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To whom it may concern,

Submission to IPART's Issues Paper: Review of prices for Sydney Water

The City of Sydney (the City) is pleased to make this submission to the Independent Pricing and Regulatory Tribunal's (IPART) Issues Paper: Review of prices for Sydney Water Corporation from 1 July 2016.

The City has two major concerns: that proposals to reduce prices from July 2016; and the 'retail minus avoidable costs' pricing model would have perverse outcomes for water efficiency and recycling. These proposals should not proceed as proposed.

Introduction

Sustainable Sydney 2030 is the City's vision for a green, global and connected future with targets for water which reflect business and the community's desire for improved water efficiency, greater water independence and improved water quality in our local catchments. The City's vision for a water sensitive city results in the following outcomes for its community including:

- Efficient use of potable water and reduced reliance on the water network;
- Increased amenity and urban cooling through improved green space maintained by independent, climate resilient water supplies; and
- Improved quality of our local waterways though reduced pollution discharged via wastewater and stormwater outlets.

These outcomes are increasingly important as we respond to the demands of an increasing population and changing climatic conditions including warmer temperatures and changing rainfall patterns.

In 2013 the City of Sydney Council endorsed the City's Decentralised Water Master Plan (DWMP) which sets out how these Sustainable Sydney 2030 targets may be achieved

through water efficiency, recycling and water sensitive urban design initiatives. The DWMP includes targets to:

- Reduce mains water consumption by 10 per cent of 2006 levels by 2030;
- Replace 30 per cent of mains water demand across the City of Sydney local government area with recycled or alternative non-potable water generated from local water resources by 2030; and
- Reduce sediments and suspended solids by 50 per cent and nutrients by 15 per cent discharged into the waterways from stormwater run-off generated across the City of Sydney local government area by 2030.

The City recognises that Sydney Water's prices play an important role in its and others' ability to realise its Sustainable Sydney 2030 vision and DWMP targets. This submission responds to several issues raised in IPART's Issues Paper. The two key issues discussed are:

1. **Sydney Water's proposed reduction in prices from July 2016** – the City is concerned that the reduction in costs is being passed through to consumers through variable charges instead of fixed charges which will lead to increased water consumption. Diluting the price signal will reduce the incentive for water efficiency with higher environmental impacts and in the medium-term higher costs for consumers; and

2. **Sydney Water's proposed 'retail minus avoidable costs' pricing model for wholesale customers and/or access seekers** – the City does not support this model as it will make future recycled water schemes unviable and represents an anti-competitive practice that creates barriers to entry for alternative forms of supply.

These issues threaten the City's ability to achieve its Sustainable Sydney 2030 vision. Detailed discussion on these and other issues follows.

Improved environmental outcomes

Issue 13. Is Sydney Water's proposed capital expenditure on projects relating to its Environment Protection Licences, including wet weather overflow abatement, efficient?

The City supports investment in environmental protection, specifically in programs to reduce wastewater discharges to waterways. This is in line with its target to reduce sediments and suspended solids by 50 per cent and nutrients by 15 per cent discharged into the waterways from stormwater run-off generated across the City of Sydney local government area by 2030.

Consideration should also be given to the benefits that wastewater recycling can provide in driving environmental improvements. In particular, wastewater recycling provides both a reduction in the rate of growth of drinking water demand and a reduction in volumes of waste water discharge, while providing a climate resilient water supply to support city greening and cooling.

Investment is also required to achieve improved environmental outcomes through stormwater management, specifically through water sensitive urban design (WSUD). Sydney Water owns and operates stormwater infrastructure across metropolitan Sydney including approximately half the stormwater infrastructure in the City of Sydney local government area.

WSUD involves the strategic integration of vegetated stormwater management systems into the urban form with the purpose of slowing down and removing pollution from stormwater. In addition to stormwater pollution reduction, WSUD initiatives such as raingardens, reduce localised flooding impacts as well as provide passively irrigated green space that improves amenity and contributes to reduction of urban heat island effect. These benefits align with Sydney Water's liveability aspirations and hence WSUD should attract appropriate funding to ensure environmental benefits are realised.

