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CEO
IPART
VIA EMAIL: Erin_Cini@ipart.nsw.gov.au
Friday February 15, 2019

Dear Hugo,

Re: IPART review of the Sydney Water Operating Licence

Thank you for the opportunity to respond to IPART's review of Sydney Water's Operating Licence.

Open Cities Alliance is a national peak association for Next-Gen infrastructure and services. We are working with our industry and government members to create policy and market setting that enable more sustainable, resilient and affordable utility and mobility services for communities and businesses. We are advocating for Integrated Water Management (IWM) and greater competition and transparency in water markets. This letter submission represents the views of our members.

Open Cities is concerned the pace of transition to Next Gen sustainable water management in NSW is too slow. There remain significant barriers to sustainable water management that need to be removed through greater competition and the setting of targets for the take-up of recycled water and local sustainable water management.

Transitioning to 21st century IWM businesses and services is now urgent and essential in our opinion. Especially because the utility model itself is not only shifting to the precinct-scale but is also converging - as data enables the water/energy nexus and the democratization of infrastructure.

Significant rethinking and modernising of government policy, legislation, regulation and market settings needs to occur. A vision for this future infrastructure state needs to be created and targets set to make the transition rapidly. It is essential innovation and decarbonisation are placed at the core of this transition plan. New utilities require a seat at State planning tables and competitive markets need to be established for these new business models and solutions that can better meet peoples' needs.

Sydney Water's Operating Licence is an important mechanism to drive this change. Sydney Water's current centralised siloed operations are becoming less fit for purpose in a future characterised by extreme heat and weather events, rapid urbanisation, and public expectations for swimmable clean waterways and oceans, reduced carbon and innovation and affordability built into their services.

Open Cities believes IPART also plays a critical leadership role in driving this future competitive and innovative water market. This includes ensuring traditional centralised utilities are operating in a way that embraces innovation and the changing needs of the community.

Competition remains absolutely critical to more sustainable water management solutions and customer choice. Competition in NSW has been eroded by the adoption of the retail-minus tariff. This interim tariff must be replaced with a bottom up approach to pricing that better reflects the positive contribution of localised IWM. Open Cities maintains the biggest barrier to innovation is the retail minus tariff approach introduced in January 1, 2018. We support our members who have provided many submissions over the past four years rejecting the retail-minus approach which has increased the cost of recycled water scheme operations by 400 to 1200 percent in urban regeneration developments.

We consider the draft licence is not consistent with the WIC Act. The statutory requirement for Sydney Water's Operating Licence arises from Part 5 of the Sydney Water Act. In passing the later WIC Act, the NSW Parliament substantially altered the legal environment within which Sydney Water operates. While the draft licence now refers to the WIC Act, in its current form it is not consistent with the WIC Act. Without change, the draft licence may be contrary to the Acts Interpretation Act 1987. This means that, in its current form, the proposed licence could be open to challenge in either chamber of the new NSW Parliament, following the March State election.

Most notably, there is a contradiction in the draft licence between "not preventing or hindering competition" - the 1.6 'non-exclusive licence' and Sydney Water's obligations to serve in section 2.2.1: *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.*

Under the Draft licence, Sydney Water would have an obligation to invest in infrastructure sized to serve the entire market, even where alternative infrastructure has already been put in place by WIC Act licensees. This is difficult to reconcile with the requirement under the Sydney Water Act for Sydney Water to be a successful business, because it would result capital and operating expenditure in excess of prudent levels required to serve non-WIC Act licensee customers.

As you know, since the beginning of 2018, IPART has sought to address this problem by implementing a discriminatory wholesale tariff whereby WIC licensee revenues are appropriated by Sydney Water to fund the excessive capital and operating expenditure arising from the licence obligation to serve the entire market. This is the basis for the retail minus tariff which represents an insuperable barrier to competition and the efficient entry by recycled water operations. This in turn is increasing reliance on economically inefficient solutions including the premature restart of the desalination plant.

