

**REVIEW OF THE OPERATING LICENCE FOR
HUNTER WATER CORPORATION**

**SUBMISSION BY TOTAL ENVIRONMENT CENTRE TO
THE INDEPENDENT PRICING AND
REGULATORY TRIBUNAL**

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INTRODUCTION

Total Environment Centre (TEC) welcomes the opportunity to comment on the review of the Hunter Water Corporation (HWC) Operating Licence. TEC regards the Operating Licence as a vital regulatory instrument and crucial to ensuring a high level of performance and accountability in the corporation's operations

TEC notes the concerns expressed by the Tribunal in the issues paper that the licence should not impose unnecessary compliance and administration costs (IPART, 2006a). TEC stresses that it should not be used as an excuse for eroding the integrity of the operating licence model and that water supply and wastewater are of such essential nature that there is a high degree of public interest in transparency and accountability. We do not believe that current regulatory arrangements place an excessive burden on HWC. Detailed comments in this respect are provided below

This submission also presents a framework for the new Operating Licence that will bring Hunter Water's operations into line with ESD principles. It also details mechanisms to improve the corporation's transparency and accountability.

HUNTER WATER'S FUNCTIONS AND REGULATORY ARRANGEMENTS

Primary functions

TEC believes that in addition to the primary functions set out in the *Hunter Water Act 1991*, HWC should be required to meet similar objectives to Sydney Water Corporation (SWC) i.e. protection of the environment, public health and economic viability. The Operating Licence should define these objectives and require HWC to give them equal weight. Such a requirement would be consistent with the triple bottom line approach which is increasingly being adopted by progressive corporations. As a major corporate entity in the Hunter region HWC should take a lead in adopting and promoting this approach.

Role of the Operating Licence

As noted above, TEC strongly supports the maintenance of the current operating licence model. We are concerned with the emphasis in the issues paper on "avoiding unnecessary compliance and administration costs" and to "not duplicate other regulatory instruments". We do not believe that the current licence results in unnecessary regulatory duplication or places an excessive burden on the corporation.

TEC notes the view put by HWC in their submission that the main focus of the Operating Licence is to ensure that Hunter Water delivers appropriate standards of service to its customers and community (HWC, 2006). This is an excessively narrow interpretation of the role of the Operating Licence. The licence also functions to ensure accountability and ensure that a comprehensive picture of the corporation's performance can be obtained from the operational audit.

The Operating Licence provides a simple and transparent mechanism for ensuring the Corporation's operations are publicly accountable. It is essential that the Operating Licence be an overarching instrument that clearly sets out obligations and performance requirements. Allowing these obligations to rest solely within other instruments could lead to regulatory

confusion, create barriers to review of performance in the operational audit and create barriers to easy public access for accountability. The Operating Licence provides an integrating instrument that allows coherent management of HWC as a whole. No other regulatory agencies or instruments provide such a function.

TEC also stresses the importance of maintaining a comprehensive operating licence model in view of changes to the water industry that will occur under the *Central Coast Water Corporation Bill 2006* and the *Water Industry Competition Bill 2006*. We note that these two Acts will require the establishment of operating licences for private sector operators and for the Central Coast Water Corporation.

We draw the Tribunal's attention to remarks by the Minister for Water Utilities, the Hon David Campbell MP in his second reading speech on the *Water Industry Competition Bill 2006* (NSW Legislative Assembly Hansard 24/10/06). The Minister stresses the importance of establishing a comprehensive regime for licensing private corporations that will operate in the water sector. In particular, the Minister notes that "Licences ensure that appropriate conditions can be imposed and enforced. They will ensure, for example, that water quality guidelines are complied with. They will also ensure that network operators and retail suppliers comply with appropriate public health, environmental and consumer protection requirements." The Minister also notes that licence will need to have regard to four core principles of:

1. protecting public health, the environment, public safety and consumers;
2. encouraging competition in the provision of water supply and sewerage services;
3. ensuring the sustainability of water resources; and
4. promoting the production and use of recycled water.