Pricing flexibility

Issues 27 – 32. Weighted average price cap (WAPC)
This is a complex issue and time does not allow the City to respond fully to the question raised.

The City supports the introduction of pricing flexibility that leads to more efficient use of water and water infrastructure. Clearly there can be benefits in moving away from postage stamp pricing, however there may be unintended consequences that diminish potential benefits.

The City agrees that the introduction of a WAPC should be considered in the broader context of a set of overarching pricing principles. These pricing principles should be developed in close consultation with key stakeholders and should not be limited to tests of short-term economic efficiency or reliability of supply. A more holistic approach is needed. In particular, pricing principles need to embed environmental impacts, promote efficient use of resources and encourage productive competition.

The stated commitment (through legislation) of increasing competitive tension in the water industry needs reinforcement. The issue of incumbency advantage needs to be specifically addressed.

Experience from other regulated industries shows that pricing principles can tend to constrain rather than enhance innovation and industry change (the electricity sector is a prime example). Regular review and periodic amendment may be required.

An issue that warrants further attention is the apparent disparity in the way that different classes of customers are charged differently for like services. The City has carried out preliminary modelling to compare wastewater charges for multi-unit residential developments with comparable commercial developments (in terms of multiple occupancy and nature of discharges) such as shopping centres. It appears that trade waste charges (with embedded retail margins) are much lower than the costs experienced by large multiunit residential developments based on comparable discharge levels. While the City's findings are not conclusive, it is a concern that there may be such disparate treatment. This is of considerable importance in the discussion around access and wholesale pricing and suggests that Sydney Water's proposed "retail minus avoidable costs" methodology is unsuitable. This is discussed further with respect to issues 59-61.

User-pays approach to wastewater pricing

Issue 35. Is Sydney Water's proposed approach to forecasting chargeable wastewater volumes (including its assumptions) reasonable?
In principle, the City supports the user-pays approach for wastewater pricing as this will provide better price signals for more water efficient behaviours.

The City agrees that reducing the discharge allowance for non-residential customers to 150kL per year could better ensure residential and non-residential customers are treated equally. It would also promote the user-pays approach as more customers will be billed for wastewater usage, which should on average lead to more efficient water use.

However, there are practical limitations on the implementation of waste water efficiency, including the cost of metering discharges and the inability of many customers (e.g. renters) to effect changes that reduce their waste water discharges. More consultation with affected parties and key stakeholders must precede a move in this direction.

Issue 40. What is the most appropriate name for the current fixed 'service charge'?
The City supports the term 'availability charge' to replace the fixed 'service charge'.

Impact of proposed lower prices on water efficiency

Issue 41. Is Sydney Water's proposed water usage charge of $1.97 per kL reasonable? If so, why?
The City is concerned that the proposed lower prices for water will lead to behavioural shifts towards increased water consumption, especially since the proposed savings are proportioned more heavily to the variable component (-13.9%) instead of the fixed component (-4.9%) of the price. Therefore available water efficiency gains may not be realised as the incentive to reduce costs with improved efficiency will be reduced. This will negate previous efforts by Sydney Water and the City to raise the importance of water conservation within the community and lead to increased consumption.

The City invests in a number of efficiency programs to reduce water consumption by 10 per cent of 2006 levels by 2030 including:

- Smart Green Business which is a direct service providing assessments and implementation support to non-office based businesses. This program has achieved 440 mega litres per annum of water savings from September 2009 to June 2013 through implementation of water efficiency measures across 330 small to medium enterprises. The program has achieved a further 620 mega litres per annum water savings in the 2013/14 and 2014/15 financial years across over 100 large accommodation businesses with an additional 200 mega litres per annum water savings target set for the 2015/16 program;
- The Residential Apartment Sustainability Sector Plan includes a target of 7 per cent reduction in water consumption by 2030;
- The Better Buildings Partnership commercial office buildings program has set a water intensity target for its members and is developing a number of projects to improve water efficiency, including a cooling tower efficiency study;
- Water and Energy Retrofit project involved installation of water efficient fixtures and fittings and other water savings measures in 45 of the City's highest water using buildings. This project has predicted water savings of up to 56 mega litres per annum;
- An Environmental Performance grants program has been established to provide support to reduce water consumption in residential apartment buildings. Funding capped at $10,000 per building is currently available for water sub-metering and water efficient showerheads; and
- The residential apartment's high-rise retrofit program will also provide hands on support and incentives for water efficiency upgrades within both common areas and apartments.

