

Submission to Consultation Paper on Introducing a dynamic and competitive metropolitan water industry

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Introduction

The Public Interest Advocacy Centre (PIAC) seeks to promote a just and democratic society by making strategic interventions on public interest issues.

PIAC is an independent, non-profit law and policy organisation that identifies public interest issues and works co-operatively with other organisations to advocate for individuals and groups affected.

In making strategic interventions on public interest issues PIAC seeks to:

- expose unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate;
- promote the development of law—both statutory and common—that reflects the public interest; and
- develop community organisations to pursue the interests of the communities they represent.

Established in July 1982 as an initiative of the Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only, broadly-based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Centre Funding Program. PIAC generates approximately forty per cent of its income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Utility Consumers Advocacy Program

The Utility Consumers' Advocacy Program (UCAP) was funded in 1998 by the NSW Government to develop policy and advocate in the interests of residential consumers, particularly low-income consumers, in the NSW energy and water industries. The project is based at PIAC and UCAP staff receive broad policy direction from a community based Reference Group. This includes representatives from the following organisations/population groups:

- Council of Social Service of NSW (NCOSS)
- Combined Pensioners and Superannuants Association of NSW (CPSA)
- Tenants Union of NSW
- Park and Village Service (PAVS)
- Rural and remote consumers
- Indigenous consumers
- Institute of Sustainable Futures, University of Technology, Sydney.

This submission to the Metropolitan Water Directorate is supported by these organisations.

1. Summary of Recommendations

Recommendation 1

That debt, disconnection and hardship policies and public reporting on these programs be included as mandatory and enforceable licence obligations.

Recommendation 2

That the NSW Government commit to a full review of water concessions and their availability to ensure that the introduction of a dynamic and competitive water industry does not undermine the affordability of water.

Recommendation 3

That third party providers of residential recycled and potable water be required to make independent quality monitoring test results available publicly and free of charge

Recommendation 4

That the provisions for the Utilities Licence Auditing Committee within the *IPART Act* be revisited to enable the committee to be convened.

Recommendation 5

Establish periodic public reviews of licences issued under the access regime.

Recommendation 6

That IPART be given clearer and stronger powers of enforcement of licence conditions.

Recommendation 7

That ECPR be established as the applicable access pricing methodology.

Recommendation 8

That proponents be required to substantiate how the public interest will be served by an access declaration under the access regime and that IPART be granted the discretion to test this.

Recommendation 9

That negotiate-arbitrate be endorsed as the model for developing third party access to infrastructure in the water and wastewater industry.

Recommendation 10

That a light-handed approach to retail price regulation be introduced for third party entrants to ensure an appropriate allocation of costs.

2. Background

The NSW Government needs to be clear about where it sees competition taking place in the water and wastewater industries. Equally, the Government needs to understand that competition in different areas of the industry will produce different outcomes and varied distribution of benefits.

At present there is considerable amount of involvement of the private sector in the water and wastewater industry in the form of competitive bidding to provide infrastructure to Sydney Water and Hunter Water. We believe competition in this form may have provided benefits to the community by ensuring the infrastructure and related services are provided in the most efficient manner. Benefits of this nature should be clear enough. It is yet to be demonstrated that competition at this level of the industry is able to deliver benefits in the nature of, for example, technological innovation. However, PIAC is on record as supporting competitive tendering where it can result in alternative approaches, particularly more localised infrastructure, being brought forward.

The *Metropolitan Water Plan*, in Section 9, sets out the simplistic assertion that ‘consumers have benefited from competition’ in the energy and telecommunications markets. We understand this to include ‘retail competition’ – providers of water services seeking to capture end-use customers including residential consumers. Having been involved closely in the development and the implementation of retail competition in electricity and gas PIAC is in a position to comment on the outcomes of retail competition for residential consumers.

