

6 February, 2008

Mr Greg Watkinson
Director, References and Research
Economic Regulation Authority
Level 6, Governor Stirling Tower
197 St Georges Terrace
PERTH
WA 6000

Dear Mr Watkinson

Draft Report: Inquiry on competition in the Water and Wastewater Services Sector

Rio Tinto Iron Ore WA (RTIO) appreciates the opportunity to comment on the Draft Report. Please find our submission enclosed. An electronic version was sent to your office on 6 February 2008.

In this submission RTIO supports proposals to remove restrictions on private sector entry into the water and wastewater sectors and provides further comments on opportunities it considers most likely to enable private sector participation. The submission also highlights areas in which both additional work and additional stakeholder consultation should be undertaken prior to the release of the Final Report.

Should you require any further information, please contact Mike Harold, Principal Advisor Water Policy on 08 9366 5641 or mike.harold@riotinto.com.

Yours sincerely

Dennis B Gibson
General Manager Water Resources

**RIO
TINTO**

IRON ORE

**Submission to The
Economic Regulation Authority**

***Draft Report: Inquiry on Competition in the Water and
Wastewater Services Sector***

6 February 2008

1. Background: Rio Tinto Iron Ore and water

Rio Tinto Iron Ore (RTIO) has operations and projects on four continents. It is the world's second largest iron ore producer and contributes a quarter of seaborne iron ore trade. RTIO is headquartered in Perth.

RTIO in the Pilbara operates three ports, eleven mines, and owns, operates and maintains one of the largest privately owned heavy freight rail networks in the world. RTIO also includes a Hismelt plant in Kwinana, Western Australia, which is a revolutionary process that converts iron ore fines into high quality pig iron.

Since 2003 RTIO has committed over US\$7.4 billion in the Pilbara and further investment is planned. RTIO's current investment and expansion program will see us effectively double export capacity to 220 Mtpa by 2009, ramping up to 320 Mtpa capacity by 2012. We have also provided a roadmap towards achieving global production of more than 600 Mtpa, of which the Pilbara could produce 420 Mtpa.

In 2006, RTIO exported 150.1 million tonnes of iron ore produced from its Pilbara mines, representing approximately 61% of total iron ore exports from Australia in 2006. In 2007 RTIO produced 163 million tonnes from its Pilbara operations.

RTIO is a significant contributor to Australia and WA's economic health, contributing approximately US\$5.8 billion in export revenue in 2006. In Western Australia RTIO has approximately 5,600 employees and a contracting workforce of over 6,000. By 2008 RTIO expects our direct workforce in WA alone to be around 7,000 employees and a contracting workforce of over 7,000.

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 addition, RTIO employs more than 20 Hydrogeologists, over 10% of Western Australia's expertise in this field.

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

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

In September 2007, RTIO made a submission to the Issues Paper at the initial stage of this Inquiry. RTIO considers that many of the comments made on key issues are

still valid. A summary of the key points from RTIO's submission to the Issues Paper is at Attachment A.

2. Key Issues for RTIO on the Draft Report

The key issues for RTIO with regard to the *Draft Report: Inquiry on Competition in the Water and Wastewater Services Sector* are as follows:

With regard to general comments on the Draft Report:

- **Security of supply** is crucial to RTIO's business. RTIO encourages the ERA to carefully consider the impact of its final recommendations to ensure they do not diminish security of supply;
- RTIO considers that the appropriate **integration of the recommendations of the Final Report with the Government's proposed water-related legislative changes** is necessary to maintain clarity and confidence amongst stakeholders that proposed changes are workable. RTIO encourages the ERA to carefully consider the impact of its final recommendations on the Government's proposed water legislation and *vice versa*.

