

INDEPENDENT PRICING AND REGULATORY TRIBUNAL

PUBLIC HEARINGS INTO PRICE STRUCTURES TO REDUCE DEMAND FOR
WATER IN THE SYDNEY BASIN

Tribunal Members

Mr James Cox
Ms Cristina Cifuentes

Held at Meeting Room 2, Level 2
44 Market Street, Sydney NSW 2000

On Thursday, 25 March 2004, at 10.05am

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1 MR COX: Good morning, ladies and gentlemen. Welcome to
2 this public hearing which is being conducted by the
3 tribunal into the structure of water prices for Sydney. I
4 need to apologise for the absence of the Chairman of the
5 tribunal, Tom Parry, who is unable to be with us today.
6
7 This hearing is part of the tribunal's investigation
8 being conducted at the request of the Premier of New South
9 Wales and as part of this investigation the tribunal
10 released in December 2003 an issues paper which included
11 settled terms of reference. The issues paper also outlined
12 some of the matters the tribunal considered important to
13 this investigation, its general approach to price setting,
14 the matters its Act says it must take into account in
15 conducting an investigation and a timetable for the review.
16
17 In the issues paper the tribunal called for
18 submissions and we have had a good response to that
19 request. Some of the organisations that made submissions
20 will be presenting their views to the hearing today.
21
22 I want to emphasise that all the submissions received
23 will be carefully considered by the tribunal in developing
24 its finding and recommendations. We consider this to be a
25 very important investigation. As is becoming increasingly
26 known, Sydney is facing a significant and potentially
27 growing imbalance between the supply and demand for potable
28 water. Population growth and requirements for increased
29 environmental flows in the rivers of our drinking water
30 catchment will place further pressure on this imbalance.
31
32 We are aware that there are many things being done by
33 the Government to address the situation and that this
34 review is perhaps part of that bigger picture. In this
35 context, both the overall price paid for water and the
36 structure of prices may be critical factors in addressing
37 the supply demand imbalance. However, as we have indicated
38 before in prior publications and the issues paper, the
39 tribunal believes that it is not yet clear to what extent
40 price can contribute to addressing the imbalance and that
41 is something we wish to investigate through this present
42 hearing. We point out, however, that price is likely to be
43 only one part of an overall strategy that deals with the
44 problem of supply and demand imbalance.
45
46 Scrutiny of the terms of reference for this
47 investigation will make it clear which price structures are

1 most likely to reduce demand to the greatest extent. This
2 issue needs to be considered in the context of assessment
3 of the affordability and equity impacts of alternative
4 price structures. We also need to consider the
5 implication of any revised price structure for Sydney Water
6 and the Sydney Catchment Authority, as we are required to
7 do by our legislation.
8

9 As noted in the issues paper, the investigation will
10 not result in the setting of prices. It is anticipated
11 that in June we will prepare and release a report that sets
12 out our findings in relation to price structures and which
13 will inform the next price determination process.
14

15 I think that is probably all I need say by way of
16 general introduction. We will hear from a number of
17 different organisations today, commencing with the Sydney
18 Water Corporation, and I would like to invite their
19 representatives to come forward.
20

21 SYDNEY WATER CORPORATION
22

23 MR COX: Would you introduce yourselves?
24

25 MR EVANS: David Evans, I am Acting Manager Director of
26 Sydney Water. Gavin Morrison over there is also sitting
27 "here" as well. He is driving the PowerPoint for me but he
28 is part of our team as well.
29

30 Just a few contextual comments first, and they echo a
31 number of things that you have already said. We really
32 welcome this opportunity to open up, if you like, another
33 frontier in the process of managing the demand supply
34 issues.
35

36 In the historical context, price has been a feature of
37 demand management and efficient running of water utilities
38 but nowhere near as long as you would have hoped. It has
39 probably been only 15 years that we have had what I call
40 the first generation of price reviews for this purpose and
41 part of what I want to do is describe some of that
42 historical context and then work out where we are sitting
43 in view of future generations to help continue the pricing
44 issue.
45

46 I agree with your comment that price is not the only
47 vehicle. The history of the last 10 years has shown us

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1 that and again I want to put that in some context.
2
3 I want to go through the context of this particular
4 exercise, what falls out of that in terms of retail price
5 reform opportunities, what the issues are, wholesale
6 incentives, and then conclude with perhaps a bit of a way
7 forward for the next generation of these issues.
8
9 We need to accept that we are very much in what I call
10 an adaptive management framework here. There is a whole
11 range of things that is happening around us, each one of
12 which has its own level of uncertainty. There are obvious
13 things like rates of population growth; issues of potential
14 climatic change; issues of the success of demand management
15 initiatives; uncertainties about the response consumers
16 will make in the ultimate to price reform and how sustained
17 those responses may be; we are in the middle of a drought
18 and historical experience has taught us that droughts
19 create sometimes lasting but sometimes not lasting changes
20 in consumer behaviour; and, of course, we are also in the
21 middle of trying to work out the appropriate approach to
22 the environmental flow releases down the Hawkesbury.
23
24 So there are probably seven or eight parameters, every
25 one of which has degrees of not only policy and conceptual
26 complexity but empirical complexity. It would be a very
27 brave person with a very big computer who can say we can
28 specify how that will all interface such that we can have a
29 25-year plan we can all sign tomorrow. We need to have a
30 25-year view but we then need to have an adaptive
31 management process of picking our way through those
32 uncertainties and recorrecting the course as we need to as
33 we go along.
34
35 Just a little bit of context on Sydney Water and what
36 it does: It is interesting that we are going first today.
37 We are happy to open the batting, but Sydney Water is a
38 water utility, it is not the emperor of the water cycle in
39 the Sydney basin. In its role as a water utility it
40 services 4 million customers who have a wide range of
41 interests, income levels, et cetera, et cetera.
42
43 It says on this overhead that it manages the water
44 supply. It manages the distribution and retailing of water
45 and a whole range of demand management activities but, as
46 we know, there are a lot of other people around who have an
47 interest in these matters as well and, more so, have

1 statutory roles. Some of them are on the presentation list
2 today.
3
4 Obviously the SCA, the Catchment Authority that Graeme
5 Head represents, is the sort of owner of the dams and
6 infrastructure and plays a very big role in the provision
7 of the basic product but the water itself is owned by the
8 Crown and DIPNR acts as the Crown's representative in that.
9 The application of the water between the environment and
10 elsewhere is ultimately a role for DIPNR and then it passes
11 through the hands, if you like, of the Catchment Authority,
12 it then passes through some filtration plants, it then
13 passes to us and it then passes through people and comes
14 back to us and then it is disposed of, so we are part of
15 the game, an important part of the game, but it is a
16 complex and I think improving institutional environment.
17
18 Just some perspective on where we sit: There is a
19 tendency for us to often think that the events of the last
20 six months should dominate what we do and that has tended I
21 think historically to cause a bit of a boom and bust
22 culture in utility management in Australia, over and under
23 investment in capacity, et cetera. It is important to take
24 a long-term view of these organisations. They are long
25 term, they have long-term assets and inter-relationships
26 with the environment, et cetera.
27
28 There is an asset base sitting behind Sydney Water of
29 about \$20 billion as well as the 4m customers and there are
30 broad issues of stewardship of that asset base that we have
31 to remember. But looking at just the demand for water,
32 which is what we are about here, we had this sort of
33 classic 50s, 60s and 70s "let's go for it" sort of mind-set
34 and then over around the last 20 years or thereabouts, it
35 is a bit hard to be precise, there has been a flattening
36 off of demand notwithstanding the fact that the population
37 has gone up by around 700,000 or 800,000 in that time.
38
39 That coincided with the introduction of a range of
40 things, principal among them being much better pay for use
41 systems, but there has also been a whole new generation of
42 demand management. It is worth noting that you can only
43 introduce pay for use in its ultimate form once. You can
44 only go once from charging \$0 to charging \$1 or whatever.
45 After that you are about changing the price, so you are
46 never going to get the first flush, as it were, again in
47 quite as fulsome a way.

1
2 What that means is you have to think very carefully
3 about what you can get out of price change and then
4 integrate it into the other demand management instruments
5 that you have already mentioned.
6
7 What is the outlook, if we just look at the last few
8 years of the next graph? The last 10 years or so has seen
9 aggregate draw on storages remain roughly constant. There
10 is a projection there, and all projections are uncertain,
11 but the yellow line is the sort of base increase in demand
12 predicated upon population growth, and the blue line is the
13 program of demand we are anticipating meeting climate,
14 corrected and uncorrected, for a range of additional demand
15 management and other initiatives. So we are in the
16 business of trying to make a big difference between the
17 yellow line and the blue line on that graph.
18
19 What is the role of price in doing that? I guess our
20 view is that there is opportunity to do more on the retail
21 side. Essentially I believe that the first generation of
22 price reform, what we crudely call pay for use where you
23 went from \$0 to \$1 roughly, now should be seen as a
24 generation old and that there is potential now to take the
25 next step. But you have to do that being careful.
26
27 Essentially what we believe is that we can go for a
28 change in the usage component of water price through
29 quarterly step increasing of the block tariff and applying
30 that at an early date to the residential sector. Carrying
31 out that has to be subject to a range of careful
32 consideration that you touched on in the introduction,
33 including what other complementary activities are
34 undertaken with respect to demand management, their
35 financing, their likely success, the understanding of the
36 environmental flow consequences and the all-up financial
37 impact of this because, without labouring the point too
38 much, water utilities do have to raise the money to sustain
39 the \$20 billion worth of assets and to ensure fundamental
40 community standards are met.
41
42 As I say, we support an increase in the usage
43 component while still retaining the basic architecture of
44 an access charge as well as a usage charge, but aligning
45 the balance more in favour of the usage than access.
46
47 We believe that can commence upon the creation of the

1 next price path that you referred to in your introduction
2 and we believe that will give us time and the capacity to
3 manage the customer communication and financial impacts.
4 We obviously will work further with you and others as
5 necessary to do that.
6
7 The question is, what does this actually mean at the
8 retail level? We want to come up with something that is
9 both sensible and would be acceptable, and I want to spend
10 just a couple of minutes on highlighting what type of use
11 we might be seeking to target here. What are our
12 objectives? We want to provide a second generation
13 reminder or signal on the issues of scarcity, value of
14 water, the need to conserve, et cetera. In commonsense
15 terms, you want to be able to do that where you are most
16 likely to be successful, that is, where the use that you
17 are targeting is more discretionary - in economist jargon,
18 where elasticities are higher. That is why we have a
19 preference for focussing on high water usage in the
20 domestic sector where there are higher elasticities and a
21 greater capacity for people to manage the adjustment
22 through varying their behaviour, using mulch, using better
23 drip irrigation systems, et cetera.
24
25 The other component that is often not touched on is
26 that that sector, the high consumption household sector,
27 not only generally has a greater capacity to pay but also
28 that high seasonal use does impose costs on the system over
29 and above, if you like, the resource scarcity cost, the
30 demand management issue. Essentially people use water
31 outside on their gardens typically seasonably of course and
32 that means you tend to get the capacity of the distribution
33 system being used up at the peak loads; a bit like the rail
34 transport system, you can go out now and catch a train
35 comfortably but two and a half hours ago those that came by
36 public transport would not have found that.
37
38 Also, of course, people tend to use more water, or
39 want to use more water, in dry spells when you are working
40 to drought, so there are some efficiency and equity reasons
41 why we believe it is appropriate for this next generation
42 of change to focus on this discretionary large outdoor use.
43
44 The other advantage of that, of course, is that it
45 does create an in-built mechanism to protect some of the
46 more vulnerable parts of the customer base, which you also
47 referred to in your introduction, and we believe that a

1 two-tiered structure of this type is relatively simple and
2 easy to apply as long as you focus it on the areas where
3 you will get the greatest gain, that is, these large
4 external use customers. Of course, most importantly, it
5 reinforces the water conservation message and therefore is
6 complementary to other issues such as community education,
7 applying subsidies, the whole spectrum of demand management
8 things that are out there at a much higher level now than
9 previously.

10
11 Just to touch on that for a moment before I get to
12 this next overhead, I think it is often not acknowledged
13 that Sydney Water is actually running by world standards a
14 very large and sophisticated demand management regime. It
15 is spending a lot of money on it, in the order of \$40m in
16 recent years, and its scope and the targets set in the
17 operating licence to achieve demand reductions are far more
18 rigorous than anywhere else in Australia and compare very,
19 very favourably with that found in the rest of the world.

20
21 Getting back to the specifics or the machinery of the
22 two-tiered tariff, these numbers here are illustrative but
23 they are designed to take us through how such a thing might
24 work and what some of its consequences might be. The first
25 assumption is embodied in the top horizontal line that says
26 there would be a ceiling before the increasing block would
27 come into effect and for purposes of illustration we have
28 picked two potential ceilings of 300 kilolitres per annum
29 and 400. The other thing for purposes of illustration we
30 have done is just said the step could be \$2 for the sake of
31 the argument or \$1.50. Again, these are not prescriptive,
32 they are just trying to illustrate the point.

33
34 Assuming you apply this in what we call a revenue
35 neutral basis, that is, the revenue of Sydney Water as best
36 we can estimate will not change as a result, the extra
37 money you raise has to be given back somehow and for the
38 purposes of simplicity we have just said, let's imagine the
39 fixed service charge is the balancing item so under that
40 arrangement, the two arrangements shown there, the fixed
41 service charge would go down to \$55 for the left-hand
42 scenario and \$74 for the right-hand one. The percentage of
43 customers impacted at 300 kilolitres is 30 per cent, at 400
44 it is 19 per cent. The percentage of use is higher for the
45 first one, lower for the second, 12 and 7 respectively.

46
47 The change in total bills: As you would expect, those

1 who are under the threshold gain. That varies, but for
2 purposes of illustration here at 300 kilolitres there is a
3 reduction of 2.3 per cent, which is substantially more for
4 people on lower consumption, and it progressively goes up
5 depending on how high people's consumptions are. But what
6 you will find if you look at the data is that the vast
7 majority of people don't exceed 300 or 400 kilolitres,
8 whatever the threshold is, by very much. The extra amount
9 they have to pay is for the incremental bit on top, and
10 that is usually not a great deal compared with whatever the
11 threshold level is. It is a bit like the income tax
12 system, there are relatively few Kerry Packers but lots of
13 people who are so-called upper and middle income earners.

14
15 That is the essence of our approach to the retail
16 issue and I don't know how you want to approach it, whether
17 you want to discuss that now or let us finish?

18
19 MR COX: Finish your presentation and then we will ask
20 questions.

21
22 MR EVANS: We then turn to the wholesale. This is pretty
23 exciting stuff, the wholesale side, because it is opening
24 up the next frontier in terms of the generational issues.
25 The first generation was pay for use and the late John
26 Patterson said to me, "If you can get that 65 per cent
27 right you will get a lot of gain, it is very difficult to
28 get it 100 per cent right", and I think he was right. We
29 are moving to the retail block we just discussed and for a
30 range of reasons I think you can get that one into John's
31 range of reasonableness.

32
33 Then you come to the wholesale stuff, which is more
34 challenging but definitely the sort of area we need to
35 investigate and travel next once we work out exactly how to
36 do it.

