

INDEPENDENT PRICING AND REGULATORY TRIBUNAL
REVIEW OF WHOLESALE PRICES FOR SYDNEY WATER CORPORATION
AND HUNTER WATER CORPORATION

Tribunal Members
Dr Peter Boxall AO, Chairman
Ms Catherine Jones and Mr Ed Willett, Members

Members of the Secretariat
Mr Hugo Harmstorf, CEO, Mr Matt Edgerton,
Mr Jean-Marc Kutschukian, Ms Anita Payne,
and Mr Justin Robinson

SMC Conference and Function Centre,
66 Goulburn Street, Sydney NSW

Tuesday, 8 December 2015, at 1.30pm

1 OPENING REMARKS

2
3 THE CHAIRMAN: Good afternoon. Thank you all for coming
4 and welcome to this public hearing.

5
6 I would like to begin by acknowledging that we are
7 meeting on the traditional lands of the Gadigal people of
8 the Eora Nation and wish to pay my respects to the
9 traditional landowners past and present.

10
11 I am Peter Boxall, Chair of the Independent Pricing
12 and Regulatory Tribunal (IPART). I am joined today by my
13 fellow tribunal members, Catherine Jones and Ed Willett.

14
15 We are conducting reviews to determine the maximum
16 prices that Sydney Water and Hunter Water can charge their
17 customers for their water, wastewater, stormwater and other
18 services from 1 July 2016.

19
20 To date, our determinations have set maximum prices
21 for residential and non-residential properties with no
22 specific reference to wholesale customers. For these price
23 reviews, however, we are considering the issue of wholesale
24 pricing. Today's public hearing is focusing solely on this
25 issue. We held public hearings in November in relation to
26 the prices to apply to other services provided by both
27 Sydney Water and Hunter Water.

28
29 Wholesale customers are utilities that buy drinking
30 water and/or wastewater services from Sydney Water and/or
31 Hunter Water and then onsell water and/or wastewater
32 services to end use customers. These wholesale customers
33 are licensed under the Water Industry Competition Act 2006
34 (the WIC Act) - that is, they act as alternative water
35 and/or wastewater retailers to Sydney Water and Hunter
36 Water.

37
38 With new water and wastewater business entering the
39 market, the wholesale pricing issue is becoming
40 increasingly important. It is important to design the
41 right form of price regulation for wholesale pricing as it
42 may influence how competition develops within the urban
43 water market. It is equally important to get wholesale
44 prices right, otherwise prices may encourage inefficient
45 costly competition if the price is too low; or discourage
46 efficient beneficial competition if the price is too high.
47

1 Our issues papers set out the key issues that we will
2 be considering on wholesale pricing. In particular, we
3 asked two key questions:

4
5 Should prices for wholesale services be regulated
6 under the price determination or the access provisions of
7 the WIC Act?

8 What is the appropriate pricing approach for wholesale
9 services?

10
11 I would like to thank everyone that has provided a
12 written submission on this matter to our issues papers,
13 which were released in September. This dedicated public
14 hearing on wholesale water and wastewater pricing is an
15 important part of our consultation process for the Sydney
16 Water and Hunter Water price reviews. In addition to the
17 views expressed in written submissions, we will consider
18 the views you provide today when making our decision on
19 Sydney Water's and Hunter Water's prices.

20
21 Today we will hold two sessions designed to help
22 address the two key questions.

23
24 The first session will focus on whether wholesale
25 prices should be regulated by the WIC Act's access regime
26 or under IPART price determinations. The second session,
27 after afternoon tea, will focus on the approach to pricing
28 wholesale services.

29
30 For each session, IPART will give an introduction.
31 I will then invite participants sitting at the roundtable
32 to respond to IPART's introductory comments and questions
33 and/or comments made by other roundtable participants.
34 After discussions from the roundtable participants, I will
35 then invite members of the audience to make statements or
36 ask questions.

37
38 Today's hearing will be recorded by our transcribers.
39 Therefore, to assist the transcribers, I ask that, on each
40 occasion you speak, you please identify yourself and, where
41 applicable, your organisation.

42
43 A copy of the transcript will be made available on our
44 website.

45
46 Assisting the tribunal today are members of IPART's
47 secretariat, Hugo Harmstorf, who is IPART's Chief Executive

1 Officer, Matthew Edgerton, Jean-Marc Kutschukian, Anita
2 Payne and Justin Robinson.
3
4 Matthew Edgerton from the IPART secretariat will now
5 begin the first session with a presentation on regulating
6 wholesale services, thank you, Matt.
7
8 SESSION 1: How should wholesale prices be regulated
9 (WICA, IPART price determination, other)?
10
11 MR EDGERTON: Thank you, Peter.
12
13 As Peter mentioned, this first session will look at
14 the question of should wholesale prices be regulated under
15 the Water Industry Competition Act or should they be
16 regulated under IPART's price determinations?
17
18 Wholesale customers are a relatively new type of
19 customer to Sydney Water and Hunter Water. The Water
20 Industry Competition Act - or the WIC Act - has licensed
21 new utilities which today we will call WIC utilities.
22
23 Some WIC utilities are purchasing drinking water and
24 wastewater services from Sydney Water or Hunter Water. In
25 our most recent price determinations - 2012 for Sydney
26 Water and 2013 for Hunter Water - we did not explicitly
27 consider these types of customers when setting prices.
28
29 As such, during these current price reviews, we are,
30 for the first time, looking at how to regulate prices for
31 WIC utilities, for drinking water and wastewater
32 services from Sydney Water and Hunter Water. Broadly
33 speaking, there are two options for how these wholesale
34 prices could be regulated - through the WIC Act access
35 regime or through our price determinations.
36
37 Part 3 of the WIC Act sets out an access regime. Under
38 the access regime, there are three avenues to access
39 agreements. The first avenue, while not explicitly part of
40 the access regime, is private negotiations between the
41 incumbent utility and the WIC utility. Private
42 negotiations allow two utilities to mutually come to an
43 agreement on the terms, conditions and prices for access
44 and other services. The WIC Act's access regime is not
45 required for private negotiations; however, it enhances
46 private negotiations through the second avenue - coverage
47 declarations.

1
2 If a private business has tried and failed to obtain
3 access, it can apply to the Minister to have the
4 infrastructure service declared. If the declaration
5 application is successful, the infrastructure owner is
6 required to provide access subject to reaching agreement on
7 the terms and conditions of that access.
8
9 Arbitration is available when the access provider and
10 the access seeker cannot reach agreement on the terms and
11 conditions of access under a coverage declaration. In
12 arbitrating an access dispute and making an access
13 determination, the arbitrator must consider a range of
14 factors including the pricing principles in section 41 of
15 the WIC Act.
16
17 The final avenue to access agreements under the
18 WIC Act is through voluntary access undertakings.
19 Infrastructure owners can submit access undertakings to
20 IPART to provide access to their infrastructure, once
21 approved by IPART, or if approved by IPART. This creates
22 certainty for all parties on the terms, conditions and
23 pricing methodology for access and removes the threat of a
24 coverage declaration. Arbitration of disputes under a
25 voluntary access undertaking would be based on the
26 arbitration methodology set out in the undertaking.
27
28 Some stakeholders raised concerns about using the WIC
29 Act's access regime. In particular, concerns were raised
30 about having to negotiate with a vertically integrated
31 competitor, being the incumbent; that WIC Act utilities
32 don't see themselves as access seekers but rather
33 non-residential customers; and also the WIC Act's
34 definition of infrastructure services.
35
36 The WIC Act defines "infrastructure services" as the
37 storage, conveyance or reticulation of water or sewage by
38 water industry infrastructure, and does not include the
39 filtering of water or sewage or the supply of water or
40 sewage unless they are a subsidiary but inseparable aspect
41 of the storage conveyance or reticulation.
42
43 As a result, WIC utilities may find that even with a
44 coverage declaration or approved voluntary access
45 undertaking, they still need to negotiate with Sydney Water
46 or Hunter Water for water, its filtration and the treatment
47 and disposal of wastewater or, instead, build their own

1 dams or other sources of water and also treatment plants.
2
3 . To facilitate such negotiations under the WIC Act,
4 IPART may decide in future price reviews to use component
5 pricing - that is, where we would separately determine the
6 prices for bulk water, water filtration and water treatment
7 and disposal. This would create price certainty for
8 services not covered by the WIC Act's access regime.
9
10 The alternative approach to regulating wholesale
11 transactions is through our price determinations. This
12 would entail either adding WIC utilities to an existing
13 customer category in our determination or creating a
14 new customer category specifically for WIC utilities.
15
16 There are a number of possible approaches to setting
17 prices for WIC utilities under our own determinations;
18 however the most likely would be a methodology or a price
19 cap. Methodologies can vary in complexity, from something
20 similar to a price cap to something like our developer
21 charges methodology.
22
23 There is an inherent trade-off between complexity,
24 certainty and cost reflectivity. A price cap gives WIC
25 utilities and the incumbent ultimate certainty, but they
26 may not reflect an individual scheme's characteristics. A
27 methodology, on the other hand, could be somewhat tailored
28 to a scheme and different activities and scheme-specific
29 avoidable costs, for example, could be taken into account.
30
31 . However, a potential concern about using our price
32 determinations to regulate WIC utilities is that Sydney
33 Water and Hunter Water, under their current operating
34 licences, are not required to supply water and wastewater
35 services to WIC utilities except in limited circumstances.
36 This creates the possibility that we could determine a
37 charge and Sydney Water, or Hunter Water, could refuse to
38 provide the service for that charge.
39
40 In response to our issues paper, or issues papers for both
41 Sydney Water and Hunter Water, stakeholders had varying
42 views on how best to regulate wholesale prices. In our issues
43 paper before we consulted on this issue, our preliminary
44 view was that wholesale prices are best regulated under
45 the WIC Act through approved voluntary access undertakings
46 but that, in the interim and until such an undertaking
47 was approved and in place, we would regulate

1 prices under our price determination.
2
3 Our interim price regulation could involve a price cap
4 specified in the determination or a pricing methodology
5 with supporting reporting requirements and documentation
6 akin to the approach to developer charges.
7
8 We would like to emphasise that this was a preliminary
9 view and we are now actively consulting on this issue and
10 we will be considering all views put forward here today.
11
12 Sydney Water generally supported our preliminary view.
13 Hunter Water supported regulation through price
14 determinations, noting the costs and difficulties in
15 submitting a voluntary access undertaking.
16
17 Most other stakeholders also supported prices being
18 determined by IPART. However, stakeholders were mixed on
19 whether the prices should deliver certainty through a price
20 cap or flexibility through a methodology.
21
22 In the following discussion, we would like your views
23 on how wholesale prices should be regulated. Questions
24 that we would like responses to include the following:
25
26 1. Should wholesale prices be regulated under the
27 WIC Act, IPART's price determination or a transition from a
28 determination to the WIC Act?
29 2. What conditions or changes would WIC utilities
30 require to use the WIC Act's access regime?
31 3. Sydney Water has proposed a voluntary access
32 undertaking. How would or should this undertaking
33 accommodate wholesale services?
34 Would it include the supply of drinking water,
35 disposal of sewage and/or treatment across the network?
36 4. Under determined prices, should Sydney Water and
37 Hunter Water be required to always provide wholesale water
38 and wastewater services within their areas of operations
39 If so, how could this be assured (eg, is it necessary
40 to include requirements in their respective operating
41 licences)?
42
43 I will now hand over the discussion to our Chair.
44 Thank you.
45
46 THE CHAIRMAN: Thank you very much, Matt. Who would
47 like to go first from around the table? Sydney Water. Sandra?

1 Kris?
2
3 MS GAMBLE: Sandra Gamble from Sydney Water. This is not
4 a topic upon which we have a strong view. We think,
5 in fact, that the legislation or the type of instrument
6 through which wholesale prices are regulated is less
7 important than the price that is actually set. Our
8 priority is very much to ensure that the price encourages
9 the right investment in the right place at the right time
10 and that that operates in a manner that is in the best
11 long-term interests of customers.
12
13 We don't have a strong view as to whether it is the
14 WIC Act price determination or a voluntary undertaking, or
15 so on, as long as it is done transparently and
16 cooperatively.
17
18 THE CHAIRMAN: Thank you very much, Sandra. Jeremy?
19 Peter?
20
21 MR BATH: Thank you, Mr Chairman. Jeremy Bath, interim
22 CEO of Hunter Water. I will summarise our position in a
23 moment but I wanted to provide some context to
24 Hunter Water's position in terms of dealing with licensees
25 to date which is slightly different to that our friends
26 at Sydney Water have experienced.
27
28 Hunter Water has always taken a competitively neutral
29 position in our commercial dealings with WIC Act licensees
30 in our area of operations. We have negotiated two utility
31 service agreements in good faith and both are close to the
32 point of final sign-off. I think my friends at Flow would
33 agree that there have been robust but very fair and
34 reasonable discussions.
35
36 Additionally, there are a number of other WIC Act licence
37 applicants in the Lower Hunter that are either approved
38 or going through an IPART review. All the WIC Act
39 licensees in our region are providing a similar service in
40 similar circumstances. All bring to development sites that
41 are generally are on the fringes of Hunter Water's area of
42 operations, predominantly residential developments, ranging
43 from 600 housing lots up to 7,500 lots at Huntlee, near
44 Branxton. The developments also include small
45 non-residential customers, shops, schools, sporting
46 facilities. The WIC Act licensee provides an on-site
47 self-contained wastewater treatment facility for the entire

1 development. The treatment facility provides recycled
2 water for supply to end use customers and other areas in
3 the development.
4
5 No WIC Act licensee or prospective licensee has
6 requested a permanent wastewater service for an entire
7 development. In all cases, the licensee has asked
8 Hunter Water to provide a permanent supply of bulk drinking
9 water to a connection point on the boundary of the new
10 development. The WIC Act licensee will on-sell this
11 drinking water to end use customers within each
12 development.
13
14 The key point to note is that all WIC Act licensees
15 have always requested a fully bundled drinking water
16 service using Hunter Water's dams, water filtration
17 facilities and water transport network. It must be said
18 that Hunter Water has had some difficulty over the past
19 couple of years sorting out the pricing arrangements and
20 the legal basis for striking an agreement with WIC Act
21 licensees.
22
23 Neither the WIC Act nor the current IPART
24 Price Determination provide explicit guidance on how to
25 deal with these types of service requests. In that
26 context, we welcome the current IPART review of wholesale
27 pricing. Hunter Water's response to the IPART issues paper
28 set out our preferred approach to the two key questions,
29 the form of price regulation and the form of the pricing
30 methodology.
31
32 Hunter Water supports IPART setting region-wide price
33 caps for the next four years. We also support IPART's
34 proposed approach of setting price caps using a retail
35 minus avoidable costs methodology.
36
37 As an overall comment, while we support competition we
38 do not support competition for its own sake. New entry
39 must deliver net overall savings, not just savings for some
40 parties or imposing greater costs on others, namely, our
41 customers. Thank you.
42
43 THE CHAIRMAN: Thank you very much, Jeremy. Flow
44 Systems? Terry? Lisa?
45
46 MR LECKIE: Terry Leckie from Flow Systems. I think we
47 are opposed to the wholesale pricing proposal. We are