With regard to specific comments on relevant Draft Report recommendations and findings:

- RTIO supports Finding 1 ie that "...it may not be appropriate at this time to separate..." the **Water Corporation's bulk water operations and distribution functions**, in the light of specific studies commissioned by the ERA for this Inquiry;
- RTIO considers that the establishment of an **Independent Procurement Entity (IPE)** (Recommendation 2) is yet to be supported by sufficient evidence, and there is a need to identify the full costs and benefits of the proposed industry structure, in accordance with the Terms of Reference of this Inquiry. In addition, RTIO has identified some key issues that need to be considered regarding the breadth of the role of the IPE;
- RTIO strongly supports the flexible, catchment-by-catchment based approach to **water trading and the allocation of entitlements** taken within the proposed *Water Resources Management Act* (which will enable a range of entitlements to co-exist). RTIO is concerned that Recommendation 5 may translate into a state-wide approach to allocation of entitlements within a catchment that is more rigid, and contrary to the Government's intended approach in the proposed water resources legislation;
- RTIO reserves its position regarding the application of a **third party access** regime to water infrastructure in Western Australia (Recommendations 8-11). More evidence needs to be provided by the ERA. RTIO encourages the ERA to undertake additional stakeholder consultation on this issue once further evidence has been gathered, and prior to the release of the Final Report to Government.
- RTIO stresses the need for extensive stakeholder consultation and further consideration of some key issues regarding the introduction of **scarcity based pricing** (Recommendation 15). Further studies should be undertaken

on this issue to consider: effectiveness of price signals for a range of users (ie. price elasticity of demand); financial impacts on users; a clear distinction between proposals for domestic consumers and proposals for commercial consumers; scarcity based pricing within a framework that offers options to customers; market limitations on where scarcity based pricing can be applied; and broader impacts on economic and regional development.

- RTIO cautions against making a definitive recommendation regarding the **formation of multi-utility** (Recommendation 17) without a robust consideration of the costs and benefits of doing so and without a subsequent stakeholder consultation regarding potential impacts of such a change, before the release of the Final Report. RTIO concurs with Finding 16 that more work needs to be done before any definitive conclusions can be made and notes that this has limited the opportunity for relevant stakeholders to make comment based on solid information.

- Regarding Recommendation 18 on **Community Service Obligations (CSOs)**:
 - RTIO endorses the ERA's finding that proposed legislative reforms being undertaken by the Department of Water will enable the payment of CSOs to all licensed service providers;
 - CSO policy should specifically address the impact of size and scope issues on the way in which services that attract CSO payments are bundled to encourage competition;
 - RTIO considers that the ERA is entitled within the Terms of Reference of this Inquiry to make recommendations regarding key issues that will need to be addressed within the CSO policy. RTIO's views on some matters for consideration are provided in this submission.

The above issues are considered in detail in this Sections 3 and 4 of this submission.

3. General comments on the Draft Report

This submission supplements the RTIO submission to the Issues Paper, and stresses key issues for RTIO. It should therefore be read in conjunction with the RTIO submission to the Issues Paper. This submission to the Inquiry does not address all the recommendations and findings of the Draft Report, as many of these have a specific application to the Integrated Water Supply Scheme (IWSS) and the South West region of Western Australia.

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

- The importance of competitive outcomes rather than competition for its own sake, without diminishing security of supply;
- The importance of coordinating and sequencing reforms in the water sector;
- A separate bulk water operator;
- A separate procurement entity;
- Third party access;
- Water Trading;

- Water usage pricing;
- Multi-utility; and
- Equal access to Community Service Obligation (CSO) payments for the private sector.

3.1 *The importance of competitive outcomes without diminishing security of supply.*

As noted in the submission to the Issues Paper, RTIO supports the achievement of competitive outcomes rather than competition for its own sake. 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.

However, RTIO believes that the pursuit of competitive outcomes should not diminish the key issue of security of supply. As a resource both essential for human life and as a critical input into economic development, security of supply should not be compromised.

Security of supply is crucial to RTIO's business. RTIO encourages the ERA to carefully consider the impact of its final recommendations to ensure they do not diminish security of supply.

3.2 *The importance of 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 is generally supportive of the planned changes to water services and water resources legislation. 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.