37
38 I think the obvious objective of the wholesale
39 approach is to - I think there are a couple of dimensions.
40 One of them is to be reinforcing the demand management
41 signal. The other one is to deal with the notion that
42 water utilities should not profit from excess water sales.
43 Just to go slightly to that second thing for a moment, I
44 know people outside water utilities tend to characterise
45 those inside as being some sort of rapacious monopolists
46 who like to sort of feast on the carcass of the community
47 in all sorts of ways. Having seen quite a few water

1 utilities in my time I think that is something of a
2 simplification of their role and there are in fact a few
3 things we have to remember.
4
5 Water utilities are part of the community, the people
6 in them are part of the community, they are managing on
7 behalf of the community not only the water resource but
8 also a very substantial community investment which is added
9 to very dramatically every year. Sydney Water has an asset
10 base of over \$20 billion. The water pipes alone that it
11 runs would go from here to London. The sewer pipes would
12 go the rest of the way around the world from here. The
13 people in them are aware of the fact they have everybody as
14 their customers, not just interest groups, and therefore
15 there is a need to balance many, many things in doing what
16 we do.
17
18 Having completed the case for the gentlemen and women
19 of the water industry, I return a bit more to the specific
20 point. We don't believe we want to create an environment
21 where the community thinks we're profiting from these
22 reforms. Despite the fact we all think we're gentle
23 people, you don't want to compromise reform by creating an
24 environment where it looks like you're trying to be
25 rapacious. We acknowledge that there is a need to address
26 that revenue neutrality question, but we believe it has to
27 be done carefully.
28
29 In contemplating what we're doing with this next
30 generation of issues, we have to factor in a few things.
31 They are some of the things I mentioned at the start about
32 the degrees of uncertainty and how to make good decisions
33 in the face of uncertainty and when you get enough data,
34 and it was to believe you can go from having an idea to
35 having a policy.
36
37 Just a few of the uncertainties we're dealing with:
38 in a world where we have very substantial drought, water
39 restrictions, a rapidly growing population, changing
40 demographic bases and a whole new generation of demand
41 management initiatives, including things like basics which
42 will have an impact on the way in which new properties are
43 designed, you have a greater difficulty than historically
44 in predicting demand. The relationship between demand and
45 the thing we call safe yield is more problematic to predict
46 over the next, say, five or 10 years than it was in the
47 previous, say, 20 years.

1
2 There are also the other uncertainties that I'll
3 mention. I think very important amongst them is the pace
4 and degree of environmental flow releases, and therefore
5 the notion of what is your, if you like, balance here. So,
6 as I said earlier, I think we're clearly in an adaptive
7 management framework where I think if John Patterson were
8 here he would probably say he doesn't quite think we're up
9 to the "65 per cent have we got it right" criteria yet. I
10 think he would also say, "Get stuck into working it out
11 properly and seeing what you can do." So I wanted to
12 reinforce, before we come back to the issue of the
13 wholesale block, that we're not fighting this battle in
14 isolation.
15
16 As you said in the introduction, Mr Chairman, and as
17 I've said several times, there are a range of demand
18 management initiatives already out there. They're embedded
19 in the operating licence. They drive Sydney Water's basic
20 business and they're driving a lot of expenditure and a lot
21 of retrofitting and a lot of recycling, et cetera.
22
23 I guess we have to ask ourselves what is the market
24 financial force we can add to that and when? We believe
25 there are four issues or four options that have to be
26 thought through in terms of handling this wholesale tariff,
27 and we can talk about it in more detail if you wish. The
28 current situation is that Sydney Water profits from water
29 sales above forecast demand in the short term, but in times
30 of below forecast sales you lose. Paradoxically during a
31 drought, of course, you lose quite substantially.
32
33 The present situation, as I understand it, is that
34 IPART sets price paths, takes into account the long-term
35 nature of the industry, sets price paths for two, three or
36 four years and, to the extent, on balance, in a preceding
37 price path there was an under or over-recovery of costs due
38 to seasonal, or whatever, conditions, IPART takes the
39 opportunity, or has the potential to take the opportunity,
40 to correct that in subsequent price determinations. So
41 even if you accepted the view that the industry was
42 populated by rapacious monopolists who wanted to exploit
43 their fellow citizens, there is IPART acting as advocate of
44 the community interests to constrain that behaviour.
45 Nonetheless, that is a simple adjustment mechanism if the
46 concern is equity, unfairness.
47

1 These aren't necessarily in order of priority, but if
2 you did introduce the wholesale step to get the process
3 started, once you worked through the myriad of
4 uncertainties and understood the logic, the next step would
5 be that you could introduce a wholesale step which would
6 remove what you might call profit above forecast demand.
7 So you could have a situation which I think has been
8 discussed by other people, and will be discussed later
9 today, of a wholesale step to remove the difference between
10 your short-run marginal costs of providing the extra water
11 and the full cost, full revenue. So essentially you remove
12 your surplus profit through some automatic machinery which
13 could be reflected in a penalty price paid to the Catchment
14 Authority.

15
16 That then raises a number of issues and we need to
17 think a little bit about them. I want to return to that at
18 the end of this overhead. You could extend the wholesale
19 step to a penalty wholesale step, which would have all
20 revenue recovered or clawed back by a wholesale step. You
21 could extend that further to say it ought to be the
22 long-run marginal cost of water based on the notion of
23 whatever the resource scarcity value is, et cetera. So you
24 could build the wholesale penalty step up and up and up.
25 As I say, I want to return to that in a second.

26
27 The alternative, which is also covered in Sydney
28 Water's submission, is what we've called a D factor - I
29 won't go into all the maths of it now because it's too hard
30 for me - where you essentially would have a penalty and
31 reward system for unanticipated outcomes to sort of
32 sterilise systematically the unders and overs rather than
33 wait for the next price path. So they're the spectrum of
34 things that can be done.

35
36 In terms of the nature of any wholesale step, we need
37 to think through what we might be doing here. A lot of the
38 discussion I've just had has been under what I'd call an
39 equity heading of saying, "Well, we don't want the
40 rapacious monopolist to profit from selling too much water,
41 so we'll clean them out somehow." If we really think about
42 this, though, what we've tried to do with pay for use in
43 the last 20 years is not deal with equity issues as such,
44 we've tried to change behaviour. We've tried to encourage
45 people to think when they turn the tap on and drive actual
46 behaviour change.

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1 If you think about it from that point of view, some
2 quite interesting conceptual and practical matters emerge.
3 If you create a wholesale step - and say, for the sake of
4 argument, it was quite a substantial one - then you're
5 creating a behaviour-influencing device. It's a bit like
6 the government setting a price for something because it's
7 not set by a market, it's set by a government feat.
8 Whenever the government does that, there is always the
9 issue of how do we know we've set it somewhere near the
10 right price and do we understand how the market place will
11 respond?

12
13 In a variety of ways this sort of thing has been done
14 over many years. Governments have on different occasions
15 set reserve prices for wool, they've done it for wine
16 grapes. They've done it for a variety of things. For many
17 years they set the exchange rate. There have been some
18 successes but a number of challenges with that sort of
19 thing because it implies some quite sound knowledge by
20 government of how it sets the price, how scarce the
21 resources are, et cetera, et cetera, and it implies an
22 acceptance by government that they will stand behind the
23 price.

24
25 If you set a reserve price for wool and the
26 woolgrowers go out and grow a lot more sheep, then you are
27 saying you're going to buy it or someone's going to buy it.
28 That is a big thing to say. I'm not saying it can't be
29 done because we support the principle of using these price
30 mechanisms, but how you go about it and the quality of the
31 data you have and the understanding of what you think the
32 scarcity value really is in a very dynamic environment
33 imposes quite a lot of challenges for actually translating
34 it into application.

35
36 Those people who have worked in trying to defend
37 exchange rates when the market thinks they're wrong will
38 appreciate how difficult it can be if you set the price in
39 the wrong place. So I think the next generation of effort
40 is for us to get our heads around how to set these prices
41 so that we get the right behavioural and market response.

42
43 I guess paradoxically it's not really Sydney Water who
44 has to worry about that, I'm happy to say that that would
45 be IPART's problem, but of course, once it were set, the
46 market place would adjust and we would all have to lift
47 with that answer.

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1
2 Where forward - just to wrap this up, we're saying
3 pursue retail price reform of the sort I've described, but
4 we clearly must manage the customer and vulnerable group
5 impact and the financial impacts of that. We're agreeing
6 that we should not be seen to be unfairly profiting from
7 excess water sales. The wholesale step price could achieve
8 that, but it is complex and there are a number of
9 challenges.
10
11 There are other ways, as the last dot point suggests,
12 of dealing with that equity problem. In terms of the
13 efficiency objective of not exceeding caps, and the like,
14 promoting recycling, driving water efficiency, the third
15 dot point tries to say there are lots of other ways that
16 are already in existence or could be enhanced to achieve
17 that whilst we are working out how we're going to go about
18 being courageous enough to set the wholesale step which has
19 the stakes standing in the market at whatever price is
20 established. I will finish up there. Gavin is available
21 to come up here, in particular if you want to address some
22 of the specifics about how these different clawback
23 arrangements might work.
24
25 MR COX: Thank you. I wonder if we can start, as you did,
26 with the retail step price. As you will recall, in our
27 issues paper we presented a number of options, things that
28 might be done to give stronger incentives to lower
29 management. These included increases in the usage price of
30 water for all customers, as opposed to simply a step price
31 for those customers that use more than a certain amount of
32 water. I'd like to understand why you favour the step
33 price of those two approaches.
34
35 MR EVANS: I think essentially there are probably two
36 reasons. There is sort of a static reason and a dynamic
37 reason. I think the dynamic reason is that it will send a
38 more coherent signal to the community about the scarcity
39 issue because the actual percentage change for the
40 consumption above a certain limit would be much greater
41 than if you made it for everybody. And I think there is an
42 issue that if you make changes just for the aggregate water
43 price - say from \$1 to \$1.10, or whatever it is - the
44 impact gets lost in people's lives.
45
46 The other more traditional argument is that there are
47 other costs that the big users impose on the system in

1 terms of seasonality and capacity of utilisation, and the
2 like. So there's an equity argument for having them meet
3 some of those costs. Thirdly, the elasticity of demand
4 based on the research we've seen for this discretionary
5 outdoor use is higher, so if your objective is to be taking
6 steps to impact on your aggregate demand management
7 strategies, to pull that yellow line down that I had up
8 there, we believe you'd probably get a bigger bang for your
9 buck out of targetting the higher elasticity demand than
10 the aggregate demand, which has an average much lower
11 elasticity.
12
13 MR COX: Thank you. Can I just clarify that the step
14 price in your proposal would apply only to single
15 free-standing residential dwellings not to industry, not to
16 flats, and so on?
17
18 MR EVANS: The rationale for that is not so much you like
19 one group or dislike the other group; it's just that
20 against the criteria I just went through of elasticities,
21 contribution to peak load and drought demand, community
22 awareness, capacity to pay, equity, all of those criteria,
23 it falls better to that definition than to expand it to the
24 other groups you referred to. There is also some
25 administrative complexity and other issues which impact on
26 that.
27
28 MR COX: Okay. The case you made for the step price
29 seemed to depend very much on the fact that the water use
30 was outside water use and sensitive to price changes. How
31 much do we know about that? Do we know that over X amount
32 of water consumption is in fact outside water use as
33 opposed to inside water use?
34
35 MR EVANS: Yes. There's a certain amount known about
36 that. I'll defer to Gavin about the detail in the Sydney
37 environment, but the broad answer is yes, although, like
38 everything, there are exceptions to rules. That's why
39 there is this issue of where you set the threshold, and the
40 like. There are the large families, there are people, such
41 as my kids, who like having incredibly long showers and
42 things but, as a rule, what you say is right. Do you want
43 to add anything to that, Gavin?
44
45 MR MORRISON: No.
46
47 MS CIFUENTES: Just on that seasonal fluctuation, a

1 seasonal tariff seems to have an intuitive appeal, but do
2 you have data that suggests that the seasonal demand is
3 significant?

4
5 MR EVANS: Oh, yes. I should say that we're not looking
6 to introduce a seasonal tariff as such. For a variety of
7 reasons, including cost of meter reading and meter reading
8 technology, et cetera, that's a bridge too far for given
9 technology, and the like. What we're saying, though, is
10 that a stepped tariff would impact substantially on the
11 seasonal demand because that's how you get to be over the
12 limit, as it were. It is by the outdoor use.

13
14 MS CIFUENTES: Does that imply that it's more of a
15 capacity problem?

16
17 MR EVANS: No, I'm not suggesting it's more of a capacity
18 problem. I'm saying capacity is an element of the issue
19 and, like all these things, you have to not be entirely
20 focused on only one dimension. I guess the simple fact is
21 that when you have a wet year and the dams are full, people
22 don't use the water, and when you have a dry year and
23 they're empty, which is the very reason we built dams in
24 Australia in the first place, they do. That's when they
25 put pressure on the resource, for outside use.

26
27 MS CIFUENTES: Just staying with the retail side, I think
28 you mentioned that there needs to be - I think the tribunal
29 would agree - for any substantial increase in prices some
30 sort of transition to address issues of particularly
31 vulnerable customers. What sort of transition would you
32 suggest might be appropriate, particularly given your
33 comments that perhaps a new pricing structure could be
34 introduced from 2005?

35
36 MR EVANS: Well, just at a higher level of generality, one
37 of your transition arrangements is community education and
38 giving people time to adjust, and I would argue we're
39 already in that phase in that sense already. The efforts
40 with demand management, community education, subsidised
41 appliance schemes, all those things, have been going on for
42 some time. It's not as if you came along back in 1990 and
43 said, "Bang, we're going to do this tomorrow." There's
44 been a quite considerable attempt, accelerated by the
45 present drought, as a result of which people would be
46 hard-pressed to argue that they haven't had an opportunity
47 to absorb a message about the need to be careful with their

1 water use. So that's the first dimension.

2
3 The second one is a notification process. When IPART
4 makes whatever decision emerges in June, there will be a
5 full year of further notification of whatever is to be
6 applied. Then you get down to whether you phase these
7 sorts of things in. This is a personal opinion, not a
8 Sydney Water opinion, but phasing can always be looked at,
9 but you have to remember your other criteria, which is
10 simplicity of administration and coherence of community
11 message.

12
13 Whilst many of us in this room spend our lives being
14 very interested in water issues, the person on the bus
15 actually is interested in their children's education and
16 being able to afford a broadband connection, and all that
17 sort of thing. There's a substantial communication
18 challenge to explain things of this nature. I think that's
19 often overlooked, that you have to remember that one of our
20 obligations to the community is not to confuse them. But,
21 yes, you can always phase it in. You can say, "It's going
22 to be X." You can play with either of your variables. You
23 can play with your threshold or you could play with your
24 quantum.

25
26 MS CIFUENTES: Just the last thing from me, the issue of
27 vulnerable customers - in particular, high-usage
28 households, low income - would you care to elaborate on how
29 we might address that equity issue while also looking at
30 ways in which we can help ourselves reduce the demand?

31
32 MR EVANS: Well, dealing with the second part of your
33 comment first, none of this, as I've said, should be taken
34 in isolation from what's happened in the last decade.
35 There are already a range of subsidy and other schemes in
36 place for people who get efficient water supplies,
37 et cetera, to manage their demand. So they are in
38 existence and there are always opportunities for them to be
39 varied. But then there are issues about equity and who
40 pays, et cetera, et cetera, all those issues that arise
41 when the state chooses to subsidise a particular activity.

42
43 The other context is just straight safety net
44 provisions. The organisation already has the equivalent of
45 hardship funds and other machinery for dealing with people
46 who may have difficulty paying their bills for a variety of
47 reasons. I think, again, we have to put all this in the

1 perspective of time and also the total bill. My experience
2 has been that people can have difficulties meeting their
3 financial obligations for a range of reasons and, when they
4 do, the size of the water use component of their bill
5 usually looms as quite a small part of their aggregate
6 problem. Even if you look at just the water bill in
7 isolation, the water and sewerage bill, we still have to
8 have machinery which we already have for coping with people
9 who can't manage under the existing regime. What I'm
10 trying to say is we have to keep in perspective that the
11 change would be a very small increment over the rest of the
12 bill. So you have machinery which you could use or refine
13 as necessary to deal with that.

14
15 MR COX: I have one further question on the retail side.
16 Do you see any difficulties, practical and equity
17 difficulties, in having a different price structure in
18 effect for houses, as opposed to other customers, such as
19 business customers?

20
21 MR EVANS: In short, we think there are some complexities
22 there, but it's quite manageable. If you do it the other
23 way, you roll into another set of equity issues. If part
24 of your rationale for this is to deal with peak load demand
25 as people who demand water in times of drought, et cetera,
26 particular industry may come forward and say, "Look, I'm
27 neither of those, I have consistent demand throughout the
28 year, by time of day, by season, it would therefore be
29 inequitable for me to be subject to this."

