic boundary of two service providers an opportunity exists for competition to occur for certain services. Usually the consumer involved is large enough to justify the extension of infrastructure from one serviced area to another, and as such are usually large commercial or industrial customers. In the UK this type of competition is facilitated through the use of '*inset appointments*,' (section 7(4) of the *Water Industry Act 1991*), whereby one service provider is given regulatory approval to provide within a competitor's defined operating area.

In practice this approach has not led to a significant increase in competition. Of the eleven inset appointments which have been granted since 1997, four are large user, one is by incumbent consent and six are for greenfield sites. All of these were in respect of business customers.

In WA this approach could have some success at the boundary between operating areas run by the Water Corporation and those run by the two Water Boards. As these arrangements are for the supply of large customers, charged on a full cost basis, the issue of 'cherry-picking' does not arise.

4. Competition between different product classes and industry structure

Currently the Water Corporation operates in the provision of water, wastewater, bulk irrigation water and drainage. As such, certain activities such as wastewater re-use may not be as attractive to the Corporation as they would be to a service provider whose sole activity was wastewater. This is because any increase in re-use water could impact on potable water sales. By splitting the Water Corporation up into its component businesses a certain amount of competition between these activities could be generated.

Much of the discussion above has focussed on water, however, within the wastewater area activities are catchment based. As such, the opportunity exists to split the activities of the Water Corporation's activities by location. Although this is unlikely to lead to significant direct competition, it would allow for competition by comparison.

There are a number of ways in which the water industry in WA could be re-structured to achieve a more competitive environment (at least in a comparative sense). These include separation by product type (water, wastewater, drainage) as discussed above, or separation by region or both. The efficiency benefits of doing this would need to be weighed against the cost of restructuring, and any economies of scope that may be attributable to one provider providing all services.

In addition, the direct and indirect impact on State finances of allowing any significant entry of private sector suppliers into a re-structured market would also need to be considered. This is because, as a Government owned trading enterprise, the Water Corporation returns its dividends and taxes (under the National Tax Equivalent Regime) to the State Government's Consolidated Fund. This would not be the case for a private provider, which would naturally return profits to its shareholders, and more significantly would pay tax to the Commonwealth Government. Assumptions can be made as to the proportion the State would 'claw-back' through the grants system, however generally it is assumed that this is significantly less than what is paid.

In addition, whereas Community Service Obligation (CSO) payments would be treated as revenue whether received by the Water Corporation or a private provider, to the degree that this payment flows through to profits (are not consumed as part of tangible cost of delivering the service), it is retained by the State in the case of the Water Corporation, but paid to shareholders and the Commonwealth in the case of a

private provider. CSO payments would therefore represent a financial leakage to the State if paid to a private sector water provider. Thus, although the underlying financial situation may be similar in terms of the long term cost of provision, the direct returns to the State are not the same.

5. Third Party Access

Third party access allows a potential market entrant to access the infrastructure of an incumbent service provider, where this infrastructure is a 'natural monopoly' and as such, cannot be duplicated at an economically feasible cost.

Following recommendations in the 1993 Hilmer Review, the Commonwealth Government introduced a national access regime for infrastructure services in 1995. The regime, set out at *part IIIA of the Trade Practices Act 1974*, establishes a legal right for third parties to share the use of certain infrastructure services on reasonable terms and conditions. The regime is confined to the services of major infrastructure facilities where it would be uneconomic to develop another facility, and where access is needed to promote competition in another market.

A number of research papers have been written on the subject of third party access to water infrastructure. They include:

1. Third Party Access in the Water Industry – Tasman Asia Pacific Pty Ltd (September 1997);
2. Third Party Access in the Western Australian Water Industry – IRIC (August 2000); and
3. Third Party Access in Water and Sewerage Infrastructure: Implications for Australia – Marsden Jacob Associates (December 2005).

Of recent times the only significant example of a company seeking third party access to monopoly infrastructure in the water industry has been that of Services Sydney. A brief historical overview is provided below with some relevant observations on the process so far.

Services Sydney Example

In March 2004 Services Sydney applied to the National Competition Council (NCC) for a recommendation under Part IIIA of the TPA to declare Sydney Water's sewage transmission and interconnection services.

Services Sydney proposed to provide sewage collection services to Sydney and compete with Sydney Water for retail customers. In order to provide competitive sewage collection services in competition with Sydney Water, Services Sydney requested access to Sydney Water's sewage reticulation network for the transmission of sewage to sewage treatment plants in the Sydney area.