1 opposed to capped pricing, not necessarily but in a
2 context, I suppose. We probably differ to what Sandra was
3 saying. It is important for Sydney Water to have a price,
4 and a price cap or a price determination would be good for
5 the marketplace.
6
7 We believe that it will not drive the right outcomes
8 for customers. It won't drive the right outcomes for the
9 market as a whole. It won't encourage innovation and it
10 won't help us with sustainability. Why do we say that? We
11 think we really need to focus on a broader sort of review
12 of competition - going to your point - which is not
13 competition for competition's sake but competition that
14 does enhance the market. What does that mean? That means
15 a broad review across the whole of government that looks at
16 what is the market structure and reviews that. Can IPART
17 do that on its own? No, not necessarily.
18
19 What does that bring us back to? It brings us back to
20 what is this interim suggestion? The interim suggestion is
21 around either a price cap or a methodology agreed. I think
22 what I am saying is that neither are going to help and that
23 there is other work that needs to be done first.
24
25 We are talking about trying to create a fair or a
26 level playing field. We have done a lot of work to lead
27 towards that and we have worked together on achieving that,
28 but there are a whole lot of things that are yet to be done
29 to create that; so therefore, that suggestion which is
30 about a review.
31
32 I think when we looked at some of the information
33 around the determination, in Sydney Water's area, it was
34 coming from the point of view which is, "Well, really all
35 of the customers, existing and future, are Sydney Water and
36 Sydney Water has an obligation to serve and they're their
37 customers and, therefore, the WIC Act proponents are taking
38 those away." Therefore, that led to a "Why are we doing
39 this?" Because we need to get wholesale pricing, because
40 it's creating a disparity or a cost to all customers and
41 that it is pushing prices up. I think that that is flawed.
42
43 With respect to retail minus, we differ from where
44 Hunter Water is at. We don't agree with the retail minus
45 of all costs and the reality is that we are saying that
46 even though we don't support that methodology and because
47 of our history and because of other areas that have shown

1 that it hasn't worked and it becomes a barrier to
2 competition. It is just really the whole context of let's
3 either create a cap or let's create a methodology.
4
5 I think that that would be extremely detrimental to
6 the WIC Act part of the marketplace because it is in its
7 infancy, it is embryonic. It has made some ground over the
8 last 10 years but we're only really just getting started
9 and we have started to produce some great outcomes and we
10 are starting to see those, some world-class sort of
11 facilities that are perhaps a little different from what
12 Hunter Water or Sydney Water might have provided and we
13 see now in an Australian context and then also the global
14 context that they're starting to look at it.
15
16 How have they done that and why have they done that
17 and what are the drivers and could we can apply that in our
18 own jurisdiction? We are getting there but I am not sure
19 that the marketplace, from our point of view, is ready for
20 that.
21
22 The status quo? We have a situation that we have
23 built our financial models on. We have built our
24 structures. We have got some facilities up and running and
25 now we're starting to measure those on what is the true
26 cost of operating those in this environment. We are not
27 there yet. We have some projections, but we have not
28 tested them, and it is about creating certainty and with so
29 many other things within the market at the moment that are
30 creating uncertainty and feedback that we are getting from
31 our customers, from our developer customers, there is quite
32 a bit of uncertainty in going this way.
33
34 We haven't even talked about price yet. At the
35 moment, under a status quo, we have a known pricing
36 approach, though if the cap was to mimic that pricing
37 approach, if the interim arrangement was to say, "Let's
38 retain the status quo. Let's sign the WIC Act participants
39 to one of the existing customer classes", as we are doing
40 presently, then I think that would be helpful. That would
41 allow us some time to be able to engage with government and
42 stakeholders across a whole-of-government review and to
43 look at how we go forward.
44
45 THE CHAIRMAN: Thank you, Terry. Scott?
46
47 MR TAYLOR: Thank you. Scott Taylor from Lend Lease

1 Living Utilities. We agree with Terry's and Flow's
2 position of opposing. We think, as your opening remarks
3 pointed out, Chairman, this is a complex area. As our WICA
4 utilities come into the market to unlock land for
5 affordable housing and facilitate things like
6 Barangaroo South, that the changes that are recommended or
7 proposed will put back the water industry and won't allow
8 things like the Bays Precinct and our activity out in the
9 Macarthur area to be unlocked in the same fashion that we
10 are currently seeing in places like Ropes Crossing or even
11 Bingara, which has recently been recognised as one of the
12 premiere communities in New South Wales.
13
14 The areas are complex. Our relationship with all the
15 utilities shouldn't be seen as competition but should be
16 seen as collaboration around trying to get the most
17 productive use out of the water infrastructure and
18 resources for New South Wales. I think the current regime
19 of promoting creates investment uncertainty and puts us in
20 competition for the wrong reasons.
21
22 I think we need to be very clear about what the public
23 utilities roles are. I would like to hear the
24 differentiations for Hunter Water and Sydney Water,
25 in particular, Hunter Water, being competitive and
26 neutral. We would like to work with the utilities to come
27 up with the best approach.
28
29 In doing so, you have to recognise that our approach
30 is to take the integrated water management perspective, so
31 all sources of water and uses of water, and currently the
32 regulating and price determination of potable water for one
33 participant or two participants doesn't really allow for
34 the full understanding of the complexity and the
35 relationships between a whole number of things, like
36 recycled water, wastewater, potable water, infrastructure
37 services, et cetera.
38
39 We are opposed to adopting any interim measure until
40 we know the full complexity and the whole blueprint around
41 how we're going to better utilise and optimise water
42 infrastructure assets in the whole of New South Wales,
43 recognising that there are issues between rural water and
44 urban water as well. It is not just about the
45 Bays Precinct but it is about communities and affordable
46 housing in the Inner West.
47

1 We are opposed in the sense that the aims are
2 admirable and we support the aims but we don't think we've
3 done enough work to get the right structure in place to
4 facilitate the best outcomes in New South Wales.
5
6 THE CHAIRMAN: Thank you, Scott. Kurt?
7
8 MR DAHL: Kurt Dahl from Permeate Partners. We have
9 mixed views. The first thing is the need to create a new
10 customer class, this wholesale customer. There is an
11 excellent and well administered non-residential customer
12 framework at the moment in terms of trade waste and buying
13 potable water and discharging sewage which everyone agrees
14 is fair. It is supposed to reflect the principles of
15 postage stamp pricing, so you can discharge sewage anywhere
16 in the network at the same rate but not be discriminated
17 against in terms of your location. I think there is a
18 working system there at the moment. I wouldn't throw that
19 out and implement a half thought through wholesale pricing
20 regime.
21
22 The second thing is in terms of wholesale pricing.
23 The structural problem I have with that is that it starts
24 with a position of retail minus and if you're trying to
25 reduce costs for the wider customer base, there are plenty
26 of parts of Hunter Water's area of operation and
27 Sydney Water's area of operation where the cost of the
28 provision of service is much more than the retail price.
29
30 If you want to deliver savings to those customers and
31 savings to the broader customer base then those areas
32 should be opened up to WIC utilities to provide a service
33 at a lower cost, if that's possible. Maybe there is a
34 retail-plus concept, if you want to use the same
35 terminology, that people could seek to be paid that.
36
37 Ultimately, at the moment, half the public water
38 utilities customers subsidise the other half. We are
39 focused on the cheap customers and making sure that that
40 subsidy has been retained, but really, if you want true
41 competition, and the Water Industry Competition Act is
42 supposed to be for every customer, not just new customers,
43 which is where WIC is focused at the moment, there is a
44 major structural discussion that needs to take place.
45
46 The thing that I would worry about too is that
47 Sydney Water and Hunter Water do a good job at the moment

1 in some sort of regional coordination and I know that where
2 you have the person who is doing the regional coordination
3 is also a participant in the market, maybe there's a
4 conflict there where they're deciding the strategy that
5 suits them as opposed to the strategy that suits the
6 region.
7
8 THE CHAIRMAN: Thank you very much, Kurt. DPI Water?
9 Cathy?
10
11 MS COLE: Cathy Cole from DPI Water. Our main concern
12 really is that the approach that is taken doesn't pre-empt
13 any wider discussion on competition or limit future
14 opportunities. Part of the question is how can the
15 regulatory settings best support efficient investment
16 decisions and facilitate competition outcomes and it is the
17 outcomes that we are seeking there?
18
19 It is an important issue. We have a fairly fledgling
20 market that has been established and the WIC Act has
21 enabled that to be established and so a decision impacting
22 the viability of that market requires careful
23 consideration. It was good to see this, at this stage, set
24 aside as a specific issue hearing.
25
26 We feel that this stage of the discussion is clearly a
27 complex one with many different views, that perhaps there's
28 merit in considering leaving the status quo until we have
29 had time to consider those other market settings that
30 impact efficient outcomes.
31
32 We know we are dealing with an imperfect market.
33 I was at a talk recently where someone was talking about
34 the theory of second best and this immediately came to
35 mind. It is a complex thing and the settings aren't all
36 perfect. If we seek to address the issue without looking
37 at those other settings, we do have the risk of creating
38 perverse outcomes.
39
40 At this stage we don't think it is appropriate to
41 change the pricing arrangements until those other settings
42 are considered in a broader context. Our concern is to
43 achieve efficient outcomes and that is part of the whole
44 approach that we undertake in terms of our, metropolitan
45 and Lower Hunter water planning.
46
47 We think that there is a range of issues that we may

1 discuss further later. Recycling seems to deliver benefits
2 beyond their boundaries and those recycling schemes are
3 undertaken by the major utilities as well as the WIC
4 utilities. Perhaps, reading some of the issues in the
5 submissions, the concerns about profiteering have probably
6 been overstated.
7

8 I think there is also an issue to consider about the
9 access regime. It may not be the best fit for the kinds of
10 schemes that are licensed today, particularly where we are
11 looking at bundled services, it's not transport from A to B
12 and accessing something that gets it from A to B, it's a
13 bundled service, and some of the questions you raised
14 earlier were about that there are different dimensions to
15 that service. Given all that, achieving efficient outcomes
16 does require holistic consideration on those wider pricing
17 and regulatory settings.
18

19 THE CHAIRMAN: Thank you very much. Is there anybody
20 else, any quick comment around the table, before I move to
21 the floor?
22

23 MR FUNSTON: Kris Funston from Sydney Water. In terms
24 of Sydney Water, can I just say that we have always been
25 supportive of competition. I think, at the moment, we have
26 demonstrated that we have a fairly constructive approach.
27 We have demonstrated a willingness and an openness to
28 discuss the matters, even on portions of the network that
29 are not subject currently to declaration.
30

31 As Sandra has already mentioned, I think our view is
32 that it doesn't matter how this is done. It is just
33 whether or not there is the appropriate legality around
34 whatever the regulatory instrument is. We have stated that
35 one way of doing this is through the pricing determination
36 and I look at the approach which is proposed as a bit of a
37 hybrid because it has the pricing determination there as an
38 interim measure and then proposes the voluntary access
39 undertaking, which would be done under WICA afterwards.
40 I look at that as using both sort of instruments.
41

42 As we have stated, though, we are reasonably
43 indifferent as to how it is done. The ultimate issue is on
44 what price it is done and on the basis that we provide a
45 service and we provide that service meeting a service
46 obligation as opposed to standard pricing arrangements.
47 I would just say that in any negotiations we undertake we

1 also have in mind that approach of competitive neutrality
2 and ensuring that it is about promoting both effective and
3 efficient competition that is in the long-term interests of
4 customers.
5
6 THE CHAIRMAN: Thank you very much, Kris. Are there any
7 questions or comments from the floor? We have a roving
8 microphone. Anybody else? Questions or comments from the
9 floor? I can't believe it. Matt.
10
11 MR EDGERTON: Matt Edgerton from the IPART Secretariat.
12 I would just like to clarify the position of Terry, Scott
13 and also I think Cathy. From what I understand, you're
14 arguing for no change to the status quo. What does that
15 mean for what IPART should do for the upcoming
16 determinations? Are you saying that IPART should not
17 regulate this space and, essentially, take a step back?
18
19 THE CHAIRMAN: Do you want us to do what we did in
20 2012 and 2013?
21
22 MR TAYLOR: I think, from our perspective, yes and no. We
23 want you not to do anything with this price determination
24 but we recognise that more work needs to be done to come up
25 with a better framework. I think what we are doing here is
26 taking a very narrow view of a few levers that could
27 unintentionally produce perverse outcomes for the industry
28 and based on IPART's adoption of it, from our perspective,
29 it would create investment uncertainty and stifle our
30 ability to progress what we are doing with our property
31 portfolio.
32
33 Things like what we have done at Barangaroo wouldn't
34 be considered viable for the Bays Precinct, which is a
35 major urban redevelopment within Western Sydney, and our
36 current programs to help facilitate affordable housing in
37 Western Sydney, equally, would be put on the shelf and
38 abandoned, if you like, or probably increase the cost of
39 service to where private utilities can provide a no cost to
40 government and there will be complementary services to
41 Sydney Water, we'd probably feel we'd have to withdraw.
42
43 We think that would be a shame. We would actually
44 promote that yes, don't adopt what you are proposing, but
45 complementary to that you set up a working group with all
46 the participants to work through a very complex issue. One
47 of the things that IPART has recently done when it has

1 reviewed the councils and their financial health and
2 fitness to manage aging infrastructure is there is a risk
3 that you are going to take the water industry down the same
4 path unintentionally, but I think by taking a breath and
5 looking back and saying, "Okay, how can we avoid that?",
6 and looking at all the complex actors in water management
7 across New South Wales, what is the better reform program,
8 and that may include better policies and regulation as
9 well, because we know and recognise that IPART is
10 constrained by the existing policy regulations.
11
12 I think it is important to note that WIC utilities,
13 when they go through to provide a solution for the customer
14 in the end, they are looking at a variety of interventions:
15 recycled water, potable water, integrated water management
16 et cetera. This is only one of those levers and we need to
17 look at all the levers to say how can we get the best
18 outcome, and that includes the benefits of offset of
19 capital infrastructure investment. Those things aren't
20 taken into consideration in the current IPART discussions.
21
22 THE CHAIRMAN: I was going to make a similar comment to
23 that. Like the rest of you, IPART works within certain
24 policy constraints. IPART has made public submissions on
25 issues like development charges being set to zero, postage
26 stamp pricing, all these sorts of things, but now we are
27 faced with a situation where the government has adopted
28 certain policies and we all have to work within them. For
29 the purpose of this determination, we are setting this
30 determination within the policy framework.
31
32 One option is to do nothing, which is what was done
33 for Sydney Water in 2012 and Hunter Water in 2013. The
34 issue wasn't addressed, it was just left for everybody to
35 work out. The reason why it has become an issue now is not
36 because of IPART, it is because the stakeholders have
37 raised it as an issue. We still have that right to do
38 nothing. That is why we are having this forum, to get
39 everybody's views. We can still do nothing, but the reason
40 why it is raised now is not because of IPART, it is raised
41 by stakeholders, so we have to make a decision and one
42 decision can be to do nothing, that can be a decision.
43
44 The broader policy issues which have been raised by
45 DPI and the WICA people are very much on the table. We
46 would love to be asked to convene a conference and give the
47 government advice on that but at the moment we haven't been

1 asked to do that and we have to operate within those
2 constraints. That doesn't mean to say that we shouldn't
3 discuss those broader policy issues, but at the end of the
4 day we can discuss the broader policy issues and we have to
5 make a decision whether to just have the status quo or
6 whether to adopt one of the other options.

