



Level 6, 655 Pacific Highway  
ST Leonards NSW 2065  
Tel +61 2 9467 8426 Fax +61 2 9436 0155

Urban Water Inquiry  
Productivity Commission  
LB 2 Collins Street East  
Melbourne Victoria 3165

June 8<sup>th</sup> 2011

Dear Sir/Madam

The Australian Water Association is pleased to make this further submission to the Productivity Commission's Inquiry into Urban Water. This submission addresses the recommendations and information requests included in the Commission's draft report of April 13<sup>th</sup> 2011.

The Australian Water Association has cautiously welcomed the findings included in the draft report and we have said so publicly. AWA is supportive of reforms that will benefit consumers, the industry and Australia generally, but we are opposed to reform for reform's sake. Regrettably, the objectives of some recent reform proposals have been obscure or the reforms have been undertaken in pursuit of a secondary goal. An example is the drive to introduce competition to the industry. The industry has no fear of competition, but as the Commission itself notes, competition is not an end unto itself, it is merely one possible mechanism to promote the primary objective of efficiency.

AWA is supportive of the Commission's recommendation that "Governments should set an overarching objective for utilities of delivering water, wastewater and stormwater services in an economically efficient manner so as to maximise benefits to the community". However, it should be a test for all future reform proposals that the proposals themselves are fully directed to these ends. Commissioners may recall that our previous submission listed some Principles for Reform (p.16). These might be considered broadly analogous in intent with the Primary Objective, as proposed in the Commission's draft recommendation 3.1. It is our strong view that reform must be driven by a need to cure an ill or seize an opportunity for improvement.


A further broad observation is that in a number of instances, the Commission's recommendations elevate responsibilities from a state level to a national one. Examples include: the proposal that utilities be subject to the *Corporations Act, 2001 (Cwlth)*, that the means of appeal with regard to economic regulation should be to the Australian Competition Tribunal; that a national customer representative body be established; and so on. While AWA has no particular loyalty to state-based mechanisms, being a national representative body itself, in many instances elevation of issues to a national level weakens the link between customers served and deliberative bodies and between state-based and owned organisations and their regulators. This may be undesirable and, in any case, may be strongly resisted by state governments.



For ease of use, the remainder of this submission addresses the Recommendations and Information Requests made by the Commission on pages XLIII to LX of the draft Report. Please note that AWA has not provided comment on each of these, but the numbering we have used corresponds to that of the Commission.

AWA is pleased to have been able to provide this submission and to speak to it at the Commission's Sydney public hearing on 31<sup>st</sup> May, 2011.

Yours sincerely

  
Chief Executive  
Australian Water Association

## Contents

<i>Draft Recommendation 3.1</i> .....	4
<i>Draft Finding 5.1</i> .....	4
<i>Draft Recommendation 6.1</i> .....	5
<i>Draft Recommendation 6.2</i> .....	5
<i>Draft Finding 6.1</i> .....	5
<i>Draft Finding 7.1</i> .....	6
<i>Draft finding 7.2</i> .....	6
<i>Draft Recommendations 7.1 and 7.2</i> .....	7
<i>Draft Recommendation 7.3</i> .....	7
<i>Draft Recommendations 8.1 and 8.2</i> .....	7
<i>Draft Recommendation 9.1</i> .....	8
<i>Draft Recommendation 9.2</i> .....	8
<i>Draft Recommendation 11.2</i> .....	9
<i>Draft Finding 11.2 and Information Request</i> .....	9
<i>Draft Recommendation 11.3</i> .....	9
<i>Draft Recommendation 11.4</i> .....	10
<i>Draft Finding 11.4 and Information Request</i> .....	10
<i>Draft Recommendation 11.5 and Information Request</i> .....	11
<i>Draft Recommendation 11.6 and Information Request</i> .....	11
<i>Draft Recommendation 11.7 and 11.8</i> .....	12
<i>Draft finding 12.2 and Information Request</i> .....	12
<i>Draft Finding 13.1</i> .....	13
<i>Draft Recommendation 13.1 and Information Request</i> .....	14
<i>Draft Recommendation 13.3</i> .....	14
<i>Draft Recommendation 13.5</i> .....	14
<i>Draft Recommendation 13.6</i> .....	15
<i>Draft recommendations 14.1 to 14.4</i> .....	15

