



NSW GOVERNMENT SUBMISSION

on

PRODUCTIVITY COMMISSION DRAFT REPORT *AUSTRALIA'S URBAN WATER SECTOR, APRIL 2011*

MAY 2011

**NSW Government submission on
Productivity Commission Draft Report *Urban Water in Australia April 2011***

The NSW Government is pleased to respond to the invitation from the Productivity Commission (the Commission) to comment on its Draft Report *Urban Water in Australia April 2011* (the draft report).

The NSW Government has considerable knowledge of and experience in urban water issues and is pleased to share its knowledge with the Commission to assist it in its consideration of these important issues. The NSW Government continues to strongly support the implementation of reforms to improve the economic efficiency of the urban water sector and the well being of the NSW and national economies.

This submission is structured as a short paper raising the NSW Government's headline issues, followed by a number of attachments which provide a response to all of the draft report's draft findings, draft recommendations and information requests (Attachment A), comments and corrections on the draft report's text (Attachment B), and which address inaccuracies in a report which the draft report quotes extensively (Attachment C).

The NSW Government supports the Commission's efforts to identify opportunities for economic efficiency improvements in the urban water sector. The NSW Government recognises that the implementation of measures to enhance economic efficiency of the urban water sector will provide benefits to the economy in general and water users in particular.

The NSW Government generally agrees with the draft findings and draft recommendations in the draft report. The NSW Government:

- supports draft recommendations 5.1, 6.2, 8.2, 9.3, 11.5, 11.7, 11.8, 13.3 and 13.4;
- supports in principle draft recommendations 3.1, 6.1, 7.1, 7.2, 7.3, 9.1, 9.2, 11.6, 13.5, 14.1, 14.2, 14.3 and 14.4;
- does not oppose draft recommendation 11.1 and 11.2;
- notes, but does not support draft recommendations 8.1 and 11.4; and
- notes that draft recommendations 11.3 and 13.6 are not applicable to NSW.

The NSW Government notes the Commission's draft recommendations 13.1 and 13.2 on local water utilities in regional NSW. The NSW Government is considering its response to the *Report of the Independent Inquiry into Secure and Sustainable Urban Water Supply and Sewerage Services for Non-Metropolitan NSW* (the Armstrong and Gellatly review).

Whilst supporting the draft report's attempt to identify efficiency gains in the sector, the NSW Government considers that the difficulty is in identifying the areas where the potential efficiency gains are largest, and in quantifying the costs and benefits of implementing such reforms. This task is complicated by the breadth and complexity of the issues contained within the Commission's inquiry terms of reference.

NSW considers that the Commission would maximise its chances of identifying efficiency gains in the sector if it were to:

- take into consideration existing reform commitments and other processes to assess the need for additional reforms;
- follow best practice consultation processes; and
- undertake a rigorous, evidence based analysis of the issues.

Existing reform commitments and other reform processes

The National Water Initiative commits all Australian jurisdictions to an existing reform agenda for the water sector, including urban water.

The NSW Government strongly urges the Commission, when investigating the potential for further economic efficiencies in urban water, to take into account the implementation of existing reform commitments and other processes underway to assess the need for additional reforms.

For example, on 7 April 2011, the National Water Commission (NWC) released its report *Urban Water in Australia: future directions*. While the draft report (at page xviii) acknowledges the NWC's work, the Commission has prepared its draft report without taking into consideration the NWC's findings. NSW strongly encourages the Commission to liaise with the NWC and draw upon the NWC's work in preparing the Commission's final report.

The need to undertake effective stakeholder consultation

The NSW Government notes the short, five week, timeframe offered by the Commission for stakeholders to respond to the draft report. NSW has concerns that the short consultation period presents a risk that stakeholders will not be able to share their knowledge and provide the Commission with considered views on the many issues in the draft report, including its numerous draft findings, draft recommendations and requests for further information.

These concerns have been amplified by the Commission's release, on 4 May 2011, of *Partial Equilibrium Models Of The Urban Water Sectors In Melbourne And Perth (Supplement 1 To The Draft Report)* and *Residential Water Consumption And Expenditure Using Combined Census And Utility Billing Data (Supplement 2 To The Draft Report)*.

The release of these important background documents at such a late stage in the inquiry allows stakeholders only two weeks to review and comment on them. This is inadequate and presents risks that the Commission's final report will not benefit from the input of stakeholder comment.

Evidence based analysis

Whilst the NSW Government generally agrees with the Commission's draft findings and draft recommendations, some areas in the draft report would benefit from further work before the Commission presents its final report to the Commonwealth Government in August 2011. These include:

- the Commission's proposal to replace price regulation with a light handed price monitoring regime;
- a more thorough discussion of the quality of the existing evidence base, including rigorous quantitative analysis based on robust empirical data. At least two important issues would benefit from this: the price elasticity of demand for water in Australia and the quantification of the costs of drought restrictions; and
- the Commission's use of the report by AECOM for Infrastructure Australia 'Review of Regional Water Quality and Security 2010'.

The Commission's proposals for economic regulation of the sector

The NSW Government has concerns with the Commission's draft recommendation 11.4:

"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.**

... 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."

The draft report does not present compelling evidence that the use of price regulation in the urban water sector is leading to material economic inefficiencies.

The economic case for regulating natural monopolies to ensure that they do not exert market power is long-established, and price regulation of monopoly service providers is an established way of seeking to ensure that monopolies do not abuse their market power in terms of pricing and service quality. Water utilities' prices are regulated because parts of their supply chain, such as transmission and distribution, are natural monopolies, not because they are government-owned. The open, consultative pricing regulation processes implemented by an independent pricing regulator offer considerable benefits in regulating service provision by monopoly service providers.

Light handed regulatory regimes involving price oversight are generally better suited to industries, such as airports and ports, with a relatively small number of well informed customers, or where there is actual competition or contestable markets in operation to place downward pressure on prices. This is not the case with water utilities. The scrutiny offered by regulatory oversight of operating expenses and capital investment is likely to lead to genuine savings to consumers and provide a level of consumer assurance that costs are scrutinised.

The proposed removal of price regulation for urban water utilities could, if implemented, have broad and far-reaching repercussions that are not satisfactorily identified or addressed in the Commission's draft report. For example, the proposed removal of price regulation would remove fundamental efficiency incentives that economic regulation places on water and wastewater utilities. In addition, an effective incentive structure for utilities to minimise costs would need to be developed to replace regulatory oversight.

The draft report does not appear to consider that draft recommendation 11.4 is inconsistent with the approach taken in the energy market, where effectiveness of competition is the test to be met before price regulation is removed.

NSW looks forward to a comprehensive analysis of these issues in the final report.

The quality of the existing evidence, including rigorous quantitative analysis based on robust empirical data, used to support measures to improve economic efficiency

The NSW Government has reviewed the Commission's draft report with interest and commends the Commission for its wide ranging survey of the literature addressing urban water issues in Australia.

The NSW Government notes the relative paucity of empirical analysis of many important issues facing the sector, and considers that the lack of evidence-based analyses may be acting as an impediment to the development of sophisticated policies aimed at improving economic efficiencies in the sector. The NSW Government would welcome the Commission's view on specific pieces of empirical analysis that should be undertaken as a matter of priority.

NSW considers that one area where further empirical work would make a major contribution to policy development is the price elasticity of demand.

The NSW Government acknowledges the work done to date in this field. However, with the notable exception of Abrams, B., Kumaradevan, S., Sarafidis, V. and Spaninks, F.¹, many estimates of the price elasticity of demand for water are based on analysis of changes in aggregate water demand rather than of detailed individual customer usage data.

Better understanding of price elasticity would help to progress policy in a number of areas including the development of alternative service offerings, flexible pricing and the costs and benefits of more universal metering arrangements. Moreover, it is inappropriate to use many studies to assess significant changes to price because they provide only point elasticity measures around a particular price range. To address this deficiency, more testing of price elasticity at several points and allowing a more significant range of change in price would be useful. Further analyses of long- versus short-run elasticities and of the elasticities of indoor versus outdoor use would also be useful.

A second area where policy makers would benefit from further empirical analysis is the estimation of the costs and benefits of using water restrictions during severe drought.

NSW notes the Commission's discussion of the quantification of the costs on households and others of imposing water use restrictions during severe drought and acknowledges that some of the costs of drought restrictions, including many listed in Box 2 on page XX and on pages 198-199 of the draft report, are very difficult to quantify. The task of estimating the costs and benefits of restrictions is complex, particularly as it involves using economic methods to quantify non-market values, which also have differential values for different users. As the costs and benefits imposed by restrictions are often not readily monetised or evidenced, these costs may not be fully appreciated by water users. NSW supports further work to quantify these costs and benefits and an evidence-based approach to the analysis of restrictions.

This could usefully include efforts to address the cost estimation difficulties discussed in a report for the National Water Commission by the Institute for Sustainable Futures (ISF)², which found that "large data gaps exist about the costs and benefits of restrictions, particularly more recent severe rules" (page 59). This report examines approaches to estimating the cost of restrictions and discusses their limitations.

Despite the difficulties of quantifying these costs, the draft report concludes that "evidence from a number of sources suggests that water restrictions are likely to have cost in excess of a billion dollars per year from the lost value consumption alone" (draft report, page xvi). The NSW Government suggests that the Commission conduct an assessment of the reliability of the estimates that have been made of the costs of

¹ *The Residential Price Elasticity of Demand for Water*, Joint Research Study, Sydney, February 2011

² *Review of Water Restrictions, Volume 1 Review and Analysis*, University of Technology Sydney, 2009

drought restrictions and provide a more detailed explanation of its estimate of more than a billion dollars per year.

NSW notes the Commission's view that the estimates of costs associated with restrictions are significant enough to warrant a closer examination of alternative measures, such as flexible pricing arrangements, to reduce water demand during periods of low water availability, with a view to reducing the future role of restrictions. The NSW Government agrees with the Commission that "consumers should not be called upon year after year to restrict their demand" (page 202 of the draft report) and supports the economic efficiency arguments that consumer choice is superior to mandatory restrictions, and that an efficient price mechanism provides allocative efficiency.

The NSW Government agrees with the Commission that further work needs to be done to examine the potential for flexible pricing to become a drought management tool and make a contribution to improved economic efficiencies in the sector and to consider practical implementation issues relating to flexible pricing.

In its 2009 review of prices for the Sydney Catchment Authority (SCA), the Independent Pricing and Regulatory Tribunal (IPART) noted that it continues to be interested in examining an innovative form of pricing at the 2012 determination of SCA's prices. IPART plans to release an issues paper for stakeholder consultation in mid 2011.

NSW notes that options and any potential proposals to introduce such a pricing reform will need to be very carefully assessed to avoid adverse consequences in terms of drought management, impacts on customers, the revenue requirements of bulk water supply utilities and implications for new investment due to increased uncertainty regarding returns of investment.

NSW considers that considerable work remains to be undertaken on the quantification of the costs and benefits of drought restrictions and on the implications of flexible pricing in the wholesale and retail water markets. Until such work is further advanced, there is not yet a compelling case to abolish the use of drought restrictions as a measure to manage severe drought in metropolitan areas, as proposed by draft recommendation 8.1 which says:

"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."

