

Hunter Water Operating Licence Review Contextual Information – Information Paper 1

25 February 2022

We are conducting this Review to assess whether the 2017-2022 Hunter Water operating licence, Reporting Manual and Customer Contract meets their objectives. This supporting document provides contextual information for the Review, specifically on the following matters:

1. Who is Hunter Water?
2. Why does Hunter Water need a Licence?
3. Why are we reviewing the Licence?
4. What have we considered in the Review?
5. How have we conducted the Review?
6. Who does this Review affect?

1 Who is Hunter Water?

Hunter Water is a State Owned Corporation (SOC), wholly owned by the NSW Government and governed by an independent Board of Directors. It operates under the *Hunter Water Act 1991* (the Act) and the *State Owned Corporations Act 1989*.

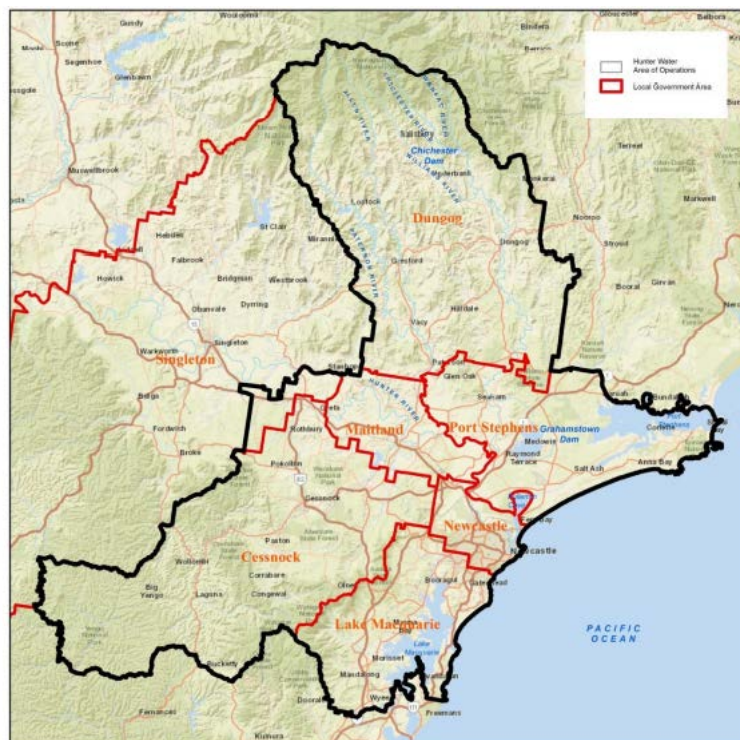
Hunter Water provides drinking water, wastewater, recycled water and some stormwater services to a population approaching 600,000 people in homes and businesses across the lower Hunter. As a vertically integrated water utility – an operator and a retailer – Hunter Water manages the water and wastewater systems from catchment to tap to provide safe, reliable and efficient services.

Hunter Water provides services to the geographic area defined by the boundaries of 6 local government areas:

- Cessnock City Council
- Dungog Shire Council
- Maitland City Council
- Lake Macquarie City Council
- Newcastle City Council
- Port Stephens Council.

Hunter Water also provides services to part of Singleton Shire Council's local government area, supplies bulk water to small parts of the Great Lakes area, and can sell up to 35ML per day to the Central Coast.ⁱ

Figure 1 Map of Hunter Water's area of operations



Source: Schedule A of the 2017-22 Hunter Water Operating Licence

2 Why does Hunter Water need a Licence?

Supply of water is an essential service that is regulated in most developed countries. Water supply businesses are commonly government-owned, public utilities and are usually monopoly suppliers within geographic regions. Several large utilities in NSW, including Hunter Water, were corporatised during the early 1990s as part of wider microeconomic reform of the NSW public sector.

The Licence was originally established in 1992 to ensure Hunter Water, as a new corporation, would not exploit its natural monopoly position. The existing Licence is the 6th licence held by Hunter Water since it was established as a SOC in 1991.

The Licence enables and requires Hunter Water to provide, construct, operate, manage and maintain systems and services for:

- supplying water
- providing sewerage and drainage services
- disposing of wastewater

in a defined area of operations in the Hunter region.

The Licence is an enforceable instrument and is subject to a compliance monitoring regime with penalties for contravention. The Licence has already been subject to a number of public reviews, conducted by IPART. We last reviewed the Licence in 2017. The current operating licence commenced on 1 July 2017 and the Licence term will end on 30 June 2022. We are responsible for administering the operating licence including the functions of monitoring, auditing and reporting to the Minister on compliance.


