Response to the *Productivity Commission Draft Report*

Australia's Urban Water Sector

May 18, 2011

Summary

The Productivity Commission's Draft Report: *Australia's Urban Water Sector* is a negative report that fails to set out a roadmap for market reform.

It does not examine how the current centralised system will adapt to the future needs and demands of the market, how it will cater for new growth areas and work alongside decentralised systems that encourage recycled and sustainable water innovations.

It fails to examine the weaknesses of the centralised system and does not acknowledge or analyse the only existing deregulated market in NSW.

1. **Urban water supply should be fully competitive, decentralised and not focussed on bulk supply.**
   Australia's urban water supply must be fully competitive and decentralised. Governments need to invest in diversified, flexible, sustainable, and innovative water systems capable of catering for high growth regions.

   The emphasis should not be on bulk water services. While this is necessary in the short to medium term, future water services will be focused on localised sustainable solutions that generate seasonal excess water supplies on site, shifting infrastructure needs.

   The Productivity Commission offers 5 structural options for urban water supply in Australia's large urban cities, Option 5 being the fully competitive decentralised model. There is no reason why Option 5 cannot be amalgamated within Options 1 – 4, rather than a stand alone model.

A fully competitive, decentralised urban water market already exists in NSW. Option 5 is catalysing the innovation and assisting in the delivery of affordable, sustainable and innovative water services to communities that would only previously be able to access centralised systems.

2. Net benefits of decentralised markets

"*There is insufficient evidence at this time to conclude that a competitive decentralised urban water market is feasible and would have net benefits." (page XL)*

"There are potentially significant risks and costs associated with establishing a fully competitive, decentralised market for urban water services at this time and it is unlikely that the benefits justify the costs." (page LV)

These are surprising generalisations that are not backed up with any detail or explanation. Existing evidence easily demonstrates the contrary.

Decentralised recycled water systems have been shown to provide net benefits to the community, including:

- Security of water supply
- Water savings
- New sources of water for irrigation/ community facilities/ ecosystems
- Greater choice and control for households over water use and wastewater
- Future proofing homes, businesses and communities, thereby increasing options for new technologies to be utilised into the future.
- Requiring significantly less drinking water supply
- Reuse of waste at source.
- Population growth under this decentralised servicing model has little impact on the existing water infrastructure
- Eases pressure on bulk water supply and network augmentation
- Lower house construction costs

3. Decentralised systems enhance the security of urban water supply, they do not put it at risk.

Decentralised systems usually provide additional water source at or near the point of consumption complementing existing centralised systems.

4. Competitive Decentralised Markets provide value <u>not</u> lower prices.

The NSW government has created a competitive marketplace through the *Water Industry Competition Act 2006* (WICA).

The NSW WICA competitive decentralised urban water market is delivering value in many ways other than direct water price reductions.

Ultimately this competitive market place may assist in lessening increases in water pricing and provide consumers with multiple water supply options and technologies that reduce the overall annual cost of water services.

Developers are increasingly engaging private water utilities to provide decentralised schemes in order to:

- Shorten timeframes for land release to market
- Reduce developer costs for headworks and lead in infrastructure
- Provide alternative water sources to achieve sustainability ratings
- Provide differentiation through green technology

In this competitive marketplace the price of water to the consumer is the same as the incumbent public water authority pricing however:

- Land prices are less as a result of lower infrastructure costs.
- House/Apartment construction costs are lower. (No rainwater tank requirement to meet mandatory sustainability targets)
- Alternative water supplies are at lower prices than drinking water
- Property values are increased through secure alternative water supplies
- Community health is enhanced through high quality recreational facilities underpinned by an unrestricted irrigation water supply.

Examples in NSW where the competitive decentralised water market is providing the above financial benefits include:

1. **Pitt Town, Hawkesbury – 1,000 lots**
2. **Central Park, Sydney – 2,000 apartments and 100,000m2 commercial/retail**
3. **Discovery Point , Sydney – 1,800 apartments**
4. **Barrangaroo, Sydney – 800 apartments, 500,000m2 commercial/retail**
5. **Green Square, Sydney - 2,000 apartments**
6. **Bingara Gorge – 1,500 lots**

There are many untapped market opportunities where the competitive decentralised water market can provide consumer benefits including:

7. **Sydney's South West growth area**
8. **Sydney Olympic Park**
9. **Homebush Bay**
10. **Rhodes Peninsula**
11. **Marsden Park**

5. **Prolonged Drought has pushed the 'reset button' on Water in Australia.**

Water restrictions are costly to the community and are likely to have cost in excess of a billion dollars per year from lost value of consumption alone. (page XVI and page XXXIII)

While water restrictions have cost public water utilities in lost revenue and the community in terms of inconvenience - these costs can be met with numerous benefits, including:

- Consumers now have security of water supply where they did not in the past
- Communities have greater awareness and education on how to better manage and use their water supplies
- Water restriction information and methodologies have informed, educated and changed behaviour

Water restrictions are a simple blunt punitive measure made necessary because of the lack of diversification in the market. States have focused on augmentation of bulk water supplies with little consideration for water solutions at point of demand Point of demand (local) solutions would be catalysed by a fully competitive, decentralised market for urban water services.

