

**Geelong Region Alliance**

**A Submission to the Essential Services Commission**

# **Access Regimes in Water**

**from  
G21 Geelong Region Alliance**



# **1 ESC Inquiry into Access Regimes**

In November 2008, the Essential Services Commission (ESC) was directed to conduct an inquiry into developing an access regime for the water and sewerage sectors and report to the Minister for Finance by 31 August 2009.

The ESC published an Issues Paper in February 2009, identifying the key issues that the Commission will address in making its recommendations on developing an access regime. Interested parties were encouraged to provide comments in response to the Issues Paper.

This report provides a submission from G21.

## **2 Access Regimes**

### **2.1 Access Regimes in Water**

Water businesses are typically structured around a vertically integrated business model, incorporating all stages in water supply from resource management, distribution, and retail supply to customer service. The sewerage service then involves collection, transport, treatment and disposal.

This model includes both potentially competitive elements such as:

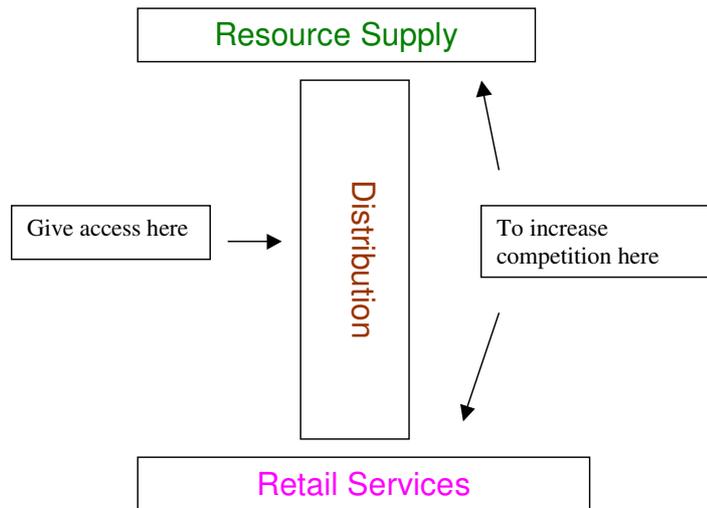
- resource supply; and
- retail services

as well as functions that are a natural monopoly such as the major water distribution and sewer networks.

At present the competitive elements of the supply are not accessible to new entrants as the incumbent water business controls access to them through management of the natural monopoly components.

An access regime seeks to promote competitive pressures in areas where competition is possible by providing shared access to the natural monopoly segments such as distribution.

**Figure 2-1: Access Regimes in Water Sector**



## 2.2 Water Management in the G21 Region

Management of the water resources and water supply within the G21 region involves a number of different players:

- **Barwon Water** provides water supplies and sewerage services to residential, commercial and industrial customers across most of the region. The water supplies are sourced from surface and groundwater resources and include recycled water from water reclamation plants throughout its region.
- **Central Highlands Water** provides urban services to residential, commercial and industrial customers in townships in the north eastern quadrant of Golden Plains Shire.
- **Southern Rural Water** is the licensing authority for diversions from rivers and groundwater for irrigation, industrial or stock and domestic use across the region.
- **Melbourne Water** will be the supplier of bulk water to Geelong when the Melbourne and Geelong Interconnector is constructed as part of a water grid across central Victoria.
- **Individual Councils** across the region have responsibility for managing and disposing of stormwater flows.
- **The Corangamite Catchment Management Authority (CCMA)** is responsible for catchment, waterway and floodplain strategy and management across the region.
- **Environment Protection Authority (Victoria):** has responsibility for the implementation of State Environment Protection Policies (SEPPs) including *Groundwaters of Victoria* and for the licensing of point source discharges such as mine wastes.

- **Department of Sustainability and Environment (DSE)** has the state-wide lead on water policy issues including surface and groundwater management. DSE also plays a governance role in regard to all water corporations.
- **Essential Services Commission (ESC)**, has the responsibility for economic oversight of the programs and prices of the water corporations through a regular, five-yearly cycle.

