

Your Ref:
Our Ref: ESC:TW
Contact: Neil Brennan
Direct Dial: 03 5320 3165
Doc. Code: RF:TW



7 Learmonth Road
Wendouree Victoria 3355
PO Box 152 Ballarat
Victoria 3353 Australia
Telephone (03) 5320 3100
Facsimile (03) 5320 3299
DX 35024 Ballarat AUSDOC

14 April 2009

Dr. Ron Ben-David
Chairperson
Essential Services Commission
Level 2/35 Spring Street
MELBOURNE VIC 3000

Dear Dr Ben-David,

Re: *An Access Regime for Water and Sewerage Infrastructure Services*

Thank you for the opportunity to provide comment on the ESC's paper into *An Access Regime for Water and Sewerage Infrastructure Services*.

This response focuses on the key issues from CHW's perspective.

CHW recognises that the Victorian Water Industry Association (Vic Water) has provided a detailed response to the ESC paper on behalf of its members. CHW is a member of the association and fully supports the Vic Water submission.

This response is not seeking to replicate the Vic Water submission but will focus on CHW specific issues.

CHW recognises the need to ensure that monopoly assets are efficiently utilised to benefit the community. This is part of the reason CHW is currently running a pilot third party access program with the Goldfields Superpipe. This pilot is open to community and commercial customers who are seeking some relief from stage four water restrictions.

In developing an access regime CHW cautions the ESC to consider the specific nature of the Victorian Water Industry and the potential for unintended impacts from any access regime that does not consider system-by-system issues.

Within reticulated water and wastewater systems, the infrastructure assets and security of supply risk are managed in different ways depending on local conditions, seasonal variations, demand and supply variability. "Spare" capacity in assets will vary significantly over seasons depending on rainfall.

Water is not an instantaneous demand and supply matching exercise, as occurs in the electricity industry, but has longer time frames due to the energy intensive nature of moving water and the longer lead times to ensure adequate volumes of water are moved within systems ahead of demand. Asset capacity is more exposed to climate variability in both the short and longer term.

The Goldfields Superpipe is a good example of how predicted available capacity can change quickly due to climatic conditions. When first conceived in the Central Regional Sustainable Water Strategy it was forecast that 3-5 GL of water would be initially required growing to 18GL over fifty years.

It would seem therefore that there is an opportunity to make use of between 13 – 15GL of water capacity within the pipeline for other users diminishing over time to 0GL. In reality, due to the lack of any substantial local yield in catchments, the first year of pumping has fully utilised the available capacity of the pipeline and this is scheduled to continue into the next season.

It is essential that any access regime within the water industry contains within it flexibility to allow capacity variation on a seasonal basis to meet urban water supply requirements.

Investment decisions in the water industry can have long lead times and air space in storages is a valuable asset that impacts overall system reliability and therefore levels and frequency of water restrictions. Therefore there needs to be flexibility in any access regime to accommodate the often unique requirements within individual systems.

We submit that an access regime should have as one of its key principles - the underlying functionality, operational risks and costs of an asset should not be marginalised due to the operation of an access regime.

In developing an access regime the ESC should be also be mindful of the underlying premise that the cost of reform should not out weigh the benefits.

When considering the methods that other industries and countries have used in the development of an access regime the cost and benefits from reform should also be assessed to validate the purpose of the proposed access regime.

CHW operates 15 different systems, varying in size from the largest in Ballarat (95,000 people) to very small systems with less than 50 people. This structure is common in regional authorities and is characterised by a reliance on an ability to provide cross subsidies between larger systems and smaller systems; and across classes and types of customers within systems.

Furthermore, there are a number of non-commercial activities undertaken by urban water authorities such as the supply of services in smaller communities.

The development of an access regime should be sensitive to the potential for “cherry picking” customers within systems that results in an inability to sustain non-commercial services. Cherry picking and flow on impacts require careful consideration especially given the Government's regional development priorities and position on sustaining essential services within these communities.

Developing an access regime to balance competing demands on monopoly assets can potentially stimulate innovation, improved investment, asset risks transfer and greater community benefits from more efficient use of asset capacities. However the risks to the supplier of last resort, sustaining and funding required/legislated non-commercial activities, ensuring public and environmental health, and continued efficient investment in assets with long lead times need careful consideration in any access regime. Therefore CHW supports transitional arrangements and flexibility as the model is developed.

Specifically in relation to the questions asked within the ESC paper CHW provides the following responses:

Section 2: PROMOTING INNOVATION AND EFFICIENCY IN WATER AND SEWERAGE SERVICE PROVISION

What lessons can be learned from experience in developing and implementing access regimes in other industries?

