

# **5-year review of Sydney Desalination Plant's network operator's licence (10\_010) and retail supplier's licence (10\_011R)**

**Prepared under the *Water Industry Competition  
Act 2006* (NSW)**

**Water — Report to the Minister**  
November 2015

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## 1 Summary

The Independent Pricing and Regulatory Tribunal of NSW (IPART) has conducted a 5-year review of two Sydney Desalination Plant Pty Ltd (SDP) licences under the *Water Industry Competition Act 2006* (WIC Act).

We recommend that the Minister varies SDP's network operator's licence (licence number 10\_010) and retail supplier's licence (licence number 10\_011R) to bring them into line with the IPART standard licence template.

## 2 Background

SDP's network operator's and retail supplier's licences were granted by the Minister on 9 August 2010. SDP was originally owned by Sydney Water Corporation (Sydney Water). In 2012, the company was sold and is currently jointly owned by the Ontario Teachers' Pension Plan Board and Hastings Funds Management Limited.

The Metropolitan Water Plan (MWP) is a Government policy document, with no regulatory enforcement. The operating rules for the plant are defined in the MWP, and are replicated in the network operator's licence to give them regulatory force. These rules require SDP to operate and maintain the water industry infrastructure with the objective of maximising the production of drinking water when the Available Storage<sup>1</sup> falls below 70%, until the Available Storage rises to 80%. This is often referred to as the 70/80 rule.

SDP has been declared a monopoly and is price regulated by IPART. The term of the current determination is 1 July 2012 to 30 June 2017. The determination sets the prices for the various modes of operation and also provides financial incentives to ensure compliance with the SDP's drought response role as defined under the current Metropolitan Water Plan.

In accordance with the WIC Act, IPART is to review each licence at intervals of not more than five years, with the first review commencing on the fifth anniversary of the granting of the licence.<sup>2</sup>

We commenced our 5-year review of these licences on 29 July 2015.

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<sup>1</sup> As defined by the network operator's licence to mean "available storage in Sydney's water supply reservoirs as published on a weekly basis by WaterNSW."

<sup>2</sup> WIC Act, section 85(2).

Following the review, IPART is to prepare a report for the Minister, which may include recommendations as to the variation or revocation of existing licence conditions or the imposition of new licence conditions.<sup>3</sup> This report meets that obligation and summarises our analysis, issues raised by stakeholders through their submissions and our recommendation to vary the licences. It also contains the proposed licences.

## 2.1 The review of the WIC Act and the new licensing regime

The primary purpose of the 5-year WIC Act licence review is for IPART to consider the appropriateness of existing licence conditions in our efficient regulation of licensees. In line with good regulatory practice, the licence conditions should direct the licensee to achieve the desired outcomes without imposing unnecessary compliance and administrative costs. However, we note that at present there is some uncertainty in a number of areas surrounding SDP's operations. These are summarised below.

- ▼ The *Water Industry Competition Amendment (Amendment) Act 2014* (NSW) will result in significant changes to the WIC Act licensing framework and conditions of consent. All existing licences will transition to the amended legislation, which we understand from the Metropolitan Water Directorate, is expected to come into force in mid-2016.
- ▼ The Metropolitan Water Plan which outlines the operating rules of the plant (in particular the 70/80 rule as described above), is in the process of review.

Given the impending changes to the WIC Act and the licensing regime, and the uncertainty around the operation of the 70/80 rule, we are recommending relatively minor changes to the current SDP licence. The current price determination will end on 30 June 2017 and will also need to consider changes to the WIC Act and potential changes to SDP's operating rules as a result of any changes to the 70/80 rule in the Metropolitan Water Plan.

The proposed minor changes would make SDP's licences consistent with the current standard licence conditions. The standard licence conditions have been developed and implemented since SDP's licences were issued, and are used as the base template for all new WIC Act licences and variations to licences.

