RESPONSE TO THE ECONOMIC REGULATION AUTHORITY'S DRAFT REPORT ON COMPETITION IN THE WATER AND WASTEWATER SERVICES SECTOR

1 February 2008

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1 Executive Summary

The Water Corporation ("the Corporation") is pleased to submit this response to the Economic Regulation Authority's ("the Authority") *Draft Report: Inquiry into Competition in the Water and Wastewater Services Sector (3 December 2007)*.

The Corporation supports most of the key findings and recommendations in the Authority's Draft Report, including:

- The finding that there are synergies between the Corporation's bulk water operations and distribution functions which indicate it may not be appropriate at this time to separate the functions;
- The draft recommendation that to facilitate an effective water trading regime, all significant users within a catchment should be taken into account when developing Statutory Water Management Plans and water allocations;
- The draft recommendation that finalisation of the Statutory Water Management Plan and Gnangara Mound Sustainability Strategy is critical. However, without finalisation of the plans, the yield benefit that could be developed via a water trading market remains uncertain;
- The draft recommendations and findings in relation to a State-based third party access regime;
- The finding that there are likely to be minimal gains from any disaggregation of the Corporation's Perth operations;
- The draft recommendation and finding that retail contestability is premature for small customers at this time;
- The draft recommendation and finding that retail contestability should be introduced for large customers; and
- The draft recommendation and finding that the Department of Treasury and Finance should develop a policy to explicitly allow for the payment of Community Service Obligations (CSOs) to non-government entities.

Bearing in mind the considerable agreement with the Draft Report, the Corporation's response will focus on the three issues where it either disagrees with the Authority or wishes to amplify and refine discussion. These are in relation to:

- The Authority's invitation for the Corporation to formulate a package of options that could allow for the deferral of the Southern Seawater Desalination Plant (SSDP), while not compromising security;[1]
- The draft recommendation that an Independent Procurement Entity (IPE) should be established with responsibility for ensuring least expected cost of balancing supply and demand subject to the constraint of maintaining security of supply at a level set by government;[2] and

[1] Economic Regulation Authority, *Draft Report: Inquiry on Competition in the Water and Wastewater Services Sector (3 December 2007)*, p. 27
[2] Ibid, p. 47

- The finding that there may be potential significant cost savings from the creation of a multi-utility by transferring the Corporation's water and wastewater assets to Horizon Power in its area of operation.[3]

1.1 Water Sourcing and the Risk of Deferring the Southern Seawater Desalination Plant

The Draft Report suggests that the Corporation's planning processes for sourcing water are biased toward the early provision of overly large sources. Based on their high level 'options' analysis of 'small' sources, the Authority has invited the Corporation to formulate a package of options that could allow for the deferral of the SSDP, while not compromising security.

The Draft Report implies that if the SSDP is constructed and dam inflows recover from their current low levels, then the Corporation could be left with a large, underutilised asset. Therefore, the Authority's analysis favours the development of small sources to 'buy insurance against excessive or inappropriate investment'. The Draft Report argues that developing a number of small sources could reduce long term expected costs, particularly if the Corporation's rationale for constructing the SSDP is based on a 'worst case' climate scenario.

The Corporation's response is that planning takes into account alternative climate scenarios, but is far from 'worst case' planning. The trend over the last 30 years has been for a continuous reduction in dam inflows. A realistic 'worst case' would see these trends continue and for further reductions to be experienced in the short to medium term. The Corporation's planning therefore incorporates consideration of both higher and lower rainfall scenarios. The results are then presented in terms of a single climate scenario to simplify general communication.

The Corporation agrees that the form of economic analysis that the Authority advocates (termed an 'options' approach) can add value to the evaluation of water source options when there is flexibility in the choice of option. The Corporation's planning processes are consistent with an options approach and consider an extensive range of water sources, both large and small, and their timing, as demonstrated through its 'Security Through Diversity' approach to water source planning and willingness to embrace alternative proposals such as the Harvey Water Trade, the Kwinana Wastewater Reuse Plant and demand management initiatives.

In addition to an analysis of expected cost, other key factors that must be considered include environmental impacts, certainty that the option can be developed within the timeframe and the water supply reliability from each source. It is the Corporation's assessment that the SSDP is the only viable

[3] Ibid, p. 87

option that can provide a sufficient volume of water with sufficient certainty to meet water supply planning objectives within the required timeframe.

Key objectives of current water supply planning include:

- water supplies and current storage levels must be sufficient to constrain the chance of total sprinkler bans to acceptably low levels. Total sprinkler bans would not only cause the loss of established lawns and gardens, but would also have severe economic consequences for the $500 million+ per year turf and garden industries including the loss of potentially thousands of jobs. By working together with the community and the Western Australian Government, the Corporation has avoided the need for total sprinkler bans, even with the current record low dam inflows;

- a second critical driver of current water source planning is the need to reduce abstraction from the Gnangara Mound groundwater system. The recent reduction in dam inflows has necessitated a total abstraction well above target levels for more than seven years. The Corporation is therefore working closely with the Department of Water to reduce long term abstraction to a sustainable level.

The 'small source options' advocated by the Authority to meet these objectives are currently being pursued by the Corporation, but the combined volumes from those sources that are known with a high level of certainty are insufficient to meet the supply reliability and groundwater abstraction targets. In addition, the Integrated Water Supply Scheme (IWSS) is experiencing significant growth in demand and by 2011 is estimated to require an additional 20 GL per year of supply capacity.

The Draft Report suggests that the 'small source options' would need to provide only a relatively small volume of additional water to delay the SSDP. However, the Corporation's water balance modelling demonstrates that under both the Authority's "post-1997" and "post-2000" climate scenarios, future demand for water could only be met with prolonged dependence on groundwater abstraction above the estimated sustainable average abstraction target of 120 GL per annum.

Ideally, the SSDP would have been constructed sooner than 2011. The Corporation had previously planned to commission the South West Yarragadee source by 2009. However, the Government's decision to build a second desalination plant as an alternative delayed the delivery timeframe by two years. Early planning at various sites for a desalination project by the Corporation had been at an advanced stage as an alternative to the South West Yarragadee option.

Procurement of large water sources such as desalination plants has a timeframe of around five years. Therefore, the Corporation has already been required to commence the procurement process for the SSDP. The Corporation will

continue to develop small source solutions but can not delay the procurement process if the SSDP is to be delivered in the required timeframe. The 'small source option' suggested by the Authority is not realistic.

Therefore, due to the insufficient volumes and lack of certainty surrounding alternative options, the Corporation is committed to continuing with the procurement of the SSDP, with completion scheduled for 2011.

1.2 Planning and Procurement for New Water Sources

The Draft Report recommends that an IPE should be established with responsibility for ensuring least expected cost of balancing supply and demand subject to the constraint of maintaining security of supply at a level set by government.

While there is currently an extensive review mechanism of major new sources that is independent of the Corporation, the Corporation agrees that for transparency there would be merit in increasing the independence and strength of this review, particularly in demonstrating that procurement processes (including those conducted by the Corporation) are impartial to all interested participants, and that economic evaluation is properly balanced.

However, in relation to establishing a new IPE, the Government already has an independent procurement entity, in the form of the Corporation. The Corporation was set up to be independent, and has an apolitical and commercially expert Board of Directors and a competent management team. If it is considered that further independence is required, then the Corporation is prepared to work with the Government to reinforce that independence.