There are still considerable opportunities available to implement water efficiencies across the business and residential communities. The high implementation rates of water efficiency recommendations (91%) through the Smart Green Business program is largely due to the associated cost savings and reasonable payback periods. Sydney Water's proposal to reduce prices will reduce the City's ability to successfully engage communities on the importance of water efficiency. Its programs will likely be diminished through a waning of community enthusiasm and reduced impetus to conserve water.

Rather than reduce the price of water, surplus revenue could be redirected to repair Sydney Water's leaking infrastructure, support recycled water initiatives, provide meaningful commitment to water efficiency programs and investment in WSUD. These investments would reduce waste and thereby provide a more cost effective solution for customers over the longer term.

Issue 42. Should the water usage charge be set with reference to the long-run marginal cost (LRMC) of water supply, or should greater weight be placed on customer preferences?
The City agrees that the water usage charge should reflect the LRMC of water supply to encourage efficient water consumption. Proposing greater savings to the variable compared to the fixed component of the price does not send the right price signal for water conservation.

Issue 43. Should Sydney Water's water usage charges vary to make drought-response costs more transparent to end-use customers (ie, by reflecting the per kilolitre cost of desalinated water if Sydney Desalination Plant is activated)?
The City agrees with the increase in water usage charge to recover additional costs incurred when the Sydney Desalination Plant is activated.

However, The City would like to highlight that decentralised systems that also provide water security through the production of a drought resilient water supply, do not attract the same cost sharing arrangements with the broader Sydney population base. Through provision of a climate resilient water supply, decentralised systems can support urban greening and cooling as well as reduced demand and subsequent investment in augmentation of existing water and wastewater infrastructure.

Further comments to issues 59-61 relating to access pricing and wholesale pricing for decentralised systems follow.

Issue 44. Are Sydney Water's proposed water service charges reasonable?
As discussed, reductions in water prices should be reflected in fixed prices rather than usage prices. This would preserve the incentive for users to conserve water as they can enjoy the cost savings this can achieve.

Issue 46. Should residential customers pay a wastewater usage charge?
The City supports the concept of wastewater usage charges as this should lead to more efficient water use. If a wastewater usage charge was applied to all residential customers, fixed service charges should decrease and customer bills would better reflect water usage, i.e. customers with low water use should face a reduction in their overall bill while overall bills should increase for large water users.

Recycled water viability: access and wholesale pricing

Issue 59. What is the most appropriate methodology or basis for setting wholesale prices?

Firstly, the City does not support Sydney Water's proposed retail minus avoidable costs pricing approach as this would make future recycled water schemes unviable.

Recycled water is critical to the City achieving its Sustainable Sydney 2030 vision as it provides independent, climate resilient water supplies to support improved green space that increases amenity and urban cooling for the community. The City has implemented 11 park-scale stormwater harvesting schemes and a further 2 precinct-scale stormwater harvesting schemes are under construction at Sydney Park and Green Square Town Centre.

The City is also developing opportunities to ensure recycled water is integrated into its future urban renewal areas. Urban renewal areas present the City's main opportunity for implementation of recycled water schemes involving local collection and treatment of wastewater. By 2030, the City of Sydney local government area population is forecast to grow by over 45% from 2011 and at least 90% of the new dwellings built will be high-rise buildings (>6 storeys). Growth at this scale and density provides opportunities for efficient water recycling schemes to develop.

The City's comments on this issue relate to access to Sydney Water's wastewater infrastructure for the purpose of disposal of residual waste from the production of recycled water at a decentralised recycled water treatment plant. (As opposed to sewer mining or purchase of bulk potable water).This should not be considered a wholesale service as defined in Sydney Water's pricing submission, s10.6.1, because a secondary utility is not on-selling Sydney Water's wastewater services but rather providing its own wastewater treatment services to its customers to produce recycled water for sale to those (and other) customers.

