

17 November 2014
Australian Water
Association

change & grow ^{AWA}

Submission to the Competition
Policy Review Panel Draft Report

**AUSTRALIAN[®]
WATER**

ASSOCIATION

17 November 2014

Professor Ian Harper
Chair
Competition Policy Review Panel
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Chair and Panel Members

Submission in response to the Competition Policy Review draft report

The Australian Water Association (AWA) welcomes the opportunity to comment on the draft report of the Competition Policy Review and would like to congratulate the Panel on its comprehensive work to date.

AWA is Australia's leading membership association for water professionals and organisations. The Association is independent and plays an essential role in supporting the Australian water sector in the delivery of effective and sustainable water management practices. Our mission is to foster knowledge, understanding and advancement in sustainable water management – its science, practice and policy – through advocacy, collaboration and professional development.

Introduction and summary

Competition for the supply of bulk water services is limited in Australia principally due to the existence of natural monopolies, the scale of investment that is necessary to supply these services, and regulatory constraints. Each State, as well as the Commonwealth, has agencies whose role is to ensure that the water utilities do not abuse their dominant market position (i.e. monopoly). Presently these agencies operate independently of each other which leads to differences in their approach to economic regulation. In the interests of efficiency and certainty, AWA submits that harmonisation of these disparate approaches should be pursued.

The Australian urban and non-urban water industry is subject to economic oversight by a number of regulators, with differing degrees of independence. Independent regulation for water was implemented to provide a response to the risk that the water services sector may seek to exploit their monopoly power.

Good economic oversight promotes the attractiveness of investment in the water sector by securing long-term returns, while poor economic oversight will have an adverse effect. Long-run investment certainty is the central characteristic that must be aligned to promote investment in the water industry's long-lived assets.

Draft Recommendation 16 of the Harper Review (Competition Policy Review Panel Draft Report) recognises the merit of such an approach. It provides that:

All governments should re-commit to reform in the water sector, with a view to creating a national framework. An intergovernmental agreement should cover both urban and rural water and focus on:

- *Economic regulation of the sector; and*
- *Harmonisation of state and territory regulations as appropriate.*

The Panel recommends that responsibility for access and pricing be undertaken by a separate national body. This body would have responsibility for electricity and gas. Should the economic regulation of water become national, it was recommended that it should then also have responsibility for water (recommendation 46).

Issues

AWA supports the Report's suggestion to amalgamate and consolidate each of the existing state-based economic regulators into the one multi-jurisdictional economic regulator. The Association believes this would result in greater capability and scale of that regulator and the predictability, transparency and consistency of oversight by such a regulator would be commensurately improved. Further, the amalgamation of multiple regulatory agencies into a single agency would reduce red tape.

Even though Australia's Constitution does not allocate responsibility for water to the Federal Government, we could have a federal economic regulator for water utilities. Such jurisdiction may already exist, but it would preferably be the subject of some form of intergovernmental agreement or referral of powers.

It is recognised that a more national approach may create a risk of reduced recognition of the different nuances between the states. In truth, however, the role of any form of regulation is to provide boundaries around inherently dynamic environments and as such they must always evolve to best give effect to their objectives. With the transition to a national body it is imperative there is appropriate consideration given to the transfer of existing expertise from the state regulators to ensure the successful implementation of the national regulatory framework to deliver a successful outcome for customers.

A national regulator, such as that mooted by the Harper Review, would also address the perceived conflict of interest in State Governments owning the utilities which are regulated by other state controlled entities (the economic regulators). The AWA/Deloitte 2014 State of the Water Sector Report gauged the perception of the effectiveness of economic regulation of participants in their jurisdictions. It found that the view of the effectiveness of regulation varies across jurisdictions, but is highest in NSW, Victoria and the ACT, where formal and well-established economic regulatory arrangements are in place. AWA believes that a national regulator with strong regulatory arrangements and independence from the entities for which it is responsible would improve the effectiveness of economic regulation.

