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Dr Michael Keating, AC
Chairman
The Independent Pricing and Regulatory Tribunal of NSW
Level 2, 44 Market Street
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Dear Dr Keating

**Investigation into Water and Wastewater Service Provision in the
Greater Sydney Region**

Thank you for the opportunity to respond to the Tribunal's Draft Report on its Investigation into Water and Wastewater Service Provision in the Greater Sydney Region.

AGL's submission is attached. Please contact Warwick Tudehope on 9921 2929 if you wish to discuss the submission.

Yours sincerely

Robert Wiles
General Manager Regulation and Policy

Investigation into Water and Wastewater Service Provision in the Greater Sydney Region

1. Introduction

This submission is made by The Australian Gas Light Company (AGL) in response to the Tribunal's Draft Report, "Investigation into Water and Wastewater Service Provision in the Greater Sydney Region".

AGL has previously made submissions in response to the Issues Paper released by the Tribunal in connection with the investigation and also in response to the Tribunal's draft determinations on water and wastewater pricing for the Sydney Catchment Authority, Sydney Water Corporation and Hunter Water Corporation¹.

AGL supports the direction of the Tribunal's recommendations in its Draft Report insofar as they are intended to facilitate greater private sector participation in the provision of water and wastewater services for Sydney.

It is acknowledged that New South Wales is embarking on a process of water industry reform which is likely to have far-reaching consequences but where the end-point and path are yet to be clearly defined. The Tribunal recommends an "adaptive management" approach in this context.

In both its previous submissions, AGL has referred to opportunities for private sector participation, some of which could be implemented relatively quickly and make a substantial contribution to alleviating Sydney's current supply problems. Recycling water for industrial and commercial use is one such opportunity. However, those projects cannot proceed without legislative authorisation. AGL is therefore concerned at the length of time it might take for the process recommended by the Tribunal to deliver that authorisation.

Given the Government's clearly stated policy to encourage greater private sector participation in the water industry and the pressing supply problems currently facing Sydney, there is a strong case for taking prompt action. The Tribunal's recommendations do not appear to address these imperatives.

This submission does not address all of the Tribunal's recommendations. It focuses on those aspects of the Draft Report that have a direct bearing on private sector participation in the infrastructure sector of the industry. The submission is organised as follows:

Section	Recommendations discussed
2. The need for a licensing regime	8, 17
3. Timing and certainty	20, 21, 22
4. Competitive procurement	1, 2, 3, 9
5. Property rights	10
6. Price regulation	15, 16
7. The proposed access regime	4, 5

¹ AGL, 15 June 2005, *Investigation into water and wastewater service provision in the greater Sydney region*, Letter to IPART
AGL, 15 July 2005, *Prices of Water Supply, Wastewater and Stormwater Services*, Letter to IPART

2. A licensing regime

Recommendation 8 refers directly to the removal of legislative impediments to private sector participation. AGL supports that recommendation. At the same time, the Draft Report states that there are “no express legislative prohibitions on private sector involvement ... ” (Section 7.1). While that may be the case, none of the existing mechanisms that might be used, such as the Water Management Act (WMA) approval process or the Pipelines Act, are workable.

The Draft Report refers at several points to the need to establish obligations that will apply to new entrants (Recommendation 17) and refers indirectly to licensing (Section 4.3.4). At Footnote 68, the Tribunal cites AGL’s submission in which a number of licensing issues are discussed. However, the Tribunal does not recommend explicitly that a licensing/authorisation regime be established. In AGL’s view it is important that such a recommendation be made. Not only does a licensing regime provide a vehicle for imposing basic obligations and accountabilities on participants, it is also a means of conferring rights and ensuring that entrants are appropriately qualified and resourced. Importantly, a licence and the rights and obligations that attach to it, provide certainty for investment decisions.

In terms of implementing a licensing regime, the Gas Supply Act (GSA) is an appropriate model in that it provides an established framework for activity-based licensing, the role of the regulator, and relevant rights and obligations. An analogous regime could be established for water through new legislation or, perhaps more efficiently, by amendment of existing water legislation such as the WMA. The principal features of the regime are:

- Definition of classes of licensed activity. In the case of gas, the classes are reticulation and supply. A wider range could be envisaged for water to cover treatment, reticulation, and supply of potable water or recycled water; and gathering, treatment and disposal of sewage.
- Arrangements for processing and determining licence applications, and for setting licence conditions.
- Licence compliance and enforcement provisions, including the role of the regulator in those processes.
- For infrastructure providers (reticulators, in the case of gas), matters relevant to installation of infrastructure assets including powers to enter public land and roads to install works, and assurance of ownership of works once installed.

