

**Water Services Association of
Australia**

**Submission to the
Productivity Commission
review of the National Access
Regime**



WATER SERVICES
ASSOCIATION OF AUSTRALIA

OVERVIEW OF WSAA

WSAA IS THE INDUSTRY BODY THAT SUPPORTS THE AUSTRALIAN URBAN WATER INDUSTRY

Its members and associate members provide water and wastewater services to approximately 16 million Australians and many of Australia's largest industrial and commercial enterprises.

The Association facilitates collaboration, knowledge sharing, networking and cooperation within the urban water industry. It is proud of the collegiate attitude of its members which has led to industry-wide approaches to national water issues.

WSAA can demonstrate success in the standardisation of industry performance monitoring and benchmarking, as well as many research outcomes of national significance. The Executive of the Association retain strong links with policy makers and legislative bodies and their influencers, to monitor emerging issues of importance to the urban water industry. WSAA is regularly consulted and its advice sought by decision makers when developing strategic directions for the water industry.

Table of Contents

1.0 Introduction and overview.....	4
2.0 Third party access and the water industry.....	5
2.1 The NSW state-based access regime	5
2.1 Access in other jurisdictions	6
3.0 Competition in the water industry	7
4.0 The role of the NAR	11

1.0 Introduction and overview

WSAA welcomes the opportunity to make a submission to the Productivity Commission's (PC's) review of the National Access Regime (NAR).

The NAR is intended to promote competition in industries with potential monopoly bottlenecks. WSAA supports competition where it is efficient and delivers value to customers. This submission provides WSAA's views on the role of the National Access Regime in promoting competition in urban water. It comments on the water industry's specific involvement with the National Access Regime to date and role of the NAR against the background of developments towards competition in the urban water industry.

The water industry in Australia manages assets with a replacement value of over \$120 billion in 2010-11. Significant elements of the industry value chain — particularly the transport of water and wastewater are widely regarded as natural monopolies. In the past bulk water was supplied largely from dams. However, in most jurisdictions sources of supply have diversified to include desalination, recycling, stormwater harvesting and groundwater. Similarly, for wastewater transport and treatment there is growing interest in decentralised systems in new growth areas.

Competition is beginning to emerge in the supply of services. In Scotland full retail competition has been introduced for all businesses and public sector organisations. In Australia new areas and redevelopments are increasingly contestable by new entrants, and the privately financed Sydney Desalination Plant has a retail supplier's licence.

On the face of it the characteristics of the water industry could indicate that the NAR may have a significant role to play in promoting competition. While the NAR provides a sound framework for third party access, a closer examination suggests that the NAR as a stand-alone policy tool, has a limited role in the future development of the water industry.

As recognised by the PC in its Urban Water report, it is not straightforward to introduce competition into the urban water industry. To use the PC's phrase large components of the value chain are not 'naturally competitive' in the traditional sense. The Commission is correct in its assessment that competition is not simply a matter of providing a right of entry. If that were the case, then extensive use of the NAR could have been expected as entrants sought out profitable opportunities.

Removing barriers to entry under instruments such as the NAR is not sufficient to generate material competition. Licensing regimes for new entrants, such as contained in the NSW as the *Water Industry Competition Act 2006*, are a logical next stage for some jurisdictions. However, they too are a step towards competition rather than an end point. As in other infrastructure intensive industries such as electricity and gas, if competition is to deliver value to customers (in the bulk water sectors in particular) it will require careful market design and supporting institutional arrangements.

2.0 Third party access and the water industry

The urban water industry's experience with the National Access Regime derives primarily from the Services Sydney application for access to Sydney Water's coastal wastewater networks and subsequent developments in NSW.

In 2005 the National Competition Council declared Sydney Water's coastal wastewater networks under Part IIIA of the (then) Trade Practices Act. In negotiations with Services Sydney, Sydney Water put forward a pricing methodology for access to its wastewater network. The method was designed to promote competition on its merits while protecting existing customers against cherry picking of profitable areas.

However, Services Sydney sought arbitration by the Australian Competition and Consumer Commission (ACCC) on the pricing method. This was the first arbitration conducted by the ACCC under the NAR. The ACCC decision endorsed the access pricing approach put forward by Sydney Water.

Services Sydney did not seek to progress access negotiations further with Sydney Water.