What factors should the Commission take into account in making its recommendations to ensure that an access regime will be flexible enough to not inhibit the potential for further reform of the water industry in the longer term and to remain applicable to a range of different industry structures?

CHW is encouraged that the ESC recognises the importance of a transitional process to learn from a staged implementation and in retaining flexibility for modification as a result of these learnings.

The supply of safe and reliable water and wastewater services is essential to our communities' well-being. Therefore a staged and conservative approach in the development of an access regime is appropriate.

Section 3: DESIGNING A STATE BASED ACCESS REGIME

What factors should the Commission take into account in designing a third party access regime for water and sewerage infrastructure services?

The following factors should be considered in developing an access regime:

- The underlying functionality, operational risks and costs of an asset should not be marginalised due to the operation of an access regime. The Assets owner's customers should not incur a financial penalty due to third party access.
- The cost of reform should not out weigh the benefits.
- Whole of system impacts should be assessed in the context of proposed reforms before implementation. For instance, an empty reservoir with air-space provides capacity for future harvesting. If this is allocated to other users then this capacity is reduced, the system security and capacity is therefore reduced, increasing the frequency of water restrictions and triggering new augmentation investment.
- The administrative burden should be kept as efficient as possible.
- Public health and security of supply should not be jeopardised.
- The risk management approach of the safe drinking water act and the environment act, and the multiple barrier approach to potable water and public safety as per the Australian Drinking Water Guidelines should not be compromised.
- The efficient investment in assets should be encouraged.
- The provision of adequate water and wastewater services to small systems and less profitable customers should not be jeopardised through cherry picking of high value customers.
- Regulatory obligations should be consistently applied to access users, for instance the ESC require Water Corporations to price recycled water based on a set of principles. Under an access regime these principles should apply all retailers of recycled water or cease to be an obligation on all participants.

Section 4: COVERAGE OF SERVICES, NEGOTIATION FRAMEWORK AND DISPUTE RESOLUTION

What types of water and sewerage infrastructure services should be covered by an access regime? Consideration should be given to types of services that are expected to satisfy the criteria of being significant, not economically feasible to duplicate and necessary to permit effective competition in related markets.

In the first instance and based on definitions of national significance, those assets involved in the bulk transportation and storage of water and wastewater would be potential assets for coverage.

As previously stated the available capacity within assets will vary from season to season and over time. The ability to provide longer term access will vary depending on the asset and growth factors.

We also note that over the last decade a number of water and wastewater assets have been created making use of Public Private Partnerships (PPP) (especially in water and wastewater treatment) involving a range of contractual conditions within fixed and variable tolls and these will normally apply over a long period of time. There may be a case to exclude these assets from third party access during the period of the PPP concession depending on the commercial risk (if any) that results from an access regime.

In the early stages of an access regime we believe that a case-by-case assessment for coverage should be applied with a no-disadvantage test within broad guidelines as issued by the ESC. As stated earlier assets within systems have different overall impacts and should therefore have at least the options of being assessed individually.

How should the significance of specific water and sewerage infrastructure services be measured?

Do the access arrangements in place for irrigation infrastructure services, that is tradable delivery shares, provide adequate access to those services?

Should water and sewerage infrastructure services in the Murray Darling Basin be subject to the state-based access regime or a national access regime?

The significance of water and sewerage infrastructure service should be measured on a case by case basis within the context of the over all system requirements.

In terms of the irrigation access arrangements CHW has found the system to work well and has had no difficulty in trading within this system.

Increased market efficiency would be achieved with standardised trading arrangements across state boundaries, improved market information and a simplification of the administrative process to transfer water rights.

Is the approach to coverage adopted in the New South Wales access regime – combining initial declaration of specific services with a process for case-by-case declaration of other services – appropriate for a Victorian access regime?

Are there any specific water or sewerage infrastructure services that should be declared from the commencement of an access regime?

CHW does not favour an initial declaration of specific services but favours guidelines to the market on the type of assets that can be declared and a process for assessing the declarations on a case-by-case basis.

This will reduce the initial administrative burden, focus attention on those assets considered valuable from a third party access perspective and enable a focused assessment of the relative impacts from the access regime on specific assets.

A no-disadvantage test should be a key component of the impacts assessment.

What features should be incorporated into a Victorian access regime to ensure sufficient investment is made in new (greenfields) investments in water and sewerage infrastructure services?

Asset investments in the water and sewerage sector typically have long lead times and long asset lives. Therefore an investor (private or public) needs some confidence that the outcomes and returns from this investment can be realised, with no additional risk.