7
8 One thing which will come up in the pricing section is
9 that at the moment a number of WICA utilities receive water
10 from Sydney Water based on the non-residents price and that
11 happens to be less than the residents price. The opposite
12 can be the case in the Hunter because of the structure of
13 the pricing, so if you were to apply that in the Hunter,
14 you might find that being on the non-residents price under
15 certain circumstances wouldn't be such a good deal. We'd
16 just better be careful on that.

17
18 MR LECKIE: Our view though is that non residential, so
19 the business-customer approach, whatever the determination
20 may be, is the right place for us and I think as to the
21 do nothing, it would be helpful to Sydney Water,
22 Hunter Water and ourselves for IPART to support that
23 status quo approach and say, "Yes, we agree that that
24 customer category is the right place for this interim
25 period." That would be helpful for the industry.

26
27 MR WILLETT: Ed Willett from IPART. Just following on
28 from your comments, particularly yours, Scott, could
29 I clarify this, it appears to me that your concern is that
30 the environment for you is complex on a case by case basis.
31 That requires detailed individual negotiations with
32 Sydney Water and Hunter Water on each project, project by
33 project.

34
35 You have more confidence in your ability to do that
36 well compared to any process where IPART is involved, to
37 set prices, because you are concerned that you might
38 perceive that the inevitable sort of one size fits all
39 approach might actually take you backwards.

40
41 MR TAYLOR: To a degree, yes. The other thing is that
42 we - as in Lend Lease - are motivated to get the best
43 outcome. When we are looking at developing a community
44 we are not wedded to whether it is a private facility under
45 the WIC Act or whether it's Sydney Water or WICA. We just
46 want to make sure we get the right solution.

47

1 In a variety of circumstances the IPART determination
2 process is not helpful. A case in point would be
3 Ropes Crossing where there is currently a water developer's
4 servicing charge that is determined by IPART to be
5 110 kilolitres per year and Sydney Water and us are working
6 together to come up with the right outcomes for
7 Ropes Crossing and the actual usage is 55 kilolitres per
8 year. For whatever reason, IPART is unable to support a
9 revision of that servicing charge to the benefit of the
10 participants.

11
12 That is just an example of where the participants are
13 getting frustrated, whereas the participants would like
14 more flexibility in the methodology to sit down and work it
15 out. I think you're right, I think every circumstance has
16 its unique considerations. Welcome Village and Windara is
17 another one where Sydney Water is actually paying us a
18 service charge to provide services to the community and
19 that is a different outcome than, say, Mt Gilead where we
20 might say, "Actually, we think Sydney Water can do a better
21 job."

22
23 It is not about the competition for us, it is about
24 getting the right use of the infrastructure and the
25 services, so a methodology that takes in all the
26 complexities over the life of the community, all the
27 customers, and I think the whole question about developer,
28 no cost to government, we have simplified it a lot. If we
29 go back to the telecommunications review and what was
30 happening then when people were regulating Telstra over the
31 role that they were playing in the industry, we see a lot
32 of similarities between that and the public facilities
33 today and depending on how you want regulate and drive a
34 particular behaviour, you either open up access or deny us
35 access. It is the same complexities.

36
37 MR EDGERTON: Scott, just to respond to that issue you
38 raised about the issue of water usage component, that
39 relates to, as I understand it, a recycled water developer
40 charge and our recycled water developer charge is a
41 determination which is basically a methodology. In that
42 methodology, we did hard codes and usage numbers. To
43 change that methodology we would need to go through a
44 full-blown review which would involve a whole public
45 consultation process. We do intend to revisit that
46 methodology at some time within the next couple of years.
47 It is on our agenda. It is just not possible to change it

1 outside of essentially a full-blow review.
2
3 MR TAYLOR: But I think you just reinforced my point.
4 We are in a project that has a clear and present need and
5 yet, we are held back by an IPART determination where
6 Sydney Water and Lend Lease want to work collaboratively
7 together. Thank you for confirming my point.
8
9 MR EDGERTON: Just on that, just so we are clear, in that
10 particular instance a value is hard coded into a formula.
11 There are provisions to have a formula in a determination
12 where those values aren't necessarily hard coded in like
13 that.
14
15 MR TAYLOR: I am sorry, I might have missed it, but
16 I haven't seen the formula proposed to consider that today.
17
18 MR EDGERTON: That is coming in the second session in
19 terms of various options that are on the table.
20
21 THE CHAIRMAN: Terry?
22
23 MR LECKIE: It is also about the uncertainty, isn't it,
24 and you talk about the complexity of each project and the
25 complexity of planning, designing, the connection between
26 them, so the interconnection of the utility services, the
27 timing of that, the cost of that, but I think there are
28 existing processes for us to go through that and the
29 development industry as a whole is dealing with those kind
30 of issues every day. We have an industry that supports
31 that and understands that as well and prepares various
32 documents to support that process.
33
34 Albeit, it is complex and we can always improve our
35 processes, it is known and so we have a whole industry that
36 works through that. The difficulty we have and the
37 uncertainty that arises is when we then go, "Right, we're
38 going to now completely change some of that and we're going
39 to bring in a different process." Albeit, it might be
40 eventually providing some certainty. It is a bit like
41 bringing in a new code. We know that the old one needs to
42 be improved but you always get this turmoil for one, two or
43 three years and I am thinking about some of the building
44 codes that have been implemented.
45
46 Right at this time we have made fantastic ground. We
47 have started to get going. We finally have a handful of

1 projects. Sometimes we are criticised because we have only
2 issued so many licences and why has it not really taken off
3 and why haven't we used the access undertaking? The
4 lifecycle of a project is 30, 40 or 50 years and we are in
5 some period in that lifecycle on a few of those projects.
6 It takes 10 years to get some of the developments out of
7 the ground. After all of that process and the planning, we
8 are now 10 years on and we are only just starting to build
9 those.
10
11 You will see a bit of momentum is starting to be
12 gained and we are starting to see the benefits, but we are
13 still in that phase where we have to implement systems to
14 know what we don't know. In some of these circumstances,
15 we don't know what the operational costs will be. We are
16 starting to get to understand what the construction costs
17 are. We are starting to now get understand what the
18 regulatory costs are, but we still have some way to go
19 because we are going through a regulatory regulation change
20 and we have a whole series of new costs and new processes
21 to come. That uncertainty is to the detriment of this
22 industry.
23
24 MR TAYLOR: I think that's a good point. We should
25 recognise that the industry is in a fragile state. There
26 are some good parallels that can be drawn from the
27 renewable energy industry in the sense that policy - I know
28 it is not regulation change - has ebbed and flowed. We
29 have had the carbon price and renewable energy targets and
30 so forth. That is a barrier to investment. If the
31 government does not want to have a cost to government and
32 it wants to augment investment infrastructure to private
33 investment, transitional arrangements or the lack clarity
34 at the end state will create uncertainty around and
35 additional risk and therefore costs to anything in
36 transition. I think we need to note that we are still in a
37 very fragile and early stage moving in to the WIC Act.
38
39 THE CHAIRMAN: Thank you. Peter and then Kris.
40
41 MR SHIELDS: Peter Shields, Hunter Water. I want to
42 elaborate a bit more on the Hunter Water situation and our
43 response on the form of regulation question.
44
45 In the Lower Hunter, we have seen, as Jeremy
46 described, the same characteristics in every project. It
47 is onsite, self-contained wastewater treatment and the

1 request to Hunter Water is for supply of drinking water,
2 and the majority of our revenues for water are collected
3 through the usage charge - 95 per cent of them and it can
4 go to 99 per cent.
5

6 We did raise some questions about what was the
7 infrastructure service and we said we were reluctant to go
8 to a voluntary undertaking. The reason we are reluctant to
9 go to a voluntary undertaking is we can see a lot of cost
10 for the organisation in going through that process for
11 little gain.
12

13 MR BATH: Potentially for no gain.
14

15 MR SHIELDS: For no gain, yes. We could spend hundreds of
16 thousands of dollars developing up a voluntary undertaking
17 under which no-one might seek to negotiate.
18

19 We are comfortable with an IPART price cap proposal.
20 We see it as having a number of advantages: get the
21 pricing principles right, set the right prices and that
22 removes any question mark over or any perception about our
23 dealings with what we call private network operators - WIC
24 utilities. In fact, it makes the negotiation of utility
25 service agreements easier and it also provides some
26 certainty for WIC utilities on the form and level of
27 price however, we still think you need to get the price
28 right and we don't see the setting of prices as a tool to
29 underwrite recycling. If you do it, you need to do it
30 explicitly.
31

32 THE CHAIRMAN: Thanks, Peter. Kris?
33

34 MR FUNSTON: A really important point that has been raised
35 is what best promotes greater certainty in the marketplace
36 and I think that is what we are interested in actually
37 coming to a landing on.
38

39 We don't believe WIC utilities are non-residential
40 customers. We think they have very different features to
41 non-residential customers, so I think that's a key point of
42 difference here. In particular they are not
43 non-residential customers because we don't see them owning
44 some land or property, which is generally the
45 characteristic of a non-residential customer. Our price
46 determination actually sets charges on different property
47 types. Performance standards in the operating licence

1 actually cover properties and our customer contract is
2 about customers who own property connected to our
3 infrastructure.
4

5 We would also sort of regard our conduct in terms
6 of entering into utility service agreement, which was very
7 separate to our customer contracts from residential and
8 non-residential customers, as highlighting that they do
9 have different characteristics in terms of onselling.
10

11 I was also interested to hear the mention of the
12 telecommunications industry because, as some of you would
13 know, I used to work in the industry. One of the things
14 that actually happened in that industry when it first
15 started was there was a start-up provider, which was then
16 called Associated Press, and I did work for them at one
17 stage - that is, Australian Associated Press
18 Telecommunications.
19

20 The way they entered the market was they bought
21 corporate contracts and then they started selling them to
22 residential customers. With what is being described here,
23 I think it is interesting that this was history 20 years
24 ago and we are now seeing it repeated in the water sector.
25 I think there is an interesting lesson to be learned out of
26 that.
27

28 I would add that, over time, an appropriate framework
29 actually developed around a wholesale customer as opposed
30 to treating the customer as a corporate customer and
31 I think that is the issue that potentially needs to be
32 resolved at the moment.
33

34 THE CHAIRMAN: Thank you very much, Kris. Katy?
35

36 MS BRADY: Katy Brady from DPI Water. In terms of the
37 options on how to address these issues, one of the issues
38 is that the timing is short. The complexity of the issues
39 and the time frame for having a draft determination out
40 by March or April next year and then in place by 1 July is
41 a challenging time frame for resolving these issues in a
42 way that does not have adverse implications for the
43 industry.
44

45 I think, too, that the determination poses risks in
46 terms of inflexibility because, as Scott pointed out, under
47 section 18(2) of the IPART Act, once a charge is set in the

1 determination, it is very hard to depart from that, so
2 there is a lot less flexibility under that framework than
3 in the current situation of negotiating commercially. That
4 does not mean that you can't give the determination. It
5 just means you need to be really careful to make sure
6 you've got it right and do that once, not twice.
7
8 Finally, in terms of the access regime, I think that
9 the Commonwealth legislation, which forms the basis of the
10 New South Wales legislation, has a clear exclusion of the
11 supply of goods and the supply of the use of production
12 processes, and the definition in the WIC Act is based on
13 that definition.
14
15 I think that the bundled nature of the services that
16 we are seeing in the WIC market reflects the fact that,
17 under the licensing regime, what is happening is
18 competition for the market not competition in the market.
19
20 That is a really important distinction in thinking
21 about whether or not the access regime is the right
22 framework and whether, in fact, an access regime is more
23 appropriate to a market where you have competition in bulk
24 supply and competition in the retail sector and you need
25 the pipes in between to get from A to B.
26
27 That is not what we are seeing in Sydney, where we
28 have infill developments that are - unlike the Hunter
29 situation - using the Sydney Water sewerage system as well
30 as taking potable water from the Sydney Water drinking
31 water system.
32
33 I think the nature of the market is a little bit
34 unique, in that sense, and that we need to think very
35 carefully about this. I should clarify that DPI Water is
36 not responsible for the administration of the access
37 regime, but we need to think carefully about the scope of
38 the definition of "infrastructure services" and whether
39 that is a good fit with the nature of the market that we
40 are in.
41
42 THE CHAIRMAN: Thank you, Katy. Are there any
43 questions or comments from the floor?
44
45 MS CURRIE: Lisa Currie from the Sydney City Council.
46 I would like to make some general comments.
47

1 THE CHAIRMAN: Sure.
2
3 MS CURRIE: The City of Sydney has a vision for a
4 water-sensitive city and part of this is the provision of
5 drought-resilient water supplies to keep our city green and
6 cool in the face of population rise and climate change. We
7 don't support the proposed retail minus methodology as we
8 do not think it promotes competition, innovation and
9 investment in recycled water infrastructure. However, we
10 do support greater certainty in the marketplace and, in our
11 experience in this issue, the uncertainty created issues
12 for us and led to risk for our organisation, so we do
13 support greater certainty.
14
15 However, we also agree that further consultation is
16 required to determine the most appropriate way forward and
17 the most appropriate regulatory framework to support the
18 objectives of the WIC Act.
19
20 THE CHAIRMAN: Thank you, Lisa. Are there any other
21 questions or comments from the floor? No? Terry?.
22
23 MR LECKIE: I have one response just around ownership. We
24 do own some land, we own some premises and we are
25 conducting a business, but we can talk about that later.
26
27 I know under the new WIC Act, we have this thinking
28 around what constitutes "ownership" and therefore term of
29 lease, and that is also a concern and something to
30 consider.
31
32 THE CHAIRMAN: Thank you, Terry. Kurt?
33
34 MR DAHL: I was going to pick up the same point that Kris
35 commented on before about the reason for the need to create
36 a new customer is because they don't own land. For me, it
37 is all about the provision of a water or a wastewater
38 service. Whether the person owns the land or not, that
39 might be a definition issue about the type of customer you
40 have, but I don't think that is the grounds to create a
41 whole new customer base just because of the land ownership
42 issue.
43
44 MR FUNSTON: May I clarify that. I would actually support
45 that view. I am just saying that, technically, we don't
46 think you meet that.
47

1 I think the bigger issue is actually the arbitrage
2 issue that occurs around having a non-residential customer
3 price. As I mentioned, I think that was the issue that we
4 saw with AAPT in the telecommunications market. With an
5 environment where we have postage stamp pricing, and we are
6 meeting that universal service obligation, it creates a
7 potential problem where an inefficient entrant can come in
8 to the market and potentially actually make profits, which
9 we can't make because the extent to which we actually would
10 make a profit, we are using that to cross-subsidise people
11 in high cost areas.