The NSW Government favours a real options approach to water planning, with restrictions considered as one measure in the mix of measures available to balance supply and demand at least cost. For example, the 2010 Metropolitan Water Plan for Greater Sydney revised the approach taken in the 2006 Metropolitan Water Plan in regard to the handling of restrictions. The 2010 Metropolitan Water Plan's analytical framework used a cost-effectiveness analysis that included restrictions as an imputed economic value (the estimated cost of time spent in restrictions). Based on this analysis, a revised restrictions regime was included in the 2010 Metropolitan Water Plan. Had no restrictions regime been included, there would have been substantial implications for the supply-demand balance and thus significant implications for the mix of measures required to secure supplies with an appropriate degree of certainty.

The next review of the Metropolitan Water Plan will re-evaluate the method used to cost restrictions, with the aim of improving the existing approach and addressing, where possible, the cost estimation issues discussed in the ISF report cited above.

Temporary drought restrictions have been effective in reducing water use during periods of severe droughts. Restricting outdoor water use was a key element in securing greater Sydney's water supply during the recent drought. Between the introduction of Level 1 restrictions in October 2003 and the introduction of permanent Water Wise Rules to replace Level 3 restrictions in June 2009, restrictions saved an estimated 575 billion litres, more than the amount of water used in greater Sydney in 2009-10.

They also deliver benefits to water supply systems in non-drought periods because, by reducing demand during drought periods with a relatively high degree of certainty, they increase the volume of water that can be supplied on an annual average basis from a rain-fed storage system (known as the system 'yield'). For this reason, temporary drought restrictions have been described as 'punching above their weight class' because they are 'tightly targeted at extreme drought needs'³.

Under a flexible pricing approach, the likely timing and scale of demand reduction in response to price signals may be difficult to estimate with a high degree of certainty and it would be appropriate for system operators to make relatively conservative assumptions about the impact of flexible pricing on storage depletion rates.

Community consultation and recent surveys indicate a high level of support for drought restrictions and Water Wise Rules.

Draft recommendation 8.1 may have significant implications for the estimation of system yield, particularly in areas characterised by highly variable inflows to storage systems, such as Sydney. The draft report does not appear to have considered these implications and the NSW Government looks forward to the final report addressing them more comprehensively.

NSW agrees that efficient pricing mechanisms are a first-best mechanism to ensure water is used efficiently. However, further work needs to be done to understand the true economic and social costs of restrictions to determine the least cost options to manage water demands.

The Commission's use of the AECOM report '*Review of Regional Water Quality and Security 2010*'

NSW notes that the draft report, particularly Chapter 13, makes considerable use of a report prepared for Infrastructure Australia by AECOM *Review of Regional Water Quality and Security 2010* which was released on 31 January 2011. This report contains numerous inaccuracies. It does not accurately represent the circumstances relating to drinking water quality; operator training; water pricing and full cost recovery; and water security in non-metropolitan NSW.

To assist the Commission in the preparation of its final report, the NSW Government provides, at Attachment C, a copy of the letter from the NSW Office of Water to Infrastructure Australia on 31 March 2011 which provides a detailed commentary on the AECOM report's deficiencies. In addition, Attachment B includes corrections to references to the AECOM report in the draft findings and draft recommendations.

³ ISF and ACIL Tasman, *Interim Report on the Review of the 2004 Metropolitan Water Plan*, Feb 2006, p19.

Inclusions

- Attachment A* Table listing NSW Government positions regarding the draft findings and draft recommendations in Productivity Commission Draft Report *Australia's Urban Water Sector, April 2011*.
- Attachment B* Additional NSW Government comments on Productivity Commission Draft Report *Australia's Urban Water Sector, April 2011*.
- Attachment C* NSW Office of Water letter to Infrastructure Australia dated 31 March 2011, commenting on the inaccuracies in the report prepared for Infrastructure Australia by AECOM *Review of Regional Water Quality and Security 2010*, released 31 January 2011.

ATTACHMENT A

Draft recommendation or draft finding or Information request	Proposed NSW Government response
Draft recommendation 3.1 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.	The NSW Government supports the articulation of a common objective <u>subject to its wording</u> being the subject of a negotiation process between jurisdictions. The NSW Government supports a broad definition of economic efficiency, which includes environmental, health and other costs and benefits that might not be priced in markets. The 2010 Metropolitan Water Plan includes key values for the sector, as identified by the community, and key planning principles which were developed from a community engagement process. These may be useful inputs to the process for agreeing a common objective. Of note is that the community principles put water for the community and water for the environment on an equal footing "one not more important than the other". The Country Towns Water Supply and Sewerage Program articulates such an objective: <i>Appropriate, affordable and cost-effective water supply and sewerage services in urban areas of non-metropolitan NSW which meet community needs, protect public health and the environment and make best use of regional resources.</i> The draft report comments that 'implementation of the overarching objective would ideally involve estimating the monetary value of changes in environmental and health outcomes, although other methods are available to support decision making' (page 266). Managing 'intangible' environmental impacts in a strict economic efficiency framework poses challenges, given the difficulty in quantifying such external impacts.
<u>Draft finding 4.1</u> 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	The NSW Government <u>notes</u> the draft finding. Property rights for water should be defined where the benefits of doing so outweigh the costs. The NSW Government also notes that governments have many roles, including enforcing compliance with regulatory frameworks and balancing multiple policy priorities.

• 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.	
Draft recommendation 5.1 Urban water sector regulators should rigorously apply the six principles of good regulatory practice spelt out by the Regulation Taskforce in 2006.	The NSW Government <u>supports</u> the draft recommendation. NSW applies the principles of good regulatory practice.
Draft finding 5.1 Price regulation is not an appropriate mechanism to deal with affordability concerns or to ensure that urban water utilities fully recover costs.	The NSW Government <u>notes</u> the draft finding. NSW also <u>notes</u> that water and wastewater services are often provided by monopoly service providers and that price regulation is an appropriate mechanism to seek to ensure that monopoly service providers do not abuse market power but can recover costs which is critical to ensure financial sustainability and to enable appropriate investment in infrastructure. NSW <u>supports</u> the statement that "it considers decisions regarding distributional aspects of pricing structures are most appropriately decisions for government or, if government does not see a reason to be involved, best left to water providers." However, NSW does <u>not</u> support the Commission's arguments regarding the role of regulation in relation to full cost recovery pricing. Full cost recovery is achievable under price regulation. For example, IPART regulates prices for Sydney Water to cover their capital and operating costs.
Draft recommendation 6.1 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	The NSW Government <u>supports</u> the draft recommendation, <u>subject</u> to the important qualification that assessment of the costs and benefits should be extended to demand side measures, as well as augmentation options. The NSW Government <u>notes</u> that the Metropolitan Water Plan has already adopted an approach which allows the costs and benefits of supply augmentation and demand side options to be considered using a real options (or adaptive management) approach. Community consultation is a core feature of the approach used to develop the Metropolitan Water Plan.

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).	Development of the Lower Hunter Water Plan, which has commenced, will adopt a similar approach. There are no legislative or regulatory bans on rural-urban trade or planned potable re-use in NSW. With regard to rural-urban trade, the NSW Government notes that impacts on rural and regional communities, and agricultural productivity, must be adequately assessed in any rural-urban trade proposal to ensure that social, economic, and environmental concerns are addressed. With regard to planned potable re-use, the <i>Water Industry Competition Act 2006</i> does not preclude a proponent from applying for a licence to use recycled water for drinking purposes. The NSW Office of Water, in consultation with NSW Health, has provided advice to a local water utility in northern NSW regarding the considerations that should inform its advanced water treatment research study (which is examining the potential to use highly treated recycled effluent to augment drinking water supplies). Planned potable reuse has, to date, not been supported by the community and there is no present need to consider it in NSW as a supply augmentation option. Where indirect potable reuse of wastewater is proposed, this needs to be assessed on cost-effectiveness grounds against alternatives and the water utility will need to follow the appropriate guidelines carefully if undertaking potable re-use. The NSW Government notes that, while the Commission's statement that "unplanned potable reuse occurs commonly without any apparent ill-effects" may be generally correct, it is important to take into consideration instances, such as in North Battleford, Saskatchewan, Canada in 2001, when unplanned indirect potable reuse has led to outbreaks of disease. The regulatory framework which applies to the non-metropolitan water utilities in NSW requires them to consider all available augmentation and demand management options. The <i>Best-Practice Management of Water Supply and Sewerage Guidelines, 2007</i>, requires non-metropolitan NSW water utilities to prepare and implement a 30-year integrated water cycle management (IWCM) strategy. The Guidelines also require them to identify the scenario which provides the best value for money on the basis of social, environmental and economic considerations (a triple bottom line basis).
Draft recommendation 6.2 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	The NSW Government supports the draft recommendation. The NSW Government notes that its Country Towns Water and Sewerage Program has a well established formal process for determining the eligibility of a local water utility for financial assistance towards the capital cost of backlog water and sewerage infrastructure (details are provided below in the NSW Government's response to draft recommendation 13.3). Non metropolitan water utilities are required to achieve 'lower bound pricing' and to move towards upper bound pricing where practicable.

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).	
Draft finding 6.1 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.	The NSW Government <u>notes</u> draft finding 6.1. The Metropolitan Water Plan, as earlier advised, has been developed on the basis of detailed hydrological modelling, cost effectiveness analysis of supply augmentation and demand management options, and engagement with the community. The Lower Hunter Water Plan will adopt a similar approach. With regard to the non metropolitan utilities in NSW, all options, including recycling projects, must be considered on their merits. The utilities are required to prepare and implement a 30-year integrated water cycle management (IWCN) strategy and to identify the scenario which provides the best value for money on the basis of social, environmental and economic considerations. In addition, the Best-Practice Management Guidelines require utilities to identify and implement cost-effective water demand management measures.
Draft finding 7.1 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.	The NSW Government <u>notes</u> the draft finding. The 2010 Metropolitan Water Plan noted that "... water pricing is a complex issue and substantial work is needed before scarcity pricing could be considered for use in the Sydney region. Whether scarcity pricing would have the desired impact and how it would impact on investment in other water sources (such as recycled water) are important considerations. Critically, any approach adopted would make sure that essential water supply is affordable for all households" (page 57). NSW is examining the scope to use flexible pricing in bulk water: • The Independent Pricing and Regulatory Tribunal has indicated that it will investigate flexible pricing as part of its next price review for the Sydney Catchment Authority to be completed in 2012. An issues paper is scheduled for release for stakeholder consultation in mid 2011. • Also, scarcity pricing, along with other drought response measures, will be further evaluated in the course of developing the next iteration of the Metropolitan Water Plan for Greater Sydney, due in 2014.

