



Government of **Western Australia**
Department of **Water**

Economic Regulation Authority's Inquiry into Pricing of Recycled Water in Western Australia

Statement of response

Looking after all our water needs

Department of Water

July 2010

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The Department of Water and the Department of Treasury and Finance jointly developed the government response that was approved by the Minister for Water and Treasurer.

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Further Information

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Statement of response to the Economic Regulation Authority's Inquiry into Pricing of Recycled Water in Western Australia

A government response to the recommendations of the Economic Regulation Authority's *Inquiry into Pricing of Recycled Water in Western Australia* was approved by the Minister for Water and Treasurer in February 2010.

This statement summarises the government's response. It is intended that this document be read in conjunction with the final report of the inquiry, which can be found at http://www.erawa.com.au/2/768/46/inquiry_into_pr.pm.

Table 1 Summary of ERA recommendations and government response

ERA RECOMMENDATION	GOVERNMENT RESPONSE
1. A set of principles for the pricing of wastewater from wastewater treatment plants should be introduced, to create a level playing field for all providers of recycled water.	<p>Not supported at this time.</p> <p>On the balance of current evidence, it is considered prudent to allow the Water Corporation to continue to negotiate with recycled water customers at this time.</p> <p>The implementation of recommendations 2 and 3 will reduce the risk of actual or perceived monopoly pricing.</p> <p>In future, the Minister and Treasurer may reconsider the implementation of the inquiry's recommended principles or other increased price intervention if a pattern of evidence emerges that pricing practices are a barrier to adoption of cost-effective recycling.</p>
2. The pricing principles and how they are applied should be subject to periodic independent regulatory review.	<p>Partially supported.</p> <p>Recycled water pricing will continue to be considered within the scope of future ERA tariff reviews.</p>
3. There should be an arbitration mechanism to assist parties in commercial negotiations with the Water Corporation in water recycling projects.	<p>Supported.</p> <p>The DoW will develop a proposal for a dispute resolution mechanism in consultation with DTF, Water Corporation and ERA by March 2010, and submit this for the consideration of the Minister for Water.</p>
4. Wastewater from wastewater treatment plants should be priced to reflect the prices that would emerge under a competitive market. These prices would	<p>Partially supported.</p> <p>See comment on recommendation 1.</p> <p>The Water Corporation may continue to</p>

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<p>have three components:</p> <p>Direct Costs. A charge associated with the costs of delivering the wastewater to the customer, including any incremental costs that might be incurred in treating the wastewater to be fit for purpose.</p> <p>(Minus) Avoidable Costs. A negative adjustment in price to take into account any avoidable costs as a result of selling the wastewater resource. For example, the operating costs of discharging the wastewater to the environment would be part of the avoidable costs.</p> <p>The price of the wastewater resource should be non-negative. Thus, if avoidable costs are greater than direct costs, the price of the wastewater should be zero.</p> <p>(Plus) Scarcity Premium. Additionally, if the amount of wastewater available to be recycled is less than the demand for the wastewater, then an additional premium would be added to the price to reflect its relative scarcity. The premium should be determined by a neutral tendering process.</p> <p>These guiding principles would complement, and may be superseded by, pricing principles that would be established under a third party access regime.</p>	<p>establish maximum prices as part of project negotiations.</p> <p>The direct costs minus the avoidable costs of a recycled water project will form the minimum charge of a recycled water project as per the ERA's principles and current practice.</p> <p>Where avoidable costs have been calculated in individual cases, the Water Corporation will publish this information.</p> <p>With regard to recycled water for public open spaces and other non-commercial uses the Water Corporations' new policy will come into effect, which requires recycled water for these particular uses to be available at direct cost.</p> <p>Following the introduction of a third party access regime, pricing principles may be superseded by the impact of the access regime.</p>
<p>5. In implementing the pricing principles for the pricing of wastewater resources from wastewater treatment plants, the Authority recommends that:</p> <p>the pricing principles be introduced into the water agencies charges bylaws;</p> <p>the avoidable costs of contestable wastewater activities be estimated for the Perth metropolitan area, and for other systems on a case-by-case basis;</p> <p>a dispute resolution mechanism be developed;</p> <p>avoidable costs be subject to regulatory approval in the case of the Perth metropolitan area, and as needed for</p>	<p>Partially supported.</p> <p>Avoidable costs</p> <p>It may be more efficient to calculate avoidable costs on a case-by-case basis. This would ensure avoidable costs are in net present value at the time of a third party proposal for access.</p> <p>Dispute resolution mechanism</p> <p>The role and structure of a dispute resolution mechanism needs to be defined. Refer to recommendation 3 above.</p> <p>Neutral tender process</p> <p>A 'neutral tender process' could be achieved using a number of different processes, including auction, tender or intertemporal</p>