The introduction of retail competition to the electricity and gas markets in NSW has produced no appreciable price benefits for consumers in general. This is due largely to the nature of energy as a commodity which requires the largest investment, and thus imposes the greatest proportion of costs, in relation to generation and network infrastructure. In this respect water and wastewater are comparable with energy. Water and wastewater, however, differ markedly from energy and telecommunications in that competition in the latter industries has proceeded on the basis of a separation of network functions from the retail function. Pursuing a competitive advantage in relation to retail end-use customers will be much more difficult for, say, greenfield developments when the major driver of prices will be the recovery of investment in physical infrastructure.

The industry structure in energy, with the largest investment being in network assets, has meant that retail competition has been accompanied by significant price rises for end-use customers. Retail energy prices in NSW now are higher than they were prior to retail competition. They remain lower in NSW than in every other jurisdiction. Our view is that this reflects largely the success of the regulatory framework in NSW.

The basic measure of retail competition is ‘churn’ – the rate at which customers switch between competing retail suppliers. Our understanding, based in part on research commissioned by the Independent Pricing and Regulatory Tribunal (IPART), is that the rate of churn for residential electricity customers in NSW is perhaps at 15% - and that after more than four years of retail competition. In other words, some 85% of NSW households remain with their incumbent supplier and purchase electricity at the regulated price. The situation with gas is approximate to that in electricity. To the extent that retail competition has brought benefits to consumers these have accrued to perhaps less than 15% of eligible households.

The rate of churn has been higher in other jurisdictions, notably South Australia where retail competition was introduced at the same time as a 25% jump in retail customer prices. We point out that a number of energy retailers have proposed to IPART that it ‘facilitate’ greater competition in energy by lifting the regulated price by including a premium for ‘retail headroom’. That is, that the hurdle of price competition be lowered for new entrants by raising the price for consumers above that which reflects efficient costs.

In the United Kingdom, where retail price controls were lifted two years ago, energy retailers have themselves introduced headroom. One academic analysis of the UK energy market suggests customers of the incumbent suppliers, including those who are refused a competitive offer of supply from a new entrant, face a price premium of as much as 33%.¹ An outcome of this sort would appear clearly to be at odds with the Government's policy of postage stamp pricing for residential consumers of water and wastewater.

Nor does PIAC believe there is any convincing evidence that retail competition has led to product innovation in energy. We observe that the bulk of innovation in electricity has been undertaken by the distribution businesses – a natural monopoly, highly regulated sector of the industry. This innovation has focused on new tariff structures and the introduction of metering technologies. However, we understand that the NSW electricity distributors have found retailers unwilling to take up these innovations and make them available directly to end-use customers.

3. Licencing

3.1 Consumer Protection

Over the period of retail competition in the energy sector, PIAC has observed those areas of the market which have required greater regulatory attention in line with increases in disconnection rates and marketing misconduct. Our recommendations below draw on the experiences of consumers in the competitive energy market and reflect the need for strong and effective consumer protection regulations.

(a) Debt, disconnection and hardship

The *Consultation Paper* notes that regulations *may* be made with respect to debt and disconnection. Licences are the primary tool for regulating retail utility providers in New South Wales. PIAC's firm view is that debt, disconnection and hardship policies must be legislated as a mandatory licence condition for firms providing retail residential water and wastewater services.

Additional and industry-specific consumer protections are required to secure access to essential services. A debt and disconnection policy ensures that where customers incur a debt, there are mechanisms in place to transparently allow for the debt to be paid without resorting to disconnection penalties. Hardship policies are equally important. Where a customer is unable to afford an essential service because of short-term hardship, a hardship policy ensures that they are not further disadvantaged by disconnection from an essential service.

Sydney Water and Hunter Water are required to have a code of practice and procedure on debt and disconnection which requires the businesses to:

- a. Provide for deferred payment or payment by instalment options for consumption bills; and
- b. Provide for the payment options referred to in (a) to be advised in consumption bills.

These provisions mean that the water utilities have an obligation to provide debt management assistance to customers in addition to reasonably applying disconnection penalties.

¹ M Giuliotti, C Waddams Price and M Waterson, 'Consumer Choice and Competition Policy: A study of UK Energy Markets' in *The Economic Journal*, The Royal Economic Society, October 2005

The State owned water utilities also have sophisticated programs to assist customers in hardship, which can both mitigate the financial impact of a price shock and provide assistance to improve water efficiency in the face of financial difficulties. These programs do not eliminate disconnection of low-income households due to debt, but they do reduce the incidence of these traumatic events.

