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W A T E R , S E W E R A G E A N D S T O R M W A T E R S E R V I C E S

T r i b u n a l M e m b e r s

Dr Michael Keating AC - Chairman
Mr James Cox Held at the Wesley Conference Centre
220 Pitt Street, Sydney

On Friday, 7 December 2007, at 9.20am

. 7/12/07 1 Sydney Water Corporation
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1 THE CHAIRMAN: Good morning, we might make a start. I
2 would like to begin by welcoming you to this public
3 workshop being conducted by the Independent Regulatory &
4 Pricing Tribunal into the review of Sydney Water
5 Corporation's prices for water, sewerage and trade waste,
6 stormwater and recycled water services.
7

8 I guess I should begin first by introducing ourselves.
9 At the top table here, I am Michael Keating, I am the
10 Chairman of the tribunal. I am joined on this review by my
11 fellow tribunal member, Jim Cox, on my left, who is also
12 the Chief Executive of IPART. And I would like to
13 apologise for Sibylle Krieger, who unfortunately can't be
14 here today, who is the other member of the tribunal, but I
15 am sure she will pay close attention to the transcript of
16 our proceedings when she gets it. There is also on my
17 right members of the secretariat, Richard Warner, who is
18 the program manager for water pricing, and Nigel
19 Rajaratnam, beside him.
20

21 IPART last reviewed Sydney Water's prices as recently
22 as 2005. In that determination IPART made provision for
23 initial expenditure by Sydney Water to investigate the
24 development of a desalination plant for Sydney. However,
25 IPART did flag at that time the possible need to make a new
26 determination before the planned expiry of that 2005
27 determination, planned to expire in 2009, if there were
28 changed circumstances.
29

30 Sydney Water's forecast expenditure has in fact
31 increased substantially since the 2005 determination and
32 that increase in the forecast capital expenditure relates
33 principally, although by no means entirely, to the decision
34 to proceed with the construction of the desalination plant
35 and some other major recycled water projects.
36

37 As a consequence of this revised forecast, the Premier
38 wrote to IPART requesting that we conduct a full
39 determination which considers all aspects of Sydney Water's
40 revenue and expenditure and the Premier specifically
41 requested that we take into account the effects of climatic
42 conditions on Sydney Water's revenue position since the
43 current determination was made on 1 October 2005, the
44 desalination project being undertaken by Sydney Water,
45 several recycling projects such as the Western Sydney
46 Recycled Water Initiative Replacement Flows Project and the
47 Camellia Recycled Water Project and other matters such as

1 the extension of the Water Savings Fund as part of the new
2 climate change fund and the extension to existing rebates.
3

4 As regards the costs related to the desalination
5 project and a range of large recycling projects, IPART is
6 required to ensure that efficient costs associated with
7 these projects are incorporated into prices. As part of
8 this investigation, IPART released in August 2007 an issues
9 paper which set out the key aspects of the review process.
10 That issues paper outlined some of the matters that IPART
11 considered important to this review, along with a timetable
12 for the review.
13

14 In that issues paper IPART called for submissions from
15 Sydney Water and all other interested stakeholders and I
16 would like to take this occasion to note that we are very
17 appreciative of those who have taken the time to make a
18 submission. All the submissions that we have received have
19 been placed on the IPART website and are available for
20 viewing.
21

22 All of the submissions will, of course, be carefully
23 considered by IPART in reaching its conclusions on the
24 maximum prices that Sydney Water should charge for raw
25 sewerage, stormwater and recycled water services.
26

27 Some of the organisations that have made submissions
28 to the review will be participating at our workshop today
29 and I would like to thank those of you who have agreed to
30 participate here today. We consider this workshop to be a
31 very important part of our investigation.
32

33 We have also engaged a range of independent experts to
34 provide assistance on specific matters related to the
35 review, such as the appropriate forecast of water
36 consumption for the future and the prudence and efficiency
37 of Sydney Water's forecast expenditure, both capex and
38 opex.
39

40 The findings of the experts, as well as the view of
41 various stakeholders, will be key inputs into IPART's
42 decision-making processes.
43

44 Before we commence proceedings today, I would like to
45 say a few words about the process for this workshop. I
46 think you have got available to you a timetable, which
47 indicates the order in which issues are to be considered.

1 You will note from that timetable that the proceedings for
2 the day are to be divided into five sessions.
3
4 In these sessions we are not trying to cover all the
5 issues that will eventually need to be addressed to make a
6 determination. We are not necessarily even trying to cover
7 all of the most important issues. Rather the focus today
8 is on issues that are certainly important and where we
9 think we would most benefit from hearing some further
10 discussion of the views that have been conveyed to us in
11 your submissions.
12
13 As I have already indicated, on some of the other key
14 issues such as the efficiency of Sydney Water's proposed
15 expenditures, we will be seeking other expert advice. We
16 also do not propose to explore some other key issues which
17 either didn't seem to be contentious or have not excited
18 general interest. I mention in this context, for example,
19 the rate of return on capital, where for example we
20 received an interesting submission from Alinta but none of
21 the other submissions addressed that particular issue, so
22 we didn't put it on the agenda for today but we will be
23 certainly pursuing it.
24
25 Of course, these other important issues that we are
26 apparently bypassing today will be fully considered by the
27 tribunal in its further deliberations.
28
29 Today's five sessions will deal with, firstly, Sydney
30 Water's revenue requirement; second, issues relating to the
31 water price structure; third, issues specifically relating
32 to scarcity pricing, and whether the scarcity pricing is
33 appropriate; fourth, issues relating to sewerage and trade
34 waste charges and, finally, miscellaneous charges.
35
36 At the outset of each session, the members of the
37 IPART secretariat will make a brief presentation to
38 introduce each item, and they will be posing a series of
39 questions. Each of the people here at the table, or panel
40 members, will then be invited to express their views on the
41 issues and questions that have been raised.
42
43 At the conclusion of all the scheduled sessions, I
44 will be making a short period of time available for members
45 of the audience, that is those of you in the back of the
46 room, to express your views and opinions on the issues
47 being discussed.

1
2 I want to commence today by inviting each participant
3 at the table to introduce themselves for the record by
4 stating their name, and the organisation that they
5 represent, and after we have gone around the table I will
6 then ask Richard Warner to introduce the first workshop
7 issue. Can I also just say that if people, new people,
8 come to the table, they will need to give their name at
9 that point of time.
10
11 MR WARNER: Richard Warner, I am the Program Manager
12 of Water Pricing at IPART.
13
14 MR RAJARATNAM: Nigel Rajaratnam, Senior Analyst in the
15 water pricing team.
16
17 MR VERSTEEGE: Paul Versteegen, from the Combined
18 Pensioners and Superannuants Association.
19
20 MR LESLIE: Greg Leslie, from the University of New South
21 Wales.
22
23 MR MARTIN: Leigh Martin, from the Total Environment
24 Centre.
25
26 MR McGUINNESS: Sam McGuinness, from the Nature
27 Conservation Council of New South Wales.
28
29 MR RAMSAY: Allan Ramsay, from Sydney Water.
30
31 MR FREEMAN: Paul Freeman, from Sydney Water.
32
33 DR SCHOTT: Kerry Schott, from Sydney Water.
34
35 MR WILSON: Stuart Wilson, Sydney Water.
36
37 MR O'NEILL: Hugh O'Neill, from the Public Interest
38 Advocacy Centre.
39
40 MR TUDEHOPE: Warwick Tudehope, Alinta.
41
42 MS GYZEN: Linda Gyzen, from Alinta.
43
44 MR WARNER: To recap on some of the Chairman's opening
45 remarks, the presentations by the secretariat today are
46 intended to seek to highlight the key issues that the
47 Tribunal will seek to resolve during this review. In the

1 workshop sessions for today we are seeking the views of
2 stakeholders, and we are particularly seeking solutions to
3 some of the questions that are going to be posed. This is
4 an opportunity for stakeholders to discuss their views with
5 each other and before the Tribunal and, as the chair also
6 indicated, at the end of each section there will be time
7 allocated for comments from the floor. There will be five
8 sessions, and the Chairman has outlined those so there will
9 be no need for me to go into detail again.
10
11 Sydney Water sought price increases that will see
12 average residential bills increase by some 33 per cent over
13 four years. They contend that they need these price
14 increases to defray the cost of the 250 megalitre per day,
15 desalination plant, the cost of renewals, servicing growth
16 and meeting operating licence requirements, cost of meeting
17 recycling and demand management needs, and to ensure
18 Sydney Water's financial viability.
19
20 In making its determination of prices for Sydney Water the
21 Tribunal has been directed to take account of the effects of
22 climate conditions on Sydney Water's revenue position since
23 the last determination effective from 1 October 2005. The
24 The desalination project being undertaken by Sydney Water
25 at Kurnell, several recycling projects, including the Western
26 Sydney recycled water project, and an extension of the water
27 savings fund as part of the climate change fund and
28 extensions of existing rebates under those funds.
29
30 The Tribunal has a number of mechanism for recovering costs
31 that Sydney Water incurs, and two such mechanisms used in
32 combination are postage stamp periodic charges and
33 developer charges.
34 Under the postage stamp pricing regime all consumers who
35 use the same quantum of services pay the same water and
36 sewerage charges irrespective of the location of their
37 properties. Developer charges are then used to recover any
38 costs of service above the average servicing cost embedded
39 in the common postage stamp periodic charges. Sydney
40 Water on average receives from developers \$125 million per
41 annum in capital contributions and assets handed over free of
42 charge.
43
44 In addition to these contributions Sydney Water is
45 looking to increase its revenue by 40 per cent over four
46 years to 2011-12, that is in real terms, with the largest
47 increase of some 20 per cent occurring in 2009. Some of

1 that revenue is shown on that table, and you can see most
2 of the revenue increase will be coming from the water
3 supply system.
4
5 It has been suggested that if Sydney Water were a
6 private sector company an investment program of the size
7 proposed would see it going to the equity market to raise
8 finance and not solely relying on debt funding. The
9 quantum of debt that Sydney Water is seeking to take on has
10 implications for its financial viability. It has also been
11 suggested that the quantum of dividends that it has paid
12 out in the past and proposes for the future may be
13 inconsistent with the size of the investment program that
14 it is to undertake.
15
16 Dividends clearly have an effect on the amount of
17 internal financing that Sydney Water is able to undertake
18 and the level of debt it must raise. This then flows into
19 the interest that must be paid on that debt. Sydney Water
20 has also sought to increase its weighted average cost of
21 capital from 6.5 per cent real pre-tax adopted by the
22 Tribunal in 2005 to 7 per cent real pre-tax.
23
24 Sydney Water's expenditure plans and increases in its
25 rate of return will have a significant effect on customers'
26 bills as shown in that slide. That is for water bills
27 only. They are in 2008/09 dollars. If you add inflation
28 to those, the increases are certainly higher. Bills for
29 water only customers using pre-restriction average water
30 usage of 250 kilolitres per year will face increases of
31 over 50 per cent over four years in real terms. As I said,
32 inflation has to be added to those sorts of increases. In
33 terms of water and sewerage bills which are shown in that
34 slide, bills for a 250 kilolitre property will increase by
35 \$274 in real terms, or over 34 per cent over four years.
36 Percentage increases will be lower for properties that
37 consume less water and higher for those that consume more.
38
39 Some of the questions that we would like to see
40 addressed during this first session are what and how much
41 of the expenditure increases proposed by Sydney Water are
42 justified and can reasonably be passed on to consumers? At
43 what rate should prices increase? Is a 33 per cent
44 increase in customer bills over four years reasonable?
45 Should and can some of the things be deferred or postponed
46 to moderate bill increases? What is the appropriate rate
47 of return for Sydney Water? I did in fact slip that

1 question in, Mr Chairman.

2
3 Should the Tribunal suggest that Sydney Water's
4 dividend payments be reviewed given the size of Sydney
5 Water's investment program? Sydney Water proposes to
6 operate the desal plant at full capacity for two years to
7 test the plant. Is it reasonable that customers or
8 consumers pay for this? What are the future operating
9 rules for the future desalination plant and how should
10 these be reflected in prices? Thank you.

11
12 THE CHAIRMAN: We might start with Sydney Water.

13
14 DR SCHOTT: The issues that have been raised I will deal
15 with sequentially. Can I say first of all, though, that I
16 really do welcome the input from stakeholders and the
17 people in this room about what will happen at this IPART
18 hearing.

19
20 Sydney Water is not in the business of putting prices
21 up unnecessarily and this is historically a very large
22 price increase we are seeking, and we are well aware of the
23 interest that it is properly arousing. We welcome people's
24 views on it.

25
26 The fact of the matter is that our expenditures at
27 Sydney Water have gone up appreciably, largely due to
28 climate change and the increased variability of our
29 rainfall patterns, and also of course the slow creep of
30 population increase in Sydney.

31
32 I think it is important that Sydney Water is not
33 seeking a price rise because our operating expenditures are
34 going up. Our underlying operating expenditures have been
35 kept steady in real terms. We have had productivity
36 improvements that have allowed us to decrease the cost per
37 property going forward.

38
39 The increase in operating expenditures that is
40 observable is related strictly to the increase in demand
41 management programs, Waterfix and EDC programs, and the
42 like, and in the efforts that have been made in recent
43 years in recycling.

44
45 So the reason that we are seeking this price rise is
46 not because of operating expenditures. It is to do with
47 the very large capital program. That large capital program

1 is dominated by the desalination plant, which I am sure
2 will elicit more discussion later, and by various recycled
3 water initiatives, three of which are quite large: the
4 recycled water plant at Wollongong which is completed; the
5 recycled water plant at St Marys which has been tendered in
6 a competitive tender and is commencing construction; and
7 the recycled water plant at Smithfield Camellia, and the
8 preferred tenderer was named recently.

9
10 All of those things mean that our capital program has
11 gone up appreciably. If you look at slide 11 you will see
12 what we are dealing with. Sydney Water's capex expenditure
13 runs at about \$550 million a year, and that is for
14 recurrent expenditure to keep our assets maintained, and
15 also for new capital that we need to augment the system and
16 for new developments.

17
18 The big increase in our capital expenditure is related
19 to desal which is the plant, the pale turquoise part of
20 that graph. The purple part is the pipeline route from
21 Kurnell to Erskinville, and the yellow slice through there
22 underneath it all is the plant at St Marys. Those three
23 large expenditures will be almost completed by 2011, but
24 that is the reason that we are seeking the price increases.

25
26 The capital expenditure program at Sydney Water - we
27 don't do capital expenditure if we don't think we need to.
28 We have a very sophisticated system for prioritising our
29 projects and we are not doing these things because we don't
30 need them.

31
32 I will spend a little while on desal, if I may. In
33 our submission we had an inflow to the dam chart, and what
34 has happened in our catchments is we seem to have 50-year
35 rainfall cycles, and there it is. In the first 50 years of
36 this century the inflows into the dams, excluding transfers
37 from the Shoalhaven, were about 951 billion litres a year.
38 We then had 50 years wet, which was when Warragamba was
39 built and we had plenty of run-in. We now appear to be in
40 another 50-year dry. What is concerning to the Catchment
41 Authority and Sydney Water is that that dry appears to be
42 more dry than the previous 50 years. The CSIRO tells us
43 that our temperature in the Sydney region is up by between
44 1.5 and 2 degrees centigrade, which is more evaporation,
45 and our rainfall is down by 15 to 20 per cent. This is
46 water that we have got to make up through water saving
47 initiatives and through water from other sources which is

1 recycled water and desal. I don't think there is any
2 avoiding it.
3
4 The other feature of the catchment in Sydney is it is
5 very variable. As you can see from the graph, the inflows
6 are very jagged. This is three times the variability of
7 any other catchment in Australia. We have storages for
8 between four and five years in the catchment. London works
9 on 11 weeks because they have steady rainfall.
10
11 What the desalination plant will do, if I can have the
12 last slide to illustrate this - while we have not yet
13 worked out the operating rules for desalination, it will be
14 an operating rule of the kind that if the dam storages are
15 at 70 per cent or 80 per cent, just to choose two numbers,
16 we will turn the desal plant off. There is no point
17 running a desalination plant if the dams are going to spill
18 and we will run the desalination plant to provide water to
19 ensure that we are basically covering the troughs.
20
21 The blue line in that chart is a 28-year simulation of
22 a relatively dry period. It is not the one we have just
23 had; it is earlier. Setting it at 80 per cent, you can see
24 there that the desalination plant over that 28-year period
25 runs in the trough period, so all the grey bars there are
26 when the desal plant is running, and the white parts are
27 where it is running at very minimal levels to just keep it
28 operable.
29
30 Our expectation is that the turn-on/turn-off levels
31 will be set somewhere between 70 and 80. We are doing a
32 lot of modelling on this at the moment. What that would
33 then allow is for the Department of the Environment to take
34 a view on the environmental flow regime. You would be
35 aware that the environmental flows have been minimal or at
36 50 per cent during the drought and our rivers are very
37 stressed. It would also allow the Catchment Authority to
38 make decisions about when and when not to be pumping
39 from the Shoalhaven, and it does have physical constraints on
40 when it can do that.
41
42 So basically the way the desal plant is likely to
43 operate going forward is it will be running for periods
44 like seven years and then it will be off for a few years,
45 and then it will be on for a few years. This is not a
46 plant that will go on and off on a weekly basis. It is a
47 plant that is going to provide Sydney initially with about