12
13 I think your point earlier, Kurt, is very well made
14 around the retail minus. One of the things that does
15 happen - and I am sure we will explore this in the next
16 session - is in those high cost areas, it does mean that to
17 the extent that you could come in and service it more
18 cheaply than us, potentially there would be, effectively, a
19 subsidy being paid to you to as being the access provider
20 in that particular area.

21
22 THE CHAIRMAN: Thank you very much, Kris.

23
24 There are a couple of things working here which are
25 probably useful to get out. One thing that gives rise to
26 the arbitrage opportunities is the fact that the pricing
27 for residents is different from the pricing for
28 non-residents. Therefore, in the case of Sydney Water, it
29 is possible to purchase water as a non-resident and provide
30 it to end users at the residential price of Sydney Water.
31 That is one issue.

32
33 With Hunter Water, that is not so clear because of the
34 pricing regime, but we will get into that in the next
35 session.

36
37 The other point on postage stamp pricing - and most
38 people are familiar with this - is that it is basically
39 where all residents, for example, face the same price.
40 That means that the residents in high cost areas are being
41 subsidised by the residents in low cost areas. That will
42 still happen. You can have postage stamp pricing, and that
43 will still happen, but that is not the arbitrage
44 opportunity. The arbitrage opportunity comes from the
45 difference in pricing of residents and non-residents. Yes,
46 Katy?
47

1 MS BRADY: In terms of the postage stamp price, I think
2 it is important to keep in mind that it is set based on a
3 line-in-the-sand valuation of assets which significantly
4 wrote down the asset base of Sydney Water and Hunter Water
5 for pricing purposes.

6
7 In terms of the scale of the profiteering or the
8 arbitrage opportunity, I think it is important to consider
9 that we are talking about a retail price set on a lower
10 than replacement value price versus new entrants who face
11 the cost of new infrastructure. We know that recycling is
12 deemed a high cost and yet recycled water prices are set as
13 a function of or a percentage of the potable price.

14
15 I think the degree to which there is scope for a great
16 deal of profit to be made is not borne out by the number of
17 schemes that we have seen come to fruition to date - we
18 have only around 16 schemes licensed under the Act and no
19 one has sought to use the access regime. It is important
20 to be mindful about the nature of the postage stamp price
21 and where it is set relative to asset values.

22
23 THE CHAIRMAN: Thank you, Katy. Is there any last
24 comment before we break for afternoon tea? No?

25
26 Let's resume in 15 minutes at 2.45, thank you.

27
28 SHORT ADJOURNMENT

29
30 THE CHAIRMAN: Welcome back everybody. The next
31 session is on pricing. So if - if - IPART is going to set a price,
32 here are some of the things that we can discuss. Thank you
33 Justin.

34
35 SESSION 2: How should wholesale prices be set (what
36 approach or methodology should be used to establish
37 prices)?

38
39 MR ROBINSON: Thank you, Mr Chairman. Wholesale pricing
40 IS important. An inefficient wholesale price may lead to
41 too much or too little market entry. Most stakeholders, in
42 one way or another, make an argument that it is important
43 to have prices that will increase market efficiency. In
44 general, we can categorise the submissions received as
45 either arguing the case for productive efficiency, where
46 output is produced at the lowest cost, or arguing the case
47 for dynamic efficiency, where the market is flexible enough

1 to promote innovation and long-term cost reductions.
2
3 If we are going to regulate price, these are some of
4 the options. There are a number of possible approaches to
5 price wholesale services, either under a determination or
6 through an access undertaking. Today we will discuss three
7 options raised in our issues paper by stakeholders:
8 Retail price minus avoidable costs;
9 The cost of service or building block approach; and
10 the non-residential price.
11 We will also introduce another option we are
12 considering: prices based on an efficient entrant's costs,
13 which is a variant on retail minus pricing.
14
15 In our issues paper we noted a preliminary preference
16 for retail minus avoidable costs. Sydney Water and Hunter
17 Water both supported a version of retail minus avoidable
18 costs in their submissions.
19
20 This method is with the maintenance of postage stamp
21 prices and allows wholesale customers to compete with the
22 incumbent on the costs of providing the contestable
23 service. It is based on the total end user retail charges,
24 as determined by IPART, less the costs the incumbent
25 service provider avoids today, or could avoid in the
26 future, or even costs of assets that become surplus to
27 needs.
28
29 Under this pricing principle, an entrant competes on
30 the avoidable costs - that is, a WIC utility would enter
31 the market when its costs to serve are less than the costs
32 avoided by the incumbent.
33
34 It is important to note that there is precedent for
35 this pricing approach. In the Services Sydney case, the
36 ACCC decided that a retail minus avoidable cost is the most
37 appropriate access price to Sydney Water's declared
38 wastewater networks.
39
40 Although compelling in principle, we note that, in
41 practice, retail minus avoidable cost could be challenging
42 to implement in a price determination. There is the need
43 for information from WIC utilities which may be considered
44 sensible - that is, to compute and implement a retail minus
45 avoidable cost price, Sydney Water and Hunter Water would
46 need to either estimate or be supplied with WIC utilities'
47 number of customers and activities to provide avoidable

1 costs. If estimates are used to compute retail minus
2 prices, WIC utilities would have access to a formal
3 complaint process through the IPART Act where they could
4 dispute the application of the price methodology.
5
6 The second approach to wholesale prices is to charge
7 WIC utilities the IPART determined non-residential retail
8 price. Some stakeholders argue that WIC utilities are
9 businesses with similar connections to the incumbent's
10 networks as any other business and, as a result, should be
11 charged as non-residential customers. This option is the
12 simplest to apply in a determination. However, these
13 prices are designed for end users, not wholesale customers.
14 In particular, margins under a non-residential price would
15 vary with usage charges and price structure changes. In
16 particular, differences in Sydney Water's and Hunter
17 Water's price structures lead to very different outcomes
18 from applying a non-residential charge. In some cases in
19 the Hunter, it may be more expensive than the residential
20 retail charges.
21
22 In this slide, we show that the differences between
23 price structures and usage charges in Sydney Water and
24 Hunter Water lead to differences in residential an
25 non-residential prices. Most notably, in the example
26 shown, a non-residential customer in Sydney can be charged
27 \$221,000 less than residential customers, while, for the
28 same complex in Newcastle, the non-residential customer
29 would be charged more than residential customers.
30
31 The cost of service or building block approach is a
32 bottom-up method that calculates the actual cost of
33 providing a service to a wholesale customer. This method
34 is not consistent with postage stamp and it could lead to
35 perverse outcomes. Notably, it could lead to inefficient
36 outcomes where high cost entrants could profitably enter in
37 low cost areas; and low cost entrants could not profitably
38 enter in low cost areas. It would also be challenging to
39 include in a determination.
40
41 The final option for setting wholesale prices is to
42 use a retail price minus efficient entrant costs. This
43 pricing approach is similar to a retail minus avoidable
44 cost approach. However, rather than estimate the costs
45 that Sydney Water or Hunter Water could avoid, it would
46 estimate the costs of an efficient entrant and base charges
47 on this margin.

1
2 We consider that the efficient entrant costs could
3 look like this in a determination. The wholesale charge is
4 based on the end user retail charges determined by IPART
5 less a series of standardised costs by relevant units for
6 retail distribution, water filtration and wastewater
7 treatment. These standardised costs could be set across
8 Sydney Water's and Hunter Water's area of operation or on a
9 more disaggregated level- for example, a regional basis.
10 Estimating the margins for different services would be
11 complicated and face similar information issues to the
12 retail minus avoidable cost approach discussed earlier.
13
14 In our issues paper, we proposed using retail minus
15 avoidable cost. We are now also considering the retail
16 minus efficient entrant costs. As Matt noted earlier, this
17 is a preliminary view and we are continuing to consult.
18
19 In its response to our issues paper, Sydney Water
20 supported the retail minus avoidable cost approach. It
21 proposed that the interim determined price should have a
22 minus of 3 per cent. Similarly, Hunter Water supported a
23 retail minus approach with a minus of 2 to 3 per cent.
24 Most other stakeholders stated a preference for the
25 non-residential price.
26
27 An important consideration in determining wholesale
28 prices is that each scheme generates different avoidable
29 costs. A standardised price cap like the non-residential
30 price or retail minus a fixed percentage may not
31 accommodate such differences. A price methodology or
32 negotiation through the WIC Act, on the other hand, may
33 better reflect individual scheme characteristics and/or
34 avoidable costs. However, a methodology may provide less
35 certainty as prices are customer specific.
36
37 In the next few slides we will explore this issue
38 through two examples of WIC utilities.
39
40 Model one: under this wholesale arrangement, we have
41 the WIC utility servicing retail customers in a high density
42 development by purchasing both water and wastewater
43 services from the incumbents, and supplying recycled water.
44 In this example, the WIC utility potentially avoids the
45 incumbent's retailing costs, some wastewater treatment
46 costs and potentially defers capital investment in the
47 network by providing recycled water.

1
2 Model two: under the second wholesale arrangement, we
3 have the WIC utility servicing retail customers in a low
4 density development by only purchasing water services from
5 the incumbent; building its own distribution network; and
6 treating and disposing of all wastewater through its
7 recycled water plant.
8
9 In this example, the WIC utility potentially avoids
10 the incumbent's retailing costs, potentially defers capital
11 investment by providing recycled water, and avoids all
12 wastewater treatment costs.
13
14 How to treat the avoided wastewater costs in a retail
15 minus framework is particularly challenging. This is
16 because the WIC utility is not connected to the incumbent's
17 wastewater network even though it may create wastewater
18 savings. The question to ask therefore is whether the
19 wholesale price, in this case, should reflect avoidable
20 costs, efficient entrant costs related to wastewater
21 activities or if there should be no wholesale wastewater
22 charge at all?
23
24 Finally, stakeholders have noted that there are a
25 number of related and overlapping pricing issues that
26 should be considered in conjunction with wholesale prices.
27 The two key pricing issues raised were recycled water
28 avoided costs and zero developer charges.
29
30 Stakeholders have noted that, under our existing
31 policy for recycled water, WIC utilities do not have an
32 ability to claim avoided costs. In contrast, Sydney Water
33 and Hunter Water can recover some recycled water costs from
34 the broader water and wastewater customer base where there
35 is evidence of an avoided cost.
36
37 Stakeholders have also noted that we are considering
38 wholesale prices in an environment where the New South
39 Wales government has set Sydney Water's and Hunter Water's
40 developer charges to zero. As a result, in growth areas
41 where WIC utilities are competing with Sydney Water and
42 Hunter Water, the incumbent utilities can cross-subsidise
43 their growth expenditure from their existing customer
44 bases.
45
46 Noting these issues that potentially limit the level
47 playing field, some stakeholders have called for a

1 wide-ranging review to look at all the issues impacting
2 competition in the water industry.
3
4 Here are five questions to facilitate discussion:
5
6 1. For each of the models presented, which pricing
7 approach should apply? Where applicable, what costs are
8 avoidable?
9 2, Sydney Water and Hunter Water estimated avoidable
10 costs of two to three per cent, what costs is this based
11 on?
12 3. Under a determination, should WIC utilities
13 providing different services face the same or different
14 charges?
15 4. If IPART set a retail minus or efficient
16 competitor approach, how would Sydney Water and Hunter
17 Water obtain the information required to calculate charges?
18 5. Should WIC utilities be compensated for savings
19 created by recycled water deferring or avoiding
20 augmentations.
21
22 I now hand back the hearing to the Chairman.
23
24 THE CHAIRMAN: Thank you very much, Justin. Questions,
25 comments from round the table. Terry
26
27 MR LECKIE: Thank you, Justin. I am just trying to get my
28 head around this. You talk about the difference in costs
29 depending on whether it is a WIC Act licence holder or an
30 incumbent. I suppose I am asking you is the marketplace
31 that we have, on which you have based your assessment, the
32 customers and service area of the incumbent and therefore
33 the WIC Act licence holders are taking those customers away
34 from that incumbent or do we have a marketplace that is
35 open and that can be served by either the incumbent or the
36 WIC Act proponent. What was your basis?
37
38 MR ROBINSON: I would go with the second. I guess what
39 complicates that is that the WIC facility is purchasing the
40 services from the incumbent, so there needs to be some
41 consideration of how that is best done.
42
43 MR LECKIE: I am a little perplexed. I suppose if that's
44 the case then I become a customer of the incumbent, a new
45 customer, I am going to be a non-residential customer, I am
46 running a business, and they haven't lost any customers,
47 have they? They've just gained a customer, so they've just

1 got themselves a new customer. We are going to talk about
2 what services I might need. We will talk about how we
3 might be able to operate two systems together, which is no
4 different to how we work with an industry.
5
6 We talk about pre-treatment: I need pre-treatment.
7 We talk about conditions at the boundary. We talk about
8 rates applied under the determination to provide that
9 service to a new customer, which happens to be me.
10
11 I run a business. Remember, it is an open
12 marketplace. They haven't lost any customers because the
13 marketplace is open. What they have is they have gained a
14 customer and they have competed to be able to either have
15 my customers as their customers or their customers as my
16 customers.
17
18 Is that what we are saying or is it the market that provides
19 the customers? I think what we are saying is the pretext
20 is that it is an open market. Therefore, we are not taking
21 customers off anyone. Therefore, the condition that we look
22 at I think comes from a presumption that they would have
23 been served by this incumbent model and that, "You've
24 come along, Mr WICA holder, and you've now applied
25 a different model to them and therefore, that money should
26 have been applied to the incumbent and they've lost that."
27 Under an open market they don't have it, for a start.
28
29 THE CHAIRMAN: That is a really good question. On the
30 presumption that it is an open market, that these customers
31 don't belong to anybody, we will come in and supply them.
32 Then the issue is - let's just concentrate on Sydney Water
33 but it applies to Hunter Water too - in the case of a new
34 infill development, Sydney Water is bound under the
35 postage stamp pricing to charge those customers a certain
36 residential rate, so they can't undercut that rate.
37
38 If somebody comes in from outside, sets up a business,
39 buys the water as a non-residential customer, which happens
40 to provide an arbitrage opportunity, that person can
41 arbitrage up to just below the postage stamp price, which
42 is fine for the customer, it promotes competition, but it
43 means that if everybody did that, what would happen is that
44 after a while Sydney Water would have no customers left in
45 the low cost areas and they would be forced under postage
46 stamp pricing to supply the high cost areas and they
47 wouldn't have the cross-subsidy which is implicit in the

1 current regime. This is a policy under which we all live,
2 including IPART, WICA licensees, Sydney Water and
3 Hunter Water.
4
5 Then there is an issue in the case now that because of
6 the differential pricing between non-residents and
7 residents, it is possible in Sydney Water for the WICA
8 licensee to purchase the water at the non-residents' price,
9 on-sell it just below the residents' price, and the
10 question then is what is a reasonable price that the WICA
11 licensees should pay Sydney Water for that wholesale water.
12
13 One thing is you can negotiate it, you can go to
14 IPART, you can negotiate it, you can have the access regime
15 or it could be put in a determination. These are all
16 options which have been looked at. I repeat, the reason
17 why these options have been looked at is because these are
18 things that were raised by stakeholders over the last few
19 years. These have been looked at.
20
21 MR LECKIE: Sure.
22
23 THE CHAIRMAN: One option is retail minus which has
24 been put up. Another option is it is another form of retail
25 minus but you are subtracting off the costs of an efficient
26 competitor. In other words, if the competitor is
27 reasonably efficient their costs would be so much, so you
28 would subtract that off from the retail price, which is a
29 postage price, and provide that as a wholesale price and
30 that would still provide room to move for an efficient
31 competitor.
32
33 That is the issue but that is a very good question.
34 The question is that it has not then come out that
35 Sydney Water or Hunter Water owns these people, it is
36 actually that these are options under WICA which are open
37 to anybody who wants to enter the market.
38
39 The question then is that we need to realise that the
40 incumbents have certain advantages, but they have a
41 disadvantage in that they have to maintain postage stamp
42 pricing and postage stamp pricing means that residents and
43 businesses in low cost areas subsidise residents and
44 businesses in high cost areas. Until that policy is
45 changed that is a constraint within which IPART as the
46 regulator, Sydney Water, Hunter Water and WICA utilities
47 all operate.