Open Cities is also concerned about the proposed appointment of Sydney Water under Section 3 of the draft licence as the long-term capital planner. For the reasons set out above, we consider this is inconsistent with the WIC Act and creates a risk that the draft licence, if retained in its current form, could be subject to challenge in NSW Parliament following the upcoming State election.

The obligation for Sydney Water to be a successful business cannot in our view be reconciled with it also being allocated sole responsibility for water conservation and planning under the operating licence. It is well established in micro-economic reform that the incumbent or dominant market participant cannot also hold the role of system planner. This is because the system operator needs to be independent from all market participants. Without this independence, the system planner may not give priority to the best long term interests of consumers and instead prioritise being a successful business.

The proposed requirement (section 3.2.4-3.2.6) for Sydney Water to enter into a Data Sharing Agreement with DPE by June 2020 (or another date approved by IPART) highlights the fact there is a large information asymmetry between Sydney Water, on the one hand, and the NSW government and Sydney Water competitors, on the other.

Open Cities welcomes the proposed requirements relating to information and services for existing and potential WIC Act competitors (section 8). This would represent some improvement relative to the status quo. Nevertheless, we remain concerned that the new obligations will not result in timely provision of detailed data sufficient to overcome information asymmetries in favour of Sydney Water. Our concerns are reinforced by the proposed Data Sharing Agreement with DPE. If the requirements under Section 8 were sufficient, then there would appear to be no basis for the separate requirement for a Data Sharing Agreement with DPE. We would also note that data sharing is a necessary but not sufficient condition for the operating licence to be consistent with the WIC Act.

An Independent Market Operator (IMO) company is required to create a logistics framework for the operation of this new market and can manage data sharing arrangements on behalf of the entire market. A similar entity to the *Gas Market Company*, for example, can ensure industry-wide contribution, set the rules of engagement, and ensure the release of right information.

Open Cities recommends the adoption of the following recommendations to ensure the market transitions to a sustainable and zero carbon future, allowing the people of NSW to recycle their water and reap the financial benefit, to keep water locally for cooling, greening and to preserve biodiversity.

AMEND THE SCOPE OF THE DRAFT LICENCE

The scope of the licence needs to be amended so that it clearly permits competition in the provision of the services set out in the draft license. This is required to ensure the licence is consistent with the WIC Act and not subject to challenge in NSW Parliament after the upcoming election.

- 1. Amend the scope of the draft licence to remove the obligation to supply all customers including those who choose or may in the future choose WIC Act licensees.**

REQUIRE SHARING OF PLANNING DATA

To ensure the timely provision of detailed data sufficient to overcome information asymmetries in favour of Sydney Water:

- 2. Ensure adequate data sharing, by requiring all DSA data available to licensed participants, and not only DPE.**

ESTABLISH AN INDEPENDENT MARKET OPERATOR (IMO)

Open Cities welcomes greater transparency of Sydney Water's operational activities. We do not think IPART's proposed amendments go far enough or tackle the institutional issues preventing a transition to Next-Gen IWM.

Open Cities believes an IMO, separate to IPART, can assist with a whole-of-Government solution to addressing lack of competition, transparency and level playing field in the water market. The aim of an IMO is to deliver new homes quicker, more affordably and with a safe and reliable water supply in a competitive and contestable environment.

The establishment of an IMO capable of setting the rules of engagement between centralised and precinct-scale solutions, delivering a level playing field, and ensuring innovative approaches to water management are implemented, is essential.

Information relating to water infrastructure servicing and investment should not sit exclusively with Sydney Water. This information should be available to the market and kept with an IMO advised by Planning NSW. An IMO would also be able to oversee and review inter-utility agreements which currently support centralised water management practices and therefore incumbent utilities.