1 14 per cent more water supply. Recycled water initiatives
2 will provide us with another 11 per cent, and permanent
3 water saving measures probably about 3 per cent. The
4 Waterfix and EDC programs will provide permanent water
5 savings, so that if water restrictions are lifted we are
6 never going to go back to profligate use of water. I am
7 expecting that the operating regimes for desal will get
8 sorted out by the government and the other agencies. It is
9 not something that Sydney Water can decide alone. It
10 depends on environmental flows and other matters.
11
12 In terms of the cost of the desal plant, we went out
13 for tender. The cost of the plant itself is just over
14 \$1 billion. The cost of the rest of the route, which is
15 pipelines and all the land and work that has gone into the
16 pipelines, will bring the entire project in just under
17 \$1.9 billion. We are still finalising the exact price of
18 the pipelines, because it is going through the most
19 contaminated area of Sydney, the Tempe and the back of the
20 Alexandra canal. You couldn't choose anywhere worse. We
21 are doing very significant testing on that. The
22 anticipated final pipeline price will go to the board this
23 month, but I am satisfied that we can say with 100 per cent
24 certainty that it will be less than \$1.9 billion overall,
25 which is pretty well what is in the report.
26
27 Just on the proposition that Sydney Water could go to
28 the equity markets to raise money to pay for desal rather
29 than financing it through debt, Sydney Water is fortunately
30 relatively lowly geared, and if we were a private sector
31 company we would borrow money to pay for the desal plant.
32 We would not be seeking money from our shareholders. At
33 the moment our shareholders, the government, have
34 \$3.1 billion invested in Sydney Water as equity. They get
35 dividends on that which last year were \$193 million, and in
36 this year, 2007-08 it will be \$140 million. We have agreed
37 a dividend position with the government which is lower than
38 it has been because of our capex program going forward.
39 That return on equity is derisory by commercial standards.
40 It is 1.4 per cent. There is not one person in here who
41 would allow their super funds to invest in something with
42 that return. So the argument that the government shouldn't
43 be taking dividends, I think, is actually an argument about
44 Sydney Water should not be set up as a corporation, which
45 is another whole argument again. But while we are set up
46 as a corporation, that is what we are doing.
47

1 Finally, I think on the question of developer charges
2 and who should be paying for desal, the desalination plant
3 is part of the whole network of the water supply
4 provisions, and while it is going to go into the
5 pressurised water tunnel at Erskinvillie and will, along
6 with water from the dams, supply the eastern suburbs and
7 the CBD and back into the inner west. It is part of our
8 whole water supply. It benefits the whole system. It
9 means there is more water for the Illawarra, the Blue
10 Mountains west of Sydney and everybody else, and it is fair
11 that everybody should pay for all of it, and not just some
12 part of the community.
13
14 Finally, on our rate of return, Sydney Water does have
15 considerable risks on its revenue side. We are down
16 \$380 million in our revenue over the last four years
17 because of grand efforts we have been making not to sell
18 water. We are the only company in the world who tries not
19 to sell our product - perhaps not the only company, but it
20 is an unusual attribute. We have big risks in our revenue
21 line, and we also have quality risks. As you know at the
22 moment there is blue-green algae in Warragamba Dam that is
23 costing us considerably extra in water treatment costs. We
24 are ready to take out taste and odour compounds that may
25 come if and when the algae decomposes, and the increased
26 floridity in water causes our treatment costs to go up, so
27 we have both quantity and quality risks on our revenue
28 side. We think that an increase obviously of 6.5 per
29 cent to 7 per cent real as a rate of return is something
30 that is appropriate.
31
32 Just on desalination and in terms of going back to
33 what the community should do about paying for it if it is
34 off for years at a time. The principal cost for the
35 desalination plant is its capital cost. Its operating cost
36 is quite small in relative terms. If it is going out it is
37 \$55 million, which in a revenue of \$1.5 billion also is not
38 a large amount. If it is ticking over, it costs about
39 \$9 million. So the principal charge that relates to desal
40 is a capital charge, not a usage charge.
41
42 We have suggested in our submission that what IPART
43 should do about the on/off aspect is every four years at a
44 determination make a correction for the past, so if it is
45 assumed by IPART in a determination that the plant is
46 running flat out for four years and it turns out that it
47 doesn't run at all, that they take that money from Sydney

1 Water at the next determination and vice versa. That is a
2 fairly easy way to fix things up, and it is a relatively
3 small amount of money in Sydney Water's budget, and we can
4 cover that with debt under a notice. I think that covers
5 the main things, Mr Chairman.
6
7 THE CHAIRMAN: Thank you, very much, Kerry. I had better
8 clarify one thing on the rate of return. I am by no means
9 suggesting that we shouldn't have any discussion on it. I
10 didn't think it would be terribly useful to get into some
11 of the detail in Alinta's submission, because it is quite a
12 complex subject, but I do not want to prevent any
13 discussion on the rate of return. That said, would Alinta
14 like to go next?
15
16 MR TUDEHOPE: Thank you for extending the invitation for
17 us to participate today. By way of background for those
18 who are perhaps surprised to see Alinta at the table,
19 Alinta owns the natural gas network in NSW, and we have a
20 strong interest in the water industry both as an asset
21 owner and as a manager.
22
23 Most recently the AquaNet Sydney consortium, which is made
24 up Babcock & Brown, Singapore Power, who are the new
25 owners of Alinta, and Veolia Water were selected as the
26 preferred tenderer to build, own and operate the Rose Hill
27 Camellia water recycling project.
28
29 That project was foreshadowed in the Sydney
30 metropolitan water plan, and is enabled by the government's
31 policy to encourage greater private sector participation in
32 the water industry in NSW. Initially that project
33 delivered 4.3 gigalitres of high quality, recycled water to
34 industrial users and irrigation users in the Camellia and
35 Rose Hill area. There is future expansion for an addition
36 of about 3 gigalitres a year in the areas further afield
37 from Camellia and Rose Hill, and then there is the
38 possibility of expansion and growth over time utilising
39 Alinta's network of isolated gas mains which can be this
40 threaded with water pipes.
41
42 Alinta's written submission to the Tribunal was made
43 in that context. At this point I should say that our
44 primary interest is in recycled water. Most of our
45 comments here will be directed at the pricing of potable
46 water, which is a natural competitor for recycled water.
47

1 In terms of the subject matter of this session, which
2 is Sydney Water's revenue requirement, we are not close
3 enough to Sydney Water's cost structure and business to be
4 able to give a view on whether or not Sydney Water's opex
5 and capex proposals are prudent and reasonable. However,
6 as a matter of principle as an infrastructure operator, our
7 position would be that whatever the prudent and efficient
8 costs are, they should be recovered in full through revenue
9 provision and through tariffs. That will ensure that
10 Sydney Water has adequate incentive to invest, and it will
11 also ensure that the private sector participants,
12 encouraged by the government's policy, can compete on a
13 level playing field with Sydney Water as the alternative
14 investor.

15
16 So on that score we would say that adjustments of the
17 type that were made in 2005 where the revenue allowance was
18 reduced by some \$98 million in present value terms below
19 the assessed efficient costs are unsustainable and are
20 inconsistent with the principle of the maximum capital
21 maintenance.

22
23 As to the question of the price increases that are
24 foreshadowed in Sydney Water's proposal, there is no doubt
25 that those proposed increases are significant, but to the
26 extent that they are the consequence of prudently incurred
27 costs, then they must be recovered over time if Sydney
28 Water is to remain viable. At the same time we make the
29 observation that there is growing political and public
30 acceptance of the fact that price increases are necessary
31 if we are to drought-proof our cities, and it is not only
32 in NSW that that is the case, but there are substantial
33 increases in other jurisdictions as well as a result of
34 climate change and the measures that have to be taken to
35 cover that.

36
37 You mentioned rate of return, Mr Chairman. It wasn't
38 my intention to go into any great detail; I realise it is a
39 highly technical subject. Suffice to say that there have been
40 some new developments in the assessment of some of the
41 many parameters that go into the WACC calculation since the
42 2005 determination, all of which I think would tend to
43 increase the weighted average cost of capital rather than
44 reduce it. So we believe that as an important part of
45 assessing Sydney Water's total costs, the weighted average
46 cost of capital, which applies to their asset base and
47 therefore determines revenue, needs to be assessed with

1 care and take into account these new findings.

2
3 The other aspect of cost is appreciation. Once again
4 we note that Sydney Water has proposed that there should be
5 a move towards a more disaggregated view of capital -
6 categorising it into a greater number of categories and
7 depreciated accordingly. We know that is the way the
8 Tribunal approaches depreciation in electricity and gas.

9
10 I guess we don't have a particular view on the
11 operation of the desalination plant other than to concur
12 with the fact that it would make little sense to be running
13 the desalination plant flat out if the dams are full.
14 There needs to be some process of phasing the operation of
15 the plant. That concludes our remarks.

16
17 THE CHAIRMAN: Thank you very much. I was going
18 suggest Mr Leslie next.

19
20 MR LESLIE: I think Sydney Water have done a tremendous
21 job in implementing the aspects of the metropolitan water
22 plan. The key issue, as Dr Schott pointed out, is that a
23 10 to 15 per cent reduction in precipitation roughly
24 equates to about a 30 to 40 per cent decrease in run-off.
25 That is basically what most of the urban centres have
26 received, so a diversified water portfolio is essential to
27 securing water supplies. That is the approach that has
28 been taken by a lot of major cities around the world.

29
30 My concern is in two areas: the first one, I agree
31 with Dr Schott, \$55m out of their budget is not a
32 particularly big number for the operation of the
33 desalination plant. However, the experience has been from
34 other larger water recycling or desalination schemes around
35 the world that use membranes - and that is our interest in
36 the process, that you really do need to hedge power costs.
37 Subtle variations in the price, the tariff for electricity,
38 can have a major impact on the O&M costs, so to that end
39 the component of the proposed price increase that will
40 recover that \$55m needs to be addressed, potentially within
41 four years or when the tribunal meets again to review that.

42
43 The second area, it is a little disappointing because
44 part of my background was seven years working in the US
45 water industry and a good three years in Asia, and one of
46 the things that Australian water utilities do extremely
47 well is asset management. A lot of Australian expertise is

1 sold back into the US water market to help agencies there
2 manage their assets. The move to disaggregation is highly
3 appropriate.

4
5 The desalination plant represents a \$1 billion
6 investment. It is a new asset. Sydney Water's submission
7 had that asset life fixed at 30 years. That is not
8 consistent with its own database on the life of electrical,
9 mechanical instrumentation and assets from both water and
10 wastewater, neither of which are as corrosive or as
11 aggressive as the marine environment where desalination has
12 to operate, so the component of the proposed price increase
13 that will cover replacement or asset life I believe will
14 need to be reviewed in four years.

15
16 And desalination is very much a mature technology, you
17 can look at a variety of installations around the world
18 where they would have a more sensible asset life factored
19 into their proposed price increase. The Hong Kong Special
20 Administrative Water Supply Department tends to use sea
21 water to flush toilets on the islands of Hong Kong and the
22 coastal regions of Kowloon. Doing a cost study on
23 desalination for WSD a few years ago, they advised us to
24 use an asset life of 13 years for things like processing
25 mechanical equipment that was associated with intakes and
26 screens, so moving from the 30-year asset life for a
27 percentage of their \$1 billion asset to a more appropriate
28 number for a system that is in contact with the marine
29 environment will really impact the ability for that
30 proposed 33 per cent increase to cover Sydney Water's
31 costs.

32
33 THE CHAIRMAN: I wonder if I could just follow up. I
34 think on asset life it is difficult for us, to put it
35 another way, to be more generous than what Sydney Water
36 asks for, but I am interested in your comments and in
37 effect what I take you to be basically saying is that
38 profits will be more variable in the future. We would
39 normally handle that through the rate of return. Is that
40 in your thinking the appropriate way to go or did you have
41 something else in mind?

42
43 MR LESLIE: No, I had not looked at it from that side at
44 all. I am not exactly sure how you will recover that. To
45 think about it quickly, one of the agencies I work for in
46 the US would look at, they have their capital fund and
47 their general fund. For large membrane-based recycling

1 systems they could look at deferred maintenance and that
2 would come around in how they would change their
3 operations strategy. That was, however, very much dependent
4 on groundwater levels because that particular plant was
5 recycling water to maintain groundwater supply in much the
6 same way that Sydney Water is proposing to use the
7 desalination plant to basically supplement our surface
8 water supplies.

9
10 If it did transpire that some of the assets associated
11 with the desalination plant need to be retired within 30
12 years it is obviously going to drive the replacement costs
13 up and, if climatic conditions allow for it, you will have
14 to offset that by looking at a reduced operating strategy.
15 But I have not thought about the general revenues and
16 dividend paid by the organisation at all.

17
18 THE CHAIRMAN: Thank you. I thought we might now ask
19 the environmentalists. I am not sure who wants to go first?

20
21 MR MARTIN: Thank you. I think the first point that I
22 have to make today is that this price review is somewhat
23 flawed as a result of the direction issued by the Minister
24 of Water Utilities as it requires the tribunal simply to
25 consider the efficient cost for a 250 megalitre a day
26 desalination plant. I think that really does stack the
27 deck somewhat in terms of the tribunal's considerations.

28
29 I would have thought the appropriate process, if
30 Sydney Water is seeking to construct a very expensive piece
31 of infrastructure and recover the costs of both
32 constructing and operating that infrastructure from its
33 customers, is to determine in the first instance whether
34 that infrastructure is actually required.

35
36 What we have as a result of the Minister's direction
37 is that the tribunal is precluded from considering that
38 point. It is not hard to understand why the tribunal has
39 been precluded from doing that when you consider that by
40 the government's own metropolitan water strategy and expert
41 review of that metropolitan water strategy by the Institute
42 of Sustainable Futures construction of a desalination plant
43 at this point of time is simply not justified.

44
45 The 30 per cent supply level trigger point that was
46 determined by the government, considered by expert advice
47 to be appropriate, is currently about half of Sydney's

1 current water supplies - just under 60 per cent. Last
2 night I think we reached 59.5 per cent. It is difficult to
3 see that 30 per cent gives you adequate time to construct a
4 desalination plant and why at 59.5 per cent a
5 desalination plant is still required at this point of
6 time. It is hard to justify the recovery of that cost by
7 customer bills.
8
9 Nevertheless, as the desalination plant is clearly
10 proceeding, the second question that arises is, how should
11 it operate and to what extent should customers be required
12 to meet those costs? I think it is quite disturbing to see
13 the proposed desalination plant will operate at all times
14 when supply is below 70 or 80 per cent or whatever point is
15 finally chosen between those two figures.
16
17 Frankly, the whole point of operating a stored water
18 system is so that you have a number of years of supply to
19 tied you through dry periods. It seems to be absurd to be
20 operating a desalination plant when you have 70 to 80 per
21 cent stored water.
22
23 The more appropriate use for desalination is as an
24 emergency supply during periods of severe shortage and it
25 is our view that the operating rules for a desalination
26 plant should be that it is only operated as a critical
27 drought relief measure and customers should only be
28 expected to meet the costs of a desalination plant operated
29 on that basis. So we think it is very difficult to justify
30 recovering from customers the cost of operating a
31 desalination plant when it is not required. That is
32 essentially what Sydney Water's submission to the tribunal
33 seeks to do.
34
35 We do not believe that is justified from an
36 environmental point of view and we do not believe it is
37 justified in terms of the impact on customers.
38
39 The other point that I wish to make is that Sydney
40 Water has put the argument in its submission that as a
41 result of water restrictions the forecast revenue of just
42 over \$1.5 billion is below that previously approved by
43 IPART at 1.7 billion. That is an argument we find
44 difficult to have any sympathy with given that as a result
45 of restrictions Sydney Water will for the first time in our
46 recollection be on target to reach its operating licence
47 demand management targets.

1
2 Unrestricted demand, and that is if restrictions had
3 not been imposed, would still be running at approximately
4 400 litres per capita per day, which is significantly in
5 excess of the 340 litre per cap operated under its target.
6 I do not see why Sydney Water should be rewarded for
7 achieving its operating licence targets with additional
8 revenue. From our point of view we find that argument
9 somewhat disturbing in that, had Sydney Water been
10 achieving its demand management targets as specified by its
11 operating licence, it would only be selling approximately
12 as much water as they are now doing courtesy of
13 restrictions.
14
15 We do have very serious concerns with the approach
16 that has been taken in terms of desalination. We do,
17 however, strongly support the recycling initiatives as an
18 important way of diversifying supply, but at significantly
19 less environmental cost and significantly less financial
20 cost, and we do have a serious concern that operating
21 desalination at full capacity for two years and then
22 operating it on the basis that it is only when supply is in
23 excess of 70 or 80 per cent will actually be a significant
24 barrier to further recycling projects. There will be
25 little impetus for additional recycling projects to occur
26 if supplies are being maintained at an artificially high
27 level because of desalination.
28
29 THE CHAIRMAN: I wonder if I can ask a question of
30 clarification. You will appreciate that at the end of the
31 day IPART's function is to set a price?
32
33 MR MARTIN: Correct.
34
35 THE CHAIRMAN: So what I am interested in is if we pursue
36 your view that the desal plant should only operate in
37 critical drought situations, what would that actually do to
38 prices? The proposition in front of us is that most of the
39 cost of the desal plant is in fact capital. If we operate
40 the desal plant less frequently then the opex would be an
41 even smaller proportion of the cost. So what I would like
42 clarification on is, given that that capital cost is
43 there, how much difference would it all make to prices and
44 how should we handle it if we operate it less frequently?
45
46 MR MARTIN: We do not have the capacity to do that degree
47 of economic analysis but our point is that that is the

1 question that should be considered, that we should be
2 looking at what the appropriate costs are of a
3 desalination plant operating as an emergency supply
4 capability. The question that the tribunal is being asked
5 to consider by Sydney Water is to determine prices on the
6 basis that the desalination plant will be operating almost
7 as at a constant level of supply.