1
2 MR LECKIE: Could I respond?
3
4 THE CHAIRMAN: Yes.
5
6 MR LECKIE: You may disagree. Where I sit, as a WICA
7 licence holder, an incumbent has an obligation to serve and
8 therefore, the incumbent owns all of the customers and
9 therefore, WICA licence holders are coming in to take away
10 those customers. That is why I am asking because I think
11 that is the basis on which we are operating. I think we
12 need to recognise that because that is driving how we are
13 approaching it.
14
15 If it is an open marketplace where we can both compete
16 then it would be a different approach. When I look at the
17 residential/non-residential basis - and I understand the
18 difference between Sydney Water and Hunter Water - I am
19 not so worried about that because at least I have certainty and
20 at least I have an approach which is well known in the
21 marketplace that I can follow.
22
23 Certainty is of greater value to me than the other but
24 I just want to make the point that we aren't working under
25 an open market, we are working under an incumbent who is
26 obligated to serve. How do we change that? I don't know.
27 WICA licence holders are considered to be taking customers
28 away from the incumbent.
29
30 MS BRADY: I just wanted to comment on the labour
31 intensive nature of some of these pricing approaches and
32 the small customer numbers that we have in the WICA market
33 at the moment. There is a transaction cost there for
34 government and taxpayers and also for customers of
35 utilities.
36
37 The concern about the arbitrage opportunity is that it
38 creates upward pressure on price because, all else being
39 equal, the public water utilities will have a smaller
40 number of customers going forward than they might
41 otherwise have. The concern has been expressed that that is
42 putting upward pressure on price.
43
44 What I think has not been picked up to date very
45 clearly is that WICA licensees can also put downward
46 pressure on price. For example, in urban developments
47 where the public water utilities don't need to extend their

1 sewerage network to service that site because they are
2 going to be serviced by an on-site system, that means that
3 the costs facing the public water utilities customers are
4 lower than they would otherwise be.
5
6 The actual effect on price is the function of the nett
7 impact of upwards and downwards pressure on price and
8 I think we need to be very mindful of both directions when
9 we are thinking about this.
10
11 I think also the community engagement work that we
12 have done in relation to the Metropolitan Water Plan and
13 the Lower Hunter Water Plan shows there is a lot of
14 community support for recycled water. In terms of the size
15 of the financial impact at the moment, I understand it is
16 in the order of 50 cents per household. There are other
17 signals in this market which means that cross-subsidies
18 from existing customers to greenfield infrastructure is in
19 the nature of \$27 per household, so there are 50 times
20 bigger cross-subsidies in the system than the one that we
21 are considering here.
22
23 I think perhaps it is a sequencing issue, that we need to
24 address the big issues first to see whether or not this
25 marketplace sends efficient signals to support efficient
26 investment and perhaps if we address those big issues first,
27 the problematic nature of this issue would be lessened
28 and if we had regard to both upwards and downwards
29 pressure, we might think that actually the current
30 situation is not so very bad, that these things do deliver
31 benefits beyond their boundaries, just in the same way as
32 the Sydney desal plant costs are shared by every customer
33 in the Sydney rate base regardless of whether they receive
34 that water. These schemes can form part of a sensible
35 portfolio of measures that make our cities more resilient
36 to drought and to climate change.
37
38 MR WILLETT: A key point from that I take is that you are
39 suggesting that some of these water costs would be quite
40 clear in the network, both in the water supply network and
41 the wastewater network, because of recycling.
42
43 MS BRADY: Yes, because our work for the Metropolitan
44 Water Plan adopts the approach of real options thinking and
45 it says that there is value in having climate resilient
46 elements in your portfolio. They may be higher cost per
47 kilolitre than the average of the cost of supplying the

1 network, but in drought those climate resilient kilolitres
2 are very valuable and they can defer big lumpy capital
3 investments that can put \$100 on to every bill, so 50 cents
4 doesn't look so bad in that context.
5
6 It is all about risk weighted costs, so the present
7 impact on a household can be heavily discounted if you are
8 looking off into the future, but these things do have real
9 value in improving our climate resilience and if you were
10 to teleport yourself 50 years into the future and look at
11 two different scenarios, one of which is wholly reliant on
12 rain fed storages plus desal, for example, versus another
13 scenario where you have well targeted investments in
14 recycling schemes, probably the latter scenario might
15 deliver you a more economically efficient outcome than the
16 former.
17
18 It is also about not just the supply and demand
19 balance but how we manage our wastewater load and with a
20 growing population and constrained river systems that I am
21 sure we don't worry about so much, the reality is that the
22 wastewater system is a big part of the network and those
23 discharges are going to grow unless we foster efficient
24 systems that can reuse those nutrient loads.
25
26 MR TAYLOR: I think you put up a model before from an
27 urban regeneration model of a community. If you could bear
28 with me, if you speculate potentially around an urban
29 growth proposal for the Bays Precinct, which is four times
30 the size of Barangaroo South currently, the proposed
31 mechanisms you are putting forward disincentivise private
32 participation in the Bays Precinct. There are 100,000
33 people there which would mean that rather than a recycled
34 water system with a water positive water balance,
35 Australia's largest carbon neutral community, et cetera,
36 you'd actually take away opportunities to manage effective
37 integrated water management for the water cycle and private
38 utilities won't participate.
39
40 It would then fall to Sydney Water to service that
41 area. That would require significant capital infrastructure
42 to augment Sydney Water's capability to service the
43 Bays Precinct and the development program and more than
44 likely would trigger the use of the Sydney desal plant
45 applying 13 per cent per person on their charges. That is
46 an example of a perverse outcome from the adoption of these
47 charges. I am exaggerating for effect, but there is a real

1 possibility that these pricing mechanisms will prevent
2 private infrastructure and WICA participants in the Bays.
3 I don't know if you share that view, Terry.
4
5 MR LECKIE: Yes. I think that is one example - and there
6 are lots of others - and the other is a greenfield.
7
8 MR EDGERTON: Scott, if the WICA licensees are avoiding
9 those costs to Sydney Water, why wouldn't that be reflected
10 in a retail minus methodology?
11
12 MR TAYLOR: Because avoiding costs or capital offset is
13 only one part of it. When you do total cost of ownership,
14 you are relying on all the costs and all the revenue to
15 operate effectively. The retail minus cost undermines the
16 returns you're seeking from that investment, but we're not
17 talking about high risk returns, we're talking about
18 regulated returns. When you run the economics of the cost,
19 something like the Bays Precinct becomes uneconomical in
20 the retail minus perspective.
21
22 In the example that we had, which may not be relevant, we
23 were seeking to put a recycled water plant in Water Bank, a
24 Lend Lease development in Western Australia, and they have
25 what you are proposing, and when we did the economics
26 around a recycled water plant and usage of wastewater and a
27 passive treatment system, et cetera, when the local water
28 utility said, "Here are my charges, it's retail minus, so
29 you need to take that", it became uneconomical. We had to
30 walk away from it. We just went back to a conventional
31 water solution for what could have been a quite dramatic
32 improvement to the foreshore of WA.
33
34 THE CHAIRMAN: What price do you think you should pay
35 Sydney Water for water?
36
37 MR TAYLOR: I think, at this point in time, we should
38 maintain the status quo.
39
40 THE CHAIRMAN: Which is non-residents' pricing.
41
42 MR TAYLOR: And I think all the comments that we made in
43 the earlier session apply to this session.
44
45 THE CHAIRMAN: Kris?
46
47 MR FUNSTON: I think we just have to move way from this

1 idea of the status quo because we have been really clear
2 over the past six months to industry that our view is that
3 the WICA utilities aren't non-residential customers and we
4 have gone out there and talked about a retail minus
5 approach which is where some of these issues have arisen
6 from. We need to be careful about what the status quo
7 actually is. Out beyond the status quo, it is retail minus
8 and that is what we are promoting, going forward, as the
9 appropriate and efficient asset price.
10
11 We do look at the avoidable costs issue and our view
12 is to the extent that any WICA utility were to enter and
13 avoid costs to us, we would have to reflect that in the
14 associated access price. To the extent that they reduce
15 treatment costs, our operating costs, transportation, we
16 would be happy to reflect that in any sort of price going
17 forward.
18
19 THE CHAIRMAN: Thanks, Kris. There is somebody in the
20 audience. Yes?
21
22 MS DAVIES: Sharon Davies from Sydney Water. I just
23 wanted to clarify the issue of the Bays Precinct. Our
24 preliminary modelling indicates that there is sufficient
25 capacity for the water network to 2036 to cater for the
26 development.
27
28 THE CHAIRMAN: Thank you, Sharon. Kurt?
29
30 MR DAHL: I think there are two groups of customers that
31 are being put together here. I don't think anyone is
32 talking about just buying a sewerage service from
33 Sydney Water, linking it up to a bunch of residential
34 apartments and selling it. There is no business in that.
35 All of the WICA licensees that we work with and support
36 actually do something. They build a sewage treatment plant
37 in the basement of a building and provide recycled water.
38
39 Just discounting people who do nothing from this whole
40 discussion I think would be fine. There is no arbitrage
41 opportunity for people like that. I don't think they've
42 got a place in the market, to be honest.
43
44 The second thing is every pricing model - and I said
45 this in the earlier session - is all based on retail minus.
46 It doesn't provide an opportunity for anyone to go and
47 access customers that are in this high cost area that

1 Sydney Water and Hunter Water are happy to subsidise at the
2 moment. If an alternate provider can provide services in
3 those parts of the network, that is a saving to the broader
4 customer base, but everything is on retail minus, so you
5 never get the opportunity to provide a service in those
6 areas.

7
8 THE CHAIRMAN: Matt?

9
10 MR EDGERTON: Kurt, just to clarify, under a retail minus
11 approach there is actually incentive for a utility to go
12 into a higher cost area of Sydney Water. For example, if
13 the WICA licensee is actually doing its own wastewater
14 treatment and disposal in a high cost area, say in
15 Western Sydney, under a retail minus approach the avoidable
16 cost would actually be higher, the wholesale price would be
17 lower.

18
19 MR DAHL: Yes, but could it go negative? Say you started
20 with \$600 and you say, "Well, it cost us \$3,000 a year to
21 provide a service to this customer. Our access price is
22 minus \$2,400. Here you go."

23
24 THE CHAIRMAN: Theoretically.

25
26 MR DAHL: Theoretically.

27
28 THE CHAIRMAN: Yes, hypothetically, yes.

29
30 MR SHIELDS: In the Lower Hunter, in those projects on the
31 fringe of our network, we have a funding growth
32 infrastructure policy where we oblige the developer to fund
33 the connection and augmentation works and we may fund
34 some upsizing costs, but if they have decided to undertake a
35 development in a part of our area of operations that is
36 remote from our infrastructure, then the cost falls on the
37 developer, not our customers, so there is no saving to the
38 customer for the project going ahead.

39
40 MR DAHL: In the recent pricing determination for
41 Sydney Water they have put something like \$600 million
42 aside for growth assets over the next pricing determination
43 that every customer pays for. I am maybe not as familiar
44 with Hunter Water, but that is a big chunk of money where
45 the broader customer base is subsidising growth.

46
47 THE CHAIRMAN: In that example, Kurt, which gets back to

1 your earlier point, if you have retail minus and it is in
2 a very high cost area then that would be a substantial
3 reduction from retail minus and so the wholesale price
4 you would be charging a WICA utility which could be charged
5 under such a regime would be lower and that would be borne
6 by all Sydney business customers in that hypothetical.

7
8 Getting back to the point that Matt made earlier, one
9 cannot like retail minus but if one were to adopt retail
10 minus, it does apply in both high cost and low cost areas.
11 Have you finished, Peter?

12
13 MR SHIELDS: Yes.

14
15 THE CHAIRMAN: Any other comments from around the
16 table? Cathy?

17
18 MS COLE: Just an observation in terms of trying to get
19 the best outcome and most efficient pricing approach for
20 the wholesale customer part of it. When you talked earlier
21 about the option of maintaining the status quo, it wasn't
22 as in do nothing, but as in while looking at the broader
23 settings that are around that, and it is quite a complex
24 world and I don't know if any of us have the right answer
25 to it, but we know developer charges are set to zero in
26 Sydney and the Hunter for water and wastewater, developer
27 charges still apply for recycled water, developer charges
28 still apply on the Central Coast. You have, for example,
29 licensees developing on the boundary between Hunter and
30 Central Coast and so if they go one way for a service there
31 is no developer charge, if they go the other way there is,
32 and the fact of the combination of developer charges and
33 postage stamp pricing is able to give the price signals for
34 what it costs to develop in different areas.

35
36 It is all part of that big mix and that is why we
37 thought that perhaps there was scope to consider those
38 things more broadly before locking in on one element in
39 this whole imperfect world. We weren't talking about do
40 nothing but look at the whole picture.

41
42 THE CHAIRMAN: Yes, Cathy. IPART is more than happy
43 and I am sure most of the other participants around the table
44 are more than happy to discuss that and indeed, we have
45 made submissions on developer charges, we have made
46 submissions on postage stamp pricing, as have many other
47 stakeholders.