As a result, in December 2005, the Australian Competition Tribunal (ACT) declared sewage interconnection and transportation services at three reticulation networks within Sydney Water.

On 6 November 2006 Services Sydney notified the ACCC of an access dispute with Sydney Water in relation to the methodology for pricing access in respect of the three declared sewage transportation services.

On 22 June 2007 the ACCC determined that the access price that Services Sydney was to pay Sydney Water in respect of the customers supplied by Services Sydney was Sydney Water's regulated retail price for those customers minus Sydney Water's 'avoidable costs', plus any 'facilitation costs' associated with providing access. This approach to access pricing is known as the Efficient Component Pricing Rule (ECPR). Although this approach has been touted as a means of introducing competition in a manner that addresses issues relating to 'cherry picking', questions remain as to its effectiveness as an access pricing methodology. Specifically it appears to leave in doubt the methodology for determining avoidable costs. (a proxy for marginal cost). Under such circumstances the incumbent monopolist would naturally seek to define it as the short run marginal cost. This is small in the context of water infrastructure services, and consequently an access price determined in this way would be very close to the retail price.

Clearly in the end third party access is as much about regulation (the regulated price of access) as it is about competition. That is, despite third party access being a means

to introduce competition a significant role is still played by the price regulator. In the absence of state based access regulation this function is performed by the ACCC.

The ECPR approach to access pricing would also seem to undermine the incentive effects of possible entry on the monopolist, since the monopolist is effectively guaranteed their return irrespective of entry. That is, the possibility of entry (third party in this case) creates less of an incentive for the monopolist to provide services efficiently since there is little financial consequence of entry.

Third Party Access in Other Industries

Third party access regimes have been successfully implemented in the electricity and gas industries. As these are both network industries, with natural monopoly characteristics, it is natural to raise the question as to the applicability of third party access in the water industry. The response to this question is that there are a number of characteristics particular to water that mitigate against the development of third party access regimes on the whole.

Where the costs sit in the network

The most important of the differences between water and electricity, for example, is that the majority of costs associated with water are in transmission (monopoly element) rather than production (generation). That is, the majority of the costs are associated with the pipes transporting the water. As such there is less “room” for cost savings in the delivered price water from different suppliers. For an entrant to provide a significant cost saving for a delivered service, they would therefore need to make significant savings in, for example, source development. However, it is exactly in the area of source development that costs are rising, as cheaper local sources have been exploited and more expensive sources are being brought on line (e.g. desalination).

Energy is an important cost to users Water is not

As the Marsden Jacob Report² points out, in the gas and electricity markets, those seeking access are generally associated with large industrial or resource projects, as they have the demand from customers to justify an open market.

In its Report³, IRIC examined a number of proposed major resource projects for WA, and found that the average annual costs for water, electricity and gas across these resource projects averaged :

. Water:	\$0.9 million
. Electricity:	\$45.0 million
. Gas:	\$75.9 million

Clearly, water is a very minor cost component for these projects (significantly less than 1% of annual operating costs) and savings are likely to be a minor consideration in the overall cost of a project. Consequently, even if water doubled in price it would have only a limited effect on these projects. Hence, market pressure and customer support for access to water infrastructure is likely to be less price driven and less pronounced than in gas and electricity.

Finally, putting aside what would appear to be the limited applicability of third party access in the water industry, Western Australia has neither the regulatory structure nor an industry structure to facilitate access.

² Third Party Access in Water and Sewerage Infrastructure: Implications for Australia – Marsden Jacob Associates (December 2005)

³ Third Party Access in the Western Australian Water Industry – IRIC (August 2000);

Regulatory Oversight

In nearly all of the examples discussed above a common theme is the need for regulatory oversight of the service provider once established. Current arrangements in WA do not allow for the type of monitoring and oversight that would be required in a more open market.

Current Arrangements within Western Australia

Of recent times there has been a lack of water industry policy development and it remains unclear which government agency is responsible for facilitating competition and market entry into the water sector. Previously one of the functions of the OWR was to advise the Minister for Water on opportunities for the introduction of competition. The OWR also ran a number of competitive tenders for the provision of water services within a controlled area, including Kemerton Industrial Park, Preston Industrial Park, Dalyellup, Coral Bay and Hopetoun. Admittedly these were generally small operations, and in the case of Coral Bay did not lead to the introduction of a new entrant into the market however, the OWR did provide a limited mechanism and process for the facilitation of market entry.