CHW believes that greenfield investment in new assets should have an ability to seek a no-coverage determination (an exemption from inclusion in an access regime) for a period of time. This may help negate some of the investment and utility risks in greenfield assets that may arise from an access regime.

The Water Industry (Private and Public Sector) is continuing to make major investments in new infrastructure. The ESC should consider including extending the no-coverage period to assets recently created or currently planned for construction to allay any concerns in the market on the impacts of an access regime on these investments.

The ESC may also wish to consider suitable mechanisms for a process of capacity scarcity pricing for sought after assets.

For example, where there is some surplus capacity in an asset – say a pipeline – and demand exceeds the available capacity what scarcity pricing principles should apply? How is the capacity allocated to ensure the greatest benefit to the community?

Scarcity pricing for sought after asset capacity would stimulate activities to create new capacity either through reducing demand (demand management) or new investments.

Should an access regime provide for scheduled reviews of coverage or should it incorporate provisions for case-by-case assessment of applications for coverage declarations or revocation of coverage?

Is the process for case-by-case assessment adopted in the New South Wales regime appropriate for Victoria?

CHW's preference, as stated earlier, is for a case-by-case assessment of applications with transparency to the community and industry.

Should an access regime include transitional arrangements? If so, what type of arrangements should be included, what would be their purpose and how long would they need to be in place?

Are there any implementation issues that should be resolved during a transition period?

As stated earlier CHW favours transitional arrangements.

The electricity markets found a number of process and logistical challenges as each group of customers in the market opened to competition. For instance the processes around customer transfer systems, metering and data forwarding services were significant challenges in the early days of the electricity market. Many customers were unable to access new retail arrangements for months despite signing contracts due to inadequacies of these processes.

This would have been a complete disaster from a customer perspective without the staged approach which limited the impact and provided an opportunity to improve processes for future customers.

CHW advocates a conservative approach in the development of an access regime, limiting the arrangements to a few large assets and a smaller number of non-residential customers in the first instance. Learnings from this process can then be used to ascertain what improvement/modifications are required and what community benefits have been achieved before defining the timeline and scope of the next steps.

At this point in time, with recent climate impacts on communities across the state, it is more important to retain consumer confidence in the availability and quality of water and wastewater services than fast track a process that has unintended detrimental impacts on these services.

Should an access regime include regulatory guidance on the processes to be followed in negotiating access, such as negotiation protocols?

CHW agrees that an access regime should include regulatory guidance on the process and protocols for negotiating access. However due to the wide variability in various assets and within systems it is important that the guidelines focus on the principles and protocols without limiting the flexibility to consider asset specific issues.

What dispute resolution mechanisms should be included in a Victorian access regime?

Should the Commission be the arbitrator in access disputes?

Are the existing merits review provisions under the Essential Services Commission Act 2001 sufficient for reviewing access-related decisions??

CHW supports the submission from Vic Water that the existing merits review provisions of the Essential Services Commission Act 2001 are not sufficient for reviewing access-related decisions.

Merit reviews should be consistent with those conducted in other industries and should be independent of the ESC.

Section 5: ACCESS PRICING AND RING FENCING METHODOLOGIES

Should an access regime include regulatory guidance on prices, such as indicative tariffs or reasonable price boundaries, to provide a framework for access negotiations between infrastructure operators and access seekers?

CHW does not believe indicative tariffs on access to specific assets are appropriate as the assets and systems are diverse with embedded cross-subsidies of various levels.

This means any price signal the ESC provides would be meaningless. Our preference would be for a system of pricing principles with case-by-case assessment, review and if required a dispute resolution processes.

What issues should be considered in determining access prices?

What is the most appropriate methodology for determining access prices for the Victorian water industry – cost of service or retail minus?

Due to the significant cross-subsidies that exist between systems and customers, and the highly variable costs associated with different geographical services and sources of water, CHW does not support a retail minus approach.

For example in some of our smaller systems it is quite possible that the costs avoided will be greater than the total revenue received.

The cost of service approach would be a more equitable method but has a higher administration cost associated with it, this is not an issue provided these cost can be recovered under the access regime.

The pricing regime should achieve the following outcomes:

- Additional costs to the asset owner and operator are fully recovered.
- A reasonable rate of return for the use of the asset.
- Scarcity pricing where demand exceeds available capacity.
- No additional costs are transferred to existing customers.
- Potential for Cherry Picking is minimised.
- Cost of administration is not passed to existing customers.

How should the greater risks associated with greenfields investments be taken into account in determining access prices?

There are two key approaches that can be considered in terms of managing the investment risk in greenfields investments.