The legislation under which the Corporation operates clearly establishes the Corporation as an entity that is independent from the Crown that must:

(a) act in accordance with prudent commercial principles; and

(b) endeavour to make a profit, consistently with maximizing its long term value.[4]

The key means available to the Water Corporation to maximise long term value is by minimising long term expected cost, subject to providing an acceptable level of service.

To date, top-level oversight has been exercised by the Water Resources Cabinet Sub-Committee, chaired by the Treasurer and comprising relevant Ministers including the Corporation's Minister. The Cabinet sub-committee has been supported by a task force led by a senior officer in the Department of Premier and Cabinet, with representation from the Corporation, the Department of Treasury and Finance, the Department of Water, and other agencies as

[4] Water Corporation Act 995, Section 30

required. The Task Force and the Ministerial Committee have obtained independent expert advice where required. This mechanism has been successful in providing for timely decisions to be reached, with independence from the Water Corporation and with the necessary consensus of ministers and agencies.

Additional independence could most effectively be achieved by building upon current arrangements, especially given the history of productive involvement of the Department of Treasury and Finance. Ultimate responsibility for independent review of the procurement process could rest with the Treasurer, who would be assisted in the process by the Under-Treasurer. The Under-Treasurer or his/her nominee could chair a panel comprising representatives of Treasury, the Authority, commercial expertise enlisted from the investment banking and/or major accounting companies, and practical water industry expertise from a consultant experienced in the area. It would seek advice from regulators, the Department of Water and utilities but would not include representation from them. The emphasis would thus be on clearly assessing the commercial impartiality of the process and ensuring that a balanced economic assessment would occur. The panel would be particularly active at times when decisions are required on major new sources and would play an important role when major planning processes are under way. It would have the ability to enlist staff by secondment, and to appoint independent specialist advisors. It would report, via the Under-Treasurer, to the Treasurer and thence to the Ministerial Committee and to Cabinet.

An advantage of the model proposed by the Corporation is that it overcomes the intractable problem of building and maintaining suitable skills in an IPE. In normal circumstances, when the State has not just experienced a massive reduction in yield from its primary sources, large new water sources are only required every five years or so. It would be impossible to recruit and develop skilled and experienced people in a small organisation with such a sporadic work-load. The Corporation, by contrast, is able to offer intensely varied and interesting professional growth paths. Thus a review mechanism that enlists expertise as and when required is likely to provide higher levels of expertise at lower cost in the long run.

In its response to the Authority's Issues Paper, the Corporation also proposed a competitive procurement model for the IWSS that would open up the development and delivery of new water sources to further competition. In this model, the Corporation would withdraw itself as a competitor for the delivery of new water sources, thereby allowing the private sector to bid for the development of a range of alternative water supply solutions. The Corporation would seek regulatory approvals for the most viable preliminary planning option to actively encourage private sector interest. This preliminary planning would also protect the reliability of the system by identifying a source that could be pursued if no other viable options were submitted. In the assessment stage, the Corporation would impartially assess all proposals, including those that had sought regulatory approvals in their own right. As the Corporation would not itself be a competitor in this process, there would be no inherent

conflict of interest and the proposed planning and tendering process would allow all potential sources to be equally assessed.

By comparison, in the Authority's proposal, bids for the provision of new water sources would be invited from both the private sector and the Corporation. The IPE would then assess the proposals and negotiate the contractual terms and conditions that, once exercised, would be transferred to the Corporation. However, the Corporation as the operator of the system is the only entity with the system knowledge required to assess these detailed and complex arrangements. An IPE would not possess the system knowledge to assess the way in which new sources would integrate with existing assets, including issues such as water quality, operating regimes and asset management and maintenance, nor to negotiate detailed terms and conditions. It would not be plausible for the IPE to independently develop a sufficient understanding of the system to cover all possible water supply arrangements. In addition, the Corporation has a legitimate commercial interest in negotiating the terms and conditions of these contracts, under which it would ultimately be required to operate. Therefore, it is more appropriate for the Corporation to take on the role of assessing new proposals rather than acting as a competitor that would enter a proposal of its own.

Under the Corporation's proposed model, responsibility for the delivery of reliable water supplies remains unambiguously with the Corporation. The Corporation believes that it is imperative for the Government to be absolutely clear about who is ultimately responsible for ensuring that water comes out of the customer's tap.

1.3 Creation of a Multi-Utility

The Draft Report suggests that there may be potential significant costs savings from the creation of a multi-utility by transferring the Corporation's water and wastewater assets to Horizon Power in its area of operation.

The Corporation and Horizon Power, with the support of GEM Consulting, undertook an analysis of the Authority's finding. The analysis concluded a significant net additional cost would result from such a disaggregation of the Corporation and merger with Horizon Power. This negative result was largely driven by the duplication of resources required as a result of splitting the Corporation in to two separate businesses.

For comparison and completeness the Corporation independently analysed the merging of Horizon Power into the Corporation. The Corporation has concluded that in terms of the restructuring options, a merger of the Corporation and Horizon would be significantly more cost effective than forming a regional multi-utility because it would avoid any resource duplication referred to earlier.

The Corporation believes that while the analysis shows the potential for a minor net benefit by merging Horizon Power into the Corporation, factoring in the inherent financial and business risks indicates that it would more likely result in a negative outcome.

The Corporation intends to continue to explore and develop collaborative opportunities with Horizon Power. It is the Corporation's view that developing an alliance between the Corporation and Horizon Power provides an opportunity to realise many of the benefits of a merger without exposing the organisations and their customers to the significant risks associated with a structural change.

The Corporation has established an open and constructive relationship with Horizon Power and both organisations intend to build this relationship further.

1.4 Support for Private Sector Involvement in the Water Industry

The Draft Report focuses on private sector involvement in water source development for the IWSS. The Corporation supports the increased involvement of the private sector and will be seeking to develop a competitive alliance for the development of the SSDP. The Corporation has also proposed increasing private sector involvement in future water source development for the IWSS through a competitive procurement process. The Corporation is also examining methods to involve the private sector in the development of new water sources for significant areas such as the Pilbara.

The Corporation's total estimated capital expenditure over the next five years is around $5.4 billion. Of this, expenditure on the SSDP accounts for only $640 million. The remainder of the program represents a substantial opportunity to increase private sector involvement in a range of other water industry sectors including wastewater treatment (which accounts for 17% of projected capital expenditure), water recycling and stormwater treatment. For example, the East Rockingham Wastewater Treatment Plant represents an ideal opportunity for the private sector to be involved from the very early stages in the development and delivery of a major asset. The Corporation notes that the Draft Report is largely silent on these additional business areas but believes there is significant potential to increase private sector involvement. The Corporation will continue to work closely with the private sector to develop ways to further harness private innovation and competitive efficiencies across all business lines.

1.5 Early Government Decision

The Corporation has welcomed this review and is pleased to provide a response to it. Importantly, due to the wide ranging nature of the review, a delay in making decisions would have an adverse effect on the morale of staff and the effectiveness of the Corporation. The Corporation therefore recommends that the Authority signals to Government, in its final report, the desirability of making timely decisions on the recommendations of the report, and the disadvantages of undue delay.

2 Background

On 6 July 2007 the Treasurer requested the Economic Regulation Authority undertake an inquiry into competition in Western Australia's water and wastewater services sector. The Corporation responded to the initial Issues Paper released by the Authority on 31 August 2007. The response dealt in greater detail with many of the Authority's themes that have now been crystallised as findings and draft recommendations.

