

29 January 2008

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

Dear Sir

Please find below Harvey Water's comments on the ERA draft report on Inquiry on Competition in the Water and Wastewater Services Sector.

In general, Harvey Water commends the ERA for another well considered contribution to the economy of WA except for the issues we highlight below.

In summary, Harvey Water believes that:

- There is a need to be more detailed and accurate about the supply and actual use of potable water.
- There is insufficient space devoted to the development of water products as compared to sources.
- The inquiry is limited by its focus on potable water supply to the IWSS.
- The NWI IGA should be regarded as one which sets the broad scope, not the final detail in its application to water management in WA.
- There are many good reasons why individual external trade is not a satisfactory option for the Harvey Water Irrigation Area including:
 - the probable collapse of the irrigation cooperative,
 - trade is only one aspect of water supply,
 - the concept of higher value use is not proven,
 - it represents sovereign risk for Directors,
 - considerable trade has already occurred and been proposed,
 - collective benefits outweigh individual benefits,
 - water administration costs will increase,
 - water quality and infrastructure limitations severely restrict the actual volume of water that could be traded
 - a true water market does not and most likely will not exist in WA except inside Harvey Water

Thank you for the opportunity to comment on the Inquiry. Please contact Harvey Water if you would like more information.

Yours sincerely

Geoff Calder
GENERAL MANAGER

INQUIRY ON COMPETITION IN THE WATER AND WASTE WATER SERVICES SECTOR

COMMENTS ON THE DRAFT REPORT BY HARVEY WATER

Introduction

Since the conversion of Harvey Water to local ownership in 1996 the world of water in Western Australia and nationally has undergone huge change. While water had always been recognised as an issue that required responsible management, which has been delivered by Water Corporation and others in WA, the effects of reduced rainfall and runoff, expanded demand for water, agricultural and industrial development and rapid population growth have all contributed to lifting the management requirements and public interest in water.

The Inquiry on Competition in the Water and Waste Water Services Sector is a timely effort given the WA government's heightened involvement in forward planning to consider all options to secure water resources for all needs. In principle, Harvey Water supports the debate being stimulated by this Inquiry as being helpful for the state's water planning and to inform broader discussions by stakeholders.

Since taking over the business in 1996, Harvey Water has made a point of being closely involved in water discussions at national, state and local levels so that it is well informed to participate in and respond to the ever evolving issues including many planning processes and meetings, changing legislation and consequent regulations and social expectations.

For the purpose of providing feed back to the Inquiry, Harvey Water's comments below are directed at matters in the Draft Report which relate to its operations, shareholders' interests and future prospects.

Security through Diversity

The Water Corporation's "Security through Diversity" strategy seems to have been well received since it appears to be the basis for much of the investigation of further options offered in the Inquiry. That is, seeking a wide range of options rather than just focussing on the one big and costly solution.

Lack of Attention to Water Products

Harvey Water feels the Inquiry would have been well served by taking a more detailed approach to what water services, or products, are actually supplied, and here we refer to the data in 2.1.1 The Structure of the Water and Wastewater Industry.

Figure 2.2 indicates that the potable water usage is 13% of the total water use in WA. In volumetric terms we understand this to be in the order of 350GL pa from all the licensed water suppliers Water Corporation, Aqwest, Busselton Water and others. While this is correct in terms of water delivery to mainly IWSS customers it conceals the very important fact that the volume of water actually used for potable purposes is only about 10% of the total supplied. This data comes from the domestic water use analysis carried out by the WA water agencies which, in their published reports, show that only about 10% of

water delivered to a household is actually used for drinking, cooking or other water use requiring that high standard of water quality. About 50% of the total is used externally on lawns and gardens. That is, most of the water treated at high cost to potable quality is not used at all for that purpose.

The volume of water actually needed for potable quality uses is therefore actually only about 1.3% of the total water use in WA or, as we understand it, in volumetric terms about 35 GL.

Harvey Water believes that this relatively small volume provides quite a different set of options for water delivery services to those proposed in the draft. We do not say that a high standard of water quality is not important for community health reasons, for example, it is just that the Inquiry does not investigate the supply of that relatively small percentage by other means. And this is a notable deficiency in our opinion.