Applying the standard licence conditions template will address gaps in the licences, provide clarification for the licensee, and improve the efficiency of administering the licences in this transitional period before the amended WIC Act comes into force.

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<sup>3</sup> WIC Act, section 85(3).

## 2.2 The standard licence template for WIC Act licences

In 2013, IPART made the decision to apply the standard licence conditions template for all new WIC Act licences. Since then, the template has been used for all new licence applications and variations. From time to time the template conditions are changed to reflect outcomes of assessments and, where broadly applicable, changes to licences made by the Minister.

IPART has decided that the standard IPART licence conditions template will be applied to all licences as part of the 5-year review process.

## 3 Review of licence – network operator’s licence

This section of the report contains an outline of the analysis conducted during our review of SDP’s network operator’s licence (licence number 10\_010) and our recommendations.

### 3.1 Stakeholder consultation and submissions

Where the outcome of an IPART 5-year review of a licence under the WIC Act, is to recommend a variation to the licence, we are required under section 17(1) of the WIC Act to consult with the licensee and other persons prescribed by the *Water Industry Competition (General) Regulation 2008* (**the Regulation**). At this time, there are no other persons prescribed in the Regulation that must be consulted for an IPART licence condition variation.

We have invited submissions from SDP and the Metropolitan Water Directorate. Both SDP and the Metropolitan Water Directorate made submissions<sup>4 5</sup> and suggested changes to the proposed conditions. These are discussed, where relevant in more detail below.

### 3.2 Variations to network licence conditions

Having been granted in 2010 and last amended in 2013, the current SDP network operator’s licence (licence number 10\_010) is not aligned to the standard licence conditions template. The template has evolved since its original format following feedback from the Minister, licensees and other stakeholders and improvements to our approach to compliance. Our review of the SDP network operator’s licence considered the differences between the current licence and the template. The outcomes of our review are detailed below.

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<sup>4</sup> Letter to IPART, Mr Justin De Lorenzo, Chief Financial Officer, Sydney Desalination Plant, 1 September 2015 and 15 September 2015.

<sup>5</sup> Email to IPART, Ms Cathy Cole, Acting Director, Metropolitan Water Directorate, 25 September 2015.

## Specified water industry infrastructure

*The Authorised Water Industry Infrastructure is specified in Schedule A, Table 2.2 of the amended SDP network operator's licence.*

The structure of the specified Water Industry Infrastructure has recently changed in the standard template. This separates the components of treatment plant and reticulation network infrastructure.

We consider the structure of the standard template for specifying Water Industry Infrastructure appropriately describes SDP's infrastructure.

## Insurance

*Relevant insurance licence conditions are prescribed in Schedule B, condition B3 of the amended SDP network operator's licence.*

The standard licence template includes additional insurance requirements to the existing SDP network operator's licence. The insurance conditions of the licence are intended to reduce risks to the licensee, customers and government. These include requirements for the licensee to provide to IPART:

- ▼ Certificates of currency for insurance.
- ▼ Provides a report in accordance with the reporting manual if there is, or is to be a change in the insurer or underwriting panel, or a change to the type, scope or limit of insurance held by the licensee.

SDP made a submission to us regarding the inclusion of the words "or is" in licence condition B3.3. SDP suggested these words be deleted based on its concern that this wording creates uncertainty as to when a proposed change needs to be reported.

Separate to this review we have amended the Network Operator's Reporting Manual. The amendments were made following a consultation period with licensees, during which no submissions were received with respect to this licence condition. A table was included in the reporting manual outlining the notification periods for provision of insurance materials to IPART with respect to various changes to insurance. It also includes the information to be included in a report to IPART. The amended reporting manual was finalised and made available on our website in August 2015 and came into effect on 1 September 2015. We consider that the amended Network Operator's Reporting Manual does provide the appropriate level of clarity sought by licensees regarding the required timing for reporting changes or proposed changes to insurance arrangements.

We consider that SDP should be subject to the additional licence condition in relation to insurance.