Sydney Water is better able to comment on the detailed application of the NAR. However, WSAA understands that the framework and processes within the NAR have proved sound. These include the pricing principles on which the arbitration was based and the merit review processes within the regime.

2.1 The NSW state-based access regime

Subsequent to the ACCC arbitration, the NSW government passed the *Water Industry Competition Act 2006*. The objectives of the act are to encourage competition in water and wastewater services and to facilitate recycling. The act contains a third party access regime and a licensing regime for water and wastewater services.

The access regime was certified as an effective state-based regime by the National Competition Council in August 2009.

The third party access regime is yet to be used, however, nine schemes have been licensed under the Act since its commencement. 'These schemes include sewer mining projects in multi-storey buildings, dual reticulation systems in housing estates, large recycling projects for industrial and commercial customers, desalinated bulk water supply, and a sewerage system in northern NSW'.¹

The Act has allowed new operators to service areas not serviced by Sydney Water. One company has applied for a licence to service a major infill redevelopment area. The new company will be the exclusive provider of all water, wastewater and recycled water services to customers in its licensed

¹ NSW Government, *Urban Water Regulation Review Discussion Paper*, p.33

area. Sydney Water will sell water to the company at the boundary and put arrangements in place to recover the costs of any discharges to Sydney Water's wastewater network.

The NSW government is now reviewing the WIC Act.

2.2 Access in other jurisdictions

Queensland has a third party access regime that applies to water and other utilities and transport infrastructure, under the Queensland Competition Authority Act 1997. Third party access arrangements for water are being considered in Victoria and South Australia.

Under Section 26 of the South Australian Water Industry Act 2012, the South Australian Government, via the Minister for the River Murray, is required to publish a report on third party access to SA Water's water and sewerage infrastructure services. The Minister released the report on 1 February 2013. The report seeks comment on the costs and benefits of establishing a state based legislative regime. However, it notes that Section 26(4) of the Water Industry Act anticipates that a state-based access regime will be introduced into Parliament.

Beyond legislative regimes, there are a range of examples in the urban water industry of access to physical infrastructure being negotiated on a cooperative commercial basis.

SA Water has demonstrated an acceptance of access arrangements in the past by voluntarily entering into a bulk water transport arrangement with Barossa Infrastructure Limited (BIL), off-peak bulk water supply agreements with irrigators and a sewer mining arrangement with the City of Tea Tree Gully. Marsden Jacob Associates research paper on Third Party Access to Water and Wastewater Infrastructure in 2005, specifically noted that the BIL scheme involved significant upgrading of the SA Water system in order to assist BIL 'and goes beyond a simple third-party access regime.'²

More recently, in Western Australia Rio Tinto (RTIO) is developing a 10GL per annum water supply scheme to substitute for their existing demand for their town of Dampier, the port operations, and to cater for their expansion. The existing capacity released by the development of their scheme will be available to meet the growing demand from other customers, and is now part of the scheme planning to meet these demands.

The Bungaroo borefield will be part of an integrated potable water scheme also supplied by the Millstream borefield and Harding Dam. RTIO needs to transport their water from the Bungaroo borefield via a dedicated 90km pipeline to the Millstream Borefield, then through the Water Corporation's augmented 130km of pipelines from Millstream to the coast.

The Water Corporation is providing access to its assets through a water transportation agreement with RTIO that includes RTIO's capacity entitlements and payments, and the terms that ensure water quality and security of supply for the whole scheme.

² Marsden Jacob, *Third Party Access in Water and Sewerage Infrastructure : Implications for Australia*, 22 December 2005, p. 22

3.0 Competition in the water industry

The role of the NAR needs to be seen in the context of the potential scale and scope of competition in the water industry. This submission does not attempt to set out in detail the scope and competition in each element of the value chain for water. It provides a high level overview as it relates to the potential role of the National Access Regime.

Competition can take a number of forms. It is important to distinguish between competition in the market, competition for the market and competitive sourcing arrangements.

The water industry has in recent decades made extensive use of the benefits of competitive pressure to efficiently source services and capital through tendering and contracting arrangements. For example, as set out in table 1 nearly all capital expenditure by major water utilities is delivered by the private sector, and a significant proportion of operating expenditure is also outsourced.