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<p>other systems; and</p> <p>a neutral tender process be developed for the allocation of wastewater resources from wastewater treatment plants.</p>	<p>reassignment.</p> <p>It is necessary to determine the most efficient and lowest cost option for neutrally allocating wastewater resources from wastewater treatment plants (possible consideration could be given to different options for different sources).</p> <p>The terms of any tender process will need careful design in order to be as fair to as many participants as possible.</p>
<p>6. The price of water from recycling plants is a commercial matter between the service provider and its recycled water customers.</p>	<p>Supported.</p>
<p>7. The Kwinana Water Reclamation Plant should be treated as a commercial venture between the Water Corporation and its industrial customers, without any regulatory oversight of prices.</p>	<p>Supported.</p>
<p>8. In the case of third pipe schemes, where services are provided by a monopoly provider and customers do not have an alternative supply option, some light-handed regulatory oversight is required to check that the rate of return is not unreasonably high.</p>	<p>Supported.</p> <p>Monopoly service provision in a regulated industry, such as water, would reasonably attract a level of regulatory oversight.</p> <p>As third pipe schemes are normally developed during the process of land subdivision, customers should know the pricing for the third pipe scheme before purchasing land within the scheme. Light handed regulation should ensure this previously agreed pricing continues.</p> <p>It is not proposed that government cap rates of return for third pipe schemes.</p> <p>It is anticipated that future ERA inquiries into the Water Corporation's tariffs will have scope to investigate pricing for third pipe schemes.</p>
<p>9. Analysis of the Water Corporation's non-potable supply charges to residents of Brighton Estate indicates that the rate of return appears very high relative to the risks of the project.</p>	<p>Noted.</p> <p>A pre-tax assessment is used by the ERA to determine the rate of return for Brighton Estate. The Water Corporation charges have been increased to accommodate tax costs (usually this is covered by the Developer contribution). This appears to be the reason that before tax rates of return to Brighton</p>

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	<p>Estate residents seem very high.</p> <p>It is believed that the charges are more appropriate based on an after-tax assessment of the rate of return. However the ERA has justified its pre-tax approach based on the majority of Australian regulators choosing to assess rates of return before tax due to the complexities associated with post-tax methodology.</p> <p>While the investigation of pre-tax return is appropriate regulatory practice in many circumstances, it should not be used in a way that constrains the establishment of financially viable schemes.</p> <p>The price charged by the Water Corporation was negotiated between itself and the developer and is a commercial matter and are publicly available on their web-site and published in their by-law charges.</p>
<p>10. All industrial customers and metropolitan commercial customers should be transitioned to cost-reflective usage charges as soon as possible (rather than by 2014). (The ERA is considering the issue of usage charges for commercial customers in its inquiry into the tariffs of the Water Corporation, Aqwest and Busselton Water).</p>	<p>Supported.</p> <p>This issue will be addressed in the Government's response to the Tariffs Inquiry which will be released shortly.</p>
<p>11. In the absence of a competitive market in the provision of recycled water projects, voluntary recycling targets can provide an incentive for service providers to seek out and invest in cost effective recycling options. However, there is a risk that recycling targets could artificially encourage projects that are not the most efficient options to balance supply and demand (or discourage others that are).</p>	<p>Agreed.</p> <p>Voluntary recycling targets are only beneficial if they do not impact a cost effectiveness assessment (or cost-benefit analysis) of the project.</p>
<p>12. The cost effectiveness of rebates will depend on the cost per kilolitre saved, where the cost is the full resource cost of offering and administering the rebate, plus the installation and operating costs to the customer.</p>	<p>Agreed.</p> <p>It is important to recognise the full costs of a rebate scheme (including administration) when assessing the effectiveness of rebates.</p> <p>Assessment of any future rebate proposals by DoW and DTF will include this consideration.</p>

