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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 Issues Paper published by the Tribunal in connection with its Investigation into Water and Wastewater Service Provision in the Greater Sydney Region.

AGL's submission is attached. Please contact Linda Gyzen on 9921 2792 if you wish to discuss the submission.

Your sincerely,

Robert Wiles
General Manager
Regulation and Policy

INVESTIGATION INTO WATER AND WASTEWATER SERVICE PROVISION IN THE GREATER SYDNEY REGION

This submission is made by The Australian Gas Light Company (AGL) in response to the Issues Paper published by the Tribunal in connection with its Investigation into Water and Wastewater Service Provision in the Greater Sydney Region.

1. Summary:

Given appropriate incentives and regulatory structures, the private sector, and AGL in particular, is well equipped and positioned to expand its involvement in the provision of water-related infrastructure and services for Sydney. This would be consistent with the policy direction established by the Government in its Metropolitan Water Plan for Sydney, and with announcements relating to the provision of water and sewer services for new land release areas in South West and North West Sydney.

While a disaggregation and access model such as that established in the energy sector (for example) may be appropriate for water at some time in the future, such a move should be made only when the costs and benefits are fully understood. We acknowledge the Tribunal's concerns about making major structural changes too rapidly. A considered evolutionary approach is preferable for reform in the long term. In the meantime, there are actions that can and should be taken to address immediate policy concerns and objectives.

In AGL's view, a significant increase in private sector participation in the water industry could be achieved in the short to medium term by modifying existing arrangements to provide for private ownership, management and operation of infrastructure throughout the industry including potable water reticulation, waste water collection, water reclamation and recycling. Some legislative changes would be required, including the establishment of activity based licensing arrangements for private business.

Structural changes will be ineffective unless accompanied by appropriate commercial incentives and signals, both for investors and for consumers. The current price of water is significantly lower than the expected cost of water from the next tranche of capacity, either by way of bulk supply (desalination?), and/or reclamation and recycling technologies. Some adjustment to pricing for potable water is inevitable if those technologies are to be viable. This could involve a combination of changes to the overall level of prices as well as to pricing structures where rebalancing of fixed and variable charges and inclining block tariffs are options.

2. The extent of reform and delivering Government policy:

The Tribunal canvasses a wide range of industry models as depicted on Page 23 of the Issues Paper. There is no doubt that the policy and implementation issues become more complex the further the chosen option is from the status quo. For example, if a third party model were adopted, access pricing and the sustainability of postage stamp pricing become issues requiring resolution.

The Australian energy sector has undergone significant change over the last decade or so including disaggregation and the introduction of access regulation to transmission and distribution. This has been accompanied by the removal of

barriers to interstate trade in gas, and increased interstate connectedness and trade for both gas and electricity. It is generally accepted that these changes have produced net economic benefits. While this may have been the outcome for the national energy sector, it cannot be said, at this stage, what the result would be if the water industry in Sydney was disaggregated and opened to access: there are significant differences between the energy and water industries, particularly in their upstream/production sections, and the costs, benefits and risks of major structural change are not yet understood well enough to enable an informed decision. Even if a start were made immediately, it is likely to be some time before a decision could be made on disaggregation and access and then, if the decision were to proceed in that direction, it would take some time to implement.

In the meantime, the Tribunal is conducting its investigation in a context where adequacy of water supply is an immediate issue for the greater Sydney region. As one strategy to address this problem, the Government has adopted a policy position of increasing private participation in the infrastructure and supply side of the industry. The Government's intention is to:

1. Establish laws and policies in relation to recycled water that protect public health, but do not raise unnecessary barriers to innovation by private developers and service providers. (Sydney Metropolitan Water Plan, p15);

and

2. Introduce contestability in the provision of water and sewer services in new land release areas with the aim of ensuring the delivery of good quality, cost-effective water supply and sewerage services, as well as increasing the efficient use of water through water recycling and re-use schemes. (NSW Government's plans for land release in North West and South West Sydney, FACT SHEET 3 What Infrastructure Will Be Provided?).

In AGL's view, establishment of a policy and commercial environment which facilitates greater private sector involvement in the provision, management and operation of infrastructure for water services (including water reclamation and recycling), should be the first priority. By facilitating that involvement, the resources available to the industry, including capital, technology, and innovation, will be increased. It is an effective first step which can be implemented relatively quickly and simply. At the same time, a process can be established for the orderly consideration, and implementation as appropriate, of other more complex options, including disaggregation, retail contestability, and open access.

In summary, AGL favours a staged approach as discussed by the Tribunal in section 3.2.7 of the Issues Paper.

3. Providing for private sector involvement

The scope for private sector involvement could range from contracting to Sydney Water to deliver specified services as at present, to disaggregation and private ownership. The Tribunal has noted that increased private sector participation has potential consequences for system planning. AGL's position on this, and the mechanisms and scope for private sector participation are outlined below.

Planning

AGL agrees that the Government should maintain a 'back-stop' centralised planning function. A significant consideration in the expansion of private sector participation in essential services such as water is the need to ensure supply while:

- managing resources in a sustainable manner;
- identifying and developing new resources efficiently;
- taking advantage of efficiencies obtainable through commercial arrangements; and
- maintaining flexibility and adaptability to take up innovations.

In AGL's view these outcomes would be best achieved, for the time being at least, by maintaining a single central planning authority, while at the same time making use of competitive outsourcing for service delivery on the basis of competitive performance.