Water restrictions have reset the Water Sector in a similar way the Global Financial Crisis (GFC) impacted the finance industry.

They have highlighted the need for Security of Water Supply (just as we found in the financial markets) and, importantly, the value of water to the consumer (just as businesses found when debt funding criteria changed following the GFC) – a wake up call to the industry that will stand the sector in good stead in the future.

Water restrictions have added value to consumers and communities in that they will:

- be provided with certainty of supply in future droughts
- understand the way water is managed
- understand how they should act in using water
- understand the cost of water and associate that with the value they may derive from additional water use

6. Learning from existing privatised decentralised markets.

The Productivity Commission did not examine the NSW Water Industry Competition Act (WICA) or the private market that has developed in NSW as a result of this legislation.

By omitting to include a study/comparison of the NSW WICA- led market, the Productivity Commission is implying that this market is insignificant and not important.

The market – while in its infancy - is creating a dynamic environment where private innovation can now make its way directly to residents and communities offering more flexible and often more sustainable water solutions.

The Australian and international water sector recognise the essential role water services play alongside energy in maximising efficiency and sustainability for families, businesses and entire communities.

The work of the Water Factory Company over the past two years demonstrates the benefits to customers and the market of both privatisation and deregulation. Central Park Sydney Water Utility (soon to be licensed) is a global best practice in water management services and practices and has been recognised by the Ozwater 11 Cities of the Future Workshop as a model water services system.

The water industry conference confirmed that sustainable water services and practices will underpin successful cities of the future, future-proofing buildings and communities and enabling next generation innovation to be installed when it comes to market.

Importantly these communities will be both decentralised and centralised with water management systems that utilise multiple water sources.

More and more, infrastructure-intense centralised systems are not providing affordable solutions to the market.

Government needs to acknowledge the important role decentralised, recycled and sustainable systems are playing now and will play in the future, and reflect this in their common objectives.

7. **Public Water Utility's centralised legacy prevents investment in decentralised systems.**
It will be impossible for centralised systems to service high growth regions across Sydney and other capital cities and regional centres without the support of decentralised systems.

These systems embrace high-tech and localised solutions that are usually highly sustainable – meeting a growing demand from residents and business for more sustainable water practice.

As the urban water sector grows to meet population growth in new housing areas and urban villages there is a greater need for Government oversight to ensure homes, businesses, families and communities are not disadvantaged.

In 2008, 26,400 new lots at Oran Park and Turner Road in Sydney's south-west growth region were released on the promise of recycled water services. The 2008 NSW South West Growth Centres REF was issued stating that the lots would be serviced with recycled water systems. Developers planned and invested money in supporting infrastructure including dual reticulation. In 2011 Sydney Water assessed the costs and decided they would not proceed opting for rainwater tanks instead. As a result, neither the developer nor Sydney Water has any onus to honour their commitment to the community. The developer is not obliged to find another supplier. Sydney Water is not obliged to provide the service. The result is that the community and homeowners are disadvantaged, when the private decentralised recycled water industry could have provided a solution.

8. **Government has a leading role to play in setting standards to protect communities from embedded water inefficiency costs.**

Buildings and communities that are not enabled with water efficiency are disadvantaged. They are encumbered with additional embedded water costs that, over time, devalue and disadvantage their property, including:

- Embedded water inefficiencies
- Embedded poor water management
- Reduced future options for innovation and water sources

With new and large growth areas rapidly opening up, Government needs to ensure these communities are serviced with optimum sustainable and affordable water facilities.

Currently there are no government requirements for recycled water in growth areas.

As a priority, Government needs to set, regulate and enforce standards for sustainable water services, including:

- Water use efficiency and conservation activities
- Working with councils and public water utilities to enable and facilitate decentralised water systems;
- Ensuring these systems have the capacity to recycle wastewater and sewerage, to create new sources of water supply, and provide more efficient and effective water solutions;
- Ensuring Government policies do not embed poor water use and management into new communities in growth areas;
- Ensuring developers and utilities are accountable for implementing planned water recycling and water efficiency systems.

Response to Draft Recommendations, Findings and Requests for Information

3.1 Draft Recommendation *(Chapter 3 — Objectives for the urban water sector)*

The Australian, State and Territory Governments should articulate a common objective for the urban water sector in relevant policy documents along the following lines:

- The primary objective of the sector is to provide water, wastewater and stormwater services in an economically efficient manner so as to maximise net benefits to the community.

Economic efficiency should be defined broadly to include environmental, health and other costs and benefits that might not be priced in markets.