A consultative process has been established to enhance the drafting the legislation. RTIO is contributing to this process via its membership of the Chamber of Minerals and Energy and the Chamber of Commerce and Industry.

The RTIO submission to the Issues Paper noted that, 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 Final 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 that are to be put in place by the new legislation.

RTIO considers that the appropriate integration of the recommendations of the Final Report with the Government's proposed water-related legislative changes is necessary to maintain clarity and confidence amongst stakeholders that proposed changes are workable. RTIO encourages the ERA to carefully consider the impact of its final recommendations on the Government's proposed water legislation and vice versa.

4. Specific comments on relevant Draft Report recommendations and findings

4.1 Separate bulk water operator

RTIO's submission to the Issues Paper indicated 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. This view was qualified by the need to ensure that any introduction of such changes needed to be careful and measured.

However, the Draft Report has brought to light new work by ACIL-Tasman (specifically commissioned by the ERA for this Inquiry) on the economies of size and scope in the water and wastewater sectors. As noted in the Draft Report, based on the evidence gathered by this and other studies considered in the Report, there are economies of scope in maintaining vertical integration that would seem, at this point in time, to outweigh evidence from other jurisdictions which suggests such a separation may deliver some benefits.

RTIO supports Finding 1 ie that "...it may not be appropriate at this time to separate..." the Water Corporation's bulk water operations and distribution functions, in the light of specific studies commissioned by the ERA for this Inquiry.

4.2 Separate procurement entity

RTIO's submission to the Issues Paper indicated support for an agency (independent of any licensed water service providers) to be given responsibility for the consideration of new supply options. Based on the submissions to the Issues Paper, this position appears to have broad support, from Government agencies such as the Department of Treasury and Finance¹, and key peak industry bodies such as the Chamber of Commerce and Industry².

RTIO stresses the need for processes that 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. In particular, it is important to provide the earliest possible lead

¹ Department of Treasury and Finance submission to ERA Issues Paper, p15

² Chamber of Commerce and Industry submission to ERA Issues Paper, p2

times for potential private sector providers to identify opportunities and to ensure that all competitors (whether private or public sector) have **equal access** to planning information, and that the development of planning serves the interests of the state as a whole.

RTIO considers that there may be efficiencies that could result from the ERA's suggestion that the Independent Procurement Entity (IPE) could reside within an expanded institutional framework for the Independent Market Operator for electricity. However, closer investigation of the synergies between the IPE and other similar bodies in the utility sector needs to take place before a final and definitive recommendation are made regarding the establishment of an IPE for the water and wastewater industries.

The ERA's proposal for the IPE indicates that its role would be more than just procuring major source developments, and that it would also have responsibility for managing a portfolio of options and being open to proposals at any time. In addition, the IPE could also be an appropriate agency to oversee consideration of the following:

- Identifying opportunities to seek 'competitive bids' for the right to provide water and/or wastewater services to Greenfield site developments, developing and running a clear and streamlined competitive process and identifying the preferred applicant³;
- Bundling services that attract CSO payments to encourage the participation of alternate service providers in a *competitive* process, and running the process by which these opportunities are to be put to the market; and
- Receiving and reviewing unsolicited proposals for the provision of services that offer to reduce the CSO payment burden to Government at a quality of service provision equal to or better than that which already exists.

However, there remains a need to define a clear process for competition for the right to provide to Greenfield sites. 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 a non-licensed private sector provider can enter into the competitive process?
- Exactly how will application for CSO payments be integrated with this process?
- 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 and time consuming to proponents, developers and government, delaying the timely progress of the supply of water services for these developments.

³ See RTIO submission to the Issues Paper, pp3-4 for a discussion of past experience of running competitive processes for Greenfield site developments, which are inclined to support some of the findings put forward in the ACIL-Tasman Report on *Size and scope economies in water and wastewater services* (2007).