The first is to reduce the risk to the investor through an ability to gain a cover exemption for a period of time. This provides greater certainty to the asset owner in terms of its ability to utilise the asset for a specific use.

Secondly allow the investor the flexibility to recover a rate of return that includes an appropriate risk premium, this could be managed through an approval process within various pricing principles.

How should access prices be structured to ensure that the full costs of providing access are recovered without unnecessarily deterring access?

The use of two part tariffs and long run marginal costs is well understood in the water industry and would be an appropriate way to structure prices. A case-by-case decision making framework with regular industry feedback (to the extent allowable given the confidentiality requirements of the access seekers and infrastructure providers) would allow a framework to encourage access to be developed.

Should the processes for determining access prices and prices for water and sewerage services be consistent?

How should government policies that impact on the incumbent businesses costs be dealt with in considering the interaction between access prices and other regulated tariffs?

It is preferable to have the processes for determining access prices linked in the water plan process, though initially a more regular review process may be justified.

Regional Water Authorities undertake a number of investments that are not commercial in nature. They relate to progressing government policy directions and in provision of services to a wide range of customers in various systems.

Inevitably there are significant cross subsidies across customers and systems. Any pricing regime that provides an opportunity for embedded customers to be cherry picked places a higher burden on the remaining customers and limits the ability of CHW to fulfil these broader obligations.

Resolving the funding of non-commercial obligations of incumbent suppliers is a key issue in the development of an access regime.

How should ring fencing be implemented in the Victorian water industry?

What information should be included in ring fencing guidelines?

Should Victorian infrastructure service providers be required to prepare cost allocation manuals and/or reports on compliance with the ring fencing guidelines?

Should a more prescriptive regulatory framework apply to infrastructure service providers that are vertically integrated?

It is too onerous for regional urban water authorities to establish separate business units for each element of its business.

Ring fencing should be achieved by the use of consistent accounting principles and reporting. To this extent further work should be conducted between the ESC and the industry to ensure allocation principles and practices are aligned across the Water Corporations.

This process has commenced with the Regulatory Accounts produced as part of the Water Plan process but will need to go to a greater level of detail to ensure an accurate picture by system as well as function.

CHW understands the greater risks where vertically integrated infrastructure providers are involved, consideration must also be given to size of the organisations involved and the cost imposed by any regulations, bearing in mind the principle that the costs should not outweigh the benefit of regulation.

How significant are the potential barriers listed above in discouraging competition and private participation in the water industry? With regard to water system planning and operational decisions.

Are there any other significant barriers to competition and private participation?

Water resource development decision making has been extremely transparent in Victoria. The system water supply and demand strategies and regional sustainable water strategies have all involved significant community consultation and community engagement in a transparent process.

However the extreme lack of rainfall over the last twelve years and in particular the last three demonstrates that the plans of authorities need to be adaptive and flexible.

The supply of water from a single source is high risk and flexibility across a range of sources is generally required. The extent that this limits competition is open to debate however in the current environment and the need to secure water supply it is a necessity.

Does the existing institutional framework ensure that obligations currently applying to incumbent providers of water and sewerage services in relation to customer protection, water quality, public health and safety and environmental protection will apply, when appropriate, to new entrants to the water industry?

Do any aspects of the current institutional framework form an unreasonable or inappropriate deterrent to potential new entrants, including access seekers?

The institutional frameworks would need to be reviewed, as it is generally understood that these do not effectively ensure that new entrants to the water industry are required to meet the same obligations as present incumbents.

CHW is concerned to ensure that any access arrangements do not compromise customer and employee safety, public health, environmental damage, asset safety and performance.

The same standards and accountabilities should apply to anyone who accesses water and wastewater infrastructure. Each party accessing infrastructure should also indemnify other users for any detrimental impacts on customers should they fail to meet appropriate standards.

With regard to sewerage services and recycled water the extent to which the Water Corporation can currently divest itself of its obligations to a third party is questionable and would require further consultation with the Water Industry, EPA and DHS.

Should the existing customer protection framework be extended to cover new entrants to the water industry?

Should new entrants providing retail services be required to participate in the Energy and Water Ombudsman of Victoria (EWOV) scheme relating to water and sewerage services?

CHW supports the extension of existing customer protection frameworks to new entrants including participation in an approved Ombudsman scheme where they provide retail services. This is to prevent a general erosion of consumer protection and customer confusion over their rights.

Water Corporations also have a number of obligations to consumers in terms of hardship, credit control processes and CSO's which should also be consistent to any entrant.

Should the retailer of last resort arrangements be established in conjunction with the development of an access regime to protect customers in the event of that access seekers start to provide retail water or sewerage services?