## Compliance with audit guideline

*Compliance with the audit guidelines are prescribed in Schedule B, condition B5 of the amended SDP network operator's licence*

The standard licence template includes a condition which requires the licensee to comply with any audit guidelines issued by IPART, which is not in the existing SDP network operator's licence.

We consider that SDP should be subject to the additional licence condition in relation to compliance with the audit guidelines.

## Reporting of information in relation to the Register of Licences

*In relation to the register of licences, the notification obligations are listed in Schedule B, Condition B7 of the amended SDP network operator's licence.*

IPART is required to maintain a register of licences in accordance with the WIC Act and the Regulation<sup>6</sup>. The register of licences is required to be kept up to date with the relevant details prescribed in the Regulation. Condition B7 of the network operator licence outlines a licensee's notification obligations in relation to changes which need to be recorded in the register of licences in accordance with the Reporting Manual. The licence conditions included in this clause vary depending on the licensed activities, that is, whether the scheme includes potable water, non-potable water and or sewerage service. We have slightly changed the structure of this clause. We have also added one additional obligation in relation to reporting changes to the arrangements for the disposal of waste consistent with the standard template.

We note that the Metropolitan Water Directorate made comments regarding this condition suggesting that sections of it were inconsistent with the approach of certain other reporting clauses such as B11 or the authorisation of the licence outlined in Table A2.17. We consider the intention of Condition B7 to be notification only. Other reporting clauses such as B11 are intended for input to our decision to require an audit and thus we have intentionally required different notification periods (as discussed in more detail below). The Network Operator's Reporting Manual provides guidance in relation to this licence condition including a clarification note about the requirement for a licence variation.

We consider that SDP should be subject to the standard licence condition for the reporting of information in relation to the Register of Licences.

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<sup>6</sup> WIC Act, section 20; The Regulation clause 18.

<sup>7</sup> Email to IPART, Ms Cathy Cole, Acting Director, Metropolitan Water Directorate, 25 September 2015.

## Provision of plan

*Provision of plans licence conditions are prescribed in Schedule B, condition B9 of the amended SDP network Operator's licence.*

The existing SDP network operator's licence requires that the licensee must provide IPART with a copy of its amended Plans if it makes any change. The standard licence template requires that when a licensee makes a significant amendment to a Plan it provides a copy of the amended Plan to IPART. This condition manages the risk related to the operation of a scheme, but is a less onerous condition for the licensee.

We consider that SDP should be subject to the standard licence condition for the Provision of Plans.

## Changes to end use

*Changes to end-use licence conditions are prescribed in schedule B condition B11 of the amended SDP network Operator's licence.*

The standard licence template includes a condition regarding changes to end-use. There is no equivalent condition in the existing SDP licence. The licence condition requires the licensee to notify IPART in writing at least three months before commencing the supply of water for an end-use which is not set out in the most recent Water Quality Plan provided to IPART. The notification period gives IPART time to review the water quality plan.

We consider that SDP should be subject to the standard licence template condition for notification of changes to end-use.

## Consistent licence terminology, language and structure

We consider the SDP licence should be varied to align it with the terminology, language and structure (including numbering of conditions) used in the standard licence template. This change will improve consistency across licences.

We note that the Metropolitan Water Directorate provided a number of alternative wordings or structure of licence conditions A2.1, B7, B11 and B12.1. For consistency of the template, we have maintained the wording of the standard licence template. IPART will be undertaking a broader review of licence structure and conditions as part of our transition to the amended WIC Act in 2016, at this time we will consider alternative structures to licence under the WIC Act.

## 4 Review of licence – retail supplier’s licence

This section of the report contains an outline of the analysis conducted during our review of SDP’s retail supplier’s licence (licence number 10\_011R) and our recommendations.