### *Draft Recommendation 3.1*

AWA supports this recommendation. However, in doing so we note that, in fact, the Primary Objective is consistent with the spirit of the 1994 COAG Water Reform agreement. We find it somewhat surprising that the Commission finds that the urban water sector's objectives are obscure. The 1994 Agreement was always intended to promote economic efficiency and to rationalise the use of water, wastewater and stormwater services by setting a correct price for water, introducing market disciplines, removing subsidies and making utilities responsible meeting all regulatory requirements, including those of economic regulators. AWA contends that it is inaction by governments and interference by politicians that has led to a lack of clarity, not the core policy instruments or in the actions of the industry itself in most instances.

In support of this assertion, we would cite Section 90 of the National Water Initiative, agreed to by all Australian governments, which sets clear objectives for the urban water industry:

"The Parties agree that the outcome for urban water reform is to:

- i) provide healthy, safe and reliable water supplies;
- ii) increase water use efficiency in domestic and commercial settings;
- iii) encourage the re-use and recycling of wastewater where cost effective;
- iv) facilitate water trading between and within the urban and rural sectors;
- v) encourage innovation in water supply sourcing, treatment, storage and discharge; and
- vi) achieve improved pricing for *metropolitan water*"

### *Draft Finding 5.1*

AWA broadly agrees with this finding. It is our view that full cost recovery is vital. Where affordability is an issue, governments should explicitly provide a CSO and not expect the sector to bear this burden. Regulation, where it is necessary, should work to making sure that subsidies are not hidden.

We agree that regulation does not necessarily ensure that utilities will recover full costs. However, this finding is not necessarily a justification for changing the regulator environment. In fact, the benefit that economic regulation confers is to depoliticise the process, such that politicians are provided with a defence against allegations that price rises are unnecessary ("the independent regulator did it") and the opportunity for political interference in price setting is reduced. AWA contends that political interference in price setting that has contributed substantially to the under-recovery of costs.

Economic regulation has introduced a surrogate for market disciplines such that utilities have been forced to be efficient in their use of capital. Utilities that have been overseen by mature and independent economic regulators for some time may not be made more efficient or produce greater social benefit if they continue to be so regulated as they are now likely to behave in a commercial manner. However, newer utilities and utilities that remain creatures of local government (as opposed to corporatised entities) may become more efficient and produce greater benefit if the

discipline imposed by economic regulators continues. A blanket approach of moving to a more light handed approach may not, therefore, be appropriate in all circumstances.

### *Draft Recommendation 6.1*

AWA generally agrees with this recommendation. However, it is AWA's view that it is political interference in augmentation decisions that has contributed most to poor decision making. In fact, most major utilities have very sophisticated processes in place to determine when augmentation should occur and the best options to achieve this objective. Too often however, politicians have found it politically convenient to usurp the planning framework or the utilities' role in this regard.

We are mindful of the comments made by WSAA (Draft Report p.126) to the effect that it may be difficult for economic regulators to deal with the cost implications of adaptive management. We also note that, in some circumstances early investment in augmentation may in fact be the cheaper option because some cost-effective options now available may not be available in future. (For example, in north Adelaide, engineered wetlands have been created to 'polish' stormwater so that it is suitable for groundwater injection and later recovery for non-potable purposes. If urban development had occurred in the areas now occupied by these wetlands, treatment plants may have had to be developed instead and a valuable community asset would have been lost.) However as a general principle we agree with the intent of the recommendation.