RESPONSE 3.1

Agree. However, recycled water and water efficiency systems must also be included in the primary objective of the sector, alongside drinking water, wastewater and stormwater.

Benefits to communities of Decentralised Recycled Systems

Decentralised recycled water systems have been shown to provide net benefits to the community, including:

- **Security of water supply**
- **Lower house construction costs**
- **Water savings**
- **New sources of water for irrigation/ community facilities/ ecosystems**
- **Providing people with choice and control over their water and wastewater, enabling them to decide how, when and how much they use.**
- **Future proofing homes, businesses and communities, thereby increasing options for new technologies to be utilised into the future.**

Cities and communities of the future will include both decentralised and centralised water systems with water management systems that utilise multiple water sources.

More and more, infrastructure-intense centralised systems are not providing affordable solutions to the market. ***(See 4. & 5 Above)***

Government needs to acknowledge the important role decentralised, recycled and sustainable systems are playing now and will play in the future, and reflect this in their common objectives. ***(See Above)***

4.1 Draft Finding *(Chapter 4 — The role of governments)*

It is the role of governments (elected representatives) to:

- set objectives for policy development for urban water and relevant objectives for each agency
- develop policy frameworks and principles in relation to public health, the environment and service delivery that are consistent with these objectives
- define property rights for water
- put in place institutional and governance arrangements for:

- public health, environmental and economic regulation relating to water
- service delivery of potable water, non-potable water, wastewater and stormwater services.

RESPONSE 4.1 Finding

Agree. Government objectives need to:

- **facilitate decentralised systems**
- **facilitate recycled water systems**
- **facilitate sewer mining**
- **facilitate the use of new proven innovations**

Institutional and governance arrangements **must include sewer mining and decentralised recycled water systems that both extract and supply centralised systems improving flows and supply.**

Government has a leading role to play in set, regulate and enforce standards that:

- **Protect communities from embedded water inefficiency costs**
- **Ensure councils and public water utilities enable and facilitate decentralised water systems**
- **Ensure these systems have the capacity to recycle wastewater and sewerage, to create new sources of water supply, and provide more efficient and effective water solutions;**
- **Ensure developers and utilities are accountable for implementing planned water recycling and water efficiency systems.**

5.1 Draft Recommendation (Chapter 5 - Improving Regulation of the urban water sector

Urban water sector regulators should rigorously apply the six principles of good regulatory practice spelt out by the Regulation Taskforce in 2006.

5.1 Draft Finding

Price regulation is not an appropriate mechanism to deal with affordability concerns or to ensure that urban water utilities fully recover costs.

RESPONSE 5.1

Agree however Option 5 in Table 2 should be included in options 1 through 4.

Price expectations in the urban water sector are established by the incumbent public water authority. In an embryonic competitive marketplace an existing public water authority has an unfair advantage unless pricing is regulated.

6.1 Draft Recommendation

State and Territory Governments should adopt policy settings that allow the costs and benefits of all supply augmentation options to be considered using a real options (or adaptive management) approach. Information on costs, risks and benefits to consumers of all augmentation options should be made publicly available and views of the community sought, especially regarding sensitive options like potable reuse. Bans on particular augmentation options (those explicitly stated and those that are implied by government decisions) should be removed, including those on:

- rural–urban trade (to allow water to be allocated to its highest value use)
- planned potable reuse (unplanned potable reuse occurs commonly without any apparent ill-effects).

RESPONSE 6.1

Agree

6.2 Draft Recommendation

The Australian, State and Territory Governments should not provide subsidies for supply augmentations and other urban water infrastructure, except where:

- it directs a utility to invest to produce a particular environmental outcome unrelated to its service delivery responsibilities and the subsidy is commensurate with the costs attributable to achieving the outcome
- a formal process has identified that a particular community should be exempted from the requirement to fully recover costs through water charges (see draft recommendation 13.3).

6.2 Draft Finding

Integrated water cycle management initiatives are often driven by the assumption that increased water reuse and recycling, and decreased reliance on centralised water supply systems are always in the community's interests. A better approach would be to seek to remove

impediments to integration (such as the absence of appropriate property rights for wastewater and stormwater and deficiencies in the analyses, and community awareness, of costs and benefits), thereby allowing efficient recycling and reuse projects to be implemented.

RESPONSE 6.2

Disagree. Subsidies can assist in demonstrating new innovations and technologies in Australia that are not yet able to reach market.

7.1 Draft Finding *(Chapter 7 — Pricing of water and wastewater)*

By more closely reflecting the opportunity cost of supply, flexible (scarcity) pricing of bulk water helps to facilitate a more efficient allocation of water resources and more efficient supply augmentation decisions.

7.2 Draft Finding

There appears to be scope for efficiency gains in ensuring that developer charges better reflect the costs of service provision in new developments. Upfront charges should be used where the incremental costs of development are well established and, in the case of urban infill, benefits do not accrue to incumbents. Where the benefits also accrue to incumbents, costs should be spread across all users through rates, taxes or the fixed part of a two-part tariff for water and wastewater.