The Corporation is now responding to the Draft Report of the Authority released on 3 December 2007, focussing upon areas of concern.

The Corporation is the principal utility for water and wastewater services in Western Australia. The Corporation was created by the *Water Corporation Act* 1995, although its antecedents have been responsible for water services for nearly one hundred years. The Act requires the Corporation to behave commercially, but to also be accountable as a provider of public water and wastewater services. Water and wastewater pricing is determined by the Government.

The Corporation is one of Australia's largest water services providers. Its key roles are to source, manage and conserve water. It provides 95% of potable water, waste water and drainages services to Western Australian serviced properties; and significant non-potable water services to the primary sector and other industries. A majority of the Corporation's profits are returned to the State Government for general public investment. The State Government made CSO payments of $340 million in 2006/07 to compensate for the provision of uneconomic services, mostly for losses on country services.

The Corporation is recognised in Australia and internationally as a successful water service provider that has planned well to deal with challenges of one of the world's largest and driest states. Planning, with fifty year time horizons, responds to national and State water policy, population growth and climate change, including the diminution of run-off in the South West dams to one-quarter of the run-off that occurred thirty years ago. Global Water Intelligence recently awarded to the Corporation a 'Highly Commended, Public Water Agency 2008', citation, noting that:

- 'The Water Corporation has shown world-class leadership in water supply management in the face of a drying climate. With an area of 2.5 million square kilometres, and the decreasing reliability of traditional water sources, there are many unique challenges to overcome;
- Western Australia's 'Security through Diversity' strategy has set the benchmark as an effective and successful approach to managing the impact of climate change; and
- Despite the scale of the resourcing challenge the Water Corporation has faced, sustainability and environmental considerations are central to its strategy.'

The Corporation has competitively outsourced substantial asset and operational activity to the private sector since 1995. The private sector now directly provides 90% of the Corporation's capital projects and 50% of operational activity. The Corporation regularly reviews internal structures and industry structures so as to embrace efficiencies, innovation and private sector engagement and investment. The next major competitive alliance with the private sector will be the construction of the SSDP.

The Corporation's Response to the Authority's Findings and Draft Recommendations

3 Bulk Water Operations and Distribution

Authority Finding

1) There are synergies between the Corporation's bulk water operations and distribution functions which indicate it may not be appropriate at this time to separate these functions

Corporation's Response

The Corporation Agrees with Finding 1.

4 Procurement and Bulk Water Sources

Authority Draft Recommendation

2) An Independent Procurement Entity should be established with responsibility for ensuring least expected cost of balancing supply and demand subject to the constraint of maintaining security of supply at a level set by government

Corporation's Response

The Corporation disagrees with Draft Recommendation 2.

Authority Finding

3) There are potentially considerable additional sources of bulk water available from Harvey Water, the Gnangara Mound and Wellington Dam

Corporation's Response

The Corporation disagrees with the Authority's analysis in Finding 3. Abstraction from the Gnangara Mound must be reduced to a sustainable level. In addition, the potential for additional water from Harvey Water or Wellington Dam is limited.

4.1 'Small' Source Options and SSDP

In relation to water source planning, the Authority discusses in the Draft Report that climate uncertainty means it may be more appropriate to build smaller sources rather than assume the "worst-case" scenario and build one large source.

The Authority promotes that the assessment of water source planning should be undertaken using a form of economic analysis termed an 'options' approach. This approach places a value on avoiding a commitment to a large source (e.g. desalination) when smaller or temporary solutions could provide flexibility and therefore options for different courses of action in the future.

The Authority asked the Corporation to investigate options that could allow for the deferral of the SSDP while not compromising reliability of supply. The Authority's view is that this could provide additional time to learn whether there has been a step-down to a six year climate scenario or recovery from drought. This involves assessing whether short term options such as one-off draws from Harris Dam, additional pumping from less environmentally sensitive bores on the Jandakot mound, water trade from the Bunbury region and mine dewatering can allow a delay in the SSDP.

4.1.1 Planning for the SSDP

The Authority has suggested that the Corporation has used "worst case scenario modelling" to justify the construction of the SSDP by 2011. However, the Corporation's planning is prudent and takes due consideration of alternative climate scenarios, but is far from "worst case" planning. The trend over the last 30 years has been for a continual reduction in dam inflows. A realistic "worst case" would see these trends continue with further reductions to be experienced in the short term. Furthermore, lessons from interstate demonstrate the possibility that inflows can fall to almost nothing despite indications from the best available projections.

Assessment of the probability that parts of the State are currently experiencing another step climate change that will persist into the future or whether it is just a temporary but prolonged drought event can not be scientifically determined and needs to be accepted as something that will continue to be uncertain. Next year's rainfall, and that for the following years, will not answer the question or remove this level of uncertainty going forward. At best a real options analysis makes explicit the assumptions required to justify a particular course of action and is therefore an aid to the communication of rational decisions. The uncertainty of the underlying assumptions remains the same.

In addition to climate uncertainty, a further key driver of water source planning is the need to reduce abstraction from the Gnangara Mound groundwater system, which is also being impacted by climate change. The recent reduction in dam inflows has necessitated a total abstraction well above the estimated sustainable average abstraction target of 120 GL per year (an average of 155 GL per year has been abstracted for the past seven years). The Corporation is therefore working closely with the Department of Water to reduce long term abstraction to a sustainable level.

To meet growing demand in the face of these challenges, the Corporation has recently delivered a range of water source initiatives including the Perth Seawater Desalination Plant, water trading with Harvey irrigators, water recycling at Kwinana and new groundwater bores into the deeper aquifers. However, even with these significant initiatives, if the average dam inflows from the last six to ten years were to continue, then the Corporation's water balancing modelling demonstrates that the level of abstraction required would continue to be higher than the average abstraction target.

A range of small source solutions have been considered to reduce abstraction from the Gnangara Mound and meet short term growth in demand (see below for more details). The Authority has suggested that a range of other water sources may also become available before work on the SSDP commences. However many of the options outlined in the

Draft Report have previously been investigated by the Corporation and those options that are feasible are being actively pursued, but at this stage will provide insufficient volume to delay the SSDP. Other options outlined in the report are speculative and require significant additional time to establish environmental, social and economic feasibility.

Understanding the level of certainty with which new sources can be developed is critical in water source planning due to the long lead times involved in procurement and regulatory approvals. Procurement of large water sources such as desalination plants typically has a timeframe of five years or more. The Corporation had previously planned to commission the South West Yarragadee source by 2009. However, the Government's decision in 2007 to build a second desalination plant as an alternative delayed the planning timeframe by two years. Therefore the Corporation was required to commence the procurement process for the SSDP immediately.

4.1.2 Small-Scale Water Source Options

Reliability of supply to the IWSS will remain highly dependent on groundwater until the SSDP is completed in 2011. As inflow into the IWSS dams in 2007 was above the average of the previous six years and the existing Perth Seawater Desalination Plant was at full production, abstraction from groundwater was reduced to 143.5 GL, but this is still significantly above the desired long-term average draw of 120 GL per year. In addition, ongoing growth in demand will increase the draw by a further 5 GL each year unless additional water sources can be developed in the short term. Therefore, as a matter of priority, the Corporation will be working closely with the private sector and the Department of Water to develop 'new' small-scale sources to meet short term water supply needs and to provide additional water for the IWSS into the longer term.

