

**Water Services Association of
Australia**

**Submission to IPART's
review of prices for
wholesale water and
sewerage services**

May 2016



**WATER SERVICES
ASSOCIATION OF AUSTRALIA**

OVERVIEW OF WSAA

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

The Water Services Association of Australia (WSAA) is the peak industry body representing the urban water industry. Our members provide water and sewerage services to over 20 million customers in Australia and New Zealand and many of Australia's largest industrial and commercial enterprises.

Based around our vision of 'customer driven, enriching life', WSAA facilitates collaboration, knowledge sharing, networking and cooperation within the urban water industry. We are proud of the collegiate attitude of our 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.

WSAA was formed in 1995 as a non-profit organisation to foster the exchange of information between industry, government and the community, and to promote sustainable water resource management.

WSAA acknowledges the assistance of Mike Woolston of Frontier economics in the preparation of this submission.

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1.0 Introduction and overview

WSAA welcomes the opportunity to make a submission to IPART's review of prices for wholesale water and sewerage services provided by Sydney Water and Hunter Water to new private and other participants in the NSW water industry.

IPART is to be congratulated for devoting the time and resources to undertaking this review as a separate investigation. This review is important because it is the first detailed examination of pricing for competition in the urban water industry. It will set some important precedents for the prices paid for wholesale water and wastewater services by new entrants and frame how regulators are likely to look at competition issues in the sector.

WSAA's interest in this review stems from its potential implications for the urban water sector nationally. There is growing support within Australia (and elsewhere) for efforts to increase competition in the provision of water and wastewater services:

- New South Wales has implemented a state-based access and associated licensing regime.
- In South Australia, a number of voluntary access arrangements have already been established and a formal Third Party Access (TPA) regime is scheduled to apply to defined parts of SA Water's network from 1 July 2016.
- In Victoria, the government's recent *Water for Victoria* discussion paper noted that the Government would consider options to facilitate third party access to water and wastewater infrastructure.
- In Queensland and Western Australia, developers and others have been active in seeking to provide water and sewerage services in new developments.
- In Western Australia, while there is not yet any legislative framework governing Third Party Access to water infrastructure, there are commercial arrangements in place in the North-West of the state that enable third parties to access the Water Corporation's infrastructure.

However, as noted in WSAA's recent joint paper with Infrastructure Partnerships Australia (IPA), to date participation by new entrants has occurred despite, rather than because of, good regulatory settings. The regulatory and competition frameworks are not yet in place which allow new players to enter the industry while ensuring positive outcomes for customers. As the need for this review demonstrates, the Water Industry Competition Act in NSW, while a good start, does not provide all the elements necessary for effective competition or the efficient entry of new players.

WSAA agrees with IPART that access and/or wholesale pricing which allows new entrants and existing public utilities to compete on equal terms is only one part of the solution for facilitating competition in the water industry. Nevertheless, WSAA considers that IPART's current review of approaches to wholesale pricing provides an important opportunity to establish precedents for one key element of this competitive framework.

The IPART review provides a timely opportunity to clarify the best way forward in the interests of all stakeholders including public utilities, private competitors, and end customers. In WSAA's view the framework for competition in the urban water sector should focus on areas of largest practical benefit rather than simply rolling out models from other sectors which may be both costly and ineffective.

At the current time, the key question is how to allow new players to enter the market while preserving governments' policies of postage stamp pricing. Under postage stamp pricing all the customers in a utilities area of operation pay the same, or very similar, charges even though the cost of servicing them vary significantly.

In this regard IPART's proposal to regulate the prices for wholesale services provided by public water utilities to wholesale customers who then on-supply services to their own end customers appears sensible. Under the retail minus approach the wholesale price will include any contribution customers in a low cost area are making to customers in a high cost area. The approach is intended to facilitate new entry only when it is efficient. By contrast a purely cost-based approach would allow entrants to cherry pick low cost areas or customers, leaving utilities — and critically their customers — to service higher cost areas. This would be unsustainable for the utility customer base.

WSAA therefore strongly supports IPART's view that a retail minus approach is the only feasible option. WSAA is not proposing to respond in detail on the wholesale pricing methodologies proposed by IPART as this is more appropriately addressed by the water businesses in NSW. However, it encourages IPART to carefully consider the detail of the methodology to ensure that its proposed approach does not inadvertently encourage inefficient entry which increases overall costs or leads to higher prices for the broader customer base, and is practicable to apply.

