

1 February 2008

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

BACKGROUND

Horizon Power is a Government Owned vertically integrated energy enterprise providing energy solutions to residential, business and industrial customers living and operating throughout regional Western Australia. Horizon's service area is vast, covering all areas outside the South West Interconnected System (SWIS), and extending from Kununurra in the North to Esperance in the South.

The ERA, in its draft report titled *Inquiry into Competition in the Water and Wastewater Services Sector* ("ERA Report", 3 December 2007), commented on the option of merging the Water Corporation's operations in rural and regional areas along with Horizon Power's electricity operations into a single multi-utility focussed on essential service provision in regional WA.

The ERA Report notes that the model of a combined power and water utility has been pursued with some success in the Northern Territory and other countries. The report (p. 87) states that "...there may be potential significant cost savings from the creation of a multi-utility by transferring the [Water] Corporation's water and wastewater assets to Horizon Power in its area of operation", and concludes that further investigation of the concept is warranted.

Horizon Power and the Water Corporation have previously collaborated on a number of projects and have worked in tandem on the *Taskforce on Essential Services to Town-Based Remote Indigenous Communities* (November 2007). Horizon Power sees value in a common approach to essential service delivery to regional communities and intends to continue in this spirit of cooperation well into the future.

KEY DRIVERS

The key rationale for this study identified by both ACIL Tasman and the Economic Regulation Authority include:

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1. **Economies of Scope** - A utility with small, remote markets as its “core business” may be better placed to realise economies of scope (water, wastewater and electricity) by addressing similar problems and needs across many small communities.
2. **Market Focus** – A metropolitan focussed utility is likely to concentrate on areas of potential growth or where the bulk of the market is rather than less viable regional markets. This represents a driver for a regionally focussed multi utility.
3. **Customer Satisfaction** - Improvements in customer service might also be realised by:
 - providing a single point of contact for land developers and builders;
 - maintaining a larger pool of service personnel available to respond to faults and emergencies.
 - a larger internally trained workforce may also help provide a substitute for low quality outsourced labour services in some remote locations.

HORIZON POWER: SPOTLIGHT ON REGIONAL WESTERN AUSTRALIA

Horizon Power’s purpose is to create lasting value by ensuring that its business actions and activities have an equal focus on delivering sustainable environmental, social and economic benefits for the company, and the regional communities it services.

Following the disaggregation of Horizon Power from Western Power Corporation, Horizon Power has applied a different approach to service delivery in regional Western Australia than its predecessor. While Western Power Corporation had pursued a centralised model of operations, Horizon Power has improved efficiencies through its decentralised approach to service provision in regional Western Australia. This approach has been a key to its success and has resulted in increased stakeholder satisfaction.

Knowledge of local issues

Horizon Power’s experience has shown that regional communities are a heterogeneous group with varying issues, challenges and opportunities. As such, regional areas warrant a decentralised model allowing for localised decision-making by staff with a deep knowledge of each individual community’s needs. Thus, the

empowerment and delegation of management responsibility to regionally located staff enables a swift and appropriate response to changes and new challenges.

Empowerment of local staff

Through the delegation of management responsibility to regionally located staff, Horizon Power has been successful in factoring the specific needs of individual regions into the development of long term planning for the delivery of services while applying consistent corporate policies, systems and standards to ensure efficient service delivery.

Stakeholder satisfaction

Horizon Power has a diverse range of stakeholders which along with its regional customers include local, state and federal governments, development commissions, industry groups, indigenous groups and other local interest groups. To date, Horizon Power's decentralised approach to service provision has resulted in significant improvements to customer service and the measurable satisfaction levels of Horizon Power's customers and stakeholders. A recent independent market survey suggests strong community support for Horizon Power and its approach to business.

JOINT REVIEW OF A REGIONAL MULTI UTILITY

ACIL Tasman in its report titled *Size And Scope Economies In Water And Wastewater Services* ("ACIL Tasman Report", 24 October 2007) identified quantitative support for the concept of a regional multi-utility. Economies of scope leading to cost reductions in the order of 16 to 22 per cent were identified in one study. Besides from ongoing cost savings accrued from economies of scope, the initial cost of disaggregation could be offset by a post-merger restructuring that would follow an efficiency and productivity review. This process has led to compressible shared-services cost reductions in the magnitude of 10-20% in mergers of a similar nature.

Following publication of the ERA Report, Horizon Power and the Water Corporation engaged a consultant to conduct a joint high-level synergy evaluation of the proposal. The review evaluated the likely impacts of a merger under two models, the creation of standalone regional utility, and a regional utility supported by Water Corporation in specialist areas through service level agreements. The review did not assume any efficiency or productivity gains and was performed on an "as is" basis with no consideration of their future plans.

As there are significant requirements for expansion of essential service infrastructure in regional Western Australia, a coordinated approach has the potential to yield significant cost synergies. Analysis of this factor has yet to be completed. Similarly, it is important to note that under different operating scenarios or through changes to the service footprint, there is potential to improve the financials of any disaggregation and merger. These alternatives did not form part of the aforesaid review and ought to be included in any further analysis.