8
9 We think that is the wrong question and that the
10 tribunal should be seeking to ascertain from Sydney Water
11 what the costs will be if desalination is operated as a
12 critical emergency supply measure, which I think is what
13 was originally proposed.

14
15 THE CHAIRMAN: I will pursue that, but I am not sure the
16 answer will be very different in terms of costs.

17
18 MR MARTIN: We don't know, because the question has not
19 been asked. We would certainly like to know the answer to
20 that question.

21
22 THE CHAIRMAN: The Nature Conservation Council?

23
24 MR MCGUINNESS: Thank you. Leigh has probably covered a
25 lot of the points that I would present. I do not want to
26 repeat them in anyway.

27
28 One of the points obviously that IPART raised was the
29 question of the first two years that the desalination plant
30 will be run at full capacity for testing. Now, the
31 Conservation Council, one of our major concerns with the
32 plant is the energy use and the impact on the release of
33 brine into the ocean. We are totally opposed to the
34 desalination plant but understand that the capital
35 expenditure will be made.

36
37 One aspect of that capital expenditure will be the
38 membranes of the desalination plant and the original
39 proposal under the metropolitan water plan which Sydney
40 Water appears to be ignoring is to have an emergency
41 drought response desalination plant starting at 125
42 megalitres a day. That has now been doubled to 250
43 megalitres a day. We would propose as a compromise that
44 capital costs be reduced and the 125 megalitre a day plant
45 first be commissioned. This has the benefit of lower
46 electricity usage in an era where climate change, as
47 recognised by Sydney Water, is vitally important, and we

1 believe that energy efficiency and lowering electricity
2 usage is highly important.

3
4 We do not believe that the plant needs to be run at
5 full capacity for two years, especially if dam levels are
6 at their highest point in four years at the moment. And
7 even if they are above 50 per cent, the 30 per cent trigger
8 point was independently tested as being able to cater for
9 Sydney Water's supply demands and we believe that this
10 should be stuck to. So initially we are not supportive of
11 running the plant at 250 megalitres a day capacity so that
12 energy use can be reduced.

13
14 I would like to emphasise the point for Sydney Water
15 to continue to meet the demand management targets and I
16 take on board what Dr Schott said earlier, that they are
17 trying to reduce the product that they are selling. This
18 is an enormous conflict. It was only through the water
19 restrictions over the past four years that Sydney Water met
20 its operating licence demand targets. We think it is
21 vitally important that these continue to be met into the
22 future despite the addition of additional supply through
23 desalination.

24
25 I would also like to note that the investment
26 disincentive to alternatives to desalination such as
27 recycling - that we are very concerned about this for the
28 future. But my main emphasis would be the two years for
29 operating at full capacity we are strongly against because
30 of its environmental impacts.

31
32 THE CHAIRMAN: Thank you. Mr Versteege?

33
34 MR VERSTEEGE: Changing the subject a little bit, I would
35 like to talk about affordability. Obviously people on
36 regular incomes will groan because of these price increases
37 that seem to be in the pipeline. There is actually a
38 section of the Australian community, of the Sydney
39 community I should say, that would be hard-pressed and in
40 many cases unable to afford these price increases.

41
42 To give you a bit of background, the quantum standard
43 of retirement living developed by Westpac and the
44 Association of Superannuation Funds of Australia sets a
45 retirement income for a single person at \$18,500 per year
46 and \$25,500 for couples. The pension currently offers
47 single people \$14,000 max and \$23,000 for couples. So a

1 lot of people, the vast majority of pensioners,
2 particularly single people, are living on subsistence
3 incomes and if you whack a 33 per cent increase on top of
4 their water bill, even though the effect is still measured
5 in hundreds of dollars, it really tips them over the edge
6 and can have the effect of early admissions to nursing
7 homes because that is the only affordable thing.
8
9 So we would ask the tribunal to really consider the
10 effect any price increase above CPI will have on the people
11 that we represent, that is, aged pensioners and also
12 disability support pensioners.
13
14 Sydney Water provides rebates to about 210,000
15 pensioner households and two thirds of those households
16 would be at a subsistence level. It is a frightening
17 statistic to us.
18
19 In our submission we highlighted the fact that because
20 of quite generous pensioner rebates that apply in Sydney -
21 elsewhere they are far more miserly - thanks to those
22 pensioner rebates, and also because the proposal is to
23 increase water usage charges in the main, the effect on
24 pensioner water bills will be far greater than it is for
25 people who don't pay a rebate.
26
27 As for the proposal Sydney Water has lodged with
28 IPART, pensioners will be looking at a 45 per cent above
29 CPI increase, whereas of course the general population will
30 be paying 33 per cent above CPI. Sydney Water has briefed
31 us, and we are appreciative of that, and says that it is
32 negotiating with New South Wales Treasury to double the
33 pensioner rebates. But of course all that is very much up
34 in the air. We really don't know. We hope they are
35 successful in those negotiations obviously.
36
37 One other thing I would like to mention is that I
38 think in the public mind the desalination plant has been
39 the big ticket item, this is what this price increase is
40 all about, this is what is in the media. But the desal
41 plant will cost \$1.9 billion tops, according to Sydney
42 Water, which means that with a \$5.6 billion cap program
43 over four years there is another \$3.8 billion for other
44 capital projects, and the point needs to be made that
45 because it is all about a desal plant that these other
46 projects that are going to be funded, that is what the
47 majority of the proposed price increase is for, and those

1 projects were in the main foreseeable.
2
3 The question is, why does it need a sudden price
4 increase of this magnitude to implement those projects?
5 Sydney Water should have been planning for that and
6 inevitably we come back to the issue of the dividend.
7 Sydney Water has paid \$1.2 billion since it was
8 corporatised back at the end of 1995 and the question
9 really is, should that money have been paid? If that money
10 had been in the kitty and invested, we would certainly have
11 \$3.8 billion today and perhaps we would have the \$5.6
12 billion that Sydney Water could spend over the next four
13 years on capital projects.
14
15 I know that the corporatised model is not up for
16 discussion here but I would like to make the point that
17 whenever we refer to corporatisation of entities like
18 Sydney Water, we refer to it as a "model" but we have to
19 make the point that it is really a very tortured metaphor
20 and nothing more than that.
21
22 I would like to ask, if I could, a question of the public
23 gallery: Who knows how many shares Sydney Water has
24 out there? We don't know what the share price is, for
25 example. It might very well be that Sydney Water is
26 declaring its own financial unviability, that Sydney Water
27 would be a penny dreadful and in that case, of course, we
28 would ask the question, should a penny dreadful pay a
29 dividend? That sums it up.
30
31 THE CHAIRMAN: Thank you. Last but not least, PIAC.
32
33 MR O'NEILL: I guess I would like to start by saying
34 totally the obvious, that the proposed price increase will
35 have an extremely strong impact on consumers. We would
36 also say that this price increase will come on the back of
37 significant price increases from the last determination.
38 We would also say that this price increase will come at a
39 time when electricity prices are also increasing and petrol
40 prices are increasing, so it is important for the tribunal
41 to understand that this price increase does not operate in
42 a vacuum.
43
44 What PIAC is quite concerned about is the price shock
45 that consumers will suffer because of the way that the
46 price increases have been proposed. We support the
47 tribunal adopting a far more bill smoothing approach to its

1 pricing so the consumers don't suddenly get whacked with a
2 massive bill which they will not be able to afford, that
3 many people won't be able to pay for, as Paul pointed out
4 quite well.
5
6 I guess that would be our first point, to say that we
7 would like the tribunal to adopt a smoother approach to
8 pricing.
9
10 Desal is not really - whether or not it should go
11 ahead or not go ahead or all of that is not really the
12 purpose of this hearing. Leigh has pointed out some good
13 factors why perhaps it should not have gone ahead. But I
14 guess the fact is that it is here. What we are quite
15 concerned about is the way that the desal plant has been
16 kind of proposed to operate we think it will have
17 significant impacts on the price signal that is put out
18 there that the tribunal has strongly supported and so we
19 are quite concerned about the way that the desalination
20 plant is proposed to be operating and its effect on
21 scarcity pricing and other pricing issues that I guess we
22 will get to later on.
23
24 Another thing we are quite concerned about is the
25 \$380m that Kerry pointed out that Sydney Water has lost in
26 revenue because of successful water restrictions. PIAC is
27 quite confused. We raised this issue three years ago at
28 the last price determination when we said there will
29 probably be significant water restrictions and there needs
30 to be some consideration of that. And now we are three
31 years on from that and suddenly Sydney Water is saying,
32 "Hey, we have lost \$380m worth of revenue", a significant
33 amount.
34
35 It should not come to another price determination and
36 say, "Oh, my God, we have got a whole bunch of revenue
37 missing so we have to increase prices". There needs to be
38 a more intelligent way of doing this.
39
40 Kerry raised the fact that Sydney Water is one of the
41 few companies that tries to reduce the product that it
42 sells. I think another industry where they do that, or
43 they should be doing that, and IPART is encouraging them to
44 do that, is distribution pricing for electricity. PIAC
45 would recommend IPART adopt a similar kind of approach to
46 demand management that it has for distribution pricing so
47 that when we get to the end of the pricing regulation

1 period we don't suddenly all put our hands up and say, "We
2 need more money". It should already be factored in.
3
4 I think I might just finish on that point.
5
6 THE CHAIRMAN: Thank you very much. As I promised, I
7 would like to now throw it open to comments from the floor.
8 I do intend also to offer Sydney Water the chance to
9 respond perhaps to a few of the points that have been made.
10 I think it would be useful if we get a response, but not to
11 the whole gamut. We will do that after I have thrown it
12 open to the floor for any comments. Sorry, before that,
13 Mr Cox.
14
15 MR COX: I think there is just one aspect that perhaps has
16 not been picked up that is worth putting on the table
17 because it does bear thinking about. Kerry Schott showed a
18 transparency during her presentation which showed in effect
19 we have a bunching of capital expenditure programs, large
20 capex programs, over the next two to three years and that
21 after that capital expenditure goes back to a more normal
22 level.
23
24 That does, I think, raise the question of whether
25 customers are being asked to pay a high price in this
26 determination period to finance Sydney Water's high capital
27 expenditure with a degree of confidence. Perhaps there is
28 a possibility that prices might be lower later on, in which
29 case I think, as PIAC was saying, it is a question of
30 whether a more averaged approach should not be taken. I
31 would be grateful if Sydney Water could respond to that at
32 the end of the session.
33
34 THE CHAIRMAN: Now, anybody from the floor?
35
36 MR BLATCHFORD: Rex Blatchford, mechanical engineer,
37 retired. I guess I would represent the domestic users of
38 water, the residents. I will make a few comments. Richard
39 Warner at the start said that we should be paying for the
40 water we use, but when you look at the multiunit dwellings,
41 such as by apartments and houses, there is a water meter
42 for the whole block. So this promotes wastage of water
43 because we are sharing the cost for the whole lot. I mean,
44 if my neighbour is wasting water, using excessive water,
45 and I have contributed to the cost of that, I don't feel
46 any encouragement to be economic myself.
47

1 The other point is that electricity, gas, and
2 telephone don't have a common meter for the whole block of
3 units. So I think we should get serious about putting
4 individual meters in each dwelling. It would be crazy, for
5 instance, to say let's have one water meter at the end of
6 each street for all the houses in that street. It is just
7 crazy, isn't it, but that is what we are doing with blocks
8 of units.

9
10 In regard to water tanks, each new dwelling should be
11 compelled to have a water tank. The Tribunal should
12 seriously look at, where dwellings have water tanks,
13 reducing the price for the water they buy rather than get a
14 once-off contribution to the cost of the tank. For new
15 dwellings the tanks should be connected to the washing
16 machine and also the toilets, and that should be a
17 condition of the house being approved. Also the washing
18 machines should have a suds-saving facility where the rinse
19 water is saved and used for flushing toilets. Thank you.

20
21 THE CHAIRMAN: If there are no other comments I will ask
22 Dr Schott if she would like to respond to some of the
23 points that have been made.

24
25 DR SCHOTT: Thanks, Mr Chairman. I am tempted to cover
26 everything but I will try not to. I did agree with a lot
27 of the comments that were made. Just a few things, in
28 putting up the price increase that Sydney Water proposes,
29 we did examine various scenarios of shaping the price
30 increase, so that we didn't have the big hit up the front.
31 The consequence of doing that, though, is that the overall
32 price rise is even more substantial, and that is because
33 you are borrowing more to cover what you are not picking up
34 in price rise in the front. So if you have less price
35 rises at the front you will have more debt, and therefore
36 larger price rises.

37
38 The modelling that we did showed that instead of a
39 \$275 price rise over four years in real terms, you would
40 need to add an additional \$145 if you smoothed the price
41 rise. It was for that reason that we put in our proposal
42 that we have a lot of pain for two years, and then we
43 revert to the CPI plus three types of levels. It is
44 obviously a matter for the Tribunal, but because of the
45 large borrowing increases at the front end, smoothing does
46 have a very large impact.

47
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1 One thing on the desalination plant that I failed to
2 mention previously was that we are in the market for a
3 renewable energy provider. The desal plant will be powered
4 by wind, and that has been calculated within our operating
5 costs. The indicative prices that we have seen from our
6 tenderer suggest that our operating costs are within the
7 ballpark - our estimates are roughly okay.

8
9 One thing on the amount of water people are using is
10 that Sydney Water at the moment is currently running at
11 about 305 litres per capita per day, so we are well below
12 our target which is 329. It is true that that will go up
13 when and if water restrictions are lifted, but because of
14 the permanent water measures that will be imposed, we are
15 not anticipating the big bounce back that has occurred
16 historically. We have permanent water saving measures
17 through Waterfix and basic requirements and in business,
18 and of course within our reduction program.

19
20 I would say that the price of water is actually very
21 important for encouraging leak reduction. Within Sydney
22 Water we go chasing leaks up to a particular cost, and the
23 higher the price of water the more chasing we will do. I
24 am sure that is the same for all major water users and
25 businesses. Also, the higher the water cost the more
26 recycled water projects become appropriate. The sad
27 reality is that the cost of desalination is considerably
28 less than a lot of recycled water projects. Our recycled
29 water costs per kilolitre range from around 55 cents up to
30 \$4. The cost of desalination is about just over 2. So
31 while there are some recycled water projects that are less
32 costly than desal, they tend to be rather unique and they
33 tend to be big users sitting just beside our sewage
34 treatment plants, and there's not very many of them. So an
35 increase in the water price does, again, put more recycled
36 water projects in a viable position.

37
38 I do agree with Dr Leslie about hedging our power
39 costs, and we will do that. On the life of the desal
40 plant, we did get some technical expertise. We are very
41 happy to go back and have a discussion about that.

42
43 THE CHAIRMAN: I wonder if I could ask you to address
44 one further issue raised by Mr Martin. That was the comment
45 that - if I have understood him correctly - the comparison
46 between demand and what he describes as the licence
47 conditions --

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1
2 DR SCHOTT: And we shouldn't be rewarded for saving
3 water. I agree that saving water is very important and in a
4 sense we shouldn't be paid for doing so, but the way that our
5 costs work, it doesn't actually matter how much water we
6 sell and therefore revenue we make, we still have to look
7 after our assets, and Sydney Water is basically a capital
8 driven business. So even though we sell less water we are
9 incurring those costs that do have to be covered. So the
10 \$380 million that IPART thought in the last determination
11 we would make, which we didn't make, just means that we
12 are behind in covering our costs and have had to borrow a
13 little more than we were anticipating.

14
15 Sydney Water is concerned about families and other
16 customers who will be in financial distress because of
17 these price rises. We have increased our attention to the
18 various programs that we fund to assist. We will fund our
19 loan program further and extend our large family
20 assistance, and also put more effort into our payment
21 assistance schemes where we work with various welfare
22 providers. It is really an issue of working very closely
23 with that sector to try to minimise the impact, but we are
24 very aware of it.

25
26 THE CHAIRMAN: Thank you. I think now I will call a break
27 for morning tea.

28
29 SHORT ADJOURNMENT

30
31 MR WARNER: During this second session we propose to
32 consider Sydney Water's pricing structure. As previously
33 mentioned, developer charges are used to recover any costs
34 of service above the average service cost embodied in
35 common postage stamp periodic charges. Water periodic
36 charges are structured such that users pay the fixed
37 service availability charge that does not vary with the
38 level of water usage, and a water usage charge varies
39 according to the amount used. Another mechanism that is in
40 use is an inclining block tariff where large residential
41 users pay more for each kilolitre of water above a
42 threshold.

43
44 The Tribunal established an inclining block tariff for
45 Sydney Water's residential customers at its last review in
46 2005 in recognition of the deteriorating water storage
47 position evident at that time. The Tribunal set the step

1 in the inclining block at 100 kilolitres per quarter, or
2 400 kilolitres per year, and some have argued that this is
3 an appropriate amount and should remain at this level;
4 others have argued that it is too generous and should be
5 wound back.