30
31 Typically what you find in this industry, given that
32 you're serving the whole community, is that there is a
33 certain amount of variation in the circumstance of the
34 domestic base, but it's bounded, because even the richest
35 and most profligate user of water can only use so much,
36 whereas once you get into the industrial sector you have an
37 incredible spectrum of outcomes and therefore things you
38 might introduce of this sort you have to think about
39 carefully. You get into another set of equity issues if
40 you go there.

41
42 MR COX: Thank you.

43
44 MS CIFUENTES: Sorry, David, just before we leave the
45 business tariffs, your submission, or Sydney Water's
46 submission, argues that the costs of applying an inclining
47 block tariff to customers would outweigh the benefits. Has

1 Sydney Water actually undertaken any research to support
2 this or is this an intuitive view?

3
4 MR EVANS: I'd have to defer.

5
6 MR MORRISON: It's more an intuitive view based on what it
7 would mean to identify across the broad range of customers
8 that fall into the non-residential sector how to target
9 their discretionary use and bill them accordingly to
10 capture that amount of water. We have undertaken modelling
11 of a particular price structure and looked at that outcome
12 but made an assessment on that basis looking at the current
13 complexity of our tariff structure, what it means to
14 currently administer the business tariffs that are in
15 place. As the submission argues, it would be beneficial to
16 look at rationalising or at least reviewing those tariffs
17 before taking a step towards making business tariffs more
18 complex.

19
20 MS CIFUENTES: That really brings me to the next question.
21 Does Sydney Water have a program in place looking at
22 reducing the complexities of those tariffs as a prelude
23 really to introducing an incline in block, or proposing
24 that?

25
26 MR EVANS: Not necessarily a prelude to anything. Our
27 views are as we've put today about that question, but, as I
28 understand it, the housekeeping is under review.

29
30 MS CIFUENTES: Will that housekeeping exercise lead to
31 better price signals for business customers? Is there a
32 need for better price signals there?

33
34 MR EVANS: Can I answer that at a very high level of
35 generality because I don't know the specific answer. I can
36 defer to Gavin on that. It's extremely complex getting
37 "better prices" for industry because there is an incredible
38 variety of people's circumstances. I think we have to be
39 pragmatic in understanding how sophisticated one can get in
40 sort of unbundling postage stamp pricing. The historical
41 view has been that postage price stamping is difficult to
42 unbundle and, with the support of the tribunal, the
43 industry has moved towards trying to get the resource
44 allocation signal for users of that type embedded more in
45 the developer charge regime so that new entrants have a
46 clear signal about location decisions and the nature of the
47 business activity they enter into, because that's when you

1 are influencing decision making and you can get the best
2 bang for your pricing buck that way. If someone had
3 already spent \$60 million or more locating a plant
4 somewhere and you came along afterwards and said, "We're
5 going to vary your marginal water price", they'd probably
6 have a bit of a laugh because they'd tell you the water is
7 only part one of their input cost and they've already
8 committed all their money. So we have tried over the years
9 to drive that type of solution through the developer charge
10 regime.

11
12 MR COX: I wonder if we can move to what I think is a more
13 difficult side of the equation, which is the wholesale
14 state price. I think a way of thinking about that is it's
15 a combination of a fixed cap of water that Sydney Water can
16 use plus a penalty if you exceed the cap. The suggestion
17 is that the cap should be set at the sustainable yield and
18 the penalty should be a long-run marginal cost. A
19 difficulty for all of us is we're not sure what the
20 sustainable yield is at this stage. I would like you, if
21 you're able to, to talk about the consequences for Sydney
22 Water of such a scenario, just to elucidate so the tribunal
23 better understands what's at stake here.

24
25 MR EVANS: That's a very big question. I think it's the
26 question that needs, as I've said several times, a lot more
27 detailed thought. Without being too trite, if I start at
28 some of the simple stuff, Sydney Water at the close of the
29 day is, as I said at the start, an infrastructure manager
30 and a retailer and it will do its job either way and it
31 will have to raise the necessary revenue it has to raise
32 either way. So if money is made or lost in the process,
33 that will just get reflected in what we come to IPART for
34 for seeking reasonable cost recovery to do the job. So if
35 you really looked at it at just that most fundamental
36 level, we could say, "Well, we'll manage either way."

37
38 Being a bit more sophisticated in response, though,
39 the issue that emerges next is variability of financial
40 outcomes and therefore cash flow management. That's
41 important, but probably manageable because price paths are
42 defined times, et cetera, et cetera. But there is
43 financial risk there which we would want to understand
44 well.

45
46 Then I think you get into the more interesting stuff,
47 which is the behaviour influencing stuff. If we are faced

1 with a price X for, say, a penalty price to pay the
2 Catchment Authority - say, for the sake of the argument,
3 its \$2, or whatever someone has the wisdom to calculate as
4 the marginal price - we would have to make decisions about
5 how to react to that, and we haven't gone through all that,
6 particularly at board level. A normal person I think would
7 say, "Well, look, if you're going to pay person A \$2 and
8 person B offers it to you for \$1.99, you will buy it from
9 the \$1.99 person", so posting the \$2 price would have
10 Sydney Water basically standing in the market to buy
11 whatever it could from anyone else for less than \$2.

12
13 That may well be a very, very good idea as long as
14 we're clear about where the cap is and why it's there and
15 what the long-run marginal cost of water is, but we would
16 have to make decisions like who would we buy it from and
17 how long may a contract be that we might enter into and
18 what take all pay provisions may it have, et cetera,
19 because the whole nature of the industry is that you don't
20 make typically short-run get in and get out investments.
21 If someone is building a supplementary source of water of
22 some description, a bore field or a recycling plant or
23 building a pipeline from an adjacent water supply area, or
24 something, that's probably a 50-year investment. So they
25 will presumably want take all pay contracts, they'll want
26 protection, their creditors would want protection.

27
28 So the commitment we would be entering into would be
29 quite a profound commercial commitment and we would have to
30 think really carefully about that, particularly if we felt
31 that the price, while it might have been set at \$2 today,
32 might be \$3 tomorrow or \$1 the day after. Everyone would
33 have to factor all those risks into their decision making.

34
35 That's the sort of context under which we're saying if
36 you want, say, to promote some of these demand management
37 projects or recycling projects, whilst you're refining some
38 of those uncertainties, you may be better off to say,
39 "Well, look, there's a defined quantum of money here which
40 will be put to the market", or whatever, "to buy a certain
41 amount of recycled water because we want to test the
42 market", or "we want to understand how well these things
43 can work" or "we want to make reasonable progress." There
44 are other ways of skinning the cap.

45
46 MR COX: Thank you for that. Another issue which you
47 mentioned in your submission, and I don't want to dwell on

1 it too long, seems to lead to fluctuating prices, and it
2 might be disliked by consumers. Have you thought through
3 that issue or is it one you need further thought on?
4
5 MR MORRISON: It's very true that of the wholesale options
6 that we've analysed it leads to fluctuation when you look
7 at it as simple application of penalty or a reward in
8 revenue provided through annual price adjustment. The
9 thing about all of these wholesale options based on the
10 analysis we've done to date is that the options are
11 unlimited and unbounded. You can combine them, you can
12 place sealings and floors on the fluctuation.
13
14 The outcome of that, of course, is excessive or
15 increased administrative complexity in managing the
16 instrument. So our analysis as it's put in the submission
17 suggests that the D factor option is more straightforward
18 than the wholesale step if you look at it against a set of
19 criteria, but when we model it in a real-time scenario, it
20 leads to fluctuations that could definitely send perverse
21 signals that would lead to IPART having to constrain those
22 signals and manage them. The outcome obviously for us is
23 to work out how any of these options would be effectively
24 applied, would require more work.

25
26 MR COX: Thank you very much.
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1 SYDNEY CATCHMENT AUTHORITY

2
3 MR COX: The next presentation is to be provided by the
4 Sydney Catchment Authority. Could their representatives
5 please come forward?
6
7 MR HEAD: Graeme Head, from the Sydney Catchment
8 Authority, managing director.
9
10 MR WARNER: Richard Warner. I'm also from the Sydney
11 Catchment Authority, project manager.
12
13 MR HEAD: Kumar Rasiah will drive the overhead. Richard
14 will do the introductory presentation.
15
16 MR WARNER: That's our introductory slide. You can notice
17 Warragamba dam there. I might also mention at this point
18 in time that storage is at 49 per cent, I think, so the
19 drought is having some sort of profound effect on us. Our
20 total storage capacity is just over 50 per cent, so in fact
21 we do face a water shortage.
22
23 Just by way of introduction, a little bit about
24 ourselves. As many of you know, the SCA was only created
25 on 2 July 1999, so we've been in existence for only a
26 relatively short period of time as a bulk water supplier.
27 Our role is to manage and protect the catchment areas that
28 supply Sydney with its water supplies and also to manage
29 and operate those catchment infrastructure works that also
30 do that. We're a supplier of bulk water and we also
31 regulate activities in the catchment to enhance the quality
32 of water that's yielded by those catchments.
33
34 Basically our area of operations is about 16,000
35 square kilometres. It extends from the head waters of the
36 Shoalhaven River down near Nowra, all the way up to the dam
37 walls of Warragamba, Nepean and Warranorra, extends up into
38 the Blue Mountains area, almost as far as Lithgow.
39
40 By far our largest customer is Sydney Water. Last
41 year we supplied them with 631 gigalitres of water. That
42 was over 99 per cent of the water we actually supplied.
43 There are a couple of smaller councils within the
44 catchments we also supply. The principal among those is
45 Wingecarribee council. We supplied 4,000 megalitres to
46 them, Shoalhaven city council 82, and there are other
47 smaller customers who also take water. In a proportion of

1 total water, or percentage of total water, they take
2 relatively small amounts, so principally the major demand
3 on our systems is Sydney Water.

4
5 This graph shows the population. This is part of the
6 problem we're confronting. This shows population
7 projections for Sydney. DIPNR has estimated three
8 population reflections - high, medium, low. This reflects
9 the medium population projection. We currently have
10 4.2 million people living in Sydney. That's expected to
11 rise to about 4.5 million people by 2011 and increase again
12 to 4.8 million people or 4.9 million people by 2021. So
13 there's a significant amount of population growth coming.
14 Population growth normally is associated with an increase
15 in not only economic activity but also water consumption,
16 housing demand, all those things. That's the problem we're
17 confronting and that's what we must turn our minds to
18 try to address.

19
20 This sets out a story of where we've been and where
21 we expect to go to. The blue line shows actual water
22 consumption over the past several years. The orange line
23 shows what would happen assuming the current per capita
24 consumption yield or rates of consumption continue in the
25 face of that rising population. The lower pink or purple
26 coloured line shows what that consumption would be if
27 Sydney Water met its 2011 demand management targets. You
28 can actually see, if that were the case, we could get up to
29 about 2025 in terms of the existing storages and using the
30 existing water supplies. If there's no change in
31 per capita consumption, we've already confronted a problem;
32 in other words, we've confronted water scarcity.

33
34 I notice that David spoke about the fact that we need
35 to look at this in the longer term. We are very concerned,
36 however, about what's happened in there, notwithstanding
37 the drought, the fact that we seem to be on an upward cycle
38 or trend, and it's time that we confronted that problem.
39 If you were to sum up the problem in terms of IPART and
40 pricing-type scenarios, we've moved or are moving from a
41 paradigm that's looked at cost reflective-type pricing to
42 one where we're now looking at water resource scarcity. I
43 think pricing has a part to play in that sort of equation.

44
45 Turning to IPART's discussion document and the
46 substance of our presentation today, IPART posed a number
47 of questions in relation to a wholesale step price and our

1 presentation will primarily concentrate on the wholesale
2 step price. Some of those questions are set up there,
3 what's the role of a step price, how should the step be
4 determined, how should tier 1 and tier 2 steps be set,
5 should there be a link with retail prices, and what should
6 be done with the extra revenue that the SCA might get out
7 of step wholesale price? I will attempt to deal with some
8 of those issues. We don't pretend to have all the answers
9 as yet. I think, as David Evans said, there's still a fair
10 degree of work to be done on some of these things. That
11 will have to be collaborative work across not only
12 ourselves and Sydney Water but also with the tribunal.

13
14 Turning to the question of what is the role of a step
15 price, we see it in the short term as to remove the
16 financial incentive that Sydney Water has to use beyond the
17 consumptive yield with catchments. We certainly see that
18 the quantity step should be the consumptive yields of the
19 catchments. That will change through time. It's also
20 there in the longer term to signal efficient demand
21 management and supply augmentation, options and activities
22 that could be undertaken. The SCA acknowledges that
23 there's a range of tools that can help manage demand
24 outcomes. I think that's very important. The wholesale
25 step price is but one of those tools and it needs to be
26 complemented by a program of on-the-ground fixes.

27
28 I think it is very important to stress that we don't see
29 the wholesale price step as a panacea of and by itself.
30 Pricing really is a very blunt instrument unless
31 accompanied by education and a range of technologies that
32 enable end users to accommodate and adjust.

33
34 As far as the wholesale step price is concerned, this
35 really only impacts on the retailer, Sydney Water. Unless
36 there are complementary types of pricing signals sent
37 beyond Sydney Water to retail customers, a step price at
38 the wholesale level will only work to take away, tax away,
39 if you like, that additional revenue that Sydney Water gets
40 currently.

41
42 As I said, the SCA is happy to look at developing
43 these things further in the lead-up to the next price
44 determination in 2005.

45
46 How should the step quantity be determined? We
47 believe that the step quantity should be the system's

1 sustainable yield for consumptive purposes. I talk about
2 consumptive purposes because, as people have mentioned,
3 there are processes afoot to redefine what the
4 environment's or the rivers' share of the available water
5 source is and that will impact on what is available for
6 consumptive purposes. At this point in time the
7 consumptive yield is estimated by us at 600 gegalitres per
8 annum. As I said, that could be reduced if environmental
9 flows are enhanced or just as a result of climate change.

10
11 It is at the consumptive yield, the 600 gegalitres,
12 that we believe the step should come into effect.

13
14 In relation to what should or how should the tier 1
15 and tier 2 prices be set, in relation to tier 1 we see that
16 as being the price that should allow full cost recovery of
17 the SCA's costs. That includes an appropriate return on
18 our efficient investments. Tier 2, which is really that
19 sort of water we don't want anybody to use anyway, should
20 be high enough to ration demand to the supply constraints
21 or the long-run marginal cost of the permitted supply or
22 demand side, whichever is the lesser.

23
24 If we get to the supply constraint by an appropriate
25 program of investment, that does not mean we need to get to
26 a higher point, and that is what David talked about, other
27 people coming in believe in \$2, if you like, that that is
28 where that price should be set. That is intended to
29 encourage alternative supply and demand side options.

30
31 That is basically it, otherwise you are looking at the
32 retail price less the short-run marginal cost, and that is
33 where that originally sat. The link between the retail
34 step prices and the wholesale price we would see being not
35 directly connected particularly given that it looks like,
36 or people are arguing, that the steps should only be
37 applying to outside residential water use. We can't see
38 how that connection can necessarily be made.

39
40 However, they would need to be set empathetically with
41 the policies being set by IPART. But, as I said, the
42 overall objective of this is to ensure that demand overall
43 and supply are matched at the existing supply constraint.

44
45 I will just give a brief example of why there is a
46 connect between the wholesale and the retail prices. In
47 terms of the retail sector, let's assume you had new

1 business growing up in Sydney and they would normally have
2 a water demand. It seems like if you are going to match to
3 the demand and supply constraint, the only way you will
4 free up water to actually provide for that new business
5 demand is to in fact get that out of residential garden
6 watering, I guess that is the best way to describe it,
7 unless of course you can have a system whereby that
8 business actually invests in a program of demand management
9 works that enables it to free up somewhere else in the
10 system sufficient water to allow it to enter. That is what
11 we mean by there is a lot more thinking got to take place
12 in that connect between retail and wholesale prices. It is
13 not just a flow through the system.