AWA agrees that the "costs, risks and benefits to consumers of all augmentation options should be made publicly available..." However, we note that the challenge of internalising externalities – particularly those associated with environmental degradation – has never been properly addressed. As long as this circumstance persists, the costs presented to the community for particular options may be artificially low (or high with respect to positive externalities)

AWA strongly supports the notion that bans on particular augmentation options should be removed. We agree fully with the Commission's findings with respect to certain government policy decisions – for example those associated with the Sugarloaf pipeline in Victoria – and urge the Commission to make clear in its final report that such decisions are detrimental to the community overall and are economically inefficient.

### *Draft Recommendation 6.2*

AWA agrees strongly with this recommendation

### *Draft Finding 6.1*

AWA agrees with the Commission's view that water reuse and recycling and decreased reliance on centralised water supply systems tends to be seen as always being in the community's interests. They may be, of course, but this cannot be known without analysis and the options chosen are likely to vary from place to place in response to local conditions. The assignment of property rights, improving analysis, and – in particular – raising community awareness of costs and benefits of the various options available are all steps that may produce outcomes that are better than the blanket approaches (e.g. recycling targets) currently promoted. However, AWA also sees a role for improved institutional arrangements (other than those addressed in chapters 11-14 of the Commission's report). To provide two examples:

- Market forces may promote efficiency, but they do not necessarily result in good planning. There needs to be clarity in government policy with respect to the integrated management of the water cycle such that master planning is effective and the responsibilities of each party are coordinated and transparent.
- Stormwater systems in Sydney are under the jurisdiction of numerous councils and other organisations such as Sydney Water and NSW Maritime. A single drain may be the responsibility of several councils and other agencies making development of a maintenance strategy or optimisation of the asset for community benefit next to impossible. Similar problems may exist in other jurisdictions. Clarifying responsibilities would add immeasurably to the opportunity to utilise stormwater and to enforce property rights.

### *Draft Finding 7.1*

The argument made by the Commission in support of flexible pricing is theoretically sound, but AWA would urge caution in implementation as the behaviour of consumers is not always rational and the elasticity of demand for the product most uncertain. In particular, AWA would recommend that if flexible pricing were to be adopted it be accompanied by an awareness campaign to make sure that customers are aware of changes. As bulk water suppliers generally are monopoly services – or at least the retailers from which purchases are made are monopoly services (in most instances) – customers cannot merely ‘shop elsewhere’, generally speaking, when prices rise. Their only rational response is to reduce consumption to the extent that the benefit lost is less than the cost saving. However, if customers are not fully aware of: (a) the fact that prices rise and fall in response to scarcity and (b) the ways in which they might conserve water while still maximising utility, the rationality of their behaviour will be curtailed. Thus, mechanisms for informing consumers of the introduction of variable pricing and the relationship between price and scarcity will need to be implemented.

Other issues raised by the Commission – including equity considerations associated with flexible pricing, the risk that persistent abundance will lead to prices below the LRMC over a lengthy period and give consumers a false sense of security, and the like – have been usefully analysed and it is AWA’s view that there is no compelling argument against further research being carried out in to the way in which flexible pricing might be implemented. Whether politicians would ever be bold enough to actually introduce flexible pricing is an unanswerable question.

AWA further notes that the approach taken to implementation of flexible pricing and its structure may, and should, vary from location to location depending on circumstances.

### *Draft finding 7.2*

AWA believes strongly that developer charges should reflect the costs of service provision in new developments. Presently, many developers pay for local reticulation to serve their developments and this is as it should be. However, they often are not faced with the cost implications of development decisions upstream of their developments. That is, the additional load placed on water mains and headworks is not always reflected in the developer charges imposed on developers and they should be.

In some jurisdictions economic regulators have imposed constraints on water authorities seeking reimbursement for what is described as “sunk infrastructure”. This has the potential to cause inefficiencies in the provision of trunk water and sewer infrastructure.