With private sector involvement in the water industry and the creation of a new Central Coast Water Corporation maintaining the integrity of the comprehensive operating licence model is of paramount importance. Any diminution of the HWC licence will set a dangerous precedent that will likely result in other water sector operators seeking a less inclusive and overarching licence.

TEC rejects the notion that current arrangements are placing an excessive compliance and administrative burden on HWC or other water corporations. We note from the report of the Tribunal's recent *Investigation into the Burden of Regulation in NSW and Improving Regulatory Efficiency* that total regulatory costs for Sydney Water are estimated at approximately \$6.7 million for the 2004/05 period, or 0.8 per cent of SWC's total operating expenditure and \$0.6 million or 1.5 per cent of total operating expenditure for Gosford City Council (IPART, 2006b).

We note also that total regulatory costs for Hunter Water (fees to Department of Environment and Conservation, Department of Natural Resources, Auditor-General and IPART audit) are estimated at \$1.2 million or 1.8% of HWC's total operating costs (IPART, pers comm.).

Total regulatory costs of a few percent of total operating expenditure are not excessive given the importance of proper regulation of major utilities. In view of this TEC does not

believe that current regulatory arrangements are creating unnecessary or excessive costs for Hunter Water.

Regulatory Framework

The Tribunal's Issues Paper (IPART, 2006a) identifies the key elements of Hunter Water's regulatory framework as including the Operating Licence, Statement of Corporate Intent, DNR water plans and licences, DEC Environmental Protection Licences, NSW Health, NSW Dam Safety Committee, Catchment Management Committees and the National Water Initiative.

TEC acknowledges the need for efficient regulatory arrangements and preventing duplication. As noted above, however, it is important that the Operating Licence be an overarching instrument that clearly sets out the corporation's obligations and performance requirements. Relationships with other statutory instruments should be included in the Operating Licence. Requirements of other regulatory agencies and instruments should be referenced in the licence to allow performance in meetings these requirements to be considered in the operational audit process.

TEC is also concerned that activities conducted by other parties on behalf of HWC should be consistent with Operating Licence requirements. We acknowledge that the Operating Licence cannot regulate the activities of other parties, however, HWC cannot absolve itself of responsibility to ensure that activities carried out on its behalf are consistent with the corporation's own requirements and obligations. HWC must be responsible to ensure that contracts with agencies or other parties require those parties to adhere to the same standards as those imposed upon the corporation. HWC must not be able to engage others to perform activities it is not permitted to carry out itself or to conduct operations at a standard below its own. The Operating Licence should, therefore, require HWC to ensure that any contracts it enters into include provisions consistent with those in the licence and other instruments. HWC should also be responsible for ensuring that contractors adhere to those provisions.

WATER QUALITY

Drinking water quality

The current Operating Licence for HWC requires compliance with Draft 1996 Australian Drinking Water Guidelines established by the National Health and Medical Research Council (NHMRC) and Agriculture and Resource Management Council of Australia and New Zealand (ARMCANZ). As noted in the issues paper, these guidelines have been superseded by the 2004 and Hunter Water is reporting against the new guidelines (IPART, 2006a).

TEC strongly believes that it is essential that the Operating Licence require HWC to comply with the most up to date standards for drinking water that are in place at any time. For this reason we believe that the licence should require HWC to comply with the 2004 guidelines and any revisions to the health related aspects of those guidelines.

TEC believes that the relationship between the Operating Licence and the MOU with NSW Health needs to be strengthened. In a submission on the 1999 review of the Operating Licence for Sydney Water Corporation (PENGOs, 1999) environment groups noted the Licence Regulator's comments that its ability to effectively review Sydney Water's operations was limited by the lack of targets and timelines in the MoUs. Effectively, the Licence Regulator was only able to check that MoUs have been completed. The report of the Sydney Water Inquiry (McClellan, 1998) recommended that the Operating Licence should be amended to require that MoUs include targets, timelines and review provisions and specifically require the Water Auditor to audit their contents.