14
15 The extra revenue for the SCA: in relation to tier 1
16 revenue and the fixed charge, as I said that should cover
17 the SCA's core business costs and those costs necessarily
18 include costs we would undertake for normal catchment
19 management activities necessary to achieve our water
20 quality objectives. I think somebody was suggesting that
21 some of the tier 2 revenue could be hypothecated to that
22 purpose. We see those sorts of activities as being
23 fundamental to our core business and should be in our tier
24 1 price. Otherwise what you have is some of your catchment
25 management activities then become discretionary on Sydney
26 Water exceeding its target.

27
28 Tier 2 revenue is a matter for government. However,
29 we would see that it is probably appropriate, very
30 appropriate, that some of that money be somehow
31 hypothecated for demand management initiatives because,
32 after all, that is the objective we are trying to achieve,
33 a reduction in overall demand such that it matches to the
34 supply constraints.

35
36 There is only one other point I would like to raise
37 and that deals with costs and revenue risks. There will be
38 increased risk to the SCA in relation to a stepped price
39 given that we are suggesting that any additional revenue
40 above the yield also be taxed or taken away from us. We
41 can't gain additional revenue from increased sales and we
42 will have to forego revenue in times of shortages or
43 restrictions and that is coupled with the fact the
44 likelihood of restrictions increases if a stepped price is
45 not accompanied by other efforts to reduce demand. In
46 other words, restrictions will have to come on more
47 frequently and be more severe because the water just won't

1 be there in dry times, hence the probability of
2 restrictions increases.
3
4 In looking at Sydney Water's cost structures we
5 suggest they could also rise depending on the quantum of
6 costs above the cap they need to make. These risks should
7 be allowed for in future price setting processes. We would
8 submit that the most appropriate way of adjusting for some
9 of those risks is via a risk premium and our rate of
10 return. That seems to be the most logical way of dealing
11 with this because there is a change in our risk profile.
12 But we are more than happy to explore those issues more
13 fully with you.
14
15 In summary, the SCA supports the principle of a
16 wholesale step price. A step price, however, is only one
17 of a range of tools that can and will need to be applied to
18 help equate supply and demand and, as I said, they need to
19 include some technological changes or technological fixes
20 as well as price. Price by itself is a blunt instrument.
21 Those tools must be developed and introduced progressively
22 with any price structural changes. In other words, we need
23 to be in a position whereby we have a portfolio of work and
24 activity available to unveil to customers, end users, at
25 the same time that this is going to impact on them so that
26 there is something they can do about it, otherwise it just
27 looks like a big tax.
28
29 As I said, a step price at the wholesale level by
30 itself is not a panacea in and of itself.
31
32 MR HEAD: If I can pick up on a couple of things that need
33 some extra emphasis, the question of the sustainable yield
34 and what is it has been a vexed question I understand for
35 many years but I do think that there is acceptance now of
36 the rigor in the modelling that the SCA is using to define
37 sustainable yield. I guess the question there is, given
38 that that model factors in assumptions about acceptable
39 frequency of restrictions and duration of restrictions,
40 there has been some suggestion in the Hawkesbury and Nepean
41 that those parameters need to be revisited. The SCA's view
42 has been that if they are revisited, they need to be
43 revisited against the context of any change in security,
44 but the figure of 600 is a reliable figure coming out of
45 that model if the parameters remain unchanged. If they do
46 change in respect of reliability or robustness criteria
47 then you would see some increase upwards, but not

1 sufficient that one could avoid looking at a whole range of
2 these other options.
3
4 The other thing is that while there are a range of
5 competing pressures on the yield which might affect the
6 component of it that is available for consumption, the
7 general tenor of the discussions within the process that is
8 looking at environmental flows has been one of an adaptive
9 management approach so there is no suggestion coming out of
10 that process that there would be a dramatic and sudden
11 pressure on the yield. There is a strong focus in that
12 process, as I understand it, about adaptive management.
13
14 The other point I wanted to make, given that we often
15 blithely talk in these discussions about the community's
16 understanding of these issues and acceptance of issues
17 related to water scarcity, is that I agree with David Evans
18 that most people sitting on the bus are worried about other
19 things than drinking water and where it comes from but
20 there are some trends coming through in research the
21 Department of Environment and Conservation has done - and
22 the field work for that research was done before the
23 current restrictions were in place - that demonstrates that
24 people's concerns about water have shifted from water
25 quality and beach water quality over the last decade to
26 being concerned about water scarcity, and that is as true
27 for people in urban areas as non urban areas, so that seems
28 to reflect somewhat of a shift in people's concerns and
29 certainly a shift in their awareness of the issue.
30
31 The other thing to point out I guess in respect of the
32 current drought and restrictions is that the most recent
33 number that is generally reported about total consumption,
34 last year's figure, was in excess of 632 gigs. We project
35 by the end of this financial year we will probably have
36 used more likely in the order of 570, and that will be the
37 least amount of water provided to our customers I think in
38 the last six years. I am not familiar with the data
39 beforehand. We don't know the extent that is able to be
40 attributed to the restrictions, plus the cool spring, wet
41 on the coast, dry in the catchment, but it is a very
42 dramatic shift.
43
44 MS CIFUENTES: I have two questions: my first question
45 relates to a statement in your submission that the
46 effectiveness of the wholesale step price depends on the
47 degree to which the signal that it generates can then be

1 passed on to end users but there also appears to be a
2 reluctance in your submission and that of others we will
3 hear from today that that price signal should not be sent
4 directly to end users, so there should not be a direct link
5 between the wholesale set price and retail prices. How do
6 you reconcile that view and how is the tribunal to manage
7 that view?

8
9 MR WARNER: I think it is not saying the signal should not
10 be passed through. It is saying that at the border
11 boundary point you need to give careful consideration to
12 what the driver of the demand or the demand change has
13 been. Has it just been population growth? It is just not
14 an automatic flow through but consideration needs to be
15 given, is that the best policy response, does it need to be
16 augmented, finetuned, put up, how do you balance between
17 increasing tier 1 versus increasing tier 2? Those sorts of
18 issues I think also need to be considered and that is what
19 that was hinting at.

20
21 MS CIFUENTES: Should end users be protected from price
22 increases?

23
24 MR WARNER: No, I don't see that there is much value in
25 doing that. After all, it is the behaviour of the end
26 consumer that has to change to actually flow back up the
27 system.

28
29 MR HEAD: This is to be seen as a complementary initiative
30 with a whole range of other initiatives that are driving
31 the behaviour of end users and clearly that signal does
32 need to be sent. The SCA is reluctant to attempt to
33 stretch its expertise across a range of areas where we
34 don't have direct expertise, including retail pricing.

35
36 MS CIFUENTES: My second question relates to the role of
37 the Catchment Authority and any potential funds that may
38 arise from the step 2. Do you see that the authority has a
39 role in implementing demand management and supply
40 augmentation programs or is that a role that should be
41 exclusively with Sydney Water?

42
43 MR HEAD: This question has come up in an enormous number
44 of forums. I think Dr Parry may have asked this last time
45 I was sitting here. My own view is that what the community
46 expects is those government organisations that have a role
47 in this to be working together to secure those sorts of

1 outcomes and in fact, irrespective of whether or not the
2 Sydney Catchment Authority is essentially above Sydney
3 Water and catchment managers, it would be out of step with
4 the community's expectations for us not to see ourselves as
5 having a role.

6
7 I think the difficulty is working out the exact nature
8 of that role. David Evans mentioned in his presentation
9 issues to do with the necessary educative response to the
10 sort of changes we are talking about. I think it is clear
11 that a concerted educative effort is required and I don't
12 see any reason why an organisation like the SCA should not
13 play a role in that. People ought to be getting a
14 consistent and comprehensive view of the issues from
15 whatever point they happen to enter government on on those
16 issues but I think it is probably fair to say that
17 historically there has been a reluctance to overstep the
18 boundaries. Sydney Water clearly has a much more
19 significant role. I think the question is, what ought the
20 partnership look like? I don't think the SCA could put its
21 hands up and say it is not interested in that.

22
23 MR COX: You have provided I think a useful clarification
24 on the issue of sustainable yield. It still seems to me
25 that this really is an agenda for price increases, that
26 costs need to be recovered from the tier 1 water has been
27 argued, which might be a bit less than at the moment, and
28 also you argue the rate of return needs to increase. Do
29 you have views about the ability of consumers to accept
30 what may be increases?

31
32 MR HEAD: I guess the first point I want to make is that,
33 and Richard did mention this in the presentation, there are
34 very real pressures on the SCA in terms of the assets that
35 it needs to continue to manage and the catchment protection
36 programs that it needs to run, and to a large extent the
37 programs that sit there are not discretionary so we are
38 very keen to make the point that the costs required to do
39 that need to be protected.

40
41 One of the difficulties in terms of community
42 acceptance of price increases is that my impression is that
43 whilst there is some focus on the issue at the moment,
44 people are aware there is a drought, there has not been a
45 comprehensive discussion with the community about what is
46 required in the long term for us to have an efficient,
47 clean water supply. In a sense when water surfaces as an

1 issue it does in a drought, as it did in 1998, and I think
2 one of the challenges over the next 12 months to two years
3 is to better engage the community in looking at what the
4 long-term issues are for Sydney Water and the range of
5 options that are available to government to deal with those
6 issues.

7
8 If you listen to the radio, it is a part of my job
9 that every time it rains I spend the afternoon on the radio
10 explaining that the dams haven't filled. It is clear that
11 people are very interested in this issue and are concerned
12 to have better information in front of them about how it is
13 that we provide them with water and what the options are
14 for managing it in the future, so I think it is only
15 through that kind of process that you can test in detail
16 some of the assumptions about the community's views about
17 pricing as one of the tools.

18
19 MR COX: Richard suggested that the step price should be
20 set at long-run marginal cost. With long-run marginal cost
21 we think of in terms of wholesale price, so my question is,
22 why long-run marginal cost? The second question is, what
23 is your estimate of what that is?

24
25 MR HEAD: We don't have an estimate. Why long-run
26 marginal cost? Because that is the appropriate level to
27 have it for looking at these permitted supply side
28 alternatives and if it is set at that level, that is the
29 level at which people will start introducing it. The
30 reason why we don't have a calculation of that is because a
31 number of the feasible side options are in fact probably in
32 the hands of Sydney Water and they involve large scale
33 reuse and proposals like that. I guess you will hear about
34 rainwater tanks and some other supply side options. They
35 are part of the foreseeable range of supply side options
36 and that is where I think we need to actually collaborate
37 to do some work on what is the feasible suite of supply
38 side options. We don't have an estimate at this point.

39
40 MR COX: Thank you very much.

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1 DEPARTMENT OF ENVIRONMENT AND CONSERVATION

2
3 MR COX: Our next presentation is from the Department of
4 Environment and Conservation, of you could introduce
5 yourselves.

6
7 MR SMITH: Simon Smith, Deputy Director-General of the
8 Department of Environment and Conservation, and with me is
9 Kate Drinkwater.

10
11 I guess we believe the department's interest in this
12 is in seeing a healthy river system in the Sydney basin
13 and, secondly, essentially part of our submission is
14 achieving a healthy environment in New South Wales. We are
15 not thinking only about the river, we are trying to work
16 towards, with other agencies, a situation where we have
17 healthy waterways and a very efficient system of service
18 provisions so we have a clean, safe and reliable water
19 supply altogether.

20
21 I guess we find ourselves from my own readings at a
22 point in a very long story about water supply for Sydney.
23 The pattern is that the population grows, it tends to
24 outgrow the water supply that is available, there tends to
25 be ever frequent restrictions, there tends to be eventually
26 community dissatisfaction with frequent interruptions or
27 problems with supply and eventually generally very large
28 investments have been made to secure a much larger supply.
29 So we have moved from groundwater to little dams to big
30 dams to lots of dams, and that has been our history. We
31 are now reaching the point, as I think the SCA pointed out,
32 that we are pushing up against those limits and we have
33 very large population growth coming along.

34
35 I suppose where we are coming from is that now is the
36 time when we have to decide how we will address that
37 problem. I think the tribunal and Sydney Water has to be
38 congratulated, and SCA congratulated, on the work achieved
39 over the last 10 years in increasing the efficiency of the
40 system as it is now. For example, water now is relatively
41 much cheaper for the community than it has been. 10 years
42 ago I understand the average water bill for a household was
43 17 per cent more than average weekly earnings but we
44 understand now that it is actually 15 per cent lower than
45 average weekly earnings, so as a proportion of household
46 income water has become much cheaper. In fact, that is
47 precisely the opposite signal that we would argue is

1 necessary in the current circumstance. .
2
3 I guess we are arguing strongly that, although we
4 talked about these issues before, there have been various
5 discussions about whether it is elastic or inelastic in
6 terms of demand but we need to commit to a path where we
7 will either now essentially do something to build an
8 efficient way of addressing this problem or if we put it
9 off we will eventually be forced to take very expensive
10 action to meet it under circumstances where there may not
11 be the luxury of time.
12
13 We focused in our recommendations on two aspects: One
14 was the wholesale price and the other was the retail price.
15 We support the same view that has been put by Sydney
16 Catchment Authority, which is that there should be a
17 two-tiered price, that Sydney Catchment Authority should
18 obtain from the revenue of the first tier what it needs to
19 efficiently operate and pay dividends and so forth and the
20 second tier should be serving a different purpose, which is
21 to provide resources to commence the work of reducing
22 demand or augmenting supply so as to meet future need.
23
24 You asked just a moment ago about what that price
25 ought to be. We agree that in principle it should be an
26 amount sufficient to stimulate all measures that are
27 cheaper than going to build another new, major
28 infrastructure, say another dam or desalination plant or
29 those large solutions. We attached to our submission a
30 detailed compendium which set out a cost benefit analysis
31 on a wide range of options that we believe are easily
32 available in the Sydney market that could be provided by
33 public or private sector service providers.
34
35 That market is not yet well developed but I believe
36 that the work we have put in shows that if there was a
37 marketplace created so that those offerings could come
38 forward, that industry would grow rapidly and we would be
39 in a position in the future to have a diverse range of
40 options that would enable or give us a bit more choice
41 about how we would meet this challenge.
42
43 We say that in doing it that way the overall cost of
44 meeting the community's need for water would be less than
45 if we continue on the current path. I guess we are not
46 arguing for a highly sophisticated system to do that but we
47 do think now is the time to start to grow that industry in

1 an orderly way and that is the basis of our argument about
2 having a two-tiered price.
3
4 Thinking about, is now the time to make that step, we
5 have to look at the situation where Sydney Water had
6 already been set demand management targets and last I knew
7 there was not anyone who was saying, notwithstanding very
8 significant effort and good work by all involved, that we
9 are on track. Those targets were set in the IPART
10 operating licence and we believe it is appropriate that we
11 acknowledge that under the current arrangements it has not
12 proved possible to deliver those targets, they are still
13 valid and useful, but we need to do something else now.
14
15 I guess I endorse the remarks from David about how if
16 there is a tiered price that will create signals about
17 going to look for alternatives that are less than that
18 second tiered price and that is a very good signal to give.
19 Demand management always tends to be a bit of a poor cousin
20 compared to the real work of other traditional methods of
21 service provision and it needs to be mainstreamed in my
22 view.
23
24 They are our views on the wholesale price. We have
25 taken a slightly different view on what should happen in
26 the retail price. Our view is that it could well prove
27 problematic to establish tiered pricing for retail
28 customers because of the issues of recognising the equity
29 considerations about everyone needing enough water to wash
30 their children and how you decide what that threshold
31 should be. We think there will be a lot of complication in
32 going down that path. We don't oppose it in principle, we
33 say it may be difficult in practice.
34
35 Our alternative is to balance between retail price and
36 what is the fixed and variable component. Our argument is
37 that we should move as quickly as possible to eliminate the
38 fixed component of the bill in terms of a higher per
39 kilolitre price. The reason we argue for that is not based
40 on an argument that people are price sensitive and that
41 would of itself cause a reduction in demand, we think it
42 would be one factor, but that it would reward people who
43 might otherwise want to do that, and I have some examples
44 of that.
45
46 For example, with the current pricing it would take a
47 household 20 years to pay back the cost of installing a

1 rainwater tank. The people who are going to do that are
2 those who are doing it not for economic reasons, they are
3 doing it because they see other benefits in doing that. We
4 understand that if the average bill was converted to a
5 purely volumetric basis that it would take only seven
6 years. That would greatly increase the community's
7 interest in taking measures like this or other measures to
8 reduce their water consumption.