Attachment 1 describes in detail the small-scale initiatives that the Corporation has considered to reduce abstraction in the short term and to meet demand growth until the completion of the SSDP. The small-scale sources include 10GL of surplus water from Harris Dam, 5GL per year by connecting Logue Brook to the IWSS, 30GL over the next 6 years from dewatering for coal mining in the Collie basin and other 'non-structural' solutions including water efficiency initiatives that have so far reduced consumption by approximately 45 GL per year since 2001.

Small source options such as those identified above will be invaluable for meeting short-term water supply requirements. However, as noted earlier, the SSDP is the only option known with sufficient certainty to guarantee a significant and sustained reduction in groundwater abstraction levels.

4.1.3 Options Planning Framework

The 'options' analysis presented in the Draft Report indicates that if dam inflows return to the average level experienced over the past 10 years, the SSDP could be deferred. The analysis also indicates that the SSDP could be delayed further if a number of small source options are introduced.

Contrary to claims in the Draft Report, the two 'new' small sources used in the Authority's illustrative analysis (Collie dewatering and Harris Dam transfer proposals) are already being pursued and form part of the Corporation's planning to meet short term growth requirements prior to commissioning the SSDP in 2011. A substantial number of other small source options have also been examined by the Corporation (some of which are described above), however most are still speculative at this stage. The volumes available from the relatively certain options fall far short of the target volumes required to effect a sustained reduction in groundwater abstraction.

An options analysis is appropriate when multiple options are available and there is some flexibility to select between these options. However, given that the Corporation is already pursuing all of the small scale sources that are practically available, the construction of the SSDP is the only course of action currently available to meet water supply needs. In the longer term, if multiple courses of action become available beyond the first stage (ie. 50 GL per year) of the SSDP, then a broader options analysis would be a valuable part of the strategic toolkit for evaluating water source alternatives.

The option paradigm favours the increased flexibility that is gained by preparing for action should alternative outcomes eventuate. Therefore, given the realistic likelihood that rainfall will be insufficient to meet water balance targets over the next four years, the paradigm would strongly support the continuation of planning and other preparatory work to ensure readiness for the commissioning of the SSDP in 2011.

A further element not captured in the Authority's analysis is the value to the community of insuring against the high level of climate uncertainty. While the cost of constructing the SSDP is substantial, the additional expense must be judged against the potential consequences, both in terms of water supply reliability and the environmental impacts, of not proceeding. This value should be incorporated into the assessment of the "trigger point" for developing new sources. The Authority has recognised the need for the Government to make a policy decision on the trigger point.

4.2 Independent Procurement Entity

The Authority has proposed that an IPE should be established with responsibility for ensuring least expected cost of balancing supply and demand, subject to the constraint of maintaining reliability of supply at a level set by government.

The Draft Report states that the IPE would *"determine a portfolio of source options and procure a portfolio of 'call options', which would give the IPE the right, but not the requirement, to insist on delivery under certain pre-defined conditions. A portfolio of call options would have differing volumes, lead times and durations of supply, recognising a range of potential inflow scenarios. The options would include demand management as well as supply options."* [5]

Under the Authority's proposed arrangements, any water source option developed by the Corporation would be assessed against alternative proposals from the private sector.

4.2.1 The Corporation's Response

The Authority's proposed procurement model is intended to provide clear independence of decision making and lowest expected cost planning (subject to relevant constraints). To achieve these objectives, the Authority has recommended that an independent entity be responsible for the planning and procurement of new water sources.

The Corporation considers an independent review mechanism to be an important part of decision-making on major water sources but practicalities such as the need for system knowledge and contractual negotiations mean that the procurement process needs to be undertaken by the Corporation.

Independent Procurement Entity

The Government already has an independent procurement entity, in the form of the Water Corporation. The Corporation was set up so as to be independent, and has an apolitical and commercially expert Board of Directors and a competent management team.

The legislation under which the Corporation operates already clearly establishes the Corporation as an entity that is independent from the Crown that must:

(a) act in accordance with prudent commercial principles; and

[5] Authority (2007) *Draft Report - Inquiry on Competition in the Water and Wastewater Services Sector,* p. 37

(b) endeavour to make a profit, consistently with maximizing its long term value.[6]

The key means available to the Corporation to maximise long term value is by minimising long term expected cost, subject to providing an acceptable level of service. The Corporation and the Authority have both proposed that the level of service, in particular the level of supply reliability, should be set by government.

Potential Conflict of Interest

The Authority has indicated that its proposed IPE is necessary as the Corporation may be biased toward certain source solutions and towards its existing sources in developing the annual source operating strategy. In practice, these conflicts do not exist, and such perceptions would not discourage serious private sector proponents from participating in the development of new sources.

It is in the Corporation's interest to assess new proposals impartially and to harness third-party innovation to the greatest extent possible. In its submission to the Authority's Issues Paper, the Corporation outlined a process in which it would withdraw as a competitor for new source development and assess third-party proposals on their merit. If multiple options are submitted, the Corporation would have the advantage of a range of options on which it could call.

The Authority's IPE proposal creates a greater potential conflict of interest for the Corporation as it would need to develop its own source proposal, and be required to negotiate terms in the water supply agreement with any private proponent.

The perception that there could be a conflict in developing an operating strategy for the Corporation's existing sources and for new privately owned sources would be resolved in the contractual arrangements for the payment for water. Such arrangements would be required by private sector participants to obtain funding in an environment of unmanageable climate risk, and would naturally eliminate any bias toward Corporation owned sources in developing a source operating strategy.

Greater Independent Oversight

If it is considered that further independence of the current review process is required, then the Corporation is prepared to work with the Government to reinforce that independence.

[6] Water Corporation Act 1995, Section 30

While there is currently an extensive review mechanism of major new sources that is independent of the Corporation, the Corporation agrees that for transparency there would be merit in increasing the independence and strength of this review, particularly in demonstrating that procurement processes (including those conducted by the Corporation) are impartial to all interested participants, and that economic evaluation is properly balanced.

To date, top-level oversight has been exercised by the Water Resources Cabinet Sub-Committee, chaired by the Treasurer and comprising relevant Ministers including the Corporation's Minister. The Cabinet sub-committee has been supported by a task force led by a senior officer in the Department of Premier and Cabinet, with representation from the Corporation, the Department of Treasury and Finance, the Department of Water, and other agencies as required. The Task Force and the Ministerial Committee have obtained independent expert advice where required. This mechanism has been successful in providing for timely decisions to be reached, with independence from the Corporation as proponent and with the necessary consensus of ministers and agencies.

Additional independence could most effectively be achieved by building upon current arrangements, especially given the history of productive involvement of the Department of Treasury and Finance. Ultimate responsibility for independent review would rest with the Treasurer, who would be assisted in the process by the Under-Treasurer. The Under-Treasurer or his/her nominee could chair a panel comprising representatives of Treasury, the Authority, commercial expertise enlisted from the investment banking or major accounting companies, and practical water industry expertise from a consultant experienced in the area. It would seek advice from regulators, the Department of Water and utilities but would not include representation from them. The emphasis would thus be clearly on the commercial impartiality of the procurement process and ensuring that a balanced economic assessment would occur.

The panel would be particularly active at times when decisions are required on major new sources, and would also have an important role when major planning processes are under way. It would have the ability to enlist staff by secondment, and to appoint independent specialist advisors. It would report, via the Under-Treasurer, to the Treasurer and thence to the Ministerial Committee and to Cabinet. It is envisaged that this would incorporate a gateway process for major source procurement.