7.1 Request for Information

The Commission is seeking further information on how developer charges are levied in each jurisdiction, for both greenfield and urban infill developments. Do these currently provide adequate signals on the costs of servicing new developments? To what extent should developer charges be set periodically on an 'across utility' basis, or be specific to the development in question? Would more development specific charges, especially in high cost areas, encourage greater innovation? Would it be better for developers to build the required infrastructure according to standards set by the utility? If so, what issues would need to be addressed to operationalise this? What are the main impediments to introducing more efficient developer charges?

RESPONSE 7.1 Request for Information

Development progress is linked with essential services such as sewerage and water. Developer returns are a function of costs to bring properties to market and return from the sale of property. Delivery options for development are market driven and susceptible to change. Developer charges are best set whereby they:

1. keep costs low and certain for the developer
2. give both the developer and the water utility control over timing of delivery of infrastructure
3. share costs on an 'across utility' basis for a portion of new development infrastructure

This may be achieved by setting a fixed developer charge across each utility that represents a percentage of the overall infrastructure cost for servicing new developments. The remaining cost may be achieved by an increase in the service charges across all customers. This will allow agreed prioritisation of infrastructure and encourage greater innovation in its delivery. The newly established infrastructure fund provides a robust targeted funding mechanism that can also assist in financing these sustainable solutions for communities.

7.1 Draft Recommendation

Metering technology should be introduced in all new single and multi-unit dwellings. The case for retrofitting existing single and multi-unit dwellings with separate metering technology should be assessed by utilities.

RESPONSE 7.1

Agree. The case for retrofitting dwellings with metering technology is just as important as new builds, and therefore utilities should be obliged to examine the implementation and make "every effort" to achieve.

7.2 Draft Recommendation

Utilities should charge tenants directly for all water charges, both fixed and volumetric, where water is separately metered. Where this does not already occur, State and Territory Governments might need to put in place transitional arrangements to ensure that savings to landlords are passed through to tenants.

RESPONSE 7.2

Agree – Responsible use and management of water is ineffective unless it is directly linked to water use information and/or savings.
Many of our clients are installing meters to achieve sustainability ratings not because they want to allow users the ability to manage their water use responsibly.

7.3 Draft Finding

The volumetric component of two-part tariffs is currently distorted by inclining block tariffs. Inclining block tariffs lead to inefficiencies and inequities. There are substantial efficiency gains to be achieved from moving to a flat volumetric retail pricing structure.

7.4 Draft Finding

Charging the same price for water over large geographic areas irrespective of the different costs of servicing individual locations within those boundaries leads to inefficiencies and inequities. There is scope for efficiency gains in moving to more location-specific pricing, particularly where cost differences within 'postage stamp' areas (uniform pricing) are currently large and easy to quantify. In such cases, the benefits are more likely to outweigh the costs.

7.3 Draft Recommendation

More consumer choice in urban water tariff offerings should be available. This would:

- allow consumers to express their preferences on security of supply and price stability
- provide an opportunity for water utilities to manage demand better as water availability changes over time.
- Utilities would be required to provide default two-part tariffs with a single volumetric component.

RESPONSE 7.3

Agree. Consumer choice may also include multiple water supplies of differing qualities not just tariff offerings.

7.5 Draft Finding

The National Water Initiative pricing principles are unclear and provide scope to implement pricing policies that are not necessarily in line with the principles of economically efficient pricing.

7.5 Information Request

The Commission is seeking views about pricing principles. What should be included in these principles so that they provide sufficient guidance for utilities?

8.1 Draft Finding *(Chapter 8 — Non Price Demand Management)*

Although apparently reasonably well accepted by the community, water restrictions generate costs for households, businesses and the community. They do so by denying consumers the opportunity to choose how to use water in the ways that are most valuable to them. The evidence suggests that the costs of restrictions are significant and can amount to several hundred million dollars per jurisdiction per year where they have been in place.

8.1 Draft Recommendation *(Chapter 8 — Non Price Demand Management)*

The use of water restrictions should be limited to times of emergency where a water shortage arises unexpectedly, or in regional urban areas where there are no viable new water sources available to augment supply and restrictions are needed to avoid running out of water. Consumers should instead be able to exercise choice in their water consumption behaviour through an efficient price mechanism.

RESPONSE 8.1

Disagree.

It is not accurate to define "cost" of water restrictions to the community in terms of lost revenue to water utilities. This is a false argument. Lost revenue and therefore lost investment in centralised infrastructure can be a positive for a community.

It can be argued that centralised systems already "*deny(ing) consumers the opportunity to choose how to use water in the ways that are most valuable to them*".

