



BARWON REGION WATER CORPORATION

**ESC ISSUES PAPER
INQUIRY INTO AN ACCESS REGIME FOR WATER AND
SEWERAGE INFRASTRUCTURE SERVICES**

**BARWON WATER SUBMISSION
30 MARCH 2009**

Background

In 2008, the Victorian Government initiated a review into the Victorian water industry, which was undertaken by the Victorian Competition and Efficiency Commission (VCEC). As part of its findings, the VCEC recommended a review be undertaken into third party access and possible arrangements that could be made to enable third party access to occur.

The Essential Services Commission (ESC) was directed to undertake the work to develop a third party access regime. The ESC released its Issues Paper on 19 February 2009.

This submission outlines Barwon Water's position and raises various issues that need to be addressed prior to a third party access regime being considered for implementation in the Victorian water industry.

Submission

Barwon Water has considered the issues outlined in the ESC's issues paper and provides the following comments.

1. Definition of third party access regime

The ESC's Issues Paper outlines many factors that need to be addressed when developing an access regime. However, Barwon Water does not believe the overall definition of an access regime has been clearly stated, leaving many uncertainties surrounding the definition of third party access and when a third party access regime would apply.

Barwon Water would like to see more detail on what the ESC considers to be third party access, under what circumstances it applies, and what process does the private party seeking access have to go through (including the rights of the regulated water utility).

Relevant "rights" once a private party has commenced providing an infrastructure service need to also be defined. If the ESC is truly seeking to simulate a competitive market, does this mean the regulated water utility can provide the same service to the same customers the private party is servicing, or does the third party access regime provide the private party with exclusivity rights to those customers?

2. *Designing a state based access regime*

Barwon Water considers a State based access regime would be more efficient than the current situation where it may need to deal with ad hoc requests from private parties given there are no guidelines in place for the infrastructure service provider or the private party. An access regime would provide some clear guidelines upfront, making the provision of information and certainty on the dealings of issues before negotiation commences. This could save time and money for the infrastructure providers and the private party.

Prior to providing comment on whether the infrastructure services outlined in Figure 2.1 could be competitive, Barwon Water wants to ensure all stakeholders have the same definition of what each service is. In addition, Barwon Water seeks further information on whether third party access extends to third parties having access to the water in Barwon Water's pipes (i.e. providing the potential for full retail competition) as well as having the ability to pump other "types" of water into Barwon Water's infrastructure, for example purified recycled water.

3. *Coverage of services, negotiating framework and dispute resolution*

Barwon Water considers coverage of services should be determined on a case-by-case basis. This would mitigate any risks that may be apparent in a blanket declaration of specific services. Each infrastructure asset, although it may provide the same service, is in a different area that may have individual requirements for issues such as environmental obligations and service requirements that would need to be covered in an access arrangement. Specific requirements would not be identified if there was blanket coverage based on the type of infrastructure service.

Barwon Water also considers coverage should be reviewed at the time of the water plan process, consistent with the access price review. This would result in all aspects of the business being reviewed at the same time, mitigating the need to provide information and have in-detail reviews on separate issues sporadically over any water plan period.

Any new regime, especially these significant ones, should have transitional arrangements in place. It is unlikely the regime will be perfect from the beginning and there may be many "teething" problems that are not considered until the situation arises in practice. Various outcomes may also have large negative impacts on customers that must be avoided. Any transitional arrangement should have a net positive effect on the industry.

Barwon Water believes it is crucial to incorporate a negotiating framework and dispute resolution when developing the access regime. The negotiating framework should outline the ground rules required by both parties. Having a framework in place will minimise the risk of assessing the applications being time extensive because the processes to be followed by both parties are set out and clearly understood. Should negotiations fail, there will be a need for a dispute resolution process to be in place.

Given the ESC's role of industry regulation and the development of the access regime, it would seem consistent and logical that this role become an extension of the ESC's responsibilities

4. Access pricing and ring fencing methodologies

Access prices should be based on cost recovery and meet the principles highlighted in Section 5.1.1 of the Issues Paper. Given the principles that must be followed when determining access prices, Barwon Water recommends there should not be further regulatory guidance of the prices imposed by the ESC. Further regulation, such as price boundaries, could skew the incentives and create inefficient outcomes for either the infrastructure service provider, the private party, or the customer. Barwon Water considers the review of the access prices should be undertaken at the time of Water Plan reviews.

When discussing the methods of determining access prices, the ESC focuses on the costs associated with the service. The retail minus approach bases the access price on the avoidable costs to the business of not having to provide that service, while the cost of service approach is based on building up the likely costs to the access seeker of providing the service. One element that is missing from the calculations is the possible downstream cost to the business if it no longer is required to provide a service. For example, if a private party was to seek access to a water business' water reclamation assets so it can treat the wastewater and pass it on to customers, it is possible there is a cost to the water business for the reduced outflow and the impact that has on the system. The water business must be able to recover these costs from the private party.