6
7 At its last determination the Tribunal set the price
8 at the first step equal to the long run marginal cost of
9 water. This first step is now equivalent to \$1.34 per
10 kilolitre and Sydney Water proposes that this first step
11 price be increased by 55 per cent in real terms over the
12 next four years, and that table sets out the prices that it
13 proposes for tier 1.

14
15 The second tier price was set to help ration water at
16 a time when water was in short supply. That price
17 currently stands at \$1.83 per kilolitre for consumption in
18 excess of 100 kilolitres per quarter. Sydney Water
19 proposes that the second tier price be further increased so
20 that it is 50 per cent higher than the first.

21
22 Since the 2005 determination the SCA water storage has
23 recovered to almost 60 per cent of capacity. In addition
24 the desalination plant provides extra insurance against
25 water shortages. It has been suggested that the inclining
26 block tariff be extended to non-residential properties.
27 The Tribunal also has in train a review of the developer
28 charges methodology, which will be completed in the second
29 half of next year. However, appropriate issues relating to
30 cost sharing will also be considered here. What I am
31 asking you to consider is whether you need an inclining
32 block; if so, what level that inclining block should cut in
33 at; and also some of those other pricing mechanisms such as
34 developer charges.

35
36 The Tribunal also sought in its issues paper views on
37 whether the cost of the desalination plant should be
38 recovered from developers given that each new lot adds to
39 the demand for water and the existing supply sources are at
40 or exceed the available yield. Some stakeholders have also
41 suggested that the developer charges are an anomaly or an
42 anachronism and should be phased out. Others have
43 suggested that that part of the desalination plant needed
44 to satisfy growth should be recovered by way of developer
45 charges, so in relation to developer charges we seem to
46 have support on both sides.

1 It has also been suggested that any consideration of
2 water pricing needs to also consider the implication for
3 recycled water pricing. For instance, if only the short
4 run marginal cost for desalinated water is included in
5 the water price, this could have adverse implications for
6 the viability of recycled water schemes. I think the short
7 run marginal cost of desalinated water is going to be
8 around 60 cents per kilolitre.
9
10 Some of the questions we would like to consider in
11 this session are should high volume residential users pay
12 more for water through an inclining block tariff and, if
13 so, why? Should non-residential properties also face an
14 inclining block tariff? What would be the implications of
15 this on business and employment? Is it appropriate to
16 adjust the first tier to reflect the long run marginal
17 cost with an offsetting adjustment in the fixed charge? If
18 the tier 1 price is set consistent with the long run
19 marginal cost is there justification for pricing above this
20 level? If an increasing block tariff is to be retained does
21 the threshold, the 100 kilolitres per quarter, need to change
22 and, if so, why?
23
24 How should the costs of desalinated water be allowed
25 for? Should it be through the service charge as some sort
26 of an insurance premium? In a developer charge for that
27 component that will supply new growth? Should we recover
28 the capital cost as a fixed charge and the operating cost
29 as a variable charge only when it is operating? Or
30 alternatively do we factor in the full operating cost and, as
31 Sydney Water suggested, have this adjustment mechanism at
32 the end of a price period? Should the price of all water be
33 set at long run marginal cost of desalinated water -
34 estimated at around \$2 per kilolitre? Is an IBT where tier
35 1 is set at SRMC of dam water and tier 2 set at LRMC of
36 desal water a fairer system? What quantity should tier 1
37 be set? Should the Tribunal set the price for desalinated
38 water so that it doesn't disadvantage the providers of
39 recycled water? How should that be done?
40
41 Some further questions in relation to recycled water
42 itself: How should the Tribunal structure potable water
43 prices so as to not disadvantage efficient recycled water
44 schemes? How does it ensure competitive neutrality between
45 incumbent water suppliers and new market entrants? How
46 does it avoid perverse incentives for inefficient
47 investment in either potable water or recycled water.

1
2 THE CHAIRMAN: Thank you, Richard. I am going to ask
3 Sydney Water to start off first again.
4
5 DR SCHOTT: Thanks Richard. Just on the issue of whether
6 high volume residential users should pay more above a
7 threshold and, if so, why, the whole issue about whether we
8 should have tier 1 and tier 2 prices rests, I think, on our
9 view that the people that we are trying to reach with the
10 higher tier 2 prices are more discretionary water users,
11 like those with swimming pools and large gardens, where
12 they don't necessarily need to use that water. For most of
13 the rest of water users the price impact is relatively low.
14 People are not going to flush the toilet less because of
15 prices. That is our major justification for tier 2.
16
17 With non-residential properties we did examine having
18 a tiered system. We found that for large water users,
19 particularly food producers and people that make beer and
20 soft drinks, the impact of being in the higher sort of
21 tariff ranges was very severe. So that if there was a view
22 in IPART of moving towards an inclining block tariff for
23 business, our view would be that it needs to be phased in
24 over a long period of time so that business can adapt to
25 it, because there are some businesses where they must use
26 potable water for a lot of their processes, and the impact
27 on them would be quite large.
28
29 I think our view on the tier 1 price in our proposed
30 prices is that it is getting into the long run marginal
31 cost arrangements. We think that tier 1 prices are pretty
32 well consistent with long run marginal costs. It is
33 actually hard to estimate what that is, but our view is
34 that it will be somewhere around \$2 a kilolitre, I think -
35 of that order.
36
37 I think most of the issues around cost of desalinated
38 water we discussed in the last session. I might make the
39 point again that the prices for water and in turn
40 desalinated water, which is the same price, the higher that
41 is the more it really assists with the recycled water
42 provision since many of those schemes are currently above
43 the cost of potable water.
44
45 THE CHAIRMAN: A number of the questions we have
46 raised would be of interest to Alinta.
47

1 MR TUDEHOPE: Thank you. We recognise that tariff is a
2 complex subject and involves many policy and economic
3 questions as well as social issues about equity and
4 affordability. From Alinta's point of view, though, as an
5 investor and alternate source of supply, the principal
6 competitor, as I said previously, is potable water, so
7 potable water pricing is of particular interest to us.
8

9 In order to ensure the competitiveness of alternate
10 sources of supply, our position would be that the tariff
11 for potable water on the margin - and that would be tier 2
12 tariff - should be set by reference to the long run
13 marginal cost of supply, and that that higher tariff on it
14 should apply to all customers on the margin, including
15 non-residential customers. In this way, so long as there
16 are alternatives sources of supply, it allows, for example,
17 the recycled network to expand sooner and more widely.
18

19 In 2005 the Tribunal concluded that long run marginal
20 cost of supply was of the order of \$1.20 to \$1.60.
21 However, while that is the tier 1 tariff, or was the basis
22 of setting the tier 1 tariff, that tariff in fact includes
23 a large proportion of network charges, but given the
24 marginal cost of supply from Sydney catchment of - I don't
25 know - 20 to 30 cents delivered into the Sydney Water
26 network, the remainder of the \$1.20 to \$1.60 is effectively
27 recovering network charges.
28

29 Looking at the figures - the comparable figures for
30 desalination, and taking into account the cost of the
31 pipeline to deliver water into the network and compare it
32 with Sydney catchment, we have calculated from the numbers
33 presented by Sydney Water that the average cost of
34 desalination water is about \$2.55, and that is delivered
35 into the network at 100 per cent load factor, and obviously
36 the average unit cost is somewhat higher than that and the
37 load factor is lower.
38

39 So irrespective of whether that is an accurate measure
40 of the theoretical long run marginal cost, we say it is in
41 fact the long run marginal cost of Sydney Water placing the
42 water into its network, so the marginal tariff should be
43 set at that level plus some allocation of distribution
44 costs to get that marginal supply through the Sydney Water
45 network and deliver it to consumers.
46

47 We note that Sydney Water's tariff proposal for tier 1

1 effectively straddle that \$2.55 plus some allowance for
2 distribution costs in the last year of their proposal. In
3 that sense we say that the proposed tariffs are pretty much
4 in the ballpark.
5

6 As to the block structure itself, we have suggested
7 the higher cost block should cover an aggregate volume set
8 by reference to total consumption, the sustainable level of
9 supply from existing sources, and perhaps forecasting
10 desalination. In other words, you might set it at, say,
11 10 per cent of the aggregate demand for a year, and so that
12 then would be priced at the higher marginal cost and would
13 be effectively the price against which new sources of
14 supply, such as recycling, would be competing.
15

16 As I said, then the allocation of that aggregate
17 volume across consumers and so on of course is another
18 issue. Then the remainder of consumption would be priced
19 at the lower tier-one tariff. In terms of setting the
20 tier-one tariff, obviously there is a balance there between
21 fixed charges and variable charges. Ultimately total
22 revenue should equal total cost, so the tier-one tariff and
23 the division of that between cost recovery - between
24 tariffs and fixed charges is somewhat arbitrary. It has
25 been historically, but at the end of the day you will be
26 looking for total forecast revenue to equal total forecast
27 costs.
28

29 As we said, we see it as important that
30 non-residential consumers should face the higher tariff on
31 the margin because they are in fact a very important market
32 for substitution and conservation, so having that higher
33 tariff on the margin provides them with the necessary
34 incentives and also, as Dr Schott said, provides Sydney Water
35 incentive to look at production and so on.
36

37 In terms of the recovery of desalination costs, in our
38 submission, and I repeat, we see it as something that
39 should be recovered as part of the general revenue
40 requirements of Sydney Water. It should not be recovered
41 through developer charges, which we see as an anomaly,
42 and make the observation that in the gas industry there is
43 only about 4 per cent of new connections over recent
44 periods at least that incur a customer contribution and
45 that we say that gas, of course, is discretionary rather
46 than water, which is mandatory for everybody, but
47 nevertheless that is just a point of comparison.

1
2 It seems that developer charges in many respects are a
3 vehicle for relieving Sydney Water of capital requirements
4 and that in some respects they are contrary to the general
5 policy of postage stamp. Of course, in terms of an
6 incentive for conservation substitution, once they have
7 paid it, it is lost. So in our view the desalination cost
8 should really be recovered from all consumers through
9 tariffs.
10
11 I think they are the comments I would like to make.
12
13 THE CHAIRMAN: I will just make a comment on our part re
14 the developer charges. We would see developer charges as
15 reflecting, where there is above average cost in servicing
16 them, to bring the service to a particular area, that is
17 what is reflected in the developer charges, and in that
18 sense it then justifies the postage stamp for the periodic
19 charge because people who have paid a developer charge
20 have paid for the fact of the cost to deliver it to them.
21
22 I might go to Mr Martin.
23
24 MR MARTIN: Thank you. There are a few points that I
25 would like to make. The first is that we have previously
26 been very supportive of the introduction of the inclining
27 block tariff system. We see that as a very important way
28 of sending a strong resource conservation signal and,
29 particularly as Kerry Schott stated in her presentation, of
30 targeting discretionary water use.
31
32 At the time that the current system was introduced, we
33 did say that whilst we thought the 100 kilolitre step point
34 was probably a useful starting point to equate customers
35 with the concept of inclining block tariff that we thought
36 that that would probably need to come back down over time
37 to strengthen the conservation signal and also that the
38 actual price step between tiers one and two would need to
39 be correct.
40
41 So, in view of that, we welcome Sydney Water's
42 proposal to increase the tier-two price. I would suggest
43 that the tribunal probably ought to look at whether the
44 step point should be changed in the next price
45 determination, particularly if 100 kilolitres is the
46 appropriate level to target discretionary water use or
47 whether there is capacity to reduce that further, and we

1 think there probably would be.
2
3 One thing that we are concerned with, though, is the
4 level of fixed charges. I guess there are a couple of
5 issues here. The first is that an increase in the
6 second-tier price need not necessarily result in a major
7 cost burden on customers if that is offset by a reduction
8 in fixed charges. We have long believed that the level of
9 fixed charges in customers' bills is too high, that it
10 effectively diminishes the resource conservation signal
11 because it reduces the ability customers have to control
12 the size of their own bill. It is a significant
13 disincentive to install a rainwater tank or any other form
14 of water efficiency if that is going to make relatively
15 little difference to the overall size of your bill, so we
16 welcome the moves that were made in the last price
17 determination to reduce some of the fixed charges and
18 instead rely to a greater extent on volumetric pricing.
19
20 We think that process needs to continue, that the pace
21 of reducing those fixed charges needs to quickened. I
22 understand why utilities like Sydney Water favour fixed
23 charges to an extent because it reduces their revenue
24 volatility and thus reduces their exposure to risk. I
25 would argue that business is about risk and managing risk
26 and that Sydney Water needs to accept a greater degree of
27 risk in terms of that and that the benefits of reducing
28 those fixed charges outweigh the potential risk that it may
29 impose to Sydney Water, so we think that process needs to
30 continue.
31
32 The other point I would like to make is in relation to
33 how the costs of recycling projects will be apportioned.
34 It is our view that the costs of recycling projects, whilst
35 not all customers will have direct access to them, all
36 customers benefit. All of Sydney Water's customers benefit
37 by any moves that are made to increase the level of
38 recycling in terms of diversifying Sydney Water's supply
39 and increasing the security of that supply, so whilst not
40 all customers will have direct access they will all enjoy
41 some of the benefit.
42
43 It is our view that recycling initiatives should be
44 funded via the general price of fresh water, not just
45 limited to those direct for some water customers, so to an
46 extent there does need to be a subsidy across the general
47 price of water and that that process will make recycling

1 schemes more attractive and more viable and we see that as
2 being very strongly in the public interest.

3
4 THE CHAIRMAN: Thank you. I wonder if I can just pursue a
5 bit further with you your proposal that fixed charges
6 should be reduced. Essentially what has been put before us
7 is that we should put the periodic charge equal to the
8 long-run marginal cost of supplying water.

9
10 If the total revenue gained is the sum of the periodic
11 charge and the fixed charge is going to cover the total
12 costs and not cover more or less than the total costs, if
13 we reduced the fixed charge and still covered the total
14 costs then that would seem to imply that we might put the
15 periodic charge above the long-run marginal cost. Is that
16 what you are saying, that we should consider doing that?

17
18 MR MARTIN: I am not sure if that is what I am saying or
19 not. I did not completely follow your line of argument.
20 It is essentially our view that any offsetting of the fixed
21 charges, any reduction, needs to be offset by an increase
22 in the volumetric prices.

23
24 THE CHAIRMAN: We try and set the volumetric price at the
25 long-run marginal price and then a fixed charge is not
26 really arbitrarily determined, it is determined as a
27 balancing item to ensure that the total revenue equals
28 total costs.

29
30 MR MARTIN: It is our view there should be a greater
31 degree of I guess exposure of Sydney Water in terms of
32 revenue volatility, so not just the long-run marginal cost
33 incorporated in the volumetric price but some degree in the
34 capital costs as well.

35
36 THE CHAIRMAN: You do appreciate that if Sydney Water
37 was exposed to greater volatility they could conceivably
38 mount an argument that that could lead to a higher rate of
39 return which would then also feed into a higher price overall?

40
41 MR MARTIN: Yes.

42
43 THE CHAIRMAN: I wonder if Mr Leslie would like to
44 comment?

45
46 MR LESLIE: I did not specifically comment on this in my
47 submission because it is not my area of expertise but,

1 having been involved in a number of recycling projects in
2 both Singapore and here, setting the price of recycled
3 water and benchmarking it to the cost of potable water is,
4 as you pointed out, a very complicated thing.

5
6 I don't think the tribunal will be really in a
7 position to be too prescriptive on that until you have a
8 better feel for where Sydney Water costs will be for
9 operating the desalination plant to cope with the
10 volatility of power prices and reduced asset life. It is
11 probably something that is more of a policy than a precise
12 calculation in the short term.

13
14 I do make two observations, though, on where we are
15 looking at some of the things that have occurred in
16 recycling schemes and also in utility prices to try to
17 recover the costs associated that the utility bears in
18 basically setting up the sewerage and potable supply
19 network in the first place that the recycling scheme builds
20 on.

21
22 The first one is the notion of a competitive
23 transition charge. That was a charge that was introduced,
24 or a concept that was introduced, by the power utilities in
25 California around about 1999. Basically the power system
26 was deregulated in California. The three big utilities,
27 Pacific Gas and Electricity, Southern California Edison and
28 Dan Diego Electric, were allowed to apply a charge to every
29 resident's power bill that covered the assets and the
30 investment that was stranded as a result of movement to the
31 new regime. The size of the competitive transition charge
32 was a way to recover that.

33
34 When consumers looked at the bill they could see that
35 they were purchasing green power, for example, it was
36 generated in Washington State through hydro, so they
37 recognised that they were paying that. It was something
38 that the consumer felt they had control over and that was a
39 bigger portion of the bill. Compared to the transition
40 charge, it was a charge introduced that covers this
41 transition while existing assets are retired and it can
42 cover those things like developer fees, so it is a way of
43 introducing some control back into it, some notion of
44 control that the consumer has while maintaining revenue for
45 the existing utility.

46
47 The second one, again it is probably not appropriate

1 to discuss it, but it is a thing we are doing a lot of work
2 on, and that is basically how to price in the cost of
3 carbon into water systems, whether it is in the form of a
4 carbon tax or whether carbon has a value that can be traded
5 on the market.

