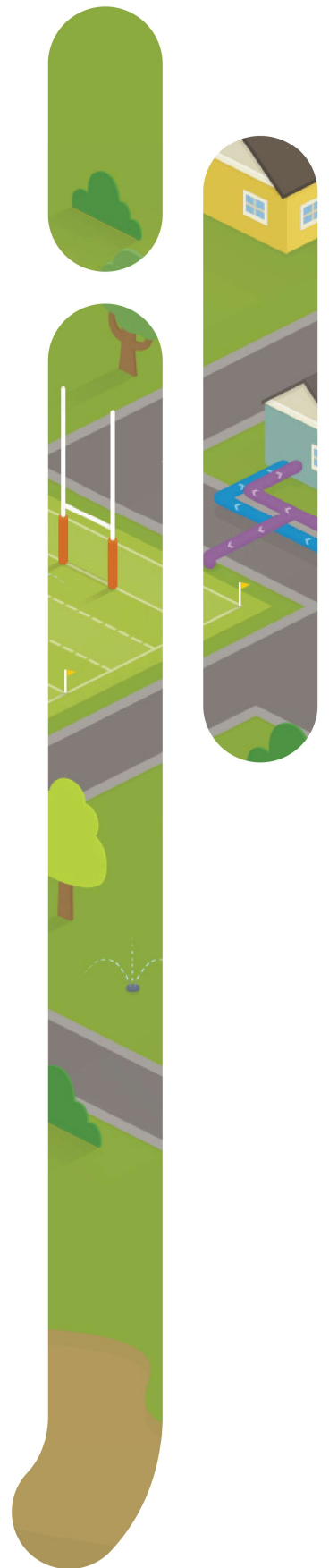




# *2019 Review of the Sydney Water Operating Licence – Draft Licence*

*Flow submission to  
IPART*

12 February 2019



# 1. Introduction

Flow is pleased to make a further submission to the Independent Pricing and Regulatory Tribunal (**IPART**) regarding its proposed draft Operating Licence for Sydney Water Corporation.

This submission follows the release of the draft Sydney Water Operating Licence 2019-2023 (**Draft Licence**) and accompanying Review of the Sydney Water Corporation Operating Licence 2015-2020 Draft Report (**Draft Report**) by IPART in December 2018.

Flow has previously commented on the IPART discussion paper for this review by way of its submission in August 2018. Flow also attended the Public Workshop held by IPART for this review on 5 February 2019 and made several oral submissions. Flow's position remains as set out in those earlier written and oral submissions.

The purpose of this document is to provide Flow's submissions regarding the Draft Licence and Draft Report and to respond to some of the matters discussed at the Public Workshop.

# 2. Executive Summary

At the Public Workshop, there was consensus that change at the policy level is needed to ensure that the benefits of competition can be enjoyed by communities within the Sydney Water area of operations. Flow submits that this policy change must include the introduction of an independent market operator to identify and allocate development opportunities in the Sydney area.

Flow continues to submit that retail-minus pricing for wholesale water and wastewater services is fundamentally anti-competitive and introduces an unnecessary barrier to entry into the water sector. However, Flow recognises IPART's efforts in mitigating some of the adverse impacts of retail-minus pricing by way of the new clause 8 in the Draft Licence. Flow would be extremely concerned if IPART were to 'water down' or step back from its draft in that regard.

Regarding the terms of the Sydney Water operating licence itself, Flow is concerned that:

1. The terms of the operating licence give effect to the policy rationale of the *Water Industry Competition Act 2006* (NSW) (**WIC Act**)
2. That holders of licences issued under the WIC Act (**WIC Act Licensees**) are not barred from entry into the residential water market
3. The duties of Sydney Water in respect of waterway health are clear and unequivocal.

These concerns relate to:

- (a) Sydney Water's universal service obligation in clause 2 of the draft licence, which should be modified to recognise that WIC Act Licensees might be servicing a Property;
- (b) that the economic level of water conservation be more transparent and identify the 'scarcity offset' that can be provided by integrated water management (**IWM**) schemes within the network;
- (c) that Sydney Water's storm water obligations should make it clear that Sydney Water must act to better protect waterway health;

- (d) that Sydney Water must provide services to WIC Act Licensees on request and must negotiate terms of those services in good faith, with a mandated escalation if terms cannot be agreed; and
- (e) that information should be provided to WIC Act Licensees generally in accordance with what is set out in the Draft Licence, but that it should be provided sooner and with an obligation to provide more detailed information on request and in a reasonable timeframe.

### 3. *Independent Market Operator*

During IPART's review of prices for wholesale water and sewerage services, there was industry consensus that a whole of system review be conducted to identify barriers to competition. While a review was conducted by iNSW in 2018, that review was ineffective, not least because the interim and final findings of the review were not shared for public consultation until well after the completion of the review (through the Department of Planning and Environment). Furthermore, the review did not adequately address the current structural limitations of water industry regulation in New South Wales.

