

**RIO
TINTO**

IRON ORE

**Submission to The
Economic Regulation Authority**

**Inquiry on Competition in the Water and Wastewater
Services Sector**

September 2007

1. Rio Tinto Iron Ore and water

Rio Tinto Iron Ore (RTIO) is one of the world's largest producers of iron ore and is formally recognised as a leading Australian exporter. In 2006 RTIO shipped 150 Mt of iron ore, generating almost US\$5.8 billion in export revenue, 64% of which was spent in Western Australia¹. Since 2003 RTIO has reinvested nearly \$5 billion in the Pilbara, and recently announced early plans to expand its Pilbara operations beyond 320 Mtpa by 2012-14.

In this period of unprecedented demand for iron ore and massive growth RTIO is acutely aware of the need to carefully balance economic, social and environmental considerations to ensure our ongoing success. Our aim is to deliver more value from our business with less impact on the environment and the community. This commitment to sustainable development is formalised within a corporate governance framework that is underpinned by RTIO's statement of business practice, *The Way We Work*.

RTIO's creation of the position of General Manager Water Resources supported by three dedicated water managers is clear recognition of the importance of water resource management as a key part of our commitment to sustainable development both in WA and across our global operations. In WA, RTIO sources approximately 90% of its water needs through self-supply. Future access to ore bodies depends on our good performance and reputation in managing water responsibly and sustainably now and into the future. A key element of RTIO's Water Strategy is to engage in the broader policy debate and the development of policy in the State at a strategic level.

In addition, RTIO (through Hamersley Iron Pty Ltd) is a licensed Water Service provider, providing potable water and wastewater services to Dampier, Tom Price and Paraburdoo.

RTIO supports proposals to remove restrictions on private sector entry into the water and wastewater sectors. Several opportunities for competition in the water industry enabling entry of new players, including private sector providers, have been summarised in the Economic Regulation Authority (ERA) Issues Paper.

RTIO welcomes the opportunity to provide comments on the *Issues Paper: Inquiry on Competition in the Water and Wastewater Services Sector* and submits the following comments for consideration to the ERA.

2. Competition and opportunities for private sector involvement in provision of water services

This submission addresses the following key themes regarding opportunities for private sector involvement in provision of water services, as identified by the Issues Paper:

- The importance of competitive outcomes rather than competition for its own sake;
- Centralised procurement model;
- Competition for the right to provide services to Greenfield sites; and
- Equal access to Community Service Obligation (CSO) payments for the private sector.

¹ Rio Tinto Iron Ore "Pilbara Operations Sustainable Development Report" 2006

2.1 *The importance of competitive outcomes rather than competition for its own sake.*

RTIO supports the achievement of competitive outcomes rather than competition for its own sake. RTIO notes that the Terms of Reference for the Review and the Issues Paper have a particular focus on competitive enhancements through structural changes. However, Chapter 2 of the Issues Paper indicates that competition is not an end in itself. RTIO considers that in an industry that displays some significant natural monopoly elements, competition *per se* may not necessarily realise the most efficient and beneficial outcomes for the state.

For example, the majority of capital costs in water service provision are to be found in the transmission and distribution networks. It may therefore, not be viable to have two or more pipe networks servicing a given geographic region. For this reason, once a service provider is established in an area, it will become a monopoly provider and the ongoing efficiency of service provision once it is established cannot be guaranteed.

The continued efficient operation of that service provider may therefore rely on the existence of an appropriate regulatory system that ensures clarity and transparency in the cost structures of providers. In these circumstances, it is the role of regulators, such as the ERA, to ensure that the provider does not exploit its monopoly position and that prices charged for service provision are cost reflective and encourage efficient outcomes.

There are ways to encourage efficient outcomes by regulatory means - such as the price regulation model used by the Independent Pricing and Regulatory Tribunal in NSW. In other Australian jurisdictions and internationally (eg. the Office of Water (OFWAT) in the UK) the regulation of prices and the monitoring of the financial viability of service providers is often undertaken by independent price regulators. It is therefore important that the ERA gives detailed consideration to appropriate regulatory mechanisms to ensure efficient pricing, and the appropriate standards for service provision and not just the question of competition in isolation.

2.2 *Centralised procurement model*

RTIO considers that a centralised procurement model, in which retail and distribution businesses are separated from the provision of bulk water, offers scope for competitive outcomes in the supply of bulk water. However, for competition to work within this model it is important to ensure that institutional arrangements oversee clear, timely and transparent processes and enable all competitors to have equal access to planning information.

The centralised procurement model would:

- Fit within the Western Australian context, as the state's water supply needs are drawn from a multiple of sources, principally groundwater, rather than a reliance on a few large sources (eg. large capacity dams); and
- Facilitate the competitive provision of additional bulk water to existing transmission and distribution systems and could also facilitate competitive opportunities in regions such as the Pilbara.