6
7 That is really going to impact the costs between
8 recycling and desalination and alternative water supplies
9 because, notwithstanding whether you source power for a
10 desalination plant from green sources of water, the
11 embodied carbon and the additional chemicals that you need
12 and the additional area of membrane that you need to
13 produce water out of seawater, compared to producing water
14 out of recycled water, is three to four times higher. So
15 ultimately you will live in a world where that carbon has
16 to be recovered, the cost of that has to be recovered.
17 Either it will have a value that can be traded or there
18 will be a tax on it, but again that is not appropriate for
19 this, it is more for the next determination.

20
21 THE CHAIRMAN: Thank you.

22
23 MR VERSTEEGE: When it comes to water pricing, of course
24 the Combined Pensioners and Superannuants Association is
25 mainly interested in the size of the rebates. As I said
26 earlier, the rebate offered by Sydney Water is quite
27 generous when compared with rebates offered elsewhere,
28 even as close a field as Newcastle. Sydney water is doing a lot
29 better there, and they seem to be committed to making sure
30 that the rebate is an effective way of keeping pensioners
31 in their own homes.

32
33 Having said those nice things, there are a few other
34 things I would like to say. First of all, the rebates
35 currently, the water service charge, is an exemption for
36 pensioners. The sewerage service charge is also an exception
37 for pensioners largely, I think it is 81 per cent at the
38 moment, so what pensioners are paying at the moment is
39 water usage charges. And, of course, they go up quite
40 substantially if Sydney Water's proposal gets up.

41
42 I would like to make a point that, and Leigh has
43 talked about this, the price signal. If we look at water
44 usage over the past few years there has been a dramatic
45 decrease simply, a regulated decrease basically, through
46 the water restrictions. The price elasticity of water has
47 not had a very great impact, although it has had an impact.

1 Elasticity. So we would argue that putting up the water
2 usage charge, when it comes to economic and environmental
3 benefits, is not as great as is sometimes made out. And it
4 is important for our constituents because why would they be
5 paying a higher price if it is not necessary?

6
7 Within that context, what we have recommended is that
8 if you have tier-two water usage charges for discretionary
9 use basically you should also have a tier-two water service
10 charge because if you use a lot of water you obviously put
11 more pressure on the infrastructure and of course that
12 would be a way of raising the revenue to fund that capital
13 program.

14
15 We also think that if you are going to use water usage
16 charges as a price signal, it should be targeted solely at
17 discretionary use, that is, at tier-two water usage
18 charges.

19
20 One point of criticism that Combined Pensioners has of
21 the proposal is that the developers get off scott free
22 because Sydney Water has not said, let's make sure that the
23 desalination plant is at least in part funded by
24 developer charges, an increase in developer charges. It is
25 all going through the residential and non-residential
26 charges of existing development. So we would really argue
27 that the price determination includes an increase in
28 developer charges to the extent that these projects cater
29 for growth.

30
31 That is really the crux of what I have to say. We
32 would really urge that the tribunal follows the user pays
33 principle, which has been much maligned, including by our
34 association, but we think it might work to our advantage
35 this time.

36
37 THE CHAIRMAN: When you said that the developers get off
38 scot free, does that imply that you think the developers
39 are unable to pass on that charge when people actually buy
40 their allotments. I think our thinking has always assumed
41 that if we increased the developer charges to cover the
42 cost of the desal plant, that would be a very heavy impost
43 on the people who bought new allotments.

44
45 MR VERSTEEGE: Yes. We think that is right to do. The
46 alternative is to get the new development up and have
47 people who are already living in Sydney, or in the Sydney

1 Water area of operations, and get them to pay for it. We
2 think that it is more reasonable that people who want to
3 put up new developments pay for it.

4
5 THE CHAIRMAN: That will mean that the people who go and
6 live in the new development will pay for it? .

7
8 MR VERSTEEGE: Yes.

9
10 MR O'NEILL: I guess again I would start by saying that
11 PIAC is very sceptical about the benefits of inclining
12 block tariffs. We are quite concerned that the benefits
13 that are often described by IPART and Sydney Water and
14 environmental groups about its ability to reduce
15 consumption are completely overstated. There is very
16 little evidence out there that price signals for water
17 actually reduce consumption. Paul touched on this talking
18 about price elasticity for water consumption.

19
20 When we have water restrictions, as we have had for
21 the last three years, I think it is important to note that
22 price signals don't get passed through to consumers, they
23 are already reducing their discretionary use, hopefully,
24 and so the only thing they should be using is non
25 discretionary use, so price signals on top of that will be
26 fairly dull in respect of water restrictions.

27
28 I think people will say, well, what happens when we
29 remove the water restrictions, we need to have an inclining
30 block tariff then. I think we should not be creating an
31 environment where we are encouraging the government to
32 remove water restrictions. Water restrictions have been
33 very successful in reducing our consumption and should be
34 maintained for as long as politically possible.

35
36 Also it needs to be pointed out, as we discussed in
37 the first session, Sydney Water says it has lost \$80m worth
38 of revenues because of water restrictions. I would like to
39 highlight the inconsistency of having price signals that
40 says if you consume more you pay more, but what I think
41 will happen if Sydney Water can reclaim money for lost
42 revenue because of water restrictions, then you are also
43 saying if you consume less you will pay more. I think
44 there needs to be some consideration of that fact.

45
46 The desalination plant also raises issues about price
47 signals, particularly if we are running it for the first

1 two years flat out. That is going to raise the price of
2 water and, correct me if I am wrong, but water through
3 desal plants is more expensive than through Catchment
4 Authorities, and I think that also has an effect on price
5 signals through water. So I think we need to be very
6 certain about why we are increasing, or what effect the
7 increase of second-tier or two-tier pricing will have on
8 consumers. I do not believe that it will reduce
9 consumption that much. I do believe it will increase
10 Sydney Water's revenue, and that might be a good thing, but
11 we just need to be plain about why we are increasing prices
12 in two-tier pricing.

13
14 I would also like to talk about the fact that the
15 price signal - that inclining block tariffs are a blunt
16 instrument and do not target discretionary use all that
17 well. In its report, IPART's household survey, it has a
18 lot of information that can be used to target discretionary
19 use. We can put in something like a pool tax. That would
20 be a much better way of targeting use that is
21 discretionary.

22
23 I do not know if I can talk about non-residential
24 properties because I do not represent them, but I would
25 like to make the point that I look around the table and I
26 do not see that they are very well represented, so I think
27 that should be noted.

28
29 I would also like to touch on changes to the fixed
30 charge. It needs to be noted that on average the lower
31 your income, the less you use and so proportionately you
32 are spending more on the fixed charge. Whether or not
33 fixed charges should be reduced or not is another question,
34 but that might go into IPART's consideration about fixed
35 charge fees, the discussion we have already had.

36
37 I think that is it.

38
39 THE CHAIRMAN: Thank you very much. Mr Doig, you
40 arrived late, you probably didn't see the particular questions
41 we asked people to address, but do you want to respond on
42 the issues of price structures?

43
44 MR DOIG: Thank you for the opportunity to speak. I have
45 been invited to jump in here on behalf of the New South
46 Wales Business Chamber as well, which I suppose we are
47 associated with. We are separate entities but we work

1 closely on these things here.
2
3 The first thing I want to indicate is that the
4 industry is doing quite a lot already in terms of reducing
5 the amount of water that, savings of water, that it
6 actually manages. It has certainly embraced the water
7 savings plan system that has been adopted along the Sydney
8 and Hunter area and now has been extended across New South
9 Wales. I am sure that will be taken up, particularly the
10 water savings grants that also have been taken up by quite
11 a number of our members.
12
13 We also applaud Sydney Water's Every Drop Counts
14 program that has given considerable cost savings and
15 efficiency gains to our members as well.
16
17 However, in looking at that, the concerning aspect
18 about price, of course, is the high cost and the
19 substantial increase in costs of water prices and from an
20 industry perspective we are seeing price increases across
21 all the major utility sectors, electricity, waste as well
22 as water for various reasons. Certainly greenhouse issues
23 will become a more predominant factor in terms of
24 electricity pricing and other energy sources over the next
25 couple of years.
26
27 It is also important to acknowledge that the economy
28 is what we consider a free speed economy, with mining going
29 rather well, agriculture not doing very well at all and
30 manufacturing kind of creeping along but going slowly
31 backwards. We even had a few members in the last couple of
32 weeks actually go out of business. I was also at another
33 meeting where an American from Indiana state was there
34 trying to catch companies and take them over there, and
35 basically go through the entire planning process, red tape,
36 in one day, and give them a spade to build their new
37 factory in Indiana. That is if you like the cold.
38
39 The high cost of water certainly will be an issue that
40 will impact on the future viability of the industry in the
41 Sydney area. It is not recognised that Sydney Water I
42 suppose, well, coming back to the main reason that IPART is
43 here to do this review is to set an appropriate price
44 structure which ensures that supply and delivery of the
45 services that Sydney Water does is conducted and therefore
46 it really is a process of making sure of controlled
47 mechanisms, to make sure that is done in an efficient

1 manner, but from an industry perspective while we always
2 would like to argue about price, we believe that supply is
3 absolutely essential. So we are certainly not in the
4 business of arguing to impoverish any utility to the point
5 that it can't provide its services. In fact, we would
6 welcome a reasonable level of security and supply of those
7 services.
8
9 Of the actual price structures, I would not say it is
10 a major concern but it is a minor issue, the stepped change
11 that actually is in the water price. I believe it is 75
12 kilolitres for residential that is proposed.
13
14 DR SCHOTT: 100.
15
16 MR DOIG: The only issue here is that many companies, I
17 suppose the vast bulk of industry, will be using well over
18 into that second tier and they will be paying the higher
19 price. Is that correct?
20
21 DR SCHOTT: No, the tier-one price is not set.
22
23 MR DOIG: Okay, thank you. The last point is on the
24 recycled water issues and that is certainly welcomed. The
25 industry is certainly in a big position there to try to
26 make the most of the new recycled water streams that are
27 coming in from the treatment of effluent from the inland
28 waste water treatment plants.
29
30 Some of the issues there are the connection costs, how
31 much will that be, and there is certainly a growing amount
32 of this water that will be on-supply. It seems that
33 industry is in a position to accept the recycled material
34 from inland water treatment facilities that is unacceptable
35 from a political perspective from supplementing it to our
36 supply waters at the dam level.
37
38 I am not sure about the ability of industry to accept
39 the 75 gegalitres that maybe available but certainly again
40 that really depends on the price structure of what will
41 happen with the recycled water and the connection costs
42 associated with that.
43
44 THE CHAIRMAN: Thank you. We will now have questions
45 from the floor.
46
47 MR DODDS: Chris Dodds, policy officer at the Energy &

1 Water Ombudsman's Office. I am well aware of the dilemma
2 in looking at the price structure in terms of the up-front
3 loading versus a much higher price outcome if it is
4 smoothed and the choice of Sydney Water has made to go for
5 the price shock but at a lesser total is one that I can
6 understand. However, it does not take away from the fact
7 that there is a price shock. And in the last tribunal
8 hearing equally there was concern about the price shock
9 with the new two-tier structure and the increase in that
10 structure will also mean a price shock particularly for
11 disadvantaged consumers.
12
13 I can remember very clearly the tribunal asking me at this
14 equivalent hearing what I thought about Sydney Water's
15 proposals in terms of amelioration and some of them I was
16 fully apprised of and others I said we would have to wait
17 and see. I am pleased to be able to say that all of the
18 programs that Sydney Water put into place last time to help
19 ameliorate the price shock have worked remarkably well,
20 particularly their investment in the no interest loan scheme
21 and certainly EWON welcomes strongly its commitment
22 to further invest in that program. WaterFix and the new
23 scheme they have proposed of a plumbing service to help
24 disadvantaged people is also extremely welcome and will play
25 a substantial part in assisting disadvantaged consumers in
26 dealing with this proposed price increase.
27
28 One of the other proposals that came out of IPART's
29 last hearing was the large family rebate and again we
30 welcome some positive expressions of improvements to that
31 program, although I must say that we still have a question
32 about the most disadvantaged large families, that is, those
33 who do not own their own home. They will be severely
34 affected by the increase in costs and we would look forward
35 to engaging in further conversations with Sydney Water
36 about an extension of the large family rebate to tenants.
37 We think this is particularly critical.
38
39 Can I also touch on pensioner concessions. While I
40 know that to a large part that is something that needs to
41 be negotiated with the State Government, there are a couple
42 of points that I think need to be made in the context of
43 the tribunal hearing. And again that is that tenants
44 aren't eligible for the pensioner concession and that,
45 similar to the situation in electricity, neither are those
46 holders of a health care card, as opposed to the
47 concessions that are available in other States. And I

1 think given the quantum of change that is taking place,
2 government, Sydney Water, IPART, all need to be talking
3 with each other, if only informally, about ensuring that
4 those people that are health care cardholders are provided
5 with some protections from the increasing costs.
6
7 This is particularly true in the context of the
8 present changes that are happening to the Landlord and
9 Tenants Act or the Residential Tenancies Act which is
10 formalising the requirement for tenants to pay for water
11 consumption. It has been an informal arrangement without
12 formal structure to a large extent in the past, but that
13 process will now formalise the requirements of landlords to
14 pass appropriate documentation on to their tenants and
15 require tenants to pay for water consumption.
16
17 That will see a significant increase in the costs for
18 tenants and it is obvious I think to all of us in this room
19 that those on the lowest incomes are the least likely to be
20 home owners in this state, so that will go on.
21
22 The final points I wanted to make was that one of the
23 ways of ensuring better access for tenants to things like
24 pensioner concessions will be some consideration on the
25 part of Sydney Water to restructure the concession
26 arrangements so that that it applies to consumption rather
27 than fixed charges. That will provide a better basis to
28 negotiate with the State Government to expand the quantum
29 of money available to that scheme and pass it on to
30 tenants.
31
32 The final point I would make is that, I am sure Sydney
33 Water will be committed to this but again it is a matter of
34 getting it on the public record, that it does not matter
35 how many good programs you have, you also need to back
36 those programs up with a really adequate education program
37 in the community to make sure that all of those front line
38 services that are dealing with disadvantaged consumers are
39 aware of the programs. I know Sydney Water is doing well
40 but EWON looks forward to working with them to improve
41 that in the context of these significant price rises, thank you.
42
43 THE CHAIRMAN: Thank you. Are there other comments
44 from the floor.
45
46 MR BLATCHFORD: Rex Blatchford again. I have noted that
47 for water there is a fixed cost and a usage cost and there

1 seems to be a bit of support for reducing the fixed costs
2 as that will be offset by higher usage costs. But with the
3 sewerage charges it is only a fixed cost. Obviously with
4 sewerage there are operational costs, pumping and treatment
5 et cetera, so I really think that this pricing structure
6 meeting should think about having an operational cost for
7 sewerage. Obviously we are not going to meter it but you
8 could use the water meter, water usage charges, as a basis
9 for charging for the usage of sewerage charges. I think
10 that would be one way of reducing the fixed costs and also
11 it could have implications for the treatment of sewerage
12 for recycling. Thank you.

13
14 THE CHAIRMAN: Do you think that if we charge for usage
15 of sewerage it would make much difference to the amount of
16 usage?
17

18 MR BLATCHFORD: I would have to think about that. But in
19 looking at costs, if you use less water you are going to
20 pay less for sewerage. Apart from the garden, most of the
21 water goes down the sewerage, doesn't it?
22

23 THE CHAIRMAN: Yes. Any other comments?
24

25 DR SCHOTT: I have four things we would like to comment
26 on. I will comment on developer charges and then hand it
27 over to colleagues.
28

29 On developer charges and the extent to which desal, or
30 indeed anything else should be tagged to it, we have been
31 relatively silent about developer charges in our submission
32 because there has recently been a review of developer
33 charges and currently IPART are reviewing them.
34

35 In terms of how they do impact on growth, Sydney's
36 population tends to expand. About 70 per cent of the new
37 population is in infill areas, and the cost for Sydney
38 Water coping with those is generally relatively minor, but
39 the cost for greenfield development in the growth centres
40 and out around Rouse Hill, and so forth, is quite
41 considerable, so that developer charges tend to impact on
42 greenfield developers rather than developers who are
43 developing within the existing urban areas.
44

45 The second area we would like to comment on is the
46 tier 1 and tier 2 issue which Stuart Wilson is going to
47 have a chat about.