At a larger scale, the OWR also had a number of meetings with proponents for a desalination plant and pipeline to provide water to the Goldfields from Esperance. At that time the proponents were Goldfields Utilities Limited (GUL). The proposal was largely underpinned by the need to meet a significant new demand for water in the Goldfields as a result of the Anaconda Nickel Project. With the failure of the significant demand for water from the Anaconda project to eventuate, the project became financially unviable (without a significant subsidy from Government). This remains the case with the present United Utilities Australia (UUA) proposal.

The continuing UUA interest in entering the Western Australian water market again raises the need for a mechanism within Government to underpin and assess possibilities for market entry. In the absence of a government water market facilitating agency this role has in part been undertaken by the Department of Industry and Resources (DOIR), where it relates to the resource development. Specifically, DoIR assisted both Goldfields Utilities Limited and UUA to undertake feasibility, cost

benefit and impact studies on the possibility of providing desalinated water to the Goldfields, and supported them in accessing Government decision makers. However, it is clear a greater role needs to be undertaken within the Department of Water to support this, and other industry policy needs of the Minister for Water.

Government Facilitation of Market Entry

If the ability for other providers to enter the market is to be promoted within the Western Australian water industry, the opportunity must exist for potential new entrants to interact with a government agency tasked with the role of examining and facilitating market entry. Part of the role of such an agency would be to examine current policies and practices that may inhibit market entry in order to create a more level playing field.

Among the matters that would need examination if the Government is to pursue greater market entry are:

- Establishing a facilitation role within an appropriate government agency to assist and oversee the introduction of competition in the water industry;
- Establishing a regulatory structure to ensure the ongoing performance of new players entering the water industry;
- Establishing the market rules under which competitive processes for the provision of services (allocation of licenses for operating areas) would occur, which Government agency would administer these rules, and be tasked with facilitating competition;
- Develop a policy position on the availability of Community Service Obligation Payments to service providers other than the Water Corporation, including agency responsibility for administering any extended CSO regime;
- Analyse the consequences of the State's uniform pricing and standard headworks charging policies on the possibility of market entry; and
- Analyse the net benefits to the State of private sector entry into the water industry taking into account revenue leakages that would occur.

Prices Oversight

The reason that price regulation takes on such a significant position in regulatory literature, is not only because of the need to set efficient prices and protect consumers from a monopoly overcharging, but because controlling the general level of prices allows the regulator to ensure the delivery of certain levels of service (set in the licence). As opposed to using fines or the threat of losing the licence to achieve compliance with the licence.

Under current regulatory arrangements there is no price oversight that is independent of Government. The ERA can provide one-off (or annual) reports on prices and charges at a point in time (in response to a reference issued by the Treasurer); however it does not provide the ongoing price regulation of the entire industry. The lack of independent price regulation also presents an impediment to the entry of new service providers, as it is unclear how such providers would be regulated. That is, who would ensure that their prices were set in an efficient manner, and on what basis. Regulation is not just about setting prices on a one off basis, but rather it is about creating ongoing incentives to improve efficiency and service levels.

The Water Corporation's prices and charges (except for headworks charges) are set by the Minister for Water Resources under the *Water Agencies (Charges) By-laws 1987*, and the *Water Agencies (Powers) Act 1984*. The Minister for Water also sets the charges for the Water Boards under the *Water Boards Act 1904*. However, no legislation currently exists for the regulation of prices for private sector service providers, except as discussed below through the extension of enactments under the *Water Services Licensing Act 1995*.

A possible option for the regulation of new private service providers would be to treat them on a case-by-case basis, setting up contractual arrangements on how they would operate in terms of their pricing and levels of service. In these circumstances, there would be a need to determine how a contract of this type would interact with the licences currently issued by the ERA. Alternatively, the government could enter into private public partnerships (PPPs), again with some means of contractually establishing prices and charges. Such a model would resemble the South Australian model of tendering out its monopoly service to a single private sector provider.

However, even in the South Australian model a government authority is still required to oversee the behaviour of the private contracted service provider.

Under the previous OWR, an attempt was made (given the limitations of the then WSC Act 1995) to regulate private providers through a mixture of conditions in the licence, and through the extension of enactments under Schedule 2 of the *Water Services Coordination Act 1995* (now *Water Services Licensing Act 1995*). This section allows for Ministers ability to make by-laws under the *Water Agencies (Powers) Act 1984* to be extended to private providers. In effect, it allows the Minister for Water Resources to set the prices of private providers in the same way as is done with the Water Corporation, by creating specific Water Agencies (Charges) By-laws for each provider.