Centralised systems do not empower households or businesses to recycle, harness local water supplies or utilise water savings technologies and innovations. Centralised systems do not allow households/businesses to control their water use, recycle or utilise their wastewater and

sewerage. Instead centralised systems provide unlimited water supplies without any onus on the user to undertake efficiency measures.

Any "cost" to communities or businesses of water restrictions are arguably outweighed by the benefits of lessons learnt and changed behaviour. This collective knowledge has enhanced our communities, making them more informed, more responsible and more sustainable. It has led to a reassessment of water supply and water demand and a shift in policy.

While water restrictions have cost public water utilities in lost revenue and the community in terms of inconvenience - these costs can be met with numerous benefits, including:

- Consumers now have security of water supply where they did not in the past
- Communities have greater awareness and education on how to better manage and use their water supplies
- Water restriction information and methodologies have informed, educated and changed behaviour

Water restrictions are a simple blunt punitive measure made necessary because of the lack of diversification in the market. States have focused on augmentation of bulk water supplies with little consideration for water solutions at point of demand Point of demand (local) solutions would be catalysed by a fully competitive, decentralised market for urban water services.

Water restrictions have reset the Water Sector in a similar way the Global Financial Crisis (GFC) impacted the finance industry.

They have highlighted the need for Security of Water Supply (just as we found in the financial markets) and, importantly, the value of water to the consumer (just as businesses found when debt funding criteria changed following the GFC) – a wake up call to the industry that will stand the sector in good stead in the future.

Water restrictions have added value to consumers and communities in that they will:

- be provided with certainty of supply in future droughts
- understand the way water is managed
- understand how they should act in using water
- understand the cost of water and associate that with the value they may derive from additional water use

8.2 Draft Finding

The WELS scheme has been successful at providing the public with an objective set of information with which to make informed decisions, and should continue.

8.2 Draft Recommendation

Neither governments nor regulators should mandate water use efficiency and conservation activities, unless there is a market failure present and it is clearly established that the social benefits of intervention exceed the social costs.

Government education and information campaigns should be refocused to provide more balanced information on the costs and benefits of water saving activities, as well as the relative merits of using prices, restrictions and water use efficiency and conservation measures to manage demand.

8.3 Draft Finding

Although there has been community support for restrictions and water use efficiency and conservation activities, not all consumers share the same preferences for using less water. There is evidence to suggest that many consumers would be willing to pay a higher water bill to avoid being subject to restrictions on their water use.

RESPONSE 8.2

Disagree.

Like energy efficiency, there is now an onus on users to manage water use in a sustainable way. This is essential if we are to protect our environment and instil best practice behaviour.

Without water use efficiency and conservation activities new communities are developed with embedded water use. New communities with dwellings served by traditional water and sewerage services are difficult to retrofit or alter if required in the future. Embedment remains intact until urban renewal occurs 50 to 100 years into the future.

Our recommendation is that governments and regulators mandate water use efficiency and conservation activities AND recycled water supply to all new urban growth areas identified within each cities metropolitan growth strategy. ***(See 5. Above)***

Regulation has worked successfully in leading world markets – Austin, Hong Kong, Netherlands. Smart regulation removes barriers by making the behavioural shift affordable and a value-add to business. C40 Cities

For example: Victorian EREP regulations ask industry to make energy and water efficiencies that can be paid back in 18 months to 3 years. Targeting the worst water and energy users – this program has saved hundreds of thousands of litres of water and forced the worse water wasters to invest in new technologies that will save water and future proof their business.

In doing so, the worst water wasters are now our sustainable water management ambassadors encouraging others in industry to follow suit. Mandating water use efficiency and conservation activities creates the catalyst for change and adoption. Thereafter regulations may be removed or altered to target other issues underpinning sustainability.

9.1 Draft Finding (Chapter 9 — Achieving affordability and consumer protection objectives)

Water consumption per capita in Australia is well above generally agreed subsistence requirements. There is no need for an 'essential' volume of water to be determined by governments.

9.2 Draft Finding

Expenditure on water and wastewater services generally represents a small proportion of income, including for low income groups. Price increases in water and wastewater services, although contributing to rising costs of living, are likely to have had less detrimental effect on consumers than price increases of other essential goods and services such as energy and housing, on which expenditure represents a greater share of incomes.

9.3 Draft Finding

Current state and territory concession arrangements for water and wastewater services are inefficient and inequitable. Efficiency gains can be made by replacing or amending water and wastewater concessions with direct payments to targeted households or rebates on the fixed component of water and wastewater service bills.

9.4 Draft Finding

The affordability of water and wastewater services for low income and disadvantaged households, in addition to the affordability of other essential goods and services, is most efficiently achieved through non-concession elements of Australia's tax and transfer payments system.

9.1 Draft Recommendation (Chapter 9 — Achieving affordability and consumer protection objectives)

COAG should commission a review of concessions on utility services across all levels of government. The review should assess:

- the appropriateness of existing arrangements for providing concessions, including eligibility criteria
- the merit of and scope for abolishing concessions and providing relevant assistance to all low income households via other elements of the tax and transfer payments system.