1.1 Key Findings

- IPART's review of wholesale prices is an important first step in developing pricing approaches to support competition in the urban water industry
- WSAA supports IPART's position that the objective of access or wholesale pricing is to promote efficient entry when competitors are more innovative or lower cost than incumbents. It is not to encourage competition for its own sake.
- regulation of wholesale services is one step to promote effective competition in the urban water sector in the short to medium term. But much more work remains to be done to design a competitive framework that will benefit customers in the long term.
- a retail minus approach to setting wholesale prices is necessary to protect utility customers under a postage stamp pricing system.
- A wholesale price will primarily allow competition or contestability for the market in specific geographic areas. However, new entrants will have monopolies over their customers in those areas. To protect customers the same retail price regulation should apply to new entrants as applies to existing water utilities.

2.0 What is competition in the urban water sector?

At a general level, it is clear that competition in the provision of services can lead to significant benefits. As observed by IPART in its Discussion Paper, “increasing competition in the supply of water and sewerage services should encourage greater efficiency in the supply of these services, thus reducing costs for the benefit of consumers”. It identifies three types of efficiency which competition should promote:

- Productive efficiency: Competitive forces generally lead to the displacement of high cost or low quality firms by more efficient ones. Where there is effective competition (with minimal barriers to entry), firms will be forced to lower their prices and/or increase their level of service quality to attract and keep customers.
- Allocative efficiency: Competition compels firms to offer products that customers value.
- Dynamic efficiency: Competition can drive innovation, where valuable new types of services become available or existing services are provided at lower cost.

In WSAA’s view, however, a key policy question is precisely what forms of competition are likely to be effective in delivering these sorts of benefits in the supply of urban water and sewerage services and how to best design policy and regulatory frameworks to support these forms of competition.

2.1 Potential forms of competition

Competition can take a number of forms. It is important to distinguish between:

- Competitive sourcing arrangements: competition for specific services which can be introduced through arrangements such as service contracts or, for larger capital works, more complex arrangements such as build own operate (BOO), or build own operate transfer (BOOT) arrangements.
- Competition *in* the market: when consumers can choose between a range of competing providers for the supply of a good or service.
- Competition *for* the market: allowing firms to compete for the right to provide services to customers in a defined geographic area/market (e.g. a franchise).

There is already widespread use of competitive sourcing arrangements in the urban water sector in Australia and has been for many years. The water industry has made extensive use of the benefits of competitive pressure to efficiently source services and capital through tendering and contracting arrangements. Nearly all capital expenditure by major water utilities is delivered by the private sector, and a significant proportion of operating expenditure is also outsourced. This type of competition is likely to be an ongoing feature of the industry under any conceivable form of industry structure into the future.

In recent years attention has increasingly turned to forms of competition which would create a market for service provision to end users. Such forms of competition are distinguished from competitive sourcing in that they involve new suppliers having a direct relationship with end customers, rather than simply supplying services to public water utilities as inputs to these end services.

IPART’s review is concerned with facilitating this type of competition. This could entail either competition in the market or competition for the market. To date however, there has been little