What has become abundantly clear to Flow and others (including as evidenced by views shared at the Public Workshop) is that the Sydney Water Operating Licence contains several apparently contradictory duties and obligations on Sydney Water (such as an obligation to provide information to potential competitors, contrary to Sydney Water's principal commercial objectives to be a successful business and to operate at least as efficiently as any comparable businesses, and to maximise the net worth of the State's investment in the Corporation<sup>1</sup>). It is critical that Sydney Water be curtailed by its licence in this way while it enjoys a monopoly position and controls the planning process.

A workable alternative would be the establishment of an Independent Market Operator to broker the relationship between the planning system and development opportunities, Sydney Water and WIC Act Licensees. Flow made detailed submissions in this regard in its August 2018 submission and reiterates its call for the establishment of an independent body to identify and allocate development, water sourcing, treatment and demand management opportunities.

In respect of specific Draft Licence conditions, Flow accepts that the Sydney Water operating licence may not be the right instrument to give effect to the IMO. However, while Flow generally supports IPART's proposed requirement that Sydney Water cooperate with the implementation and review of the Metropolitan Water Plan, it also submits that this process of review, and the information sharing referred to in clause 3.2.4 of the Draft Licence should be able to be accessed by WIC Act Licensees and overseen by an IMO.

#### *Submission:*

*That an IMO is critical to the effective entry to market of WIC Act Licensees.*

*That the planning process in New South Wales needs to operate in a way that WIC Act Licensees are not effectively excluded by planning only to the Sydney Water capital works program (and vice versa).*

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<sup>1</sup> Section 21(1)(a) of the *Sydney Water Act 1994* (NSW). We note that Sydney Water's principal commercial objective is of equal importance to Sydney Water's other two principle objectives, ie to protect public health and the environment: see section 21(2) of the *Sydney Water Act 1994* (NSW).

## 4. Objectives of the Operating Licence

Flow agrees with the Institute for Sustainable Futures that Sydney Water should be required to provide services in a way that promotes competition. Flow accepts that including such an obligation does create a difficulty for Sydney Water in both striving to meet its commercial objectives and promote competition. However, in the absence of an Independent Market Operator, Sydney Water's dominant market position and monopoly in the provision of drinking water within its area of operations means that operating as a successful business is simply a fiction. Sydney Water must be given the mandate to act in a way that promotes competition. Otherwise, Sydney Water's "business as usual" will be an insurmountable barrier to a diverse water sector.

The New South Wales Parliament acknowledged more than 10 years ago that the involvement of the private sector and a competitive landscape is critical to water security, sustainability, resilience and growth. That acknowledgement was embodied in the WIC Act. IPART now has the opportunity to support the premise of that Act and must do so in the face of the current and impending water supply crisis in Sydney.

The new provisions that IPART has sensibly included in the Draft Licence in respect of Sydney Water's interactions with potential competitors must be supported by a clear objective that gives Sydney Water licence to implement those new provisions in a way that will overcome existing barriers to entry.

*Submission:*

*Clause 1.1.1(b)i. should read: "promotes competition".*

## 5. The Universal Service Obligation

Sydney Water has an obligation to ensure that drinking water and wastewater services are available on request for connection to any Property situated in the Area of Operations for which a connection is available<sup>2</sup>.

This "universal service" obligation has justified Sydney Water planning to service all infill and network extension growth in service demand. This could lead to inefficient duplication or oversizing of assets designed to service growth that could be or will be serviced or mitigated by WIC Act Licensees.

Flow submits that instead of having a universal service obligation, an operator of last resort scheme (as envisaged by the amendments to the WIC Act passed in 2014, but not yet in force) should be commenced now to provide consumer protection over the long term.

*Submission:*

*Clause 2.2.1 should read: "Sydney Water must ensure that Services for the supply of Drinking Water and disposal of Wastewater are available on request for connection to any Property situated in the Area of Operations for which a connection is available and for which a WIC Act Licensee does not have a licenced connection available."*

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<sup>2</sup> Clause 2.2.1 of the Draft Licence.

## 6. *The Value of Water Conservation*

As detailed in our submission of December 2016 in respect of IPART's review of wholesale water and sewerage services, IWM brings a significant benefit to the overall water supply system by reducing potable water demand in the serviced area and by reducing (and often eliminating altogether) wastewater flows into the Sydney Water system from the serviced area. Flow previously called this benefit a "water scarcity offset".