	NSW notes that the literature on flexible (scarcity) pricing suggests a range of potential benefits, such as: • setting a pricing signal that reflects relative scarcity (and plenty) and better reflects the short-run supply-demand balance; • maximising consumer welfare over time; • the avoidance of costs associated with complying with water use restrictions; and • the potential beneficial postponement of supply augmentation investments; and facilitating investment in alternative supplies. NSW <u>notes</u> that there are numerous practical implications that need to be carefully identified and assessed before scarcity pricing of bulk water can be considered for implementation. These include: • the appropriate management of revenues that exceed a utility's efficient operating costs; • dealing with the implications for bulk water service providers, such as ensuring the bulk water service providers receive adequate revenue; • implications on distribution-retail utilities and on water customers; and • implications for new investment due to increased uncertainty regarding returns on investment. NSW <u>notes</u> the importance of evaluating the array of issues involved with introducing flexible pricing on their merits. In this regard, the NSW Government acknowledges the view that over the past decade arguments against pricing reform have tended to be over-emphasised, while the level of rigour applied to understanding the direct and indirect costs imposed by non-price demand management measures has tended to be under-emphasised. The recently released Frontier Economics report (<i>Efficient water resource pricing in Australia</i>) includes a useful discussion of the range of possible approaches to implementing more flexible pricing, and the trade-offs between maximising economic efficiency gains and managing administrative complexity and cost. The report notes that there may be value in implementing less complex approaches as a first step, for example using a drought surcharge to signal emerging scarcity prior to imposing mandatory drought restrictions. NSW will consider such options in the course of developing the next metropolitan water plan.
Draft finding 7.2 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	The NSW Government <u>notes</u> the draft finding. NSW also <u>notes</u> that the Council of Australian Governments (COAG) is pursuing reform in this area. COAG has asked the Ministerial Council on Federal Financial Relations to examine housing supply issues, including the impact of infrastructure charging. The inter-jurisdictional working group under the Ministerial Council is likely to propose a set of principles including measures to ensure efficiency, transparency and accountability, predictability and equitability across all jurisdictions. It is expected that the report will be presented to the

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.	Ministerial council in mid-2011.
<i>Information request</i> <i>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?</i>	The <i>Developer Charges Guidelines for Water Supply, Sewerage and Stormwater, 2002</i> require the levying of water supply and sewerage developer charges in non-metropolitan NSW. The Guidelines aim to provide cost-reflective pricing signals on the cost of infrastructure required for servicing urban development. They are based on the developer charges methodology developed by the Independent Pricing and Regulatory Tribunal (IPART). In 2010-11, the State-wide median developer charge for water supply and sewerage in non-metropolitan NSW was \$8,900 per equivalent tenement.
Draft recommendation 7.1 Metering technology should be introduced in all new single and multi-unit dwellings. The case for retro-fitting existing single and multi-unit dwellings with separate metering technology should be assessed by utilities.	The NSW Government <u>supports</u> the draft recommendation, <u>subject</u> to the benefits outweighing the costs. NSW notes that Sydney Water Corporation requires individual metering of all new single storey residential and non residential single and multi-unit developments. The Best-Practice Management Water Supply and Sewerage Guidelines 2007 which apply to non-metropolitan water utilities in NSW require the individual metering of new multi-unit residential developments. Utilities which are implementing this requirement include Ballina Shire Council, Byron Shire Council, Coffs Harbour City Council, MidCoast Water, Port Macquarie-Hastings Council and Tweed Shire Council. Of these, Ballina, Coffs Harbour and Port Macquarie use remote sensing meters which enable meter reading and billing without the need to enter the premises. NSW also <u>notes</u> that the retrospective metering of many multi story developments is unlikely to be feasible as they do not have a single pipe to each unit to allow a meter to be fitted and the meter must be fitted in a common area to allow access for maintenance.

Draft recommendation 7.2 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.	The NSW Government <u>supports</u> the draft recommendation, <u>subject to</u> the benefits of this approach outweighing the costs. NSW <u>notes</u> that recent reforms in NSW to residential tenancies legislation facilitates pass through of charges from landlords to tenants.
Draft finding 7.3 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.	NSW <u>notes</u> the draft finding. NSW <u>notes</u> that inclining block tariffs are not used in metropolitan NSW and the requirement for regional utilities to use inclining block tariffs was removed in March 2011. The NSW Government encourages the regional utilities to use a flat volumetric pricing structure.
Draft finding 7.4 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.	NSW <u>notes</u> the draft finding and that water utilities in NSW do not cover large geographic areas, unlike those in WA, SA and the NT. The NSW Government <u>acknowledges</u> that postage stamp pricing can be relatively inefficient from a theoretical pricing perspective because it provides a geographical cross-subsidy between certain customers. On the other hand, there can be sound social and economic arguments for charging postage stamp prices, including administrative simplicity and equity. A large amount of analytical work remains to be done before the potential size of any allocative efficiency benefits that may result from moving to a fully cost reflective pricing system may be identified with certainty. Any proposal to move to more location-specific pricing needs to carefully consider the costs and benefits for water and waste water customers in the particular location covered by the proposal. In particular, given the equity concerns with unravelling postage stamp pricing, policy makers need to be satisfied that there are material efficiency benefits to accrue from locational cost related water pricing.
Draft recommendation 7.3 More consumer choice in urban water tariff offerings should be available. This would:	The NSW Government supports the recommendation <u>in principle</u>, noting that it may have far reaching implications and that careful consideration of the costs and benefits would need to be given to any proposed changes in tariff structures. In addition, it would be useful to seek community feedback on any such proposals.

- **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.

NSW also notes that Sydney Water Corporation already offers an alternative service to some industrial customers of recycled water, including steel works.

One aim of potential pricing reform is to avoid the need for restrictions, rather than let supply drop to the point that restrictions are the only viable option. Some pricing reforms, for example flexible pricing, replace the role of restrictions in managing demand, except in times of extreme drought.

The NSW Government supports the economic efficiency arguments that consumer choice is superior to mandatory restrictions and that an efficient price mechanism provides allocative efficiency. However, the introduction of such pricing reform will need to be carefully managed to avoid adverse consequences in terms of drought management and the funding requirements of bulk water supply utilities.

The NSW Government appreciates that flexible pricing and differential tariff offerings may provide more scope to address consumers' differing values for water as well as signal future investment requirements. The NSW Government considers that detailed empirical analysis in this area would be valuable including analysis of different types of water consumers, with the aim of identifying the scale of potential efficiency gains in the various customer classes. NSW notes that water forms a small part of household expenses and many residential customers do not pay directly for their water use while for some industrial and commercial customers, water is a significant component of operating costs. Further analysis should have regard for detailed end-use data and consideration of the relative elasticity of demand across different customer classes.

As mentioned above in the response to draft finding 7.1, the NSW Government is taking action to examine the scope to use flexible pricing in the supply of bulk water. IPART's forthcoming review of the Sydney Catchment Authority's prices for bulk water will provide a useful public forum to progress this issue. Prior to any such reforms being initiated, the implementation issues involved would need to be thoroughly examined and worked through on a utility-specific basis. The draft report identifies a number of the impediments to flexible retail pricing, including responsiveness of demand; support for restrictions; and concerns with having more volatile and higher residential prices. Accompanying issues are:

- the most appropriate apportioning of the fixed charge and the variable charge;
- the most appropriate way to recycle potential excess revenues;
- the ability to communicate the price signal given delayed billing cycles; and
- the lack of ability to communicate the price signal given that in many areas a large proportion of dwellings are not individually metered.

The NSW Government considers that considerable work is needed to examine these issues in detail and to develop a consensus on the most efficient ways to address them.

Structuring a process to elicit the service offering and tariff structure preferences of individual or groups of customers is a complex process. In addition, on the assumption that tariff preferences can be meaningfully identified, implementation may lead to a more complex metering and billing regime and risk greater volatility of

	revenues. The NSW Government will continue to monitor the scope for efficiency gains in retail pricing reforms.
Draft finding 7.5 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.	The NSW Government <u>notes</u> the draft finding. The NSW Government <u>notes</u> that the NWI principles have largely been adopted in NSW. NSW also notes that the draft report's assessment of the NWI pricing principles (pages 192-193) does not explain why the Commission has made a draft finding that the NWI pricing principles are unclear. Further, NSW <u>notes</u> that the pricing principles were agreed as recently as in 2010.
Information request <i>The Commission is seeking views about pricing principles. What should be included in these principles so that they provide sufficient guidance for utilities?</i>	NSW agreed the NWI pricing principles in 2010 and has agreed that they will be reviewed by January 2012. The National Water Commission's (NWC) publication <i>Review of Pricing Reform in the Australian Water Sector</i> argues that the NWI pricing principles tend towards documenting current practice rather than best practice, and that there is a lack of integration in pricing reform objectives, principles and actions between the pricing principles and other activities; and states that the NWC considers there is a question mark about the level of commitment of jurisdictions to more transparent and efficient approaches to recovering the costs of water-planning and management activities, although the NWC report excludes NSW from this, having recognised NSW's progress in this regard. Like the NWC, NSW is open to reassessing the benefits and costs of reform. However, it is difficult to do so when the materiality of the costs of water planning and management activities is unclear in some jurisdictions. In the first instance, NSW considers that jurisdictions need to commence transparent reporting on these costs, in accordance with the NWI pricing principles framework.
Draft finding 8.1 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.	Community consultation and recent surveys undertaken in NSW indicate a high level of support for drought restrictions and permanent light water wise rules. However, the NSW Government <u>recognises</u> that restrictions impose costs on individuals, businesses and communities. The costs imposed by restrictions are often not readily monetised or evidenced, and consequently these costs may not be fully appreciated by water users. The task of estimating the cost of restrictions is complex, particularly as it involves using economic methods to quantify non-market values, which also have differential values for different users. The NSW Government supports an evidence-based approach to the analysis of restrictions that has regard to both the costs and benefits of using restrictions. The NSW Government <u>notes</u> that the economic literature includes a number of studies which seek to estimate the costs of water restrictions during drought. One study found that "large data gaps exist about the costs and benefits of restrictions, particularly more recent severe rules" (Institute for Sustainable Futures and ACIL

	Tasman, <i>Review of Water Restrictions 2009, Volume 1 Review and Analysis</i>, produced for the National Water Commission and available at http://www.nwc.gov.au/resources/documents/Water_restrictions_Volume_1.pdf. The report notes the difficulties in estimating the cost of restrictions and notes the value of eliciting consumer preferences through well designed willingness to pay studies. NSW considers that draft finding 8.1 would be improved by acknowledging that the evidence on the costs and benefits of restrictions is unclear and that further empirical work in this area would be valuable. This further work should include context-specific studies to elicit consumer preferences regarding price and non price measures to reduce demand during drought.
Draft recommendation 8.1 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.	The NSW Government <u>notes</u> draft recommendation 8.1 but does not support it. NSW proposes additional work to improve understanding of the economic and social costs and benefits of restrictions and further work to assess the potential implications of draft recommendation 8.1 on the security of water supply. The NSW Government favours a real options approach to water planning, with restrictions considered as one measure in the mix of measures available to balance supply and demand at least cost. For example, the 2010 Metropolitan Water Plan for Greater Sydney revised the approach taken in the 2006 Metropolitan Water Plan in regard to the handling of restrictions. The 2010 Metropolitan Water Plan's analytical framework used a cost-effectiveness analysis that included restrictions as an imputed economic value (the estimated cost of time spent in restrictions). That analysis concluded that it was cost-effective to retain a two level restrictions regime. Further, the next review of the Metropolitan Water Plan will re-evaluate the method used to cost restrictions, with the aim of improving the existing approach. <u>In Sydney</u> Drought restrictions have been effective in reducing water use during periods of severe drought. Restricting outdoor water use was a key element in securing greater Sydney's water supply during the recent drought. Between the introduction of Level 1 restrictions in October 2003 and the introduction of permanent Water Wise Rules to replace Level 3 restrictions in June 2009, restrictions saved an estimated 575 billion litres, more than the amount of water used in greater Sydney in 2009-10. Community consultation and recent surveys indicate a high level of support for drought restrictions and Water Wise Rules. As discussed above, the approach used to manage drought has important implications for the estimation of system yield. NSW <u>notes</u> that the draft recommendation may have significant implications for system yield, particularly in areas, such as Sydney, characterised by highly variable inflows to storage systems. Catering for a lower probability of water restrictions would be expected to require significant under-utilised water supply capacity in times of water availability. The draft report does not appear to have considered all the implications of draft recommendation 8.1. See also comments on draft recommendation 11.1 <u>In non metropolitan NSW</u>

