



Reference: BN16/6097

Mr Hugo Harmstorf
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Dear Mr Harmstorf

Submission on review of Hunter Water's operating licence

Thank you for the opportunity to make a submission on the review of Hunter Water Corporation's operating licence. DPI Water's submission is attached.

The submission canvasses a number of issues arising from the review that have potential implications for DPI Water's role in metropolitan water planning and water industry competition. These broadly relate to:

- water security planning delivered through the Lower Hunter Water Plan, including questions around water conservation, reporting, and the roles and responsibilities protocol between Hunter Water and DPI Water
- questions around the definition of customers and consumers, and Hunter Water's service obligations to wholesale customers, especially private utilities licensed under the *Water Industry Competition Act 2006*.

DPI Water would appreciate the opportunity to further discuss with IPART some of the issues raised in the submission. If you have questions regarding this submission, please contact Brendan Fletcher, A/Manager Metro Water Policy, on [REDACTED]

Yours sincerely

[REDACTED]

Gavin Hanlon

Deputy Director General, DPI Water

29/07/2016



Department of
Primary Industries
Water

DPI Water submission to IPART's review of Hunter Water's Operating Licence

July 2016

Introduction

A number of issues arising from IPART's review of Hunter Water's operating licence have potential implications for DPI Water's role in metropolitan water planning and water industry competition. These broadly relate to:

- water security planning delivered through the Lower Hunter Water Plan (LHWP), including questions around water conservation, reporting, and the roles and responsibilities protocol between Hunter Water and DPI Water
- questions around the definition of customers and consumers, and Hunter Water's service obligations to wholesale customers (in particular, to private utilities licensed under the *Water Industry Competition Act 2006*).

These issues are discussed below.

Water quantity

Question 4: What are your views on adopting the Economic Level of Water Conservation (ELWC) approach in the new licence, and removing the water conservation target and Economic Level of Leakage requirements?

Any requirements relating to water conservation should be designed to ensure an economic level of investment (from a societal perspective, taking into account environmental and social costs and benefits).

There are different mechanisms by which this could be achieved and reflected in the operating licence, such as:

- a methodology for estimating the economic level of water conservation (similar to the requirement in Sydney Water's operating licence)
- targets for water conservation and leakage, similar to those currently in Hunter Water's operating licence
- reference to the water conservation measures in the LHWP portfolio, either through specific obligations in the operating licence reflecting requirements of the LHWP, or through requirements for complying with responsibilities under a protocol between Hunter Water and DPI Water.¹

Differences in the water security planning for Sydney and the Hunter should be considered before deciding whether or not to adopt similar ELWC requirements in Hunter Water's operating licence.

The 2014 Lower Hunter Water Plan (LHWP) incorporates a set of demand side (water conservation) measures developed and modelled in consultation with Hunter Water. The analysis underpinning the LHWP was designed to identify the portfolio of supply and demand measures that represents the economic level of investment to achieve a secure water supply, taking social and environmental factors into account. The LHWP includes water conservation programs that apply during normal climate conditions, and expanded programs that are triggered sequentially during a drought as water storage levels fall. This reflects the higher value of water during periods of scarcity and thus, a greater level of economically efficient investment in water conservation at such times.

If an ELWC approach is adopted in the operating licence, it would be desirable to frame the requirement with reference to the LHWP to support consistency and integration, and reduce the risk of duplication. This would also be consistent with the adaptive management approach to water planning, whereby the portfolio of measures is evaluated on a regular basis and can be revised if circumstances change.

¹ DPI Water notes that IPART is considering both these options in its review of the operating licences for WaterNSW, refer p108 of the Issues paper for Review of the WaterNSW Operating Licences.

An ELWC approach, in the operating licence or via the LHWP, would supersede the water conservation target and economic level of leakage by addressing their fundamental objectives.

The LHWP references the water conservation target in the operating licence². Performance against this target shows consistent compliance, with a general downward trend in residential water use per property for more than a decade. While the trend may continue to be a useful indicator, the numeric target has limited value in the current water planning framework as it was not set to achieve economic investment.