Last year PIAC published research into the extent and impact of utility disconnection/restriction for non-payment by households. Of the surveyed participants (who had their water supply restricted due to non-payment in the previous 12 months), 75% were paying off a mortgage, 71% received income from paid employment as the main source of income and 88% were family households.² The research identifies young families in paid employment but struggling to manage mortgages as particularly susceptible to debt and disconnection.

Water utilities operating in the retail market have a social responsibility to their customers as the provider of an essential service. Debt, disconnection and hardship policies mitigate the extent and intensity of these events and provide protections to these households. While the introduction of competition in the market place may produce greater innovation in supply sources, competition among supplies requires additional industry specific regulations to protect customers.

Recommendation 1

That debt, disconnection and hardship policies and public reporting on these programs be included as mandatory and enforceable licence obligations.

(b) Community service obligations

Affordable access to essential water and wastewater services in NSW is supported via pensioner rebates and other rebate programs funded by the New South Wales Government. In its recent pricing determinations for Sydney water, Hunter Water and Gosford and Wyong Councils IPART reiterated its view that “customer-impact mitigation is primarily the responsibility of the State Government, as part of its broader social policy.”³ We also note that IPART has identified a concern that the current level of pensioner concessions is not in line with the recent regulated price increases. As a consequence, at the same time as the competitive framework is being introduced, there is a risk that the Government’s concession program is failing to deliver affordable access to essential services.

As the access regime will operate in a competitively neutral environment, customers of new entrant suppliers must be capable of accessing pensioner rebates, payment assistance schemes and large household rebates. We note that the *Consultation Paper* envisages new entrant firms supplying greenfield development areas on a monopoly basis. These customers will require the same access to concessions as customers of the existing network. The access regime will therefore necessitate changes to the administration of concessions program across the state to enable customers of any new entrant suppliers to access government funded concession programs.

² Ross, S, Wallace, A, & Rintoul, D (2005) *Cut Off: The impact of utility disconnection*, report prepared by Urbis Keyes Young for the Utility Consumers’ Advocacy Program, see appendix

³ IPART (2005) *Sydney Water Corporation, Hunter Water Corporation, Sydney Catchment Authority; Prices of Water Supply, Wastewater and Stormwater Final Report*, Sydney Reference No 05/222, page 155

The New South Wales Government is responsible for the delivery of concession/rebate programs across the State. PIAC views equitable access to concession programs a key deliverable of the competitive framework.

Recommendation 2

That the NSW Government commit to a full review of water concessions and their availability to ensure that the introduction of a dynamic and competitive water industry does not undermine the affordability of water.

(c) Pricing Regulation

The *Consultation Paper* states that “new licensed suppliers will also be subject to price regulation if they are a monopoly service provider” and envisages this occurring where, for example, all developers in a new development area are required to connect to a reticulated recycled water supply.

PIAC supports price regulation where a monopoly provider delivers an essential service to residential customers. We therefore support the price regulation of new entrant monopolists in the water and wastewater industry. We envisage that this will apply equally to monopolist suppliers of grey water where that supply is mandated to the internal plumbing of housing and thus for essential household use, eg. for mandatory use in toilets/washing machines.

In addition to a commitment to regulate prices of new entrant monopolists, the *Consultation Paper* also states, “all consumers will retain the opportunity to purchase essential water and wastewater services at postage stamp regulated prices from the incumbents” (page 3). PIAC supports retaining customer access to first tier or incumbent retailers. However, further clarification is required about how this principle will be applied to greenfield developments that may not be owned and operated by either Sydney Water or Hunter Water.

3.2 Public Health Laws

We note that Sydney Water and Hunter Water Corporations are required to make water quality monitoring results available free of charge by collection and on their websites.