The GSA currently includes retail market operation and consumer protection provisions and, when first enacted, also included open access provisions to cover the period prior to implementation of the national gas access regime. Similar provisions could be included in a water enactment as appropriate.

While the WMA provides already for the establishment of water supply authorities, those arrangements are not directly applicable to private participants. For example, it would be totally inappropriate to have private sector participants subject to the structural, governance, and direct Ministerial control provisions that apply to water supply authorities (Chapter 6, Part 2). One option would be to establish a private sector licensing stream in parallel with the existing water supply authority provisions. Alternatively, the existing approval regime in Chapter 3, Part 3 of the WMA might be used with some amendment.² The Pipelines Act is yet another alternative, however it is

² For example:

- the approval process does not apply to all of the types of water-related activities that are to be opened to private sector participation (such as wastewater treatment and recycling) or in all areas of the State. (See WMA s90 and definitions of water management works and

primarily designed to facilitate point to point cross-country pipelines that have an essentially static configuration. Access to private land, including the acquisition of easements, forms a significant part of the Pipelines Act scheme. The Act is not designed for or suited to the administration of activities such as large scale recycling projects which involve processing operations and pipe networks in public roads.

An important requirement if the private sector is to become involved in the provision of water infrastructure is the right to access public land and break roads to lay pipe. We note that the WMA provides those rights already, but only to water supply authorities (ss297 and 298). If the existing WMA rights were considered too extensive for a private sector entity, then the GSA (Part 4, Divisions 1 and 2) provides an acceptable alternative model.

Certainty of ownership of infrastructure, once installed, is also essential. This is particularly the case where the infrastructure is in or on public land. Ownership should be confirmed in legislation. Once again the GSA (s52) provides a model.

3. Timing and certainty

AGL agrees with the Tribunal's observation that, given Sydney's current supply situation, the primary focus of reform, at least initially, "should be on developing new supply sources and efficient water usage, compared with more traditional reform objectives of improved productive efficiency, increased customer choice, lower prices and better service standards." (Section 4.1). In that context, the sequenced approach suggested in section 10.4 is logical i.e. establish the basic principles and features of the framework and "progress initiatives that can make material improvements for little effort", before progressing to matters (such as an access regime) which will take time to develop. Having said that, it appears likely that it will be some time before the process recommended by the Tribunal (Recommendations 20 to 22) will produce any concrete results.

There are significant opportunities that could be implemented relatively quickly to assist in alleviating Sydney's supply problems. However, it is most unlikely that a new entrant will commit to any such project and the significant expenditures involved without facilitating legislation. While "clear advance indication from Government of the nature of proposed changes" (Section 9.1) as suggested by the Tribunal would be useful, it would not be adequate. The Tribunal's qualification says as much: "(Although the Tribunal does recognise that Government policy can change and that therefore there are may be some instances where it is appropriate or unavoidable for regulatory requirements to change *after* private sector involvement)".

It would be helpful if the Tribunal could give clearer guidance as to the legislative changes that are required and the priority that should be given to implementing those changes. For example, it appears inevitable that a licensing regime will be a component of the framework. Thus, in order to avoid unnecessary delay, preparatory work on licensing could be undertaken as a matter of priority, concurrently with work on definition of the framework. Once again the focus should be on those aspects of the

water supply works. See also WMA s88A and New South Wales Gazette No 110, 30 June 2004.)

- There are a number of circumstances where approval must not be granted, including where the applicant does not own or otherwise have access to relevant land (s97 and 97(5) in particular).
- With limited exceptions, a water supply authority has exclusive rights within its area of operation (s289).

regime that go to the construction, ownership and operation of infrastructure for supply, including recycling. Access and retailing aspects of the licensing regime are less urgent.

4. Competitive sourcing of additional water supplies and improvement and expansion of Sydney Water Corporation's outsourcing practices generally

AGL supports Recommendations 1 and 2 concerning competitive sourcing by Sydney Water with two qualifications:

- a) The Sydney Catchment Authority was established as a separate entity to Sydney Water to give appropriate management focus to the very different activities of catchment management on the one hand, and water treatment, reticulation, and supply, and management of sewerage operations, on the other. It would be inappropriate, and a regressive step, for Sydney Water to own and operate any significant new source of supply as part of its monopoly infrastructure operations. The proposed desalination plant is a case in point: it should be owned by the Sydney Catchment Authority or some other entity.