### 4.1 Stakeholder consultation and submissions

Where the outcome of an IPART 5-year review of a licence under the WIC Act, is to recommend a variation to the licence, we are required under section 17(1) of the WIC Act to consult with the licensee and other persons prescribed by the *Water Industry Competition (General) Regulation 2008 (the Regulation)*. At this time, there are no other persons prescribed in the Regulation that must be consulted for an IPART licence condition variation.

We have invited submissions from SDP and the Metropolitan Water Directorate.

SDP made one comment in relation to a change in the wording of the insurance condition of the retail supplier’s licence<sup>8</sup>.

MWD made comments regarding our proposed changes to the licence, as detailed in the relevant sections below.

### 4.2 Variations to retail licence conditions

SDP’s licence was granted in August 2010. Since that time we have made changes to the standard licence template relating to insurance, compliance with audit guidelines, establishing a Code of Conduct for the delineation of responsibilities for interconnections, notification of changes to authorised persons, and obligations relating to the infrastructure to be used. We have also made a specific change to the description of authorised infrastructure. These changes are discussed in more detail below.

#### Specified Water Industry Infrastructure

*The Authorised Water Industry Infrastructure is specified in Schedule A, Table 2.2 of the amended SDP retail supplier’s licence.*

Following our 5-year review, we have amended Table 2.2 of the SDP retail supplier’s licence. The specified Water Industry Infrastructure of the proposed retail supplier’s licence references the water industry infrastructure of the proposed network operator’s licence *only*.

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<sup>8</sup> Letter to IPART, Mr Justin De Lorenzo, Sydney Desalination Plant, 15 September 2015.

The current licence includes a second reference to the infrastructure under the Sydney Water Operating Licence. This reference was originally included when ownership of SDP was held by Sydney Water. At the time, the licence was granted it was possible that SDP could retail water through SDP infrastructure and some components of infrastructure owned and operated by Sydney Water. As this arrangement is no longer relevant to SDP's operations, we have removed this reference from the table of specified infrastructure. We consulted with SDP on the change and they did not make any comments or raise any concerns.

We have left the retail area of operations unchanged to include the full Sydney Water area of operations, meaning that SDP could retail to customers anywhere in the area of operations. At present, SDP's network operator infrastructure is only connected to Sydney Water infrastructure, so retailing to 'non' Sydney Water customers will require either a variation to its network operator's licence or an access agreement with Sydney Water. MWD questioned the perceived inconsistency of the specified Water Industry Infrastructure and the area of operations, however we consider it appropriate that water is only retailed through Sydney Water infrastructure by agreement with Sydney Water.

## Insurance

*Relevant insurance licence conditions are prescribed in Schedule B, condition B3 of the amended SDP retail supplier's licence.*

The standard licence template includes additional insurance requirements to the existing SDP retail supplier's licence. The insurance conditions of the licence are intended to reduce risks to the licensee, customers and government. These include requirements for the licensee to provide to IPART:

- ▼ Certificates of currency for insurance.
- ▼ Provides a report in accordance with the reporting manual if there is, or is to be a change in the insurer or underwriting panel, or a change to the type, scope or limit of insurance held by the Licensee.

SDP made a submission to us regarding the inclusion of the words "or is" in licence condition B3.3. SDP suggested these words be deleted based on its concern that this wording creates uncertainty as to when a proposed change needs to be reported.

This obligation mirrors the obligation in the network operator's licence. Separate to this review we are amending the Retail Supplier's Reporting Manual to incorporate the same reporting table as the Network Operator's Reporting Manual. The table outlines the notification periods for provision of insurance materials to IPART with respect to various changes to insurance. It also includes the information to be included in a report to IPART providing the appropriate level of clarity sought by licensees regarding the required timing for reporting changes or proposed changes to insurance arrangements.

We consider that SDP should be subject to the additional licence condition in relation to insurance.

### **Compliance with audit guideline**

*Compliance with the audit guidelines are prescribed in Schedule B, condition B5 of the amended SDP retail supplier's licence*

The standard licence template includes a condition which requires the licensee to comply with any audit guidelines issued by IPART, which is not in the existing SDP retail supplier's licence.