We are concerned that the current HWC Operating Licence may similarly constrain the scope of the licence audit. In the interest of transparency and accountability we believe that the licence should include the requirements of HWC's MOU with NSW Health and make performance against them subject to consideration in the operational audit.

Bulk water

TEC acknowledges that there may be merit in adopting similar requirements for monitoring bulk water as currently apply to the Sydney Catchment Authority (SCA). We also support retention of the requirement to report the results of monitoring carried out under the Water management Licence and the five year water quality trends in the Williams River.

TEC agrees with the Tribunal's comment that the quality of water released into rivers is an important environmental issue (IPART, 2006a). We note, also, the comment that HWC is not the only agency responsible for environmental water quality, and that other agencies share responsibility for catchment management. In view of this TEC would support a requirement for HWC to use its "best endeavours" to ensure the quality of environmental water as suggested in the issues paper.

Water supplied for purposes other than water treatment

TEC believes that it is important that recycled water and raw water be fit for the purpose for which it is supplied. This will obviously vary depending on the application involved and will generally be specified in the supply contract with each customer. It is important, however, that HWC's performance in supplying recycled water to customers be considered in the operational audit. The operating licence should, therefore, require HWC to supply recycled water in accordance with supply contracts and allow performance against these contracts to be considered in the audit.

CATCHMENT MANAGEMENT AND PROTECTION

TEC strongly supports the retention of current Operating Licence requirements for HWC to report activities done to comply with other regulatory instruments. This is important in maintaining an overarching licence and ensuring a comprehensive audit of performance. We note that these obligations do not place compliance costs on the corporation (IPART, 2006a).

Requirements to produce the 5 year Environmental Management Plan and to publish an annual Catchment Report should also be returned. We concur with the Tribunal's view that

requiring HWC to report on its performance against the Water Management Licence and Dams Safety Act provides transparency and enhances accountability in these areas (IPART, 2006a).

PROTECTION OF THE ENVIRONMENT

Environmental Management Plan

As stated above TEC supports retention of the requirement to produce the 5 year Environmental Management Plan. We note from the Issues paper that this forms part of HWC's Environmental Management Plan (EMS) the Tribunal is considering also requiring that the EMS be certified to the relevant Australian standard (IPART, 2006a). TEC supports this proposal which would bring the HWC licence into accord with the licence for Sydney Water and ensure best practice.

Environmental and ESD Indicators

TEC acknowledges that there is value in aligning the indicators for HWC with those of SWC and the SCA as much as possible in order to allow benchmarking of performance. Comparing performance between agencies would allow opportunities for improvement to be identified and successful strategies in one agency to be adopted by others. This should only be applied, however, to indicators that are relevant to HWC and should not be at the expense of providing a comprehensive overview of HWC's environmental performance. Indicators that remain valid for HWC should be retained, irrespective of whether they apply to SWC and SCA. Where indicators can be aligned, however, this should occur. The indicators chosen should be made available for public review and comment

Energy management

As noted in the discussion paper (IPART, 2006a) water agencies are major consumers of energy through STPs, sewage pumping and offices. Consequently, increasing energy efficiency and the proportions of electricity generated from renewable resources is one way in which Hunter Water could reduce the overall environmental impact of its operations.

NSW Government requirements to prepare energy savings plans should be reflected in the Operating Licence. TEC would also support the proposal for inclusion of requirements to report progress in reducing energy consumption and increasing renewable energy, supported by appropriate indicators (IPART, 2006a).

This should not, however, be the limit of energy management requirements in the licence. To build upon this the Operating Licence for HWC should require HWC to adopt best practice in energy efficiency through measures such as:

- implementing a comprehensive energy use and management strategy, incorporating energy audits and energy conservation measures;
- monitoring energy opportunities that may require additional capital expenditure but would allow and provide for;
 - * diversity and flexibility to switch between energy forms to complement and augment grid electricity;
 - * insurance against unexpected supply constraints or price rises.
- using energy efficient motors for all new projects or motor upgrades and replacements.