Vertical separation of potentially competitive activities from monopoly infrastructure activities will also ensure that supplies to Sydney Water are costed transparently, both as a signal to Sydney Water in the conduct of its operations, and as a signal to potential suppliers. Establishing that principle now for Sydney Water will ensure clarity of Sydney Water's role in sourcing and distributing supplies as opposed to production, and avoid the need for subsequent separation if structural disaggregation of Sydney Water is undertaken at some time in the future. It is also consistent with the separation that has occurred in other industries as a precursor to open access.

Sydney Water's supply situation is currently complicated by the Government's policy decision to build a desalination plant when raw water is available to Sydney Water from the Sydney Catchment Authority in contractually unrestricted quantities, but not sustainably, at less than 20 cents/kL. This complication exists independently of whether the desalination plant is to be owned by Sydney Water or others.

- b) The Tribunal's discussion of implementation issues (Section 3.1.4) suggests that it may take some time before the recommended processes are established. Sydney Water should not be prevented from entering into new binding arrangements in the meantime, especially in view of Sydney's current supply problems. Whatever processes are established for competitive sourcing, Sydney Water should also have the discretion to enter into new arrangements without going to competitive bids, for example, to take advantage of opportunities which are unique in terms of innovation, technology or timing/availability.

AGL is also strongly supportive of Recommendation 3 which proposes the adoption of outcomes-based procurement practices and expansion of Sydney Water's competitive procurement program generally. However, one of the key requirements for private sector participation in this activity will be access to relevant information. Improved arrangements for the collection and dissemination of information, as called for by Recommendation 9, is therefore an important prerequisite for the successful implementation of Recommendation 3 and a number of other recommendations.

5. Property Rights

The Tribunal recommends (Recommendation 10) that the Government establish property rights for sewage and stormwater.

There is no doubt that assurance of title to feedstock resources is essential for investment in water processing and distribution infrastructure. However, there would appear to be a distinction between public or communal resources, such as stormwater and seawater (as a feedstock for desalination) on the one hand, and sewage where, on AGL's understanding, Sydney Water presently has title to sewage in its system.

Of equal importance to title itself, is the question of how title should be awarded and any associated costs/charges. For example, assessments performed by AGL confirm that, at the potable water prices recently determined by the Tribunal for Sydney Water, water recycling projects cannot afford to pay anything for the sewage feedstock from which water is reclaimed for recycling.

6. Price Regulation

The Tribunal's Recommendations 15 and 16 deal with the regulation of prices. The discussion at Section 8.1 includes recycled water among the services for which price regulation is recommended.

In a recent paper³, the following observation is made:

"Throughout Australia, policies established for pricing recycled water often lack transparency and are inconsistent, varying from case to case. This inconsistency is unfortunate because it makes the economic feasibility of future recycled water projects more difficult to undertake. Real cost estimates for the production and delivery of existing recycled water projects indicate that the provision of recycled water is seldom economically feasible and rarely meets full cost recovery."

No private sector project will proceed unless there is an expectation of full cost recovery. The projects discussed in the Hurlimann paper all produce recycled water for domestic consumption where one of the considerations in setting prices is to encourage the uptake of recycled water in a situation where emotive/psychological issues are said to play a part. Those issues are unlikely to be of concern for non-residential consumers who can be expected to take a rational commercial approach.

In AGL's view, the retail price of recycled water for residential and non-residential non-potable use, and for environmental flows, should not be regulated given that recycled water is likely to remain a relatively small component of total supply and that it will, in all cases, be competing with or substituting for potable water, the price of which is regulated.⁴

It is perhaps appropriate in this context, to comment briefly on the Tribunal's recent Final Determinations on pricing for Sydney Catchment Authority, Sydney Water Corporation and Hunter Water Corporation.

The retail price of potable water and the prices of Sydney Water's supply alternatives (principally from SCA) will be fundamental determinants of the growth in private sector

³ Hurlimann A et al, Pricing of Drinking Water vs Recycled Water: Fairness and Satisfaction, Water, March 2005, p50

⁴ If use of recycled water is mandated e.g. for non-potable use in new development areas, it may be appropriate to set a price cap at no less than the potable price.

participation and the success of any move by Sydney Water towards competitive procurement of supplies. As AGL observed in its previous submission⁵ and in section 4 above, for so long as Sydney Water has access to raw water from SCA at less than \$0.20/kL (as set by the Final Determination), it will have no incentive to take water from new sources such as desalination or recycling. Likewise there will be no retail market for water derived from higher-cost sources while the price of potable water is suppressed, unless subsidies are introduced.