This arrangement involves different parties having the responsibility for managing different elements of the total water resource portfolio of the region, with separation between Barwon Water, Southern Rural Water and local councils for urban supply, rural water use and stormwater management respectively.

That separation may not drive the optimal coordination between different resource options in all cases.

### **3 Costs & Benefits of an Access Regime**

#### **3.1 Benefits of a State Based Access Regime**

Introduction of a state based Access Regime will result in agreed protocols and procedures that provide greater certainty than reliance on Part IIIA of *the Trade Practices Act 1974*, which requires an application for a declaration for access to the National Competition Council on a case-by-case basis.

The greater simplicity and clarity of a state based access regime will benefit both incumbents and new entrants. G21 supports the proposal to develop a state based access regime under Section 44M of *the Trade Practices Act 1974* and provided new entrants meet all regulatory requirements under which incumbents operate. This follows the approach currently being implemented in New South Wales and under consideration in Western Australia.

#### **3.2 Consideration of Costs and Benefits**

G21 recognises that an access regime cannot be introduced without full and proper consideration of the potential risks as well as the possible benefits. As the ESC points out:

*Without extensive and wide-ranging research into the types of reforms required in the Victorian water industry, identification of their expected outcomes and quantification of their costs and benefits, it is not possible, at this stage, to map out a detailed reform strategy or to identify an end-point for the reform process. [Issues Paper: para 2.2.2]*

G21 supports the need for this careful consideration. Moreover, it encourages that thoughtful research because G21 believes that the approach can generate benefits as well creating potential risks.

#### **3.3 Benefits of Natural Monopoly**

G21 recognises the leadership and high performance in water supply issues played by the incumbent water corporations in the region. Given the natural monopoly characteristics of the supply, having one integrated business coordinate delivery of the resource drives positive outcomes in terms of *productive efficiency*. This reflects the ability of a single provider to deliver services at lowest overall cost.

#### **3.4 Benefits of an Access Regime**

However, the incumbent water service providers are generally constrained to deliver a standardised product with averaged costs and socialised prices across the whole customer base. That may limit their ability to deliver specialised products that meet the specific demands of particular customers.

An access regime could help promote:

- innovation in sourcing alternative water resources - such as stormwater, creating integration across the different water resource managers in the region;
- development of a wider range of water products to match the different demands of different customers, moving beyond the standardised product that the incumbents are required to provide;
- greater efficiency in service delivery; and
- enhanced customer service, for instance smart meters with time of day tariffs.

These outcomes involve driving greater emphasis on *dynamic and allocative efficiency*. These outcomes should benefit customers and the regional economy.

### **3.5 Risks from an Access Regime**

Introduction of an access regime could create risks to efficiency and the financial viability of the incumbent providers. There are four major issues:

#### **3.5.1 Cherry Picking & Access Pricing**

The incumbent is required by its Statement of Obligations to supply all customers across its region in declared water districts. That involves considerable socialising of costs and charges across the customer base. New entrants will seek to service those customers that generate high charges and involve low costs. This is commonly known as 'cherry picking'.

Pricing rules would need to be implemented for access rights that reflect the full costs of supply and recognise the considerable redundancy built into a network system, rather than relating solely to the immediate assets servicing the individual contestable property and meeting all state regulatory requirements. This approach would argue for a 'Retail-minus' approach to pricing rather than a bottom-up building block approach.

#### **3.5.2 Capacity Management**

Providing rights of access of third parties to the incumbent's infrastructure would add complexity to current management arrangements. Translating current decisions into legal contractual terms with explicit service delivery commitments could reduce the flexibility and sophistication of the management of that system.

#### **3.5.3 Public Health**

The incumbent has onerous duties under *The Safe Drinking Water Act 2003* to ensure that water delivered through its supply system meets high quality standards.

Allowing third parties to introduce alternative water resources into the supply system has the potential to compromise these standards and create legal liability issues.

#### **3.5.4 Transaction Costs**

Implementing an access regime would trigger additional costs in:

- responding to applications
- implementing greater cost allocation by service function
- legal and contractual arrangements for access agreements
- senior management time in establishing the new terms
- operatives' time in implementing and monitoring arrangements

The benefits of the new arrangements would need to out-weigh these costs.

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