Stormwater

Pollution from stormwater is an issue needing considerable attention. Hunter Water should meet measurable performance targets for both the quantity and quality of stormwater that flows through its drains. These standards should be developed in cooperation with other relevant agencies, including local government and the targets written into the Operating Licence. The fact that local councils are generally responsible for top-of-catchment stormwater drainage is not a justification for maintaining inadequate performance.

Performance standards for stormwater must be based on *the hydrological capacity of each catchment*. Capacity targets should reflect the need to reduce both the quantity and velocity of stormwater which runs off urban catchments. This target would involve consideration of initiatives undertaken upstream in the catchment, especially as the tendency for development and redevelopment is to increase the amount of impervious land in a catchment. (NCC et al, 1998). In this respect a standard for stormwater would strengthen HWC's EMP requirements in relation to participation in Catchment Management Committees and working with councils to develop Stormwater Management Plans.

Operating Licence stormwater standards would also encourage HWC to vigorously pursue source control initiatives and encourage cleaner production amongst local industries.

As a further step toward improving stormwater management HWC should actively pursue a program (in association with local government) of restoring and rehabilitating drainage canals to a more natural, riverine habitat. Such a program would offer considerable environmental benefits through improving the quality of stormwater discharged into receiving environments and increasing aquatic habitat. The Operating Licence should include a requirement to develop a program of canal restoration along with a target for km's of stream to be restored over the course of the licence.

SYSTEM PERFORMANCE

System performance standards and indicators

TEC notes that the current system performance standards have generally been complied with. It is likely, however, that customers expect, as a minimum, that there will be no deterioration of service levels. To comply with expectations that there should be no decline in service standards, these targets should be set to ensure that current service levels are enshrined in the licence as minimum standards. While we acknowledge the need to retain a

certain degree of 'headroom' in the system performance standards, it is important that there not be an excessive degree of headroom that would permit a decline in service standards.

TEC believes that current indicators are generally appropriate, however, we note that the Tribunal has engaged GHD Limited to conduct a detailed review of system performance standards and indicators. TEC looks forward to the report of GHD Limited on the system performance standards and indicators and would welcome and opportunity to comment on their report.

Asset management

Appropriate investment in asset management is essential to prevent decline in service levels and environmental protection. While system performance standards and indicators provide a measure of current performance, we support the Tribunal's view that they do not provide warning of underinvestment in asset management and possible problems in the future (IPART, 2006a). Given the critical importance of HWC's assets and the possible consequences of failure TEC strongly supports the inclusion of asset management requirements in the Operating Licence.

TEC believes that the Operating Licence should include a requirement for HWC to maintain an asset management strategy that is subject to independent audit. The requirements of the asset management strategy should be similar to those in the SWC and SCA Operating licences.

MANAGING THE SUPPLY AND DEMAND FOR WATER

TEC does not believe that current Operating Licence requirements for balancing supply and demand are adequate, particularly in relation to demand management and recycling. TEC is particularly concerned at the heavy emphasis on supply augmentation in the Integrated Water Resource Plan (IWRP). We note that HWC considers that this reflects the least cost approach (IPART, 2006a). We are particularly concerned that current least cost assessment may not adequately consider externalities such as environmental costs in assessing supply augmentation options against demand management and recycling options.

Demand management, water efficiency and reuse

Demand management

Demand management and effluent re-use must be given priority as options for meeting increasing demand for water and avoiding augmentation of supply. TEC acknowledges that household usage in the Hunter has typically been lower than other Australian cities. This is largely a result of historic factors, including the fact that HWC was the first agency to adopt user pays pricing and that its introduction corresponded with a major drought and water restrictions. It is unclear whether HWC's non-price demand management is adequate. It is important to note, however, that the Hunter is experiencing rapid population growth that is expected to continue under the recently released Draft Regional Strategy for the Hunter with 125,000 extra residents forecast over the next 25 years (Dept Planning, 2006). A large number

of these new residents will not have been exposed to historic factors that have influenced consumption patterns in the area.