RESPONSE 9.1

Agree.

9.5 Draft Finding

Properly designed hardship policies that outline the obligations of water utilities when dealing with customers facing payment difficulties, including the availability of payment extensions or payment plans, are in the interests of consumers. Other measures to alleviate hardship for low income and disadvantaged consumers in exceptional circumstances, such as utility grant schemes, also have merit.

9.2 Draft Recommendation

COAG should develop a set of best practice consumer protection principles for water utilities. These could be included in any new intergovernmental water agreement. At a minimum, the principles should include:

- access to an independent dispute resolution process, preferably by a specialist utilities industry ombudsman
- the establishment of an industry code defining service standards and provisions to assist consumers facing hardship.

RESPONSE 9.2

Agree.

9.3 Draft Recommendation

COAG should progress implementation of measures to support consumer advocacy and research consistent with Recommendation 11.3 of the Commission's 2008 Review of Australia's Consumer Policy Framework.

RESPONSE 9.3

Agree.

11.1 Draft Finding (Chapter 11 — Institution-centred reform)

A key impediment to performance is the lack of clarity about roles and responsibilities for the procurement of new water supplies and services. The most appropriate organisations are the retail–distribution utilities. They:

- are best placed to understand the preferences of urban water consumers
- are in a position to facilitate contestability and competition for new water supplies and services from potential service providers
- have the incentives to, and are best placed to, manage the commercial risks of procurement, particularly those associated with long-term supply and service contracts.

11.1 Draft Recommendation

Retail–distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services.

RESPONSE 11.1

Agree. This may apply to both public and private utilities and centralised and decentralised systems.

11.2 Draft Recommendation

State and Territory Governments should draw up charters for urban water utilities incorporating best practice governance arrangements and governments' requirements for the performance of utilities.

The charter would set out details about:

- obligations to serve (security of supply and obligation to procure)
- transparent processes and procedures for choosing supply augmentations (public consultation, tenders for supply, public reporting of the decision, and monitoring by an independent body)
- principles for pricing and service offerings
- transparent processes and procedures for setting prices that involve public consultation, public reporting of decisions and periodic review by an independent body
- borrowing and dividend policies
- customer service standards/hardship policies
- risk allocation (between consumers, government shareholders and private suppliers)
- nature and funding of Community Service Obligations.

There should be public consultation regarding the contents of the charter, and independent economic regulators in each jurisdiction would also be well placed to provide advice to the government.

Independent economic regulators, or some other appropriate government agency in each jurisdiction, could oversee reporting against the charter.

RESPONSE 11.2

Agree. This should be extended to all water utilities including private water utilities.

11.2 Draft Finding

Government-owned water utilities are typically given a number of conflicting objectives by governments. Some objectives are inefficient (for example, utilities being required to reduce per capita consumption) and some are more appropriately assigned to other agencies. Often, little guidance about the relative importance of objectives is provided.

11.3 Draft Recommendation

Governments should further improve governance arrangements for publicly-owned urban water utilities. Areas for improvement include:

- governments setting overall water security and reliability objectives, and requirements for wastewater, stormwater and flood mitigation

- further separation between Ministerial and board governance
- greater definition and alignment of objectives and assignment to appropriate agencies
- implementing procedures to ensure independence of boards
- regular reviews of Community Service Obligation payments
- regular reviews of board performance
- greater flexibility regarding dividend payments to ensure they are consistent with investment intentions. Initial recommendations on payments should be made by boards.

RESPONSE 11.3

Agree. Government should also set objectives for the provision of recycled water to new urban growth areas and the implementation of decentralised systems within a competitive market place.

11.3 Draft Finding

Establishing good governance procedures would render much of the current price regulation of government-owned water utilities unnecessary, and would be likely to provide greater net public benefits when compared to price regulation.

11.4 Draft Recommendation

State and Territory Governments should move away from regulatory price setting to a price monitoring regime (where some form of prices oversight is considered necessary). Within five years of moving to a price monitoring regime, all State and Territory Governments should initiate independent reviews (not by regulatory agencies) to determine:

- whether water utilities are abusing their market power and, if they are, what action should be taken to deal with this
- whether ongoing price monitoring would likely produce net benefits to the community and, therefore, whether it would still be required. If such benefits cannot be demonstrated, all price regulation should be abolished and replaced by a self-reporting regime to be overseen by an appropriate government agency in the relevant jurisdiction.

Rather than proceeding to implement a price setting regime, Queensland should continue with its interim price monitoring arrangements until it undertakes a review of whether price regulation produces net benefits to the community.

The National Water Initiative pricing principles should be amended to remove any reference to independent regulatory price setting, except where it can be demonstrated that a more light handed approach as described above would be unlikely to prevent an abuse of market power.