Hunter Water's Licence is supported by a Customer Contract, the terms and conditions for which are set out in the Licence, and a Reporting Manual. The Reporting Manual was established so that reporting requirements associated with the Licence could be more easily updated.

<p>The Licence contains terms and conditions to regulate how Hunter Water undertakes its functions in its area of operations</p>	<p>The Licence also contains a Customer Contract which sets the terms and conditions for how Hunter Water provides services to its customers</p>	<p>We issue a Reporting Manual to support the Licence which includes details and deadlines for Hunter Water's reporting requirements</p>
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3 Why are we reviewing the Licence?

The current operating licence term will end on 30 June 2022 and contemplates an end-of-term review prior to expiry. We are conducting this Review to assess whether the current operating licence is fulfilling its objectives. As part of the Review, we investigate issues that have arisen during the Licence term. In the draft Licence, we have recommended amendments to the Licence to address the issues we have identified. We have considered the findings of our concurrent review of *How we regulate the water businesses* to inform our recommendations. This end-of-term review will help ensure the Licence remains current and reflects changes in public expectations, best practice and Hunter Water's circumstances.

If the Minister accepts our recommendations, the Minister will endorse the new Licence for approval by the Governor of NSW.



The current operating licence term will end on 30 June 2022

To continue undertaking its functions, Hunter Water must have a new Licence, or the current operating licence term must be renewed by 1 July 2022.

4 What have we considered in the Review?

We have considered Hunter Water's regulatory framework, including the Act and other applicable regulatory instruments. We have also had regard to Hunter Water's objectives, issues that have arisen during the current operating licence term, and other public water utility operating licences.

The findings of our review of *How we regulate the water businesses* has informed our recommendations. This review will help us to identify the most efficient way the Licence can achieve its outcomes, maximising the benefit for customers and minimising the costs.

4.1 Licence requirements from the Act

The Act specifies terms and conditions that the Licence **must** include, and others that the Licence **may** include.

As the current operating licence is a mature licence,^a it already includes terms and conditions addressing the requirements of the Act, as shown in **Table 1** and **Table 2** below.

Table 1 Terms and conditions that the Act states the Licence must include and corresponding terms and conditions in the existing Licence

Terms and conditions that the Act states must be included in the Licence	Relevant section of the Act	Terms and conditions in the current operating licence or customer contract that meet the requirement of the Act
The Licence must require Hunter Water to provide, construct, operate, manage and maintain efficient, co-ordinated and commercially viable systems and services for supplying water, providing sewerage services and disposing of wastewater.	13(1)(a)	Licence clause 12 – Licence authorisation Licence clause 15 – Obligation to make services available
The Licence must require Hunter Water to provide, operate, manage and maintain a drainage service within a specified capacity.	13(1)(b)	Licence clause 12 – Licence authorisation
The Licence specifies quality and performance standards for water quality, service interruptions, price levels and any other relevant matters.	13(1)(c)	Licence clause 18 – Pricing Part 3 of the Licence – Supply services and performance standards (including performance standards for drinking water quality, recycled water quality, water pressure standard, water continuity standard and dry weather wastewater overflow standard)
The Licence must require Hunter Water to maintain procedures to consult with its customers at regular intervals about the provision of systems and services referred to in section 13 of the Act.	13(2)	Licence clause 5.4 – Customer advisory group
The Licence must set out the terms and conditions of a customer contract.	35(1)	Licence clause 5.1 – Customer Contract Schedule B – Customer Contract

^a The 2017–22 Operating Licence is the 6th licence Hunter Water has held since it was established in 1991.

Terms and conditions that the Act states must be included in the Licence	Relevant section of the Act	Terms and conditions in the current operating licence or customer contract that meet the requirement of the Act
A customer contract must specify the contract charges, or how Hunter Water determines the contract charges, for the provision of water or sewerage services.	35(3)	Schedule B – Customer Contract, clause 9 – What You Pay

Table 2 Terms and conditions that the Act states the Licence may include and corresponding terms and conditions in the existing Licence