1
2 So far the government has taken a position. They have
3 either just introduced or they are about to introduce, or
4 I think it might be passing the second WIC Act, so we have
5 a policy framework within which we have to operate and
6 IPART needs to make a decision, as a result of these
7 consultative processes, to go in or not go in the
8 determination starting on 1 July, so we don't have a lot of
9 time to deal with these bigger issues which require Cabinet
10 decisions.
11
12 MS COLE: The question is this, is there scope to look at
13 that more broadly, particularly given some of the bundled
14 nature of the service versus the access regime? There seem
15 to be a few issues on the boil there. Yes, it is a complex
16 world to operate in.
17
18 THE CHAIRMAN: It is indeed.
19
20 MS COLE: We appreciate that.
21
22 MS McLEAN: Lisa McLean, Flow Systems. Just a reflection
23 on Sharon's comment about the Bays Precinct. I think one
24 of the intentions of WICA was to drive innovation in the
25 sector. We know that investment in infrastructure is a 30
26 to 100-year investment. At some point the state needs to
27 make this transition into sustainable, modern innovation
28 and new ways of doing things and I think pretty much
29 100 per cent of the industry is pushing for that at the
30 moment.
31
32 We would argue that this is an important part for
33 IPART to consider. We are trying to break in, we are
34 trying to do things differently. We have made the revenue
35 streams work. It has been a decade now since WICA came in
36 and there has been enormous investment in the sector,
37 working with Sydney Water and Hunter Water to work out
38 how we interact and also to get the economics right.
39
40 The innovation side of things is absolutely critical
41 because every year that slips past and we don't get another
42 Barangaroo or another Central Park or another new way of
43 doing things, we really are slipping behind as a state, and
44 we know it is an objective that the city has to be more
45 liveable and we know that these are innovations and
46 sustainable options and hopefully one day we won't have to
47 pump sewage out to sea, hopefully, we will be able to do other

1 things, and I think that is a shared belief for the whole
2 industry, but at some point WICA needs that support and we
3 would be looking for that leadership from both government
4 and IPART.
5
6 THE CHAIRMAN: Thank you very much, Lisa. That is a very
7 good point and that is a point that we have made too - the
8 dynamic benefits of competition. It is not just a matter
9 of supplying something at the lowest cost now; it is an
10 issue of dynamic efficiency and your point is very well
11 taken.
12
13 MR FUNSTON: I just thought it was worthwhile clarifying
14 something. In our response to the issues paper, we did
15 mention the retail minus the 3 per cent. We also flagged
16 that that was really just the retail cost at the time.
17 I think to the extent that there are other avoidable costs,
18 we have suggested that if we went down the path of a
19 wholesale access undertaking, they should be taken into
20 account and those costs should be recouped.
21
22 We were of the view that it was really just an
23 indicative bundle but that hopefully, in the course of an
24 undertaking, that issue could be resolved. That is
25 something that is an issue that is open for discussion.
26
27 THE CHAIRMAN: Thank you, Kris.
28
29 MS BRADY: I just wanted to make a comment about
30 estimating what is avoided and I think also the proposal to
31 look at an efficient entrant. It sounds to me like a very
32 labour intensive thing to do. It almost sounds like a
33 building block approach to look at the efficient manner in
34 which a service is delivered by a new entrant, which sounds
35 a bit like a price determination for that new entrant.
36 Another option under the WIC Act is separation of the
37 suppliers and setting prices under that framework using the
38 bottom-up efficient approach.
39
40 The nature of the market is important to keep in mind.
41 Under the current section 10(4)(d) of the WIC Act, new
42 entrants must bring a new source of water to market, they
43 can't just on-sell, so that is why we are seeing the nature
44 of schemes develop that we have. Under the amending Act
45 that was passed last October but has not yet commenced, the
46 intention remains, with respect to licence schemes, that
47 retailers can only retail services to customers in

1 connection with a scheme approved under the Act. The
2 government made a decision not to go down a full retail
3 contestability path and so what we will see into the
4 future, as we have seen to date, are schemes coming forward
5 that involve onsite reuse and recycling.

6
7 You can't compete with the incumbent utilities on a
8 business as usual basis, it is just not that kind of
9 sector. There are a lot of economies of scale and there is
10 a lot of capital intensive infrastructure. What has been
11 happening is this new model where you have on-site
12 recycling and reuse.

13
14 IPART's issues paper flags that where there is more
15 than on-selling happening then a price cap approach will
16 not reflect the efficient costs of that scheme and that is
17 the case in every single instance under the WIC Act. Every
18 single licensee has either brought a new source of water to
19 market in the form of a desal plant or has done on-site
20 recycling or reuse, which does pose the question, does that
21 retail price average approach work or will it be blunt and
22 not capture the scheme specific savings that can arise
23 under this system?

24
25 THE CHAIRMAN: That is one of the problems that we
26 outlined in the slides.

27
28 MS BRADY: Yes. It does beg the question of the high
29 transaction costs if you go for specific cost estimations
30 versus a cheaper but more blunt approach and both of them
31 are problematic.

32
33 MR EDGERTON: Katy, I think you have summed up quite
34 well the challenges that we are facing. You talked about the
35 intensity of calculating the minus part of retail minus,
36 but then the bluntness associated with the price cap.
37 Given that trade off what is the best course of action for
38 IPART?

39
40 THE CHAIRMAN: Now you can offer a solution.

41
42 MS BRADY: I think one of the issues is the sequence with
43 which we tackle the problems and that perhaps this is not
44 the first one to tackle.

45
46 THE CHAIRMAN: Which one would be first?

47

1 MS BRADY: The elephant in the room, the developer charges
2 problem, which you have alluded to and which is also very
3 blunt in terms of signalling where things are efficient and
4 where things are not. If you had cost reflective developer
5 charges you wouldn't have to have the situation where the
6 price could go negative. I think that it would be
7 fantastic if we had an opportunity to consider the issue
8 holistically and then the difficulty of tackling this issue
9 would be reduced.

10
11 THE CHAIRMAN: Until the government makes a decision to
12 allow developer charges in Sydney Water and Hunter, we are
13 stuck with the current situation.

14
15 MS BRADY: In which case, as a theory of the second best,
16 the status quo.

17
18 I am not sure I agree with Kris's view that the status
19 quo is the Sydney Water position because there are existing
20 agreements which are commercial-in-confidence, so we don't
21 know the details, but I would have thought that they are
22 part of the status quo because they exist.

23
24 THE CHAIRMAN: But of the blunt instruments versus the
25 labour intensive instrument essentially calculating retail
26 minus efficient costs, which would you go for?

27
28 MS BRADY: I wouldn't go for either. I would go for the
29 developer charges that send cost signals.

30
31 THE CHAIRMAN: Okay, well, we will go for one of them -
32 or none at all. Yes?

33
34 MR KEMP: I am Adrian Kemp, from Houston Kemp
35 economists. I was going to pick up the points that Katy just
36 picked up on. I want to commend IPART for where they are
37 reaching in terms of their preliminary decision on a retail
38 minus. The reality of this market in these circumstances is that
39 that is really the only wholesale access pricing option
40 that you have for you given postage stamp pricing, so
41 I think that is exactly the correct answer in terms of what
42 the methodology should be.

43
44 Then the question really is the one that we were just
45 debating - how do we come up with the minus? Of the
46 options, avoidable or avoided and the short-run/long-run
47 concepts, clearly the answer I believe there is avoidable.

1 There is no apparent reason why we should not think about
2 the medium to long-term costs that might be avoided.
3 Then I think real question becomes: to what extent do we
4 apply some sort of averaging approach or do we apply
5 something more bespoke?
6
7 Katy, I guess I will give my opinion as to what
8 I think is the probably right answer in these
9 circumstances. My opinion, and if I was the tribunal,
10 would be to apply an avoidable cost on a bespoke basis. My
11 reasoning for that is actually quite simple. It is just
12 that we are only talking about a relatively small number of
13 schemes. It should be possible, and I think it is quite
14 doable, to think about where are those schemes connecting?
15 How does that impact on costs downstream of that particular
16 connection, or upstream of that particular connection, and
17 fundamentally work it out.
18
19 Part of that may be to think about some of the more
20 medium to longer term avoidable costs as well to make sure
21 that we are getting the right sorts of price signals. We
22 will always be in a world where we are thinking about how
23 can we optimise and deliver the least cost solutions to
24 customers and that inherently will be bespoke questions as
25 to how to provide those right incentives.
26
27 I do a fair bit of work these days in the electricity
28 sector. We don't want to end up in a situation like we had
29 with solar PV, whereby we had very broadbrush feed-in
30 tariffs that lead to a lot of investment and a lot of, you
31 know, kit on the ground to deliver benefits in areas where
32 often those benefits fundamentally were not delivered.
33
34 I would dread seeing a circumstance whereby we would
35 go down an averaging type approach, essentially providing a
36 feed-in type tariff for recycled water or the like, based
37 on some notion of average avoidable costs across the
38 network that then delivers, in actual fact, no benefits and
39 only imposes costs on people who sometimes have great
40 difficulties paying for those costs. I guess that is my
41 opinion.
42
43 The other option that you have proposed today is
44 around the efficient new entrant costs. The theory on
45 that, as I am sure you understand, is you should do that in
46 circumstances where you may have some spare capacity in
47 terms of the actual network. I think the reality that we

1 are talking about here is that that is probably not really
2 valid in this circumstance.
3
4 I guess that leads me back to the answer being retail
5 minus avoidable costs on a bespoke basis, thinking
6 carefully about some of those medium term or longer term
7 costs along the lines of some of the things that Katy was
8 mentioning earlier. Thank you.
9
10 THE CHAIRMAN: Thank you very much, Adrian. Is there
11 anybody else from the audience who would like to comment?
12 Yes?
13
14 MR HALL: Steve Hall, Flow Systems. Could I ask Adrian to
15 clarify something? Would you see bespoke costs being
16 independently calculated, like done by IPART, or just
17 negotiated between the public utilities and the WICA
18 licensees?
19
20 MR KEMP: I guess that is a process question. Clearly the
21 extent to which there might be any dispute about that might
22 suggest that there should be some framework put around
23 examining what those avoidable costs are. One option would
24 clearly be to what extent might IPART play some role in
25 that? I don't know. I think that is probably even beyond
26 the discussion we were having in the earlier session.
27 I suspect that sort of framework would not appear in either
28 a WIC Act or under the determination.
29
30 At the end of the day, I think what we are after is
31 making sure that those affordable costs are a reasonable
32 estimate of what the avoidable costs are on a bespoke
33 basis, and the process that you might want to put around
34 that to make sure you get the right answer - the right
35 thing - the best estimate of what the avoidable costs are
36 seems very sensible to me.
37
38 THE CHAIRMAN: Thanks Adrian and Steve. Does anybody
39 else have questions or comments? Katy?
40
41 MS BRADY: Just a quick one. I think that increased
42 transparency would be a helpful component of estimating
43 where it is efficient to invest, both for the private
44 sector, which is looking to invest, and for regulators and
45 utilities, who are trying to work out avoided costs.
46
47 In the electricity sector we see quite a lot of data

1 being published in, say, the Transmission Network
2 Development Plan. That is designed to give information to
3 the market about where constraints are presently posing
4 problems and where investment could help avoid
5 augmentation costs.
6
7 I think one element of the solution to this - it might
8 not be a pricing determination issue; it might be a related
9 issue through an operating licence requirement or similar -
10 would be for more data to be made available to the
11 marketplace about where constraints are arising and where
12 the opportunities are that would really target those
13 geographically specific cost savings. They are not
14 vanilla, and they can be very large, and that's where the
15 real savings could come in through geographically targeting
16 investment to where you face constraints, or where you face
17 high operating costs. Long distances from the treatment
18 plant to the end user involves a lot of energy to pump that
19 water that far. So when you have data available to the
20 market about those kinds of issues, you can optimise your
21 efficiency gains.
22
23 THE CHAIRMAN: Component pricing would be relevant in
24 that context too. Yes, Terry?
25
26 MR LECKIE: Just as a corollary to that, maybe it is worth
27 noting that there are other jurisdictions in the water
28 industry that have applied the retail minus. It would be
29 worth understanding what has happened in those markets
30 and what Ofwat has just done recently, which is to remove
31 retail minus pricing in that UK jurisdiction after having
32 applied it and trialled it and run it.
33
34 Our parent company, Brookfield Utilities UK, has been
35 operating under that regime for some time, so it
36 experienced it and understood the issues. It was found by
37 that industry and that regulator that the retail minus
38 needed to be removed because it was creating an inefficient
39 barrier to competition.
40
41 It is just worth understanding that in this context.
42 It may not apply. I do not fully understand the reason why
43 Services Sydney did not continue, but I do understand why
44 I have not sought to act through the access regime, and
45 that is because it just does not work for my business. It
46 is not necessarily retail minus, but it is an indication.
47 Those are two sort of examples of where it is not working

1 and there are others.
2
3 THE CHAIRMAN: Thank you. Thanks, Terry. Any
4 questions or comments? Peter?
5
6 MR SHIELDS: This whole issue being brought up through the
7 review has forced us to look hard at how we approach all of
8 this. We commissioned Frontier Economics to go away and
9 look at some pricing principles and how you should apply
10 those pricing principles. Again we have the circumstance
11 that it is drinking water and the only costs that are being
12 avoided are some metering and billing costs. On the water
13 side, it is simple. We are not seeing requests for
14 wastewater; hence, we were asking for a price cap less some
15 avoidable costs on water.
16
17 On the wastewater side, we do face that obligation to
18 postage stamp price. We may get infill development
19 requests in the future. We have taken this to our board.
20 Based on the advice we got from Frontier, we are applying
21 IPART's preliminary position to all future negotiations of
22 utility service agreements. We think it is efficient.
23 However, if we get wastewater service requests, we will do
24 a case-by-case assessment of what the avoidable costs will
25 be.
26
27 In terms of tailoring or in terms of writing a
28 determination for Hunter Water, we think the water side is
29 straightforward but we recognise that it is more difficult
30 on the wastewater side.
31
32 I have another observation about recycled water. In
33 the context of not requiring an augmentation for some time,
34 I would make the observation that recycling is expensive.
35 We commissioned an industrial scale plant, I think at the
36 end of 2014, and it cost a lot. There were a couple of
37 dual reticulation schemes as well and they cost a lot.
38 So there are benefits, but they are expensive pieces of
39 technology.
40
41 THE CHAIRMAN: Thanks, Peter. Kris?
42
43 MR FUNSTON: If I could add to that statement, I think the
44 issue was raised earlier by Katy about a potential subsidy
45 that is being paid. The question in relation to the
46 recycled water is: is that something that the entire
47 customer base should be funding? I think that comes back