In relation to leakage management, the 2014 LHWP addressed water loss minimisation - through active leak detection and pressure management - as part of the modelling and evaluation of water efficiency measures. As discussed above, a methodology focused on economically efficient investment is desirable as part of an integrated approach to both demand and supply measures.

DPI Water would welcome the opportunity to discuss the ELWC approach, water conservation target and leakage requirements further with IPART, in the context of the LHWP planning framework and economically efficient investment (in the broad sense of the term, ie including social and environmental costs and benefits).

Question 5: If the ELWC approach is adopted, what are your views on the appropriate reporting requirements? Should Hunter Water continue to report on its water conservation performance?

Irrespective of the approach adopted for the ELWC, DPI Water supports an ongoing need for Hunter Water to report on its water conservation outcomes (whether defined by the LHWP portfolio, the ELWC approach, or as a water conservation target) and a summary of current water conservation initiatives.

From a LHWP perspective, implementation and performance are assessed in accordance with a Monitoring, Evaluation, Reporting and Improvement (MERI) plan, which sets out the approach to annual, drought and major evaluations.

The evaluations currently utilise Hunter Water's annual reporting to IPART on its water conservation performance as one of many inputs. The MERI plan recognised synergies with Hunter Water's reporting to IPART, and avoided duplicating these requirements.

If water conservation reporting is removed from the operating licence, DPI Water will need to obtain this information directly from Hunter Water as part of the annual evaluation process under the MERI framework.

Significant community interest in Hunter Water's water conservation performance was evident throughout DPI Water's community and stakeholder engagement program while developing the LHWP. Reporting to IPART on water conservation performance is a valuable way to ensure this information is publicly available.

Question 6: What are the factors that we should consider, in the context of Hunter Water's operating environment, if/when adopting the ELWC approach?

Issues for IPART to consider if/when adopting the ELWC approach include:

- introducing a new ELWC clause for Hunter Water would be consistent with Sydney Water's operating licence, but may result in duplication or inconsistency unless framed in a way that supports integration with the LHWP
- the LHWP is the primary mechanism for developing an optimal portfolio of demand and supply measures to secure the region's future water needs - it may be inefficient to set up a new process for

² Lower Hunter Water Plan (2014), p30

water conservation, separate from the integrated modelling of a portfolio of demand and supply measures for the LHWP, which considers economic and social costs for supply and demand measures in a consistent manner

- a potential gap is raised in Sydney Water's issues paper on the methodology for determining ELWC³, which states: *'The requirements create an expectation that Sydney Water will implement some water conservation projects if they are economic. However, implementation of projects is not a firm requirement of our Operating Licence.'*

While water utilities are usually well- placed to implement water conservation programs (and recover their costs through prices), some of the benefits are non-monetary and therefore do not accrue to them. Where this is the case, there is no financial incentive for utilities to invest in water conservation even though it is economically efficient to do so from a societal perspective. The LHWP reflects the economic level of investment in supply and demand measures in the broader context and reference to the LHWP in the operating licence would recognise this and strengthen the requirement to implement it.

Question 7: Should the new operating licence require Hunter Water to continue to have a roles and responsibilities protocol with DPI Water, given that the development of the Lower Water Hunter Plan is complete? If so, what should be the scope of such a protocol?

While the 2014 LHWP is complete, both Hunter Water and DPI Water have ongoing roles and responsibilities for its implementation, monitoring and evaluation, and development of the next LHWP. Hence it is appropriate for the new operating licence to continue to reflect Hunter Water's ongoing obligations regarding the LHWP.

A new roles and responsibilities protocol was agreed with Hunter Water after the 2014 LHWP was released, for 'implementing, evaluating and reviewing the LHWP'.

The scope includes:

- governance
- implementation responsibilities for HWC and MWD (now DPI Water)
- adapting the LHWP if necessary, and developing future iterations of the LHWP
- communications and community engagement
- liaison with government stakeholders
- financial responsibilities
- dispute resolution.

This protocol is important to maintain as both organisations continue to implement the 2014 LHWP and move into the review phase to develop the next iteration of the LHWP.