Using by-law powers to regulate prices for private providers is a convoluted means of regulating prices. In order to establish a regulatory and licensing system equivalent to that found in NSW or Victoria a new regulatory structure needs to be established that either extends the pricing powers of the ERA or establishes a partial regulatory system outside the ERA that is responsible for the regulation of non-government service providers.

The current work being undertaken by the Department of Water to develop a *Water Services Act*, brings together the various pieces of legislation currently regulating water service providers and will eliminate many of the problems highlighted above. However, the regulatory structure will still lack the level of independence that exists in a number of other jurisdictions, such as IPART (NSW) and the ESC (Victoria). Part of the ERA's considerations should include an analysis as to the degree to which current and proposed regulatory arrangements will facilitate competition with a large incumbent government owned monopoly.

Long term planning, in terms of the future provision of services

Outside an Operating Area

It has been suggested that there has been a lack of long term planning outside licensed operating areas as a result of existing service providers not being allocated these

services under the current licensing regime. It is unclear why a licensing system would cause this, particularly when current licenses are now non-exclusive. It would seem in the long term interest of any commercially oriented service provider to plan for future business.

In any event, there is nothing prohibiting government from contracting the Water Corporation to provide it with long term infrastructure planning for areas outside of the current extensive reach of its existing operating areas. Alternatively it could make long term planning, for defined areas outside of existing licensed operating areas a condition of licences for existing operating areas.

Within an Operating Area

Under the *Water Services Licensing Act 1995*, Water Services providers are licensed to operate within a defined area (operating area). Although these areas are no longer exclusively the domain of the service provider granted the licence, as mentioned previously the nature of the industry means that it is unlikely any wholesale competition will occur within the area. As such there is little risk in any investment in planning within an operating area being wasted as a result of the entry of a new service provider.

There is nothing about the current licensing regime that would lead to a lack of long term planning for existing licensed operating areas. The opposite is true, detailed asset management plans are a requirement of all licenses in Western Australia, and the process for undertaking this planning is audited every two years.

Summary of Issues

1. The aim of introducing more competition is to ensure the efficient behaviour of what is, for the most part, a natural monopoly service. For natural monopolies the competition will generally be 'for the market' not 'in the market'. Once established the natural monopolist will need regulation. The current Water Services Bill being developed by the Department of Water will see the Minister for Water Resources as the regulator for all water service providers (public and private) and as the Shareholder for the Water Corporation, the primary water monopoly in Western Australia. This presents some challenges to any competitive model instituted in Western Australia.
2. Currently there is no agency within Government specifically tasked with the role of facilitating entry into the water industry. The Department of Water would seem to be the logical choice as the agency that should be facilitating competition in the Water Industry.
3. State Government policy requires government owned service providers to charge for its services using uniform headworks charges, and to apply a uniform pricing policy for water (except in the case of major industrial consumers). This creates the possibility for 'cherry-picking' operations that are cheaper to provide, leading to the average charge across the services increasing. In the 'cherry-picking' scenario it is open for competitors to the government service providers to undercut them for the provision of services in areas which can be provided at less than average cost. That is, where the actual cost of provision is lower than the average prices required under uniform charging policy. The main beneficiary of this process will often be the developer who can increase their bottom line at the expense of the State (the Dalyellup example given by the ERA pp.12 is a case in point).

The problem of cherry-picking is not insoluble. It does however, raise questions as to the basis on which competition for greenfields sites should be undertaken in a uniform charging regime. In the case of country operations, which are essentially loss making, competition could occur on a cost basis. The lower cost provider would require a lower CSO from Government (again the relationship of Water Corporation finances to State finances makes this assessment more complicated than it superficially appears).

Despite the discussion above, it is important to realise that the cherry-picking argument does not apply to major industrial consumers which are charged at full economic cost. For example, the opportunity that existed to have a competitive process for water provision in the Burrup Peninsula.

4. There are a number of ways in which the water industry in WA could be re-structured to achieve a more competitive environment. These include separation by product type, or separation by region or both. The competitive advantages of doing this would need to be weighed against the benefits of having one provider providing all services.

The direct and indirect impact on State finances of allowing any significant entry of private sector suppliers into a re-structured market would need to be considered.