The issue arises where the first developer in a growth area is requested to construct a new water or sewer main, where the main is sized to cater for a number of developments that will occur subsequently. Past practice has been for the authority to reimburse the developer for the additional capacity (ie the capacity above that necessary to cater for the developer’s subdivision) and then recover contributions from subsequent developers which connect to the water or sewer main.

This process has been criticized by some state economic regulators on the basis that it is recovering costs of “sunk infrastructure”. This appears to AWA to be taking an unreasonably narrow economists view without recognising the efficiencies inherent in providing one large main to be jointly funded than a series of smaller mains installed by each developer.

### *Draft Recommendations 7.1 and 7.2*

In principle, all residences should have their water consumption metered. In practice, however, the costs of retrofitting many multi-unit developments may outweigh the benefits, as noted by the Commission and, indeed, may be impossible in some circumstances (e.g. when multiple pipes serve a single unit). By extension, the costs of charging tenants directly may also outweigh benefits and this circumstance may be exacerbated by the extra billing costs associated with a relatively more transient group.

### *Draft Recommendation 7.3*

There would, in principle, appear to be merit in the introduction of variety of service options. As with the introduction of flexible water prices, however, some caution should be exercised. Community consultation and further research may be needed to ensure that the offerings available maximise social benefit while promoting efficiency.

### *Draft Recommendations 8.1 and 8.2*

AWA agrees with recommendation 8.1. That said, we do believe that there remains scope for limitation on the way in which water can be used in some circumstances. For example, it makes little sense for automatic sprinklers to be set to operate in the afternoon heat. The hours of operation of these devices should be restricted to night time hours as this will result in less water being used to irrigate gardens with no loss of amenity. There may be other examples, such as low water use toilets that provide the same level of service at no extra cost than the appliances that have now been banned. In short, where the total cost of a water restriction is clearly less than the loss associated with the measure, including externalities, consideration should be given to its implementation as a permanent measure, notwithstanding the restrictions on consumer choice that this implies.

With regard to the arguments behind recommendation 8.2, AWA would stress that any realignment of government messages from an ‘every drop counts’-style campaign to one which merely seeks to improve the information available to consumers needs to be handled with subtlety. It would be

unfortunate if this realignment were broadly interpreted as meaning that water conservation is not important (that is, that using water sensibly is not rational behaviour).

### *Draft Recommendation 9.1*

AWA sees no grounds for objecting to this recommendation. We would look forward to making a submission to any future COAG inquiry on this topic.

### *Draft Recommendation 9.2*

In principle, AWA would support this recommendation. We have no objection to the first point included here, but have some concerns about the second. An industry code that defines service standards may be problematic in two ways. The first is that the costs of particular levels of service may be significant for some jurisdictions and without careful analysis of consumers' willingness to pay the cost benefit to consumers is unknown. There has been a tendency over time for regulators to increase service standards once a particular level of service has been achieved on the grounds that this will produce better outcomes for consumers. However, such 'ratcheting up' should not occur without rigorous analysis. Furthermore, provision needs also to be made for local variation. It may, for example, be inappropriate to set a common standard for service interruption as local conditions may affect the frequency of asset failure. Similarly, it may be inappropriate to require, say, Tasmanian authorities or authorities in regional areas to achieve the same standard on a particular criterion as those in, say, Victoria given the under-investment in infrastructure that has occurred historically in Tasmania and regional areas of NSW and Queensland and which is only now being addressed.

Examples of changing standards that may affect costs and call into question customer's willingness to pay for them are listed below. Note that it is not AWA's assertion that these standards are not necessary for other reasons – for example to protect a sensitive environment – but it is our view that willingness to pay should be part of the analysis that accompanies increases in service standards.

Our examples include:

- The movement of dam safety standards which, in rural areas, have required (or may still require) significant capital investment to bring some structures up to standards for which they were not originally designed
- Standards related to the allowable frequency of sewer overflows.
- Standards related to the allowable frequency of water service interruptions.