An advantage of the model proposed by the Corporation is that it overcomes the intractable problem of building and maintaining suitable skills in an IPE. The problem is that, in normal circumstances when the State has not just experienced a massive reduction in yield from its

primary sources, large new supplies are only required every five years or so. It would be impossible to recruit and develop skilled and experienced people in a small organisation with such a sporadic work-load. (The Corporation, by contrast, is able to offer its people intensely varied and interesting professional growth paths.) Thus a review mechanism which enlists expertise as and when required is likely to provide higher levels of expertise at lower cost in the long run.

A possible argument for the Authority's proposal for a new independent entity is it would remove political interest – and influence – in the adoption or otherwise of new sources. However, it is unlikely that governments will ever relinquish interest in water supply – or that the public would permit them to do so. For example, it is unlikely that the decision whether or not to proceed with the South-West Yarragadee proposal would have been different with an IPE in place. Furthermore, the dominant issue at the last State election was a proposal for water from the North.

The establishment of an IPE would require two conditions to be in place to promote private sector interest. First, the State Government would need to pass full control of water source development to the IPE, subject to regulatory constraints. If the State Government retained final discretion over water source proposals, as evidenced by moving from South West Yarragadee to the SSDP, then private sector confidence would be significantly undermined. Secondly, Statutory Management Plans would need to be completed as the private sector is unlikely to invest significant resources in ground or surface water source development without certainty about the associated water entitlement.

Specific Concerns with IPE Proposal

Specific concerns with the Authority's proposed planning and procurement arrangements include:

A. The proposed arrangements could jeopardise the timely delivery of new water sources.

The Authority's proposed model would add administrative complexity to the planning process that the Corporation believes will add significantly to the time taken to approve and deliver new water sources. The Authority's process envisages that the Corporation and other competitors will initially develop a range of new water sources at a high level, and then submit their plans to the IPE for approval, before finally beginning detailed development work. Presently, responsibility for water source development and delivery sits unambiguously with the Corporation. Adding an additional layer into the process will increase approval time and make it less clear which organisation is responsible for timely delivery of water sources, particularly if the IPE is responsible for

negotiating 'call options', while the Corporation is responsible for commissioning those options. It is imperative that the Government makes absolutely clear who is ultimately responsible for ensuring that water comes out of the customer's tap.

In general, water source assessment and approvals require a substantial lead time. For example, the sustainability assessment for the South West Yarragadee took more than four years and required extensive investigation including drilling, testing and modelling, environmental impact assessments, social impact assessments and an extensive public involvement program.

The Authority has also proposed that, in addition to the approval of new sources, the IPE would approve the timing to construct new sources and the annual source management strategy. Both processes would add to the approval time and potentially slow down the process of delivering a reliable water supply to the community.

B. The IPE will not have sufficient system knowledge to assess or negotiate third party supplies independently from the Corporation.

The Authority has proposed that the IPE would review the 'call option' proposals (ie. water source options that can be called upon at any time) developed by alternative water source providers. Once the 'call option' was exercised, the terms and conditions agreed between the IPE and the third party provider would then be imposed on the Corporation.

The Draft Report has focussed on reliability of supply, however, a large number of other terms and conditions would also need to be assessed by the IPE depending on the type of water source, its location and operating requirements. 'Call option' proposals could include such diverse initiatives as water recycling, desalination, catchment management or evaporation reduction.

The assessment and negotiation of third party bulkwater supplies will include, but would not be limited to, a review of issues such as:

- water quality;
- integration with existing assets, including assumptions about the existing capacity and level of treatment at the interconnection point;
- legal liability;
- catchment management plans;
- operating regimes that are compatible with existing assets;

- health and safety regimes;
- asset management and maintenance regimes;
- monitoring and reporting protocols; and
- emergency management plans and procedures.

As the operator of the water supply system, the Corporation is the only organisation with the system knowledge required to assess and negotiate the terms and conditions of a third party water supply contract for the IWSS. It would not be plausible for the IPE to independently develop a sufficiently detailed understanding of the system to cover all possible water supply arrangements. These arrangements will require significant negotiation and detailed assessment of individual proposals.

Furthermore, it is against the Corporation's legitimate business interest to have contractual arrangements imposed on it that have been determined entirely by third parties.

An alternative arrangement would be for the Corporation to enter a tripartite agreement negotiated with the IPE and the third party supplier. However, this arrangement would require the Corporation to be a neutral third party with no conflict of interest and therefore would disallow the Corporation from developing a water supply proposal of its own. This scenario would entirely remove the Corporation's expertise from either the development or the assessment of new water source proposals.

Therefore, it is more appropriate for the Corporation to remove itself as a competitor from the development of new sources and apply its expertise in managing and assessing the procurement of third party proposals.

C. Shifting planning resources to the IPE would lead to unnecessary duplication, additional administration and thinning of the relatively small pool of professional planners.

While an IPE could theoretically undertake the same planning and procurement functions that are currently successfully undertaken by the Corporation, in practice the additional step in the planning process would be more time consuming and administratively complex, with genuine concerns about the maintenance of technical expertise within the IPE and the efficiency of information flows between the IPE and the Corporation.

It is unclear from the Draft Report whether the IPE would be responsible for the IWSS only or the entire State. If the IPE were responsible for the IWSS only, the work load would be extremely sporadic, particularly if a major source was only required every

five years or more. The long intervals between source development would lead to the unnecessary employment of resources between development periods and would have substantial implications for the quality of staff that could be attracted. The planning and procurement of sporadic sources is better suited to a large organisation that can redistribute resources as required.

If the IPE were responsible for the entire State, the responsibilities and workload would be more complex than envisaged by the Draft Report. It is anticipated that around 30 small to medium sized schemes will require some form of augmentation in the next 5-7 years, including around 20 that will require the development of an entirely new water source.

In either case, the Corporation would need to retain planning resources to develop source options of its own, to assess consortium proposals and to technically assess third-party options that were under review by the IPE. It is anticipated that the IPE model would require a significant duplication of resources between the two organisations. As the Australian water industry has a relatively small pool of professional water source planners, the quality of advice to either organisation is likely to suffer as a result.

D. The IPE would not benefit from distribution planning and operational synergies.

Unlike the Corporation, the IPE would not have the opportunity to take advantage of the close synergies between water planning, distribution system planning and water system operations. Currently, water planning is conducted on a holistic basis, taking into account operational requirements and both source and distribution augmentations. A disconnect between source and distribution planning would tend to favour an inefficient "just in time" approach for distribution infrastructure due to the higher level of uncertainty surrounding the development of each source.

E. The untested IPE arrangements would be introduced at a time when timely delivery of new water sources is critical.

There are significant risks to the successful procurement of new sources and the efficient maintenance of reliability of supply from the Authority's proposal to undertake the planning and procurement of new sources through an IPE.

The arrangements proposed by the Authority have not been introduced anywhere else in the world. Given the significant challenges facing the water supply system – including the changing climate and the need to reduce draws on the Gnangara Mound – it would be imprudent at this time to implement an untested regime that would increase the time required to develop new water

sources, and would reduce the clarity regarding responsibility for delivery of those sources. In addition to the immediate administrative, organisational and institutional challenges facing a newly-created organisation, an IPE would face a steep scientific, engineering, environmental and social learning curve.

