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Your reference:



**GIPPSLAND**  
WATER

Essential Services Commission  
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Dear Sir/Madam

**INQUIRY INTO AN ACCESS REGIME FOR WATER AND SEWERAGE  
INFRASTRUCTURE SERVICES (DRAFT REPORT) - GIPPSLAND  
WATER RESPONSE**

Gippsland Water has reviewed the draft report released by the Essential Services Commission (ESC) in relation to the development of an access regime for water and sewerage infrastructure services.

While the ESC identified several specific issues that it sought responses on in the draft report, Gippsland Water has identified a number of issues that the ESC should take into account when providing recommendations to the Victorian government on the development of a state based access regime. Some of these issues were raised by Gippsland Water at the ESC's recent public meeting, while others have come to light after further consideration of the draft report.

The issues identified by Gippsland Water are outlined below for consideration by the ESC:

**1. Coverage**

1.1 Critical infrastructure and public safety

Discussion on coverage of the regime clearly sets out that the regime would apply to all monopoly assets of water businesses across the state. The disclosure process advocated in the draft report includes the release of information packs by water businesses to access seekers as they seek to understand their potential to utilise water supply and sewerage systems.

*Gippsland Water comment:*

*In determining those infrastructure assets that would be covered under an access regime, it would appear that consideration has not been given to limiting access to infrastructure that has been identified as "critical infrastructure" under Sustainability Vulnerability Risk Assessment Guidelines. The development of any access regime must take into account that particular infrastructure across the State, given its nature, has been identified as being of state or national importance.*

*Water businesses maintain a significant amount of sensitive information about water supply and wastewater transfer systems. This information is protected by water businesses to maintain public safety. Any disclosure process for the release of details pertaining to monopoly infrastructure must recognise public safety concerns, and actively manage this process. How best to achieve this level of protection while at the same time providing enough detail to access seekers is a matter for consideration. One potential solution may be to structure the access regime in such a way that access seekers are required to register with the ESC, and undertake security checks before details of any infrastructure can be provided by a water business under an access commitment. With some thought, this process could form a preliminary licence application process, which could be expanded into a full licence request should the access seeker wish to proceed.*

*Certainly, any access regime must be concerned with ensuring that “critical infrastructure” access by third parties, and information disclosure on these particular infrastructure assets either does not occur, or occurs with appropriate controls.*

## 1.2 Storage Facilities

The draft report promotes the inclusion of water and sewerage storage facilities (dams) as monopoly infrastructure assets that should be covered by any regime. The draft report notes that this position is at odds with the New South Wales provisions which exclude storage facilities, but indicates that this would be preferable to allowing continued access under the Trade Practices Act provisions, and the possible creation of a piecemeal access regime. The opportunity derived from inclusion of storage facilities was identified in the draft report as the potential to use short term spare capacity that exists in storage facilities.

*Gippsland Water comment:*

*Gippsland Water agrees that a level of clarity in terms of coverage would benefit all parties concerned. The existence of one set of rules under a state based access regime would therefore be preferable to multiple rules, dependant on the type of infrastructure, when access seekers seek access under different legislative provisions.*

*Gippsland Water is concerned that any access regime includes a risk allocation framework to deal with likely capacity issues in storage facilities. While many dams across Victoria reach relatively low levels during the summer months in particular, the conclusion that this short term spare capacity can be shared by new entrants is contentious.*

*In developing the access regime, recognition must be given to the role spare capacity plays in capturing rainfall events, regardless of the time of year. While winter and spring rains may dominate the annual fill process, it is not uncommon for rain events to provide significant volumes of water during the summer months for existing water businesses. The speed at which rainfall events can fill various dams across the state is dependant on issues such as the size of the catchment area, the dryness of the catchment and the size and location of the rainfall event. In recent years, Gippsland Water has seen first hand its major storage facility (30,000 megalitres) move from 50% to 100% full, and spill water, in a matter of two days.*

*The risk allocation framework Gippsland Water proposes the ESC consider is how in these circumstances a water business can allocate a proportion of storage space to another access seeker. For example, should water spill from a dam that holds water from both the water business and an access seeker, whose water is lost over the spillway? These risks and how to manage them need to be understood before the industry enters into access commitments for storage facilities. From a water business perspective, Gippsland Water would not support a proposition that may significantly reduce the effective yield of existing storages by requiring water that would otherwise be naturally collected, and used to supply customers, to spill to the detriment of the water business, and the customers that businesses serves.*

### 1.3 ESC proposals for infrastructure inclusions

The draft report outlines that a water business will initially nominate specific infrastructure for which the business proposes to make access commitments. The report then adds that additional infrastructure services could be proposed by the ESC, which would then advise the government of its recommendations.