	When planning the sizing of their urban water supply headworks, most regional utilities in NSW have elected to use the NSW Security of Supply Basis. This is commonly referred to as the '5/10/10 rule'. Planning is on the basis that future droughts would not involve an excessive duration, frequency or severity of drought water restrictions. On average, drought water restrictions would not be required for more than 5 per cent of the time or more than one year in 10. The NSW Security of Supply Basis has been demonstrated to be robust and cost-effective.
Draft finding 8.2 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.	NSW <u>agrees</u> with the draft finding.
Draft recommendation 8.2 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.	The NSW Government supports the draft recommendation to not mandate water efficiency and conservation measures unless there is a market failure or the benefits outweigh the costs. All the water use efficiency measures contained in the Metropolitan Water Plan are subjected to a thorough cost benefit analysis. The Lower Hunter Water Plan will follow the same approach. Complementary policies, including water use efficiency and conservation activities have a valuable role to play in delivering water services at least cost. NSW <u>notes</u> the lumpy and irreversible nature of capital investments in large scale supply augmentation infrastructure and the value in a real options framework of making cost effective investments in incremental supply and demand management measures. NSW <u>agrees</u> that there is a role for Governments to play in providing information on the costs and benefits of water saving activities, and other policy instruments. In greater Sydney, community consultation was a key input to developing the 2010 Metropolitan Water Plan. In addition, the Water for Life Education Program provides a strong community engagement and education vehicle for the NSW Government. However NSW recognises that engaging with the community in relation to complex policy issues poses significant challenges
Draft finding 8.3 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	NSW <u>notes</u> the draft finding. NSW suggests that the Commission's final report should include an evaluation of the 'evidence to suggest that many consumers would be willing to pay a higher water bill to avoid being subject to restrictions'. Context specific analysis would be helpful, as there is a wide range of conditions applying across Australia. For example, the restrictions imposed during the recent drought were not severe by comparison with those

suggest that many consumers would be willing to pay a higher water bill to avoid being subject to restrictions on their water use.	imposed elsewhere. NSW <u>notes</u> that water use efficiency and conservation activities can provide economic efficiencies and benefits to consumers by helping to defer or avoid the need to invest in supply augmentation. Community consultation and recent surveys undertaken in NSW indicate a high level of support for drought restrictions and permanent light water wise rules. However, the NSW Government recognises that restrictions impose costs on individuals, businesses and communities. The costs imposed by restrictions are often not readily monetised or evidenced, and consequently these costs may not be fully appreciated by water users. The task of estimating the cost of restrictions is complex, particularly as it involves using economic methods to quantify non-market values, which also have differential values for different users. The NSW Government supports an evidence-based approach to the analysis of restrictions, having regard to both their costs and benefits.
Draft finding 9.1 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.	NSW <u>notes</u> the draft finding, but considers that in some instances there is a need for Governments to determine an 'essential' volume of water, such as when planning alternative services when the existing supply is reduced or restricted (for example when carting water to a community with a 'failed supply' during drought, or when the normal supply is cut during natural disasters). During the recent drought, a number of small communities became 'failed supplies' with insufficient water for the population. NSW Health has advised NSW Government agencies on minimum water volumes as part of drought planning. NSW Office of Water provided funding to cart water to these communities. A minimum volume (in the range of 60 to 130 litres per person per day) forms part of NSW Government drought policy. The National Health and Medical Research Council's <i>Dietary Guidelines for Australian Adults</i> recommends to 'drink plenty of water' and notes that 'to be properly hydrated in a temperate climate, adults require some 2500–3000 millilitres of fluid a day, depending on body size'. Serious illness can arise from chronic mild dehydration and poor fluid intake. People with certain health conditions require much greater volumes of water, for example those on renal dialysis. In addition to physiological needs, water is also essential for personal hygiene and food preparation.
Draft finding 9.2 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	NSW <u>notes</u> the draft finding. Providing water that is affordable and safe to drink is a key planning principle of the NSW Government. The NSW Government also appreciates that an overemphasis on affordability concerns may have the potential perverse effect of entailing costs if prices are distorted. NSW also <u>notes</u> that the Commission's draft recommendation for more flexible pricing policies, if implemented, may have implications for this draft finding, including the possibility that it no longer holds when drought conditions exist. NSW also <u>notes</u> that saving water helps to reduce both water bills and energy bills.

greater share of incomes.	
Draft finding 9.3 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.	NSW <u>notes</u> the draft finding. NSW is examining the current approaches to water and sewerage rebates applying to pensioners in NSW.
Draft finding 9.4 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.	NSW <u>notes</u> the draft finding.
Draft recommendation 9.1 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.	NSW <u>supports</u> the draft recommendation <u>in principle</u>, but <u>considers</u> that the Commission has not made a compelling case that a national approach on concessions will produce significant economic efficiency gains. The draft recommendation may also be inconsistent with draft finding 14.3 that there is no case for Commonwealth funding to promote urban water reforms.
Draft finding 9.5	NSW <u>notes</u> the 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.	More sophisticated monitoring and analysis by utilities of late payments may help to both identify genuine cases of hardship and appropriately tailor payment plans.
Draft recommendation 9.2 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.	The NSW Government <u>supports in principle</u> the development of best practice consumer protection principles for water utilities. Sydney Water Corporation and Hunter Water Corporation are members of the Energy and Water Ombudsman of NSW (EWON). The NSW Government <u>notes</u> that the Armstrong and Gellatly review recommended that local water utilities use and publicise the services of the NSW Ombudsman and EWON. The NSW Government is considering its response to the Armstrong and Gellatly review. NSW <u>notes</u> the reference in the draft recommendation to a new intergovernmental agreement may be inconsistent with draft finding 14.3 that the States should implement the Commission's draft recommendations without Commonwealth facilitation payments.
Draft recommendation 9.3 COAG should progress implementation of measures to support consumer advocacy and research consistent with Draft recommendation 11.3 of the Commission's 2008 Review of Australia's Consumer Policy Framework.	The NSW Government <u>supports</u> the draft recommendation and <u>notes</u> that the communiqué by the Ministerial Council on Consumer Affairs (MCCA) in December 2010 stated that "MCCA believes that enhancing capacity in consumer representation in Australia is a worthwhile and timely goal. Ministers directed consumer affairs officials, led by Victoria, to continue work on a range of practical and innovative ways that governments can support and facilitate consumer affairs advocacy."
Draft finding 11.1 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	The NSW Government <u>notes</u> the draft finding. The implementation of this draft finding may entail the clear structural separation of bulk water suppliers from retail-distribution utilities. In NSW, this structural separation has been implemented in the greater Sydney area since 1998. The NSW Metropolitan Water Chief Executive Officers Committee oversees the development of

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.	the Metropolitan Water Plan which coordinates the activities of Sydney Catchment Authority and Sydney Water Corporation, as well as others, to deliver optimal outcomes for water customers and the environment. The NSW Government <u>notes</u> that retail-distribution utilities focus on distribution and retail issues and do not necessarily have expertise in management of bulk supply and whole of system yield issues. Many decisions relating to the provision of water and wastewater services will have triple bottom line impacts and involve difficult trade-offs. It may be difficult to establish regulatory settings with sufficient clarity to enable utilities to procure services and deliver optimal outcomes in all cases. As such, it may be more appropriate for government bodies to make major procurement decisions. There may also be an opportunity or need to coordinate resources across a region that encompasses a number of entities. In such cases, decisions by individual entities may lead to inefficient outcomes. NSW notes that, in the national electricity market, the market operator retains the capacity to enter the market and procure services in the event that market participants do not deliver adequate and timely investment in generation capacity or demand side response. This reflects the importance of ensuring, even in a competitive market, that security objectives are 'front and centre', and not leaving procurement decisions solely in the hands of 'downstream' entities. NSW also notes that there may be some tension between this finding and recommendations regarding structural reform. In the event of horizontal separation of the retail-distribution functions, or a more diverse market place where new entrants are in competition with retail-distribution entities, it may be more appropriate for another entity to coordinate the procurement of water services. The NSW Government <u>notes</u> that as there are no more available supplies of cheap water in metropolitan NSW, procurement will generally mean higher cost options which may be under-utilised outside of drought. This may mean that utilities are reluctant to take on the risk of procuring new sources of supply. For these reasons, the NSW Government makes decisions relating to the procurement of new water supplies and services.
Draft recommendation 11.1 Retail–distribution utilities should be assigned responsibility for meeting security of supply standards and procuring water supply and services.	The NSW Government does not oppose the draft recommendation, but notes that its implementation is likely to require a restructure of the urban water utilities so that there are multiple bulk water suppliers and multiple retail-distribution utilities. As noted below with regard to draft finding 12.1, the costs and benefits of any potential proposals to restructure government owned utilities should be carefully considered before being implemented. Retail-distribution utilities focus on distribution and retail issues and it is not clear that they have expertise in management of bulk supply and whole of system yield issues. As noted above with regard to draft finding 11.1, the NSW Government makes decisions relating to the procurement of new metropolitan water supplies and services. The Metropolitan Water Chief Executive Officers' Committee provides the Government with whole-of-government advice on metropolitan water planning. It is not proposed to devolve this role to the

	retail-distribution utilities. In many cases, procurement of higher cost options, which may be under-utilised outside drought, may mean that retail-distribution utilities would be reluctant to take on the risk of procuring new supplies. In metropolitan NSW, the utilities with retail-distribution functions are responsible for meeting reliability of supply standards.
Draft recommendation 11.2 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.	The NSW Government agrees that there should be transparency in the governance arrangements and performance requirements for water utilities and does <u>not</u> oppose the draft recommendation. However, the NSW Government notes that the existing governance framework in NSW provides for best practice governance arrangements and transparency with regard to the Government's requirements for utilities' performance. The governance arrangements for metropolitan water utilities in NSW transparently set out the Government's requirements for the performance of utilities. The NSW Government is <u>not</u> opposed to the development of a charter. However, the NSW Government also notes that NSW metropolitan water utilities are rigorously and effectively regulated through operating licences and price regulation and it is not clear that a charter would lead to enhanced outcomes for customers. A charter may simply add another layer of reporting and self-monitoring. Dividends are the amount of a company's post tax net profits that the board of directors decides to distribute to shareholders. With regard to the proposal that a charter should set out details of dividend policies, the NSW Government notes that the dividend policy of any business is a matter of negotiation between the shareholders and the management of the business. In the case of Government-owned urban water utilities, the dividend policy is negotiated between the Government, as shareholder, and the business. Dividend policy is a part of a company's capital structure and it is not appropriate to include dividend policy in a service performance charter. For non metropolitan water utilities in NSW, the current regulatory framework, including the Best-Practice Management of Water Supply and Sewerage Guidelines, 2007, addresses most provisions in draft recommendation 11.2. In response to the draft recommendation's proposal that a charter would set out details about "obligations to serve (security of supply and obligation to procure)", NSW notes that, although the public health, environmental and living standards benefits make it desirable to provide appropriate water supply and sewerage services to all urban areas in the geographic region served by a water utility, it is often not cost-effective to service all outlying areas and villages. The NSW Government is considering its response to the Armstrong and Gellatly inquiry into non metropolitan urban water utilities.