Table 1 Proportion of total expenditure outsourced by WSAA members

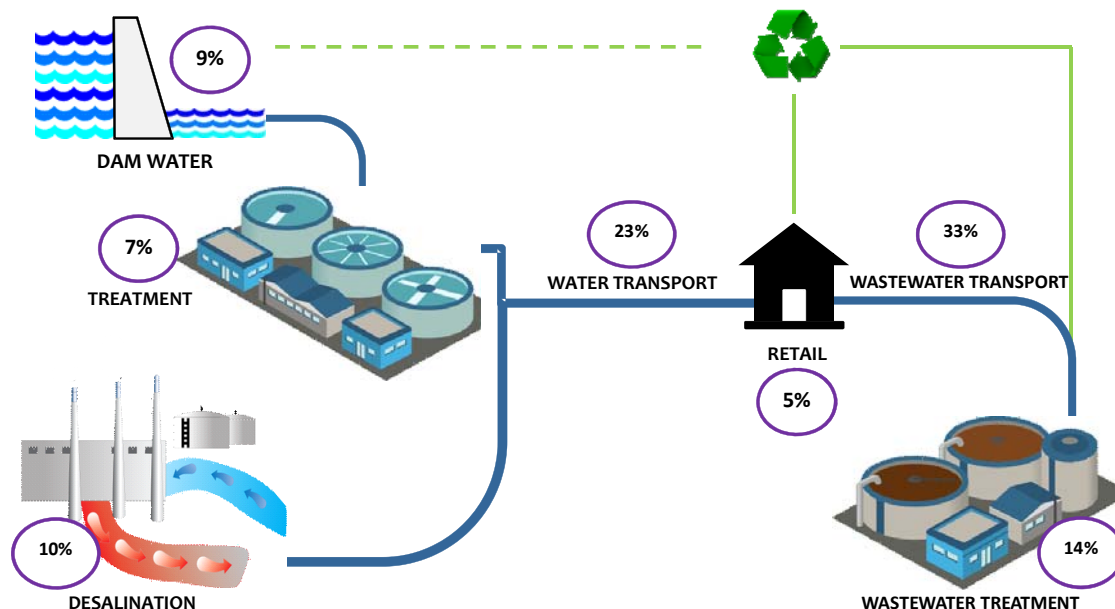
WSAA member	2009-10: % Capital expenditure outsourced	2009-10: % Operating expenditure outsourced
Water Corporation	93	30
Sydney Water	94	72
Sydney Catchment Authority	99	64
Melbourne Water	100	73
South East Water	90	42
Yarra Valley Water	98	58
		(with further 33% benchmarked)
Hunter Water Corporation	100	65
ACTEW	100 (28 to ACTEW/AGL, 72 to other alliances)	100 (outsourced to ACTEW/AGL)
SA Water	94	65

As noted above, the area of greatest activity is geographic contestability *for* the market. There is increasing interest from new players in servicing fringe areas of urban developments, not currently served by utilities, serving entire greenfield developments or servicing infill redevelopments.

However, there is not the traditional head to head competition that characterises many markets. Significant elements of the supply chain are natural monopolies.

A generalised value chain is presented in figure 1. It shows the percentage of costs of each major component of the water industry. Bulk water costs represent around one quarter of costs, but are likely to vary significantly among utilities, depending on the sources available to each community and the level of treatment required.

Figure 1 Indicative value chain for the water industry (% of total costs of each stage)



Source: Sydney Water

The water and wastewater networks comprise over 50 per cent of the costs of the industry and are widely regarded as natural monopolies. It would be uneconomic and wasteful to duplicate elements of the network.

The retail segment of the industry can be competitive. As noted, Scotland has introduced retail competition for non-residential customers (Box 1). The UK is now developing a seamless Anglo-Scottish retail water market. Owing to the complexity of the issues it is not expected to commence operations until 2017.

In Australia, retail margins tend to represent a small proportion of a utility's total costs and retail competition has not yet commenced. However, with new bulk water players, such as the privately financed Sydney Desalination Plant, retail competition is likely at some point in the future.

Box 1 Retail competition in the Scotland and England

In 2008 full retail competition was introduced in Scotland for businesses and public sector organisations. The *Water Services (Scotland) Act 2005* established the framework for competition and required the separation of Scottish Water's wholesale services from its retail function. The retail company is called Business Stream. The Water Industry Commission for Scotland is responsible for implementing the framework set out in the Act, including licensing all participants in the market. Currently there are 8 licensed suppliers.