9
10 In that example, if a household reduced its water
11 consumption by 10 per cent, they would save \$24 a year.
12 This is not an amount that is really going to change the
13 community's attitude fundamentally, whereas if the bill was
14 put on a volumetric basis, the bill would be reduced by
15 \$66, which we believe is a much more significant amount and
16 more meaningful to the community.

17
18 Our experience has been in other fields, particularly
19 in relation to pollution control, that we need a range of
20 measures. We need to educate people about what they can
21 do, we need to encourage them to take action, we need to
22 provide the information, the technical advice and access
23 and so forth, but in the end there is a group in the
24 community which is fundamentally going to say, what is the
25 payback in this for me, and for many people it does not
26 always need to be a sufficient payback to make it
27 profitable but it is a very powerful incentive that
28 motivates their thinking about what it is they should do.
29 I would argue this would be true with water as well. This
30 is a very powerful complement to other measures that could
31 be taken.

32
33 I guess we would like to see a situation where demand
34 management is mainstreamed and that it does that in a way
35 that involves a range of service providers who perhaps
36 don't even exist yet and we would urge the tribunal to give
37 serious consideration to providing the start of that
38 framework. That is all we have to say.

39
40 MR COX: Thank you very much. I wonder if I can explore
41 with you a bit further your views on how the tier two price
42 should be set. It seems to be somehow we should take
43 account of the schedule you provided us and use that to
44 develop the price; is that right?

45
46 MR SMITH: No, what we are saying is that that appendix we
47 put in shows there are lots of things out there. In a

1 perfect market we would not need to look at the schedule
2 but what is available in the Yellow Pages about alternative
3 options. Look at that list, recognise that we are just
4 starting out on this, set a price that will raise
5 sufficient sums to enable the beginnings of a scheme that
6 would bring forward those offerings and recognise that is
7 only part of the solution, nevertheless think about how
8 much money would be appropriate to allocate to start to
9 stimulate the private sector offerings coming forward. We
10 would be happy to provide further detailed information
11 about that if you wanted it.

12
13 MR COX: That would be of great help. You also asked us
14 to venture down the vexed path of industry encouragement.
15 You can certainly argue there is a need to stimulate the
16 demand management industry but the problem with that, of
17 course, is that you may end up with an industry that simply
18 depends on the encouragement we give it and further more,
19 as demand management becomes mainstream, it might become
20 difficult to do that because people come to depend on that.
21 How should we manage those competing problems with
22 management assistance?

23
24 MR SMITH: I would not see the situation as providing
25 industry assistance. I would see it as addressing a
26 current market failure, that is, that there are people in
27 the market who would offer water efficiency services but at
28 the moment they are only able to capture in the revenues
29 those benefits that accrue to the public, not those costs
30 from additional infrastructure. You are not heading down
31 the path of building something just for its own sake, you
32 are correcting a failure.

33
34 MR COX: Maybe what we should provide should be linked in
35 some way to the failure and extent of it?

36
37 MR SMITH: I think so. We have done some modelling,
38 business models, of the people who might be in a position
39 to enter this market. We have looked at what their revenue
40 stream would be from various sources. Say, for example,
41 there was a company that set themselves up to offer water
42 and energy efficiency makeovers to small industry, they
43 would be able to go to a company, like an energy
44 contracting company does now, and say, we will install,
45 make some changes in your plant and some of that and this
46 will be paid by savings in energy, by savings in water
47 consumption on your bill, by potentially generating the

1 greenhouse certificates that may go with energy savings,
2 and as a package they would be very viable businesses. We
3 would be happy to provide that information also to you.

4
5 MS CIFUENTES: Just on this issue, presumably there will
6 be some time period involved within which this industry
7 will develop. During that time Sydney Water, under your
8 suggested scheme, will be exposed to financial pressure
9 possibly from higher tier prices. How do you propose that
10 we should deal with that financial pressure during that
11 time in which an alternative water business will commence?
12

13 MR SMITH: The minimum and maximum amount paid by
14 Sydney

15 Water should be stipulated so that the extent of exposure
16 could be capped.

17 MS CIFUENTES: There should be some allowance for recovery
18 of those two-tier prices.

19
20 MR SMITH: If you set up the tier 1 so SCA is in business
21 and the tier 2 price is set so that there would be a
22 sufficient sum available for this encouragement of the
23 demand management service provider but an ultimate cap
24 above which there is nothing extra to pay so Sydney Water
25 could not be exposed to excessive risk, that would be a way
26 to get going on it.

27
28 MS CIFUENTES: Would you also provide some clarification
29 about how you reconcile the two proposals, that is, that
30 Sydney Water should not really have a direct pass through
31 on tier 2 prices and looking at a new retail structure
32 which is essentially just volumetric price?
33

34 MR SMITH: I am not sure I am saying there should not be a
35 pass through. I would have thought that the cost of
36 obtaining water is one of Sydney Water's core costs and
37 that it needs to recover it from the customers.
38

39 MS CIFUENTES: It just was not clear from the submission
40 that that was the argument. The impression I got was that
41 there should not be any cost recovery of tier 2?
42

43 MR SMITH: No, I think there should be, but I acknowledge
44 that it is hard to say, because of the variability of
45 demand, how much that might be. That is why we are
46 suggesting that the scope for variability should be
47 constrained, at least in the initial years of change to the

1 system.

2
3 MR COX: Just one final question from me: Graeme Head
4 mentioned your Department had done work on the
5 acceptability of price increases for water and attitudes
6 towards water. Can you tell us a bit more about that?
7

8 MR SMITH: What I would prefer to do - I am familiar with
9 the document, it is called "Who Cares About the
10 Environment", which is a survey we have done about every
11 three or four years for quite a long time - I will provide
12 a copy to the tribunal. The questions didn't specifically
13 say, "Do you want to pay more on your water bill", but they
14 do seek to gauge the community's attitude about what
15 environmental issues they see as most important, which ones
16 they believe more resources should be spent on, even at
17 their own expense, and whether that should be through taxes
18 or user charges, et cetera, so there is that information
19 available to you. As Graeme said, it does show that water
20 conservation is a very important thing to be addressed now.

21
22 MR COX: Thank you very much.
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1 TOTAL ENVIRONMENTAL CENTRE & NATURE
2 CONSERVATION COUNCIL

3 MR COX: The Total Environment Centre and Nature
4 Conservation Council are next and I understand are doing
5 joint or linked presentations, so if you can perhaps both
6 come forward and we will get underway. What you will do is
7 both speak briefly and then we will have a combined
8 question period.

9
10 MR PRINEAUS: I am representing the Nature Conservation
11 Council, which represents some 120 non government
12 conservation organisations throughout the state.

13
14 We believe the retail price for water in Sydney is
15 lower than it needs to be and I think it has been mentioned
16 at previous hearings and again today that the real price of
17 water today is lower than it was 10 years ago, and that is,
18 of course, a reflection of IPART's success in making the
19 industry more efficient. However, it is sending the wrong
20 signal in terms of water use and we think that needs to be
21 addressed and we congratulate you for addressing the
22 situation.

23
24 The dams managed by the Sydney Catchment Authority
25 from which Sydney Water draws its water are beyond
26 sustainable yield and, indeed, we feel that the 600
27 gegalitres suggested sustainable yield is actually quite
28 high and that when we come to take into account
29 environmental aspects, including the need for environmental
30 flows, the sustainable yield from the storage is made
31 significantly lower than that, maybe closer to 500
32 gegalitres, so the situation is fairly serious taking into
33 account the excess draw or storages that exist now and the
34 estimated population growth over the next 20 years or so.

35
36 In addition, of course, we have a drought, and there
37 are the effects of climate change which pose additional
38 uncertainties.

39
40 There has been some criticism of the fact that it is
41 New South Wales Government policy at the moment not to
42 encourage the building of another dam as a way of dealing
43 with the problem. This is stated as having been ruled out
44 in the foreseeable future on environmental grounds. The
45 view of the Nature Conservation Council is, of course, that
46 it is not just an environmental issue, indeed, there are
47 very few options for new dams that can serve Sydney which

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1 would not take water from other communities and which could
2 be established in an environmental sustainable manner
3 anyway.

4
5 The Welcome Reef dam on the Shoalhaven is often
6 mentioned as the next site. We feel that the Shoalhaven is
7 already contributing a significant amount of water to
8 Sydney and it is not at all clear that it can supply any
9 more on a sustainable basis, so we question whether that is
10 really a serious alternative proposal.

11
12 Other proposals such as desalination of seawater we
13 think are outside the reasonable range of alternatives
14 because of cost and the enormous amounts of energy that
15 would be consumed contrary to state green house policy.

16
17 We support recycling or reuse as a major solution and,
18 of course, demand management in various forms, including
19 non-price demand management, and we support pricing as a
20 part of an integrated approach which involves all these
21 various tools.

22
23 We ask that consideration be given by the Government
24 too to the effects that the present situation might have on
25 an increasing draw on groundwater in the Sydney area.
26 There are some early indications that there is a movement
27 in this direction and the NCC is concerned that if such a
28 trend is established that the environmental issues should
29 be adequately addressed and the resource well regulated.

30
31 In terms of the pricing choices, the Nature
32 Conservation Council favours the inclining block for the
33 retail tariff. We think an inclining block is an
34 appropriate structure that sends a good strong signal. It
35 is educative. There is some indication in surveys done I
36 think by Sydney Water that suggests that people are
37 receptive to the idea of the inclining block and have some
38 confidence in the efficacy of that particular structure in
39 reducing water consumption, whereas not so much confidence
40 is expressed in the other models.

41
42 Also we favour the inclining block because it does
43 target the higher end user and so there is some kind of
44 moral appropriateness about that, and again from an
45 efficacy point of view it is the higher user in the
46 residential sector that is more likely to respond to the
47 higher price because the elasticity of demand is going to

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1 be greater.
2
3 In terms of the various scenarios in the discussion
4 paper, we would want to put the step low. 300 kilolitres
5 was mentioned in scenario three and one of your scenarios
6 in the appendix went down a bit lower, I think to 200.
7 Perhaps some development of a model in between those two
8 could be seriously looked at because there is some doubt
9 about the response that will be got given IPART's concerns
10 about whether there will be a reaction to the average price
11 bill or to the marginal price and that is a bit of an
12 unknown at this stage and further investigation of that
13 needs to be done. At this stage we are asking that you
14 don't rule out higher steps of the kind that are mentioned
15 in I think scenario seven in your appendix.
16
17 The business or commercial industry price: We accept
18 that if at all possible there should be a consistent
19 approach to pricing across residential and industrial
20 sectors. However, there does not appear to be any logic in
21 the step in the residential context when you apply it to
22 the business context and we note IPART's efforts to find
23 another step nexus, including the meter size, and we are
24 not convinced of that either but would not rule it out at
25 this stage.
26
27 I think the important thing is to make sure that you
28 do get the mechanism working in the residential sector
29 because that is where most of the demand is and if you
30 can't apply something consistent to business then I think
31 we may have to have a different approach. Instead of
32 looking at the second block as some kind of penalty in
33 terms of the price setting, perhaps we should look at the
34 first block as some type of concession. In other words,
35 the second block price should be the across the board price
36 because it is approaching the real price of water and the
37 first block is really a concession to those people in the
38 private capacity and in their homes who need to have water
39 for essential uses, and therefore business which is capable
40 of passing on its costs and also defraying its costs
41 through tax claims and deductions is in a better position
42 than the private citizen to meet the increased price of
43 water. So block 2 price should be seen as the norm and
44 block 1 as the concession. Business should be treated
45 accordingly.
46
47 Getting onto the wholesale situation, the Nature

1 Conservation Council supports the wholesale step price
2 structure. The step quantity should be set at the
3 sustainable yield of the catchment. However, we note our
4 earlier position that the sustainable yield is probably
5 certainly lower than 600 gigalitres per annum.
6
7 In terms of pricing, we are not absolutely sure of
8 where or how the pricing should be determined, but we would
9 point out that if you're going to seriously reflect
10 environmental costs in the price of water generally - I
11 believe the long-run marginal cost is an attempt to do
12 that - then some element of the long-run marginal cost
13 really has to be reflected in the tier 1 of the wholesale.
14 Otherwise you're not getting to the ecologically
15 sustainable position which you're aiming at in the long
16 run.
17
18 If you have the long-run marginal cost reflected in
19 tier 2 only, you're really allowing yourself to get into a
20 position where you're acting too late. One would hope that
21 Sydney Water would not be venturing too much into tier 2 in
22 the wholesale area and that it will be successful in
23 actually meeting demand management targets as a result of
24 the price reform and other reforms. So NCC would argue
25 that the long-run marginal cost, including the
26 environmental costs of water, should be reflected in tier 1
27 pricing and that tier 2 should be a penalty over and above
28 that.
29
30 In regard to what happens to any money that is more or
31 less a windfall from tier 2, we would argue that there is
32 not much point in rewarding Sydney Water in revenue terms
33 for having ventured into that area. Therefore, that
34 revenue should be hypothecated to a fund of the kind that
35 was mentioned in the discussion paper which would be set up
36 to invest that money by tender process as suggested in
37 demand management and recycling investment projects in the
38 Sydney area. That should be an independent body and
39 preferably under a different minister. We suggest the
40 environment minister.
41
42 I looked at the Department of Environment and
43 Conservation submission and its range of scenarios and it's
44 not all bad because one can find, I think, something like
45 300 gigalitres of extra water from quite acceptable
46 proposals, not including the need to build a new dam or
47 build a desalination plant. So there is a lot of water to

1 be saved and made available. It's just a question of us
2 working through the institutional structures so that they
3 are progressed over the next five to 10 years. Thank you.
4
5 MR COX: Thank you. Leigh, do you want to go on?
6
7 MR MARTIN: Leigh Martin from the Total Environment
8 Centre. There's probably a fair amount of common ground
9 between what I'll say and what Peter's just said, so I'll
10 try to avoid needless repetition. It's important to start
11 by emphasising that I certainly agree with NCC's view about
12 needing to consider the actual level of sustainable yield,
13 the knowledge that 600 gegalitres is sustainable yield in
14 current supplies without factoring in environmental flows
15 which we believe are absolutely essential.
16
17 We know that it's going to require about 600
18 gegalitres. I don't believe you could consider any yield
19 is sustainable if it doesn't provide for environmental
20 flows for the Hawkesbury Nepean system. It needs to be set
21 at 600 gegalitres, certainly in terms of providing
22 long-term sustainability for the system. We can't continue
23 to operate on the basis of 600 gegalitres.
24
25 I want to make a couple of brief comments about some
26 of the theoretical considerations the tribunal raised in
27 its discussion paper. The first was about the use of
28 short-run marginal cost or long-run marginal cost as a
29 basis for determining prices. We support the long-run
30 marginal cost, acknowledge its difficulties and some of the
31 complexities in actually determining what they would be,
32 but certainly support it in terms of allowing the
33 environmental costs and other factors to be incorporated
34 into the pricing decisions.
35
36 There's also been a degree of consternation over the
37 years about the relative inelasticity of water. I note
38 that some of the tribunal's research has concluded that,
39 for instance, a 10 per cent increase in price would equate
40 to only about a one per cent decrease in demand. I think
41 you have to view that in the context of, allowing for
42 environmental flows with sustainable yield being at 600
43 gegalitres and current use running at about 630, even 1 per
44 cent of that is a fairly significant, we're talking about
45 6.5 gegalitres. That's a fairly significant contribution
46 to getting us down towards what is currently considered
47 sustainable yield.