Alternatively, or in addition, there is an opportunity for the operating licence to strengthen the requirement on Hunter Water to implement the LHWP - and, in turn, to strengthen the driver to invest efficiently in supply and demand measures to achieve broad societal outcomes.

The LHWP is not a statutory plan, although IPART's latest price review for Hunter Water recognised the LHWP 'is an important element in Hunter Water's operating environment'.⁴

³ Sydney Water Corporation (April 2016), Sydney Water's methodology for determining its economic level of water conservation – Issues paper, p51

⁴ Independent Pricing and Regulatory Tribunal, Review of prices for Hunter Water Corporation from 1 July 2016 to 30 June 202- Final report (June 2016), p 176

An alternative (or complementary) approach to the roles and responsibilities protocol could be for IPART to strengthen the relationship between the operating licence and the LHWP with a requirement for Hunter Water to comply with its obligations to implement the LHWP and contribute to its periodic review. As IPART notes in the context of Hunter Water's MOU with Health, 'Placing an obligation in the operating licence reinforces its importance and ensures it is independently audited during the term of the operating licence'.⁵

DPI Water would welcome the opportunity to discuss these options further with IPART.

Customers and consumers

Question 13: What changes, if necessary, are needed in the operating licence and/or customer contract to account for 'wholesale' customers and services?

Currently, water utilities licensed under the *Water Industry Competition Act 2006* are required to develop a code of conduct with any other network operator or retail supplier in their area of operations. Currently this is the incumbent public water utility.

Stakeholder comments to the Sydney Water operating licence review issues paper indicated that WIC licensees were concerned that the requirement to develop a code of conduct was placed on them without there being a corresponding requirement on Sydney Water. In response, IPART recommended the inclusion of a corresponding clause in the Sydney Water operating licence.

DPI Water proposes a similar clause be added to Hunter Water's operating licence, as the issues facing WIC licensees in Sydney Water's area of operations also apply to WIC licensees in Hunter Water's area of operations.

Question 14: Are the definitions of 'customer' and 'consumer' in the customer contract suitable for the current operating environment? If not, how can the definitions be amended to provide greater clarity?

DPI Water suggests that the definitions of 'customer' and 'consumer' in the customer contract should not be changed without considering the relationship between definitions of customer in the operating licence and the related price determinations.

Question 15: Should Hunter Water be obliged to service anyone other than property owners? If so, who are these 'customers' and what are the appropriate obligations on Hunter Water to service them?

The obligation to serve is a matter that is closely related to IPART's current review of the prices that Sydney Water and Hunter Water can charge wholesale customers (this mainly refers to WIC licensees). As such DPI Water suggests that it would be preferable for this matter to be considered once the related pricing issues are settled.

Question 16: What are the factors that we should consider, in the context of Hunter Water's operating environment, when considering changes to the customer contract. The changes being considered (for consistency) reflect recent changes that were made of Sydney water's customer contract.

In principle, DPI Water supports the standard Hunter Water customer contract containing obligations that are consistent with those required under the Sydney Water customer contract.

⁵ Independent Pricing and Regulatory Tribunal, Review of the Hunter Water Corporation Operating Licence – Issues paper (May 2016), p 38

Environment, quality, performance monitoring and memoranda of understanding

Question 21: What are your views on including a requirement for Hunter Water to report against NWI performance indicators in the operating licence?

DPI Water supports including a requirement for Hunter Water to report against NWI performance indicators in the operating licence.

The NWI established a significant water utility benchmarking program and reporting against NWI indicators is important for continuing this exercise. The information reported is important for a range of water planning and evaluation activities. For this reason, we agree with IPART's preliminary position that the NWI indicators form part of the comprehensive framework for assessment of water utility performance in NSW and should continue to be reported on.

DPI Water relies on particular performance indicators for annual MERI evaluations of Lower Hunter Water Plan implementation and performance. Reporting requirements under the MERI plan were designed to leverage existing reporting requirements where feasible, to minimise any impact on Hunter Water's regulatory burden.

The NWI performance indicators include many relevant indicators for MERI reporting, as well as for LHWP analysis, particularly those in categories W, A, C and E.