1 to the policy issue which you have raised earlier and which
2 was articulated by Flow Systems. I agree that is something
3 that potentially needs to be on the table in terms of
4 future discussions.
5
6 THE CHAIRMAN: Thank you, Kris. Steve?
7
8 MR HALL: If I can pick up on a point that Peter made
9 about the approach to retail minus. Peter, you mentioned
10 that, for Hunter Water, your view is that the only
11 avoidable costs would be some billing and metering costs.
12 For us, we see it differently because there is a whole
13 reticulation network there of drinking water with regard
14 to which Hunter Water will never have to spend a dollar on
15 operating, maintaining or replacing. I think what that
16 does is highlight the fact that, at the moment, we are
17 coming from very disparate positions, so for me, it just
18 reinforces that.
19
20 I understand what you were saying before, Adrian,
21 about how, from an economist's point of view, it is quite a
22 pure approach do it in a bespoke way; but for me that just
23 highlights that it is probably highly unworkable.
24
25 To pick up on Katy's point, I think, that the
26 transaction costs of trying to work through those things
27 and work through that process on a case-by-case basis would
28 be higher than any potential savings that were trying to be
29 sought, in the first place.
30
31 THE CHAIRMAN: Thanks Steve. Peter?
32
33 MR SHIELDS: I am sorry, I should have included
34 maintenance of the local reticulation system in those
35 comments. I think we documented in our issues paper
36 response, and it is in the Frontier response, that normally
37 we would be gifted those assets by the developer and it
38 would be our job to maintain that local distribution
39 system. We would recognise that as an avoided cost
40
41 THE CHAIRMAN: Thanks, Peter. Is there anybody else in
42 the audience? Yes?
43
44 MS TURNER: Emma Turner from Hunter Water. I wanted to
45 address one of the issues raised by Justin about the
46 difference in the cost recovery mechanisms for WIC
47 utilities versus public price regulated utilities,

1 particularly where it relates to potential recovery of the
2 avoided cost of recycled water schemes from the water
3 customer base. This is a decision arising from, I think,
4 the 2006 recycled water pricing review guidelines and
5 determination.
6
7 I would like to highlight that, at the moment, Hunter
8 Water only has one scheme for which we are recovering
9 essentially a cross-subsidy from a different product - from
10 the water product - due to a deferral of expenditure on the
11 water side from one recycled water scheme.
12
13 It is not an easy process. It has become apparent
14 that, at every single price review, Hunter Water will have
15 to justify that cross-subsidy from the broader customer
16 base. That inevitably is a deterrent from requesting it,
17 because the initial basis on which you make a calculation
18 will inevitably change with a moving capital works program.
19 To do that ad infinitum has such high transaction costs
20 that it is a big deterrent to utilities to actually do it.
21 I think there is a bit of an overstatement of the
22 difference in pricing and cost recovery between the public
23 utilities and the WIC utilities when it comes to recycled
24 water avoided costs.
25
26 THE CHAIRMAN: Thank you, Emma. Are there any other
27 questions or comments? Yes, Terry?
28
29 MR LECKIE: We are running recycled water schemes and we
30 are building them. We have been able to drive down the
31 cost to make it economic. The models are not foolproof
32 yet. The operational component of them is still yet to be
33 fully tested, I believe, to get that operational model, but
34 we are getting there and that is by just applying a
35 different approach. It is a help to the industry and
36 I think we can all learn from that.
37
38 We are learning also from Kooragang. It is great
39 example. There are a lot of lessons to be learned out of
40 that and we apply those also. That is just really a
41 comment.
42
43 There is another thing with regard to heading down the
44 status quo, which we believe is to remain as a
45 non-residential customer. I would hope that, in the
46 pricing determination that is occurring at the moment with
47 Sydney Water and Hunter Water, there is not only a

1 consideration for the existing WICA proponents and their
2 build-out of customers or their capture of customers, but
3 that there is also some view on what that might look like
4 over the period. Therefore, you would have to look at the
5 effect of that, I suppose, on each of those incumbents,
6 which you will have done no doubt, and then look at the
7 effect, I suppose, of that. We look at the effect and it
8 is very, very small.
9
10 We do have this market situation, which is where we
11 are taking away customers from the incumbent, but under
12 that assessment, then we will only be doing that if the
13 assessment is short or if it is a shortfall, I suppose, of
14 the number of WIC Act proponents or customers that are
15 actually served in that period.
16
17 I know how long it takes to get these schemes off the
18 ground. Scott, I don't know how many customers you have so
19 far at Barangaroo, but it takes a very long time. This is
20 a very short time frame and for us to be able to
21 dramatically increase the number of customers we will get,
22 it is hard. So the volatility, I suppose, of that is very
23 small and that is just a consideration.
24
25 THE CHAIRMAN: Sure. Those points are well taken.
26 Anybody else? Any other questions or comments? Matt?
27
28 MR EDGERTON: This is just a general question perhaps, in
29 the first instance, to those around the table.
30
31 We have put forward two broad options in terms of
32 retail minus. One is retail minus Sydney Water's or Hunter
33 Water's avoidable costs, and there is a whole potential
34 discussion around how you might estimate those. The other
35 is retail minus, an efficient entrant cost.
36
37 If you assume the efficient entrant was, say, a
38 smaller scale to Sydney Water, it may be that their costs
39 are actually higher and, therefore, the minus part might
40 also be greater. I know Sydney Water and Hunter Water have
41 expressed support for retail minus avoidable costs and that
42 essentially WICA licensees have expressed opposition to
43 that retail minus methodology, but I was wondering what
44 each of your views were on the retail minus efficient
45 competitor costs.
46
47 THE CHAIRMAN: Thank you, Matt. As a matter of fact,

1 Catherine just mentioned that we should make that point.
2 There is a difference between retail minus avoidable costs
3 and the retail minus efficient costs or the costs of an
4 efficient contributor.
5
6 MS JONES: If I can just help clarify, when we talk about
7 an efficient entrant, you are not going to be at the scale
8 of the incumbent, so the costs of the efficient entrant
9 will be higher. If you are doing all these innovative
10 things in your business, you should hopefully be able to do
11 something below that efficient entrant cost and that is
12 where your opportunity is
13
14 MR LECKIE: Yes, but I wish I could --
15
16 MS JONES: That was our view and we'd like to hear --
17
18 MR LECKIE: -- honestly say that I can identify and manage
19 all my costs and be able to give you a report, but there
20 are so many dynamics, aren't there, in an emerging
21 marketplace? We talk about prices and pricing. This
22 pricing issue just creates another uncertainty. We are
23 trying to deal with a whole lot of other things. Just
24 getting the gig, getting infrastructure on the ground and
25 getting it operational and through the licensing approvals
26 process, that is a large cost. It depends on what scheme
27 and it is usually time.
28
29 We are dealing with all of those kinds of issues right
30 now that it is just hard for us to be able to respond
31 to, "We are going to deal with this issue around pricing
32 and can we get some efficiency around that": We are trying
33 to get efficiency out of the process at the moment, let
34 alone deal with the price.
35
36 MS McLEAN: We really need a bigger and broader
37 government review before we can, we believe, use these levers
38 to impact on the industry.
39
40 THE CHAIRMAN: Kurt, and then Scott.
41
42 MR DAHL: Could I seek maybe clarification from you,
43 Matthew. Avoidable costs are very much location specific
44 and project specific. Is the efficient entrant project
45 specific or location specific or will it be a broadbrush
46 how much does it cost to enter this market no matter where
47 you are?

1
2 MR WILLETT: It would be location specific.
3
4 MR EDGERTON: Just to clarify, it might be that, under the
5 avoidable cost approach - think of wastewater - if a WICA
6 licensee is actually taking the wastewater away themselves
7 and treating and disposing of it, then that would be a cost
8 that Sydney Water avoids. There is a discussion over what
9 time frame you measure that and what costs you do and do
10 not include, but essentially they are the costs Sydney
11 Water avoids.
12
13 Sydney Water is obviously a large scale utility
14 whereas under the efficient competitor approach, it would
15 be an estimate of what an efficient new entrant's costs are
16 in those activities and you would subtract that from the
17 retail price. As we said, generally you would expect, in
18 most cases, it would be a small scale utility and the costs
19 may be higher, so you actually may be subtracting a large
20 amount from the retail price.
21
22 MR DAHL: And the avoided costs are capital and operating?
23
24 MR EDGERTON: Yes.
25
26 THE CHAIRMAN: In general you would expect, especially
27 where the entrant is smaller than the incumbent, that the
28 retail minus efficient costs is lower, the lower wholesale
29 price, than retail minus avoidable.
30
31 MR DAHL: Maybe just to clarify this, with the no
32 developer charges at the moment, if it was going to cost
33 Sydney Water, \$50 million to service a new area under
34 a "business as usual" approach would that \$50 million
35 be available to a private proponent from Sydney Water?
36
37 MS JONES: If they do not spend the money, then we do not
38 say that is prudent expenditure in the next price
39 determination. They don't keep the money for doing
40 nothing.
41
42 MR TAYLOR: No, but I think this goes to discussion topic
43 number 5. So if the WICA utility comes in and it can
44 provide the same service that Sydney Water does at a lower
45 cost, does it get the benefit of that water cost to Sydney
46 Water?
47

1 MR WILLETT: Under the avoidable cost approach, yes.
2 Query how that would play out under the efficient new
3 entrant cost.
4
5 MR TAYLOR: I think it is important. The efficient
6 competitor approach deserves some consideration. I think
7 the argument we outlined at the start is this is a complex
8 issue and there are lots of variables. When you are trying
9 to compare an efficient competitor approach, you have said
10 it was bespoke to a location, but clearly whether it is a
11 first-time WICA applicant or they are part of a new
12 business like we are trying to create, it is not fair to
13 compare them with Sydney Water. Bonding, insurance, risk
14 premiums, the application of a WICA licence are all
15 additional costs that a new entrant has to bear, but they
16 get --
17
18 MS JONES: That's captured.
19
20 THE CHAIRMAN: Yes, I think that is the point, Scott. The
21 point of subtracting the costs of a reasonably efficient
22 entrant as opposed to subtracting the avoided or avoidable
23 costs of Sydney Water is to take account of that and it is
24 most likely those costs would be greater.
25
26 It is this concept of dynamic efficiency which is
27 providing a greater opportunity for somebody to enter the
28 industry and be able to innovate and establish themselves
29 in the industry. That is what we are trying to do. We
30 have not made a decision yet, but that is the whole reason
31 for floating this particular proposal. It is not a sort of
32 type as minus avoidable costs, because it is very difficult
33 for somebody outside the industry to be able to compete on
34 retail minus Sydney Water's avoided costs because they have
35 a substantial incumbency advantage
36
37 MR TAYLOR: I guess what I was trying to say was the
38 efficient competitor approach deserves merit. We just have
39 not had the time --
40
41 THE CHAIRMAN: No, that's fine --
42
43 MR TAYLOR: -- to digest it and come back with a
44 comprehensive view. What we are saying is we are not
45 proposing we do nothing. We are saying we suspend doing
46 anything for four years to allow us the appropriate time to
47 fully consider all the mechanisms that need to be put in

1 place so we would have a much better considered, holistic
2 and symbiotic approach to things that need to apply in the
3 determination. At the moment, we risk putting in a
4 determination that has perverse or unwarranted or
5 unintended consequences on the WICA participants.
6

7 THE CHAIRMAN: The issue is what goes in the current
8 determination, and there is a difference of view about what
9 the status quo is. From the point of view of some WICA
10 utilities, the status quo is being charged the non-resident
11 charge and from the point of view of Sydney Water, that is
12 not the case.

13
14 So this is a non-trivial issue which needs to be dealt
15 with and it is a big decision about what to put in the
16 determination or whether to put in anything at all, so we
17 might not have four years to work it out

18
19 MR TAYLOR: We agree with you that it is a big decision.

20
21 THE CHAIRMAN: Yes.

22
23 MR TAYLOR: There is no dispute on that.

24
25 MR LECKIE: I suppose a question would be how do you
26 verify that?

27
28 THE CHAIRMAN: Verify what, sorry, Terry?

29
30 MR LECKIE: Well, you have a difference of opinion, so how
31 do you verify that?

32
33 THE CHAIRMAN: What we will do is we are consulting and
34 we will have to come to a landing. We will have to make a
35 decision. That's part of being in IPART. We do this on
36 lots of occasions and we try and make the best decision
37 possible, which is why we are consulting and will continue
38 to consult.

39
40 I think the point I just wanted to make in this
41 exchange was that I don't see - unless somebody else wants
42 to put up some discussion - an option of just leaving it
43 for four years. We have to make a decision now, and the
44 decision might be to put nothing in there, but that would a
45 decision

46
47 MR LECKIE: Sure.

1
2 THE CHAIRMAN: A lot of the other things that have been
3 raised on water policy are issues that IPART is on the
4 public record as supporting being raised. The more we
5 discuss it, that is great, but it does not mean that we
6 won't have to make a decision. Sandra?

7
8 MS GAMBLE: Thank you. We very much appreciate IPART's
9 interest in this matter and we would encourage you to
10 settle the matter at this stage. What might be considered
11 by some as the status quo is an unsustainable position for
12 Sydney Water in the long term. It certainly is not one
13 that would encourage efficient new entrants, and that is
14 our primary concern. Our primary concern is making sure
15 that, under the current circumstances, the customers pay no
16 more than they have to.

17
18 I really appreciate the point that Peter made earlier
19 about the environment in which we are operating with
20 postage stamp pricing and no developer charges. That is
21 not negotiable for the time being, so let's make the best
22 of what we've got. We can change that if those
23 circumstances change.

24
25 Inherent in the idea of postage stamp pricing is that
26 Sydney Water has economies of scale that it uses for the
27 benefit of customers. I think sometimes we forget that
28 scale is actually a good thing. It is not a barrier to
29 entry. It is actually something that benefits customers
30 enormously. It is not something you would put aside easily
31 and compromise because, potentially, that creates
32 disappointments.

33
34 I guess we need to make sure that we are applying
35 postage stamp pricing as it was intended where Sydney Water
36 uses its scale to supply both high cost and low cost
37 companies and charges everybody the same. What we are
38 talking about here is the situation where an aberration in
39 the market, which is the difference between non-residential
40 and residential customers, is somehow leveraged.

41
42 We believe retail minus Sydney Water's avoidable costs
43 does encourage the best and most efficient investment,
44 especially from a productive efficiency side. The dynamic
45 efficiency side is pretty much unknown and, for us, it is
46 better that the new entrants take that risk. If they are,
47 in fact, dynamically efficient, then they are the ones who

1 will actually benefit from those dynamic efficiencies. We
2 would be concerned about customers taking that risk -
3 subsidising new entry on the speculative basis that,
4 potentially, it will provide dynamic efficiency.

5
6 The other thing, of course, is that Sydney Water is
7 not just sitting around doing nothing the same way every
8 single time. It is also innovating. It is also finding
9 new technologies to service customers. It is not
10 necessarily adopting a centralised approach where a
11 decentralised one might be better. I think we just need to
12 not discount the things that already exist.

13
14 THE CHAIRMAN: Sure.

15
16 MR FUNSTON: I will just add to that that we asked for the
17 location specific avoidable costs because we do agree that,
18 in areas where entry could occur, potentially we do avoid
19 much higher costs with those entries.

20
21 MS GAMBLE: We appreciate the practicalities of that and
22 some of the ideas around transparency, and potentially
23 review, and we would very much support that.

24
25 THE CHAIRMAN: Thank you, very much, Sandra and Kris.
26 Yes?