With regard to the last point, CSIRO produced for WSAA in 2002, a report, *Setting and Evaluation of Customer Service Standards* which included development of a methodology for identifying consumers' willingness to pay for improved services. This report, project managed by Andrew Speers, now AWA's National Manager, Policy, included the following statement which gives some insight into the derivation of some standards:

*"Any asset management strategy must be directed to some type of goal. Higher standards will accelerate replacement of assets, and lower standards will defer them. In Australia regulators set goals for performance of assets as an aspect of preventing the abuse of monopoly power. Often*



*mandatory standards are included in Operating Licences or similar instruments specifying performance. Thus, for example, Melbourne retail water companies are regulated on the number of interruptions. Other jurisdictions may regulate duration of interruptions or cumulative duration of interruptions. Asset management strategies are directed toward achieving these goals at the lowest possible cost through use of techniques such as clamping, replacement, pressure management and reduction in 'shut-off block size' (i.e. reduction in the number of properties between valves).*

*The derivation of these standards is, however, often historically based. That is, upon the introduction of regulation the standards adopted were those particular water companies were attempting to achieve to meet their perception of what constituted quality service. These were based on the water authorities' knowledge of the level and type of complaints it received from customers at the time. In any case, standards are inconsistent even within the same jurisdiction and may not accurately reflect current customer requirements."*

### *Draft Recommendation 11.2*

AWA sees advantages in this approach. As indicated in the opening paragraphs to this submission, AWA is concerned about the potential for political interference in the operation and regulation of water utilities, to the detriment of the majority of consumers and to the utility in question. A transparent Charter, incorporating best practice governance arrangements and governments' requirements for the performance of utilities, may help to clarify the competing objectives faced by utilities.

### *Draft Finding 11.2 and Information Request*

AWA believes it will be to individual utilities or regulators to comment on the extent to which Ministerial directions are given informally or interfere with decision-making.

With respect to the idea that utilities be constituted under the Corporations Act 2001 (Cwlth), AWA's view is that, in as much as the spirit of the 1994 COAG Water Reforms and the NWI work toward utilities being placed on an equal footing with the private sector, and in as much as competitive neutrality is desirable, the recommendation could be supported in principle. In practice, however, there is unlikely to be significant benefit gained as state government owners of utilities can, and do, introduce elements in relevant legislation obliging directors to have regard to certain public policy requirements, including the directions of a Minister. It is AWA's view that in general, it is likely to be just as effective, if not more so, to have utilities constituted under well-designed and transparent state statutes, than constituting these agencies under the *Corporations Act (Cwlth) 2001*.

### *Draft Recommendation 11.3*

AWA supports this recommendation. We have some concern, however, that the proposal that "governments [set] overall water ...reliability objectives and requirements for wastewater, stormwater and flood mitigation" is unclear in its intent. We hold this view for the following reasons:

- It is not clear what the term 'reliability' covers with respect to wastewater and stormwater, and possibly flood mitigation. In many circumstances it may be to the environmental or health regulators or the relevant urban planning authority to set these objectives based on

sound science. For example, while governments may set overarching goals, it would be to a regulator to impose conditions – which may broadly be considered measures of the ‘reliability’ of a system – that specify, say, the quality and volume of wastewater that might be discharged over a defined period to meet government requirements.

- It is not clear how consumer willingness to pay for the standards set will be determined. In saying this we are mindful of the Commission’s view that there should be a greater role for a consumer advocate. We are not convinced, however, that such an advocate would ever be a surrogate for rigorous cost benefit analysis of standards or consumers’ willingness to pay to achieve them (see comment on draft Recommendation 9.2, above).

#### *Draft Recommendation 11.4*

In principle, AWA does not oppose the intent of this recommendation. However, we believe that while it is not likely that utilities will abuse their monopoly positions, the existence of an economic regulator in many jurisdictions has imposed useful discipline with regard to rationalisation of capital programs, improved asset maintenance, greater customer responsiveness and other factors. As one senior AWA member put it “the requirement to review these factors annually has introduced a rigour that had not been present, but which has been highly valuable”.

