



11 March 2008

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Dear Lyndon

Thank you for providing the opportunity on 29 February 2008 for the Water Corporation to elaborate on our Response to the Economic Regulation Authority's Draft Report on Competition in the Water and Wastewater Services Sector. Mr Greg Watkinson has asked that we follow up with a written description of our position on some of the issues raised.

The Water Corporation has presented a robust model for private sector participation in our 1 February 2008 response to the Draft Report. The model was developed with extensive consultation with potential industry participants, and we consider that it will ensure a competitive outcome at the time that tenders are called for supplying a new source.

Our model was developed based on the independence of the Water Corporation's Board and an understanding of the Government's desire to be a participant in the decision making process. The Corporation has provided below a variant of this model that would achieve the Authority's objective of ensuring that decisions on new water sources are made independently from Government.

The Corporation's position on the Authority's proposed Independent Procurement Entity (IPE) model remains unchanged. Our view is that the proposed model is fundamentally flawed. The need for the Corporation to submit a proposal would discourage private sector participation and would, therefore, result in lower levels of competition than the Corporation's proposed model.

With the Authority's proposed model, the Corporation would need to develop a proposal and bid for the next source to ensure there is at least one viable bid. Preventing the Corporation's participation would introduce the risk that the process would not deliver a source and would also exclude the most knowledgeable participant. However, the Corporation's participation in bidding a source:

- creates a real conflict of interest, as any private sector bidder would need to negotiate many significant items in a water supply agreement with the Corporation;
- would discourage private sector participation due to the unavoidable information asymmetry between the Corporation and other bidders;
- would require the Corporation to commit to our bid partners much earlier in the process, effectively reducing the level of competition achieved as potential participants would be discouraged from participating beyond that point.

Additionally, the model would be unlikely to attract the ongoing participation of private sector proponents if the Corporation won the bid for the first source.

Other practical problems include the intermittent nature of the decision making (every five or more years for the Integrated Water Supply Scheme in normal times) leading to problems for the IPE in obtaining, developing and retaining skills and system knowledge.

The Corporation also views the model as counter-intuitive in that the proposed IPE has been given the same objective as the Corporation's Board, but would clearly be more constrained in its ability to deliver on that objective. As with the proposed IPE, our independent, commercially focused Board is interested in making sure that there are a number of viable options capable of being developed and that procurement will proceed on efficient terms. An IPE would, however, be naturally constrained in the system knowledge and skills available to it in making the same decisions. The only advantage of an IPE is in the area of perceptions, which can be addressed more efficiently through the proposal outlined below.

In reviewing the model proposed in our 1 February 2008 response, independence from Government can be effectively achieved by establishing an independent panel to undertake the proposed review functions. We suggested these would be undertaken by a panel reporting to the Treasurer through the Under-Treasurer. The Chair and members of this panel could be appointed on an independent basis with the authority to make the decision on the next water source. This decision would need to be consistent with transparent Government policy advice on supply security and other service objectives. The panel would convene as necessary.

The model is represented diagrammatically in the attachment. The role of the independent panel would be to:

- issue guidance as to the likely timing of a new source based on planning assumptions. This will provide project proponents with an indicative timetable to allow them to develop their projects and obtain approvals in readiness to place bids;
- independently exercise the trigger to acquire based on the prevailing conditions (e.g. dam levels, groundwater access, and demand projections) and the Government's security policy;
- determine the successful bid. The panel would be responsible for the assessment of the bids. This would involve input from the Corporation to ensure a successful water supply agreement can be negotiated as part of the bid process.

The role of the Corporation would be to run a planning and prequalification process that would ensure there will be at least two and up to four competitive bids to be assessed. This process provides the Corporation with the comfort that a source will be available when required. This avoids the need for the Corporation to develop our own bid and resolves the conflict inherent in the Authority's proposed process.

Additionally, our assessment is that the prequalification process will maximise the private sector's willingness to commit their best available skills to develop their bids. A more open process at that point of the process where significant resources are required in developing a bid will discourage participation as it would be difficult for companies to assess their chances of winning, and they would therefore tend to seek alternative, less risky opportunities.

Additional points to note include:

- The significant length of time required to plan, obtain approvals and develop a source. Most private sector participants have indicated their preference to prequalify and prepare a bid on a developed option rather than take an option from start to finish. This type of participation needs to be retained to maximise the competitive outcome. This allows significant scope for technical innovation on the option being developed.

- There is a strong tendency for environment and water regulators to pre-select the sources that are available to be bid through the application of their approval processes and this is unlikely to be undertaken on a purely economic basis (using the broader definition of this term).
- There is significant uncertainty that private sector proponents will fully understand the approval processes and be in a position to put forward viable projects when bidding is required.

The Corporation has examined many variations of private sector participation models, has talked to industry participants and has a significant amount of experience in developing competitive procurement models. The Corporation has an independent Board with an objective of ensuring new services are planned and procured in an efficient manner. Our proposed model incorporates our conclusions of how to achieve the best outcome from private sector participation, which includes efficient and secure delivery and the opportunity for innovation. The inclusion of an independent assessment panel is an opportunity to enhance this model if it is acceptable to Government.

Yours sincerely

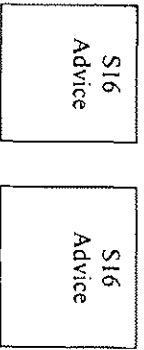


J. I. Gill
CHIEF EXECUTIVE OFFICER

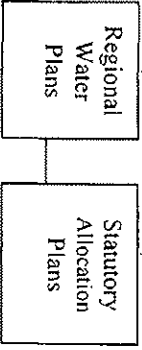
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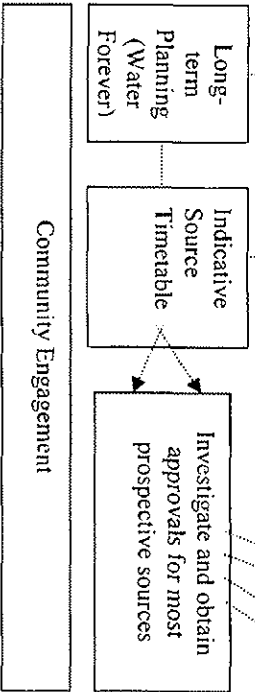
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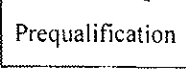
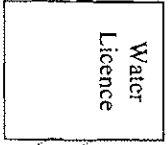
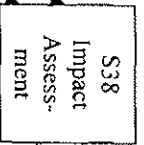
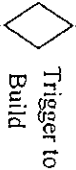
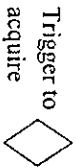
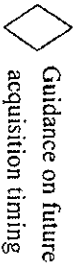
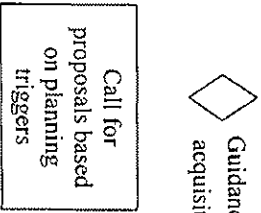
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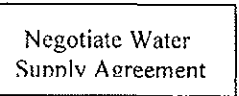
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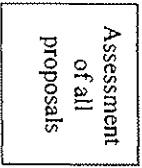
Independent Panel



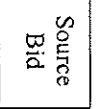
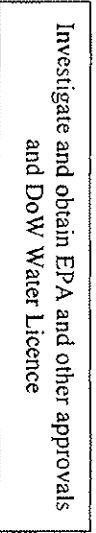
2 to 4 prequalified PS Bids



PS BUILD, OWN, OPERATE



PS



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