It is important that an agency (independent of any licensed water service providers) be given responsibility for the consideration of new supply options, and that processes are transparent and fully integrated with state planning processes to ensure that opportunities for introducing competitive processes for supply of water services are identified at the earliest possible point in the planning process.² This institutional arrangement would:

- Ensure the earliest possible lead times for potential private sector providers to identify opportunities;
- Test economics of the project; and
- Receive necessary approvals for market entry.

There is also a need to ensure that all competitors have equal access to planning information and that the development of planning serves the interests of the state as a whole. For example, for a number of years following the establishment of the Water Corporation, the Corporation enjoyed a place on the Western Australian Planning Commission's Infrastructure Coordinating Committee (ICC). It is noted that the Department of Water now sit on the ICC. However, the Water Corporation has not yet been asked to relinquish its place on the ICC and would therefore have access to planning information that could give it a competitive advantage over any private sector provider wishing to enter the market, or indeed the Water Boards

Similarly, it is evident that the Water Corporation inherited the Water Authority's source development planning functions following the corporatisation, which again has provided them with early access to planning information. It is important that the ERA inquiry consider the best location of planning functions to ensure that, in bidding for new opportunities in the water service provision, all participants (private and public) are treated equally with regard to access to the necessary planning information.

2.3 Competition for the right to provide services to Greenfield sites

Greenfield sites, by definition, have 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.

A number of attempts have been made in the years following the corporatisation of the Water Corporation to run competitive processes for a number of small Greenfield site development, including the Preston Industrial Estate and the Dallyelup Estate residential development, both in the greater Bunbury region. However, the regulator responsible for initiating the processes at the time (the Office of Water Regulation) acknowledged that there were some limitations on achieving the desired outcomes, including:

- The size of these developments was generally too small to attract bids from large water companies from interstate and overseas;
- Lack of competitive neutrality between the licensed Western Australian based service providers (the Water Corporation and the Busselton and Bunbury

² The same institution could also be required to consider demand-side management solutions to demand for additional water services and be required to transparently weigh the costs and benefits of these solutions against supply-side solutions.

- Water Boards), limited the ability of the Water Boards to compete on a level playing field (being significantly limited under the *Water Boards Act 1904*)³;
- A need to develop appropriate, clear and streamlined rules for the competitive process, and for the process to be run by an independent body.
 - The need for early and equal access to source planning information for all bidders.

Whilst competition for Greenfield sites may be a good opportunity for encouraging competition amongst providers and offering an opportunity for market entry for private sector providers, there is a need to define a clear process for competition for the right to provide to Greenfield sites. Some key issues need clarification and that could be addressed in the ERA's final report are as follows:

- Is approval for an Operating Licence required before a non-licensed private sector provider can enter into the competitive process?
- Exactly how will application for CSO payments be integrated with this process?
- Which Government agency is best placed to identify opportunities for Greenfield site developments, oversee adherence to competitive processes, and analyse applications? It may be that an agency independent of existing or potential service providers and of other stakeholders such as developers would be best placed to undertake this role.
- There is a need to ensure that processes are clear, transparent, timely and streamlined, and that source planning information is made available early to ensure bidders have equal access to this information.
- Acknowledging the scale limitations to competitive processes for the right to provide services to Greenfield sites, where bidding processes for small scale Greenfield sites can be costly to proponents, developers and government and time consuming, delaying the timely progress of the supply of water services for these developments.

2.4 *Equal access to Community Service Obligation payments for the private sector*

RTIO considers that a way of encouraging private sector participation in the provision of water services (particularly in regional areas) is ensuring that CSO payments are available to the private sector.

CSOs are a requirement to provide a service at a reduced rate or less than the cost of provision. Historically, services that have attracted a CSO payment have been provided by the Water Corporation.

The provision of services in regional areas is generally at a greater cost than provision of the similar services to the Perth metropolitan area. The continued application of the uniform pricing policy will most often mean that the provision of services to regional areas will be at a loss. The availability of CSO payments to the private sector will therefore be essential to ensuring the private sector can participate in the Western Australian market on an equal footing with the incumbent providers.

³ This situation was identified by the National Competition Policy legislation reviews of water industry legislation and the competitive neutrality reviews of the Water Boards. The recommendations of these reviews were partially addressed in the *Water Legislation Amendment (Competition Policy) Act 2005* and will be fully implemented with the proposed Water Corporation (Amendment) Bill, planned for introduction to Parliament in late 2007.

In terms of encouraging competitive outcomes, it is feasible that competition for the right to provide a loss making service (that would attract a CSO payment) could potentially enable the provision of this service at the least cost to Government, as well as achieve some dynamic efficiencies.

Provisions enabling CSO payments to be made available to the private sector are to be included in the proposed Water Services Bill, currently being drafted. RTIO understands that it is proposed that the availability of CSO payments to the provision of a particular service will be able to be specified within an Operating Licence.