Unlicensed local water utilities do not currently have the same obligation and, as a result, it is difficult for residents to have confidence in the quality of water supplied. When contamination does occur, residents do not have ready access to impartial and scientific advice about the quality of the water supplied. PIAC is aware of at least one community serviced by a local water utility that has recently experienced chemical contamination of their water supply. In this particular instance, inadequate information was provided to customers and there was no transparency in monitoring compliance with Australian Drinking Water Guidelines. This community continues to seek assurance from NSW Health and the NSW Government that the water is safe to consume.

Recommendation 3

That third party providers of residential recycled and potable water be required to make independent quality monitoring test results available publicly and free of charge

3.3 Procedure for licence application

The proposed licensing regime grants considerable Ministerial discretion to the content of new entrant licences, with a key advisory role for IPART. We acknowledge the need to institute a flexible licence arrangement to account for the variation in schemes that may emerge under the new access regime. In such circumstances, public consultation will prove vital to ensure that the community has confidence in the regulation of a private business providing an essential service.

The additional obligations to be granted to IPART to assess, audit and enforce new entrant licences could, however, benefit from additional, independent and formal input from the community.

The most recent amendment of the *IPART Act* established the Utilities Licence Auditing Advisory Committee (ULAAC). The purpose of ULAAC is to furnish advice to IPART on the scope and methodology of licence auditing being or to be conducted under the licence auditing functions of the Tribunal. Unfortunately, due to inadequacies in the drafting, the committee is yet to be convened.

PIAC endorses the consultative principles enshrined in ULAAC and would encourage the Government to revisit these provisions in the upcoming amendments to the *IPART Act* to enable the Committee to be formally constituted. The integrity of the licencing process in the reformed water industry would be strengthened through this process.

We also note that new licences are proposed to have a fifteen-year duration. Currently Sydney Water and Hunter Water licences are reviewed on a rolling 5-year basis. Since the inception of these licences, important amendments have been made to service quality reporting and reliability standards in response to technological and environmental developments. Additionally, prices are periodically reviewed on a 1-4 year basis. PIAC's preference would be for new entrants to be subject to similar public reviews of licence conditions. We stress that such reviews should be seen as separate to the grant or revocation of licences.

Recommendation 4

That the provisions for the Utilities Licence Auditing Committee within the *IPART Act* be revisited to enable the committee to be convened.

Recommendation 5

Establish periodic public reviews of licences issued under the access regime.

3.4 Enforcement of licence conditions

Effective enforcement of licence conditions for new entrants will be an important element of the proposed new regime for third party access. In part this is because of the need to ensure community confidence that the new arrangements will continue to protect consumer, health and environmental interests. Related to this is the character of water and wastewater services as essential services. This means that, even where supply can be undertaken on a competitive basis, consumers have less choice than with other services or products. At minimum consumers are not able to withdraw from a market for water and wastewater – meaning confidence in the licences is a critical issue.

We note, too, that effective enforcement equally is important to give confidence and parity to all providers in the water and wastewater industry whether the incumbents or new third party access holders.

PIAC supports broadly the outline of the enforcement measures provided in the *Consultation Paper*. However, the detail of the final arrangements will be important. We believe there are several points the Government needs to consider in designing the statutory provisions for enforcement of these licences.

The current powers given to IPART for enforcement of licence conditions in the energy and water industries have not been reviewed since their introduction in 2000. We believe there is considerable anecdotal evidence to suggest the current powers are not adequate with respect to a number of areas of the competitive retail energy market. IPART has not used its powers to impose sanctions on energy businesses that have breached their licence obligations. We believe strongly this is because the powers are ineffectual. Instead, IPART has opted for an approach of seeking to encourage a 'culture of compliance' which we believe also has not been effective in achieving licence compliance.

PIAC believes it is time for the Government to consider giving clearer and stronger powers of enforcement to IPART. Certainly we do not believe it is reasonable to assume the current arrangements will work better in water than they have in energy. Thus it is appropriate that a public review be undertaken before competition is extended into the water and wastewater industry.

In addition, our observation is that IPART has not been given the necessary resources to undertake an appropriate level of compliance monitoring and enforcement activity. PIAC agrees that the compliance monitoring arrangements should not be unnecessarily onerous on the businesses concerned. Periodic audits and even audit holidays are appropriate measures as a market develops and the businesses can demonstrate a high level of compliance.