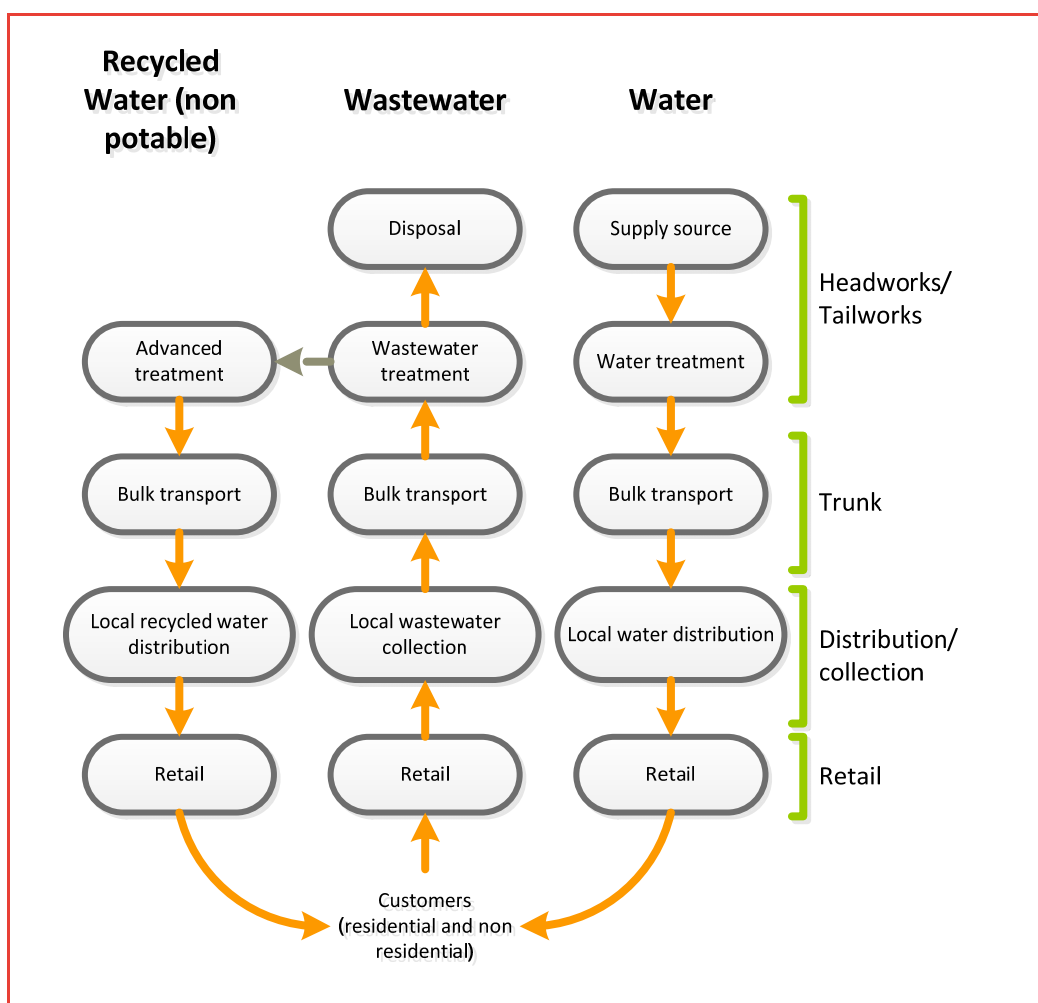
clarity about the type of competition which policymakers are seeking to encourage in the urban water sector and the policy and regulatory frameworks which will best support this.

2.2 Competition in the market

In other utility sectors, models of competition have focussed on competition in the market. For example, this applies in electricity and gas where there are competitive markets in wholesale and retail supply. In order to enable competition in these contestable activities, third party access regimes have been established to enable access to the natural monopoly networks needed to deliver services.

In considering the potential applicability of a similar model for urban water, it is helpful to consider the supply chain (see Figure 1).

Figure 1: Water and wastewater supply chain



Source: Frontier Economics

In recognition of the benefits that competitive markets can provide, pro-competitive reforms in a range of utility sectors have focused on:

- separating the monopoly and potentially competitive industry segments;
- deregulating those sectors that are capable of being competitive; and

- providing open access to, and regulation of, the monopoly transport networks where competition is not feasible or economic.

As a result of these reforms competitive markets have been established for upstream production and wholesale supply of the utility commodities (e.g. in electricity and gas) and retailing to end users.

Similar market-based reforms could be envisaged in the urban water sector, with the potential for market-based competition in a number of elements of the water cycle including bulk water supply (including storage based, extractive and manufactured bulk water), water and wastewater treatment, local water supply based on smaller scale solutions or technologies and retail supply of water and wastewater services.

However, competition in the market is arguably more difficult to introduce in the water industry than in most industry sectors and is challenging even by infrastructure sector standards. For example, in 2011 the Productivity Commission (PC) conducted a major review of the urban water sector. As part of this the PC examined the role of competition in urban water, concentrating on the bulk water sector. While the PC saw a case to ‘introduce greater competition and promote innovation where cost effective’, it noted:

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

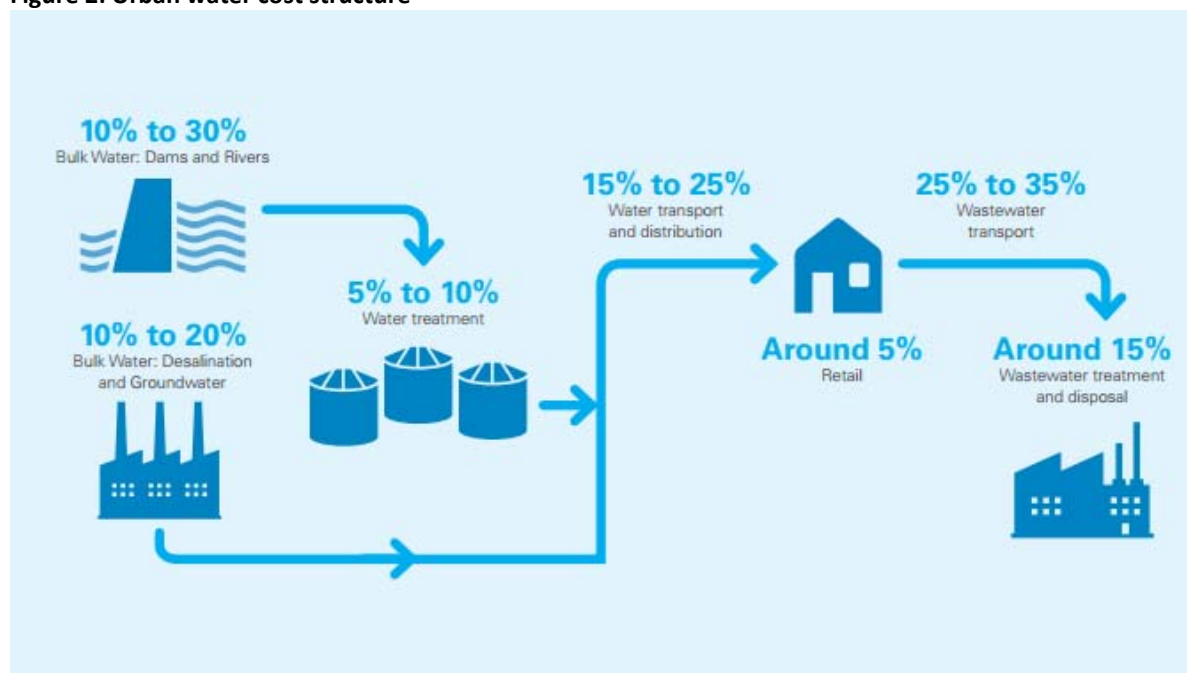
- limited forms of competition have already been introduced through contracting out and build, own and operate arrangements
- compared with other utility sectors, a greater proportion of costs are in natural monopoly elements of the supply chain (for which competition in the market would be inefficient).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

Thus the question is not just whether competition in the market can be introduced, but whether the costs of creating such a market are justified by the potential benefits.

A generalised value chain is presented in figure 1. It shows the percentage of costs of each major component of the water industry. The water and wastewater bulk transport and distribution 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 these networks – analogous to transmission and distribution networks in electricity.

In principle, however, it may be feasible to facilitate competition in upstream or downstream activities – bulk water supply and treatment, wastewater treatment, and retail services.

Figure 2: Urban water cost structure



Source: WSAA

2.3 Competition in supply of bulk water/wastewater treatment

Australia leads the world in developing bulk water markets for trading rural (mainly irrigation) water and the ACCC has recently developed water charging rules for rural water. These rules recognise the interaction between water charges and water trading.

However, there are only limited arrangements in place for rural to urban trading and no effective competition between different sources of bulk water for human consumption in major cities.

Urban water 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. Wastewater treatment comprises 14 to 25 per cent of costs depending on the level of treatment required.

The extent to which these activities are contestable is likely to vary depend on specific circumstances and the particular urban supply system in question. For example, competition in bulk supply might be conceivable in systems where there are multiple independent supply sources, but may be less so in systems dominated by a single supply source.

An essential element to establishing a functioning market in urban bulk water supply is to have multiple, competing bulk water entities. To ensure effective competition in a bulk water market, it would be necessary to ensure that there are no bulk water suppliers that are capable of exercising market power (e.g. through their dominant size); there are no artificial barriers to market entry and exit; and competing bulk suppliers are able to get access to their customers on an equal basis (i.e. equal access to the services of the transportation networks and on equal terms).

It would appear to be much more difficult to achieve a competitive urban bulk water market than, say, a competitive generation sector in electricity. Some urban water systems are dominated by one or two major supply sources. There are also more complex interactions in managing different bulk water sources in a way which optimises security of supply for the overall system.