F. Uncertainty of timing and regulatory approvals may impede competition.

A key area of focus for the Authority was to investigate opportunities for enhanced competition.

The Corporation widely consulted with the private sector to establish the prerequisites that would make investment in the water industry more attractive. A key conclusion was that most private sector participants would prefer that key impediments, such as environmental approvals, were progressed to reduce the uncertainty associated with entering a bid. Under the Corporation's proposed competitive procurement model, the Corporation would seek regulatory approvals for the most viable preliminary planning option to actively encourage private sector interest. In the assessment stage, the Corporation would then equally and impartially assess all proposals, including those that had sought regulatory approvals in their own right. Under the proposed IPE model, the uncertainty associated with early approvals could discourage many private sector participants and reduce the breadth of the market.

In addition, the Authority's model requires the private sector to bid for 'call options'. These options would not necessarily be exercised immediately, but may be required some years later. The Corporation's assessment is that this high level of uncertainty would reduce the 'bankability' of many projects and would significantly compromise the funding options available to participants. The suggestion that the private sector may take on some of the climate risk associated with the system would also impose a level of 'unmanageable' risk that would impede funding.

The IPE proposal therefore has the potential to reduce rather than increase the interest and opportunity for many participants to provide new water sources.

G. If the Corporation is a 'bidder' for the development of new sources, then competition may be severely curtailed.

Under the Authority's proposed model, it is anticipated that the Corporation would be required to enter a bid in case no other suitable bids were submitted. The Corporation would effectively be a competitor, in addition to a supplier of last resort. However, the Corporation's detailed knowledge of the current operation of the

transfer and storage system would create an unfair advantage for any consortium formed with the Corporation. The Authority notes that the Corporation could run its own selection process, however the consortium would need to be formed before 'bid costs' were incurred, thereby reducing the chance that the best combination of partners had been formed during the initial development of the consortium. Alternative bidders would thereafter be severely disadvantaged because the Corporation would be acting as a competitor rather than a collaborator or assessor of more detailed proposals.

In addition, the field of private sector competitors will be weakened until certainty about ground and surface water allocations had been determined through the development of Statutory Water Management Plans.

5 Water Trading

Authority Draft Recommendation

4) Pricing arrangements within irrigation cooperatives should be adjusted to allow for the trade of water out of cooperative areas by individual members should they choose to do so. A recent decision by the Australian Competition and Consumer Commission provides guidance on a possible approach

Corporation's Response

The Corporation notes Draft Recommendation 4.

Authority Draft Recommendation

5) To facilitate an effective water trading regime, all significant users within a catchment, including pine plantations, should be taken into account when developing Statutory Water Management Plans and water allocations

Corporation's Response

The Corporation agrees with Draft Recommendation 5.

Authority Draft Recommendation

6) On the Gnangara Mound, finalisation of the Statutory Water Management Plan and Gnangara Mound Sustainability Strategy is critical. In the meantime, an effective water trading market should be developed, despite a degree of environmental uncertainty

Corporation's Response

The Corporation agrees with Draft Recommendation 6 that it is critical to finalise the Statutory Water Management Plan and Gnangara Mound Sustainability Strategy. However, without finalisation of the plans, the yield benefit that could be developed via a water trading market remains uncertain.

Authority Finding

7) The concerns regarding water hoarding appear to be limited. However, there is the potential for a single individual or entity to obtain a significant share of water allocations and thereby be in a position to exert a degree of market power. While the Authority considers that the Trade Practices Act 1974, would be sufficient to deal with such potential anti-competitive behaviour, the Authority will consider the matter further

Corporation's Response

The Corporation notes Finding 7.

6 Third Party Access

Authority Draft Recommendation

8) A State-based third party access regime should be implemented in Western Australia

Corporation's Response

The Corporation agrees with Draft Recommendation 8.

Authority Draft Recommendation

9) A State-based third party access regime should be based on the principles of the Competition Policy Agreement, including provisions for negotiated access between the infrastructure owner and the access seeker, independent dispute resolution and an appeals mechanism

Corporation's Response

The Corporation agrees with Draft Recommendation 9.

Authority Draft Recommendation

10) Further consideration should be given to prices under the State-based third party access regime being based on a 'retail minus avoidable cost' approach

Corporation's Response

The Corporation agrees with Draft Recommendation 10.

Authority Draft Recommendation

11) Any State-based third party access regime should be supported by sound and transparent regulation to ensure that access arrangements are safe, efficient and achieved at a minimum cost

Corporation's Response

The Corporation agrees with Draft Recommendation 11.

7 Structure

Authority Finding

12) There are likely to be minimal gains from any disaggregation of the Corporation's Perth operations at this time

Corporation's Response

The Corporation agrees with Finding 12.

8 Retail Contestability

Authority Draft Recommendation and Finding

13) Retail contestability is premature for small customers at this time. However, to facilitate third party access and the potential use of recycled water, contestability should be considered on a case-by-case basis

Corporation's Response

The Corporation agrees with Draft Recommendation and Finding 13.

Authority Draft Recommendation and Finding

14) Retail contestability should be introduced for large customers

Corporation's Response

The Corporation agrees with Draft Recommendation and Finding 14. However, this will occur with the introduction of a third party access regime.

8.1 Comment on large customer retail contestability

The Authority has recommended that retail contestability should be introduced for large customers.

The Corporation notes that retail contestability would effectively occur with the introduction of a well developed third party access regime. Water and wastewater operating licences are non-exclusive in the metropolitan area, and therefore alternative service providers are currently able to apply for a licence to supply certain areas or specific customers. In addition, third parties can access independent water resources if required and receive water allocation licences through the Department of Water. Therefore the only impediment to retail contestability is the ability to access monopoly infrastructure, which would be overcome with the establishment of a third party access regime.

9 Pricing

Authority Draft Recommendation and Finding

15) There is merit in exploring the introduction of scarcity based pricing to improve price signals for customers regarding the true cost of their consumption and producers regarding potential investment opportunities

Corporation's Response

The Corporation disagrees with Draft Recommendation and Finding 15.

9.1 Comment on Scarcity Pricing

The Draft Report outlines the possibility of introducing scarcity pricing – that is, prices that rise in times of drought to reflect the relative scarcity of water (Draft Report pp. 80-82).

It is unclear from the Draft Report how scarcity pricing will encourage competition in the industry.

Key concerns regarding scarcity pricing in the water industry include:

- Customer protection – the large increases in price that could occur from year to year have the potential to affect essential water use for health and hygiene. Any pricing regime should ensure that basic water use is not placed at risk;
- Uncertainty about customer response – there is considerable uncertainty about the degree that customers will respond to price signals in the short-term. Restrictions are a more reliable manner to deal with short-term supply shortages;
- Matching pricing signals to investment decisions – fluctuations in the price of water may lead to uncertainty about long term water costs and therefore may not promote efficient investment in long term water saving initiatives such as water efficient gardens and whitegoods; and
- In addition to the objective of sending pricing signals, pricing must also take into account other objectives including the ease of administration and customer preferences for price stability.

Due to the complexity of the issues, the Corporation recommends that the issue of scarcity pricing is better addressed as part of a pricing inquiry, rather than as part of the current inquiry into competition.

10 Regional and Remote Areas

Authority Finding

16) There may be potential significant cost savings from the creation of a multi-utility by transferring the Corporation's water and wastewater assets to Horizon Power in its area of operation. However, further investigation prior to the release of the Final Report is required before any definitive conclusions can be made

Corporation's Response

The Corporation disagrees with Finding 16.