*Gippsland Water comment:*

*While the draft report discusses the arbitration of disputes between access seekers and water businesses, the report is silent on whether water businesses will have the same ability to put forward a case to defend a decision not to nominate certain infrastructure. The processes surrounding nomination of assets must allow the water businesses some form of “right of reply” to any ESC proposals.*

## **2. Access Considerations**

### 2.1 Potential downstream implications when access provided

The draft report discusses the benefits of an access regime which will promote innovation, leading to the delivery of “new water” into existing water distribution systems. Appendix three cites examples such as access seekers seeking to inject water from groundwater or irrigation sources into existing transfer networks, or moving this water into “shared” storage facilities.

*Gippsland Water comment:*

*Gippsland Water understands that the ESC review could not look to cover off the range of technical or risk considerations associated with mixing various water sources. Gippsland Water is concerned however that a level of understanding is promoted surrounding the stark contrasts that can exist in water quality, firstly between various surface water sources, and secondly between surface water and groundwater.*

*The simplicity that abounds in the ESC examples should be clearly understood by all concerned to be an extremely optimistic view. Introducing (for example) groundwater to a surface water system may have significant implications requiring major changes to downstream water treatment processes. Gippsland Water notes the absence in any ESC diagrams in the draft report referring to water treatment processes.*

*A major concern for water businesses and the customers they retain in any retail market scenario is who bears the costs of any significant additional treatment processes? These costs may be evident as a step change in costs for running treatment plants. Gippsland Water would contend that access prices for access seekers should include a component to reflect new costs imposed on the water business, where the water business can demonstrate that providing access will lead to significant cost increases. Basing access prices on existing treatment processes and neglecting new downstream treatment costs would be extremely unfair on those customers who remain with the water business.*

## 2.2 Capacity constraint issues

The draft report discusses a range of issues with respect to coverage of infrastructure assets and contains a discussion of system coordination and management issues including implications for network operations and network balancing.

*Gippsland Water comment:*

*There appears to be no recognition in the draft report of fundamental capacity constraint issues associated with water business infrastructure. Water businesses will be required to determine whether capacity exists in particular infrastructure assets covered by any access regime. The determination of spare capacity that is available for use for any particular asset could be very different depending on what flow rates are deemed acceptable for use. Water businesses maintain data on various flows including average flows, peak day flow rates, peak summer day flow rates and peak instantaneous flows. ESC guidance should provide water businesses with some direction on what will be considered appropriate. An inability to cover these issues off from a guidance perspective may lead to a significant number of disagreements between access seekers and water businesses, and require substantial time from an arbitration perspective.*

## **3. Timeframes**

### 3.1 Concurrent processes

The draft report appears to indicate that water businesses will be required to commence the process of nominating specific infrastructure for which access commitments would be made at the same time as the ESC will be developing guidance on two key issues – identifying infrastructure services for which nominations should be made; and matters that should be included in access commitments.

*Gippsland Water comment:*

*The development of guidance on substantial changes to the water industry by the ESC is a key component of any move toward an access regime. As such, completion of ESC guidance should be a precursor to water businesses being asked to commence the nomination of infrastructure process. The nomination process for infrastructure assets should only commence after ESC guidance has been prepared and tested with the water businesses and other interested parties. Any haste to move into an access regime should be tempered with the knowledge that the opportunities afforded under Trade Practices Act legislation have not been used in Victoria since becoming available. It is far more important to develop a robust access regime, than to rush headlong into an access regime that is poorly developed.*

## **4. Pricing**

### 4.1 Access pricing, ring fencing and transfer pricing

The draft report outlines in some detail the methodology that the ESC considers should be used in determining how access pricing should be calculated and how measures such as accounting or functional separation would promote clarity and transparency in determining access prices. The concept of transfer pricing is identified as an outworking of functional separation, and transfer pricing is seen as the basis for setting access prices for assets that have been functionally separated. Draft recommendation 7.2 indicates that water businesses will be required to implement ring fencing within three months of becoming subject to access.