RTIO considers that the above discussion suggests that more detailed consideration needs to be given to the following before a recommendation is made:

- The responsibilities and powers of the IPE;
- Clear lines of interaction and authority with regard to other Government agencies and regulators; and
- Experience with the establishment and operation of similar bodies in other sectors and jurisdictions.

Furthermore, the Terms of Reference for the Inquiry state that "...the Authority is required to have regard to...the costs and benefits of alternative industry structures, including transitional costs that may be incurred in changing to a new structure". This has not yet been undertaken with regard to Recommendation 2.

RTIO considers that the establishment of an Independent Procurement Entity (IPE) (Recommendation 2) is yet to be supported by sufficient evidence, and there is a need to identify the full costs and benefits of the proposed industry structure, in accordance with the Terms of Reference of this Inquiry. In addition, RTIO has identified some key issues that need to be considered regarding the breadth of the role of the IPE.

4.3 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 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 trading of perpetual Water Access Entitlements (WAEs), as envisaged under the National Water Initiative, was principally developed with the Murray-Darling Basin in mind, and 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.

However, a significant proportion of Western Australia's water is sourced from non-integrated water systems, many of which are remotely located and the majority of which are not close to full allocation. This will limit the size of the water market, and therefore the opportunities to engage in water trading.

Nevertheless, in the inland Pilbara region (where the majority of RTIO's mining operations take place), there are significant obstacles to the formation of markets and hence the ability to engage in water trading. These include:

- The need to access surplus water for limited amounts of time for dewatering purposes (as is the case of many mining operations that are going below water table to access the mineral resource);
- The remote and isolated location of mining operations, including the high costs of transporting water long distances from water surplus operations to water deficit operations or other demand centres. This is also limited by short project duration;

- The temporal differences in mine site developments that further exacerbates the isolation factor; and
- Low likelihood of resources approaching full allocation.

The limited life of mines plus the need to ensure access to fixed volumes of water, noting that the potential costs of lost production are high, will mean that the application of WAEs to areas such as the inland Pilbara, in which the mining industry is the predominant supplier and user of water, is likely to be limited.

There may still be scope to facilitate trading between water surplus catchments and water deficit catchments, but this would need to be considered on a catchment-by-catchment basis through the relevant statutory management plans.

RTIO strongly supports the flexible, catchment-by-catchment based approach to be taken within the proposed *Water Resources Management Act*. The approach to statutory management plans envisaged by the Government of Western Australia intends to enable this flexibility, with 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.

Importantly, this approach is seen to be consistent with Paragraph 34 of the NWI.

Furthermore, 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 where the water resource management circumstances of a particular catchment may not partly or fully support the allocation of WAEs. RTIO fully supports the State Government's intentions to continue these trading provisions, alongside provisions for the trading of WAEs, under the new legislative arrangements.

RTIO notes that the consideration given to matters concerning water trading in the ERA Draft Report is limited to the IWSS and to the South West of Western Australia. This is clearly where resources are most likely to be nearing full allocation, and where water trading is most likely to take place. However, there is a danger of not recognising the variability of hydrological and market circumstances across the State, as conclusions may be drawn that lock-in a response that may be appropriate for one region of the State, but inappropriate for another.

In particular, the background discussion that leads to Recommendation 5, may lead to a conclusion that all water users within a catchment should be issued with perpetual WAEs, which would result in the ability of these entitlements to be traded to higher uses. While this may have application to the specific circumstances in the Perth Metropolitan area and the South West, RTIO would be concerned if this Draft Recommendation translated into a state-wide approach to allocation of entitlements within a catchment.

Lastly, Recommendation 5 does not define the term "significant users". It is RTIO's understanding that the proposed Water Resources Management Bill will contain some detailed requirements for identification of, and consultation with, all significant users within an area covered by a statutory management plan, and that this will also include the environment, communities, Traditional Owners, and industry.