In a competitive WIC Act market landscape an IMO can help to plan for new water infrastructure in an open and transparent way. It can facilitate greater competition by establishing frameworks for the WIC Act sector to contest for water services in new growth areas. It can also play a key role in ensuring new communities leap frog in management/technologies driving the most innovative and sustainable outcomes for customers.

The solution is in the policy approach Governments Australia-wide have taken to the energy, finance and telecommunications markets. For example, by establishing the Australian Stock Exchange or the Gas Market Company – Government has ensured a transparent and arms-length level playing field to enable the private sector to compete without fear or favour and according to agreed terms and conditions.

The establishment of a wholesale water market is a policy response to the following blockages:

- Expensive and unsustainable (no recycled water) servicing water strategies by Sydney Water
- Exclusive Gateway processes that entrench BAU
- Urgent need to transition to Integrated Water Management to tackle heat island, liveability and resilience issues.
- Slow delivery of water infrastructure for new homes
- Increasing cost of land and housing products
- A slowing down of land and housing release by as much as 12 month

Gas Market Model

In the same way Government moved to establish an independent gas market to break AGL's monopoly over the gas market and deliver diverse services to consumers in 2000 - Government now needs to establish an independent operator for the water market.

A Gas Market Company equivalent, such as a 'Water Market Company', will remove decision making from public water utilities and Government and put it rightly with an independent body capable of protecting consumers and encouraging a level playing field, fostering innovation and self-sufficiency to deliver sustained downward pressure on utilities.

An Independent Market Operator would:

- Ensure industry wide membership and contribution;
- Create a logistics framework for the operation of a new market;
- Determine the rules on how private companies can enter the market, operate in the market, connect to existing infrastructure, and deliver services;
- Enable private sector competition to drive faster housing release and lower cost housing;
- Set water service strategies and manage procurement processes for those strategies from both the public and private water utilities;
- Create a transparent framework through which the market can develop to ensure incumbent monopolies cannot distort the market.

Control of decision-making surrounding 'access to market' issues must be independent and cannot sit with Sydney Water only. Government and Sydney Water need to open up all water data to provide transparency for from third parties to provide solutions. Agencies like Transport for NSW have done this successfully and there are strong benefits to the people and businesses.

It is very difficult for WIC Act utilities to compete when public utilities control key decision making around access to market. As part of its role to establish a transparent framework through which the new private water market can develop, the IMO would take responsibility for decision-making over access to the market.

WIC Act utilities need access to this strategic data before they are able to submit a truly competitive tender. At the moment this data can only be obtained second or

third hand from developers or consultants. Its accuracy is not always guaranteed and the regional water plan may not form part of the solutions offered.

An IMO can hold and control the release of all data relating to water infrastructure service delivery, including regional water plans and water servicing strategies. At the moment there is no independent decision-making process which would be able to enable private sector participation in the delivery of services. Without these changes it will be near impossible to achieve a competitive market place.

3. Establish an independent NSW Water Market company to set frameworks to transition from existing centralised approaches to a new competitive IWM market, including:
 - 3.1. Defining IWM and how it applies to water management of new precincts
 - 3.2. Rules of engagement, information & guidance for councils, stakeholders & industry
 - 3.3. Collating and sharing of data

SYDNEY WATER FACILITATE BETTER CONSULTATION

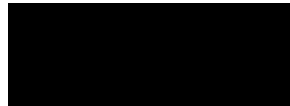
4. Require Sydney Water to provide a resource to represent industry and the community so they are able to respond to reviews of Sydney Water. More meaningful engagement would lead to better outcomes.

CONCLUSION

Open Cities believes IPART has an opportunity through this review of Sydney Water's operating licence to begin the transition to next century IWM approaches that drive new more sustainable and affordable approaches to water management and real and lasting downward pressure on bills.

We hope to see this key industry feedback reflected in IPART's amendments to the Sydney Water Operating Licence. Open Cities welcomes the opportunity to meet with IPART to discuss this submission.

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