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.	
Draft finding 11.2 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.	The NSW Government <u>notes</u> the draft finding. Inevitably, there will be instances when social policy objectives or expectations placed on government-owned utilities conflict with commercial objectives. These are best managed through explicit funding for non commercial activities or, a second best solution, explicitly recognising the cost impost of unfunded social objectives in evaluating business performance. There is evidence to suggest that the Commission's draft finding that requiring utilities to reduce per capita consumption is necessarily inefficient is not always correct. For example, the operating licence requirement on Sydney Water to reduce per capita water consumption has underpinned a sustained investment in water efficiency that has lowered costs to consumers without impairing service levels. The Sydney Water program has been supported by its customers and is internationally recognised. The NSW Government understands that a range of factors influence per capita consumption and that a utility is not responsible for all of these. However, a retailer-distributor is well placed to understand consumption patterns and help customers to realise potential efficiencies. An appropriately designed target can play an important role in a least cost planning framework.
<i>Information request</i> <i>Are ministerial directions common for Government Trading Enterprises (GTEs) in the urban water sector? If so, are they given formally, and are they publicly reported? Are informal directions seen as a problem?</i> <i>Are there similar issues with instructions from councillors in those cases where utilities are council owned?</i> <i>Would independence, responsibility and accountability</i>	The governance arrangements which apply to the NSW Government owned water utilities are consistent with commitments made under the National Competition Policy. The NSW Government is unaware of any evidence that indicates that there would be advantages in constituting them under the <i>Corporations Act 2001 (Cwlth)</i>. For water utilities in metropolitan NSW, ministerial directions are rarely given. When they are given, they are made in accordance with the requirements of the <i>State Owned Corporations Act 1989</i> and, if applicable, the <i>Independent Pricing and Regulatory Tribunal Act 1992</i> (these include publishing the direction and providing reasons for the direction being issued in the public interest). For water utilities in non metropolitan NSW, the NSW Government is unaware of any such instructions from councillors.

<i>be improved by constituting utilities under the Corporations Act 2001 (Cwlth), rather than state water industry or general GTE legislation?</i>	
Draft recommendation 11.3 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 draft recommendations on payments should be made by boards.	The NSW Government <u>supports</u> clear governance arrangements for publicly owned urban water utilities. The NSW Government considers that the governance arrangements applying to metropolitan urban water utilities in NSW comply with best practice. These recommendations are substantially in place for NSW utilities under the <i>State Owned Corporations Act 1989</i> (the SOC Act) and governance arrangements. Water security and reliability objectives are set through operating licences. The SOC governance arrangements provide for clear separation between ministerial shareholder roles and portfolio minister roles, and board governance. Board performance is reviewed, the last review undertaken in 2010. Dividends are negotiated with boards, based on boards' proposed dividends. Community Service Obligations where not funded are costed in evaluating business performance. With regard to the governance arrangements applying to non-metropolitan urban water utilities, the NSW Government is considering its response to the Armstrong and Gellatly review, including its draft recommendations concerning governance.
Draft finding 11.3 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.	The NSW Government <u>notes</u> the draft finding. As stated above in the response to draft finding 5.1, NSW also <u>notes</u> that water and wastewater services are often provided by monopoly service providers, and that price regulation is an appropriate mechanism of seeking to ensure that monopoly service providers do not abuse market power. The open, consultative pricing regulation processes implemented by an independent pricing regulator offer considerable benefits in regulating service provision by monopoly service providers. NSW also <u>notes</u> that draft finding 11.3 is inconsistent with the approach taken in the energy market, where

	'effectiveness of competition' is the test to be met before price regulation is dropped, not good governance arrangements.
Draft recommendation 11.4 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.	The NSW Government does <u>not support</u> this draft recommendation. This draft recommendation lacks an evidence base. The draft report does not adequately identify the costs of existing arrangements. NSW would like to see the final report provide more empirical evidence in support of the Commission's draft recommendation 11.4, including empirical evidence on the costs of price regulation and the allocative efficiency benefits of price monitoring. The open, consultative pricing regulation processes implemented by an independent pricing regulator offer considerable benefits in regulating service provision by monopoly service providers. The NSW Government <u>notes</u> that light handed regimes involving price oversight are generally better suited to industries, such as airports and ports, with a relatively small number of well informed customers. This is not the case with the metropolitan water utilities. The scrutiny offered by regulatory oversight of operating expenses and capital investment is likely to lead to genuine savings to consumers. The proposal to abolish price regulation for monopoly water services could, if implemented, have broad and far-reaching repercussions that are not satisfactorily identified or addressed in the Commission's draft report. For example, the proposed removal of price regulation would remove fundamental efficiency incentives that economic regulation places on water and wastewater utilities. An effective incentive structure for utilities to minimise costs would need to be developed to replace regulatory oversight. This could pose substantial challenges and entail costs. The NSW Government <u>considers</u> that the economic case for regulating natural monopolies to ensure that they do not exert market power is long-established. The open, consultative pricing regulation processes implemented by an independent pricing regulator offer considerable benefits in regulating service provision by monopoly service providers. Light handed regulatory approaches including price monitoring are not suitable for urban water utilities.

Draft finding 11.4 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.	<u>NSW notes</u> the draft finding. <u>NSW notes</u> that it is extremely difficult both to undertake competitive market based processes to reveal the preferences of individual consumers and to develop tariff schemes to accommodate them. The Commission may wish to provide further detail on the design and implementation of such a scheme. <u>NSW supports</u> the use of representative consumer groups. Sydney Water currently has a Corporate Customer Council, a Commercial and Industrial Customer Forum and the provision to establish short term Advisory Groups. Members include key representatives from peak organisations and the groups have been used to review and provide input into a wide range of strategies and programs. Hunter Water's Consultative Forum is an advisory body made up of key community representatives who provide advice on customer and consumer interests in relation to its Customer Contract and the operational requirements of its Operating Licence. The Forum is an opportunity to provide two-way open communication to discuss Hunter Water's activities with relevant local councils, community representatives and important stakeholders. The NSW Government <u>notes</u> that it may be difficult for representative consumer groups to represent the wide range of views held by customers. Other tools, such as surveys, may be better suited to elicit customer preferences for different service offerings. In addition, meaningful engagement with the community in relation to complex issues (including tradeoffs between cost and other issues) is challenging and resource intensive. Eliciting feedback on such issues requires a range of tools and approaches, including consultation with the wider community (beyond particular consumer groups). In Sydney, community consultation has underpinned the development of long-term water plans and the development and implementation of individual initiatives within those plans. Local water utilities in regional NSW are required to consult their community in evaluating future supply and demand options and before taking significant decisions. The required consultation includes appointing a Project Reference Group (PRG) to provide community inputs in the development of a 30-year integrated water cycle management (IWCM) strategy, as well as obtaining community feedback on the utility's draft IWCM strategy, draft strategic business plan and financial plan and the proposed draft water supply, sewerage and trade waste tariffs each financial year. The utility is required to take account of community views, preferences and concerns in its decision making.
Information request <i>The Commission seeks views on the desirability of establishing a consumer representative body, and on the appropriate scope, funding and governance model</i>	In NSW, the Public Interest Advocacy Centre Ltd administers the Energy and Water Consumers' Advocacy Program (EWCAP). PIAC's role in this regard is funded by the NSW Government, consistent with the funding of Community Service Obligations (CSOs). Several other organisations also represent different customer groups in the process of setting water prices and developing plans and policies (e.g. pensioners, residents of caravan parks, horticultural sector etc). Given the breadth of views in the community, it is important that all

for such a body.	such groups have a voice – for example through public, consultative price setting processes and community engagement to support the development of water plans. A single consumer representative body may in practice struggle to represent all views and may not obviate the need for other consultative tools.
Draft recommendation 11.5 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.	The NSW Government <u>supports</u> the draft recommendation.
<i>Information request</i> The Commission seeks views on the most appropriate appeal mechanisms for regulatory decisions. In the case of economic regulation, is the Australian Competition Tribunal the most appropriate appeal body? If not, why not? What are the most appropriate appeal mechanisms for environmental and health regulators?	
Draft recommendation 11.6 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.	NSW <u>agrees</u> that environmental and health regulators should be transparent and accountable in their decision making, and <u>notes</u> that environmental and health regulators in NSW are transparent and accountable. <u>Environmental regulation</u> The <i>Protection of the Environment Operations Act 1997</i> (POEO Act) is the principal legislation in NSW for regulating environmental impacts of activities. Administered by the Environment Protection Authority (EPA), which is part of the Office of Environment and Heritage, the POEO Act establishes the framework for regulating public and private sector activities that can have a significant impact on the environment across all environmental media. The POEO Act includes mechanisms to ensure transparency, economic evaluation and public participation in development assessments, licences and reviews of licence conditions, including: establishment of public registers of regulatory action taken by the EPA and local government to ensure transparency in the licensing and regulation of industry. EPA's register includes details on all licence