We consider that SDP should be subject to the additional licence condition in relation to compliance with the audit guidelines.

### **Establishing a code of conduct for the delineation of responsibilities for interconnections**

*The requirement to establish a code of conduct with other licensed network operators, public water utilities and retail suppliers are described in Schedule B, condition B9 of the amended SDP retail supplier's licence.*

This clause has been included in our standard template since 2012 and mirrors the requirement in the condition B10 of the network operator's licence to establish a code of conduct with licensed network operators, retail suppliers or public water utilities which operate interconnected infrastructure to delineate responsibilities. The Metropolitan Water Directorate suggested that condition B9 be removed as there are already detailed arrangements in place governing the relationships between SDP and Sydney Water Corporation. As this is a condition in the standard template, we consider that it is appropriate to include this condition, and assess the extent to which the existing agreements conform to the requirements of a code of conduct. SDP made no comments about this condition.<sup>9</sup>

We consider that SDP should be subject to the additional licence condition in relation to establishing codes of conduct.

### **Notification of changes to Authorised persons**

*The requirement to notify IPART of changes to Authorised Persons is described in Schedule B Condition B10 of the amended SDP retail supplier's licence.*

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<sup>9</sup> Letter to IPART, Mr Justin De Lorenzo, Chief Financial Officer, Sydney Desalination Plant, 1 September 2015 and 15 September 2015.

This condition has been included in our standard template and mirrors the obligation of condition B12 in the network operator's licence. It allows IPART to consider the proposed alternative arrangements for the services previously undertaken by the Authorised Person. Once notified, IPART can make an assessment of the licensee's ongoing capacity to operate (required under condition B1) and take compliance action if necessary. This additional condition reduces the risk that a licensee will undertake activities that it does not have the capacity to undertake.

We consider that SDP should be subject to the additional licence condition in relation to notification of changes to authorised persons.

### **Infrastructure to be used**

*The requirement specifying infrastructure to be used in sourcing and supplying water is described in Schedule B Condition B11 of the amended SDP retail supplier's licence.*

The condition that the licensee must only source and supply water by means of water industry infrastructure maintained and operated by a licensed network operator or public water utility has been included in our standard template to prohibit the use of unlicensed infrastructure to source or supply water.

We consider that SDP should be subject to the additional licence condition in relation to Infrastructure to be used.

### **Sufficient Quantities**

*The requirement about obtaining water has been removed from the licence (Schedule B Condition B8 of the existing retail supplier's licence).*

The condition that the licensee must ensure sufficient quantities of the water supplied by the licence holder to its customers have been obtained otherwise than from a public water utility has been removed from the standard licence conditions. This is a criterion that the Minister must consider during assessment of applications<sup>10</sup>, but is not an explicit requirement of the WIC Act.

We consider it appropriate that this condition be removed from the SDP retail supplier's licence.

### **Consistent licence terminology, language and structure**

We consider the SDP licence should be varied to align it with the terminology, language and structure (including numbering of conditions) used in the standard licence template. This change will improve consistency across licences.

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<sup>10</sup> WIC Act, section 10(4)(d).

We note that the Metropolitan Water Directorate provided a number of alternative wordings or structure of licence conditions B7.1 (a), B9 and B11. For consistency of the template, we have maintained the wording of the standard licence template. IPART will be undertaking a broader review of licence structure and conditions as part of our transition to the amended WIC Act in 2016, at this time we will consider alternative structures to licence under the WIC Act.

## 5 Recommendations

We recommend that the Minister:

- 1 Varies the SDP network operator's licence (licence number 10\_010) and conditions imposed on that licence as set out in the proposed amended licence.
- 2 Varies the SDP retail supplier's licence (licence number 10\_011R) and conditions imposed on that licence as set out in the proposed amended licence.

Once we receive notification of the Minister's decision on variations to the licence, we will notify the licensee.