Terms and conditions that the Act states may be included in the Licence	Relevant section of the Act	Terms and conditions in the existing Licence or customer contract that meet the requirement of the Act
The Licence specifies how the Licence may be amended.	14	Licence clause 1.4 – Licence amendment
The Licence specifies the area of operations for Hunter Water.	16	Licence clause 7.1 – Definitions Schedule A – Area of Operations
The Licence may confer functions on the IPART in connection with operational audits.	18B	Licence clause 6.1 – Operational audits
The Licence may include terms and conditions for determining the cost of carrying out the operational audits (without limitation).	18D(2)	<i>No terms and conditions in the current operating licence</i>
The Licence may specify how Hunter Water is to, following variation of a customer contract, make available to the public copies of the contract and associated explanatory material.	38(5)	Licence clause 1.7 – Making copies of this Licence available Schedule B – Customer Contract, clause 2.6 – Variation of this Customer Contract?
The Licence may specify the basis for fixing contract charges, availability charges, environmental levies and rates.	39(1)	Licence clause 1.8 - Pricing
The Licence may require Hunter Water to impose an availability charge on the owner of land that is not connected to a water main or sewer main but to which a main is available for connection.	43(1)	<i>No terms and conditions in the current operating licence</i>
The Licence may require Hunter Water to impose an environmental levy on owners of land that is not connected to a water main or sewer main (whether or not a connection is available) but to which Hunter Water proposes to make a sewer main available.	45(1)	<i>No terms and conditions in the current operating licence</i>
The Licence may require Hunter Water to make and levy rates on the owners of land within a drainage area in the area of operations.	46	<i>No terms and conditions in the current operating licence</i>

4.2 Requirements under other legislation

The Licence is not the only regulatory instrument that applies to Hunter Water. We have considered other regulatory requirements imposed on Hunter Water to avoid duplicating requirements and imposing an unnecessary regulatory burden on Hunter Water.

Because of the essential nature of the services that Hunter Water provides, and their potential health and environmental impacts, Hunter Water is subject to regulatory oversight by other departments and agencies, including NSW Health, EPA, DPE and OEH.

We work closely with the other government departments and agencies and have liaised with them during the Review.

4.3 Hunter Water's objectives

As part of the Review, we have considered if Hunter Water is meeting its objectives and how the Licence can help Hunter Water achieve them.

The Actⁱⁱ and the *State Owned Corporations Act 1989*ⁱⁱⁱ prescribe Hunter Water's principal functions and objectives. Hunter Water has its own corporate objectives as well.^{iv}

5 How have we conducted the Review?

5.1 Our application of the Best Practice Licensing Framework

We have generally applied the Best Practice Licensing Framework^v to consider changes to the terms and conditions in the current operating licence. The framework provides guidance in determining whether introducing an obligation in Hunter Water's Licence is the best response to address a problem or risk. We have considered stakeholder's views when developing our draft recommendations.

In some instances, we deviated from the framework because we consider stakeholders' views are reasonable to adopt in the context of the regulatory environment. In such cases we have provided explanation in the relevant sections of this draft report.

In general, we found that the current operating licence is well designed and working effectively and have largely recommended changes for further clarity and ease of administration. We have proposed changes to the current operating licence conditions for water conservation and water planning to reflect NSW Government policy and the Lower Hunter Water Security Plan. We have also recommended some changes to the Licence conditions protecting customers' rights (such as recommending a new requirement for a family violence policy) to ensure that customers are being effectively protected and to ensure that customers are aware of their rights and protections when dealing with Hunter Water. Finally, we have recommended minor changes to the current quality and system performance standards for clarity.

Box 1 The Best Practice Licensing Framework consists of the following 4 stages:

1. Consider whether licensing is appropriate.
2. Consider whether the Licence is well designed.
3. Assess whether the Licence can be administered effectively and efficiently.

4. Confirm that licensing is the best response when comparing its costs and benefits against other options.

Stage 1 – Consider whether licensing is appropriate

Licensing Hunter Water's operations is appropriate because:

- The policy rationale and objectives justify ongoing intervention in Hunter Water's operations.
- Current legislation does not adequately address the policy objectives in the absence of a licence, there would be gaps in the scope and enforcement of existing legislation.
- Licensing provides policy and administrative functions that are required to meet the objectives of the Hunter Water Act

We applied Stage 1 to both the current and potential terms and conditions using a pragmatic approach. When assessing whether to recommend retaining a current operating licence condition, or include a new Licence condition, we considered whether it was necessary and appropriate to address the specific problem or risk. One of the key questions we considered is whether the same outcome would be achieved in the absence of a licence condition.