The following quantitative factors influence the outcome of the analysis and would affect any economic rationale for the creation of a regional multi-utility:

- The initial cost of disaggregation and merger
- Costs associated with diseconomies of scale relating to disaggregation of regional water services
- Benefits arising from an efficiency and productivity review
- Benefits arising over time from economies of scope, including the rationalisation of existing costs and the ongoing synergies from future civil works program

The review's preliminary findings indicate that the creation of regional multi-utility is likely to result in cost neutrality at best and a negative economic outcome at worst as the initial costs of disaggregation and the diseconomies of scale would outweigh any economies of scope. This assessment should be viewed in the context of the study's limited scope and further analysis that would incorporate savings from future works programs and organisational restructuring may yield a different result.

Nonetheless, Horizon Power adopts the view that any case for the creation of a regional multi-utility is unlikely to be based on short-term operational costs reductions. Horizon Power sees the primary motive for the creation of a regional multi utility to be qualitative benefits arising from a regional focus. These benefits are of interest to stakeholders and ought to be considered alongside any quantitative evaluation.

THE CASE FOR A REGIONAL MULTI UTILITY

Horizon Power is of the view that it is imperative to ensure that any recommendation made in regards to a regionally merged utility is measured in regards to its fulfilment of the aforesaid core strength that arise as a result of a regional market focus, namely:

1. Knowledge of local issues
2. Empowerment of local staff
3. Customer satisfaction

A Regional Multi Utility: Knowing local issues

Horizon Power's experience has shown that regional communities are a heterogeneous group with varying issues, challenges and opportunities. Application of Horizon Power's business model would capture the critical needs of local communities leading to better planning and decision-making.

The ACIL Tasman Report suggests that a regional market focus is a key driver that ought to be considered and states the following in this regard:

A key rationale for reconfiguring the provision of essential services in remote parts of Western Australia is that a utility management team is likely to be focused on areas of potential growth or where the bulk of the market is located. Issues associated with small markets that are distant from head office may be difficult to deal with, time consuming and expensive.

At the same time, it is crucial that remote areas receive adequate attention and resources. A utility with small, remote markets as its "core business" may be better placed to realise economies of scope by addressing similar problems and needs across many small communities.

(ACIL Tasman Report, p.43)

Additionally, a regional multi-utility could better coordinate infrastructure, planning and maintenance activities and ensure that wherever possible ongoing cost and operational efficiencies are achieved through common works. For example, when applied to underground infrastructure (i.e. common trenching) common electricity, water and wastewater planning would yield economic as well as environmental benefits.

A Regional Multi Utility: Empowering local staff

Based on Horizon Power's experience and market focused business model, the multi-utility would empower regional staff to service the specific needs of individual regions leading to improvements in long-term planning and development and customer service standards.

Additionally, a regional multi utility could present more meaningful and productive regional employment opportunities. Horizon Power currently employs several community-based Essential Service Officers (ESOs) who are responsible for asset monitoring, maintenance and community liaison. A regional multi-utility could require

and afford additional ESOs, providing an invaluable stimulus to the development of capacity and capability in remote communities.

The provision of employment opportunities coupled with the other qualitative benefits considered are consistent with broader government policies to increase the self-sufficiency of remote communities.

A Regional Multi Utility: Satisfying Stakeholders

The ultimate consideration in any evaluation of a regional multi-utility are the stakeholders that are common to Horizon Power, Water Corporation and government alike – namely the residents of regional WA. The cost of disaggregation ought to be measured against improvements in service levels offered to regional areas.

The ACIL Tasman report suggests that a regionally focussed multi-utility could see improvements in customer service realised by:

- providing a single point of contact for all enquiries (particularly vis-à-vis land developers and builders);
- maintaining a larger internally trained workforce and relying less on outsourced servicing;
- providing additional locally based staff who can respond in a timely manner to faults and emergencies;
- servicing smaller remote communities which would not be economically viable to service under a single utility model

It is suggested that a regional multi-utility would receive additional community support resulting from an improvement in services.

CONCLUSIONS

As noted above, Horizon Power is of the view that any case for the creation of a regional multi-utility is unlikely to be based on short-term operational costs reductions. Horizon Power sees the primary motives for the creation of a regional multi utility to be qualitative in nature and arising from a regional focus. These benefits are of interest to stakeholders and ought to be considered alongside any quantitative evaluation. Further, the socio-economic benefits associated with a regionally focused multi utility warrant further examination.

The existing Horizon Power business model has proved to deliver benefits to stakeholders and the community at large and as such a decentralised approach to delivering water services may be of merit. Horizon Power makes the following suggestions for the ERA's consideration:

1. Horizon Power and Water Corporation will continue developing an alliance (which predates the ERA Report) aimed at providing essential service delivery to regional remote communities.
2. Horizon Power and Water Corporation should undertake a comprehensive analysis of a merged regional utility. It is imperative that this be done in a collaborative approach between the ERA, Horizon Power, the Water Corporation and other relevant stakeholders. The analysis ought to examine quantitative and qualitative aspects associated with the proposal.

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