For example, in Sydney and Melbourne customers pay for water they use but also an effective insurance premium to ensure that the city will not run out of water in a drought. Insurance is provided by desalination and recycling. In particular desalination plants can be cycled down when water is plentiful and produce more water when it is scarce.

While these issues are not necessarily insurmountable, they do mean that a number of complex issues need to be resolved – and potentially significant structural reforms adopted – before effective bulk water markets could be established.

IPART has effectively concluded that bulk water supply is not readily contestable – at least in the supply regions of Hunter Water and Sydney Water (Discussion Paper, p.16):

Sydney Water and Hunter Water are monopoly suppliers of water and sewerage services in their areas of operations. Most of their wholesale water and sewerage customers have no alternative supplier of these services. This gives Sydney Water and Hunter Water a dominant wholesale market position and potential bargaining power, which could be used to create a barrier to retail entry in the absence of price regulation.¹

Perhaps the most practicable form of competition for traditional bulk water supply comes from alternative water supplies (e.g. recycled water) in non-potable uses. This simultaneously represents competition in wastewater treatment. This competition however is typically limited in scale and location.

2.4 Retail competition

In principle, the retail segment of the industry could also be competitive. Retail competition allows end customers to choose their retail supplier. Competition may be extended to all customers (full retail competition) or smaller groups of customers (e.g. only large users if they are likely to reap most of the benefits of retail competition).

Full retail competition (to all customers including households) has been introduced in the gas and electricity industries in many jurisdictions, starting with the largest customers and moving to the smallest customers. However, significant effort was required in these industries to develop the regulatory framework and systems to support retail competition for all customers and ongoing expenditure and effort is required to monitor compliance with these arrangements.

There is little experience with full retail competition in the water industry. However, Scotland has introduced retail competition for non-residential customers and the UK is now developing a seamless Anglo-Scottish retail water market. In May 2014, the UK Government's Water Act 2014 provided for all non-household customers in England to be able to switch their supplier of water and

¹ Sydney Water purchases bulk water from bulk water suppliers, Water NSW and the Sydney Desalination plant. Hunter Water is a vertically integrated utility.

sewerage retail services (including handling customer queries and complaints, billing and meter reading) from April 2017.

In Australia, retail margins tend to represent a small proportion of a utility's total costs, raising questions about the cost-effectiveness of full retail competition in this industry. WSAA also notes that no State Government has yet endorsed full retail competition in urban water as a policy objective. Indeed, in NSW, recent legislative amendments to WICA have limited the right of WICA licensees to provide retail services only in connection with a scheme approved under the WIC Act, so that they could not simply purchase water from a public utility and on-sell it without providing any investment in physical infrastructure. The NSW Government's concerns with retail contestability were that it may provide incentives to sell more water, thereby compromising water security. The amendments do however allow for 'competition in the market' to service industrial and larger commercial customers. The NSW Government has indicated that more analysis and consultation would be required before a decision could be made to move to a full retail contestability model.

As discussed below, introducing full retail competition into the urban water sector would require complementary reforms such as a customer protection framework and supplier of last resort arrangements.

Nevertheless, with new bulk water players, such as the privately financed Sydney Desalination Plant, retail competition may occur at some point in the future. There is merit in emerging regulatory frameworks for competition in the sector having regard to such future possible policy developments, although they may not be the focus of attention at the current time.

2.5 Competition for the market

As noted above, competition for the market involves allowing firms to compete for the right to provide water and wastewater services to customers in a defined geographic area. This approach has been used by governments around the world to introduce competitive pressures into the provision of water and wastewater services. For example, France has made extensive use of concession contracts in water supply over a long period. In Australia, SA Water has contracted out the operation, maintenance and management of the entire Adelaide water supply and wastewater system under long-term contracts.

In the water sector, geographic contestability *for* the market is in fact the area of greatest recent activity. 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. Such entry may offer benefits particularly on the urban fringe where local solutions may be more cost-effective than extending centralised networks.

Geographic contestability will often require physical access to an existing water utility's networks. For example, under the WICA in NSW, the majority of Hunter Water's interactions with private network operators have involved the provision of a bulk water supply to the boundary of a new development area (predominately residential developments). Under this model, the new entrant would on-sell drinking water to each customer in the development as well as provide self-contained sewerage and recycled water services. This is consistent with the NSW Government's intent to promote competition to service new greenfield or infill developments ('competition for the market'), rather than full retail contestability across all of a public utility's region ('competition in the market').