	applications including all licensing decisions (grant, refuse, vary, suspend, revoke), licence reviews, notices issued, convictions and exemptions; • inviting public comment and submissions on licence reviews and licence variations (where variations authorise a significant increase in environmental impact and have not already been the subject of environmental assessment and public consultation); • a duty to notify pollution incidents; and • long standing practices of negotiation of draft licences with proponents or licensees to allow robust economic analysis to inform decision making. The POEO Act is closely linked to the planning system via the <i>Environmental Planning and Assessment Act 1979</i> (EP&A Act), which sets out formal environmental assessment and public consultation requirements for new developments. Licences issued by the EPA for activities that have been assessed under the planning system must be consistent with any conditions imposed. The EPA must consider any public submissions received in this process. It is important to note that new water infrastructure proposals and significant upgrades or augmentations to existing infrastructure will be assessed under the planning system and all relevant issues such as cost, community views and impact on the environment are considered as a part of this process. Regulatory decisions made under the POEO Act may be appealed in the NSW Land and Environment Court. Under the POEO Act, third parties are able to appeal licensing decisions and to commence legal proceedings. <u>Health regulation</u> NSW Health exercises its responsibility as the public health regulator of metropolitan water utilities (Sydney Water Corporation, Sydney Catchment Authority and Hunter Water Corporation) through operating licences and memoranda of understanding. This includes regulation of drinking water supply, wastewater and water recycling. Under the <i>Public Health Act 1991</i>, NSW Health provides public health oversight of more than 100 non-metropolitan water utilities. NSW Health regulates fluoridation under the <i>Fluoridation of Public Water Supplies 1957</i>. NSW Health provides advice to local councils, NSW Office of Water and the Independent Pricing and Regulatory Tribunal (IPART) on applications made under the <i>Local Government Act 1993</i> and the <i>Water Industry Competition Act 2006</i> for water recycling schemes. Approval of recycling proposals is made by these organisations, not NSW Health. NSW Health exercises its regulatory responsibilities in a transparent manner. NSW Health consults regularly with water utilities and other water suppliers. Changes to regulatory instruments are subject to public consultation, including the development or amendment of Regulations, memoranda of understanding and, through IPART, operating licences. When developing policies, NSW Health consults with peak industry bodies
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	including the Local Government and Shires Associations, the NSW Local Government Water Directorate and NSW Aboriginal Land Council. The rationale for regulatory instruments and policies is published in consultation papers and drafts. NSW Health's regulatory decisions and advice are generally based on national guidelines which are endorsed by the National Health and Medical Research Council. When communicating with water suppliers, NSW Health explains the basis for its decisions and advice (for example the need to issue a boil water alert, or to specify the testing that is required for a water supply). Given that these decisions generally relate to the exercise of powers under an Act, there is no broader public consultation. On rare occasions, NSW Health is required to place an order under the <i>Public Health Act 1991</i> for example to close or rectify a water supply that presents a risk to public health. The reasons for decisions are provided in these cases. The reasons for NSW Health's decisions may also be released under the <i>Government Information (Public Access) Act 2009</i>. In summary, NSW Health is accountable and transparent in its decision making. When changes are proposed to regulatory instruments or policies, consultation occurs with the public and industry. The rationale for regulatory instruments and policies is published in consultation papers and drafts. When making decisions relating to individual water suppliers, NSW Health provides an explanation to the water supplier concerned. As these decisions generally relate to the exercise of powers under an Act, there is no broader public consultation.
<i>Information request</i> <i>The Commission seeks feedback on whether there are regulatory inconsistencies between jurisdictions that are creating unnecessary burdens for urban water sector participants. How significant are these burdens?</i>	The NSW Government is unaware of regulatory inconsistencies between jurisdictions that create unnecessary burdens for urban water sector participants.
Draft recommendation 11.7 All remaining impediments to rural–urban trade, particularly volumetric restrictions and excessive termination fees, should be removed as soon as possible.	NSW <u>supports</u> the draft recommendation. NSW notes that in NSW there are no impediments to rural–urban trade, particularly volumetric restrictions and excessive termination fees.
Draft recommendation 11.8 Any bans (legislated or otherwise) preventing trade between regional water utilities should be	NSW supports the draft recommendation and notes that there are no bans (legislated or otherwise) preventing trade between non metropolitan water utilities in NSW. A utility is required to demonstrate its water supply security before it is permitted to trade. The utility is only

independently reviewed and, if it cannot be shown the bans provide net public benefits, they should be removed.	permitted to trade a component of its demonstrated water savings.
Draft finding 12.1 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.	The NSW Government <u>notes</u> the draft finding. The NSW Government also <u>notes</u> that in 2007 it recommitted to the Competition Principles Agreement, which, at Clause 4(3), states: “Before a Party introduces competition to a market traditionally supplied by a public monopoly, and before a Party privatises a public monopoly, it will undertake a review into: (a) the appropriate commercial objectives for the public monopoly; (b) the merits of separating any natural monopoly elements from potentially competitive elements of the public monopoly; (c) the merits of separating potentially competitive elements of the public monopoly; (d) the most effective means of separating regulatory functions from commercial functions of the public monopoly...” The NSW Government would consider any potential proposal to aggregate or disaggregate utilities only after a thorough analysis of the merits of doing so. With regard to the Commission's draft finding that “horizontally aggregating small utilities is expected to generate gains from economies of scale”, the NSW Government is considering its response to the Armstrong and Gellatly review.
<i>Information request</i> <i>Can you provide the Commission with any further information or analyses on scale and scope economies in the urban water sector?</i>	
Draft finding 12.2	The NSW Government <u>notes</u> the 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: 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: vertical and horizontal separation of the wastewater treatment function (in addition to option 2) • Option 4: 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.	The NSW Government is <u>considering</u> the structural arrangements applying to Local Water Utilities in regional NSW, as part of its consideration of the draft recommendations in the Armstrong Gellatly report. The NSW Government <u>agrees</u> with the PC that "it is important that the benefits of vertical separation exceed the associated transaction and co-ordination costs associated with it before pursuing separation" (Draft report, Appendix D, page 530), and that consideration of options needs to be on a detailed case-by-case basis. The NSW Government <u>notes</u> that Option 2 has been implemented in greater Sydney area. In relation to the Commission's comments regarding Option 5, the NSW Government notes that the <i>Water Industry Competition Act 2006</i> provides a framework to facilitate the entry of new participants in the markets for metropolitan water and waste water services. The framework includes a licensing regime and a third party access regime. The Act has successfully facilitated the entry to the market of a growing number of new licence holders.
<i>Information request</i> <i>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?</i>	See comments on draft finding 12.2 above.

<i>Information request</i> <i>Is the economic real rate of return an appropriate measure to assess full cost recovery? Are there any risks in using this measure, especially in considering whether utilities are properly providing for returns on capital invested to date, and on future capital expenditure? Is there merit in adopting a measure, or at least a benchmark, that reflects full economic cost?</i>	A primary shortcoming with using economic rates of return is that they are usually measured against a regulated asset base. Regulators are inclined to write back the asset base of water utilities to avoid price shocks associated with recognising full cost recovery of invested assets. This provides apparently adequate returns but against an artificial "line in the sand" asset base. In addition, it also has implications for the entry of competitors to the market, under the <i>Water Industry Competition Act 2006</i>, who face the full cost of new investment. NWI Indicators F17 to F19 report the economic real rate of return for water supply, sewerage and water supply and sewerage respectively. They are suitable for reporting full cost recovery for urban water supply and sewerage. Non-metropolitan NSW water utilities are required to determine the current replacement cost and the written down current cost of their water supply and sewerage infrastructure, in accordance with NSW Reference Rate Manual for Valuation of Water Supply, Sewerage and Stormwater Assets. This Manual provides a consistent basis for asset valuation on the basis of competitive tendered prices. The Manual is being updated. It is proposed to release a consultation draft of the new Manual shortly.
<i>Draft finding 13.1</i> <i>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.</i>	The NSW Government <u>notes</u> the draft finding and is considering its response the Armstrong and Gellatly review. Non metropolitan utilities achieving an economic real rate of return of about zero achieve 'lower bound pricing', as specified in Clause 66 v) a) of the National Water Initiative 2004. Such utilities will be able to sustainably deliver future services at current prices, including funding of all recurrent expenditure and renewals. In NSW, non metropolitan urban water utilities are required to achieve lower bound pricing (NWI, Clause 66 v) a)). In addition, such utilities are required to continue to move towards upper bound pricing where practicable (NWI, Clause 66 v) b)). Utilities which pay a dividend to the Council from the surplus of their water supply or sewerage businesses are moving towards upper bound pricing.
<i>Information request</i> <i>Do local government financing policies, including restrictions on rate increases, directly or indirectly influence the price setting or investment behaviour of council-owned utilities, and if so how?</i>	Non-metropolitan water utilities in NSW are required to manage and price their water supply and sewerage businesses in accordance with the NSW Government's <i>Best-Practice Management of Water Supply and Sewerage Guidelines, 2007</i>. This involves financial planning to determine the lowest sustainable typical residential bill required to meet the utility's 20 to 30-year total asset management plan (operation plan, maintenance plan and a capital works plan which discloses each of new works for improved standards, new works for growth and renewals), together with any dividend payments for utilities which comply with the requirements of Best-Practice Management

	Guidelines There are no 'restrictions on rate increases' on water supply and sewerage in NSW. While local water utility financial reporting and auditing must comply with the Local Government Code of Accounting Practice, the NSW utilities are generally able to access loan funding for capital works projects in accordance with the requirements of their strategic business plan and financial plan. The NSW Government has sent to the Commission a number of documents which may be of assistance. These cover developer charges for water and sewerage in non-metropolitan NSW, reference rates for valuation of water and sewerage assets, strategic business planning for water and sewerage, water supply security in non-metropolitan NSW during the recent severe drought, and a handbook on affordable water supply and sewerage for small communities.
<i>Information request</i> <i>As with the major metropolitan utilities, the Commission is interested in views as to whether regional water corporations should be structured as Government Trading Enterprises or corporations under the Corporations Act 2001 (Cwth). Further, what are the ways that community views could be reflected in the utilities' activities without undermining the principle of board appointment by merit?</i>	The NSW Government will consider the appropriate governance model(s) for local utilities in developing its response to the Armstrong and Gellatly review.
Draft recommendation 13.1 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	The NSW Government <u>notes</u> the draft recommendation and is considering its response to the Armstrong and Gellatly review.

• regional water corporation • regional alliance (or regional organisation of councils).	
Draft finding 13.2 The Productivity Commission endorses the majority of the draft findings and draft recommendations of the Armstrong and Gellatly inquiry into urban water supply and sewerage services for non-metropolitan New South Wales. The Commission does not endorse draft recommendation 1 (that utilities should necessarily be grouped into 32 regional aggregations) or draft recommendation 4 (independent price regulation).	NSW <u>notes</u> the draft finding. The NSW Government is considering its response to the Armstrong and Gellatly review.
Draft recommendation 13.2 The New South Wales Government should provide a formal response to the draft recommendations of the Armstrong and Gellatly inquiry as a matter of priority. The 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).	NSW <u>notes</u> the draft recommendation and is considering its response to the Armstrong and Gellatly inquiry.
Draft recommendation 13.3 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.	NSW <u>supports</u> the draft recommendation. A "system of self-supply" is taken to mean that residents of such towns use rainwater tanks or other sources for their drinking water and are provided with a non-potable source of water through the town's reticulation system. In these instances, residents and visitors need to be regularly warned that the water in the pipes is not safe to drink without further treatment, such as boiling. The NSW Government provides subsidies towards the capital cost of the 1996 backlog in water supply and sewerage infrastructure to local water utilities in regional NSW under the Country Towns Water Supply and