1
2 MR WILSON: Just to pick up on a couple of points that
3 Kerry made earlier with respect to the long run marginal
4 cost, we certainly think the tier 1 charge that rises to
5 just over \$2 in 2011-12 is consistent with long run
6 marginal cost, but, as Kerry said, the long run marginal
7 cost is a tricky concept.
8

9 With the tier 2 charge which reaches \$3, although we
10 have not presented it in the submission as consistent with
11 long run marginal cost, we have targetted it as a
12 signalling device to higher discretionary water users. As
13 Kerry mentioned, recycling projects range in price to
14 around \$4 a kilolitre, and that second tier charge is
15 certainly consistent with the costs of residential dual
16 reticulation recycling, so although we have not sought to
17 present it in that framework it is not necessarily
18 inconsistent with long run marginal costs.
19

20 To comment on tariffs for business, because we are not
21 proposing businesses pay the tier 2 charge, and the
22 question of are they getting off scot-free, when you look
23 at the water and waste water bills combined in our
24 proposal, we have a proposal to rebalance waste water
25 charges which affects the bills across business and the
26 residential sector broadly in the same way. We might cover
27 that in the later section, but in considering water charges
28 for business, you have to think about what we are also
29 suggesting for waste water charges for business.
30

31 DR SCHOTT: Finally, Colin Ridley is going to comment on
32 the 100 kilolitre threshold.
33

34 MR RIDLEY: It is always difficult to find the right place
35 to put a threshold. It is meant to affect the
36 discretionary use of water, and there will be potential
37 risks that will affect non-discretionary use, especially
38 for large households. So the 100 kilolitres per quarter is
39 based on the average consumption of a six-person household.
40 If you lowered the threshold it would capture a lot more
41 people and it would capture a fare bit of non-discretionary
42 use, especially even in medium households. So that would
43 be our concern. That is why we propose to keep the
44 threshold at 100 kilolitres per quarter.
45

46 In fact at the moment at 100 kilolitres per quarter,
47 typically each quarter there is about 12 per cent of

1 residential customers who pay the 2 tier charge. If you
2 reduce the tier to 75 kilolitres a quarter, you would net
3 about 25 per cent of residential customers, and I think
4 most people agree that is probably too high.

5
6 THE CHAIRMAN: We might move to the next issue of
7 scarcity pricing. That has been touched on already, how far
8 prices affect consumption.

9
10 MR WARNER: As the chair indicated this session is about
11 scarcity pricing. That is a notion that is put up as an
12 alternative to water restrictions, and its aim is to better
13 balance supply and demand at any point in time through the
14 pricing mechanism. Under this approach prices should be
15 able to fluctuate so that they better reflect the scarcity
16 of water.

17
18 Under the most usual approach suggested, prices would
19 vary inversely with the level of water in storage. As the
20 storage levels decline in droughts, prices would increase;
21 conversely, when the storage is full, prices will decline.
22 Having prices that move flexibly to reflect changes in
23 supply and demand in emerging scarcity will have
24 implications for price regulation. For instance, the
25 Tribunal will determine a methodology for fixing prices
26 rather than setting prices four years or even one year in
27 advance.

28
29 Another approach or variant that has been suggested is
30 that water users be given a property right in water in the
31 same way that property rights have been allocated to
32 irrigation farmers. Under this approach users can trade
33 water in a time of shortage, such as during droughts;
34 scarcity of water would mean the prices would rise, and the
35 available water would be allocated to the users.

36
37 Under another variant of scarcity pricing property
38 owners would be given a small basic entitlement, say 170
39 kilolitres per property at a lower price. Such an
40 entitlement would represent about 150 litres per person per
41 day for a three-person household. The balance of any water
42 available above these basic entitlements would be sold at
43 prices that reflect scarcity value.

44
45 The Tribunal secretariat has done a bit of modelling
46 on one such approach, and this table sets out the sorts of
47 percentage increases that would need to be achieved to

1 achieve the same outcomes as sought under the various
2 levels of water restrictions that have been imposed by
3 Sydney Water over the past few years. For each of the
4 three levels of restrictions, different price
5 elasticities have been assumed. We all know that water is
6 relatively elastic. We have assumed three elasticities of
7 minus 0.3, minus 0.17 and minus 0.13.

8
9 What is evident from that is the greater reduction
10 being sought in water consumption, the greater price rise
11 is required. The more inelastic the demand for water, the
12 greater the price increase required to achieve the desired
13 demand reduction, and the larger the basic entitlement.
14 Across the top, there's cases there where there is no
15 entitlement, one of 155 litres per capita per day, and an
16 entitlement of 220 litres per capita per day, and the
17 larger you make that entitlement, the greater the price
18 rise that is required to achieve the desired demand
19 reduction. If I move on, they are the actual prices you
20 would need coming off a current price of \$1.34 to
21 achieve those sorts of reductions. The larger the
22 entitlement, the less water there is to impact the higher
23 price, means that the price increase you are looking for
24 has to be much higher.

25
26 It has been suggested that scarcity pricing could make revenues
27 more stable. For instance, when water is scarce the price would
28 rise as a consequence, and so would the revenue. Others have
29 argued that there could be increased volatility.

30
31 Some of the questions we would like you to consider in relation
32 to scarcity pricing is: How feasible is it to use prices to balance
33 supply and demand rather than water restrictions? What are the
34 equity implications of these alternatives? Would a low priced
35 basic entitlement concept overcome concerns about low income
36 households? Under scarcity pricing what is to stop water
37 agencies deliberately deferring supply augmentations to
38 earn monopoly rents? That is to always have some sort of
39 induced scarcity. If some form of scarcity pricing were
40 introduced, how will the regulatory regime need to change?
41 What are the implications of these changes? Should the
42 price of the basic entitlement be set at the average cost
43 of the system excluding desal with these costs to be
44 recovered from the water used above the entitlement
45 threshold?

46
47 Will there be a need for scarcity pricing under an

1 orderly, planned and managed water supply system supported
2 by desalinated water? Will adopting an approach where
3 prices fluctuate according to the demand and supply
4 conditions of water lead to revenue volatility for water
5 services? How important is revenue certainty for water
6 agencies? Are there other ways of managing this increased
7 volatility?
8

9 THE CHAIRMAN: Some of the submissions suggested that
10 the price of desal water should be considered as another way
11 of dealing with excessive consumption. That is another way
12 of posing some of these questions here. A higher price above
13 a basic entitlement to reflect water scarcity.
14

15 MR MARTIN: I must confess to a degree of ambivalence on
16 the issue of scarcity pricing. While it is an interesting
17 concept, I suspect its applicability for the Sydney
18 situation is somewhat limited. It is probably most
19 applicable for run of river type supply systems where there
20 is either no storage or very limited storage, and there is
21 no capacity during periods of high flow to store water, but
22 during periods of low flow you need to be squeezing down
23 the consumption as much as possible.
24

25 It is our view that in a situation such as we have in
26 Sydney where there is a very high level of storage, that it
27 is as important to conserve water during the periods of
28 abundance as it is to conserve water during periods of
29 scarcity, in that by saving water during periods of
30 abundance you build up a greater buffer for those lean, dry
31 periods. So our view is that permanent water saving rules,
32 such as will be introduced once the current temporary
33 restrictions are lapsed, and pricing that seems to ensure
34 conservation on a constant basis is more applicable.
35 Certainly we would like to see patterns of water
36 conservation and behaviours entrenched, not just a concept
37 that people need to embrace during periods of scarcity. I
38 think its applicability in that respect is somewhat
39 limited.
40

41 The one situation where we can see it may have some
42 applicability is if the desalination plant was operated as
43 essentially an emergency drought relief measure, so
44 operated less often rather than more often. Given that the
45 additional price of water from a desal plant - you may seek
46 to increase prices during the period that the desalination
47 plant was in operation if it was operating in that manner

1 as an emergency supply. That is, I think, perhaps the only
2 circumstance in which it would be warranted. Done that way
3 it would give a signal to customers that desalination is a
4 more expensive and more damaging source of supply, and so
5 it would give them certainly a much stronger resource
6 conservation signal. But our general view is that those
7 water conservation efforts need to be done on a constant
8 basis, so the use of scarcity pricing has essentially a
9 limited contribution to make.
10

11 MR DOIG: Certainty of prices - how much and how quickly
12 will they change with the scarcity of water supply? The
13 timing issue of how these changes in prices will come in
14 will not only just affect our members but also Sydney
15 Water, I can imagine, in that you would need to be able to
16 budget and to be able to deal with such changes, if they
17 are going to be substantial, within a reasonable business
18 cycle. I know that the weather may not be that kind, but I
19 am sure that there is some sort of capacity in the system
20 there to give us a reasonable time of warning.
21

22 What happens to the extra money that is generated when
23 there is scarcity pricing? Certainly that is one way of
24 controlling that. One way to prevent the questionnaire
25 about dealing with monopoly rents, but that could be put to
26 good use in terms of drought proofing the Sydney area.
27

28 One particular application could be the next tranche,
29 instead of building a new dam, we have a desal plant, so do
30 we build another desal plant, or do we do something
31 different like mining the ocean outfalls. Maybe we will
32 have matured a little by then and we'll accept that kind of
33 water to supplement our potable water supply.
34

35 THE CHAIRMAN: To clarify, when there is scarcity pricing
36 there is not much water to sell by definition.
37

38 MR DOIG: I understand that.
39

40 THE CHAIRMAN: The presumption is that there would not
41 be a lot of extra money. It would be like a farmer who is
42 similarly affected by a drought. They have got less crop
43 to sell, but they get a higher price for the crop, so it
44 cushions the decline in volume rather than producing
45 excessive profits.
46

47 MR DOIG: That is certainly the case but it depends on

1 whether demand is reduced by 80 per cent but the price is
2 doubled. There would be monopoly rents there. It depends
3 on the quantity sold and the price. So the quantity is not
4 that much and the price increase is that much that they
5 actually may go backwards.

6
7 THE CHAIRMAN: Mr O'Neil?

8
9 MR O'NEIL: I would like to raise the point that there is
10 very serious equity issues raised by scarcity pricing. We
11 don't believe that access to the ability to enjoy water
12 should be contingent on the capacity to pay. That is
13 fundamental. I think as we keep on going down the scarcity
14 pricing, the prices signal road, that is where we are
15 heading.

16
17 Scarcity pricing already exists in Sydney, I believe.
18 We have got it in the 2 tier pricing. We have got it in a
19 desalination plant. So we are going to be paying much more
20 for the in fact we don't have much water at the moment, and
21 also through water restrictions with Sydney Water losing
22 revenue, that is a form of scarcity pricing.

23
24 Scarcity pricing really is an unacceptable passing on
25 of risk from Sydney Water or from government to consumers.
26 That is the point of damming rivers and having IPART and
27 Sydney Water, so that we can manage risk involved in
28 sourcing water, so that consumers don't have to manage that
29 risk.

30
31 I think it is important to bring up a point made by
32 one of the gentlemen sitting in the audience about the fact
33 that some people don't have meters and therefore sending
34 price signals does not work, because some people cannot
35 actually see how much they are consuming, so you are not
36 getting success through there.

37
38 I would also like to touch on a point raised by Chris from
39 EWON about education and awareness. If we are having
40 scarcity pricing, or price used as a signal, we can look at
41 the survey released by IPART and see that that is 50 per
42 cent of people who are on the tier 2 pricing didn't even
43 know they were on tier 2 pricing, and of those people only
44 about half of them actually changed their behaviour. So
45 again we need to consider, if the message gets through,
46 what more can we do.

47

1 I would also like to touch on property rights, putting
2 private profit rights into water. I think that is sending
3 the completely wrong signal about water. It is a community
4 problem. I think successful water restrictions have been
5 because it has been seen as a community obligation. I
6 think giving people a private right in water is a very
7 dangerous path, so I would be quite concerned about that.

8
9 THE CHAIRMAN: Despite our best efforts we have not got
10 any representatives from the advocates of scarcity pricing.
11 So I think perhaps in fairness to them I will try to
12 summarise some of their key points.

13
14 First of all, the typical proposition - there are
15 various advocates and they are not going to agree on all
16 the details - is it is a basic entitlement for which there
17 is no scarcity pricing, so the scarcity pricing is meant to
18 impact on what we might call, for want of a better phrase,
19 the discretionary element in consumption.

20
21 The second point is that they would claim - and they
22 purport to show this - that there is a considerable loss of
23 economic welfare in any rational system including a water
24 rationing system. That is to say that there would be some
25 people whose welfare would be augmented if they could
26 purchase water from people who would willingly sell, and
27 the people who sold would lose less than the people who
28 would gain from the purchase, and they purport to show that
29 is a significant amount of money. If people were allowed
30 to freely trade, swap their water rights, and whatever, you
31 would get a net augmentation in welfare. That is not an
32 uncommon proposition in economics and markets.

33
34 Third, they would claim that, by giving an individual
35 a property right to water, is analogous to what has
36 happened with irrigated water, and if a low income
37 household is able to make some savings, in a scarce
38 situation, below whatever they can save on their initial
39 allocation, then they in fact can augment their income from
40 a willing trade. So we can't immediately assume that this
41 is a scheme that is biased against low income households.
42 In fact, you make it a net overall improvement in welfare.
43 That is the background to it.

44
45 I think another question, which if they were here I
46 would be asking them, is whether in fact while we're
47 looking into the future there really is a scarce situation.

1 I think that goes to the point that Mr Martin raised. In a
2 situation such as Sydney, it is not like irrigated water,
3 with rivers, and so on. Here in Sydney we have, firstly,
4 catchments which are meant to tied us over, like dams that
5 are meant to tied us over, and more particularly with the
6 desal plant, and that comes to how often it is operated of
7 course, but if it is operated as was proposed by Sydney
8 Water, if it is operated in that way, are we in fact
9 looking at the future scarcity over the next decade or
10 more.

11 MR TUDEHOPE: We don't have much comment to make on
12 this subject, but in short we would support scarcity pricing
13 based on short to medium term variations in the supply
14 demand balance. Stability and predictability are important
15 for investors making significant commitments to long-lived
16 assets. In our view, the current round of investments,
17 significant investments in new sources of supply and
18 conservation is a response to a well-judged view that
19 scarcity in the long term is an issue to be resolved, and
20 so should be addressed through long term investments, and
21 should be addressed over the long term rather than the
22 short term.

23 Also I guess the sorts of transactions that you are
24 foreshadowing under this sort of arrangement where you
25 have entitlements and short term variations in price, would
26 make a paradigm shift which I should imagine would have to
27 be introduced carefully and over time, and if the proposition
28 were to be advanced it perhaps should be done as a separate
29 consultation exercise rather than to do it as part of this
30 round.

31 THE CHAIRMAN: Dr Schott?

32 DR SCHOTT: I will say something about the scarcity issue
33 generally and then hand over to Stuart. For those
34 economists in the room, you will not go to lunch
35 disappointed because there is a supply and demand graph.

36 On the issue of scarcity, in 2004 there was a real
37 danger that this city was going to not have sufficient
38 water. If you can imagine the disaster that it would cause
39 to a city to have insufficient water, it would just be
40 shocking. It was at that stage that various measures were
41 undertaken, including recycling and demand management
42 and the consideration of desalination.

1
2 If we could look at slide 15, this is to remind
3 everyone that what is happening on the recycled water
4 front. By 2015 - we have projects in place that will allow
5 11 or 12 per cent of the water supply to be replaced by
6 recycled water. The ones with the arrows there are our big
7 projects, Rouse Hill, Wollongong, Camellia and St Marys.
8 They are all built, under way, or about to be built.

9
10 The next slide shows the amount of the city that is
11 going to be getting recycled water within the next decade.
12 The purple bits are already getting it, and the turquoise
13 parts are new developments areas and particularly new
14 apartments, and the like, along Parramatta Road and into
15 the Rhodes Peninsula. A lot of the city is going to be
16 benefitting from these programs.

17
18 The next slide on the demand management front there are
19 permanent demand management measures going on. The big
20 ones are Waterfix - which is efficient shower heads and dual
21 flush toilets, and the like, which will save 4 per cent of the
22 water supply. Businesses as Andrew has mentioned
23 have done a terrific job on the EDC programs. They will be
24 saving 5 per cent and will continue to do so. Sydney Water
25 has been saving 4 per cent. All of those measures on top
26 of desal really do mean, I think, that for the next decade
27 at least and possibly longer Sydney Water doesn't have a
28 problem with the security of its water supply.

29
30 Personally, I agree with the position that Leigh was
31 taking about scarcity pricing. When you get into urban
32 water and you are talking about public health and the
33 requirement of every citizen to have water, it doesn't
34 quite make as much sense as it does more generally. If we
35 go to slide 20, so Stuart can introduce everyone to
36 economics 101 again.

37
38 MR WILSON: This is a standard supply and demand analysis
39 where we have a price for water and based on the supply and
40 demand people are consuming a quantity of water. Now,
41 under water restrictions, the quantity of water that you
42 can consume is reduced to Q1, say 10 per cent under level 1
43 restrictions. That means, as Dr Keating said, when you
44 restrict consumption you lose consumer surplus, or you lose
45 the value that people place on the water that they would
46 have consumed. It is true, as Dr Keating said, that the
47 economic argument for scarcity pricing is that water

1 restrictions do not target every activity equally. You may
2 not minimise the loss in consumer surplus to that little
3 triangle that we are showing there. So the economic
4 argument is that we can raise the price to where that Q2
5 line cuts the red demand curve, and we can achieve a given
6 reduction in the quantity demanded more efficiently, and that
7 is shown with a rise in price from P1 to P2.
8
9 However, the difference between water restrictions and
10 price is this green box which is transfers. It is really
11 the transfers that we are focussing on. With under water
12 restrictions, you don't get to use the water but you don't
13 have to pay more for the reduced quantity.
14
15 Under scarcity pricing there is a transfer from
16 consumers to the water agency, or to the government if it
17 is done as a tax. Pure economics does not worry about
18 transfers, because they don't involve efficiency
19 consequences, but everybody in this room is concerned about
20 transfers. Much of the discussion around this table has
21 been how would you manage that, and what would you do
22 about that.
23
24 So that leads to a suggestion that you need a free
25 entitlement, and that is one way. By removing some of the
26 water out of the equation you have to put up prices even
27 further on the remainder to get a given reduction in
28 quantity.
29
30 As I think PIAC pointed out, we agree water is a
31 highly inelastic commodity, and IPART's analysis is
32 similar - elasticities are around 0.1, but we really don't
33 know what they are for certain. So that means that you
34 have to have a higher price rise to get a given reduction
35 in quantity, so the amount you are transferring into Sydney
36 Water is big. The sort of price rises, we think, would be
37 much larger than what is contained in our submission. We
38 have not taken a stand as IPART has in quantifying that,
39 but they would be significantly bigger so the implications
40 for equity and consumers would similarly have to be handled
41 very carefully.
42
43 DR SCHOTT: Just to conclude, the volatility and revenue
44 that scarcity pricing would introduce also makes it quite
45 difficult when you are a utility that is basically a fairly
46 steady as she goes sort of business. That would add to the
47 arguments about our rate of return going up, and so forth.