RTIO welcomes the proposed legislative changes that would make CSO payments available to the private sector. However, there remains a need to define a clear process for accessing CSO payments. Some key issues that need clarification and that could be addressed in the ERA's final report are as follows:

- Is approval for an Operating Licence required before approval of a CSO payment can be granted, or *vice versa*?
- Exactly how will CSO payments be calculated?
- It is important that the process for and availability of CSO payments be the same for the private sector as for incumbent providers to ensure competitive neutrality.
- Which Government agency is best placed to oversee competitive processes, analyse applications and calculate the applicable CSO payments? It would seem that the ERA's role in the gas and electricity sectors would be consistent with it assuming this role for the water industry. Powers such as the power to require information that would be necessary to properly undertake these responsibilities already exist under the *Economic Regulation Authority Act 2003*.
- Acknowledging the need to ensure that processes are both timely and streamlined, what is the most appropriate head of authority for approving the applications for CSOs?

3. Water Trading

RTIO supports a planning framework that enables flexibility in the application of the rules for allocation of water to suit the local context.

The trading of perpetual Water Access Entitlements (WAEs), as envisaged under the National Water Initiative, which were principally developed with the Murray-Darling Basin in mind, may have application in areas where the water allocated for consumptive purposes is nearing full allocation, such as in the South West region of Western Australia.

The limited life of mines plus the need to ensure access to fixed volumes of water will mean that the application of WAEs to areas such as the Pilbara, in which the mining industry is the predominant supplier and user of water, may be limited.

RTIO considers that the statutory management plans envisaged by the Government will provide this flexibility, provided there is a capacity for the continuation of fixed term/fixed volume licences (such as those provided for under the *Rights in Water and Irrigation Act 1914*) to co-exist with WAEs in areas where a consumptive pool has been defined (generally where the resource is fully allocated or close to fully

allocated). RTIO understands that the proposed *Water Resources Management Act* will provide for such flexibility.

The opportunities for water trading in Western Australia are likely to be less extensive than in areas such as the Murray-Darling Basin, where the consumptive pool is both large and fully allocated and a large range of uses co-exist within its catchment. The sourcing of water from non-integrated water systems, many of which are remotely located and the majority of which are not close to full allocation will limit the size of the water market, and therefore the opportunities to engage in water trading.

The current provisions of the *Rights in Water and Irrigation Act*, which enables the trading of s5c licenses as well as temporary trades, is considered a reasonable approach to facilitating water trading under these circumstances, and should be continued under the new legislative arrangements, alongside provisions for the trading of Water Access Entitlements.

4. Coordinating and sequencing reforms in the water sector

The State Government's water reform agenda has been progressing at a rapid pace, particularly over the last year. Despite the amount and pace of reform, RTIO acknowledges the need for a water resource management framework that is fit for the 21st century and supports the general directions proposed in the Government's water reform agenda.

RTIO supports the planned changes to water services and water resources legislation, which the Government has indicated that it intends to introduce to Parliament by the end of 2007. The legislation reform is being developed based on significant and substantial policy changes that have taken place in water resources management over a number of years and which ties in closely to the national water reform agenda.

RTIO intends to participate in the consultative processes that have been established to enhance the process of drafting the legislation. RTIO will be contributing into this process via its membership of the Chamber of Minerals and Energy and the Chamber of Commerce and Industry.

Given the extent of proposed change in the industry, it is important to ensure consistency in changes to policy and legislation to maintain clarity and confidence amongst stakeholders in the water sector. It is critical that the development of the ERA Draft Report fully acknowledges the changes proposed in the legislation reform, the process for reform and the timelines involved, and recognises the need to build on the foundations put in place by the new legislation.

Any proposals for structural or regulatory change to the industry should seek to appropriately sequence with the introduction of the legislation in a way that is least disruptive to this process and should also ensure that they take full account of the planned legislative changes so that there is a considered and appropriate articulation with the planned legislation.⁴

⁴ For example, the Report will need to recognise the planned amendments to the *Water Corporation Act 1995*, which will be amended to include AQWEST and the Busselton Water Board, and thereby enable their provision of other services such as wastewater, in addition to the provision of potable water, as well as provision of services outside of their historical boundaries (restrictions that were previously prescribed in the *Water Boards Act 1904*).

5. Summary

RTIO supports proposals to remove restrictions on private sector entry into the water and wastewater sectors. More specifically, RTIO considers:

- The achievement of competitive outcomes is more important than competition for its own sake;
- A centralised procurement model, in which retail and distribution businesses are separated from the provision of bulk water, offers scope for competitive outcomes in the supply of bulk water. However, for competition to work within this model it is important to ensure that institutional arrangements oversee clear, timely and transparent processes and enable all competitors to have equal access to planning information;
- There is a need to define a clear process for competition for the right to provide to Greenfield sites and some key issues considering institutional responsibilities for this process need clarification;
- An important way of encouraging private sector participation in the provision of water services (particularly in regional areas) is by ensuring that CSO payments are available to the private sector;
- The current provisions of the *Rights in Water and Irrigation Act*, which enables the trading of s5c licenses, as well as temporary trades a reasonable approach to facilitating water trading, should continue under the new legislative arrangements; and
- Proposals for structural or regulatory change to the industry should seek to appropriately sequence with the introduction of the legislation in a way that is least disruptive to this process and should also ensure that they take full account of the planned legislative changes so that there is a considered and appropriate articulation with the planned legislation.