- Scottish Water Business Stream Limited;
- Osprey Water Services Limited;
- Aimeria Limited
- Wessex Water Enterprises Ltd;
- Severn Trent Select Ltd;
- Thames Water Commercial Services Ltd
- Veolia Water Projects Limited
- United Utilities Water Sales Limited

A Central Market Agency (CMA) was set up to administer the new market. The CMA registers who is the licensed supplier of each business customer in Scotland. The CMA also calculates the money owed by each supplier to Scottish Water for wholesale services. All licensed suppliers in the Scottish market are required to:

- become party to the Market Code and a member of the CMA;
- undergo a process of assurance and technical checks performed by the CMA.

The Water Industry Commission of Scotland suggests that the benefits of multiple retail supplies for customers are: a higher standard of service; services that are more closely tailored to business needs; better value for money and advice about how to use water more efficiently.

The UK published a draft water bill in July 2010 outlining plans for an anglo-scottish water market based on the experience of the Scottish market. All non-domestic customers in England and Scotland will be eligible to be part of this market. It is intended that the new market will commence in April 2017.

Debate about prospects for head to head competition centres on the bulk water and wastewater treatment components of the market. Wastewater treatment comprises 14 to 25 per cent of costs depending on the level of treatment required. While the original Services Sydney application was for the wastewater networks, the extent it is economically efficient to duplicate wastewater treatment plants is questionable.

The PC examined the role of competition in urban water, concentrating on the bulk water sector. WSAA considers that the PC reached a balanced view in relation to competition. The PC saw a case to 'introduce greater competition and promote innovation where cost effective' and considered the gains could be substantial, particularly for bulk water supply. However, it noted :

The potential gains in urban water are likely to be more modest [than other utility industries] because:

- limited forms of competition have already been introduced through contracting out and build, own and operate arrangements
- compared with other utility sectors, a greater proportion of costs are in natural monopoly elements of the supply chain (for which competition in the market would be inefficient). (p. 245)

The PC reached the conclusion that competition is unlikely to ‘naturally’ develop in urban water. It also questioned whether the benefits of established competition via administered markets outweighed the costs at this time.

If well-functioning markets already exist, competition in the market can develop ‘naturally’. Alternatively, competition in the market can be administratively established (that is, markets can be created).

Naturally occurring competition depends on a number of preconditions being met, for example:

- many producers offering a relatively similar/homogenous product
- many consumers that can choose between competing providers
- low or no transaction costs
- low or no barriers to market entry or exit (over the long term), and so on.

Where these conditions do not hold, and competition in the market does not occur naturally, there might be a case for *establishing* competition. The National Electricity Market provides an example of this approach.

Administering competitive markets is a complex and costly task, and has relatively onerous preconditions. The Commission is not convinced that there is a compelling case for creating this type of competition in the urban water sector at this time — a view strongly supported by inquiry respondents. The absence of any international precedent of urban water markets compounds the risk and uncertainty associated with establishing competition of this kind in the Australian urban water sector at this time. (p.334)

WSAA is pleased that the PC has recognised the complexities of the water industry. A significant proportion of the services in the water industry are subject to competitive tendering, and the industry has shown a preparedness to work with new players. However, competition in the market in its traditional form is more difficult to introduce in the water industry than in most industry sectors and is challenging even by infrastructure sector standards.