RESPONSE 11.4

Disagree.

Early Stage competitive markets require pricing stability in order to establish business and prove commercial models.

The current market pricing is well known and established under independent regulatory price setting.

To remove this would undermine the establishment of a competitive marketplace.

11.4 <u>Draft Finding</u>

In urban water, there is no competitive market-based mechanism to reveal the preferences of individual consumers regarding potential service offerings, such as the willingness of individual consumers to pay for different levels of reliability and security of supply. One possible way to facilitate the revelation of such consumer preferences is through the use of representative consumer groups

11.5 <u>Draft Recommendation</u>

The Australian Government should proceed with the scheduled independent review of the National Access Regime. This review should commence no later than 31 December 2012. The terms of reference should include an examination of all state-based access regimes, including those for the urban water sector.

RESPONSE 11.5

Agree. However this should also state based licensing.

11.6 Draft Recommendation

Environmental and health regulators should be more transparent and accountable in their decision-making. Except in matters where urgent public or environmental safety issues are involved regulators should also publish draft decisions and seek public comment on these. They should publish the reasons for their decisions in a similar manner to economic regulators and governments should consider the development of appropriate decision review mechanisms.

RESPONSE 11.6

Agree

11.7 Draft Recommendation

All remaining impediments to rural–urban trade, particularly volumetric restrictions and excessive termination fees, should be removed as soon as possible.

Any bans (legislated or otherwise) preventing trade between regional water utilities should be independently reviewed and, if it cannot be shown the bans provide net public benefits, they should be removed.

RESPONSE 11.7

Agree.

12.1 Draft Finding (Chapter 12 — Structural reform options for large urban cities)

Available evidence on economies of scale in the water and wastewater industry suggests:

- water supply and wastewater utilities are characterised by constant or increasing returns to scale (economies of scale) for a wide range of output levels
- horizontally aggregating small utilities is expected to generate gains from economies of scale. This is particularly likely if utilities are located in relatively close proximity to each other, and there is scope to increase scale without a significant increase in network costs
- horizontally disaggregating very large utilities is unlikely to lead to economies of scale losses, that is, produce utilities that thereafter operate below minimum efficient scale. However, scale impacts are location (and context) specific, and should be assessed on a

case-by-case basis. Some utilities may be approaching diseconomies of scale, such that there are efficiency gains from horizontal disaggregation, all else equal.

12.2 Draft Finding

There is a range of structural options for urban water supply in Australia's large urban cities, including:

Option 1: A vertically-integrated utility

Option 2: A vertical separation of the bulk water supply function from other elements of the supply chain, and horizontal separation of the bulk water supply function

Option 3: A vertical and horizontal separation of the wastewater treatment function (in addition to option 2)

Option 4: A horizontal separation of the retail–distribution function (in addition to option 3)

Option 5: A fully competitive, decentralised urban water market.

There are potentially significant risks and costs associated with establishing a fully competitive, decentralised market for urban water services at this time (option 5), and it is unlikely that the benefits justify the costs. This should be reviewed on a periodic basis.

The potential benefits of options 2, 3 and 4 are much more compelling. State and Territory Governments should undertake a detailed assessment of the full costs and benefits of undertaking structural reform in large urban cities.

12.1 Information Request

Are any or all of these options feasible and cost effective for delivery of urban water supply, wastewater and stormwater services in Australia's large urban cities? If so, where? If not, why not? How could these options be improved?

RESPONSE 12.1 Request for Information

A fully competitive, decentralised urban water market already exists in NSW. This option 5 is catalysing the innovation and assisting in the delivery of affordable, sustainable and innovative water services to communities that would only previously be able to access centralised systems. Option 5 should be included in all four options.

13.1 Draft Finding (Chapter 13 - Reform in regional areas

In many areas of regional Australia, water utilities recover their costs and are financially sound. However, a significant number of regional water utilities are earning negative or very low real rates of return. It is not clear that these utilities are achieving genuine cost recovery (that is, recovering all costs — including asset maintenance and renewal costs — over the capital cycle). This could have serious implications for water system infrastructure over the longer term, particularly if negative or low returns are sustained over a number of years.

13.1 Draft Recommendation

There is a strong case for undertaking aggregation of small water and wastewater utilities in regional areas of New South Wales and Queensland. The precise approach — including identification of affected councils and the preferred grouping of councils — should be assessed and determined by relevant State Governments, in consultation with Local Governments and affected communities.

This process should consider the relative merits of alternative organisational structures, including:

- county council
- regional water corporation
- regional alliance (or regional organisation of councils).

RESPONSE 13.1

Disagree.

A better approach would be to catalyse local industry and jobs by incentivising and collaborating with the private sector to create cost efficient solutions such as Public Private Partnerships, Privatisation or Operate Maintain Contracts.

New growth may be served by decentralised systems that can offer recycling and sewerage services at lower cost than the existing systems.