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<p>13. An assessment of costs per kilolitre of water saved indicates that most rebate products (with the exception of rain sensors, garden assessments and flow regulators) are more costly to society than the alternative of producing more potable water.</p>	<p>Agreed.</p> <p>Cost per kilolitre of water saved is an appropriate indicator of the effectiveness of rebate products.</p>
<p>14. The cost effectiveness of mandatory standards will depend on the cost per kilolitre of water saved.</p>	<p>Agreed.</p>
<p>15. Mandatory standards involving water efficient technologies or new house design may generally involve little or no incremental cost to consumers, while achieving water savings. However, mandatory swimming pool covers are an expensive way to achieve water savings (i.e. more costly than producing potable water).</p>	<p>Noted.</p> <p>Standards for new homes which involve water efficient technologies or new house design at little or no incremental cost are appropriate.</p> <p>Any proposed regulation must be subject to a Regulation Impact Statement to ensure that the benefits of the proposed regulation outweigh the costs. This will be achieved through the Regulatory Gatekeeping Unit process.</p>
<p>16. The reservation of water supplies for specific purposes involves second-guessing the value of water to users. Whenever wastewater is a scarce resource, it should be allocated using a neutral tendering process.</p>	<p>Partly supported.</p> <p>In general, a neutral tendering process can be simple, low cost to administer and equitable where the resource is scarce.</p> <p>However, it will not always reflect the long-term value as not all potential customers will necessarily be in a position to participate, for example, potential uses that require further research or potential customers still undertaking investigation and assessment of the viability of their project.</p> <p>An effective secondary market could potentially address some of these concerns but may not result in the optimal outcome.</p> <p>Wastewater from the Beenyup Wastewater Treatment Plant will be reserved while a drinking water replenishment trial continues.</p>
<p>17. A trial of a neutral allocation mechanism for allocating wastewater should be conducted, involving stakeholders (for example, for wastewater from the</p>	<p>Partially supported.</p> <p>A trial of a neutral tender process should be conducted from the most appropriate source.</p> <p>The most efficient and least cost option</p>

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<p>Beenyup wastewater treatment plant).</p>	<p>should be used to trial for any one potential source. However, it should be noted that different neutral tender options are more applicable for different sources. Therefore, the results of the trial should not be used to discount other (un-trialled) options. Rather, the results should highlight outcomes and improvements for future neutral allocation processes.</p> <p>A trial of neutral allocation processes may be appropriate where competition to obtain recycled water has been identified.</p>
<p>18. A State-based third party access regime should be introduced. This would allow third parties access to the wastewater network for the purpose of providing recycled water.</p>	<p>Supported.</p> <p>An access regime should be developed to simplify existing processes under the <i>Trade Practices Act</i>. However, consideration is needed as to when the regime should be introduced.</p> <p>An access regime was also recommended in the ERA's <i>Inquiry into Competition in the Water and Wastewater Services Sector</i> and is being considered by the Competition Inquiry Steering Group.</p> <p>Implementation of an appropriate access regime will be addressed in the Government's response to the ERA's <i>Inquiry into Competition in the Water and Wastewater Services Sector</i>.</p>