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1
2 It's also, I think, very important to consider pricing
3 is only one mechanism for demand management and it should
4 be used to complement non-price mechanisms as well. It
5 shouldn't be viewed narrowly as pricing being able to offer
6 only a relatively small contribution. It should be there
7 to reinforce the signals that have been sent by non-price
8 demand management measures as well.
9
10 Regarding the actual retail pricing structures, we
11 support inclining block pricing basically for both its
12 ability to send a clear signal to consumers about the need
13 to conserve water below a certain level, but, in
14 particular, its ability to target discretionary water use
15 most tightly, but we also see, and we've long argued, that
16 there needs to be a significant reduction or indeed even an
17 elimination in fixed charges. So what we would support
18 would essentially be a hybrid between the two systems
19 whereby we would see a significant reduction in fixed
20 charges, or preferably even their elimination, and
21 ultimately those factors which weren't covered in fixed
22 charges would be incorporated into the tier 1 price and
23 then the tier 2 price would be used to target that higher
24 end water use.
25
26 I support Peter's comments about where that step
27 should actually be and closer investigation of some of the
28 other scenarios the tribunal looked at in terms of lowering
29 the step volume. I think it should be set at the lowest
30 point that is feasible whilst still allowing for those
31 people who use less than average water consumption to have
32 some reward in terms of reducing the size of the bills.
33 There is some value, some strong value, in rewarding people
34 whose consumption is less.
35
36 I note - I think it is a legitimate concern - that
37 step pricing may have an impact on large disadvantaged
38 families. I don't believe that issue on its own is enough
39 to reject step pricing. I think the tribunal can certainly
40 do some work on how to alleviate that. But I think it's
41 very important to bear in mind some of Sydney Water's own
42 figures on consumption which show that some of the highest
43 water use has been recorded, for instance, three years in a
44 row in Woollahra, at 409 kilolitres; Kuringai, at 402;
45 Hunters Hill, at 401; Baulkham Hills, at 399; and Mosman,
46 at 371. Those are not generally parts of Sydney that are
47 regarded as representing the economically disadvantaged.

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1 So I think there's a point to be made that some of that
2 high-volume water use is certainly for discretionary
3 purposes, such as large gardens, heavy water-consuming
4 gardens, swimming pools, et cetera. The equity arguments
5 need to be kept in perspective and certainly viewed in
6 terms of where the highest consumption is occurring in
7 terms of socioeconomic factors. I think there's clear
8 indication that some of the wealthier areas of Sydney are
9 using the greater volumes of water.
10
11 There's also, I guess, as Peter acknowledged, the
12 issue of how you apply the step pricing to the commercial
13 sector. Obviously it's difficult to transfer the step
14 point across at the same volume. We see some merit and
15 some logic in essentially having the same pricing steps,
16 but in having the step point determined by the actual meter
17 size. There are some limitations in that, but from what
18 we've seen so far, it is probably the best approach for
19 transferring inclining block pricing to the commercial
20 sector.
21
22 There are a couple of other points I wanted to make
23 regarding residential use. One of those is the issue of
24 wastewater and sewerage pricing. We've argued for a long
25 time that there should be essentially usage pricing for
26 wastewater services. I know that is something the tribunal
27 has been reluctant to consider in the past because I guess
28 the tribunal's view has been that wastewater charges
29 shouldn't be used as a means of trying to reduce usage of
30 fresh water. I think that's perhaps a narrow way of
31 looking at it. Pricing of wastewater services is not
32 merely a function of covering the demand for water and the
33 environmental costs of use of water. It needs to be
34 recognised that disposal of effluent, treating of effluent,
35 carries with it economic and environmental costs,
36 particularly in accordance with the user pays principle.
37 We think there's strong argument for having volume
38 wastewater pricing. We acknowledge that that is difficult
39 to do without any form of metering, so we would favour the
40 usage of a discharge factor. Again, we acknowledge that
41 that's an imperfect system, but we believe it's a fairer
42 system and certainly a more environmentally responsible
43 system than the current pricing arrangements. Also, just
44 in terms of reducing the fixed component of bills, it's
45 another contribution to giving customers greater control
46 over the size of their bill.
47

1 I think as important as residential pricing is in
2 application of inclining block pricing, it's equally if not
3 even more important for inclining block pricing to be
4 applied at the wholesale level. It's something that we've
5 argued for for a number of years, certainly in the last
6 several pricing investigations and in operating licence
7 reviews. I think there is a serious problem in that there
8 is a perverse incentive for Sydney Water to fail its demand
9 management goals and not to meet its demand management
10 targets, in that essentially the more water it sells, the
11 greater its profit will be. Rather than being penalised
12 for failing to meet demand management, as has been the
13 trend, they are essentially rewarded by gaining more
14 profit.
15
16 The tribunal recognised that in the discussion paper
17 of the last pricing determination, where it acknowledged
18 that there was surplus revenue, certainly it sets its
19 prices on the assumption that Sydney Water will meet
20 demand
21 management targets. If those targets are exceeded, then
22 extra revenue accrues to Sydney Water. So we see that it
23 is very important to introduce a financial penalty for
24 Sydney Water if they exceed the level of sustainable yield.
25
26 We believe that cap, as I said, should be set at
27 500 gegalitres. If Sydney Water purchases more water from
28 the Catchment Authority than that, then that is reflective
29 of the fact that they have failed to meet their obligations
30 in terms of demand management. We want to see a situation
31 where it is essentially economically more sound for Sydney
32 Water to invest in demand management and particularly
33 non-price measures to reduce demand for water than it is
34 for them to incur the financial penalty from the Sydney
35 Catchment Authority for its exceeding the bulk water limit.
36
37 I have some concerns about some of the arguments that
38 the tier 2 price should be passed on to the consumer. That
39 would limit its effectiveness as an incentive for Sydney
40 Water to invest in demand management and essentially would
41 no longer be a financial penalty for failing to meet their
42 demand management targets. They could essentially pass it
43 straight through to the customer. There needs to be a
44 recognition that customers have a responsibility in terms
45 of reducing demand for water but also Sydney Water has a
46 clear responsibility in terms of ensuring that its programs
47 are in place and that it's doing everything possible to
reduce demand as well. As I said, step price we believe

1 should be linked to the actual sustainable yield, the
2 actual step point. So we believe it should be 500. It may
3 even in the future need to be revised from that.
4
5 I guess that raises the issue of there will need to be
6 some acceptance of changes in security of supply criteria,
7 acceptance of perhaps permanent outdoor water restrictions
8 or more frequent and more severe water restrictions. We
9 very much look forward to the opportunity to go into
10 those in detail when the tribunal considers those issues,
11 which I understand will now be in the first half of next
12 year, but I think there needs to be a recognition that we
13 have to change the way we use water in Sydney. Other
14 cities around the country have done that. So we
15 acknowledge that setting the cap on bulk water extractions
16 of 500 gigalitres will have issues in terms of how we
17 manage the demand and supply imbalance.
18
19 I think those are the most important issues. The only
20 remaining issue I want to discuss is what you do with the
21 surplus revenue, the additional revenue that would come
22 from a wholesale step price. We support NCC's position
23 that it should be placed in a dedicated fund for use on
24 demand management works. It serves no purpose if the extra
25 revenue is essentially passed back to treasury. We believe
26 it should be used to address the problem that has occurred.
27
28 MR COX: Thank you very much. Cristina?
29
30 MS CIFUENTES: I guess my difficulty with the issue of
31 whether the higher cost of wholesale water should be passed
32 on to end users is how will Sydney Water fund the purchases
33 above that step level and, in particular, on a sustained
34 basis? I think underlying this is an assumption that those
35 demand management responses will happen very quickly,
36 that
37 Sydney Water will be able to significantly reduce demand.
38 It seems to me that that's a reasonably bold assumption
39 which again exposes Sydney Water to financial risk. Is
40 that an appropriate financial model, given that IPART has a
41 responsibility to balance a suite of interests, including
42 the financial viability of the organisation?
43
44 MR MARTIN: I guess the ultimate goal was that Sydney
45 Water should not be incurring a penalty because it won't be
46 incurring the second tier price. I acknowledge the
47 difficulties that you're pointing out, but I stress that if
48 Sydney Water is essentially able to pass through the whole

1 financial penalty, then it provides a very weak incentive
2 for them to invest in demand management and not to incur
3 that penalty price. So we want to see a situation where
4 Sydney Water has to make its commercial decisions on
5 avoiding that.
6
7 I believe an organisation of Sydney Water's size and
8 expertise and with the nature of its budget, it has the
9 capacity to manage those issues. I think the signal for
10 them should be as strong as possible that if they do exceed
11 the sustainable yield, then they have an obligation to
12 meet. That's their risk. That's a risk they have to
13 address. The risk is that if they exceed sustainable
14 yield, that will incur a financial cost to the corporation.
15 So that provides them with a clear signal that they have to
16 make investment now to reduce demand in order to avoid that
17 financial risk.
18
19 MS CIFUENTES: Shouldn't some of those same arguments,
20 though, apply to the end user, and it seems consistent with
21 the argument for a purely volumetric retail tariff, we need
22 to get price signals out there, particularly to the end
23 user? But to some extent the end user won't get that price
24 signal.
25
26 MR MARTIN: I think the end users, their signal should be
27 in terms of if they are exceeding what is considered the
28 average water use or what is a sustainable level for
29 customers, then they incur the financial penalty. I guess
30 to that extent some of the extra cost is passed through,
31 but I think the burden needs to be shared by customers and
32 Sydney Water. If customers are already being penalised for
33 high-volume water use by an inclining block system, then I
34 don't think Sydney Water should then be able to pass
35 through the penalty that's applied to them as well.
36
37 MR PRINEAUS: Can I make a comment on that?
38
39 MS CIFUENTES: Yes.
40
41 MR PRINEAUS: The proposition is that Sydney Water will
42 be
43 selling less water at a higher price. That's not a bad
44 situation to be in. I don't see that that will impose
45 enormous risks on them from the point of view of their
46 revenue, or at least risks that are unreasonable or
47 unmanageable.

1 There is a problem in terms of the lead time in
2 bringing it in. I agree it would be expected that there
3 might be some overstepping of the sustainable yield at the
4 dams, but maybe this is going to be an iterative process
5 and you're going to be adjusting that level in the light of
6 experience over the next few years. Maybe you're not going
7 to start at 500 gigs. Maybe you're going to start at
8 something a bit higher.

9
10 I heard an encouraging remark from the SCA that last
11 year they were down to 570. We're talking about something
12 that's achievable. I don't think anybody suggested they
13 shouldn't retain the revenue from the second block retail.
14 That's never been suggested.

15
16 MR COX: That's right.

17
18 MR PRINEAUS: That is a windfall for Sydney Water.

19
20 MR COX: Depending what we do for the rest.

21
22 MR PRINEAUS: Well, yes.

23
24 MS CIFUENTES: Just finally from me a number of thresholds
25 or step levels have been suggested, including possibly one
26 as low as 250 kilolitres. Do you have a basis for having
27 suggested that, just as a modelling estimate, or do you
28 have a feel for what might be discretionary use or what
29 might be an appropriate level of use?

30
31 MR PRINEAUS: I'm really reliant on the literature that
32 I've read and my own experience as a consumer. The
33 high-end users certainly are over the 300, getting above
34 the 300 level. A lot of people in Sydney don't go anywhere
35 near that because they're living in flats and they're not
36 even getting to 300, they're well below it. So 300 is
37 getting into the ballpark.

38
39 I think perhaps some work ought to be done on
40 scenario 6, I think it was, which went down a bit lower, to
41 200 kilolitres per annum. That's obviously too low. Some
42 sort of hybrid of those two scenarios might be looked at
43 and investigated a bit more. The 400 is far too high, I
44 feel. That would really leave you with only a very small
45 proportion of people affected and the block price would not
46 apply.

47

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1 MR COX: I guess the issue is, if you have a low step on
2 the retail side you get more water, so to speak, subject to
3 the higher price, but you're probably also getting more
4 non-discretionary water. People need to use that water for
5 internal purposes, and whatever. There's a tradeoff there,
6 isn't there?

7
8 MR PRINEAUS: Yes, you don't want to punish people for
9 having a shower and brushing their teeth. But I think
10 you're well within that if you're looking at 250 to 300
11 kilolitres per annum as the appropriate step. If you're
12 going to affect some group unjustly - I think, looking at
13 Sydney Water's submission, there's only one group that
14 comes out as being seriously affected because they're high
15 users of water and low income, and that's a subset of the
16 large family group, and I think there was not a large group
17 of people in that category. I think it was 20,000 or so at
18 the lower end of the income level. So we're not looking at
19 a large group that use a lot of water and can't afford what
20 is being proposed.

21
22 A safety net program has been established which can be
23 applied to that group. They can have assistance with
24 retrofit to get their water consumption down and there are
25 various other strategies that Sydney Water has which have
26 been applied in situations like this. So I don't see that
27 as a big issue.

28
29 MR MARTIN: It's difficult to give a precise figure on
30 what the step point could be because obviously we're
31 reliant on the modelling the tribunal has done. We want to
32 manage demand for water, not to manage thirst, so trying
33 not to target the non-discretionary use. I think the
34 principle the tribunal should follow is trying to achieve
35 the greatest savings in water consumption for the least
36 social impact, and if you can find a mechanism which allows
37 the step point to be set lower than some of those models,
38 or some of those two options that you had in the discussion
39 paper, we certainly believe the lowest possible step point
40 for the least social impact is the way to go.

41
42 MR COX: On the wholesale side, you seem to be saying, as
43 I understand you correctly, that you'd like the first step,
44 so to speak, to be long-run marginal cost and then there to
45 be a penalty for the tier 2 price. Any thoughts on what
46 the penalty there should be and how one would work it out?
47 What do you think the appropriate amount would be given the

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1 tier 1 is long-run marginal cost?
2
3 MR PRINEAUS: No. We haven't done the calculation.
4 Really the modelling, and so on, that's required is beyond
5 the capacity of a group like the NCC. If you're going to
6 apply long-run marginal cost to tier 1, I think maybe you
7 can only apply elements of it, I don't know. If you apply
8 long-run marginal costs comprehensively at tier 1, you may
9 get a price that's a bit frightening, so you may be able to
10 apply only elements. The idea that you can apply the
11 short-run marginal costs to tier 1 is a bit self-defeating
12 if you're trying to improve the overall demand supply
13 balance because you don't even begin to address the problem
14 until you've got into the prohibitive zone of excessive
15 demand. You have to address it before you get there.

16
17 I think that's being recognised in the retail side of
18 things, in what's envisaged in the pricing there, but it's
19 perhaps not being recognised sufficiently in the wholesale
20 side. We're talking only about applying long-run marginal
21 cost after sustainable yield has been exceeded. That's not
22 realistic. In terms of actual dollars, I haven't done the
23 calculation and we don't have the modelling capacity to do
24 it.

25
26 MR COX: Thank you very much. We'll now break for lunch
27 and we'll resume at 1.30.