13.2 Draft Recommendation

The New South Wales Government should provide a formal response to the recommendations of the Armstrong and Gellatly inquiry as a matter of priority.

Queensland Government should commence a similar process, in consultation with Local Governments and communities, to consider the costs and benefits of different structural reform options for the urban water sector in regional Queensland (outside of south-east Queensland).

RESPONSE 13.2

Agree.

A response to the Armstrong and Gellatly Inquiry into a secure and sustainable urban water supply and sewerage service would be welcomed.

This is a critical issue for NSW and its high growth areas – particularly in Sydney's north and south west where Government has not legislated/regulated to ensure residents get sustainable water and sewerage services.

13.3 Draft Recommendation

Jurisdictions should identify those regional utilities that are unable to provide safe and secure water and wastewater services for economic reasons. In doing so, the relative merits of alternative supply options (including moving to a system of self-supply) should be considered.

State and Territory Governments should subsidise the provision of water supply and wastewater services in regional areas where it is uneconomic for the utility to provide these services safely and efficiently. This funding should be granted via an explicit Community Service Obligation, and subject to periodic review.

The case for providing subsidy funding for capital works, financial incentives for reform and assistance for affected local councils should be determined by State and Territory Governments.

RESPONSE 13.3

Agree.

Private Water Utilities may be able to assist with the economic provision of water services in these areas.

13.4 Recommendation

State and Territory Governments should undertake regular, public reviews of water and

wastewater outcomes in Indigenous communities. Water and wastewater services should be assessed against the same metrics that are used to measure service quality in non-Indigenous communities.

RESPONSE 13.4

Agree that regular reviews should take place in Indigenous communities. Here decentralized systems can offer cost affective services.

13.5 Recommendation

Compliance with the health critical elements of the Australian Drinking Water Guidelines should be mandatory, and implemented via legislation.

Utility performance against all elements of the Australian Drinking Water Guidelines should be publicly reviewed and reported on annually by State and Territory Governments. Sanctions should apply if water utilities do not comply with the mandatory elements of the guidelines, and directors or other accountable persons such as councillors should be personally liable for the risks associated with non-compliance.

Utilities that do not comply with the non-health critical elements of the guidelines must develop and implement a risk management plan (approved by the relevant health department) that will move the utility toward full compliance with all elements of the guidelines.

RESPONSE 13.5

Agree

13.3 Draft Finding

There may be scale and scope benefits for water supply and wastewater services to be provided by a single utility in regional areas. This should be considered by jurisdictions as part of the reform process.

13.6 Recommendation

The Governments of Western Australia, South Australia and the Northern Territory should consider the costs and benefits of replacing the single, jurisdiction-wide public corporation model with a regional water corporation approach (horizontal disaggregation).

In undertaking this analysis, relevant State and Territory Governments should consider factors other than scale, including opportunities for yardstick competition, the proximity of utilities to the customers they serve, opportunities for more location-specific pricing arrangements and the effectiveness of water resource management and water system planning.

RESPONSE 13.6

Agree if this occurs with a privatisation of the market.

14.1 Recommendation (Chapter 14 — Implementing reform and monitoring progress)

Governments should implement the universally applicable reforms to policy, governance and institutions identified by the Commission.

These should be the highest priority for reform of the urban water sector as they present the greatest scope for efficiency gains, and are an essential precursor to pursuing structural reform. These universally applicable reforms centre on:

- setting an overarching objective for government policy in the sector for the provision of water, wastewater and stormwater services in an economically efficient manner to maximise the net benefits to the community
- developing appropriate policies and principles that align with this objective
- putting in place best practice institutional, regulatory and governance arrangements.

RESPONSE 14.1

Agree.

However, water recycling and water efficiency management programs must be included in these objectives, along with decentralised systems.

14.2 Draft Recommendation

Agreement across all jurisdictions is not necessary for the State and Territory Governments to

pursue the recommendations made by the Commission as most relate to implementation of best practice. The State and Territory Governments should immediately commence enacting reforms unilaterally.

RESPONSE 14.2

Agree

14.3Draft Finding

State, Territory and Local Governments will be the major beneficiaries of the Commission's proposed reforms to the urban water sector. While some costs will be incurred, these are expected to be outweighed by the benefits from more widespread cost recovery and increased dividend payments. Therefore, there is no case for Australian Government funding to promote urban water reforms.

14.3 Draft Recommendation

Progress against COAG agreed water reforms should be subject to monitoring. The National Water Commission would be the most logical body to undertake such monitoring.

RESPONSE 14.3

Agree. COAG water reforms should be subject to monitoring.

Disagree there is no case for Australia Government funding to promote urban water reforms. Funding should be available to promote decentralised recycling and sustainable systems.

14.4 Recommendation

An independent public review of the reform package should take place after five years.

RESPONSE 14.4

Agree