RTIO strongly supports the flexible, catchment-by-catchment based approach to water trading and the allocation of entitlements taken within the proposed *Water Resources Management Act* (which will enable a range of entitlements to co-exist). RTIO is concerned that Recommendation 5 may translate into a state-wide approach to allocation of entitlements within a catchment that is more rigid, and contrary to the Government's intended approach in the proposed water resources legislation.

4.4 Third Party Access

In a study on this issue in 2000, the Institute for Research into International Competitiveness (IRIC) identified a number of characteristics particular to water that limited the opportunity to develop third party access regimes⁴. These included:

- **Alternative suppliers must exist and be competitive:** otherwise there will be no alternative suppliers seeking to access the incumbent's infrastructure;
- **Energy costs must be inexpensive relative to accessing water from local sources:** The energy costs for transmission and distribution of water is a major component of the final costs for water services (unlike electricity, where the critical cost component is generation). If the costs of distribution are relatively high, it is more likely that supply will be sourced from alternative sources closer to the point of distribution.
- **Infrastructure must have spare capacity available:** Unlike gas, which can be compressed, water is more limited in the extent to which available capacity can be accessed or increased. Capacity is limited by pipeline size and the number of pumping stations on a given pipeline. Thus, in many instances, capacity can be expanded only at substantially higher costs, making it an unattractive proposition.⁵
- **Limitations to local supply:** Demand for third party access arrangements is only likely to occur where the consumptive pools for local sources are approaching full allocation or where water is simply not available.
- **The natural monopoly component must be isolated:** The ability of alternative suppliers to compete will be impaired if the owner of the transmission network is not disaggregated from the supply and the distribution/retail aspects of the supply chain.
- **Variations in water quality:** The quality of the water in the transmission pipe may be compromised where two or more suppliers share water transmission infrastructure via third party access arrangements. In cases where the water is being supplied for the purposes of human consumption for example, low quality or non-potable supplies may compromise drinking water quality

⁴ Institute for Research into International Competitiveness (IRIC) "*Third Party Access in the Western Australian Water Industry: Final Report*" (August 2000).

⁵ Institute for Research into International Competitiveness (IRIC) "*Third Party Access in the Western Australian Water Industry: Final Report*" (August 2000), p49.

guidelines. Furthermore, if the quality of a water resource being fed into common infrastructure suffers a compromise in quality due to a system failure, the integrity of the entire resource could be compromised – with implications for rectification of quality problems and may raise issues of compensation.

RTIO notes that the Draft Report has not considered these limitations and would encourage the ERA to consider these factors in the Western Australian context.

Further, the Draft Report has noted the introduction of a state based third party access regime for water and wastewater infrastructure in NSW and arrangements in England and Wales, but has not provided comment on the success or otherwise of these regimes.

RTIO reserves its position regarding the application of a third party access regime to water infrastructure in Western Australia (Recommendations 8-11). More evidence needs to be provided by the ERA. RTIO encourages the ERA to undertake additional stakeholder consultation on this issue once further evidence has been gathered, and prior to the release of the Final Report to Government.

4.5 Water usage pricing

Recommendation 15 notes that:

“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.”

The Draft Report then briefly outlines the framework which would enable some flexibility in the range of price plans available to customers, which would include an option for a scarcity-based approach. There are some aspects of the proposal that seem unclear:

- The suggestion that a range of possible price plans, including an option that includes scarcity-based pricing, suggests a move away from the Government policy on uniform pricing, but this is not expressly stated; and
- The discussion of the options for price plans suggests a domestic customer focus. What is the intention for commercial consumers?

Furthermore, section 4.3 of this submission (Water Trading) identifies significant obstacles to the formation of markets in the inland Pilbara region, and in certain areas within this region, the existence of surplus water. This suggests that scarcity based pricing may have limited application in certain regions of the state.