This low volume, high cost truly potable water use represents a clear and discrete opportunity which consumers are already showing a distinct preference for, and ability to pay for, by forking out ridiculous amounts of money for bottled water at a retail level or through larger containers supplied to workplaces and homes. The relativities are that at the cost of 70 cents per kilolitre (or 0.07 cents per litre) from the tap, there is a thriving market for similar water at around \$4 to \$5 per litre in a retail bottle. If that is not an opportunity for competition, then we have never seen one and are actively investigating how Harvey Water might participate! The ERA draft report provides no guidelines for us on this, unfortunately.

Harvey Water thinks that the ERA has focussed too much on its economic analysis of different strategies for the future and has regrettably overlooked the actual current market situation for alternative supply of potable water. Bottled water is Coca Cola Amatil's most profitable line for example.

Anybody who has travelled overseas knows that it is a commonplace to obtain your potable water supplies at the shop and to avoid the tap supply in many countries. Although they may be seen to be backward in community health terms, they may actually be ahead in water supply services, at least in terms of the cost to consumers and their ability to choose, which is the basis of the market theories which underpin a lot of the ERA analysis.

This lack of inquiry into the range of possible water products which might be developed is something of an "elephant in the corner" which cannot be reasonably overlooked in an Inquiry of this kind and we would enjoy some attention being paid to it.

Limitations caused by the IWSS

The reality is that Water Corporation has an excellent IWSS, which other states, notably Queensland, are now rushing to emulate, but it does place severe limitations on the water services that Water Corporation (and Aqwest and Busselton Water) can provide.

None of the following comments are meant to imply any kind of criticism of Water Corporation since they are inheritors of the water distribution system

which was developed in kinder times in terms of water supply. Also their record in supplying water to the WA community stands proudly, when compared to other states, particularly in recent times.

It is just that, almost exclusively, the IWSS restricts them to supplying potable quality water to all customers, even when those customers don't actually need that quality of water and would be just as happy to receive water of lesser quality for their needs and presumably also pay less for it. And this applies pretty much to every one of Water Corporation's stated 600,000 domestic customers with a garden.

Despite the fact that the ERA has caught onto the mantra that "water ain't water" they have failed to put anywhere near enough emphasis on how this relatively small percentage of potable water might be obtained in other ways. In fact, almost all the analysis basically assumes that all water can be used for potable purposes, including the section on trade which we will return to later.

Urban Focus of the Inquiry

Following on from the comments above, Harvey Water takes issue with the focus of the Inquiry being almost exclusively devoted to ensuring water for urban users without placing how that supply may be obtained within the full context of the regional, social and economic environment in WA. This also includes the narrow and often inconsistent focus on economic theory being considered and applied in isolation of other factors which will undoubtedly influence the decision making and outcomes.

Regional WA, including the SW, is where almost all of the economic activity is happening and requires potable and fit-for-purpose water yet the almost exclusive focus of the draft report is on supplying potable water to the IWSS, which as we have demonstrated constitutes the merest poofteenth of the total water consumed in the state.

Water Trading

Harvey Water now turns its attention to Section 3.1.5 on Water Trading which we find unsatisfactory. An Appendix at the end of this submission details the errors in the section.

The National Water Initiative (NWI) Intergovernmental Agreement (IGA) includes provisions to encourage trade of water so that it moves more freely to where it may be better used. This includes allowing trade by individuals out of companies where the licence is held and managed centrally.

All states are expected to comply with the provisions of the IGA, albeit that it was principally designed to address serious water issues in the Murray Darling Basin (MDB). There are real questions about the extent to which MDB conditions apply to Western Australia and therefore the extent of compliance possible or necessary. It is expected that this will be a matter of negotiation between the governments.

A great deal has been learned in even the few years since the IGA was developed as we go along in the ever evolving world of water in Australia. We believe that the IGA should not be regarded as "holy writ" but should

encompass sufficient flexibility and intelligence to recognise that there are alternative solutions which are just as or even more successful, appropriate and acceptable as those proposed in the IGA for the MDB.

Harvey Water is one of the foremost exponents and proponents of trade in water in Australia. There has been trade between irrigators for 11 seasons and it is a simple and effective process by which water moves between users.