1 For what it is worth, they are our views on scarcity
2 pricing, thank you.
3
4 THE CHAIRMAN: Thanks. Are there comments from the
5 floor? In that case, I think we might talk a pause and have some
6 lunch.
7
8 DR SCHOTT: Before we break, in the last comment the
9 representative from EWON spoke about tenant rebates, and
10 the difficulty that we have got with low income households
11 who are often tenants and where the landlord is paying the
12 bill and then just directly passing it on to those. With
13 the new arrangements between landlords and tenants, Sydney
14 Water is very happy to have a look to see what we can do
15 about getting some sort of concession in place for tenants
16 under that arrangement.
17
18 Earlier there was a comment on metering for
19 apartments. We are trialling metering in apartments
20 currently both smart meters and dumb meters. It is quite
21 difficult in old buildings because they are not piped for
22 metering, but where it is possible in the future, I don't
23 doubt we will be moving in that direction, but it is going
24 to take some time.
25
26 THE CHAIRMAN: Thank you very much for that.
27
28 LUNCHEON ADJOURNMENT
29
30 UPON RESUMPTION:
31
32 THE CHAIRMAN: We might make a start again. Thanks for
33 being back on time. The next topic is sewerage charges,
34 which seems to have got rather less attention than water
35 has in recent years, but it was raised earlier in the day,
36 so it is over to Nigel.
37
38 MR RAJARATNAM: We have two sessions this afternoon,
39 one is on sewerage use and trade waste charges, and then after
40 that on miscellaneous charges.
41
42 Session 4 is on sewerage and trade waste charges.
43 IPART currently sets these charges for Sydney Water. In
44 its submission Sydney Water has not proposed any changes to
45 the structure of trade waste charges, although they have
46 asked to maintain it in real terms up to 2012.
47

1 In relation to sewerage charges, currently residential
2 properties pay a fixed charge for sewerage services, while
3 non-residential properties also have a sewerage usage
4 charge which depends on the level of discharge, so if it's
5 above 500 kilolitres a year the sewerage usage charge
6 applies. And this is the area where Sydney Water has
7 proposed some changes. It is not proposing to change
8 significantly the residential element of it but for the
9 non-residential element there are a number of changes.
10
11 This is highlighted in the table here. There a couple
12 of elements to this table. One is an increased emphasis on
13 the usage component of the charge, so if you look at the
14 row down the bottom, in the first year it increases by 11.9
15 per cent compared to a 6.6 per cent increase in the fixed
16 component. The second element of the change is to the
17 threshold. Currently the 500 kilolitres applies for
18 non-residential customers and Sydney Water is proposing to
19 reduce that to 400 kilolitres from 1 July 2008 and to 300
20 kilolitres per annum from 1 July 2011.
21
22 Sydney Water has rationalised these movements on the
23 basis of a recent ACCC arbitration on access to Sydney
24 Water's sewer network. In particular Sydney Water has
25 found that for non-residential properties with a sewerage
26 charge close to 500 Kilolitres a year, allocated sewerage
27 treatment and disposal costs in some of these networks can
28 exceed the fixed charge for the property, although little
29 evidence has been provided in the submission to support
30 that.
31
32 If we look at this table this illustrates the combined
33 effect of both the price increases proposed as well as the
34 changes to the discharge levels. So both those effects
35 magnify the impact on non-residential users.
36
37 For example, if you look at the 500 kilolitre
38 discharge level, that is the level that non-residential
39 customers are charged for 500 kilolitres. Currently they
40 would experience a 42.3 per cent increase in the charge, in
41 their sewerage usage bill, in 2008/09 but by 2011/12
42 it goes up compared to the present level, by 98.3 per cent,
43 so the combined effect of the price increases as well as
44 the changes to the threshold have a significant impact on
45 some customers.
46
47 So some of the questions that we are posing today are:

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1 Will Sydney Water's proposal unfairly impact some
2 customers, particularly small businesses; how cost
3 reflective will the new charges be if allocated costs in
4 only some of the networks can exceed fixed costs per
5 property and does the same apply for residential
6 properties; has Sydney Water built a good enough case to
7 justify a movement in the sewerage usage charging threshold
8 of 500 kilolitres; what are the implications for businesses
9 of the sewerage usage price increases and the threshold
10 changes proposed; what consultations have taken place with
11 business; and should the tribunal increase trade waste
12 charges at all given the lack of justification even for a
13 CPI increase?
14

15 Those are the questions that we pose to you and I hand
16 it over to the Chairman.
17

18 THE CHAIRMAN: Thank you, Nigel. I think we will start
19 with Sydney Water because some of the questions are very
20 much directed to Sydney Water. I am particularly concerned
21 to better understand the justification in terms of costs,
22 how that relates to the proposed prices.
23

24 DR SCHOTT: Thank you. The essential thing that we have
25 been doing with these proposed changes is more directly
26 aligning our charges with the costs of the service provided and
27 this is particularly important as we are heading into a world
28 where the private sector will be seeking access to some of our
29 sewerage customers and wanting to move effluent
30 through our network to their recycled water or treatment
31 plants, so it is very important for us that what we are
32 charging reflects our costs or we can find ourselves having
33 customers taken away who will get all sorts of distortions
34 arising if we don't have costs and prices aligned properly.
35

36 Over the next four years Sydney Water will spend over
37 \$1.6 billion in wastewater capital and waste water prices
38 do need to rise to cover that investment. For residential
39 customers, the increase is less than for water because the
40 costs are rising less. For business, the reason we are
41 reducing the usage threshold from 500 to 400 and then
42 finally to 300 is to better align revenue with costs.
43

44 At present the residential sector makes a
45 proportionately bigger contribution to cost than business
46 and the business sector accounts for 26 per cent of
47 effluent but less than 20 per cent of revenue, and it is

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1 that difference that we are trying to correct by gradually
2 lowering that threshold.
3
4 Business users will face increases in combined water
5 and wastewater charges comparable to those of residential
6 customers, but for business the increase is larger in waste
7 water.
8
9 We propose to maintain trade waste charges in real
10 terms, just increasing at CPI, and the principal reason
11 that we are not seeking larger charges is that our
12 principal operating costs with trade waste are linked to
13 CPI, it is largely labour, and we also don't want to
14 encourage illegal dumping and we are recognising that many
15 businesses have on-site treatment costs before they are
16 permitted to discharge into the sewer network.
17
18 So that is the general broad reasoning behind it. I
19 will pass over to Stuart to provide a little bit more
20 detail about a couple of those price rises.
21
22 MR WILSON: As Kerry said, the headline figure is driving
23 the change. Non-residential users account for 26 per cent
24 of the flows in the system yet only about 19 per cent of
25 the revenue. We do not see necessarily a policy reason why
26 you would want the residential sector to carry more of the
27 cost in this case and, as Kerry mentioned, when we got into
28 access modelling and looking at the cost of each of our
29 networks we found that most of the shortfall was in the
30 range of 300 to 500 kilolitres of discharge, so within the
31 non-residential sector, the threshold being at 500
32 kilolitres, that is accounting for the majority of that
33 revenue shortfall. We are not calling it a cross-subsidy
34 but it is definitely the case that business is making a
35 lesser contribution to fixed costs than the residential
36 sector.
37
38 With the question, if allocated costs in only some
39 networks can exceed the fixed cost, with our access
40 modelling we found that even on our low-cost networks for
41 many small business customers in the 300 to 500 kilolitre
42 range their revenue is less than their calculated cost
43 based on their flows, so that across all networks, let
44 along on the high-cost networks, even on the low-cost
45 networks we are not currently covering our costs. So that
46 underpins why we think rebalancing charges is desirable.
47

1 MR COX: I think it might be useful if you could share the
2 details of your modelling with us on that. I am not sure I
3 fully understand the 300 versus the 500 and what difference
4 it makes.
5
6 MR WILSON: We are happy to provide that. I think we have
7 even provided some of our cost models as part of the
8 ongoing interaction. But at the moment for residential
9 customers, they might discharge something like 150 to 200
10 kilolitres into the wastewater system and have a flat \$400
11 charge, whereas a business customer could discharge two to
12 three times that at least and still have the same charge
13 and that is because the usage charge does not come in until
14 you exceed 500 Kilolitres, which is a fairly high
15 threshold.
16
17 MR COX: Lowering the threshold has also has an effect
18 further up the range as well because you lower the
19 threshold cap.
20
21 MR WILSON: Yes, it will flow up the range as well. But
22 with major business customers, they exceed that, they are
23 in the thousands and thousands of kilolitres discharge, so
24 it is a small impact on them, or relatively smaller impact
25 on them, than on the customers at the lower end.
26
27 THE CHAIRMAN: Andrew, did you want to comment. It
28 affects your interests, I guess.
29
30 MR DOIG: Thank you very much. As Sydney Water
31 mentioned, the impact really does tend to impact on the
32 smaller scale of businesses. Perhaps we are not the
33 appropriate industry body there. You might be actually
34 looking at someone who represents the caterers and
35 restaurateurs and people of that nature because they are
36 probably the ones that will be largely impacted.
37
38 In terms of some of the arguments there, 26 per cent
39 of the flow versus 19 per cent of the revenue, that may be
40 the case. I suppose, though, there will be some economies
41 of scale built into that, whereas the larger customers will
42 have one bill where you might be dealing with thousands of
43 smaller ones in terms of the residential side, so it is not
44 a bad comparison but it is not exactly 100 per cent aligned
45 on that.
46
47 Certainly some of the other issues that have come out,

1 with trade waste, probably they are not that effective with
2 these changes in prices for the sewerage usage or
3 thresholds for sewer usage charge, they probably more
4 reflect the actual cost of the post treatment processes
5 associated with discharge into sewer. In other words, the
6 liquid waste that currently go to sewer have been
7 undergoing substantial cost increases over the last two
8 years. This is due to a rationalisation in the liquid
9 waste treatment market, being I suppose the intensive
10 competition that was there up until about 2004/05 has now
11 ended, one of the parties selling their treatment services
12 to another organisation. That has resulted in increases,
13 our members say, anything from twofold to sevenfold in
14 their liquid waste discharges.

15
16 On top of that, we recently had the liquid waste levy
17 applied to these types of wastes as well, another \$38.60 a
18 tonne, which is going up to about \$65 a tonne by 2010.
19 While this is probably a side path associated with dealing
20 with trade waste issues, it certainly is linked into it
21 from a customer perspective and it is certainly concerning
22 to our members that these prices are so high and reflect in
23 some of the comments it will encourage illegal dumping
24 because Sydney Water sewers is one of the easiest ways to
25 hide it, unfortunately illegally, and something I hate to
26 say.

27
28 MR O'NEILL: I don't know how much I can really add to the
29 debate. But one thing I would like to bring up is if
30 non-residential contributions are going to increase, does
31 that mean residential contributions will decrease? Okay.

32
33 There are a number of pretty interesting questions
34 here and I guess what I would ask is whether or not the
35 tribunal has been satisfied with the answers? In
36 particular my only concern would be about consultation with
37 business. If it is going to affect small business quite
38 significantly then I think there needs to be some more
39 consultation than what is happening currently.

40
41 DR SCHOTT: Can I just make a comment on the consultation.
42 I met with our commercial and industrial customer forum and
43 that includes both peak bodies and also some specific
44 businesses. There has been a level of consultation with
45 those groups much the same as there was with PIAC and
46 others on other matters, so it is fair to say that nobody
47 is happy about prices going up but they understand why we

1 have asked for it.

2
3 THE CHAIRMAN: Thank you. I would like to welcome the
4 representatives from the Waste Contractors and Recyclers
5 Association. I am sorry we got ahead of time. It is not
6 an apology I normally have to make. But, as you are
7 probably aware, if you allow for the fact that Sydney Water
8 is proposing to reduce the thresholds from 500 down to 300,
9 this will involve some very substantial increases in prices
10 for small businesses and I would like to give you the
11 opportunity now to comment more generally.

12
13 MR KHOURY: Thank you. If you combined that reduction in
14 threshold from 500 to 300, I presume that is contaminants
15 that you are referring to?

16
17 MR WARNER: The discharge.

18
19 MR KHOURY: If you combine that with the fact that the New
20 South Wales Department of Environment and Conservation
21 has recently introduced a tax of \$38.60 per tonne on the
22 discharge of industrial waters to trade waste and small
23 business, and in fact all business, will be even more
24 affected by these reductions in threshold. We would be
25 concerned if that reduction in threshold was to go through.

26
27 THE CHAIRMAN: I think their logic, and it is a fairly
28 powerful logic, is that this produces a better alignment of
29 costs with revenue for each customer type. In effect the
30 revenue from businesses in this area of 300 to 500 are not
31 presently covering cost recovery from and that will
32 particularly, if there is a more competitive water market,
33 which is the aim of government policy, that could lead to
34 significant inefficiencies if costs and prices are not
35 better aligned.

36
37 MR BRANDSTATER: I would like to know where the
38 relationship is between two government bodies like the EPA
39 and the Water Board and whether there is any communication
40 going on between them because for them to come forward and
41 virtually straight away impose a levy on all waste coming
42 in and it has to be treated, which obviously then has to go
43 to the sewer, and now you people come through and say,
44 hang on, there will be another 20 per cent increase, how is
45 business supposed to cope with that? We have had a big
46 jump in costs from one, with a lot of customers already
47 being very much affected as far as we are concerned with

1 regards to this costing from the EPA, and now if we have to
2 go and throw on another cost of another 20 per cent, where
3 will that leave a lot of small businesses?

4
5 THE CHAIRMAN: We note your comments.

6
7 MR BRANDSTATER: That is a cost that has to be borne by
8 them but it is also a cost being borne by some of the
9 people certainly within our industry too.

10
11 THE CHAIRMAN: In terms of our terms of reference, at the
12 end of the day we have to pay considerable attention to
13 aligning prices with costs and cost recovery and we could
14 probably get some more detailed evidence from Sydney
15 Water, we will pursue that, but their proposition is that the
16 present price structure in effect does not produce that
17 alignment of costs and prices.

18
19 MR KHOURY: We would urge you to communicate with the
20 NSW Department of Environmental Climate Change in
21 relation to this matter before you proceed too much further
22 because it will affect all business, not just small business, and
23 we make the same comment to you that we made to them,
24 that the harder we make it for business then you will increase
25 the likelihood of probable illegal disposal and businesses
26 moving out of the state.

27
28 MR BRANDSTATER: This is like a two-edged sword, we
29 missed the part this morning obviously on water, obviously
30 there is a big cost on the desalination plant, and there is a
31 question about whether it should go ahead anyway but we are
32 lumbered with it, and now basically there seems to be
33 another flow-on cost as far as treatment facilities go.
34 Yet the EPA is basically urging everybody to put in their
35 own treatment facilities. But ultimately they all end up
36 discharging water through to Sydney Water.

37
38 MR DOIG: One of the outcomes of the levy and the high
39 prices of liquid waste is that there is more of an
40 incentive now for companies to dilute their waste stream so
41 it does not meet the sewer concentration limits and as a
42 consequence of that there is a perverse water conservation
43 message, so that is certainly one area that needs to be
44 taken into account when you are looking at liquid waste as
45 being a completely separate entity. It seems to be the
46 approach that the government is taking, rather than
47 actually intertwining it with the whole wastewater services

1 sector.

2
3 THE CHAIRMAN: I am not sure we can take it a lot further
4 here so we might move to the last topic in that case, which
5 is miscellaneous charges.

6
7 MR RAJARATNAM: IPART sets maximum prices for a range
8 of miscellaneous services that Sydney Water provides. Sydney
9 Water's submission is that they have not proposed any
10 increases to the price, they are proposing that it be
11 maintained in real terms over the next determination
12 period. But they have introduced two new charges, sorry,
13 they are proposing to introduce two new charges. One of
14 these is a late payment fee of \$5 on accounts that remain
15 unpaid 4 days after due date. Currently I understand
16 customers have 14 days to pay from the due date. Sydney
17 Water maintains that 53 per cent of customers fail to pay
18 their accounts by the due date and it was obliged to send
19 out about 1.3 million reminder notices at a cost of
20 \$650,000.

21
22 This cost is currently built into the general
23 operating expenditures, which the tribunal grants in the
24 revenue requirement.

25
26 Sydney Water is also proposing to introduce a credit
27 card fee to directly recover the merchant fees rather than
28 recovering these through existing charges. Sydney Water
29 proposes that the credit card processing fee be set at the
30 weighted average merchant fee rate, which is currently
31 about 0.8 per cent.

32
33 We bear in mind it wasn't that long ago that Sydney
34 Water introduced payment by credit card, and at that time
35 that mode of payment was expected to save on administration
36 costs. Since then there has been a growth in the use of
37 credit card and other remote payment options, which is also
38 one of the reasons I understand Sydney Water wound back its
39 customer service in this area.