The criteria for establishing competitive performance should be developed not only in relation to commercial propositions such as price, availability and quality but also with regard to the sustainable practices required to manage these in the long term, consistent with the Government's broader sustainability principles.

Structures for private sector involvement in major undertakings

Under the evolutionary model proposed by AGL, Sydney Water would remain the principal asset owner and service provider, and the sole retailer for the time being.

Within that model, AGL supports private sector participation in service provision for significant projects and for the development of specific service areas. This could include developing, owning and operating parts of the water and waste water networks and major facilities and could involve a variety of commercial structures to effect risk and opportunity allocation between Sydney Water and the private participant. These structures include:

- Public Private Partnerships (PPPs) which allow for appropriate allocation of risk and responsibility, ownership of assets and varied goals.
- Alliances which allow for joint involvement of parties that both have a vested interest in the system ownership and operation.
- Build Own Operate mechanisms which allow for the development, ownership and operation of specific projects, allowing the assets to be owned by the private sector.

Private sector participation, particularly for new development areas and specific projects, can lead to more efficient use of water resources through, for example, synergies in service delivery and by taking advantage of related industry developments and innovations.

Competitive Procurement

In the case of existing assets for water and wastewater distribution, AGL supports the continuation and expansion of outsourcing to the private sector of tasks to assist Sydney Water in its operations, such as:

- Construction and rehabilitation of Sydney Water's distribution, recycled water and sewerage networks;
- Restorations after planned and scheduled maintenance;
- Metering and meter reading of water supply;

- Operation of smaller treatment plant and reticulation systems;
- Maintenance of electrical and mechanical systems;
- Scheduled and emergency civil maintenance;
- Call centres and customer billing;
- Operation and Maintenance of networks; and
- Asset Management.

AGL considers outsourcing an efficient model to contain costs and meet tight timeframes for maintenance of existing infrastructure.

4. Pricing

Water is an essential commodity and must be priced so that all people have sufficient for their basic needs, within their means.

AGL suggests that retail pricing for potable water be set by reference to the greater of Long Run Marginal Cost and Sydney Water's actual costs. That is, prices should be reflective of the availability of water and of the real cost associated with providing it from the next generation source. This approach does not necessarily discriminate between how the water is produced, for example expensive desalinated water, or cheap gravity fed surface water. Instead, it takes account of the full administration, production and transportation costs associated with providing water from any source.

Uniform pricing of water across the consumption scale, and at prices below the real cost of production, sends the signal that water is not a valuable commodity.

Regardless of the elasticity of demand for water and hence the value of pricing as a means of moderating demand, multi-tier pricing is considered necessary to signal that high consumption is not sustainable and to provide the economic incentive for the development of new, more costly, sources of supply including recycling. AGL therefore supports the Tribunal's 2004 finding that "the most suitable [pricing] structure for Sydney is likely to be an 'inclining block' structure, which includes a two-tiered variable water use charge and a lower fixed access charge."¹

It is essential that the price of recycled water be sufficient to encourage private sector investment in, and development of, recycled water schemes with due regard to the risks and social and environmental factors.

At the same time, consumers are likely to require some encouragement to use recycled water, particularly in existing areas where continued use of potable water is a choice². Price is one means of providing this encouragement. Alternatives include, for example, legislation – in California's Orange County it is illegal to use potable water where recycled water is available and its use is appropriate. Consultation and education can also be effective. In Singapore the community has accepted potable water reuse following an extensive program. Niche marketing is a further option where local recycled water treatment can be tailored to meet the quality requirements of specific industries.

¹ Issues Paper, p9

² In new developments where recycled water is reticulated and connected at the outset, uptake can be facilitated by restricting the locations and number of potable water outlets on a property.

5. Legal and Regulatory Framework

From AGL's perspective, the key requirements for facilitating greater private sector involvement (including for recycled water) include:

- Amendments to the licensing regime to provide for private participation and activity-based licenses. Activities would include:
 - Raw water treatment
 - Water distribution (potable and recycled)
 - Waste water collection and treatment
 - Water retailing (potable and recycled) (Under the approach proposed by AGL, where the first step would be facilitation of greater private sector participation in infrastructure provision etc, Sydney Water would continue to be the sole retailer for Sydney for the time being at least.)
- Any changes necessary to facilitate private sector participation in infrastructure provision etc such as rights to access land and to lay pipe
- Establishment of standards for recycled water
- Ensuring that there are no impediments to Sydney Water entering into appropriate commercial arrangements (for example PPP, BOOT, BOO and other structures) with the private sector

The Tribunal makes a number of comments about licensing arrangements and the types of obligation that might be imposed through licenses. It is not clear which types of obligation the Tribunal envisages being in the licences themselves as opposed to the regulations.

The content and structure of licenses for gas and electricity was dealt with by the Tribunal in a review which concluded in 2003. We take this opportunity to reiterate the position taken by AGL in that review, that licenses themselves must not be a vehicle for making and implementing policy. License conditions should be standardised and limited to those technical and prudential matters relevant to the fitness and competence of the licence holder. Matters of policy should be dealt with in legislation (including regulations) and, where appropriate, in codes and guidelines made in accordance with legislated principles. It is unnecessary and undesirable for a licence to duplicate the provisions of legislation and regulations.

The Tribunal also invites comment on the extent to which agencies involved in the regulation of the water industry should be independent of Government. In AGL's view, the importance and value of separation of powers as a principle, cannot be overstated. Policy making is the domain of the Government and must be separate from the functions of administration and enforcement.