On the other hand, it is important that compliance and enforcement drive the behaviour of the businesses and not the other way around. Along with stronger powers to impose sanctions for licence breaches the Government should consider whether IPART needs additional resources to be able effectively to monitor compliance in a new water and wastewater market. It seems likely the level of resources needed for this task will increase if there is an increase in the number of businesses participating in the new market.

Recommendation 6

That IPART be given clearer and stronger powers of enforcement of licence conditions.

4. Access Regime

4.1 Postage Stamp Pricing

PIAC welcomes the New South Wales Government's commitment to retain postage stamp pricing in the proposed access regime. Postage-stamp pricing reflects long-standing community concerns with affordability and equity in the pricing of water and sewerage as essential services.

The Consultation Paper defines postage stamp pricing as “a uniform periodic charge for a supplier’s area of operation” allocated by customer class. Under the terms of the Sydney Water Corporation and Hunter Water Corporation price determinations, postage stamp pricing is applied to all water, wastewater and stormwater services provided on a monopoly basis, including ancillary and miscellaneous charges. In the case of Sydney Water Corporation and Hunter Water Corporation there are two main customer classes: residential and non-residential. These customer classes each contain customer sub-classes determined by the either the size or type of the asset and are not geographically differentiated by either water utility. The system-wide costs associated with maintaining the security of supply and the net health of the water supply system is equitably allocated across the customer base. The same principle is applied to the 126 local water utilities providing water, wastewater and stormwater services in non-metropolitan regions of New South Wales. In practice this means that regulated cross subsidies ensure that within each water utility, residential customers with a standard meter size pay the same water service and water usage charge and the same sewerage service charge.

Our expectation is that, under the access regime, water and wastewater services will continue to be delivered with the same cross-subsidies. For example, postage stamp pricing should be understood to require the cost of new greenfield developments to be spread over the existing customer base, rather than within the customers of the new localised network. For postage stamp pricing to be universally applicable, both new and existing customers of Sydney Water and Hunter Water operational areas must be able to enjoy the costs and benefits of regulated cross subsidies.

4.2 Access Price

PIAC appreciates that the allocation of costs between the incumbent and the new entrant is critical to the success of the proposed access regime. It is equally critical to customers of the incumbent and new entrant, who will ultimately pay for any economic inefficiency in an access price determination. A poor allocation of costs could, for example, result in the inequitable subsidy of one customer group by the other. Moreover, the pricing methodology used to determine the access price could potentially undermine the regulated retail postage stamp price.

PIAC is concerned that the access pricing principles outlined in the *Consultation Paper* inadequately articulate how these concerns will be actively addressed by the proposed access regime. We note that the access pricing principles are drawn from the recent COAG national competition policy review and are expected to become part of the amended Competition Principles Agreement. These principles have not been meaningfully communicated in either the *Consultation Paper* or the COAG agreement from which they are drawn. At this stage we cannot be confident that customers’ economic interests under the access regime will be best addressed by these principles alone.

The amended Competition Policy Agreement will be an important consideration within the operational access regime but must remain a guiding tool for IPART rather than the sole foundation of access prices under the access regime. PIAC would prefer to see pricing principles that are relevant to the water and wastewater industry that is the subject of the access regime.

PIAC is particularly concerned that the retention of postage stamp pricing will depend on which access pricing methodology is employed. This concern was raised by PIAC in its

submissions to IPART's investigation and to the Australia Competition Tribunal (ACT) during the declaration proceedings commenced by Services Sydney last year. The ACT acknowledged this situation in its judgement, as follows:

Sydney Water currently uses 'postage stamp pricing', whereby residential customers pay a uniform price for sewage collection services irrespective of their location or the costs of sewage treatment. If uniform retail prices were maintained but access prices for the transport and interconnection services were non-uniform, this would create incentives for 'cream skimming' entry, whereby new entrants targeted low cost customers, leaving Sydney Water to supply services to the higher cost customers. This would be unsustainable and would likely result in the unwinding of postage stamp pricing.
Application by Services Sydney Pty Limited [2005] ACompT 7, paragraph 203