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.	Sewerage Program. The utilities are responsible for fully funding all other expenditure, including capital expenditure for growth since 1996, all renewals expenditure and all operation, maintenance and administration expenditure. In considering the provision of adequate services to existing backlog areas, the merits of on-site systems and appropriate standards in accordance with the Handbook for Affordable Water Supply and Sewerage Systems for Small Communities, Agriculture and Resource Management Council of Australia and New Zealand / Waste Services Association of Australia, 1999 are routinely considered.
Draft recommendation 13.4 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.	The NSW Government supports the draft recommendation. Uniform assessment of service to Aboriginal and non-Indigenous communities already occurs. In NSW, the challenges faced by discrete Aboriginal communities in managing their drinking water and wastewater systems have been recognised for some time. The NSW Aboriginal Communities Water and Sewerage Program (the program), a joint initiative of the NSW Government and the NSW Aboriginal Land Council, was established in 2008 to improve water supply and sewerage services in eligible Aboriginal communities in NSW. The program provides \$200 million over 25 years to fund the full service of drinking water and sewerage infrastructure in discrete Aboriginal communities. The program covers the maintenance, operation and repair of water supply and sewerage systems in sixty one eligible Aboriginal communities. The program aims to raise service standards by engaging local water utilities with expertise and experience in managing water supply and sewerage systems to take responsibility for the day-to-day operation and maintenance activities. One of the program's explicit goals is to provide services to the same standard as those in non-Indigenous communities.
Draft recommendation 13.5 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	NSW Government agrees that utilities should comply with the health critical elements of the Australian Drinking Water Guidelines. The NSW Government supports water utilities to provide safe drinking water. The most important aspect of the <i>Australian Drinking Water Guidelines</i> is the implementation of the Framework for the Management of Drinking Water Quality. The NSW Parliament has passed the <i>Public Health Act 2010</i> which is expected to commence in 2012. The Act includes the requirement for a supplier of drinking water to establish, and adhere to, a quality assurance program that complies with the requirements prescribed by the regulations. Regulations may

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.	require the implementation of risk-based drinking water quality management plans consistent with the Guidelines. With regard to utilities in regional NSW, the NSW Government is considering its response to the Armstrong and Gellatly inquiry. In relation to the draft recommendation regarding sanctions for non compliance, including directors or other accountable persons such as councillors being personally liable for the risks associated with non compliance, the NSW Government notes that, in 2008, COAG agreed to a set of principles to harmonise the treatment of directors' liability across Australian law. On 4 May 2011, the NSW Government introduced into the Legislative Council the <i>Miscellaneous Acts Amendment (Directors' Liability) Bill 2011</i>. The Bill aims to implement the COAG principles by repealing legislative provisions making directors and executives personally liable for certain offences committed by their companies, lowering the level of personal liability for certain other offences, and increasing the level of liability for offences under one Act. The Government understands that other jurisdictions may be introducing similar legislation. This matter remains on the agenda of the Business Regulation and Competition Working Group of COAG (BRCWG) and a further round of reforms is possible. The NSW Government recommends that the Productivity Commission consult the BRCWG Secretariat before making any final recommendations relating to directors' liability, to ensure consistency with the COAG reform directions. Regulation of water quality and the management of drinking water supplies from a health perspective help water utilities to achieve their main role, which is to provide safe drinking water to their communities. In NSW, the public health regulator of urban water utilities is NSW Health, which works with water utilities to apply a preventive risk management approach to their supply systems. Addressing risks from the catchment, storage, treatment and distribution of drinking water provides the best approach to protecting the health of the community. The NSW Government recognises that there are costs involved in NSW Health's requirements of water utilities. Since 2001, NSW Health has provided supplementary funding under the <i>NSW Health Drinking Water Monitoring Program</i> to three laboratories in NSW which provide free analyses of drinking water monitoring samples for the public water utilities of NSW. NSW Health also supports the NSW Drinking Water Database, which communicates laboratory results back to the water utilities. The NSW Government considers that the benefits of NSW Health's regulation of water utilities outweigh the costs of that regulation.
Draft recommendation 13.6 The Governments of Western Australia, South Australia and the Northern Territory should consider the costs and benefits of replacing the	Not applicable to NSW.

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.	
<i>Information request</i> <i>What are the likely sources of costs and benefits of undertaking structural reform of the urban water sectors in Western Australia, South Australia and the Northern Territory?</i>	
Draft finding 13.3 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.	The NSW Government is considering its response to the Armstrong and Gellatly review.
<i>Information request</i> <i>Is there a case for reintegrating water supply and wastewater services in regional areas where they are currently provided separately? In which regions? What are the principle costs and benefits of separate, as compared to integrated, water supply and wastewater service provision?</i>	The NSW Government is considering its response to the Armstrong and Gellatly review.
Draft recommendation 14.1	The NSW Government supports in principle the draft recommendation.

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.	Before committing to any individual reform, the NSW Government will investigate their relative benefits and costs, including implementation costs and the costs of transitional arrangements. As noted above, the NSW Government considers that further analytical work is required on a number of the 'universally applicable reforms' which are listed on page 435 of the draft report.
Draft finding 14.1 An intergovernmental agreement could be formulated by the end of 2012 through the COAG process that commits each jurisdiction to implementing the universally applicable reforms identified by the Commission, and to implementing structural reform, with agreed deadlines for progress. The universally applicable reforms could be in place by the end of 2013. Where a case in favour of structural reform is identified, the reform process could begin by the end of 2014.	The NSW Government <u>notes</u> the draft finding. As noted above (draft recommendation 14.1), NSW will consider the draft recommendations, including their costs and benefits before committing to enact them. NSW <u>notes</u> that draft finding 14.1 may be inconsistent with draft finding 14.3 that the States should implement the reforms and that there is no case for Commonwealth payments to act as an incentive to undertake the reforms. Draft finding 14.3 does not require a new intergovernmental agreement.
<i>Information request</i> <i>The Commission is seeking feedback on its suggested timetable for reform.</i>	The NSW Government <u>notes</u> that there are various current proposals for urban water reform, including the existing agreed reform program under the National Water Initiative, as well as recent work by the National Water Commission, Infrastructure Australia and this draft report by the Productivity Commission. These have significant resourcing implications.

	Governments in the various jurisdictions will need to consider their current reform agendas and the reform programs suggested by each of these processes and determine their priorities for reform. NSW looks forward to the Commission's views and recommendations on the potential to streamline reform processes currently underway and considers that the Commission's proposed timetable is likely to be ambitious.
Draft recommendation 14.2 Agreement across all jurisdictions is not necessary for the State and Territory Governments to pursue the draft recommendations made by the Commission as most relate to implementation of best practice. The State and Territory Governments should immediately commence enacting reforms unilaterally.	The NSW Government <u>supports in principle</u> the draft recommendation. As noted above (draft recommendation 14.1), NSW will consider the draft recommendations, including their costs and benefits before commencing to enact them.
Draft finding 14.2 The social security and taxation systems, together with generally available adjustment measures, are likely to be the most appropriate ways of providing transitional assistance to those significantly disadvantaged by urban water reform. However, in some cases there might be a need for additional specific transitional assistance from State and Territory Governments. General principles for the provision of such assistance should be spelt out at the beginning of the reform process.	NSW <u>notes</u> the draft finding.
Draft finding 14.3 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	The NSW Government <u>notes</u> the draft finding. The NSW Government notes that both the Australian Government and the State Governments have a responsibility to communities, and that a cooperative approach should be adopted which does not rule out any joint funding model. The NSW Government also notes that draft finding 14.3 appears to be inconsistent with draft finding 14.1. If, as proposed by draft finding 14.3, there is no case for Commonwealth funding, then there appears to be little point in negotiating a new intergovernmental agreement which would focus exclusively on obligations on the

no case for Australian Government funding to promote urban water reforms.	States, as proposed by draft finding 14.1. With regard to the Commission's draft finding that there is no case for Commonwealth funding to promote reforms, the NSW Government notes that it has, for many years, allocated considerable resources to the existing agreed water reform program. The NSW Government also notes the Commonwealth's slow progress in meeting its funding obligations under the Water Management Partnership Agreement and under the no additional net costs provisions of the Intergovernmental Agreement on Murray Darling Basin Reform.
Draft recommendation 14.3 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.	The NSW Government <u>supports in principle</u> the draft recommendation. The NSW Government <u>agrees</u> that reporting against reform commitments is sound practice and <u>notes</u> the existing time consuming, resource intensive reporting requirements for national water reforms where States are required to report to both the NWC and the COAG Reform Council on progress in achieving their reform commitments. The NSW Government would not agree to the imposition of any additional reporting requirements if they required resources to be diverted from the implementation of agreed reforms. NSW <u>notes</u> that the NWC is subject to a review.
Draft recommendation 14.4 An independent public review of the reform package should take place after five years.	The NSW Government <u>supports in principle</u> the draft recommendation. The NSW Government <u>supports</u> a review of agreed reforms five years after their implementation.

ATTACHMENT B

Additional NSW Government comments on the Draft Report

In addition to commenting on the Commission's draft recommendations and draft findings, this NSW Government submission comments on a number of other aspects of the Commission's draft report which deserve closer attention in the Commission's final report.

The National Water Quality Management Strategy

The Commission's draft report does not reference the National Water Quality Management Strategy, the main objective of which is to achieve sustainable use of the nation's water resources by protecting and enhancing their quality while maintaining economic and social development. The Strategy provides a management framework for participants to identify community desired objectives for the uses and values of waterways and to work towards achieving those objectives over time. All jurisdictions have adopted the Strategy.

NSW has undertaken comprehensive water quality objective setting process in accordance with NWQMS process. It would be inappropriate and inefficient to frame overall water quality objective setting around the regulation of just one pollution source. The NWQMS framework allows the community's to be consulted about its objectives for a waterway with the costs and benefits of those objectives assessed at that time. Once objectives are established they can then be met over time using affordable approaches and initiatives as needed. This approach avoids repeat consultation and re-establishment of community views on environmental objectives for waterways each time an individual regulatory decision is made in a catchment, particularly in catchments with multiple sources and types of discharges.

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The terminology used in the table is inconsistent with the terminology used by the NWC in the National Performance framework. To avoid confusion, NSW suggests that the Commission adopt the terminology used in the *National Performance Framework 2010-11 Urban Water Performance Report Indicators and Definitions Handbook*.

For example, the Commission should use term 'stormwater harvesting' [W28.4] in this Figure and in the Report to avoid confusion with recycling reported in the *National Performance Report 2009-10* (www.nwc.gov.au) where indicators W26 and W27 refer to 'total recycled water supplied' and 'recycled water (percent of effluent recycled)'. Recycled water in the *National Performance Report* refers only to treated sewage effluent. Thus terms such as 'local stormwater (recycling)' would be replaced by 'stormwater harvesting' [W28.4], and 'bulk recycled stormwater' would be replaced with 'bulk stormwater received' [W28.2] or 'bulk stormwater exports' [W28.1] as appropriate.

Page 18 of the draft report shows the total sourced water for regional NSW as 193.9 GL. The figure is incorrect. This volume applies only for the NSW utilities with over 10,000 connected properties which are reported in the *National Performance Report*.

This figure should be corrected to 311 GL, as indicated on page 138 of the *2008-09 NSW Water Supply and Sewerage Benchmarking Report* (www.water.nsw.gov.au). The components for surface water, groundwater, recycled water and bulk water are respectively 66.9 per cent, 14.8 per cent, 2.6 per cent and 15.8 per cent.

Page 22 refers to 'per capita consumption'. The NSW Government notes that since 2005-06, Australian urban water utilities have been reporting against 'residential water supplied per connected property' (NWI Indicator W12) and recommends that the Commission's final report use the NWI indicators.

Page 29 final paragraph states that the Orange Blackman's Swamp stormwater harvesting scheme can only be used when "Orange's combined water supply is below 50 per cent" of full capacity.