Having been subject to economic regulation for a number of years, it may be that the more mature utilities will, because it is good business, continue to focus on these factors. However those that have only recently been subject to such discipline or which are not currently subject to it may benefit from its continuation or creation in a manner that is stricter than the ‘light handed’ approach suggested by the Commission.

Finally, we note that yardstick comparison has been a useful way of encouraging improved performance, regardless of the regulatory environment. Victorian has been successful in this regard and there may be opportunities to extend yardstick comparisons either by using them more extensively, or by refining them. With regard to the latter, there may be benefit in setting some target performance KPIs based on the good work of other comparable utilities. Thus, if ‘best practice’ is, say, a meter reading cost of \$25/property, other comparable utilities should be required or encouraged to reduce their costs to the same level. (We do, however, urge caution with respect to any attempt to introduce yardstick comparisons across disparate utilities as comparisons may not be able to be meaningfully made. In this respect, please also see our comments at 13.6)

#### *Draft Finding 11.4 and Information Request*

AWA member utilities engage regularly with customers through a variety of means and the idea of convening a customer representative body is not opposed. However, we do not believe that a national representative body would be desirable, given that there are numerous utilities in Australia each providing water services in various ways under unique circumstances. Unless the responsibilities of a national customer representative body were very broad and shallow – which would cause one to wonder whether it is worth the effort – such a national body is unlikely to produce recommendations that are representative of customers within any particular utility’s area of operations. If this approach were to be adopted it would be best done at a utility level.

### *Draft Recommendation 11.5 and Information Request*

AWA supports this recommendation. With regard to the information request, the Australian Competition Tribunal may be an appropriate body for appeals, but this might depend on the outcome of the review of the National Access Regime. There may be merit in the appeals body being state based rather than federal, given that the way in which water systems are operated reflects local conditions.

### *Draft Recommendation 11.6 and Information Request*

AWA supports this recommendation.

A key challenge facing the water sector is the need to balance health and environmental protection with water efficiency and supply considerations. There is a growing view that some health and environmental regulators have too much influence over water management and the consideration of water supply options. In Victoria at present, opportunities for recycling of treated wastewater are being frustrated by prescriptive requirements of the health agencies which appear to be imposed without due regard to the multiple barriers being imposed to manage risk and the water management and efficiency goals which are sought to be met.

This circumstance may obtain in other jurisdictions, or may emerge if other states follow Victoria's lead. AWA believes there are ground for determination of national principles regarding the use of recycled water and these should make reference to the health and environmental standards that should apply and the management controls that should be in place (e.g. multiple barriers) to minimise public health and environmental risk

With regard to the request for information concerning existing regulatory inconsistencies, AWA would cite the case of the regulation of biosolids. The AWA supports the Australian and New Zealand Biosolids Partnership (ANZBP), a collective of biosolids producers (utilities), researchers, consultants and processors. Recently, the ANZBP members conducted a review of the biosolids guidelines that apply in the various states and territories and federally in Australia, and also in New Zealand. This review included a series of recommendations for rationalisation of these regulations and guidelines to reduce inconsistency. As might be evidenced by recent controversy in the tabloid press, use of biosolids, while safe, may be contentious. Inconsistencies between jurisdictions do nothing to engender community confidence in the approaches that are taken. Further, over-regulation and inconsistency increases the cost of biosolids management unnecessarily.

There is justification for rationalisation of biosolids guidelines and regulations as the regulatory burden and risks associated with such inconsistencies are not insignificant. By way of example, the table below shows the varying nomenclature that applies to contaminant grades among the various Australian jurisdictions and the allowable contaminant levels that apply to the topmost grades.