The ACT went on to identify how this situation could be avoided and postage stamp pricing be retained:

It is the NSW Government's prerogative to determine whether or not postage stamp pricing should be maintained. However, we can see no reason why the maintenance of postage stamp pricing is not compatible with declaration. As long as access prices do not vary with the location of the customer, there would not be any incentive for cream skimming. This could be achieved either through the use of ECPR based pricing, as recommended by IPART, or through some other average cost approach, including an average building block cost approach. As discussed earlier, these are matters to be dealt with at the second stage of the access process, when the terms and conditions of access are negotiated or arbitrated.
Application by Services Sydney Pty Limited [2005] ACompT 7, paragraph 205

IPART's investigation into water and wastewater service provision in Sydney also acknowledged the critical role of access pricing methodology and recommendation 7 specifically sought that access be priced according to the ECPR. We note that the NSW Government endorsed all the recommendations from IPART's investigation, including the use of ECPR.

The proposed access regime is not explicit about the use of an ECPR pricing methodology. High-level principles set out in the *Consultation Paper* (page 22) do not preclude the use of other, less satisfactory pricing methodologies. Yet, independent policy advice endorsed by the NSW Government has asserted the merits of ECPR pricing.

Recommendation 7

That ECPR be established as the applicable access pricing methodology.

4.3 Public interest test in access declaration

As identified in the Consultation Paper, one component of assessment of access proposals under the *Trade Practices Act* (TPA) is a 'public interest' test, which specifies that a service cannot be declared unless it has been demonstrated that access to the infrastructure would not be contrary to the public interest. However, use of the TPA test raises concerns about how the framework will be implemented.

As the term 'public interest' is not defined in the TPA, the National Competition Council (NCC) and the Australian Competition Tribunal have adopted a case-by-case approach to determine whether a particular access arrangement would be contrary to the public interest. The factors mentioned in clause 1.3 of the Competition Principles Agreement are tentatively relied on for guidance in relation to the public interest. Those factors are:

- a) Ecologically sustainable development;

- b) Social welfare and equity considerations, including community service obligations;
- c) Government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- d) Economic and regional development, including employment and investment growth;
- e) The interests of consumers generally or a class of consumers;
- f) The competitiveness of Australian businesses; and
- g) The efficient allocation of resources.

PIAC supports the use of these principles to explore issues of public interest. Drawing on these principles, PIAC has, for example, identified a number of potential public interest concerns associated with declaration of essential wastewater networks with respect to the interests of consumers generally. This includes the loss of equity in pricing; the impact on prices for the incumbent; risk of consumers being excluded from price benefits; and the magnitude of public costs.

However, for the proposed approach to a State-based access regime to be effective in promoting or protecting the public interest this test must place a greater obligation on proponents of access to demonstrate positive public interest outcomes. Indeed, this would appear to be consistent with the terms of the *Intergovernmental Agreement on a National Water Initiative* (IGA) agreed in June 2004 by the Council of Australian Governments (CoAG). The objectives of the IGA for a market based system for urban water use include achieving ‘statutory provision for environmental and other public benefit outcomes’.

In its application to the Australian Competition Tribunal, Services Sydney sought to argue that the public interest was served largely on the basis of claims that their business model would generate improved environmental outcomes. Likewise, in considering the initial application by Services Sydney, the NCC appeared to rely primarily on the assertion of competition leading to environmental benefits as indicating a net public benefit from the proposal for access.⁴ That is, both the applicant and the agency charged with assessing the application made little effort to substantiate the claimed benefits and costs to the public interests of declaration and access.

It was left, then, to a community organisation, in this case PIAC, to assume this burden while relying on few resources and having no direct insight into the nature of the business model proposed by the applicant. PIAC made a written submission to the Australian Competition Tribunal and to the parties. In doing so, however, we were forced to rely on supposition and comparisons with retail energy markets to explore the potential implications the public interest.