In response, the NSW Government notes that the Blackman's Swamp Stormwater Harvesting scheme was developed as a drought emergency measure for Orange and therefore did not undergo the normal water licence application consultation process involving downstream water users as well as environmental water needs. An emergency licence was provided to Orange City Council to enable it to secure the Orange water supply from this source when the Orange storage volume was below 50 per cent of full capacity.

Council has now applied for a 'full licence' for this source through the normal licensing process which will determine the Council's water access and use rights from this source, as well as those of the other water users in the area. The matter is currently before a Land Board hearing.

Page 58 of the draft report states that "Often standards, particularly recycled water standards, will vary between jurisdictions." In response, the NSW Government notes that NSW Health is contributing to work towards harmonisation of the different legislation and requirements in different States through the National Recycled Water Regulators Forum.

Page 65 of the draft report states that:

"Managing such risks efficiently does not usually involve eliminating all risks entirely. Consider a situation where there are large benefits available from developing a fit-for-purpose recycled water product for garden watering, toilet flushing and other uses. A risk eliminating approach might specify that the quality of such water needs to be comparable to that of potable water on the grounds that a small number of people may drink it. Such a requirement might make the project uneconomic, meaning that a large benefit is lost in order to eliminate what may have been a very small risk".

In response, the NSW Government notes that NSW Health supports the recycling of wastewater to appropriate quality for its purpose. This approach is set out in the Australian Guidelines for Water Recycling. The Guidelines support lower levels of treatment of water used in situations where little human exposure can be expected, for example in irrigation. However, where recycled water is used in place of potable water for specific purposes, for example toilet flushing and laundry uses, the greatest risk to public health is well known. This arises from accidental cross-connecting of the pipes carrying recycled and drinking water. This could lead to recycled water being supplied, unknowingly, to outlets for drinking water, such as kitchen taps. The recycled water could also back-siphon from the cross-connected property into the drinking water distribution network, affecting a greater number of properties.

Extensive cross connections have been identified in the recycled water schemes at Rouse Hill and Sydney Olympic Park, with hundreds of people having consumed recycled water. Cross connections have also been found with other schemes in other States and in the USA. If standards for recycled water quality are reduced, then there needs to be much increased plumbing regulation and inspection.

The NSW Government considers that augmenting drinking water supplies by wastewater recycling needs to be carried out in such a way that predictable hazards, such as cross-connections, are unlikely to pose a risk to public health.

Diffuse and point sources of water pollution.

Page 87 of the draft report refers to a submission from the Water Services Association of Australia which contends that environmental regulation is problematic in most

jurisdictions, with water businesses frequently encountering a focus on point source discharges when the optimal approach might be to deal with diffuse sources.

In response, the NSW Government notes that environmental regulation in NSW focuses on both point and diffuse source discharges and appropriate policy tools are used in relation to each. The aim is to ensure that responsibility for the share of the pollution from different contributors is allocated to the appropriate contributor, while pollution reduction actions are implemented wherever most cost effective. For example, in western Sydney the EPA applied a collective annual total pollution load (bubble) limit across a group of Sewage Treatment Plants, allowing Sydney Water Corporation to invest in pollution reduction wherever most cost effective. This was estimated to save \$45 million in capital. The EPA has also championed the option of point sources to procure emission reductions at non-point (i.e. diffuse) sources if equivalent outcomes could be achieved at lower cost.

Page 112 of the draft report discusses planned potable re-use of recycled water. NSW notes that there is little experience world-wide in using recycled water (i.e. treated sewage effluent) in a planned way for potable purposes, with the exception of aquifer recharge in Orange County, USA since 2008 and in Windhoek, Namibia where potable reuse is a necessity due to the city's arid climate and its location 700km from the nearest river and 300 km from the sea.

NSW suggests that the Commission may wish to consider acknowledging, in its final report, the inherent difficulties of implementing a sound recycled water system for potable re-use. These difficulties include the extensive monitoring required of both source and treated water quality and the complexity of the required multiple treatment barriers and their operation and maintenance in order to ensure a consistently safe water supply is provided to the community.

Pages 121-123 of the draft report include the contention that the decision to build the Sydney Desalination Plant was not consistent with the NSW Government's Metropolitan Water Plan framework. The NSW Government does not agree with the Productivity Commission's characterisation of the decision to build the desalination plant.

The decision to commit to the construction of the plant represented a balanced outcome given the continued learning from the 2004 and 2006 Metropolitan Water Plans and the legitimate role of the NSW Government to secure Sydney's water supply.

The Commission concedes, in Box 3.1 on page 82 of the draft report, that achieving least cost planning by not building desalination plants if subsequent years are going to be wet:

"is clearly infeasible as it requires knowledge of the future that is unobtainable."

Despite the end of the recent extreme drought conditions and investment in measures such as desalination, recycling and water efficiency, severe and extreme drought conditions can re-emerge quickly in Sydney. As seen in the period between 2004 and 2006, dam levels can and do deplete rapidly, at one to two per cent per month. In the circumstances, desalination represents a valuable component of a total water security plan for Sydney.

As such, the adaptive, Metropolitan Water Plan framework remains in place to safeguard the water supply into the future. An updated Metropolitan Water Plan was released in 2010.

Page 146 of the draft report refers to 'inefficient asset management in some regional areas'. Most local water utilities in regional NSW manage their assets in an efficient manner. In non-metropolitan NSW, all local water utilities have had an asset register for well over a decade. Of these utilities, 89 percent have completed a sound 20 to 30-year strategic business plan and financial plan, and an associated total asset management plan, which includes an operation plan, maintenance plan and capital works plan which discloses the capital works required for each of improved standards, growth and

renewals. Further information on asset management planning is available in the *NSW Water and Sewerage Strategic Business Planning Guidelines*, forthcoming.

Page 160 states that Hunter Water Corporation levies residential sewer usage charges. This is incorrect. In July 2009, the application of these charges was discontinued. See Part B of the National Performance Report 2009-2010 (www.nwc.gov.au).

Page 162 of the draft report discusses trade waste. The NSW Government advises that the *NSW Trade Waste Regulation Guidelines 2009* (www.water.nsw.gov.au) are a suitable basis for the regulation of sewerage and liquid trade waste in Australia. These Guidelines require the approval and monitoring of each trade waste discharger, appropriate trade waste fees and charges, and appropriate non-residential sewer usage and access charges. The NSW Independent Pricing and Regulatory Tribunal determines cost reflective trade waste fees and charges. Utilities which comply with these Guidelines also comply with the *National Wastewater Source Management Framework, 2008* (Water Services Association of Australia).

Page 175 states 'there are still some areas of Australia where water consumers do not face a price that is related to the amount of water they consume'. The NSW Government advises that there is only one urban water utility in NSW without a fully metered potable water supply. It has fewer than 500 connected properties.

The third paragraph on **page 386** says 'AECOM observed that 'treatment plant operators working in regional areas do not receive access to the same level of training provided in the larger metropolitan areas'.

In response, the NSW Government notes that the operator training, mentoring and feedback provided by the NSW Office of Water to NSW water utility operators are of a consistently high standard. For details, please see the NSW Office of Water's letter of 31 March 2011 to Infrastructure Australia at Attachment C to this submission.

The final paragraph on **page 389** quotes from the AECOM Report that "even those utilities that earn sufficient revenue to allow a dividend payment to State Government shareholders sometimes fail to supply high quality drinking water". In response, the NSW Government notes that local water utilities in regional NSW do not pay dividends to the NSW Government.

Page 390 of the draft report states that:

"A number of respondents to this inquiry commented on the high costs imposed on water utilities by the existing regulatory and legislative framework, and considered that regional utilities face proportionally greater costs and difficulties managing these requirements relative to metropolitan utilities. Kempsey Shire Council (sub. 30, p. 18) commented 'environmental and public health standards have led to a significant increase in the capital and operating costs of water utilities'.

In response, the NSW Government notes that NSW Health's Drinking Water Monitoring Program supports water utilities to meet some of their public health regulatory requirements. The standard of management of drinking water supplies set out under the Australian Drinking Water Guidelines has increased over time. In addition, the standards have risen to address hazards identified through the experience of waterborne outbreaks in other developed nations. The Framework for the Management of Drinking Water Quality set out in the Guidelines represents an Australian interpretation of best practice for water utilities. The NSW Government considers that the public health standards set out in the Australian Drinking Water Guidelines and the Framework for the Management of Drinking Water Supplies are appropriate.

Page 394 refers in the final paragraph to a situation where 'one wastewater treatment plant may serve an aggregated group of the utilities in place of multiple plants'. NSW notes that this is not the case in NSW. As towns sewered by the existing utilities are

typically separated by more than 50 kilometres, there are few opportunities to reduce the number of treatment plants required.

Page 395 refers to 'economies of scale in water treatment'. Note our comments on Page 394 above.

Page 399 states that "AECOM 2010 observe that many small towns are currently without water treatment because the increase in residential bills required to recover the cost would be substantial".

In response the NSW Government notes that this 'observation' is incorrect with regard to non-metropolitan NSW. Surface water supplies in non-metropolitan NSW receive comprehensive multi-barrier water treatment at the level of sophistication needed to assure a high quality potable water supply. Where source water quality is high and does not require filtration, it is not cost-effective or necessary to burden customers with the high cost of providing filtration. For such water supplies, disinfection alone is sufficient treatment. For a small number of very small villages, only a non-potable reticulated water supply is provided, with drinking water obtained from rainwater tanks. This is a satisfactory option.

The discussion of 'Yardstick competition' on **page 401** fails to acknowledge the public disclosure of a broad range of performance indicators for each NSW utility. The *NSW Annual Water Supply and Sewerage Performance and Monitoring System* and the *Best-Practice Management Guidelines* including strategic business planning, financial planning and asset management by each local water utility have resulted in the demonstration of financial sustainability by each of the 89 per cent of NSW utilities with a sound strategic business plan and financial plan, as well as significant improvements in utility performance and accountability.

Appendix B2 NSW's structural, institutional, governance and regulatory arrangements

There are a number of inaccuracies in the commission's draft report. The following amendments are suggested.

Page 458, last paragraph – Sydney Water Corporation, not the Sydney Catchment Authority, is responsible for water treatment.

Page 459, 2nd paragraph – update with "The Central Coast Water Corporation was formed in February 2011 and by July 2013 will take over full responsibility for providing the bulk and retail water, wastewater and stormwater services presently provided by Gosford City Council and Wyong Shire Council."

Page 460, 2nd last dot point - update *Public Health Act 1991* to *Public Health Act 2010*, also add a note to indicate that the 2010 Act requires preparation of a risk-based drinking water quality management plan by each local water utility.

Page 461, 2nd paragraph - update NSW Office of Water (within the Department of Environment, Climate Change and Water) with 'NSW Office of Water (within the Department of Primary Industries)'.

Page 461, sub-heading and 3rd paragraph, update the reference to 'Department of Environment, Climate Change and Water' with 'Department of Premier and Cabinet'.

Page 462 – final paragraph update 'Department of Water and Energy' with 'Department of Primary Industries'.

Page 464, final paragraph - update *Public Health Act 1991* with *Public Health Act 2010*.

Page 465, 2nd paragraph – update 'Minister for Water' with 'Minister for Primary Industries'.

Page 465, 4th paragraph – update 'Department of Environment, Climate Change and Water' with 'Department of Premier and Cabinet'.