In early 2004 Harvey Water proposed to government the permanent trade of 39.1 GL (or 25.5% of total licence) of water with 17.1 GL coming from the Harvey and Waroona Irrigation Districts and 22 GL coming from the Collie River Irrigation District (CRID). To date, only the 17.1 GL (or 20% of the Waroona/Harvey licence) trade proposal has been accepted due to water quality issues with water from Wellington dam. However this opportunity remains on the table.

The 17.1 GL permanent trade proposal also included the additional temporary trade of 21.6 GL over 4 years which has also occurred.

These trades are the first and largest on a percentage of licence basis between regional and urban Australia.

It is also clear that commentary does not recognise the difference between a licensed entitlement and what may be in the dam at any one time. There is mention of opportunistic trades and discussion of Harvey Water potentially increasing the cost of potable water to all consumers throughout the IWSS. The latter is a remarkably long bow to draw.

The facts are that the second desalination plant will cost the equivalent of about \$20 million per Gigalitre to supply IWSS consumers. When the \$49 m funding promised by the federal government for the Harvey Pipe Project and water trade of 17.1 GL is provided, the net cost to the state will be about \$25 million or just under \$1.5 million per Gigalitre. The correct statement would be that Harvey Water has made water considerably cheaper for all consumers in the IWSS.

The fine detail of all trades from surface water sources is that it is only possible to take what is there at the time. If the dams supplying the IWSS are dry, it is a moral certainty that the dams in the south west will be dry as well. The opportunity to trade when the IWSS is short will virtually always correspond to the need for more water in the irrigation area as well.

Trade is not the only way.

The discussion in this section of the Inquiry starts with the statement that trade is to “balance supply and demand in the IWSS”. As noted above, Harvey Water disagrees strongly with this bias and notes the many other demands and uses for water in WA other than the IWSS.

For example, there are many industries in the SW which require fit-for-purpose water for industrial use at a lower price than potable water. There are many industries within the scope of IWSS supply which would be able to use less than potable quality water and pay less, if they could.

Trade of water is not the only way to satisfy those needs. In the way of any current ordinary water business their demand can be met by sale of water to them under current licences. It is the access to delivery infrastructure which allows water products to be provided, not just the existence of water entitlement.

The structure of the discussion in this section confirms the situation that Harvey Water has commented on time and again. Water Corporation is the major monopoly and there can be no competition, particularly when the explicit assumption is that water should be supplied to Water Corporation so that they can continue and entrench their monopoly. Such should not be the case and reflects a lack of understanding of the water industry and the movements and opportunities within it and even the subject of this Inquiry, which is competition. Or, at least as we see it, the provision of water services which are complementary to those supplied by Water Corporation through the agency of separate infrastructure.

What is really higher value use?

The discussion invokes higher value use to justify external trade. Harvey Water disagrees with the simplistic assumptions used in identifying supposed higher value use.

As we have demonstrated above, only about 10% of water in the WA IWSS can be identified as being truly used for potable (drinking, cooking etc) purposes which is unarguably the highest value use of water. The great majority of the rest is used for non-potable purposes or put another way, uses for which potable quality water is not required.

These non-potable uses include watering gardens and lawns with about 50% of the water. Harvey Water disputes that watering of urban lawns with potable quality water constitutes a higher value use of water than using non-potable water to produce food.

It is not necessary to look too hard to find independent support for this position as nearly every other capital city in Australia has watering restrictions which make watering lawns nigh on impossible. No such restrictions have been placed on fresh food production.

Also, take the situation with passenger aircraft. It is not the case that a person who flies first class on a plane is making higher value use of that plane than someone stuck back in cattle class. It is just that he can afford to, or chooses to pay more. It is discretionary expenditure from the capacity to pay more. And Harvey Water says that is the same case with urban use of water. Urbans can afford to pay more but however it may be jiggled and juggled to fit the concept, an urban lawn is not a higher value use of water than a citrus orchard, a vineyard or a field of melons or tomatoes if the value of food production to the community is properly taken into account in full social, regional development and economic context.

Trade and Risk Management

The comments on trade made in some of the submissions indicate a lack of understanding of how trade actually works to manage production risks for irrigators. An irrigator who has a lot of capital tied up in his perennial crop does not rely on temporary trade to manage risk. He buys enough permanent water to cover his needs in poor seasons and trades out the excess temporarily in good seasons. A dairy farmer manages his risk for pasture production by limiting his capital investment in permanent water and trades in temporary water to be able to finish off in a dry autumn.