The need for supply of bundled wholesale services to these developments is a key driver of the current IPART review.

2.6 Effectiveness of third party access regimes in promoting competition in urban water services

An access regime is a regulatory framework which provides an avenue for firms to use certain infrastructure services (most notably a transport service) provided by monopoly infrastructure owned and operated by others. In electricity, gas, and rail, industry-specific regimes governing access and competition have been established and subsequently authorised by the ACCC. Typically, the underlying objective of an access regime is expressed in terms of promoting the economically efficient operation of, use of, and investment in the infrastructure by which services are provided, thereby promoting effective competition in upstream and downstream markets.

To date, government initiatives to promote competition in the provision of urban water services to end users have - in common with other utility sectors such as electricity and gas – relied primarily on the application of third party access regimes.

The urban water industry is already subject to the National Access Regime. Indeed, the urban water industry saw the first arbitration under the National Access Regime.

As it currently stands, New South Wales is the only jurisdiction which has implemented a state-based access regime to support the emergence of new suppliers and technologies for the provision of water and wastewater services. The Water Industry Competition Act (WICA) establishes an access regime for the storage and transportation of water and sewage using existing significant water and sewerage networks in the areas covered by Sydney Water and Hunter Water – the first access regime developed specifically for the water industry in Australia. Importantly, it also provides for a licensing regime to ensure appropriate regulatory obligations are placed on new suppliers to protect consumers and the public interest in relation to a range of factors, including: security of supply; ensuring water quality; protection of public health; environmental matters; and allocating responsibilities for managing emergencies and national security matters. This Act was developed by the NSW Government to promote innovative solutions to the water supply and demand balance, particularly the development of infrastructure for the production and reticulation of recycled water.

Legislation providing for a third party access (TPA) regime for the water sector in South Australia is expected to come into effect on 1 July 2016. The TPA regime provides a framework for the negotiation of access to certain water and sewerage infrastructure services, with the potential for arbitration should negotiations fail.

The NSW experience with WICA to date suggests that simply enacting an access regime is unlikely to unleash widespread competition. Notably, there have been no instances of access since WICA came into operation. Instead, as noted above, there has however been extensive use of the licensing regime and there are now 28 WICA licence holders in NSW (this includes both Network Operator licences and Retail Supplier licences). In some cases new licensees have sought to negotiate supply of a wholesale service because that is the product they want for their business models (e.g. potable water delivered to boundary of a development, rather than having to secure their own water and negotiate access). IPART has suggested that the WICA access regime is too cumbersome and costly

for new entrants to secure what they really want: a wholesale water or wastewater service to the boundary of their development.

This experience suggests that given the characteristics of urban water markets the role of purely access-based competition will be limited. Third party access regimes are predicated on the existence of vibrant upstream or downstream markets. But in the urban water industry, upstream and downstream markets are only now beginning to emerge. Removal of barriers to entry as provided by an access regime is a first step but is not sufficient in itself for effective competition to emerge.

While third party access regimes have the ability to cover a range of potential third party access scenarios (some of which may be difficult to predict in advance), it would appear that at least in the case of urban water, they may not necessarily be very effective in facilitating the types of competition which are actually emerging and which may offer the scope for most benefit in the short to medium term.

It would therefore seem more productive to put in place arrangements which focus on promoting effective competition in the activities where competition is most likely to occur and be beneficial.

3.0 Role of wholesale pricing in promoting beneficial competition

3.1 The benefits of regulating wholesale services

In light of the discussion above, WSAA concurs with IPART that regulation of wholesale services may be more likely to promote effective competition in urban water sector in the short to medium term than relying solely on third party access regimes.

The previous discussion also highlighted that IPART's review is not attempting to set prices for bulk water markets to facilitate trade. Nor is it attempting to introduce an electricity style retail market where customers choose suppliers. Rather it is primarily a solution to allow competition or contestability for the market in specific geographic areas. Whether it is explicit or not is also a solution that is confined to more profitable areas of the network.