There is a significant amount of work that would need to be undertaken to develop any reasonable and workable proposals on this issue. Any such work would need to carefully address the following:

- Consideration of scarcity-based approaches within a framework that offers pricing options to customers. There are market circumstances in some

areas of the state where markets are dysfunctional or do not exist, and therefore limit the effectiveness of price signals;

- Careful consideration of the effectiveness of scarcity-based approaches and other options on the responsiveness of a full range of water consumers to price signals (ie. issues relating to the price elasticity of demand for water for this range of consumers). Commercial consumers will have different consumption patterns and behaviours to domestic consumers;
- Extensive consultation with a broad range of users to assess the financial impact of various options;
- A detailed assessment to ensure that proposals result in a higher value use for the water, rather a higher price paid by the existing user;
- Consideration of the impact of any changes on economic sectors and broader economic and regional development; and
- Careful consideration of the regulatory aspects of pricing.

RTIO stresses the need for extensive stakeholder consultation and further consideration of some key issues regarding the introduction of scarcity based pricing (Recommendation 15). Further studies should be undertaken on this issue to consider: effectiveness of price signals for a range of users (ie. price elasticity of demand); financial impacts on users; a clear distinction between proposals for domestic consumers and proposals for commercial consumers; scarcity based pricing within a framework that offers options to customers; market limitations on where scarcity based pricing can be applied; and broader impacts on economic and regional development.

4.6 Multi-utility

RTIO notes that the formation of a multi-utility was not considered in the Issues Paper, and that Finding 16 has emerged primarily from work by ACIL Tasman commissioned by the ERA for the purposes of the Inquiry.

The opportunities for cost reduction are outlined in the Draft Report and Finding 16 concludes that there are "...potential significant cost savings from the creation of a multi-utility...". Conversely, the Draft Report clearly notes that the ACIL Tasman Report concluded that "...complete amalgamation of the country water business with the Horizon electricity business may only yield a marginal improvement in cost saving."⁶

It is therefore unclear as to whether there is strong evidence to suggest that the creation of a multi-utility through the transfer the Corporation's water and wastewater assets to Horizon Power in its area of operation is justified at this point. In accordance with the Terms of Reference of this Inquiry, it will be necessary for the ERA to clearly identify the costs and benefits of such a change.

⁶ ACIL-Tasman Report on *Size and scope economies in water and wastewater services* (2007), p48, as cited in the *Draft Report – Inquiry on Competition in the Water and Wastewater Services Sector* p86.

RTIO cautions against making a definitive recommendation regarding the formation of a multi-utility (Recommendation 17) without a robust consideration of the costs and benefits of doing so and without a subsequent stakeholder consultation regarding potential impacts of such a change, before the release of the Final Report. RTIO concurs with Finding 16 that more work needs to be done before any definitive conclusions can be made and notes that this has limited the opportunity for relevant stakeholders to make comment based on solid information.

4.7 Community Service Obligations

The Draft Report notes that in its submission to the Issues Paper, RTIO welcomed the proposed legislative changes that would make Community Service Obligations (CSOs) available to the private sector. Ensuring that CSO payments are available to the private sector is one way of encouraging private sector participation in the provision of water services (particularly in regional areas) under the continuation of the uniform pricing policy.

RTIO endorses the ERA's finding that proposed legislative reforms being undertaken by the Department of Water will enable the payment of Community Service Obligations (CSOs) to all licensed service providers.

RTIO reiterates that *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. However, the findings of the ACIL Tasman report *Size and Scope Economies in Water and Wastewater Services* (2007), commissioned to inform the development of the ERA's Draft Report, would suggest that more detailed consideration should be given to the way issues of size and scope should shape the way in which services that attract CSOs are bundled to encourage competition.

This is supported by the submissions of some key stakeholders. The Water Corporation, for example, noted that "New services to small communities are essential services but are not attractive business opportunities and tend to take up a disproportionate amount of management time. The Water Corporation has chosen not to participate in competitive processes for new schemes in the past as these were not attractive from a purely commercial point of view."⁷ Furthermore, the Department of Water's submission on the Issues Paper observed that, in practice, the value to be derived from competition for services that attract CSOs will depend on, amongst other things, the existence and willingness of alternative service suppliers.⁸

⁷ Water Corporation submission to ERA Issues Paper, p vii

⁸ Department of Water submission to ERA Issues Paper, p32

Together with the findings of the ACIL Tasman report, these views suggest that competition for the right to provide services that attract CSOs on a scheme by scheme basis may be limited, and that the efficiencies deriving from a competitive process may only be realised if these services are appropriately bundled.