It seems curious to Harvey Water that a study could identify that up to 150 GL could be available but in practical terms, particularly Health regulations on water quality, it probably wasn't. We don't understand the point of that discussion and conclusion.

Wellington Water

In the same vein as the focus on water for the IWSS, Harvey Water would like to point out on behalf of all water users and industries in the south west that there is major need for fit-for-purpose water in the south west to support the industrial growth which is happening there. There are very good reasons for water from Wellington dam to be preserved for local needs as well as the lesser potential for transfer to the IWSS.

Restraints on Trade

The comments titled "Restraints on trades within (sic) Harvey Water", when discussing the potential for individual external trade of water, reflect the narrow view and lack of understanding previously identified. There are no restraints to trade within Harvey Water except where topography does not permit water to physically flow between buyer and seller irrigator.

Restrictions by Harvey Water on individual external trade are soundly and sensibly based. There is a clear precedent where a thirsty neighbouring city managed to secure water from a few irrigators in an irrigation area leading to all the water eventually leaving such that the area is now a desert. This is the famous Owens Valley case in California. The movie "Chinatown" was based on this event.

Harvey Water can see the exact same thing happening with the HWIA because if the trade price of water internally is \$500 (or \$200 or \$30) per Megalitre and the external trade price from the only buyer in WA, which is urban, is an order of magnitude or more greater, then irrigators would be financially foolish not to participate.

This would rapidly lead to all or the greater part of the irrigation water leaving the HWIA, never to return. In this case, the recent investment of around \$100 million into a world class irrigation system is pointless and wasted and the food production capacity of the HWIA disappears. Current indicators are that the world is facing a crisis from food shortages and irrigation areas are the most efficient way to increase food production per unit of land area and per volume of water.

This is a matter beyond mere economic theory considered in isolation but one which has political, social and regional economic considerations which must

be taken into account. That is, do the state and national governments see the need for irrigated food producing areas or not? It is as well to remember that irrigated areas are only about 1% of the agricultural land area of Australia but produce about 35% of the food. Food security, food miles, food scarcity and similar modern considerations must impact on decisions made on irrigated agriculture, not just economic theory on markets.

Directors Responsibilities

It is a major consideration for Directors that they are required to act in the best interests of Harvey Water as a private company so that it remains solvent. If they were to accept the possibility of individual external trade, knowing and/or believing that this would send the company broke, their legal situation as company officers would be perilous.

Collective or Individual Benefits?

Harvey Water is bemused that much of the argument about trade centres on the benefits that might accrue to individuals. We beg to point out that Harvey Water is a cooperative and the joining of it is a voluntary act which an individual presumably does to share in the collective benefits that derive from membership that almost certainly would not be available if they were to run their business independently.

The benefits that have come from being part of the Harvey Water cooperative are beyond the imaginings of any member when the business commenced in 1996. Through the principle of joint – not individual – action and pooling of resources, the majority of members now have access to a world class gravity driven irrigation water delivery system at no extra cost to themselves in either cash or water and with water price remaining within CPI increases.

Rough calculations indicate that the individual benefit to the 415 irrigators who have a new gravity driven water supply from the piping is about \$175 000 each and that is just from the infrastructure. At \$5000 per Megalitre for external trade this means that every irrigator would have had to trade 35 ML for equal individual benefit, when many of them don't have anywhere near this volume of water. And if the trade was done in an open channel scenario this outcome would only provide them with cash, not the means to further improve their on-farm water use efficiency and to secure their financial future through greater competitive advantage. Trading water in the way envisaged under an open channel system would hasten the end of the irrigation scheme.

There are those who argue that the barrier to individual external trade prevents irrigators finding capital to fund on-farm improvements. It is only because there is a pipe system in place which has been obtained through collective action that the realistic opportunity for on-farm improvement exists. For example, there were no centre pivot irrigators before we piped, despite these being common technology for over 20 years, but now there are 10 with many more planned in just a few years. An irrigator cannot reasonably expect to have it both ways. The arguments about individual benefits do not stack up when compared to the benefits obtained by acting collectively.