Authority Finding

17) There may be potential significant cost savings from the reconfiguration of water and wastewater services in the Bunbury and Busselton areas. However, further investigation prior to the release of the Final Report is required before any definitive conclusions can be made

Corporation's Response

The Corporation notes Finding 17.

Authority Draft Recommendation and Finding

18) Proposed legislative reforms being undertaken by the Department of Water will enable the payment of CSO to all licensed service providers. The Department of Treasury, the agency responsible for the payment of CSOs, should develop a policy perhaps similar to that in operation in Queensland to explicitly allow for the payment of CSOs to non-government entities

Corporation's Response

The Corporation agrees with Draft Recommendation and Finding 18.

10.1 Potential to establish a Multi-utility

The creation of the multi-utility as proposed by the Authority would result in a significant net additional cost. This assessment is based on a review undertaken jointly by the Corporation and Horizon Power, with support from GEM Consulting (GEM).

The Corporation believes that opportunities exist to improve levels of service to regional areas of Western Australia through stronger collaborative

arrangements (alliances) with Horizon Power. This is particularly true for remote towns located a considerable distance from the major regional centres.

Consistent with this view, the Corporation commenced discussions with Horizon Power in 2007 aimed at identifying and realising synergies that could be achieved through collaborative work in remote communities. While the direction of these discussions was focussed on how to address the future provision of services to indigenous communities, it was recognised that the opportunities identified also applied for servicing of mainstream towns.

The release of the Draft Report provided a catalyst for the Corporation and Horizon Power to analyse the prospects for restructuring options in addition to the current work on collaborative opportunities.

Consequently the two organisations agreed to jointly and cooperatively assess the viability of a merger of country operations as outlined in the Draft Report. GEM was selected to support the exercise because of their familiarity with the businesses of both organisations, having worked with both in recent years.

The joint working party also discussed the likely costs and benefits associated with the establishment of any alliances. It was concluded that this approach would not result in significant costs or savings but would potentially realise service level improvements for the customers of both organisations.

For comparison and completeness, the Corporation independently analysed the merging of Horizon Power into the Corporation. This was done by recasting the analysis completed jointly for the regional based utility.

The Corporation concluded that in terms of the restructuring options, a merger of Horizon Power into the Corporation would be significantly more cost effective than forming a regional multi-utility. The single merged entity would achieve most of the advantages associated with a regional utility but avoid many key costs. Essentially separating one whole water business into two, would result in the need for significant duplication of water related resources. This duplication would be avoided under the Corporation and Horizon Power merger.

Given the short time available, a comprehensive analysis of each option was not possible. However the high level conclusions drawn are considered reliable in terms of their relativities to each option and the order of magnitude of both costs and benefits.

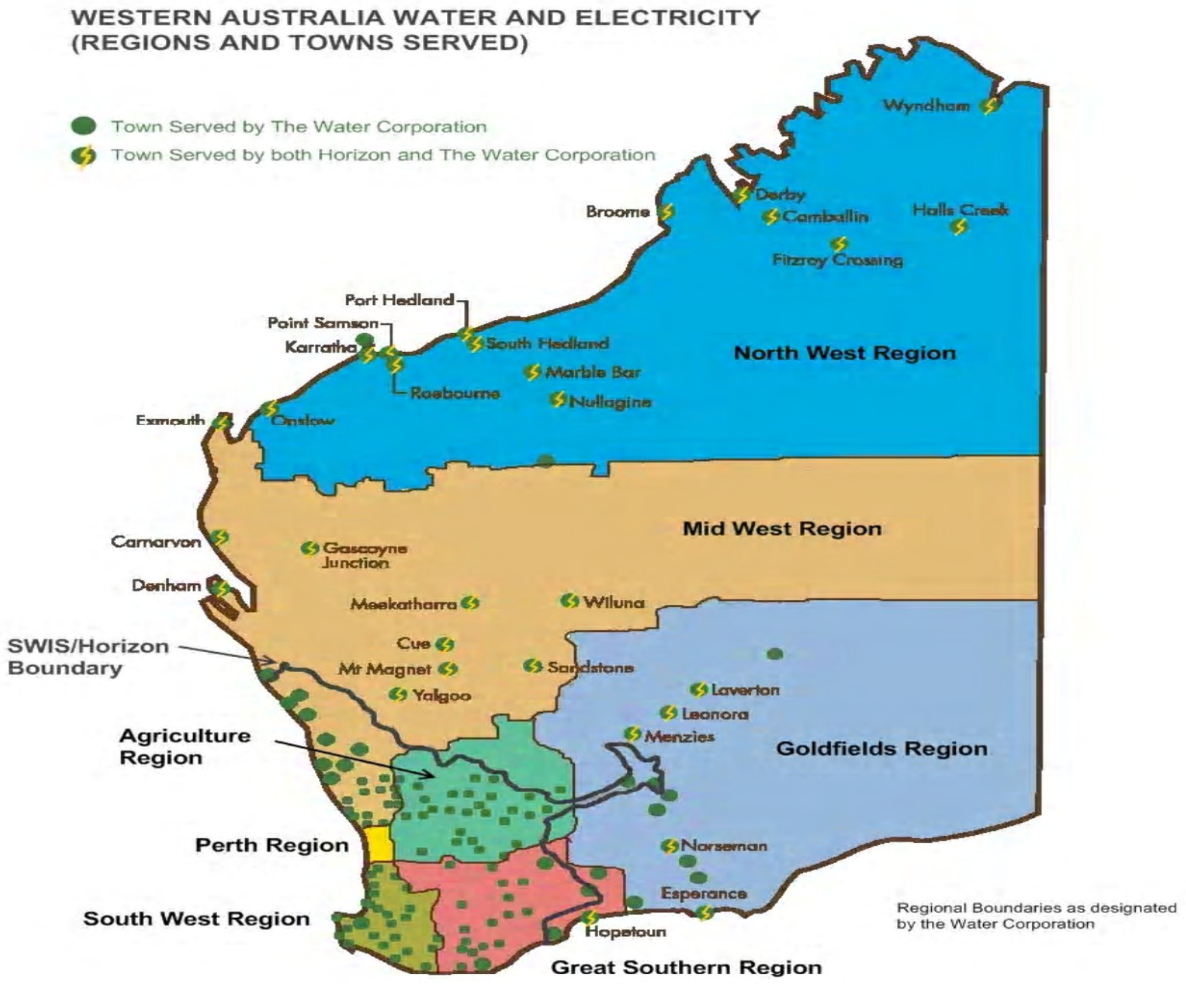
The Corporation believes that both restructuring options have significant risks in terms of costs, benefits and ongoing business stability particularly in the short-term. While the merger of Horizon Power into the Corporation is the most cost effective of the two restructuring options examined, the risks discussed above suggest that there is only a low likelihood that either option would result in a positive economic outcome. Accordingly, the Corporation believes that neither form of restructure merits further investigation and

recommends that both organisations continue their collaborative efforts to establish alliances in remote areas.

10.1.1 Comparison of Corporation's Country Operations with Horizon Power

The Corporation currently provides water and wastewater services to most communities in Western Australia. Horizon Power provides power services to communities that are not connected to the South West Interconnected System.

The following map shows the areas of the State currently serviced by the Corporation and Horizon Power.