These views are reinforced by a recent IMF Report on Australia⁶

"32. Productivity gains can also be realized by improving the efficiency of key infrastructure sectors, where reform of pricing is essential. A recent review proposed regulatory reforms to reduce the risk of infrastructure constraints on export performance, but important infrastructure reform challenges remain, especially in water, land transport, and electricity (Box 4). Reform programs to address some of these issues, such as the National Water Initiative, are already in place, and the recent meeting of the Council of Australian Governments agreed to renew the NCP reform agenda. With demand for infrastructure services likely to grow, the mission urged that the reform agenda be ambitious. In particular, improving the price signals in each of these sectors is a priority to encourage the efficient use of water, road and rail networks, and electricity. Such signals will also help stimulate appropriate and timely investments to meet growing demand."

"Better pricing of infrastructure services can promote the best use of these services while also stimulating appropriate investments. State governments are planning large increases in infrastructure spending, but simply increasing the quantity of infrastructure is not an efficient strategy. In the case of water, appropriate prices would not only moderate demand by discouraging waste and inefficient uses of water, it would also enhance supply by making investments (e.g., in dams, pipe repairs, and recycling facilities) more economic. A well functioning market in rural water rights is therefore needed."

AGL is encouraged by the Tribunal's statements in its Final Determinations Report that it could reopen the Determinations prior to 2009 to address changed circumstances, such as the construction of a desalination plant. Given recent Government announcements, there is now a high degree of certainty that the desalination plant will be built. Accordingly, AGL urges the Tribunal to consider reopening the pricing Determinations sooner rather than later.

7. Proposed Access Regime

AGL agrees with the Tribunal's suggestion that work to progress an access regime should be carried out after "initiatives that can make material improvements for little effort" (section 10.4). The development of an access regime will no doubt involve thorough consultation at that time and AGL would expect to participate in that process. However, there are several aspects of the Tribunal's current proposals that warrant comment:

- a) In a previous submission, AGL commented on the importance of separation of powers as a matter of principle in the context of granting and administering/enforcing

⁵ AGL, 15 June 2005

⁶ International Monetary Fund, Australia, Staff Report for the 2005 Article IV Consultation, August 24, 2005 (pages 19 and 20)

licences⁷. Similar issues arise in relation to administration of an access regime. The Tribunal suggests (Section 4.3.4) that the regulator's responsibilities could include determining which assets should be subject to open access. In AGL's view it would not be appropriate for the regulator to have that role. The preferred position would be to have access assessments and decisions made independently of the regulator as is the case under the national access regime. AGL accepts that, for water, it may not be feasible or efficient for New South Wales to establish and maintain a dedicated "coverage" review body. As an alternative, consideration could be given to using the services of the National Competition Council which is well equipped to perform that role.

If the regulator is to make "coverage" assessments, then its role should be an advisory one and the Minister should be the decision maker. Likewise, the roles of making and enforcing the proposed regulatory guidelines (section 4.3.4 and Recommendation 5) must be separated. Responsibility for making guidelines should reside with the Minister.

- b) The Tribunal proposes that there be a "statutory contract override mechanism" whereby the Tribunal would have the power to override a contract that did not conform to the Tribunal's regulatory guidelines. Such powers would appear to be unnecessary under a negotiate and arbitrate model. If the Tribunal's concern is the possibility of contracts that are anti-competitive in effect, then they can be dealt with under the Trade Practices Act. Alternatively, legislation could include a prohibition on hindering access, such as in the Gas Pipelines Access Law (s13).

If the Tribunal's recommendation is adopted, then the form of the proposed regulatory guidelines will be critical. It follows that there must be thorough consultation on development of any such guidelines.

- c) It is not clear at this stage what the level of demand will be for access. In any event, the parties seeking access are likely to be businesses with commercial acumen. In view of this, AGL suggests that consideration be given to a less intrusive approach than that recommended. For example, it could be left to Sydney Water to develop and publish its policies for the provision of access, together with standard terms and conditions and with provision for independent review and reporting of Sydney Water's adherence to its policies. This would be much the same as the approach taken by uncovered gas pipelines.

The Australian Gas Light Company, September 2005

⁷ AGL, 15 July 2005