Flow understands Sydney Water's oral submissions at the Public Workshop that the current Economic Level of Water Conservation (**ELWC**) model is flexible enough to value the water scarcity offset generated by IWM schemes. Flow is somewhat agnostic (to a degree) regarding the methodology implemented by Sydney Water in this regard, but does submit that:

1. The inputs, calculations and outputs of the ELWC method must be clearer and more fully and publicly communicated;
2. The method and model chosen should be shared with IPART and WIC Act Licensees so that discussions regarding the value of the water scarcity offset generated by IWM schemes can be had in a transparent manner.

Regarding the terms of the draft licence, Flow is otherwise generally supportive of the terms proposed by IPART.

### *Submission:*

*Clause 3 of the Draft Licence should remain as proposed by IPART, except that further provisions be added in clause 3.1 such that:*

1. *The inputs, calculations and outputs of the ELWC method are clearer and more fully and publicly communicated;*
2. *The method and model chosen are shared with IPART and WIC Act Licensees so that discussions regarding the value of the water scarcity offset generated by IWM schemes can be had in a transparent manner.*

## 7. *Not harming the health of our waterways*

WIC Act Licensees are held to very strict requirements regarding the health of our waterways. Sydney Water is also regulated under its environment protection licences (the terms, and shortcomings, of which we accept are outside the scope of this review). However, where waterway health issues are dealt with in the Sydney Water Operating Licence, the terms of the licence should be clear that Sydney Water is required to conduct their activities so that they do not adversely impact the health of waterways. In many areas of Sydney, waterway health is currently adversely affected by Sydney Water's activities (primarily wet weather sewage overflows). Flow agrees that the specific measures should not be legislated by the Operating Licence, but that an outcome-based obligation (namely, improvement of the impact of Sydney Water's activities so as not to adversely impact waterway health) is appropriate and necessary.

*Submission:*

*In reference to Draft Recommendation 14 in the Draft Report, that the Draft Licence be amended such that there is a positive obligation on Sydney Water to adopt measures to ensure their activities and their provision of services does not adversely impact waterway health.*

## 8. Negotiation of terms of access

Flow welcomes IPART's initiative to expressly deal with the interaction between Sydney Water and its competitors. Such provisions are critical in circumstances where, by virtue of retail-minus pricing for its services to WIC Act Licensees, its historical position, its unique ability to determine planning outcomes and hence box seat when it comes to servicing the resulting growth (both urban infill and network extension) Sydney Water has an overwhelming competitive advantage over any new entrants.

Flow supports the introduction of an obligation for Sydney Water to negotiate in good faith with WIC Act Licensees and to provide services where requested.

However, we are concerned that the ability of Sydney Water to set unconstrained conditions of access could be detrimental to competition without the objectives of the licence expressly stating that Sydney Water should, in the provision of its services, promote competition. While the Draft Licence provides, as one objective, that Sydney Water should provide services in a way that 'does not prevent or hinder competition'<sup>3</sup>, it is necessary that the promotion of competition be included as an objective.

We welcome IPART's proposal regarding requiring Sydney Water to negotiate in good faith. Given that the phrase "good faith" is capable of a variety of interpretations, Flow supports IPART including within the Operating Licence a definition of good faith as set out in part 12.2.1 of the Draft Report.

Flow remains of the view (as expressed in our August 2018 submission on the Discussion Paper) that some form of compulsory dispute resolution mechanism should be available if Sydney Water and a WIC Act licensee are unable to agree satisfactory terms of service and access to wholesale services. We suggest that IPART could mediate or determine the outcome on application by either party to the issue. In the absence of a mandatory escalation pathway, Flow anticipates that Sydney Water could simply refuse to agree terms (even a good faith obligation in this regard gives little practical protection) for long enough to mean that the WIC Act licensee's window of opportunity to participate in the development the subject of the connection application could pass. This could constitute a serious barrier to entry.

Dispute resolution only by agreement is completely inadequate to protect WIC Act licensees, particularly in the absence of an express licence objective requiring Sydney Water to promote competition in the provision of its services.

Until the establishment of an IMO, Flow accepts that IPART may be the appropriate body to arbitrate or determine disputes between Sydney Water and WIC Act Licensees regarding non-price terms.

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<sup>3</sup> Clause 1.1.1(b)(i) of the Draft Licence.

*Submissions:*

*IPART should include a definition of “good faith” in the operating licence to reflect the definition set out in part 12.2.1 of the Draft Report.*

*Clause 8.1 of the Draft Licence should be augmented by a provision that mandates resolution of deadlocks around non-pricing terms of the provision of Services to WIC Act Licensees by way of a mandatory mediation and, failing resolution, by arbitration.*

## 9. Information provision

In IPART’s final report of its review of pricing for wholesale water and sewerage services, it said:

*“Our view is that stakeholder concern about information asymmetry between Sydney Water and Hunter Water and wholesale customers in relation to facilitation costs is best addressed through the process of a scheme-specific review. During such a review, if necessary, IPART would require further information from Sydney Water or Hunter Water and/or wholesale customers and seek to verify this information - eg, via engaging engineering consultants (similar to the approach to expenditure reviews in a retail price review). If the issue of information asymmetry emerges as a significant problem, this could inform consideration of implementing a remedy as part of future reviews of Hunter Water’s and Sydney Water’s operating licence conditions.”<sup>4</sup>*

Information asymmetry was also identified in the INSW review as being a critical barrier to competition in the water industry.