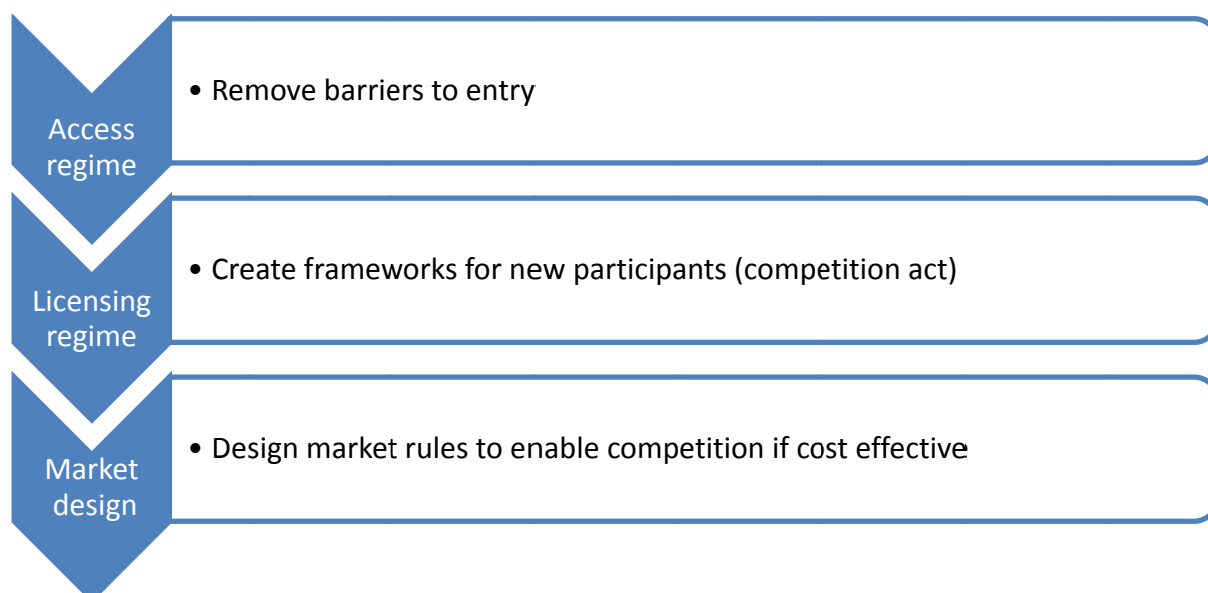
Geographic contestability would often require physical access to an existing water utility’s networks. However, this form of competition for the market is likely to be integrated with planning for urban growth and be a result of a policy decision by governments. The NAR on its own is unlikely to be able to support widespread geographic competition.

Figure 1 summarises WSAA’s view of the preconditions for effective competition in water. Removal of barriers to entry as provided by an access regime is a first step but not sufficient for competition. For an essential service such as water a minimum requirement is a licensing regime for all players to ensure health standards are met and infrastructure meets appropriate technical standards, and ensure appropriate levels of consumer protection. Last resort arrangements are also necessary to define who will provide services in the event of withdrawal or financial failure by new entrants.

However, both the access regime and a licensing regime presuppose a degree of natural competition. If this is absent the third stage — market design and market rules — would be necessary. For example, to allow scope for the Sydney Desalination Plant to sell directly to customers, the NSW pricing regulator, IPART, included a range of mechanisms in its price determinations for the Sydney Desalination Plant, Sydney Water and the Sydney Catchment Authority. The timelines for the development of retail competition in Scotland and England illustrate the complexity of the issues.

In NSW, the first two stages appear to have offered benefits to the industry and customers and enabled innovation. As the PC noted the third stage has not been attempted anywhere in the world for bulk water supply and would need to be subject to a cost benefit test before implementation to protect the public interest.

Figure 1 Institutional requirements for competition in the water industry



4.0 The role of the NAR

The NAR provides a framework for third party access, and has underpinned industry-specific regimes in a number of industries including water. The urban water industry saw the first arbitration under the NAR. The ACCC arbitration set a pricing regime that protected the interests of existing utility customers from inefficient cherry picking.

However, given the characteristics of urban water markets the role of the NAR will be limited. The NAR is predicated on the existence of vibrant upstream or downstream markets. It is intended to promote competition by removing barriers to entry via access to monopoly bottlenecks. But in the urban water industry, upstream and downstream markets are only now beginning to emerge. Monopoly networks have not constituted a bottleneck to competition. It is the characteristics of the water industry across the value chain that have limited the extent of natural competition, rather than the actions of utilities in blocking access.

The current value of the NAR to the water industry lies in its position as sitting at the apex of economic regulation. It underpins industry specific access regimes, including the certified water access regime in NSW. However, third party access is itself a subset of monopoly regulation more generally. It is important to have consistency between access regulation and general economic regulation.

As third party access regimes become part of the regulatory landscape of the water industry, the NAR could play a positive role in securing more consistent, transparent and predictable general economic regulation of water utilities. Strong features of the NAR include merits review and clear pricing principles. As these become incorporated into state access regimes it highlights the absence of such features in much of the existing economic regulation of water utilities.