CSO policy should specifically address the impact of size and scope issues on the way in which services that attract CSO payments are bundled to encourage competition.

Recommendation 18 of the Draft Report has recommended that "...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." However, RTIO notes that the explicit allowance for the payment of CSOs to non-government entities is a policy position that has already been accepted by Government in the National Competition Policy legislation reviews of water industry legislation, and understands that the proposed Water Services Bill will enable CSO payments to be made available to the private sector.

What remains is the need for a policy to address the following:

- A clear, step by step process for all participants (private and public sector) for accessing CSO payments, which treats public and private sector applicants equally;
- A clear approach to the process for identification of opportunities for provision of services that attract a CSO, including;
 - Consideration of bundling services to encourage the participation of alternate service providers in a *competitive* process, and the process by which these opportunities are to be put to the market; and
 - Consideration of unsolicited proposals for the provision of services that offer to reduce the CSO payment burden to Government at a quality of service provision equal to or better than that which already exists.

The Draft Report does not consider these in any depth and recommends that the Department of Treasury and Finance develop its own procedures related to the payment of CSOs. However, it is noted that the Terms of Reference require that a key area of focus for the Inquiry include "...arrangements for community service obligations paid by the State Government to service providers." As an independent source of advice to Government on key matters concerning competition, it is squarely within the ERA's remit to make recommendations regarding some of the key issues that will need to be addressed within the CSO policy referred to in Recommendation 18.

RTIO considers that key matters that will need to be addressed in the development of this policy include:

- Integration with the process for issuing an Operating Licence;
- Method of calculation of CSO payments;
- How to incorporate incentives for private sector participation in delivering services that attract CSO payments;

- Appropriate governance arrangements for oversight of competitive processes, analysis of applications and proposals, and calculation of applicable CSO payments⁹;
- The need to ensure that processes are both timely and streamlined; and
- Arrangements for appropriate scrutiny and review¹⁰.

RTIO considers that the ERA is entitled within the Terms of Reference of this Inquiry to make recommendations regarding key issues that will need to be addressed within the CSO policy. RTIO's views on some matters for consideration are provided above.

For further information in regards to this submission, please contact Mike Harold, Principal Advisor Water Policy on 08 9366 5641 or mike.harold@riotinto.com.

Dennis B Gibson
General Manager Water Resources

⁹ If an IPE is to be established in Western Australia, with the express role of making decisions regarding competitive supply of specified works and operations as well as the need for additional water sources, then this may be an appropriate agency to oversee consideration of that part of CSO policy that relates to analysis of applications and calculation and review of the applicable CSO payments.

¹⁰ RTIO concurs with the Chamber of Commerce and Industry's view that CSOs will need to be audited carefully and reviewed regularly. (Chamber of Commerce and Industry submission to ERA Issues Paper, p4)

ATTACHMENT A

Summary of RTIO's comments on the ERA's Issues Paper dated September 2007

Key points raised in the RTIO submission to the ERA's Issues Paper were as follows:

- RTIO's interest is in competitive outcomes (ie. efficiency) and not necessarily with competition *per se* – without diminishing security of supply.
- RTIO supports a phased approach to reform in the water industry – specifically it is better to bed down the legislative environment before embarking on significant structural change as there are risks of doing it too fast and getting it wrong.
- RTIO supports the removal of impediments to competition/private sector participation.
- 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.
- The availability of CSOs to the private sector and the ability to competitively bid for CSO provision is a key way of enabling the private sector to participate in the WA water and wastewater sectors.
- Mechanisms are required to provide detailed source planning for all potential competitors as early as possible to facilitate optimal benefits from private sector participation.