The secondary utility would be a customer of Sydney Water's like other non-residential customers that discharge to Sydney Water's wastewater infrastructure. It should be charged a fee to discharge its residual waste stream that reasonably reflects the cost to Sydney Water to manage that waste stream. This is consistent with the pricing principle of the WIC Act s41(2)that:

the price of access should generate expected revenue for the service that is at least sufficient to meet the efficient costs of providing access to the service, and include a return on investment commensurate with the regulatory and commercial risks involved.

The price should also reflect savings from avoided or deferred augmentation of Sydney Water's water and/or wastewater infrastructure or reduced operational costs to manage reduced volumes in the network as a result of the scheme.

This would place downward pressure on future postage stamp pricing due to changes in forecast customer volumes and corresponding demands on existing and planned infrastructure as a result of competition in the market.

In comparison with Sydney Water's customers base, the number of actual and potential customers of businesses operating under the WIC Act is very small. Sydney Water should not assume entitlement to future customers. Future recycled water schemes in the City of Sydney urban renewal areas involve new customers that are not existing Sydney Water customers. They also provide a higher level of wastewater treatment producing a resilient water supply that provides additional community and environmental benefits than the alternative primary treatment provided by existing facilities at Malabar and Bondi.

Sydney Water's proposed retail minus avoidable costs model does not promote competition, innovation and investment in recycled water infrastructure as per the broad objectives of the WIC Act. Based on its internal business case, the City believes that this approach will make recycled water schemes unviable.

Issue 60. What is a reasonable retail-minus avoidable costs price cap to apply to all wholesale customers?

As discussed, the City does not support the proposed retail minus avoidable costs approach to access pricing with respect to wastewater. The City believes that this approach will make future recycled water schemes unviable and represents an anti-competitive practice which is a barrier to entry for alternative suppliers.

Issue 61. Should wholesale prices be regulated under the WIC Act, IPART's price determination or a combination of both?

The City supports creating greater certainty in the market place and access arrangements that facilitate greater competition and market entry. The access regime under the WIC Act requires an access seeker to apply for access and negotiate the terms of that access under a negotiation arbitration model, with IPART acting as (or appointing) the arbitrator if required. The arbitrator's award may be appealed in the NSW Supreme Court, creating delay and uncertainty. Further, the access regime under WICA is principally concerned with transportation of water or sewage and in effect excludes 'filtering, treating or processing of water or sewage'. That regime cannot extend to an access seeker acquiring bulk raw water, and having it filtered and treated so that it is safe to drink, or having its exported sewage treated. Nor does it extend to the purchase by the access seeker of the water itself.

Requiring WICA licensees to procure drinking water and dispose of excess sewage and/or its residual waste via the WICA access regime therefore gives rise to significant legal as well as commercial and practical uncertainties.

While developing a recycled water project in one of its urban renewal areas, the City found this access arrangement unsatisfactory because it was unable to complete its internal business case analysis without entering a lengthy negotiation with Sydney Water to understand the cost to discharge the residual waste stream to Sydney Water's wastewater infrastructure. Sydney Water's proposed retail minus avoidable costs model and its indicative example provided at a meeting between Sydney Water and the City on 5 February 2015 indicated an access charge of approximately 90% of the revenue collected from the City's proposed future customers via wastewater charges. This access charge would deem the scheme unviable. This process introduced uncertainty and risk to the City's proposed recycled water project.

It is the City's understanding that no WIC Act licensees have used the WIC Act access regime to date, but have negotiated alternative "Inter-Utility Agreements" with Sydney Water.

Further consultation with stakeholders is required to determine the most appropriate regulatory framework to support the objectives of the WIC Act.

Issues 62 and 63. Sydney Water's proposed recycled water price for mandated schemes

This would require further consideration within the context of access pricing and wholesale pricing to ensure a level playing field within the industry.

We would welcome the opportunity to discuss these important issues with you further. To arrange a meeting or for any questions in relation to this submission please contact Lisa Currie, Manager Water Strategy on [redacted] or at [redacted].

Yours sincerely

[redacted]

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