If so, what factors should be taken into account in designing appropriate retailer of last resort arrangements?

The retailer of last resort arrangements should be established in conjunction with the development of an access scheme as water and wastewater services are essential for public and environmental health. Factors to be taken into account may include:

- Financial stability test on new entrants, where applicable with parent company guarantees;
- Provision of asset information;
- Access to relevant employees and/or operating information;
- Cost recoupment provisions.

The costs of providing the retailer of last resort should not be incurred by the existing customer base and should be recovered through access arrangements.

Any retailer of last resort must be consistent with constitutional arrangements.

Will any changes to existing water quality regulatory arrangements be required to ensure that public health, safety and water quality standards are not compromised by allowing access seekers to enter the water industry?

Do any aspects of the existing water quality regulatory arrangements create an unreasonable impediment to new entry by potential access seekers?

Is the existing environmental protection regulatory framework sufficient to ensure that access will not compromise existing environmental standards?

Do any aspects of the existing environmental protection regulatory arrangements create an unreasonable impediment to new entry by potential access seekers?

CHW supports the approach detailed in the VicWater submission.

It is paramount that public safety is assured through any access regime and that the risks and accountabilities for maintaining public health and environmental impacts are explicit.

Should a licensing system be developed for the water industry? If a licensing system is not used, what alternative approaches could be considered for regulating service quality and customer protection in the water industry?

Who should be responsible for assessing licence applications (or applications for registration) and for making decisions on the issues of licences?

A licensing system would be consistent with the approach taken in the development of contestable electricity markets. However in the context of the Victorian Water Industry the question is what is the reform trying to achieve relative to the reform costs and benefits.

If the access is initially focusing on access to transmission assets at a wholesale level then there is little to be gained from a licensing system as access is negotiated on a case-by-case basis.

If the intent is to move to full retail competition then a licensing system may be required to manage the quality and standard of participants and to lock in consumer protection.

What features should be included in the arrangements for managing the Victorian Water Grid to ensure that potential access seekers are able to participate effectively in the water industry?

CHW understands there are several differing views on how a Water Grid would operate and be structured.

The main features would be around efficiency of costs, security and reliability of supply, no disadvantage test, public and environmental health, appropriate pricing, transparency of arrangements and competition for available capacity.

How should network balancing and system losses be managed?

This depends on the model adopted.

Losses can be managed through financial tools to provide an incentive for the operator to minimise losses.

Network balancing needs to be managed in a coordinated way with the operator, however it is not quite the same as in the electricity industry where supply and demand are matched throughout the day. Water, unlike electricity is heavy, can be stored, and is slow to be transported due to its weight.

Therefore network balancing is not just about daily demand, it is also about transporting water for system security over seasons. This is because of the risk of resource variability which is based on rainfall.

The capacity availability in some assets will change as a season develops.

How should the existing emergency management procedures be modified to include access seekers?

In emergency management situations it is likely that the Water Corporation will be the main entity managing the incident or liaising with the other emergency services.

Therefore it is important that the Water Corporation has full access to all emergency management procedures of the access seeker and has the means to require the access seeker to implement or improve procedures if they are viewed as inadequate.

What information collection, reporting and auditing requirements should be placed on access seekers providing water and/or sewerage services? What factors should be taken into account in determining the amount and type of information required by regulators?

What types of information would access seekers need to be able to assess the viability of proposals to provide water and sewerage services and to be able to negotiate effectively with infrastructure service providers?

What types of information would be subject to confidentiality requirements?

Access seekers would need to provide all information necessary for the infrastructure provider to fulfil its regulatory requirements, including but not limited to:

- OH&S;
- DHS reporting;
- EPA reporting;
- ESC reporting.

Where the Water Corporation retains control of an asset and it is purely access being provided, then reporting requirements may be simpler.

A simple principle of any access regime should not result in any greater risk to customer protection, water quality, public health and safety and environmental protection.

Normal principles of confidentiality would hold, subject to this not increasing any risks as above.

As the access seeker may be a competitor against the Water Corporation, some restriction on the level of cost information would be appropriate, though they should have access to the proposed access costs. This may require provision of details on proposed access before the costing can be given.

Details of reporting expectations and regulatory compliance obligations as above would be necessary.

Closing Comment

There are a number of issues that need further clarification and development before an access regime would be workable. The key issues of public health, service security, environmental protection, non-commercial obligations and ensuring efficiency in future investments in assets whilst retaining flexibility for industry adaptation are critical to ensuring that the Victorian community continues to receive water and wastewater services they trust and can depend on.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Neil Brennan', is written over a thin red horizontal line.

Neil Brennan
Managing Director