The Corporation has approximately 153,000 customers outside of Perth and the South West Region which includes approximately 135,000 water accounts and 68,000 wastewater accounts. Approximately 40,000 of these customers also receive a power service from Horizon Power.

The relative customer bases reflect the overall scale of the two businesses in regional Western Australia. This relativity is also observed when comparing

the asset base, capital expenditure and the number of staff dedicated to servicing regional areas.

To service its regional customer base the Corporation has adopted a regionally based operations structure with corporate and specialist technical support provided from the Perth head office. The regional offices have accountability for the provision of services to customers, liaison with communities and overriding management responsibility during incidents and outages.

The Corporation's business model has enabled it to more efficiently deliver high standards of service to country areas due to the provision of centralised specialist engineering and technical services. The provision of specialist services such as infrastructure planning and design, asset management, water and wastewater treatment and drinking water quality from Perth allows the Corporation to more successfully attract and retain staff and build critical mass than if this expertise was built into regional structures without compromising service standards.

This mix of regional presence backed by corporate support has ensured that the Corporation continues to receive very high levels of positive feedback from regional customers and stakeholders. Both the Corporation's and Horizon Power's regular regional surveys demonstrate a very high level of customer satisfaction.

10.1.2 Potential Restructuring Costs and Benefits

The following initiatives were identified as offering the most potential for efficiency gains as a result of a merger:

1. Rationalisation of regional management;
2. Rationalisation of regional property;
3. Rationalisation of passenger and light commercial fleet;
4. Establishment of a single point customer and billing interface;
5. Rationalisation of meter reading.

Many other initiatives were also identified but the costs to implement these appeared to offset the ongoing benefits that may be realised.

A number of potential intangible benefits were also identified. The major benefits include:

1. Establishment of a regionally focussed utility with an executive team that resides in the country areas of the State;
2. Establishment of a single point of contact for regional customers;
3. The potential to improve operational performance in locations with single or no utility presence by sharing resources for low level faults, after hours callout and so on;

4. Increased regional scale allowing dedicated staff to be located in more regional locations therefore improving operational performance and customer response and service times;
5. The ability to multi-skill regional employees and gain productivity benefits in field staff;
6. Improved coordination of response and recovery efforts associated with significant incidents; and
7. Coordination, planning and delivery of regional infrastructure.

The Corporation acknowledges that the first of these is only achievable by the disaggregation of the Corporation and merger with Horizon Power. However given the current relatively high customer survey rating of the Corporation's regional operations, which is generally equal to that of Horizon Power, the potential benefits of this intangible are thought to be limited.

The remainder of the benefits are largely, if not entirely, achievable under both the restructuring options and the alliance model.

The disaggregation of the Corporation would incur significant intangible costs including:

1. Loss of critical mass and fragmentation of technical centres of expertise in water specialist functions. For example:
    a. water and wastewater treatment;
    b. specialist asset management; and
    c. drinking water quality and protection of public health.
2. Net loss of scale for regional corporate and technical support.
3. Inability to attract and retain staff particularly during the disaggregation and merger. The option for employees to relocate between regional and metropolitan locations is viewed as a key benefit for Water Corporation's regional employees

The Corporation's experience has shown that to successfully deliver safer reliable drinking water to regional and remote communities it is necessary to build strong centralised, monitoring and specialist technical support. This monitoring and support is currently available to regional operations State-wide. As problems are experienced in one scheme the knowledge gained is quickly transferred and implemented across the State.

The Corporation takes great pride in how successfully it has delivered services to country areas. The Corporation believes that structural changes that result in a fragmentation of existing water industry centres of expertise would be to the detriment of all communities in Western Australia.

10.1.3 Optimising the Merger

Regardless of where the line of disaggregation was drawn through the Corporation's regional water business, splitting one water utility into two will result in resource duplication. Therefore the optimal merger structure will be

to aggregate the metro water, regional water and Horizon Power businesses into one. This will avoid duplication and arguably incur less of the restructure cost because it avoids any disaggregation and requires the merger of a much smaller entity.

10.1.4 Corporation's Position

The Corporation intends to continue to explore and develop collaborative opportunities with Horizon Power. It is the Corporation's view that developing an alliance between the Corporation and Horizon Power can:

- Build capacity to more efficiently deliver services to remote communities;
- Improve service delivery standards to regional communities;
- Minimise human resource and industrial relations impacts;
- Maximise multi-skilling and training of employees to foster cross utilisation of personnel; and
- Improve coordination of planning and delivery of power and water infrastructure to country areas.

This provides an opportunity to realise many of the benefits of a merger without exposing the organisations and their customers to the significant risks associated with any structural change.

The Corporation has established an open and constructive relationship with Horizon Power which has included high level consideration of how best to collaboratively service remote indigenous communities. Both organisations intend to build this relationship further.

The Corporation does not agree with the Authority's finding that significant cost savings could be realised through the creation of a multi-utility by transferring the Corporation's water and wastewater assets to Horizon Power in its area of operation.

10.2 Comments on CSO Payments

The Corporation supports the Authority's recommendation that the Department of Treasury and Finance should develop a policy to explicitly allow for the payment of CSO payments to non-government entities.

The Corporation is not aware of any impediments to making CSOs available to private sector water service providers and has discussed with the Department of Treasury and Finance the opportunity to progress this issue in the near future. The Corporation looks forward to working through any relevant issues with the Department of Treasury and Finance.

Attachment 1: Small-Scale Water Source Options

The following small-scale initiatives have been considered to reduce abstraction in the short-term and to meet demand growth until the completion of the SSDP:

- There is approximately 10 GL of "surplus" water (5 GL per year for 2 years) currently stored in Harris Dam that is available for transfer to the IWSS. The transfers are scheduled to occur from 2008-2010 but will not permanently increase the total system capacity;

- Following the recent announcement to convert the Logue Brook Dam to a public drinking water source, actions are under way to construct the necessary infrastructure to connect this dam into the IWSS. Approximately 5 GL per year is available and works are scheduled for completion by 2010. Water from Logue Brook Dam is already included in the Corporation's source development timetable;

- Over the next six years, the volume of dewatering for coal mining in the Collie Basin exceeds local demand of the power generation industry. Based on current mining schedules, the total surplus is around 5 GL per year for the next six years. A proposal to transfer this water to the IWSS has been developed and is currently undergoing preliminary design;

- A proposal has been developed to construct two new Yarragadee bores and increase capacity from existing shallower "coastal" groundwater bores within the existing Neerabup Groundwater Scheme. However, advice from the Department of Water indicates that abstraction from these bores would be offset against abstraction from the Gnangara Mound and therefore would not provide any additional long-term supply capacity to the IWSS;

- Other 'non-structural' solutions such as the Gnangara Sustainability Strategy, which is being led by the Department of Water, will establish a framework for long-term sustainable management of the Mound. The Strategy is due for completion in 2009 and is likely to recommend a lower maximum volume of annual abstraction than the currently permitted 165 GL per year. In addition, the Government has also introduced water efficiency initiatives (eg. permanent watering regimes, water efficiency requirements for large commercial users) that have so far reduced consumption by approximately 45 GL per year since 2001.

Other water supply options such as additional catchment management, groundwater replenishment and expanded water trading, are also being pursued, but are speculative at this stage. In addition, the Corporation will also continue to work closely with the Department of Water to understand how groundwater abstractions can be varied over time or at different locations.