28
29 LUNCHEON ADJOURNMENT
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1 AUSTRALIAN BUSINESS LIMITED AND QENOS LIMITED.
2

3 MR COX: The first session we start with this afternoon are
4 presentations from Australian Business Limited and Qenos
5 Limited. I understand they are going to make two
6 presentations, one after the other, and a joint question
7 time. I invite the representatives to come forward and
8 introduce themselves. .
9

10 MR CAROLIN: Michael Carolin, I am the Environment Adviser
11 with Australian Business Limited and have been for the last
12 seven years. Australia Business Limited is an industry
13 association representing approximately 17,000 members and
14 associates across manufacturing through to the service
15 sector, from large businesses down to micro.
16

17 I will be limiting my comments to those parts of the
18 issues paper which relate directly to commercial and
19 industrial customers, primarily sections 4.2.4 and 4.3.4.
20 This issue of inclining block tariffs was discussed by the
21 ABL Environment Committee on 20 February. While all
22 participants recognise the need for commercial and
23 industrial customers to continue efforts to reduce
24 consumption of water there was a failure to see how the
25 proposed system of an inclining block tariff would actually
26 achieve this effectively, efficiently and without bias,
27 that is, by targeting that portion of water use that
28 industry could manage without unfairly burdening one sector
29 to the benefit of another.
30

31 As Sydney water alluded to, for commercial and
32 industrial customers the failure of the inclining block
33 tariff is founded in the problems associated with finding a
34 general calculation that could be applied to the commercial
35 and industrial users that would achieve the desired
36 outcome, that outcome being to target that part of water
37 consumption which can be reduced as described in the issues
38 paper as discretionary water use, that is, the elastic
39 part.
40

41 The scenarios given, use a water meter, for example,
42 to position a price stepped base on this mechanism ignores
43 a variety of sector specific issues, that is, the level of
44 discretionary water use in sectors based on company size or
45 company sector and geographic issues which were seen as
46 water pressure issues in the mains, which is a function of
47 water draw through any meter size. The mechanisms in an

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1 inclined block tariff target large water users which
2 appears to work on the assumption that water use is bad
3 regardless of how efficient it is used within a sector. In
4 fact, it is these sectors which have done the most to
5 manage water use, simply because there are greater
6 financial gains to be made.
7

8 If the inclining block tariff were not the mechanism,
9 the committee asked itself, what is the mechanism to drive
10 demand management in business? There is general agreement
11 that the information provided in the issues paper wasn't
12 able to give us enough detail on the split of water cost
13 increases in the various sectors to make a valid decision
14 on it. The committee acknowledges that the debate was a
15 necessary one and a valuable one and looks forward to
16 continuing engagement in the discussion. Thank you.
17

18 MR COX: Perhaps now Qenos could come forward and make its
19 presentation.
20

21 MR BELL: I hand you a hard copy of what we are going to
22 go through. I am Steve Bell, General Manager, Commercial,
23 for Qenos.
24

25 MR FOX: Gary Fox, Plant Manager, Utilities.
26

27 MR BELL: Qenos is here making representation on behalf of
28 its own operations and also as part of an integrated
29 facility at Port Botany. It is Australia's only and
30 largest producer of polyethylene and supplies a broad range
31 of chemicals across both the consumer and industrial market
32 sectors. We have plants in Victoria at Altona and Botany
33 in New South Wales and employ directly nearly 1,000 people
34 within those two operations. We are the cornerstone of the
35 Australian petrochemical industry, adding significant value
36 to ethane and oil from the Moomba Basin in South Australia
37 and Bass Strait by converting them into high value
38 plastics.
39

40 We are an integral part of the Botany industrial park.

41 We supply steam, raw materials and services to all the
42 other manufacturers on the site, and those manufacturers
43 employ a further 400 people within the site.
44

45 The utilities plant at Botany is part of an integrated
46 site which supplies utilities, as I indicated, which is
47 steam, gas and water, to the other co-tenants. Qenos's

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1 manufacturing operation is a two-stage process, whereby we
2 have an olefines operation which manufacturers ethylene and
3 that ethylene is then converted into Alkatuff and Alkathene
4 through a polymerisation process in downstream plants.
5

6 By nature the operations are very high capital
7 manufacturing operations. It is a very capital intensive
8 process with a replacement value estimated to be \$1.2
9 billion. Water is an integral part of the Botany
10 operations and the usage is broken down, as you can see,
11 roughly 60 per cent cooling water, 35 per cent to steam
12 generation and some 5 per cent to general plant usage. We
13 recognise an incremental water reduction program is
14 possible and in fact a certain amount of success has been
15 enjoyed in that area, which I will go through in a minute.
16 However, further reductions require investment in
17 technology and time to harvest the benefits.
18

19 Typically for our operation, water usage is not a
20 discretionary activity and we have a limited ability to
21 impact water usage due to the nature of the process. Qenos
22 cannot readily reduce water consumption on a year on year
23 basis in order of magnitude of 20, 30 or 40 per cent.
24

25 There is a chart next showing some of the success we
26 have had with water reduction to date, which has been
27 significant, and that is overlaid against a backdrop
28 whereby we have actually increased the production on the
29 site by some 12 per cent. So, whilst reducing overall
30 water usage, there has been a significant increase in
31 production and hence the unit water usage per tonne of
32 product produced is in fact quite significant in terms of
33 reduction.
34

35 The current price, there is a typo there, that should
36 read 90 cents a kilolitre, of water at Botany. This is
37 already significantly higher than the price that we pay at
38 Altona, Melbourne, and the proposed price scenarios
39 outlined in the paper represent a 30 to 40 per cent
40 increase in water cost to our operation.
41

42 In Qenos's view the proposed pricing structures
43 scenarios need to be designed to assist large customers to
44 work with Sydney Water to establish opportunities. Pricing
45 structures that provide a disincentive to use water fail to
46 suit the mechanisms of the manufacturing industry such as
47 ours who use water as a major input into capital intensive

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1 manufacturing processes.
2
3 Large customers like ours can contribute significantly
4 to water reduction programs on the basis of a reward
5 penalty structure on achieving agreed milestones. This is
6 similar to the approach used by the EPA in Victoria.
7
8 The way we would see it from the paper is that Sydney
9 Water is proposing a pricing strategy in the absence of
10 having calculations of short-run and long-run marginal
11 costs. From our point of view we believe it is necessary
12 to have an understanding of costs before proposing a
13 pricing strategy. We believe that these calculation costs
14 should be addressed as part of any review of the pricing
15 mechanism strategies. We also don't agree that the
16 valuation of assets at current cost levels and pricing to
17 reflect replacement cost is realistic and in line with what
18 should be the practice - or standard practice.
19
20 Based on Qenos's water consumption of approximately 3m
21 kilolitres per annum over the last five years Qenos will
22 under the proposed pricing structures incur substantial
23 increased water costs of between 30 and 40 per cent and
24 that basically translates into a \$1m per annum increase in
25 the cost of inputs to our manufacturing operation. Qenos's
26 business in petrochemical is a global business and is
27 exposed to global supply demand economics. We don't have
28 the ability to pass on any cost increases through to our
29 customers. Our business is priced on market pricing based
30 on pricing in the region. There is not an opportunity to
31 pass the costs onto the marketplace.
32
33 I have shown a graph there as well in the pack which
34 shows the price of polyethylene, which is the product that
35 we manufacture and market in the south-east Asian region
36 since the mid-1980s, and you can see from the pricing trend
37 there, which is quite volatile due to supply demand
38 factors, that the trend line over time is a continually
39 decreasing price for our product. In fact, the price of
40 polyethylene declines on a typical basis in the order of 2
41 to 4 per cent per annum in real terms year on year and
42 therefore we must continually and relentlessly drive our
43 cost and efficiency at the same rate just to keep pace. In
44 fact, we must be better because of the competitive
45 pressures coming from offshore.
46
47 Any pricing structure that adds significant cost

1 impact to our operation without the ability to readily
2 defray that is a real problem for the business.
3
4 In summary, Qenos believes that Sydney Water should be
5 calculating the short-run and long-run marginal costs of
6 water delivery and that this is a key prerequisite to any
7 sort of pricing strategy. There is a very significant
8 impact through increased water charges on Qenos's cost
9 competitiveness and the viability of the business and we
10 are in a globally competitive environment where the
11 competition for capital to increase or invest and increase
12 investment in our business is quite demanding and if the
13 cost impost that comes through increased input costs are
14 such that they can't be addressed adequately then we will
15 have a lot of difficulty justifying investment in this
16 marketplace.
17
18 We have options of investing in either the Altona or
19 Botany operations and those decisions are based on the
20 long-term economics of the operations and the
21 competitiveness of the operations, so comparison of costs
22 of even basic inputs such as water are quite critical to
23 that process.
24
25 It is worth noting also that frequently this is a bit
26 in the opposite direction to what we have experienced in
27 recent times with other utilities such as gas and
28 electricity whereby we have been successful in reducing the
29 costs of those inputs.
30
31 The introduction of pricing structures that provide
32 self help or incentive operations for large non industrial
33 customers to work with Sydney Water in partnership and to
34 identify mutual water saving opportunities we feel are
35 approaches that ought to be considered. Basically we see
36 that pricing should not be a punitive pricing approach but
37 one that has a reward aspect associated with it whereby the
38 benefits of working together to reduce water consumption
39 are shared as opposed to a punitive approach because Qenos
40 certainly does not, and most manufacturing generally, have
41 a lot of discretion in terms of its ability to just readily
42 reduce water consumption.
43
44 MR COX: Thank you very much. I think both presentations
45 stress that you were not greatly attracted towards some of
46 the step pricing options. Do you have views about whether
47 water pricing in Sydney is excessive, inadequate,

1 unreasonable?

2
3 MR CAROLIN: A classic industry answer is we are quite
4 happy with the water pricing at the moment but the issue of
5 financial incentives is one that comes up constantly when
6 we are dealing with inputs into businesses and the need to
7 reduce them. Finding the right mechanism, where to apply
8 the pricing incentive and how that functions, is the key to
9 it all, so I guess the devil is in the detail as always.

10 But we feel that there are opportunities out there, it is
11 just a case of exploring them.

12
13 MR BELL: From our point of view, and Garry will talk to
14 some of the detail, we have identified a range of projects
15 where we can actually reduce the water consumption in our
16 operation. Those projects typically require significant
17 time and capital to fully implement and as such we would
18 always be seeking time to stage in changes and improvements
19 in the business. We acknowledge that water is an issue for
20 the community generally and for manufacturing industry and
21 therefore have already positioned our business in terms of
22 looking to drive some of those improvements.

23
24 MR FOX: If we can work together with Sydney Water in
25 using, it is difficult to actually reduce the amount of
26 water we use in our operations but it is possible to
27 actually reuse some, either effluent water and/or using the
28 opportunities of bore water. We have got access to bore
29 water within the Botany region. If we can invest in that
30 area, quite substantial investments, in the order of \$1m to
31 clean up some of that bore water, we could certainly use
32 that within our cooling towers and in our boilers as well.
33 That would provide opportunities of reducing our water
34 consumption per annum to about a third.

35
36 We use 3 gigalitres per annum. That would be the
37 order of about 1 gigalitre we could actually put in place
38 and save. One of the key things there is the time and also
39 the working together with Sydney Water and indeed other
40 authorities to ensure that we can utilise that bore water
41 in a successful manner.

42
43 MR COX: What is underlying my question is the thought
44 that water in Sydney is getting increasingly scarce and
45 that will put pressure on prices. It may not come to a
46 step price but some other mechanism. I am wondering what
47 you think about how you will respond to that situation as

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1 it is likely to arise at some stage?

2
3 MR FOX: One of the key things is that we really need to
4 start looking for alternatives. We will still need the
5 water, it is a matter of finding alternative sources,
6 either using grey water and/or in our case utilising some
7 bore water and/or indeed there are some retreatment plants,
8 retreating some contaminated water in the ground, and
9 utilising some of that also. The key fundamental thing is
10 it is very difficult for us to start reducing the actual
11 amount of water we use in terms of operations. We have
12 been working on that for the last ten years and reduced
13 from 4 gigalitres to 3 in the last ten years. That is
14 driven by economics.

15
16 MR BELL: The other challenge is that as we evolve with
17 these things, the reality is we have to maintain
18 competitiveness, otherwise these industries will disappear
19 and go offshore. Our challenge is, as it is in a whole
20 range of areas, not just water, but to find ways to reduce
21 usage and cost and continue to drive our costs of
22 production downwards so we can maintain our competitiveness
23 against our offshore competition. A lot of industry that
24 is impacted by this faces that very same challenge. It is
25 not unique to our organisation.

26
27 MR CAROLIN: Can I respond on two points. I don't think
28 there are too many businesses in Sydney that don't see
29 water as an issue. There are pressures to make better use
30 of it and there are programs which Sydney Water runs, the
31 "Every Drop Counts Business Program", that is very
32 efficient and we have had good feedback on that, but it
33 stops at 50,000 litres a day, and there is a whole raft of
34 other businesses out there, smaller consumers, which are I
35 suppose a target for that.

36
37 Sydney Water recognises, they might want to correct
38 me, that they believe 20 to 30 per cent efficiencies can be
39 gained in business. It is a case of how we go about that
40 and how we access these people and get these efficiencies.
41 That is not so much discretionary as non discretionary use,
42 it is about using water better, more efficiently, water
43 recycling for cooling towers and boilers and things, so
44 there are opportunities out there.

45
46 The other point I guess comes to the crux: You
47 mentioned water will be scarcer in Sydney, and we have

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1 mentioned in our submission that given the lead time for
2 such large infrastructure projects we should be maybe
3 tackling, what happens if demand management does not work
4 and we run into problems with these programs and Sydney
5 does find its water supply under a larger degree of stress
6 than we thought. I am not talking about the stuff we can
7 see, I am talking about the stuff we can't see, so there is
8 a general feeling in the committee that a failure to plan
9 for contingencies seemed to be a policy of government at
10 the moment to draw a line and say, no, we will not look at
11 any more dams. Maybe we should be just scratching our
12 heads and say, if we do run out of water, what will we do?
13

14 MR BELL: One of the ironies in this for Qenos is that one
15 of the largest markets we have here is in the pipe market.
16 Some 20 per cent of our production goes into that market,
17 which is focused mainly on water. A lot of it is dedicated
18 to relining of bores, improved irrigation processes, et
19 cetera, potable water improvements, which are actually all
20 focused on more efficient delivery of and greater use of
21 the water resources available. So we would contend that
22 with a significant investment in technology and the
23 manufacturing assets we have on the ground here, we are
24 actually making a very significant contribution to the
25 improvement in water resource availability and utilisation
26 overall right across the border.
27

28 MS CIFUENTES: I am assuming that this process of trying
29 to, one, reduce your overall water consumption and, two,
30 looking at alternative sources of water is an ongoing
31 process within the organisation Qenos specifically but
32 business generally, which suggests to me that at what point
33 do you have a trigger for making these sort of decisions or
34 for undertaking these decisions with Sydney Water?
35 Presumably that trigger is not just price? When you say
36 what the price should be, or Sydney Water should look at
37 long-run marginal cost, is that a suggestion that your
38 water should be priced and that?
39

40 MR BELL: That comment is more from a concern that one
41 could undertake a review of a pricing structure and
42 strategy in the absence of the knowledge of, a detailed
43 knowledge of, your costs. Typically in manufacturing we
44 have a very good understanding of our costs and it becomes
45 a key consideration in terms of evaluating the viability of
46 the business long term, measuring the expected returns on
47 the business and just the total economics involved. That

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1 is really more where that is coming from.

2
3 MS CIFUENTES: There is a limited amount that the tribunal
4 can actually do in this area other than through price
5 mechanisms. Are there any impediments to business
6 generally negotiating with Sydney Water on some of these
7 issues? Is there something the tribunal can actually do
8 through price mechanisms to try to remove impediments or
9 encourage this other than increasing your water costs? We
10 can always do that, but that has undesirable effects.
11

12 MR CAROLIN: I guess you have just asked a loaded question
13 and I am not about to pull the trigger. The mechanisms
14 that we have in place, the imperatives for business to do
15 things - and I can only speak for those businesses that are
16 in the larger end of the market - there is an incentive
17 there that is existing and current, it is a financial
18 incentive based on reducing water costs and there are gains
19 to be made from those users. I guess it is when you get
20 down to lots of small users that you run into problems in
21 accessing the issue of cost. How you go about that, I
22 can't answer that question, but there is a mechanism out
23 there and it is a case of finding it.
24

25 Somebody mentioned earlier about their kids having
26 long showers. That is a non discretionary water use for
27 which remedies can be found. You simply reduce the time
28 that your kids have showers. It is tough work, I know,
29 because I have that battle every night with my kids, and it
30 does not come easy. Industry is in exactly the same boat
31 where you are constantly battling to get water consumption
32 down. It is a case of working away at that, (a), your kids
33 have shorter showers and, (b), your cleaner does not waste
34 water on the floor.
35

36 MR BELL: The comment I make is that if you look at what
37 happened in the electricity industry and power generation
38 industry where there are effectively similar situations, I
39 would contend, where there was not going to be investment
40 in large new generating capacity the whole paradigm
41 switched around to how do we incentivise people to use the
42 available resource. The same applies here with water. We
43 would see that if we can find a way, rather than taking a
44 punitive approach, whereby industry and the water
45 authorities work collaboratively in terms of identifying
46 opportunities for water savings and by virtue of that
47 thereby both parties sharing in the benefits, then that is

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1 we feel likely to be more productive than a purely punitive
2 mechanism.