Barwon Water considers it is appropriate to implement ring fencing requirements as part of the third party access arrangements, however the costs borne by the business of undertaking this activity needs to be recovered. Including the ring fencing requirements part of the access arrangements provides the ability to review the guidelines enforced as part of the access review each time that is undertaken.

The ring fencing guidelines are likely to be imperfect at first imposition and being able to review these as part of the access review would be efficient. Barwon Water, however, considers the ring fencing should only be limited to financial reporting and should not extend to ring fencing physical parts of the business, for example employees.

Ring fencing guidelines need to stipulate the process for cost allocation. Cost allocation is still very subjective across water utilities and this needs to be more consistent to ensure increased certainty for prospective private parties trying to determine what is most beneficial for the private parties to seek access. Guidelines on general business costs, such as the allocation of corporate overheads are critical. Definitive guidelines provided by the ESC should eliminate the need for cost allocation manuals.

5. *Legislative, regulatory and co-ordination issues*

The potential barriers to competition, as outlined in the Issues Paper, may discourage private participation in the water industry, however Barwon Water believes these may not be significant as these are likely to be resolved as the access regime develops. As specific access applications arise, amendments can be made if required (and if it is in the best interests of the water industry) to relevant legislative and regulatory requirements. With regards to asymmetrical information for water demand and supply management, the water businesses' water plans outline the future supply and demand forecasts, as well as the capital works program which is proposed for the planning and management of water and wastewater systems. The water plans should provide private parties with sufficient information for potential investment and innovation.

Barwon Water strongly recommends that any new service provider must comply with relevant legislation and all regulations related to resource management, environmental protection, and water quality, health and safety. If there are any "gaps" that inhibit these regulations to be placed on the new entrants, these need to be amended for all parties before the access regime could be implemented. Barwon Water also believes the existing customer protection framework should cover new entrants and new entrants must be required to participate in the Energy and Water Ombudsman of Victoria scheme. This is vital for the protection of consumers to ensure the service delivered by the new entrant meets all regulatory requirements.

Retailer of Last Resort (RoLR) arrangements is critical when developing an access regime. RoLR arrangements guarantee supply continuity to customers in the event a new service provider fails. It needs to be highlighted that there is risk exposure to the retailer that is adopted as the RoLR (whether it is an alternate licensed retail supplier or the public water utility) and this risk needs to be accounted for in the access price. RoLR arrangements do not only apply to the supply of water and sewer services security, but also to activities such as metering, retail services including billing, and knowledge by the customer of who their retailer is. Timely and accurate facilitation of these services needs to be taken into account when designing RoLR arrangements. To determine when RoLR is required, trigger events should be identified as part of any access arrangement.

Barwon Water does not consider there is a need for a grid manager for regional water corporations. Regional water companies are in the best position to coordinate, manage and optimise their systems to provide a secure level of supply at least cost. The option of establishing a grid manager is subject to a current process being managed by Department of Sustainability and Environment. The outcome of this process will determine the need and role of a grid manager.

As mentioned previously, private parties seeking access to an infrastructure service should be bound by the legislative, regulatory and coordination requirements as any regulated water business, including information collection, reporting and auditing requirements. Also private parties must be required to meet service and performance standards as required by the regulated business.

Should an access regime be implemented, the effectiveness of the regime should be reviewed during the water plan period. This provides businesses with the opportunity to undertake their own analysis of how access regimes performed in their regions and any changes that need to be implemented can be done so in time for the following water plan.

6. Other issues

Barwon Water strongly suggests that it is important to include in an access regime the requirement to assess the applications based on a whole-of-region analysis. There may be applications that arise which are efficient for the local area but become inefficient for the region due to future work that is required. For example, a private party may seek access to a system and build connecting infrastructure that would service Stage 1 of a development. When the water business undertakes its planning it has factored in the requirement to build infrastructure to service Stage 1 and 2 of a development. For a developer to service Stage 1, and the water business was still required to service Stage 2, the combined cost may be larger than if the water business was to develop infrastructure that would service both Stage 1 and 2. This is an inefficient outcome and one where the broader area needs to be considered rather than just the localised area the private party is seeking to service.

Another example where the region needs to be considered is where the water business has planned to undertake work that would see a large portion of its region benefit from the work. If a private party seeks access to provide services to a localised area, the individual cost may be less however the investment being undertaken by the water business will benefit a larger number of customers in a larger area than simply the single development being proposed by the private party. Therefore, the private party access would be inefficient when considered on a regional basis.

The Issues Paper has a glaring gap by not addressing the establishment of private schemes, where a developer provides the natural monopoly assets as a private utility. This is an important issue that needs to be considered as natural monopoly assets such as water and sewerage underground infrastructure being provided and owned by a private party may result in inefficient and sub-optimal regional provision of infrastructure - disjointed and 'piece-meal' provision of infrastructure may result. It could be assumed that it would be more efficient for a region if one entity were responsible for planning for natural monopoly essential assets for an entire service area - private parties can then access these assets via the proposed access regime.