This in itself is a poor outcome with respect to the public interest. PIAC believes it is reasonable and appropriate for parties seeking to gain access to water and wastewater infrastructure to substantiate how the public interest will be served by their proposal. It is critical, furthermore, that IPART have the discretion and the capacity to test assertions about the public interest before making a declaration about access or approving an individual access undertaking.

⁴ National Competition Council, *Services Sydney application for declaration – Final recommendation*, 2004, pp68-77

Recommendation 8

That proponents be required to substantiate how the public interest will be served by an access declaration under the access regime and that IPART be granted the discretion to test this.

4.4 Negotiating access

PIAC supports the proposal that access to Sydney Water's infrastructure be obtained on the basis of a 'negotiate-arbitrate' approach. In particular, we support the role for IPART is arbitrating disputes over access proposals. We believe this is consistent with the role of IPART as an independent regulatory body. It also ensures that the decision maker in such matters will have available to it appropriate information regarding the costs associated with the relevant infrastructure and the services it provides.

The treatment of proposals for investment recently has been the subject of considerable discussion in relation to the national energy market. Of particular relevance to the proposed framework for access to water infrastructure has been the debate over how regulators should respond to proposals for new investment. A major review of the regulatory framework for access pricing was commissioned by the Ministerial Council on Energy (MCE). The review, undertaken by an Expert Panel, identified three options:

- receive-consider;
- negotiate-arbitrate; and
- propose-respond.⁵

We note that IPART previously has recommended that negotiate-arbitrate be used for access proposals in relation to the existing water and wastewater infrastructure⁶. PIAC supports this proposal as the most appropriate means of balancing different interests, including those of consumers.

PIAC is aware that some potential investors in water and wastewater infrastructure have indicated their preference for propose-respond. However, we believe this stems from a misunderstanding of the regulatory process. Certainly in the case of energy it is presumed that the party making the substantive proposal in relation to a regulated outcome is the incumbent owner of the assets rather than the party seeking access. In other words, propose-respond gives greater weight to the case made by the incumbent owner than the proposal made by the would-be competitor.

The final report of the MCE's Expert Panel sets out a lengthy discussion of the pros and cons of these three options and focuses particularly on negotiate-arbitrate and propose-respond. It was noted that support for propose-respond was concentrated among the owners of infrastructure and proponents of new investment. On the other hand, the Panel acknowledged the range of concerns over propose-respond expressed by a range of stakeholders including PIAC. In summing up the Expert Panel expressed the view that propose-respond:

⁵ *Expert Panel on Energy Access Pricing Report to the Ministerial Council on Energy*, April 2004

⁶ See recommendation 5, IPART (2005) *Investigation into Water and Wastewater Service Provision in the Greater Sydney Region Final Report*, p8

- may tend to produce higher price outcomes for successful proposals rather than increase investment generally;
- reduces regulatory certainty and consistency; and
- may encourage regulatory gaming.

Parallel to the Expert Panel's deliberations the Australian Energy Market Commission (AEMC) has been developing new rules for the regulation of electricity transmission revenues. The AEMC had put forward propose-respond. However, in its response to the Expert Panel the MCE has moved against propose-respond being entrenched in the *National Electricity Rules*. Instead, the MCE has adopted the Panel's recommendation that the regulatory framework include a 'best fit' approach to determining the form of regulation.

To sum up, negotiate-arbitrate continues to provide an appropriate, best practice method for dealing with proposals for third party access to infrastructure in water and wastewater. We believe it provides for an appropriate balancing of different interests, particularly since it relies on an appropriate measure of regulatory discretion. PIAC anticipates that the MCE will move to introduce formal guidelines for the exercise of that discretion by the national energy regulator. The NSW Government may want to consider a similar approach while preserving the independence of the Tribunal.

Recommendation 9

That negotiate-arbitrate be endorsed as the model for developing third party access to infrastructure in the water and wastewater industry.

5. Other issues

5.1 International trade implications of reform

Australia's service commitments in international trade agreements may adversely impact the ability of governments to regulate water services in NSW. Trade agreements signed at a Federal level are binding on both state and local governments. Specifically, Australia is a member of the World Trade Organisation (WTO) and has made commitments in water-related services under the WTO's trade in services agreement (GATS). Australia has already included sewerage services and wastewater management in the GATS. Once a service is included in the GATS, it means that the Government must provide 'market access' and 'national treatment.' Government regulation would be subject to international trade law, and could be challenged by other governments on the grounds that it was burdensome to business or a barrier to trade.