Further, Harvey Water is now working cooperatively with the National Program for Water Security to implement a pilot project on supporting

irrigators to make on-farm improvements in water use efficiency. It is through the collective effort of the cooperative that a water delivery system to the farm has been possible and now makes on-farm improvements easier, cheaper and a lot more sensible.

A cooperative is a powerful and successful way of operating to, amongst other things, obtain some market power where traditionally farmers have none. Harvey Water has demonstrated beyond doubt the validity of the business model and does not believe that it needs to change its rules to permit the whole structure and the rights of the majority to be jeopardised by a few individuals or to satisfy a market theory which does not seem to recognise the validity of acting collectively. If individuals wish to achieve the benefits of the external trades, then Harvey Water notes they have the option of voluntarily cancelling their membership of the cooperative and to run their irrigation businesses another way.

It is also through collective action that Harvey Water has been able to negotiate the deal and implement the project which provided the water to the IWSS in exchange for funding the piped delivery system. It would not have been possible to aggregate the water and negotiate the deal without an organisation working for the interests of its members.

Harvey Water suggests that the continued push for individual external trade represents a failure of the IGA to recognise other valid and successful business models for managing water, such as a represented by the locally owned Australian irrigation companies that belong to the Bondi Group, including Harvey Water.

We recognise that the IGA was structured using the best ideas that were thought to be available at that time, however it is plain that its implementation requires flexibility to accommodate alternative and successful ways of doing things and we believe it is reasonable to expect this to occur.

Water Administration Costs

If individual Water Access Entitlements (WAE) are issued to our 771 individual irrigators as a result of Statutory Water Management Plans, then Department of Water will have to deal with the consequences of the eventual dissolution of the cooperative and the need to individually manage each of those WAE, whereas this is now done for it by Harvey Water reporting on its centrally managed licences. If anyone is seeking growth in government employees, then this is certainly one way to achieve it.

Anti-competitive behaviour

Harvey Water has the experience of dairy deregulation fresh in its memory and is astonished that the issue of “anti-competitive behaviour” can seriously be raised again so soon. The ACCC and its apologists may fudge and fiddle the facts as much as they like but if they still think that stripping of any market power from dairy farmers in favour of the oligopolistic processors and retailers represents competitive behaviour then they have avoided studiously examining the real outcomes. WA is now short of milk by about 50 million litres per annum, the price to the consumer rose and the return to the dairy

farmer fell immediately after deregulation, all contrary to what the ACCC predicted would happen.

And even if the ACCC, in their ineffable wisdom, assert that preventing individual external trade is still anti-competitive behaviour then our argument is that it is also pro-collective benefit behaviour and the value of the latter outweighs the former in our real world.

Harvey Water believes that the Draft Recommendations 3 and 4 should be subject to significant review and reconsideration because of the obvious weakness of their foundations.

Other Matters

Under Other Matters it is suggested that the “establishment of an effective trading regime is necessary” but without a shred of evidence as to how this would happen in practice. The reality is that with only one major monopoly buyer and very few prospective sellers, the chances for true markets (see page 77, para 5, for example) to develop, with many buyers and sellers with equal access to market information, is minimal.

The IGA and other proponents of trade need to come clean and recognise this reality. This does not mean that trade should not take place. In fact Harvey Water will be continuing to look for ways to make the best benefit out of its access to water which will include trade but just not within a highly unlikely true market.

APPENDIX: CORRECTIONS TO SECTION 3.1.5 Water Trading

1. The proper names are South West Irrigation Management Cooperative Ltd or Harvey Water , not Harvey Water Irrigation Cooperative
2. Water Corporation does not have sole entitlement to Stirling dam but shares the inflows with Harvey Water on a 60:40 basis with a further swap arrangement involving Wokalup Pipehead dam and Harvey dam.
3. The piping replaced the open channel delivery system, it did not pipe them.
4. The opportunity for trade from Logue Brook dam includes the 5.3 GL traded to Water Corporation under the 17.1 GL trade. Any further trades involving the balance of 5.7 GL owned by Harvey Water will more than likely be opportunistic and temporary at least over the medium term rather than permanent. Harvey Water will always retain a sizable portion of the water in Logue Brook dam since this provides the gravity head pressure to drive the delivery system in the wider area.