*Gippsland Water comment:*

*Gippsland Water is concerned that the impact of ring fencing on urban water businesses may not have been properly considered. Water businesses across Victoria may be in a position to develop, or may in fact already have the basis of accounting ring fencing in place. The ability of urban water businesses to undertake functional ring fencing is however a very different matter. Ring fencing resources that are utilised across a variety of assets, only some of which may be captured under an access regime, may be extremely difficult to achieve. Other water businesses have already indicated to the ESC that there may be significant costs involved in developing ring fencing. Gippsland Water shares this concern. The obvious question is who pays for the costs incurred in establishing ring fencing?*

*During the public meeting, Gippsland Water raised concerns relating to the ability of accounting systems used in water businesses to cope with transfer pricing concepts. While transfer pricing is a simple concept in theory, in practice many accounting software packages do not have this functionality, or are not easily modified to enable transfer pricing mechanisms. Many water businesses would not presently even consider adding non-financial data that would be need to support transfer pricing to their accounting systems.*

## 4.2 Limitations with the cost of service approach

The draft report outlines two separate approaches to access pricing, namely the retail minus approach and the cost of service approach. Discussion in the report identifies situations when either approach may be used.

*Gippsland Water comment:*

*The book value of infrastructure assets, based on historical cost accounting and asset revaluation processes is maintained on an asset by asset basis by Gippsland Water. This cannot be said for the regulatory asset base (RAB), which was first calculated as part of the June 2005 Water Price Review. The RAB is a consolidated number which has never been allocated to individual assets. The only exception to this statement is where an asset has been created after the introduction of regulation in July 2005. In these instances book and RAB values will normally be similar. This situation limits the benefits of the cost of service approach, as individual asset values need to be determined before regulatory depreciation and return on assets can be calculated.*

## **5. Obligations**

### 5.1 Environmental Contributions

In determining prices for their customers, water businesses must include the costs of environmental contributions paid each year under the Water Industry (Environmental Contributions) Act 2004. Environmental contributions are collected from water businesses for the purposes of funding initiatives that seek to promote the sustainable management of water; or address adverse water-related environmental impacts.

*Gippsland Water comment:*

*While the draft report clearly identifies a range of legislative requirements that will be applied to access seekers, including associated licence fees, the report does not appear to consider environmental contributions. To maintain a level playing field, the ESC should recommend that in future the same rules apply to all participants. This must include a requirement to pay an Environmental Contribution, which is a significant component of water business costs, or conversely remove contribution system for all participants in the industry.*

### 5.2 Statement of Obligations

As noted above, the draft report clearly identifies a range of legislative requirements that will be applied to access seekers.

*Gippsland Water comment:*

*Gippsland Water indicated at the recent public meeting that consideration needs to be given to other requirements placed on water businesses that are not direct legislative requirements. Perhaps the most obvious example is the Statement of Obligations (SoO), issued by the Minister for Water pursuant to the Water Industry Act 1994.*

## 6. Information Provision

### 6.1 Statement of future opportunity

The draft report identifies information provision to access seekers on issues such as industry conditions, costs and supply demand balance as another key consideration. Reference is made to the national electricity industry and the publishing of an annual Statement of Opportunities, a ten year look ahead at the future need for generation capacity, demand and augmentation issues. The draft report also notes some of the publicly available water industry planning information.

*Gippsland Water comment:*

*In the central Gippsland region, Gippsland Water manages 12 independent water supply systems. Gippsland Water has released supply demand information publicly on each of these systems in the form of a Water Supply Demand Strategy, a 50 year look ahead at water resource availability and consumer demand for water.*

*Despite recent and proposed additions to water industry infrastructure, a state wide water grid does not yet exist in Victoria. The aggregation of water industry data into a state based summary along the lines of the Statement of Opportunities may be of little value in helping access seekers understand the supply demand issues across the state given the lack of interconnectivity between water supply systems. At this time, data on the major networks servicing metropolitan Melbourne may be the only real area of interest to access seekers.*

### 6.2 Long term planning

Water businesses are currently responsible for long term planning activities for all water supply systems under their control. As noted above Water Supply Demand Strategies have been developed and are publicly available.

*Gippsland Water comment:*

*The potential for both supply and demand information to be decentralised in the future, as access seekers enter both the water sourcing and retail supply arenas, could severely restrict centralised planning efforts. Poor quality data will hamper infrastructure planning and increase the risk of exposure to unplanned events. Questions arise such as –*

- Who will be allocated responsibility for planning?*
- How will information be collected from competing businesses in future?*
- How will infrastructure prioritisation occur if both water businesses and access seekers seek to introduce new infrastructure?*

*These planning issues all require consideration in the development of a state based access regime.*

Gippsland Water appreciates this opportunity to provide input to the ESC on the introduction of an access regime for water and sewerage infrastructure services. Comments or questions on any of the issues outlined in Gippsland Water's submission should be directed to Mr Kevin Enguell, Manager Strategic Planning on telephone 5177 4684.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'David Mawer', with a stylized flourish at the end.

**David Mawer**  
**MANAGING DIRECTOR**