**Table 1 – Biosolids Contaminant Grade Comparison**

Australia National	NSW	Vic	SA	Qld	Tas	WA	NZ	EU	USA
C1	A	C1	A	A	A	C1	a		
	B		B	B					
C2	C	C2	C	C	B	C2	b	1	A
	D			D				2	B
	E	C3		E	C	C3			

**Table 2 – Biosolids Contaminant Level Comparison Grade C1/A**

Contaminant	NSW, Qld, ACT	National	SA	Tas	Vic	WA	NZ 'a' (after 31/12/12)
	mg/kg	mg/kg	mg/kg	mg/kg	mg/kg	mg/kg	mg/kg
Cadmium	3	1	1	3	1	1	1
Chromium	100	100-400	1 (Cr V1)	100	400	100	600
Copper	100	100-200	100	100	100	100	100
Lead	150	150-300	-	150	300	150	300
Zinc	200	200-250	200	200	200	200	300

### *Draft Recommendation 11.7 and 11.8*

AWA is very strongly in support of these recommendations. The bans and restrictions in place are highly counter-productive and inefficient, preventing water from being used for its highest and best purposes.

### *Draft finding 12.2 and Information Request*

In the introduction to this submission and its previous submission, AWA stressed strongly that the objective of delivering safe high quality drinking water should remain paramount. We accept that there are a variety of structural options available that would not inhibit achievement of this objective, but we are concerned that some options may be counter-productive in this regard.

AWA's view is that while there is little justification for considering water service delivery as unique and not amenable to further efficiency improvement. However, we do believe that certain characteristics of water services militate against certain structural options. We hold this view because:

- The *quality* of water matters. Electricity is electricity, communications are communications. Water varies in quality, taste, clarity and other characteristics depending on the source used, *and consumers can tell the difference in the finished product and when their source of supply changes*. Sydney Water has, for example, invested considerable effort in getting the taste of desalinated water to match that of dam water so as not to upset consumers. It cannot be assumed that all bulkwaters will produce similar levels of customer satisfaction.
- Water is heavy and difficult and costly to move around. At times, this militates against using some water sources or transporting wastewater to particular service providers. It could be said that these costs will be expressed in the market place if there is a vertically disaggregated industry. However, there may be externalities (e.g. social dislocation,

environmental impacts) that arise from the transport of water and wastewater that are not so expressed. Furthermore, these circumstances may significantly limit the opportunity for private providers to enter the market.

- Accountability is vital. Water quality at the consumer's tap depends on a series of processes being established to minimise risks and to maximise quality at numerous points in the supply chain (raw water source, transport, treatment, reticulation and with regard to maintenance at each of these points). A vertically disaggregated industry will need to maintain very effective interfaces at each point (between the bulkwater supplier, the transporter/strategic grid manager, and the retailer distributor) to ensure that quality is maintained. These interfaces relate not just to the financial transactions and contracts that might exist with regard to the procurement of services but to a range of information flows and exchanges, not all of which can be contractually described. AWA is concerned that whichever models emerge, the potential for interface 'friction' is recognised and that the risks of accountability loss are minimised. A large majority of water sector leaders interviewed for stage II of the AWA/Deloitte *State of the Water Sector Survey* were concerned about the potential for a highly disaggregated model to produce sub-optimal outcomes for these reasons.
- New sources of water and new wastewater services are capital intensive. It is not clear that the emergence of a more competitive market for bulkwater and wastewater services would provide sufficient incentives for the private sector to enter this market given the risks involved. Certainly one industry leader interviewed for the AWA/Deloitte *State of the Water Sector Survey* doubted that the private sector would be willing to so invest because the capital required and risk was too great. That person argued that he would rather bid for the right to operate a facility than to build it and accept the full project risk.
- There is a risk that structural reform will directed to the major utilities and urban areas and that regional and remote areas may be 'left behind'. Arguments are included in the Commission's report in support of disaggregation of the large utilities that exist in WA, SA and NT. It is AWA's view that in some regional and remote areas of Australia, circumstances militate against disaggregation as it is unlikely that contestable models would be successful in these areas. While a provider of last resort could be established, it may face significant difficulty in attracting skilled staff and resources given it will likely be dependent on government subsidies.