In its Discussion Paper IPART defines 'wholesale customers' to be those that purchase water supply and/or sewerage services from the public water utilities for the purposes of on-supplying water and sewerage services to customers. A wholesale service represents a 'bundled' product comprising the combined outputs of several elements of the supply chain. For example, a wholesale water supply service comprises a combined bulk water, treatment and transportation service to deliver potable water to a wholesale customer's connection point from where it can then provide retail water services to its own end-use customers. Similarly, wholesale customers could purchase a wholesale sewerage service comprising, for example, sewage transportation, treatment and disposal and provide retail sewerage services to end-use customers.

Provision of a wholesale service (and its regulation where appropriate) has a number of attractive features:

- It is a simple approach for new entrants – they do not necessarily want to secure a new source of bulk water from a distant dam or water factory and then transport it to their location. Purchasing a bundled wholesale service is much easier than negotiating bulk water purchase, purchase of treatment services and transport services.
- It also ensures that all customers pay for water security – the bulk water component is a combination of dam water costs, desalination, groundwater and regulated recycled water costs (for schemes implemented by public water utilities in accordance with a Government direction). In this way it does not allow some customers to opt out of buying water security leaving these costs to be fully borne by other customers.

The distinction between a 'wholesale' service and access to a service of a monopoly facility is crucial and has several implications. The first is that prices for wholesale services may not fall within the legal ambit of a third party access regime, so that any power for an independent economic regulator to oversee wholesale prices may need to rely on other powers (or alternatively explicitly brought within the ambit of the access regime). The second issue relates to how the different types of services might be priced. For example, a 'wholesale water or wastewater service' clearly involves more activities – and hence more costs to supply – than an unbundled transport service.

3.2 Approaches to regulating wholesale services

It is critical, however, that such wholesale prices are set in a way which promotes effective competition which is in the long-term interest of customers.

WSAA is not proposing to respond in detail on the wholesale pricing methodologies proposed by IPART as this is more appropriately addressed by the water businesses in NSW. However, it offers the following high-level observations.

First, WSAA strongly endorses IPART'S stated objective for access or wholesale pricing as being to promote efficient entry when competitors are more innovative or lower cost than incumbents. It is not to encourage competition for its own sake.

In this context, WSAA strongly supports IPART's view that – in the presence of postage stamp pricing - a retail minus approach is the only feasible option. It also concurs with IPART that a cost-based approach or non-residential customer approach could lead to inefficient entry based on cherry-picking.

Cherry picking refers to the situation where a new entrant targets an incumbent's profitable customers and leaving the unprofitable customers to be supplied by the incumbent. The potential for cherry picking often arises when the incumbent has obligations not faced by the entrant or where prices include significant cross-subsidies between different customer groups (such as occurs with postage stamp pricing regimes applying to public urban water utilities in Australia).

This underlines the need for congruence between retail and wholesale prices. We note that the WICA Act in NSW, in listing the pricing principles which are to apply for access, also has a requirement that:

These principles must be implemented in a manner that is consistent with any relevant pricing determinations for the supply of water and the provision of sewerage services, including (where applicable) the maintenance of "postage stamp pricing" (that is, a system of pricing in which the same kinds of customers within the same area of operations are charged the same price for the same service).

WSAA proposes that all state-based access regimes and frameworks governing regulation of wholesale pricing should include a principle along these lines. This is a notable omission from the SA legislation establishing the TPA regime in that state, particularly given the strength of the SA Government's commitment to state-wide pricing.

WSAA also notes that the precise detail of how a retail minus approach is applied will be important in determining whether it will achieve the objective of encouraging only efficient entry. It therefore encourages IPART to carefully consider the detail of the methodology to ensure that its proposed approach does not inadvertently encourage inefficient entry which increases overall costs or leads to higher prices for the broader customer base, and is practicable to apply. In this regard, WSAA has some concerns with IPART's proposed retail minus 'reasonably efficient competitor' approach, particularly if it were to be applied more generally to access pricing. The approach would seem to sanction inefficient investments, and higher bills for today's customers, without any mechanism to either generate or capture dynamic efficiency gains in the future.

Finally, WSAA also considers it is important to avoid approaches which might impose excessive compliance burdens on both public utilities and potential competitors and is proportionate to the benefits of new entry. In this regard, it supports a framework where regulation is seen as a fallback and that in the first instance the parties should be able to negotiate mutually agreeable arrangements.

4.0 Towards a broader competitive and regulatory framework

IPART recognises in its Discussion Paper that access and/or wholesale pricing which allows new entrants and existing public utilities to compete on equal terms is only one part of the solution for facilitating competition in the water industry.