Australia is currently going through a round of WTO negotiations that seek to increase Australia's commitments in GATS. The Government has confirmed that services relating to 'water for human use' will not be listed in Australia's GATS offer. Water for human use includes water collection, purification and distribution through mains. This exclusion is important and indicates that both Federal and State Governments acknowledge that governments must have full flexibility to regulate water services to ensure both equitable access and environmental sustainability. However, it is unclear how proposals to move to recycled water may interact with Australia's existing GATS commitments in wastewater.

There is an argument that water services would not fall within GATS because GATS commitments do not extend to 'public services'. However, the definition of 'public service'

under GATS is any service carried out in the exercise of governmental authority and provided neither “on a commercial basis nor in competition with a service provider” (GATS Article 1.3). In other words, wastewater services remain outside the reach of GATS so long as they remain a strict ‘public’ service. If the NSW government permits greater private sector involvement in wastewater treatment, it could be exposed to the limitations of international trade law and reduce its ability to regulate this industry.

5.2 Tenancy Issues

The *Residential Tenancies Act 1987 (NSW)* stipulates in section 17 the allocation of charges between landlords and tenants:

It is a term of every residential tenancy agreement that the landlord shall pay all rates, taxes or charges payable under any Act in connection with the residential premises (other than charges for electricity, gas, excess water and any other prescribed charges).

Across NSW the contractual arrangement for the provision of water and wastewater services is solely between the property owner and the water utility. The *Consultation Paper* is silent as to whether this contractual arrangement would remain unchanged under the access regime. With current arrangements unchanged, the residential tenancy agreement between landlord and tenant subsequently determines the payment of water consumption charges, but not the fixed service charge, by the tenant to the landlord.

As part of its price determination process IPART allocates costs between service charges (payable by landlords) and usage charges (payable by tenants). The current maximum prices for fixed and usage components of water and wastewater services are indicated below.

Regulated Charges for Residential Properties 2005/06

Water Utility	Water Service Charge	Water Usage Charge	Sewerage Service Charge
Sydney Water Corporation	\$56.84	\$1.20/kL – tier 1 \$1.48/kL – tier 2	\$280.59
Hunter Water Corporation	\$21.48	\$1.09/kL	\$178.37

Under the proposed access regime new entrants to the industry who do not have their prices regulated will not be subject to scrutiny about cost allocation between landlord and tenant. An unintended consequence of these reforms could see landlords entering into contractual arrangement with new entrant suppliers that effectively shift costs from the landlord to the tenant. PIAC is concerned that new entrants may seek to shift costs from the fixed service charges to the usage charge to compete with the incumbent supplier. Tenants would be unfairly charged under this arrangement.

To offset this risk the Government could introduce a light-handed regulatory approach by regulating the pricing methodology that is used by second tier retailers to allocate costs between fixed and usage components.

Recommendation 10

That a light-handed approach to retail price regulation be introduced for third party entrants to ensure an appropriate allocation of costs.

5.3 GST Status of 'premium' water services

Finally we seek clarification as to the Goods and Service Tax (GST) exemptions applying to premium services delivered by competitive private firms entering into the market. The supply of water is GST free providing it is not supplied in containers of less than 100 litres. Similarly sewerage services do not attract a goods and services Tax. The legislation does not explicitly provide the same exemptions to grey or recycled water, nor is it clear whether premium environmental services should be able to avoid a GST on their product.

5.4 Exposure draft

The New South Wales Government is the pioneer in the development of comprehensive third party access to water and wastewater industries within the scope of the Access provisions of the *Trade Practices Act*. Transparent and consultative processes are therefore required to promote consumer confidence in the new market design for water and wastewater industries. We would encourage the Water Directorate of the Cabinet Office to continue its efforts to consult widely throughout the development of licences and the access regime, but particularly through the release of an exposure draft of the proposed legislation.