27
28 MR DERKSEMA: Hi, I am Chris Derksema from the City of
29 Sydney. One thing I wanted to bring up is when we are
30 looking at avoided costs, we are not actually talking about
31 the same product because, in the City of Sydney, we have
32 done a lot of consultation broadly with our stakeholders.
33 We have asked them what do they want for the future of the
34 city. As Lisa highlighted before, they want a liveable a
35 and resilient city, and they see recycled water as a major
36 component of delivering on that outcome to be a green,
37 global and connected city.

38
39 When we are talking about avoided costs we are not
40 comparing apples and apples because we are not actually
41 giving the same product to the customer. The customer
42 wants recycled water and it needs to be provided in an
43 efficient way. If we are talking about efficient pricing
44 but we're still not delivering to the customer what they
45 want, it is an irrelevant kind of argument. We need to
46 also consider what product we are actually delivering or
47 the customer actually wants delivered in these particular

1 areas: that is one point.

2
3 The second is the city is actually going through a
4 huge growth phase at the moment and there is a huge amount
5 of urban redevelopment in the city. An issue like this, if
6 not handled correctly, can prevent a lot of great
7 opportunities being realised within the city. We have
8 Central Everleigh, which has had a huge amount of
9 residential development as well. We have heard about the
10 Bays Precinct. We have one or two projects up already with
11 Barangaroo and Central Park, but this is a trend that is
12 not going to go away, it's only going to get an increase in
13 demand from our customers. Making a determination that
14 allows those developments to actually implement a rigorous
15 solution to customer wants is really, really important at
16 this time.

17
18 THE CHAIRMAN: Thank you very much, Kris. Other
19 questions or comments?

20
21 MS WATSON: Rachel Watson. I am sorry if this question
22 reflects my lack of understanding. The only thing I really
23 understand is how complicated this issue is.

24
25 THE CHAIRMAN: That's fine.

26
27 MS WATSON: I see that there are two different prices
28 currently under the price determination of residential and
29 non-residential customer and that is based on the fact that
30 for postage stamp pricing all customers of the same type
31 should pay the same amount, as long as they have the same
32 impact on the system and from the research I've been doing,
33 buildings with integrated services have substantially
34 different impacts on the system from the traditional
35 residential development. What I am trying to understand is
36 why they should pay the same retail price if they have a
37 substantially different impact on the system. I thought
38 pricing principles are that you paid the same price as long
39 as you have the same impact on the system.

40
41 My second question is --

42
43 THE CHAIRMAN: The first question is a really good
44 question and I am sure Matt would like to answer it. You
45 obviously know much more about water than you let on.

46
47 MR EDGERTON: Just to clarify, is your question about our

1 retail prices, why there is a difference between
2 residential prices and non-residential prices?
3
4 MS WATSON: No, I understand why there is a difference.
5 I am just saying that everyone has been talking about how
6 you are either a residential customer or a non-residential
7 customer and I just think there is scope in here for some
8 discussion about different customer classes, or if you are
9 a residential customer, there might be grades of
10 residential customers if you happen to have an integrated
11 system. I can't do the definition myself, but the pricing
12 principles are if you put the same impact on the system,
13 you pay the same price, but if you don't, then perhaps you
14 don't.
15
16 MR EDGERTON: We are obviously operating under a
17 postage stamp pricing regime. There is some difference
18 amongst non-residential customers that relates to trade waste
19 charges, so customers pay trade waste charges.
20 Non-residential customers pay trade waste charges based on
21 the strength and volume of their discharges to the sewerage
22 network. In terms of an integrated non-residential
23 development potentially having a different impact on the
24 system --
25
26 MS WATSON: No, I think you have misunderstood. All I
27 was saying is Sydney Water is suggesting that because there
28 are residential people in a building, because they are
29 residential they should be placed under the residential
30 price. My understanding of the pricing principles is yes,
31 as long as they have the same impact on the system as a
32 residential customer and perhaps the research shows that
33 they don't have the same impact on the system as a
34 traditional residential customer, so perhaps they shouldn't
35 be charged as a traditional residential customer.
36
37 MR EDGERTON: Could you give me some examples about
38 what they might not --
39
40 MS WATSON: They have a different average demand on the
41 system, they have different peak demands on the system,
42 peak hour and peak days.
43
44 MR EDGERTON: Would that be because of something like
45 recycled water?
46
47 MS WATSON: Yes.

1
2 MR EDGERTON: To the extent it is because of recycled
3 water, that could potentially be factored into the retail
4 minus calculation.
5
6 MS WATSON: Yes, but it might be able to be done under
7 another model, that's what I was saying, that's just my
8 point.
9
10 THE CHAIRMAN: You are raising the possibility, are you,
11 that you could have one sort of price for residents that
12 are in houses and then another sort of price for residents
13 that are in apartment buildings?
14
15 MS WATSON: Residents in integrated service provision.
16
17 THE CHAIRMAN: Yes, in integrated service provision, yes.
18 Thank you. Have you thought of the other question?
19
20 MS WATSON: I am sorry, no.
21
22 THE CHAIRMAN : Thank you very much, Rachel.
23
24 MR PEROSKI: Zoran Peroski, Sydney Water. I am sorry to
25 go back to avoidable costs, but I think it is an important
26 issue because it helps to fund the margin here, and bear
27 with me, I will get to my point, which is that Sydney Water
28 is looking at its equally efficient incumbent's avoidable
29 costs which are going to be much lower because of scale.
30 On the other hand, entry is a good thing because it brings
31 in this dynamic element. We are talking about two
32 extremes, the reasonably efficient operator versus the
33 equally efficient operator.
34
35 I think BT, or Ofcom in BT's wholesale broadband
36 product thought about the adjusted equally efficient
37 operator test. This is around margins. What is the
38 appropriate margin to not disadvantage entrants because
39 they don't have scale, but that's not to disadvantage
40 customers who are going to be, from the scale, BT
41 customers. That is probably in the middle ground. Is that
42 something that could be considered? That then takes away
43 the administrative burden from the entrants to provide
44 information because there could be a baseline model here
45 that could be adjusted. It is possibly in the middle
46 ground from the two extremes that we are debating which are
47 creating two sides of the argument.

1
2 THE CHAIRMAN: Thank you very much, Zoran. Anybody
3 else? Any questions, comments?
4
5 MS WATSON: I am just wondering if there's a real-life
6 example of what actually for one of these developments the
7 avoided costs would look like. Under WIC, the whole point
8 was to encourage innovation and recycling and activities
9 that promote the water industry in a different way and
10 after discussions at the last public forum as to the prices
11 for Sydney Water, there was obviously a lot of discussion
12 in the room about how the current pricing regime doesn't
13 necessarily allow for some of these wider benefits to be
14 included in the activities that have been undertaken.
15
16 There was a lot of discussion about whether funding
17 for livability could actually be included in the water and
18 wastewater price and I think, as far as I read the
19 Sydney Water submission, for them at the moment the most
20 efficient thing to do is to turn off the Hoxton Park
21 recycled water system. It seemed like 100 per cent potable
22 water was going through that scheme. It seems that the
23 current system does not seem to be promoting these
24 outcomes. Yes, under WIC there are schemes that are
25 bringing them up.
26
27 I was just wondering if you could explain if you've
28 done any modelling on what an avoided cost would be so that
29 we can start to understand how that would then promote the
30 type of competition that we have envisioned under the
31 WIC Act.
32
33 MR EDGERTON: We have essentially raised the question in
34 our presentation today which is what avoidable costs should
35 be considered when we're looking at these schemes. Should
36 it consider things such as the avoidable costs of recycled
37 water schemes and what other avoidable costs should we
38 consider? It really probably depends on, to a high level,
39 how much the WIC licensee essentially brings to the table
40 with their new scheme. If they are simply just buying
41 water from Sydney Water at the point of connection and
42 onselling it then the avoidable costs are basically
43 Sydney Water's retail costs. If they are doing something
44 more to defer the need for major augmentation of the water
45 system, bulk water supply or water treatment or water
46 distribution, then similarly the avoidable costs would be
47 higher.

1
2 At this stage, we haven't done any specific
3 quantification around that, but I know that Sydney Water
4 and Hunter Water have both proposed figures of minus
5 3 per cent associated with just the avoidable costs of
6 retail services, that is, where a WIC licensee is just
7 purchasing water for a connection and onselling it, but as
8 Kris mentioned, you have acknowledged that where the WICA
9 licensee does more, the avoidable costs would be a lot
10 greater, or would be greater.
11
12 MR FUNSTON: Just to reiterate Matt's point, I think that
13 retail costs, billing call centres is one aspect and we
14 also see transport costs, treatment costs, if there was any
15 avoidance of operating costs associated with corrosion and
16 odour, they are things that we take into account.
17 Likewise, potentially, if there is deferral or avoidance of
18 any kind of amplification, that should also be incorporated
19 in an avoidance cost calculation. I think there are all
20 these components where to the extent that we no longer
21 incur those costs, we are happy to provide that in part in
22 the access price.
23
24 MS BRADY: It seems to me one of the challenges is that
25 the value of schemes in deferring or avoiding larger
26 augmentation costs is about the sum of all of the
27 incremental investments made and so it is always difficult
28 in doing avoided cost calculations, particularly if your
29 market diversifies and your base case becomes less and less
30 real, how you estimate those avoided costs in a way that
31 picks up that, if you like, portfolio level benefit, that
32 the sum of all of these incremental investments together
33 equates to what might be a more efficient portfolio, but
34 translating that back to an individual scheme and
35 conferring an avoided cost on an individual scheme is a
36 hard thing to do.
37
38 The other thing I'd say is that, picking up on this
39 portfolio benefit again, a kilolitre of drinking water from
40 a dam is not the same as a kilolitre of recycled water, so
41 they're not fungible units, and I think it is fair to say
42 that the recycled water pricing guidelines, when it talks
43 about avoided costs, doesn't pick up on that, that we are
44 not talking about the same unit of water and that we know
45 that in the Sydney Water area of operations we have the
46 highest variability of rainfall in the country, it is three
47 times more variable than Melbourne, so the value of water

1 supplies that are climate resilient is high, but conferring
2 a kilolitre value on an individual scheme from that
3 amorphous, general, first-principle concept is a tough
4 thing to do, but it shouldn't be forgotten because I think
5 the point Kris was making was that these schemes together
6 add up to a more resilient system, but it is making sure we
7 don't kill off the industry by a thousand cuts by failing
8 to recognise that system-wide value at a project specific
9 scale.

10
11 THE CHAIRMAN: Thank you. Kris?

12
13 MR FUNSTON: I recognise Katy's point. I think that is
14 one of the challenges for a system like Malabar, the
15 avoided cost is likely to be fairly small, but when you're
16 talking about a system maybe in a high cost area further
17 out in Western Sydney then that avoidable cost might be a
18 relatively large sort of avoidable cost.

19
20 I think it is a fair point to make. I think to the
21 extent that obviously we are servicing a large proportion
22 of the customer base, to the extent there is a very small
23 proportion actually serviced by this particular scheme,
24 then the avoidable cost is likely to be relatively
25 negligible. I understand the point and I think it is an
26 issue.

27
28 THE CHAIRMAN: Thank you. Steve?

29
30 MR HALL: I want to reinforce Katy's point about timing,
31 the practicalities of doing this, this idea that we're
32 going to negotiate or work out an avoidable cost on a
33 scheme-by-scheme basis and how that would impact on us at
34 the coalface.

35
36 In our business, Terry does business development and
37 he goes and talks to a developer and says, "We'd like to
38 service your development", and the developer says, "Okay.
39 Well, put a proposal to me, put a cost proposal to me." If
40 we don't have that certainty of what the cost of providing
41 parts of that service is going to be, we can't put a
42 proposal to him. Are we expected to then approach Sydney
43 Water or Hunter Water and say, "Guys, we need to work out
44 what the avoidable costs would be for this"? Remember
45 we're in competition with these same parties at the same
46 time; it is completely unworkable.

47

1 The second point I want to make is WIC has been around
2 now for nine years. I sat in a really good briefing about
3 compliance this morning. As of 30 June this year we have
4 2,420 customers connected to the WICA scheme, so nine years
5 and how many millions of dollars, Terry and Scott and
6 everyone else, have we invested as a private sector into
7 this? We have all poured lots and lots of money into it
8 and to date we have got 2,420 customers across 15 licences.
9 The scale isn't there yet. I just want to put that out
10 there to challenge the notion that the current situation is
11 unsustainable and I do think that there is time to spend
12 the time to get it right.

13
14 The third point I want to make is that notwithstanding
15 the sequencing and the timing of having those discussions
16 around what would the avoidable cost be, the time it
17 already takes us as WICA licensees and WICA applicants to
18 get a WICA licence for a new development, we are already on
19 the knife's edge with the time it takes.

20
21 Remember we often get a jersey with a developer
22 because they are looking for an early release of housing
23 supply and therefore, time is of the essence. It already
24 takes us a huge amount of time to get a licence, to get the
25 Minister's approval to bring that new infrastructure into
26 commercial operation, also to negotiate utility services
27 agreements for supply of bulk drinking water, all those
28 things take a lot of time, and I put it to this forum that
29 to introduce another really, really complex and bespoke
30 step into that process would just strangle the whole thing
31 beyond what it already is today.

32
33 THE CHAIRMAN: Thanks, Steve. Lisa?

34
35 MS McLEAN: Just to add to what Steve was saying, in the
36 industry's call for more time to input on this, we don't
37 want to be in a situation where a single market participant
38 is dictating a tariff for the whole industry. I think it
39 is really important that the rest of the industry gets a
40 chance to think about that and run those models through
41 their own businesses and come back in a considered period
42 of time.

43
44 THE CHAIRMAN: Thanks, Lisa.

45
46 Anything else? Any other questions or comments? No?

47

1 CLOSING REMARKS

2

3 THE CHAIRMAN: Thank you very much. It has been a really
4 interesting session. You will be pleased to know that you
5 will get another opportunity for input. We will obviously
6 take input along the way but also we will issue a draft
7 determination in March and there will be a chance for
8 public comment on that. That doesn't mean to say that you
9 can't provide input to our staff before then.

10

11 On behalf of IPART, I would like to thank you all very
12 much for your participation in today's proceedings.

13 I think it has been a really good discussion and it has
14 been of great benefit to the tribunal.

15

16 A transcript of today proceedings will be available on
17 our website in a few days.

18

19 We will consider what has been said today before
20 making our decisions on Sydney Water's and Hunter Water's
21 prices to apply from 1 July 2016.

22

23 As I mentioned, we will release a separate draft
24 Sydney Water and Hunter Water determination and reports
25 for public comment in March 2016. Stakeholders will have
26 about four weeks to make further written submissions before
27 we make our final decisions on Sydney Water's and
28 Hunter Water's prices.

29

30 A final report and determination will be released in
31 June 2016 which will set the maximum prices from 1 July
32 2016.

33

34 Finally, I encourage you to visit IPART's website for
35 updates and further information on our timetable, including
36 the release date for the draft report and the date by which
37 submissions are due in response to that report. Once
38 again, thank you very much and have a great afternoon.

39

40 AT 4.20PM THE TRIBUNAL ADJOURNED ACCORDINGLY

41

42

43

44

45

46

47