### *Draft Finding 13.1*

AWA is strongly of the view that wherever possible, utilities should seek to recover costs. However, where the capacity of consumers to pay the full cost of current services and maintenance (of which there may be a significant backlog due to past under-investment) is limited, explicit and transparent subsidies may need to be paid to ensure that consumers are provided with the services they need.

AWA is also strongly of the view that price caps and similar policies have the potential to prevent full cost recovery and to distort investments.

### *Draft Recommendation 13.1 and Information Request*

Ideally, council owned utilities should be established as GTEs. This is the reform that is most likely to contribute to improved governance and financial management. However, in structuring such utilities care will need to be undertaken to ensure that other services carried out by councils, such as road maintenance and the like are not undermined by the loss of capital, staff and expertise to a new GTE. Furthermore, it should not be assumed that the boundary of a new or amalgamated GTE has to conform to existing council boundaries; there may be benefit in different boundaries as councils limits are not based on a catchment areas.

### *Draft Recommendation 13.3*

AWA agrees with this recommendation.

### *Draft Recommendation 13.5*

AWA does not agree with this recommendation. The Australian Drinking Water Guidelines (ADWG) are not intended as standards. While some water quality specifications are included, many aspects of the ADWG relate to processes and actions required when exceptions occur, rather than parameters that must be adhered to in achieving a particular water quality goal. It may be possible to mandate water quality standards, although this is not necessarily desirable, but adoption of the ADWG as a standard is not appropriate.

AWA notes with significant concern part of Draft Recommendation 13.5 which reads “...directors or other accountable persons such as councillors should be personally liable for the risks associated with non-compliance” and we strongly oppose this recommendation. Directors are appointed by state governments on fees which generally reflect a community service role. State water acts do not all provide indemnity for acts done in good faith, and in some jurisdictions have been amended to remove previous indemnities. If personal liability is introduced without adequate Directors and Officers cover (which may not cover a breach of the Australian Drinking Water Guidelines) suitably experienced persons will not want to take on the important roles as directors of water authorities. In practice directors have only an indirect influence over the day to day operations at the water treatment plant level.

AWA view is that there are other ways to encourage improved performance with respect to water quality. In our response to Draft Recommendation 3.1, we noted that Section 90 of the National Water Initiative states that the objective of urban water reform should be to “provide healthy, safe and reliable water supplies”. The intent of that objective is clear, but it could be made more specific. AWA would suggest that these three terms be better defined such that they are quantifiable and reportable. Consideration could then be given to the best means by which utilities might be obliged to report performance. Encouraging transparency rather than enforcing compliance will be a more effective way of raising water quality standards, particularly for those utilities with a legacy of under-investment and which are only now in a position to work towards higher drinking water quality standards (e.g. the new Tasmanian utilities )

### *Draft Recommendation 13.6*

AWA does not disagree with the notion that the Governments of South Australia and Western Australia and the Northern Territory should examine the case for reform, but in addition to the comments we have made at 12.2 (regarding the servicing of rural and remote communities) we would argue that geographic scale is not necessarily the key determinant of the best size for water utilities. Rather, we think it more likely that diseconomies of scale will emerge above a certain number of connection, rather than the area covered by the utility. One could, perhaps, make a stronger case for disaggregation of Sydney Water than the Water Corporation.

AWA also notes that yardstick competition work less well if the utilities to be compared operate in significantly different operating environments (e.g. geographically; demographically, commercially/industrially; with respect to relative social advantage of their customers; and so on). Thus, comparison of the performance of entities formally part of SA Water, the Water Corporation or NT Power and Water, is not necessarily valid.

### *Draft recommendations 14.1 to 14.4*

AWA generally agrees with each of these recommendations. In particular we agree that recommendation 14.3 is appropriate.