It is also important to note that Hunter Water is being called upon to supply increasing quantities of water to Gosford and Wyong Councils with the upgrade pipeline to the central coast eventually able to supply up to 175ML each week (Newcastle Herald, 8/7/2006). The potential will exist to supply up to 9,125 ML per year. This is equivalent to 12% of HWC's usual annual water supply or 16.5 years normal growth in demand (HWC, 2003).

In view of this, the relatively secure position of HWC's supply in comparison to other areas should not be taken for granted. TEC is concerned that a degree of complacency on water supply and demand issues may result in serious problems occurring in the future unless concerted action is taken to ensure sustainable management of the Hunter's water resources. TEC, therefore, calls on the Tribunal to introduce rigorous demand management and recycling targets in the new Operating Licence.

TEC notes that the current voluntary water savings target of 1000 ML has been easily exceeded and that the IWRP notes that water savings double the targeted amount are possible (IPART, 2006a). In view of this there seems little reason not to set a more vigorous target that will ensure that greater savings are realised.

TEC is also concerned that the current per capita target of 215 KL is inadequate as it considers only residential consumption. There is thus little incentive for pursuing demand reductions or promoting further recycling in the commercial sectors. TEC notes that when the consumption of these sectors is considered that per capita consumption in the Hunter may be less efficient than within SWC's area of operations (IPART, pers comm.). TEC calls on the Tribunal to introduce a consumption target that includes the commercial and industrial sectors.

Reduction of water leakages

TEC notes the Tribunal's comment that greater emphasis could be placed on leakage reduction through setting leakage reduction targets or minimum response times (IPART, 2006a).

In the Issues Paper for the 2001 review the Tribunal noted that HWC had the highest overall leakage rate of any metropolitan water agency in Australia at 15.5% (IPART, 2001). In view of this TEC believes that it is appropriate for HWC to be set a leakage reduction target as has been included in the SWC Operating Licence.

The Operating Licence should also require HWC to implement a rigorous program of leak detection and prevention.

It may be argued that such requirements would place an additional cost burden on the corporation, however, this should be considered in light of deferring the costs of supply augmentation.

Water recycling and reuse

In the 2001 review the Tribunal noted that Hunter Water recycled around nine percent of dry weather flows, a figure considerable higher than most other major water authorities (IPART, 2001). It is important to consider, however, that most of this re-use is concentrated in a very small number of large applications (i.e. Eraring Power Station). It is also important to consider that the loss of any of the current applications would significantly reduce the quantity of water recycled. New industries may also significantly increase demand for water. To curb increasing demand Hunter Water must play a major role in promoting re-use applications and water conservation technologies for both established and new industries as part of its contribution to the development process. The Operating Licence should clearly commit HWC to this course of action and the goal of preventing supply augmentation.

The Operating Licence should, therefore, commit HWC to actively promoting increased effluent re-use and preventing supply augmentation. This will require the inclusion of a target for increased volumes of effluent recycled over the term of the licence. As a minimum the voluntary target of 13% in the IWRP should be formalised by inclusion in the Operating Licence as a mandatory target..

Permanent restrictions

TEC strongly advocates the introduction of permanent water conservation measures similar to those adopted in Melbourne and Adelaide as a key component of entrenching sustainable water use behaviour and ensuring long term demand savings. We note in particular that research shows 61% support for some form of permanent restrictions by Hunter Water Customers (IPART, 2006a).

OPERATIONAL AUDITS OF THE LICENCE

TEC acknowledges that there are a number of areas in which HWC consistently achieves a high degree of compliance with Operating Licence requirements. TEC accepts that there may be merit in providing 'audit holidays' for parts of the Licence in high levels of performance have been shown in the preceding period and adopting a risk based approach to licence audits as adopted for SWC and SCA.

TEC believes that the first and final audits of each licence period should be comprehensive and cover all aspects of the licence. Other audits could be confined to areas where performance has been less consistent or where failure to comply would present a serious risk to the environment, public health and safety or the financial performance of the corporation.

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