With the current debate about privatisation triggered by the Commission of Audit Report and the Commonwealth and State Governments' capital recycling program – with its aim of increasing infrastructure investment – it is timely to ask how the water industry is going to fund the required investment. There is limited appetite for investment by state and territory governments due to their already stretched balance sheets and competing demands – most notably from health, education and other forms of infrastructure such as roads and public transport that arguably provide a greater political dividend. This is further hampered by the view that the water industry has had more than its share of the 'big capital spend' with desalination plants and other measures. There is also a view that the water sector can fund its own investment through prices, although customers' willingness to pay for investment is low after a sustained period of significant price increases.

In order to attract private investment the regulation of the water sector will need to change. There is a desperate need for consistency of economic regulation across all states and territories to attract long-term private investment. Further, there is the need for a national framework that covers all areas relevant to water and wastewater management – inclusive of environmental, health and pricing aspects. The degree of competition or contestability that could be achieved is worthy of closer scrutiny. The UK's model provided private water monopolies with the opportunity to manage the

sector for many years before only recently introducing limited retail competition. To enable this, an adequate framework is required. Australia needs a model similar to this: one that can accommodate both public and private ownership to maximise the benefits for customers and the community

Under a national framework, investors would have a single set of rules concerning the economic regulation of businesses that may be located in different states in Australia. This will reduce transaction complexity and compliance costs to all potential investors.

AWA's position

AWA supports all efforts to harmonise the different approaches that have been adopted in Australia to support competition policy, as it believes that simplicity and consistency best serves the interests of consumers of water services.

AWA does not believe that the current approach to economic regulation is sufficiently consistent to best promote investment in the water services sector across the nation. The association also believes that red tape and compliance costs can be reduced by greater harmonisation of economic regulation in the sector.

The current approach also gives rise to a perception of conflict of interest with state-based economic regulation of state-owned assets.

For these reasons, the AWA supports the recommendations of the Harper review.

AWA believes that the national regulatory framework should at least meet the following criteria:

- a) Has clear objectives – protecting the long term interests of consumers;
- b) Is customer-centric – the regulator avoids getting unnecessarily between the utility and its customers;
- c) Establishes a framework where broader costs and benefits can be incorporated into investment decisions for the full range of services it provides across the water cycle;
- d) Has appropriate risk sharing mechanisms — for example, revenue caps, and pass through mechanisms;
- e) Has strong incentives for efficiency and innovation, including rewards as well as sanctions; and
- f) Contains an appeal mechanism.

AWA's commitment to driving reform

In October 2014, AWA hosted the inaugural National Water Policy Summit to provide opportunity for industries across urban water, mining and agribusiness to discuss how to provide national leadership, following the closure of the National Water Commission. Over 120 representatives from the water, mining, energy and agribusiness sectors met to discuss the challenges for the sustainable management of water in Australia. Following Summit discussions, the Australian Water Association agreed to the following actions:

1. Facilitate the development of an industry-led National Water Strategy accommodating cross-sector water users to be presented to State and Federal Ministers in May 2015.
2. Call on all State and Territory governments to make environmental, health and economic regulation of water consistent across all jurisdictions.
3. Recommend ways to reform the regulatory regime and structure of the water sector to reduce the political interference in the decisions and roles of State regulators and water utilities to enable more independent and effective management of water.

4. Convene a Water Regulators Forum for the State and Territory water regulators to discuss implementing harmonised regulations at Australia's largest water conference, Ozwater'15, to be held in Adelaide in May 2015.

5. Lead the development and implementation of a community campaign to evolve consumer perceptions about the main water issues including the value of water in the Australian economy and the level of customer service.

AWA supports the findings of the Harper review and agrees that in the interests of efficiency and certainty, the harmonisation of the disparate approaches to economic regulation should be pursued. The Association and its members would welcome the opportunity for further consultation on the national regulatory framework for water.

Yours sincerely

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Australian Water Association