40
41 A few questions: Has Sydney Water explored with
42 customers the reasons why so many fail to pay accounts on
43 time? Given the number who pay late, 53 per cent, does
44 this imply that Sydney Water's payment terms are already
45 too onerous? Is four days beyond the due date a reasonable
46 time to wait before or imposing a late payment fee? Is a
47 late payment fee of \$5 reasonable and what are the

1 implications for low income customers? If Sydney Water is
2 already reimbursed for the cost the credit card merchant
3 fees through its IPART sanctioned annual revenue, what is
4 the value in imposing a credit card fee? Finally, isn't
5 access to credit and the ability to pay by credit card
6 likely to be one of the factors which reduces the risk of
7 late payments and therefore the additional costs Sydney
8 Water would incur?

9
10 THE CHAIRMAN: We might start with Sydney Water.

11
12 DR SCHOTT: On the issue of the late payment fee, can I
13 make it clear that it doesn't apply to 210,000 pensioners.
14 It doesn't apply to any cost customer who has contacted
15 Sydney Water to arrange to defer payment or to pay by
16 instalments. It doesn't apply to any customer on CentrePay
17 or anyone who has used payment assistance vouchers in a
18 previous period or customers who are currently in dispute
19 either directly with Sydney Water or via EWON. Frontline
20 staff are empowered to waive the late payment fee in
21 circumstances of financial difficulty. Amongst utilities,
22 Sydney Water allows the longest time to pay, 21 days, of
23 any utility, and what we are allowing is an extra four days
24 grace.

25
26 What late payment does to us is it causes the
27 behaviour of some to be a further cost to all. We spend
28 about \$600,000 chasing people, and it costs us about
29 \$900,000 a year in money coming in late. So all up, late
30 payments are costing us about \$1.5 million, which is being
31 shared by all our customers because some people pay late.

32
33 The late payment fee is \$5. It is not large.
34 Comparable utilities have late payment fees that are
35 considerably higher. Energy Australia's is \$5, but all the
36 telcos are higher, and AGL's is \$11. The basic driver is
37 to encourage everyone to pay their bills on time. We don't
38 have it. We are one of the few utilities that don't, so we
39 are the last cab off the rank in terms of payment.

40
41 We did look at why people might be paying their bills
42 late. We looked at three possible reasons - billing
43 errors, customers experiencing hardship, and just people
44 neglecting to pay on time. Our analysis indicated that
45 account charges and billing complaints made up only a small
46 number, 0.5 per cent, of total customers. Financial
47 hardship was also a very low amount, and the 53 per cent

1 were people who are not paying attention to what they
2 should be doing.

3
4 One of the things that Sydney Water does not do is
5 turn people's water off, unlike other utilities who are
6 delivering an essential service. We can in extreme cases
7 lower pressure, which we do from time to time, but there
8 really is no penalty for late payment which is then carried
9 by the rest of our customer base.

10
11 On the credit card fee, during the 2005-06 financial
12 year about 27 per cent of bill payments were made by credit
13 card which cost us about \$2.5 million in merchant fees.
14 The basis for introducing the credit card fee is cost
15 efficiency rather than revenue generation. If IPART were
16 to approve this request, the revenue from this fee reduces
17 the revenue required from other sources by that quantum.
18 Merchant service fees would be recovered by applying the
19 average weighted merchant fee rate, 0.8 per cent, instead
20 of through overall charges as has been noted. The 0.8 per
21 cent is less than that applies by again most other
22 utilities.

23
24 The current \$1,000 limit on credit card payments can
25 be removed for customers who wish to use their credit card
26 and that simplifies the administration of large business
27 accounts. Customer service staff have the discretion to
28 waive the fee when negotiating payment terms.

29
30 There are six other payment channels at Sydney Water.
31 People can pay their bills through 500 post offices, 700
32 newsagents, direct debit from bank account or CentreLink
33 payment, by mail, over the Internet, through bPay, for
34 example, and by telephone. Customers would be advised of
35 the fee on the bill and reminded at the time of making a
36 credit card payment, but I would stress that they do have
37 other ways of paying their bills.

38
39 Sydney Water has recently over the years closed down
40 its direct customer centres. Most people do not wish to
41 pay their bills in that manner. We have two remaining
42 customer centres open. One is at head office in Bathurst
43 Street, which will close when we move to Parramatta in
44 2009, and one in the Illawarra which will close when we
45 relocate our operations there to another site, or if that
46 takes time, sometime in the next six months or so. Those
47 offices are not important bill paying centres; they are

1 largely used for other purposes. We will still meet those
2 customers who are largely looking for plumbing services,
3 and other matters.

4

5 I think they are really the main comments we want to
6 make on these matters. They are not major matters. They
7 really in the form of housekeeping matters.

8

9 THE CHAIRMAN: Yes, I guess we might take a similar view
10 and say why wouldn't you absorb it? You did suggest that
11 the credit card fee would come off the total revenue
12 requirement. I take it that would be equally true of the
13 late payment fee?

14

15 DR SCHOTT: Yes, quite.

16

17 THE CHAIRMAN: Because I think the secretariat, Nigel, in
18 his remarks suggested this was already built into
19 allowances for operating expenditures, and so on.

20

21 DR SCHOTT: Yes, it is a cost efficiency measure.

22

23 THE CHAIRMAN: From our point of view, you are getting
24 covered for this anyway. Presumably the advantage, from
25 your point of view, is that by separately identifying and
26 putting a separate charge on for it, that will change
27 behaviour.

28

29 DR SCHOTT: Yes, it means that somebody who chooses to
30 pay through bPAY or some other method is not cross-subsidising
31 someone who is paying by a credit card, which is the way it
32 is happening at the moment.

33

34 MR O'NEILL: I appreciate the way that Sydney Water is
35 proposing the late fee in terms of excluding certain
36 people. I think that is quite appropriate. But we have
37 concerns about the success you will have in implementing
38 the fee. We are quite concerned that it won't change the
39 behaviour the way you want it to, and that it will just be
40 a penalty rather than an incentive. If you are going to
41 introduce a penalty, we think you should also introduce an
42 incentive. That is probably something the Tribunal should
43 explore. If you are going to permit a \$5 late fee, then
44 you should introduce a \$5 reduction for early payment. I
45 mean that seriously. You may have more success in getting
46 your customers to pay on time.

47

1 I would like to question whether a \$5 fee is
2 appropriate considering the costs. Can I suggest it is a
3 bit of gouging. If it is 50 cents for the cost of putting
4 out a reminder notice, then \$5 is 10 times the cost of
5 reminding people. We are concerned about the four days
6 that you would give for a late fee. We appreciate that you
7 already give three weeks to pay, but four days on top of
8 that is probably not appropriate, because people often miss
9 their mail or don't have access to it. I think there is
10 probably more clever ways of doing that. Perhaps instead
11 of waiting 21 days, you could wait two weeks, and then give
12 a late notice, or fee. Give people more notice.

13

14 PIAC doesn't think there is any strength in Sydney
15 Water's argument that they are the only utility that don't
16 already have the fee. You can't compare Sydney Water to
17 the electricity industry because Sydney Water remains a
18 monopoly. Because of competition in the electricity
19 industry, consumers who may have a tendency to pay late, if
20 they don't want to pay a late fee, to go to a company that
21 doesn't charge them a late fee. Consumers don't have that
22 option in the water industry.

23

24 I would also like to highlight that \$5 might not sound
25 like a lot of money, but on top of the price increases that
26 we have already discussed today, very significant price
27 increases, there is going to be a lot of consumers who are
28 going to struggle paying their accounts and finding ways to
29 come up with the money on time. So we really do not think
30 it is appropriate that on top of very large price increases
31 that you should put a \$5 fee on top of that. At the very
32 least we would want the fee to be postponed or delayed for
33 a few years before implementing it, so that when consumers
34 are hit with a price shock they are not also going to be
35 hit with a \$5 fee.

36

37 The Chairman has already touched on reducing the cost
38 of the \$650,000 you say that it costs removing that from
39 the price determination. However, I am still a little
40 confused over whether or not the revenue raised from the \$5
41 would be considered revenue, or would that be something
42 that the Tribunal would put in as part of their overheads?
43 I would like clarification on that. I think I would really
44 like to reinforce that Sydney Water should consider
45 alternative ways to get people to start paying their bills
46 on time. We have seen it in every other industry. Late
47 payment fees are a stick; they are not a carrot. You need

1 some kind of carrot to get people to pay on time. If you
2 want to change behaviour, a fee is not going to do that.

3
4 MR KHOURY: We believe that Sydney Water and the
5 Department of the Environment, because of climate change,
6 should get their heads together on the levy. The department is
7 charging that levy independently of Sydney Water, and it is
8 in fact a tax on the discharge to the sewer.

9
10 MR BRANDSTATER: It is a double whammy. You are going
11 to charge us more for water used in the waste industry where
12 it is used a great deal. You will charge a lot more for
13 our water and a lot more for our waste. It is a tax on a
14 tax. It is like a double whammy.

15
16 DR SCHOTT: I have had some more information on this
17 matter. The department has introduced a levy on companies
18 wanting to discharge liquid waste in specific treatment
19 depots run by private enterprise. Sydney Water was not
20 aware that that charge was coming. Secondly, the
21 cumulative impact with our charges is therefore a matter to
22 be considered. While the tax on the discharge to private
23 enterprise treatment depots is occurring, those same depots
24 then discharge into our network, so the point that the
25 gentlemen are making is correct. It is like an indirect
26 charge. It may encourage illegal dumping into our sewer
27 which we absolutely do not want to have happening. We will
28 get more information from the department and follow up on
29 this.

30
31 I must make it clear to everyone here that what is
32 discharged into our sewer network is of huge interest to
33 Sydney Water. If we get the incorrect mix of discharges,
34 or highly corrosive discharges, it causes us enormous cost.
35 We have seen discharge that eats concrete, and it does
36 cause us considerable expense.

37
38 MR COX: So you will come back to us on this issue?

39
40 DR SCHOTT: Yes, we will speak to the EPA and come back
41 to you on the matter.

42
43 MR KHOURY: If I could make a comment on that. This levy
44 will encourage the decentralisation of discharges across
45 the whole of the Sydney area. Whereas in the past the
46 philosophy of Sydney Water was to encourage industrial
47 liquid waste to go to centralised treatment facilities,

1 this tax will only apply on the discharges from commercial
2 liquid waste treatment facilities. This tax will not be
3 imposed upon generators who have their own on-site
4 treatment facilities, so it will make your job of
5 monitoring that much harder.

6
7 THE CHAIRMAN: Are there any comments from the floor?

8
9 MR DODDS: I would like to congratulate Sydney Water in
10 terms of their treatment of recipients of PAS. I think the
11 system they are proposing, if someone has received a
12 voucher in the previous billing period then they don't get
13 a late payment fee, is an excellent resolution to the
14 problem that we reported to IPART with the exemption of
15 recipients of EAPA from late payment fee, and the
16 systematic problems in the billing system with the energy
17 companies.

18
19 I would endorse what PIAC has said. Through personal
20 experience with working with Telstra on their credit
21 management working party, I watched the late payment fee
22 go from \$5 to \$7 to \$9 to \$11 as its initial impact worked for
23 a while but then fell away, so it just kept getting put up.
24 I agree very strongly that a late payment fee without an
25 incentive scheme alongside will not achieve the desired
26 outcome.

27
28 The other point I would make is that in terms of the
29 statement that our front office staff will have discretion
30 to waive, one of the difficulties is the adequate level of
31 training in identifying hardship and also customers
32 willingness to disclose hardship. It is a very humbling
33 thing for someone to have to talk to a complete stranger
34 about their inability to pay the bills when everyone around
35 them can pay. Certainly I think that some sort of process
36 in the billing system that flags a series of late payments,
37 so that there is some tip-off to staff to be a bit
38 sensitive in dealing with customers may be of use.

39
40 The final point I will make is a rhetorical question
41 to Sydney Water, but just to get it on record. In our
42 discussions around energy, one of the issues we raised was
43 that Sydney Water didn't charge late payment fees,
44 et cetera. The issue that Sydney Water can charge interest
45 on arrears is one of the peculiarities of water. That is
46 not allowed to happen with energy. As to the introduction
47 of late payment fees, I know from informal discussions with

1 Sydney Water, that they have indicated that interest will
2 not be charged on accounts in arrears where there is a late
3 payment fee being charged. I just wanted that on the
4 record.

5
6 THE CHAIRMAN: Any other comments? In that case I will
7 try to bring the proceedings to a close. I will not try to
8 sum up everything that has been said today, but I think I
9 should draw out some of the points that have been aired in
10 our discussions today.

11
12 Regarding the revenue requirement, which is perhaps
13 the most central issue, I think there is general acceptance
14 and agreement that Sydney Water does have to cover its
15 costs with a rate of return. There is clearly a concern
16 about the front loading that is proposed, and we will want
17 to pursue further analysis - I am not saying reach a
18 conclusion. We may accept the proposal as it currently is
19 but we will want to analyse closely the possibility of
20 smoothing, and we look forward to getting further
21 information from Sydney Water on the modelling that is done
22 in that connection.

23
24 There was some discussion on rate of return in terms
25 of potential volatility of profits and how that should be
26 allowed for in relation to rate of return, particularly in
27 the context of energy prices being more variable in the
28 future and the production of water being more energy
29 intensive. I think that point is well taken.

30
31 Equally - and this has not come up but I will insert
32 it anyway - if as proposed the desal plant ran 70 or 80 per
33 cent of the time, my expectation is that revenue would be
34 more stable than it has been in the past, and that might be
35 some offset to the increased variability of costs. Costs
36 may be more variable, but revenue may be more stable.

37
38 The issue flagged on behalf of the environmentalists,
39 who are no longer here, was whether we should build in an
40 assumption of 70 or 80 operation of the plant or something
41 considerably less. I think they made the point that if you
42 are going to have big dams and store water, do you need to
43 keep them so full for so long, and perhaps that is an issue
44 we need to think more about, particularly in terms of the
45 pricing implications.

46
47 My sense is that, with the exception of PIAC who are

1 sceptical about inclining block tariffs, there was general
2 support for inclining block tariffs, and at present
3 inclining block tariffs only affects a very small
4 proportion of customers. I think the figure was 11 or
5 12 per cent - something of that order.

6
7 Sydney Water has suggested if you lower the threshold,
8 as was supported by the environmentalists, that could
9 become more controversial. I think there is an argument
10 about do you need an inclining block tariff if water is not
11 scarce? The world that was sketched out for us with the
12 desal plant running at 70 or 80 per cent at a time is that
13 water will not be scarce over the next decade or perhaps a bit
14 longer. Of course if the desal plant didn't run as long,
15 then water could be scarcer. It is that balance that we
16 want to think about.

17
18 No-one has disagreed with the proposition that the
19 volume charged should approximate the long run marginal
20 cost. At least Alinta thought that the proposal in front
21 of the Tribunal was consistent with achieving a long run
22 marginal cost.

23
24 There was some discussion about developer charges, but
25 I think the consensus, with the possibly exception of
26 pensioners, was that this charge should not be loaded
27 through developer charges, and if it affects developer
28 charges it might effect them at the margin, but it would be
29 at the margin. Developer charges should not bear the main
30 cost of introducing the desal plant. I think the
31 pensioners accepted that.

32
33 There is clearly a concern that there should be
34 rebates, given the very substantial nature of the price
35 increases. There was a suggestion from the floor from that
36 the rebates should be extended to help tenants. At the end
37 of the day that is not our decision, but in the past we
38 have made recommendations to governments about coverage
39 of rebates, substantive rebates, and so on, and I think they
40 have had some influence, so we will give attention to those
41 sorts of suggestions, about how far we can ameliorate the
42 impact on low income households.

43
44 Scarcity pricing I have already touched on. I suppose
45 my sense of our discussion on scarcity pricing is that,
46 while the main advocates were not present, I think for the
47 people here it is pretty much dead in the water.

1
2 Sewerage charges - I think the main take on that is
3 that Sydney Water recognises that there is a cumulative
4 impact of charges that need to be considered, and they will
5 get more information on that and follow it up. I
6 appreciate you want to hear an outcome.
7

8 In terms of miscellaneous charges, my sense of that is
9 that Sydney Water, first of all, is not going to put credit
10 card payment charges on what I will call vulnerable groups,
11 and they are taking a lot of care to ensure they don't do
12 that, that they see credit card charges and late payments
13 for the rest of us as important in terms of trying to
14 change behaviour, and they accept there should be some
15 offset - if we go down this route, there would be some
16 offset consistent with matching the total revenue offset.
17

18 Thank you for your participation today. As I
19 mentioned at the outset, our main purpose today was to get
20 clarification in areas where there seemed to be divided
21 opinions, in order to test those divided opinions. Other
22 areas which might be particularly important, but for want
23 of a better phrase I will say they were submissions on,
24 were more technical, and we will take them up separately
25 through our processes, such as efficiency, prudence. We
26 are getting expert advice on that. We do appreciate the
27 effort people have put into making submissions and in being
28 here today. I think I can say with considerable confidence
29 that it has helped us enormously. Thank you very much.
30 This hearing is closed.

31
32 AT 2.15PM THE HEARING WAS ADJOURNED
ACCORDINGLY

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