The following discussion identifies some of the key elements of the broader regulatory framework needed to facilitate effective competition which is in the interests of both customers and the broader community. Ideally these elements should be developed together.

4.1 Non price terms and conditions are also important

Beyond pricing arrangements such as setting wholesale prices, non-price terms and conditions are also very important. In allowing access by new entrants to existing water infrastructure to supply services, appropriate consideration must be given to the maintenance of quality and technical standards. The advent of new entrants who are wholesale customers rather than retail customers may also necessitate review of current operating licences held by public water utilities which to date are largely predicated on obligations to and responsibilities of end customers.

4.2 Regulation of retail prices and developer charges

IPART's Discussion Paper rightly highlights the importance for the development of competition of the interaction between wholesale prices and retail prices charged by existing utilities. It also notes the role of developer charges.

In Sydney, water and wastewater developer charges are set to zero. However, in a number of other jurisdictions they are an important funding source to offset the costs of new infrastructure. The costs of developing in greenfield areas are generally significantly higher than the costs of established areas.

The treatment of developer charges is likely to be an important element in a comprehensive competitive framework. WSAA acknowledges IPART's arguments about the potential benefits of developer charges to fund higher cost new developments without cross-subsidies from existing customers. How developer charges should be incorporated into a competitive framework raises a number of complex issues, beyond the scope of the current inquiry. However, from a competitive neutrality perspective, a reasonable starting point is that that developer charges should be treated symmetrically between existing utilities and potential entrants.

4.3 Regulation of new entrants

The advent of non-government water and sewerage service providers gives rise to the need for a comprehensive and effective regulatory framework to ensure that the provision of these services by new private suppliers is consistent with protecting customer interests, public health, and the environment. The customer protections which apply to the provision of services by the existing government water businesses should also apply to customers of any new water and sewerage service providers.

As discussed, setting a wholesale price is one step that could assist to promote effective competition for the market in specific geographic areas. These include infill redevelopments and greenfield developments.

Critically however, this form of competition does not give customers choice or the ability to switch suppliers. Where new entrants are servicing a discrete geographic area they will have an effective monopoly over the customers in that area. There will be no competitive pressure 'in the market' to displace the new entrant if its costs turn out to be high or offerings poor. It follows that economic regulation of these suppliers is important both to protect customers and to promote competitive neutrality.

Given that new entrants will likely need to be regulated as monopoly suppliers of retail services, the incentives for the new entrant to be efficient over time will come from the independent regulator, much as they currently do for incumbents.

For essential services such as water and wastewater a minimum requirement is a licensing regime for all players to ensure health standards are met and infrastructure meets appropriate technical standards, and to ensure appropriate levels of consumer protection. This is because, for a number of water and related activities, risks to customer protection, public health and the environment are relatively high and the consequences of not meeting appropriate standards can be severe.

One of the key concerns that Government may have in opening the market to a larger range of new suppliers is to ensure that customers have ongoing access to essential water and sewerage services should a new private supplier fail. This is not a major issue under the current industry arrangements as failure of an existing government business is not a realistic prospect.

While initial vetting of new entrants when granting a licence should minimise the risk of subsequent failure, there may nevertheless still be need to have arrangements in place in advance to deal with any situation that threatens the continuity of essential services to end customers. Supplier of last resort arrangements are necessary to define who will provide services in the event of withdrawal or financial failure by new entrants. Such arrangements to protect end customers need to be clearly defined upfront including how they will be funded.

4.4 The way forward

To date, there has been little analysis across Australia of where competition will benefit consumers or where it has less of a role to play. IPART suggests that there would be merit in an industry-wide review of how to better facilitate competition in the water industry. While these issues go beyond the scope of IPART's current review, WSAA in its collaborative paper with Infrastructure Partnerships Australia, has also flagged the need for a systematic assessment of where, when, and how competition can best be deployed within urban water markets, in the interests of the customer. As in past competition reform programs this is likely to be best pursued by all states and the Commonwealth collaborating to develop the principles that should underpin state competition frameworks.

WSAA emphasises that the process for resolving the long-term competitive and regulatory structures of each urban water system will need to allow for individual variations and local requirements.

Contact details

WSAA welcomes the opportunity to discuss this submission further. If there are any details you wish to follow up on please contact:

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