Stage 2 – Consider whether the Licence is well-designed

In applying Stage 2, we considered whether the existing or potential licence conditions meet the principles of a well-designed Licence, including whether it:

- is outcomes-focused rather than prescriptive
- is proportionate to the problem or risk being addressed
- does not duplicate other existing regulatory requirements
- requires only the minimum necessary reporting.

In doing this, we considered information from:

- your feedback to the Issues Paper and our preliminary views for the Licence, Reporting Manual and Customer Contract
- discussions with Hunter Water and other government agencies including DPE.
- previous operational audits of Hunter Water, including its compliance with its existing Licence conditions
- other recent Public Water Utility operating licence reviews, including our 2019 review of the Sydney Water Operating Licence
- relevant examples of current good or best practice in the regulation and operation of utilities in Australia and other countries.

Stage 3 – Assess whether the Licence can be administered effectively and efficiently

We applied Stage 3 and considered whether we could effectively monitor compliance against an existing or proposed new Licence condition using a risk-based approach.^{vi}

In general, when we apply a risk-based approach, we audit those licence clauses that are high risk and have a low level of compliance more frequently than licence clauses that are low risk but have a high level of compliance. We also rely on Hunter Water's annual statement of compliance to determine whether we undertake an audit of some of the clauses.

Where a management system has been certified by a third party, we generally accept certification reports from specialist auditors rather than including a comprehensive audit of the management system in our audit scope. This allows us to minimise duplication and the burden on Hunter Water.^{vii}

Where the Licence requires Hunter Water to cooperate with certain government agencies, we monitor compliance through direct annual contact with these agencies and seek feedback on Hunter Water's performance.

We implement continuous improvement based on our internal reviews and by seeking feedback from Hunter Water and our independent auditors at the end of each audit. We also have our [Audit Guideline – Public Water Utilities](#) which sets out our expectations regarding the conduct of operational audits, and we update it periodically.

Stage 4 – Confirm that licensing is the best response when comparing its costs and benefits against other options

While some objectives could potentially be delivered through amendments to a range of legislation, our assessment supports continued licensing of Hunter Water as the most efficient option to administer and ensure compliance and enforcement.

Stage 4 involved conducting cost-benefit analysis to confirm that licensing is the best response. Where we found, in the previous stages, that a licence obligation was necessary and appropriate to address a problem or risk, we analysed different options to address that problem or risk.

Where a condition must be included in the Licence due to a legislative requirement, we consider that licensing is the best approach (but considered the best design). We considered different options to address a problem or risk once we established that licensing was appropriate. In generating options, we considered a range of realistic and feasible options and analysed each option to determine a short-list.

We used the cost-benefit analysis to support our final recommendations for each Licence condition. We considered the most appropriate approach to conducting the cost-benefit analysis in the context of each Licence condition. Where sufficient benefit data has not been available, we have made the evaluation using a qualitative discussion of benefit criteria.

6 Who does this Review affect?

As this Review may result in amendments to the current operating licence, it may directly affect the operation of Hunter Water. The following stakeholders would also be affected by this Review because they have direct relationships with Hunter Water under the Licence:

- all customers and consumers of Hunter Water's water, sewerage, stormwater and recycled water services, particularly where there are amendments to Hunter Water's customer contract
- some licensees under the *Water Industry Competition Act 2006*
- Central Coast Council with regard to the Hunter/Central Coast Pipeline Agreement, and
- NSW Government agencies that Hunter Water has cooperative relationships with (NSW Health, Fire and Rescue NSW and DPE).

ⁱ Hunter Water, *Growth Plan, Funding and delivery of growth infrastructure*, version 3, March 2021. Available at: <https://www.hunterwater.com.au/documents/assets/src/uploads/documents/Building-and-development2/growth-maps/Growth-Plan.pdf>

ⁱⁱ *Hunter Water Act 1991*, sections 4A and 12.

ⁱⁱⁱ *State Owned Corporations Act 1989*, section 20E.

^{iv} Hunter Water, *Towards 2024: To be a valued partner in delivering the aspirations for our region*, page 5, available at https://issuu.com/hunterwater/docs/towards2024_business_plan?fr=sMDMzOTE0MjE3MTM.

^v IPART, *A best practice approach to designing and reviewing licensing schemes*, prepared by PricewaterhouseCoopers, March 2013.

^{vi} Our approach to compliance is detailed in our *Compliance and Enforcement Policy*, December 2017.

^{vii} IPART, *Audit Guideline – Public Water Utilities*, July 2019.