Flow support’s IPART’s views regarding the necessity, types and scope of information that should be provided by Sydney Water to competitors and prospective competitors. Without such information, WIC Act Licensees and potential WIC Act Licensees will not have the information available to them to determine if a commercial proposal to establish private infrastructure would even be viable in the face of retail-minus pricing for wholesale water and (in some cases) wastewater services.

Flow strongly urges IPART not to water down the information sharing provisions of the Draft Licence but would welcome a review of the effectiveness of those provisions at the time of the next review of the Operating Licence.

### 9.1 Types of information that should be provided

WIC Act Licensees and potential competitors to Sydney Water must have all the information they will need to model the likely facilitation costs (positive or negative) that would likely be applied by IPART in a scheme-specific determination of pricing for any wholesale water or sewerage services requested by the WIC Act Licensee or Potential Competitor.

Information will also be needed by potential competitors to ensure that planning and ideation of WIC Act licenced schemes is done an efficient manner and in a way that will bring the most benefit to the customers of both Sydney Water and the WIC Act scheme’s customers.

Flow accepts that it may take a few years to bed down exactly what information is needed and in what form but submits that at this point a broad requirement is justified pending a review of the

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<sup>4</sup> Prices for wholesale water and sewerage services final report, page 70



effectiveness and efficiency of that requirement at the end of the 2019-2023 operating licence period.

Flow supports the provision of a forecast of at least ten years of servicing information, as that timeframe matches well with development planning timeframes.

## 9.2 Scope of information provision

Flow supports IPART's Draft Report and Draft Licence regarding the scope of information that must be provided. In the Draft Licence, at clause 8.2.1, Sydney Water is required to provide information in respect of each "region, development of major system".

At the Public Workshop, Sydney Water indicated that they would, in their written submission on the Draft Licence, argue for a narrowing of the scope of information to "major system" only.

Flow believes that the current formulation adopted by IPART is appropriate, given that what is critical is to be able to identify sizeable areas of opportunity for competition. Removing "development" or "region" from the formulation may mean that the information provided by Sydney Water is not specific enough to allow for commercial planning.

One way to potentially navigate the uncertainty flagged by Sydney Water might be to better define region, development or major system and to include a right for a Potential Competitor to request information about a more specific zone, development or area, with an obligation on Sydney Water to provide the items listed in 8.2.1 for that specific zone, development or area within a reasonable time (say 20 Business Days or longer on approval by IPART after consultation with the Potential Competitor).

Potential competitors should also have a right to ask for any updates to published information and to have those requests responded to in a timely manner.

## 9.3 Time at which the obligation should commence

Flow and other potential competitors have been subject to retail-minus wholesale pricing since 1 January 2018. WIC Act Licensees currently have almost no way of even estimating what wholesale price would apply to their schemes, should they request a connection to Sydney Water's water or sewerage services. This is an almost insurmountable barrier to entry (as previously submitted on numerous occasions by Flow in its submissions on IPART's review of pricing for wholesale water and wastewater services) and must not be allowed to continue.

Sydney Water should be required to provide the information outlined in clause 8.2.1 by no later than 30 June 2019. In that regard, Flow expects that most of the information will be readily available (noting that Sydney Water outlined how it makes daily calculations against long run marginal cost impacts to assess operating versus capital expenditure) and would also have, to a large extent, already been prepared and provided to the Department of Planning.



*Submission:*

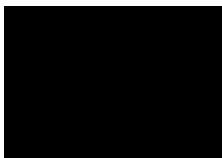
*Clause 8.2.1 should remain as set out in the Draft Licence, except that “30 June 2020” should be amended to no later than 30 June 2019.*

*Clause 8.2.2 of the Draft Licence should read: “Sydney Water must update the Servicing Information published on its website at least every 12 months, and should provide any material updates to that information in respect of a particular region, development or major system on written request from a competitor or Potential Competitor within a reasonable time of that request (and in any event, not more than 20 Business Days following that request).”*

## 10. Conclusion

Flow is grateful for the opportunity to provide this submission and to participate in IPART’s review of the Sydney Water Operating Licence.

Save for the submissions made above, Flow is supportive of the advances made by IPART in this review of Sydney Water’s Operating Licence. There is still much to be done at the policy level to ensure that Sydney is a resilient, sustainable and affordable city facilitated by a competitive business environment and the innovation that competition brings.



Rob Gittins  
**Acting Chief Executive Officer**