3
4 Sure, you have the financial savings, but that is
5 available now. If we can reduce water then even on current
6 tariffs we enjoy a financial benefit and we are always
7 striving for that. The challenge becomes, how do we find a
8 way to make it a beneficial approach in which gains are
9 shared as opposed to a punitive approach. The power
10 industry I think had considerable success along those
11 lines.

12
13 MS CIFUENTES: Is the process best left to private
14 negotiations between business and Sydney Water?

15
16 MR CAROLIN: I think so.

17
18 MR BELL: I am not sure I feel qualified to answer that.
19 It probably needs some framework or some encouragement of
20 some sort. I am not sure what the best approach is.

21
22 MR CAROLIN: Every business is different. Every business
23 uses water in a different way and every business has
24 different opportunities, and that is the basis behind the
25 "Every Drop Counts Program", where they go through a
26 structured program to identify those cost benefits or those
27 water savings that can be made and returned to the business
28 and to Sydney Water. You only get that through
29 one-on-ones. It is a laborious process but highly
30 effective, particularly for small business where you show
31 the degree of concern to the consideration of business and
32 do it that way.

33
34 MR FOX: From our perspective a holistic approach to not
35 only purchasing water but disposing of water needs to be
36 looked at. One thing we do find is that there are two
37 different arms within Sydney Water and therefore it is
38 difficult for us to actually look at both areas because
39 they go arm in arm. If we can actually reduce the amount
40 of water we are using, we will reduce the amount of wastage
41 and effluent. One of the key things for us to do is try to
42 improve that and build up some form of framework so that we
43 can look at both sides of it at the same time rather than
44 as two independent areas.

45
46 MR COX: Listening to you I get a sense that you believe
47 there is a fairly strong financial incentive for you to

1 reduce water usage if you can and even at the existing
2 price you are actively seeking to do that?

3
4 MR BELL: Certainly from our perspective that is the case.
5 We can't afford to stand still or we will go out of
6 business.

7
8 MR CAROLIN: I sit here representing the smaller
9 businesses, the smaller consumers of water, and a lot of
10 people would see opportunities within their premises to do
11 these sorts of savings, but there are issues for them about
12 how they resource it. A lot simply don't know what to do.
13 They see things that might be wasteful but do not know the
14 solution. There was a case, it is just not about a pricing
15 mechanism, the pricing mechanism is already there, it is
16 about education as well, getting through to these people
17 that there are other ways of doing things.

18
19 MS CIFUENTES: Is Sydney Water being sufficiently
20 proactive in that process?

21
22 MR CAROLIN: They are with large customers. Sydney Water
23 recognises that the smaller customers, the 50 kilolitres a
24 day customers or less than 50 kilolitres a day, are a
25 target in their next sector they have to tackle and it is a
26 case of finding the most cost effective mechanism to get to
27 those people. Maybe Sydney Water can comment on that later
28 but there are a lot of them out there and small gains
29 across a large number of businesses usually ends up to be
30 quite sizeable.

31
32 MR COX: Thank you very much for your assistance.

1 PUBLIC INTEREST ADVOCACY CENTRE

2
3 MR WELLSMORE: Jim Wellsmore, from the Public Interest
4 Advocacy Centre. I thank the tribunal for the opportunity
5 to address today.

6
7 It is an interesting experience, I guess, to be back
8 talking about price and demand management again. I think
9 we will all be experts in a short space of time. I am
10 certainly getting plenty of practice, anyway.

11
12 It is a shame that some of the other work that has
13 been done in the last couple of years was not taken into
14 account before the Government decided it wanted to launch
15 into this process again. Be that as it may, I have tried
16 not to photocopy the submission from last time and I will
17 try to expand on the written submissions that PIAC has
18 already given to you rather than just regurgitate it, and
19 try to focus on residential users.

20
21 If I can start off by stressing that from our
22 perspective we did think that demand management is
23 important. The issue of long-term safe sustainable yield
24 from the catchment is directly a matter of public interest
25 so I don't want to be sitting here and banging the table
26 saying, "You can't put the price up". Clearly we have a
27 problem that needs to be addressed and really needs to be
28 solved.

29
30 I know the terms of reference of this inquiry pretty
31 much direct us towards price, but our concern is that yet
32 again most stakeholders seem to put their hands on the
33 lever which is marked "price" and just say, "Let's just go
34 for it on price and that will get us there". Price looks
35 easy. There has even been an assertion that it is simple.
36 We disagree with that fundamentally. It is not actually
37 simple at all. It becomes very complicated. And
38 particularly we think it is a poor option by comparison
39 with physical demand management programs.

40
41 We are well aware that Sydney Water does undertake
42 some demand management activity. They seem to do more
43 than
44 their counterparts in the electricity industry, which is
45 pleasing. They probably do more than comparable water
46 businesses. On the other hand, is it enough? Could they
47 be doing more? From our perspective we want to see more
work being done on physical programs that actually mean

1 less water being consumed at the end of the, well, at the
2 consumer stage of the cycle.

3
4 The problem I think related to price is the idea that
5 the price of water is very low. I don't dispute that it is
6 not high. We question some of the claims that have been
7 made about how low it is. For example, someone this
8 morning made a comparison between movements in the price of
9 water and average weekly earnings. I don't think that is
10 an appropriate linkage to make at all. The price of water
11 isn't set by reference to average weekly earnings in any
12 event and in terms of average weekly earnings that simply
13 highlights the issue that a lot of people are making less.
14 So I don't think we are helping people by focussing on
15 that.

16
17 The real point I think people are getting to when
18 talking about the price of water is an assumption that if
19 it is cheap it will be wasted, that people abuse the
20 product or the service because it is cheap or it is for
21 free. I have a great deal of difficulty with that. It
22 stretches my credulity somewhat, I must say. I think a lot
23 of time there is an issue that says, "You are poor, you
24 don't care, you are ignorant and you don't care, you will
25 suck it all up". That is a very unfortunate attitude.

26
27 Certainly from my perspective I don't think there is
28 evidence that consumers do respond to subsidised or free
29 services in that way. We don't see that with the Sydney
30 Water payment assistance scheme or see it in the energy
31 sector with the energy vouchers.

32
33 I am aware of having informal discussions with people
34 from Sydney Water around the issue of tenant billing.
35 There is some evidence that, for example, Department of
36 Housing tenants are using more water. On the other hand,
37 that is balanced by the reality that those people tend to
38 be home more during the day, not having ten cups of coffee
39 at work or flushing the toilet four times a day at their
40 employer's premises. It is not valid to say that the poor
41 sit at home all day and run their taps. That seems to be
42 sometimes where people are coming from.

43
44 The real issue about price and relying on price to get
45 demand management activity and behaviour from customers
46 is
47 that it is based on the assumption that people respond in a
certain way. It is seen as a rational price signal which

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1 will result in a rational behavioural response. From where
2 we sit, that is a fairly discredited line of thinking. In
3 the case of water, it is not the case that the bulk of
4 households sort of interact with their water supply or
5 water suppliers as if it was an economic market. For a lot
6 of people the vast bulk of the consumption is not based
7 around what is economically rational, it is based around
8 the fact that water is a necessity of life. To try to
9 import some of these more economic notions into it about
10 how markets work, if it was always about rational behaviour
11 we would not have market failures, but in this case it
12 seems to be that a lot of the thinking is we will just
13 bring in a signal and everybody will respond in a way that
14 we can know in advance and predict in advance and we can be
15 certain about in advance. That is highly flawed.

16
17 In our written submission we have gone to some length
18 to detail some of the reasons why we think that is the
19 case. Apart from the issue about it being an essential
20 service, the price signals will just not get through to a
21 lot of people. A lot of people are not individually billed
22 and, as we said, once you fiddle around with the balance
23 between fixed and volumetric charges, those components,
24 once you go to stepped pricing there are some real issues
25 there about even to the extent that a signal is being
26 given, to who is the signal being given and what is going
27 to be the response.

28
29 Some people will benefit without making any effort
30 whatsoever. Other people will have a cost, a disbenefit,
31 if you like, irrespective of how much they might make. We
32 think that on those grounds it is a very, very poor measure
33 to be using price in that way. Not only is it crude and
34 blunt, but it actually, as I say, in some cases will
35 actually have the reverse impact. Some people's costs will
36 go up no matter how hard they try to reduce their
37 consumption. That is ruled by the mix of what happens
38 between landlords and tenants and people not being
39 individually billed.

40
41 There is an equity issue. It is probably an economic
42 and equity issue, what is fair. It also comes back to the
43 issue that when we are talking about the per capita
44 consumption of water what we are really talking about is
45 the consumption per meter. There is no way for prices to
46 really address the number of people that actually live in a
47 household so by, for example, having an inclined block or

1 stepped prices, household A with four people in it will
2 actually have less of a burden and will be asked to make
3 less of an effort than household B with eight people in it.
4 Sure, we may or may not get water conservation but clearly
5 it will be a lot harder on some people to meet these new
6 sorts of expectations about behaviour.

7
8 That applies even if you - part of me says it would be
9 great, let's have pricing which is differential according
10 to suburbs, but you get the same issue unfortunately. If
11 you talk about what the average is in Woollahra versus
12 Seven Hills, which is obviously just down the street from
13 Castle Hill and Baulkham Hills, that does not even
14 necessarily allow you to be identifying individual
15 households within those suburbs that maybe using more or
16 less than the average. Maybe we need a garden tax. I am
17 not sure how that would work either but that would be an
18 issue for government clearly to decide.

19
20 In terms of the price issue and the impact it would
21 have on some people, numbers are thrown around about how
22 few people it is. The reality is they are real people.
23 There are real families that will be given a larger burden
24 financially. Also, in practical effect, they have to make
25 a large effort, as I was saying, to save water. There are
26 more bodies in their house to be washed and fed, and so
27 forth.

28
29 It's an easy response for people to say, "Well, we'll
30 come up with some new social welfare-type scheme, some new
31 scheme which will compensate people for that." Before we
32 could be confident about any of these issues, we'd like to
33 see real detail about what the scheme will look like and
34 how it will operate, rather than, "We'll whack the price up
35 now and some time in X number of years we'll get around to
36 coming up with a scheme and convincing government to pay
37 for it that will ameliorate the impact on people with large
38 families and low incomes."

39
40 For example, Sydney Water has a few of those schemes
41 at the moment. We think they're very, very good schemes.
42 We're quite happy to support what Sydney Water does in
43 terms of its social programs. The problem has been that
44 Sydney Water has proven reluctant to promote those schemes.
45 They also seem to be possessed with a belief that they'll
46 be inundated with poor people trying to rip them off and
47 abuse the schemes. Again, as I was saying before, that's

1 contrary to the evidence, it's contrary to what we see in
2 the behaviour of particularly low-income consumers. If
3 we're going to have schemes, they need to be seen to be
4 effective.
5
6 Then you're back to the same problem anyway. Even if
7 the price signal were going to get through to people, the
8 problem you would have is, "Well I'm getting a price
9 signal, but actually I'm not getting a price signal anymore
10 because it's been taken away because I can turn around and
11 get the voucher." It's a bit self-defeating. Either
12 you'll hit people for it or you won't. Therefore, just
13 targetting the rich with large gardens with rows of rose
14 bushes, and so forth, sure, okay, that's a taxation
15 measure, but is that really what water prices are supposed
16 to do? Aren't there other ways of addressing those sorts
17 of issues?
18
19 At the end of the day, let's say the price signals get
20 through, which they won't in lots of cases, let's say we
21 can solve the problem of ameliorating the price signals
22 because we'll give rebates to everybody, you still have the
23 whole difficulty of elasticity demand. The amount of
24 effort that's required in order to get even a negligible
25 increase in behaviour, if people respond in a rational way
26 to price signals, seems to me to be quite out of whack. A
27 10 per cent price increase and one per cent price saving
28 seems not worth anyone's time, particularly if you have
29 more effective ways of going about it.
30
31 In our submission we've spent a little time putting up
32 an argument about physical demand management.
Essentially
33 it comes back to the issue about we have a problem, okay,
34 perhaps prices do need to go up, but what will consumers
35 see for those price increases? What will we get back for
36 it? Is it a hail Mary, "We'll put the price up and if we
37 get it wrong, in five years time we'll put the price up
38 again and see whether that works", or do we trade it off
39 and say, "Okay, we can have a one per cent price increase
40 which funds physical demand management over the next five
41 to 10 years and for that one per cent price increase we can
42 get a 5 per cent reduction in water consumption?"
43
44 For example, the experience PIAC has had with the
45 refit program that was run in the Hunter, that largely
46 focused on energy. Electricity Australia put up the bulk
47 of the funding for it. Hunter Water also participated in

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1 it. The sorts of numbers that we're getting from that, in
2 terms of what households themselves are reporting, suggest
3 that a 5 per cent to 10 per cent reduction is not
4 impossible; it's quite achievable. What you're getting for
5 that as a consumer is my bill goes up, but at the end of
6 the day I get something for it. Most of all, as the
7 consumer, I use less, therefore I get a smaller bill. So
8 even if the per unit cost goes up, I'm in front. There's
9 no need for me to act rationally or not rationally, the
10 service is provided.
11
12 What's more, I make the point that refit specifically
13 targeted tenants in private rental accommodation who are on
14 low incomes. It's a great shame that the Department of
15 Housing is not able to be here today to give their views on
16 these things. Sydney Water has been trying to have some
17 discussions with the department for a long period of time.
18 We could have had some much larger scale experience to
19 draw
20 on in these discussions about physical demand management if
21 the department had got their act together in recent years,
22 but sometimes these things move slowly, I guess.
23
24 The great thing about that sort of approach is that
25 it actually provides a direct link, not a hail Mary, not a
26 kind of wishful thinking it might work out, because what
27 you're doing on one side, what you're getting on the other
28 side in terms of consumers and reduction, it actually
29 fulfills government policy. It actually enables Sydney
30 Water to meet their regulatory obligations in terms of
31 their per capita demand management targets and it addresses
32 a lot of the social equity concerns.
33
34 It's not a simple scheme and it carries costs but, as
35 I say, if we're going to talk about using price as a
36 surrogate for taxation, I can't think of a better way to
37 use it than this - put the price up for everybody in order
38 to fund physical demand management which specifically
39 targets residential users. You start at the top, those who
40 have the largest consumption, the lowest incomes, you go
41 for them and work your way around the list. You get
42 immediate returns for it and, as I say, it becomes much,
43 much simpler to put into place and to predict what will
44 happen with it. The alternative, in terms of price
45 increases, would be to perhaps provide some extra revenue
46 so that Sydney Water had more money to step up its program
47 to address system losses. That would be another thing.

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1 I think we mentioned in our written submission that
2 consumers, residential users, would find it a bit galling
3 to think, "Hey, my prices are going up, but I'm not the one
4 who owns the leaky taps" perhaps. So that's our position.
5 I thank you for your time.
6
7 MR COX: Thank you very much. I have two questions.
8 Firstly, you will recall if you were here earlier today
9 that Sydney Water were arguing for a step price retail
10 level essentially targetting discretionary use in garden
11 water, and so on. Assuming the program does that, how big
12 a problem is it, from PIAC's point of view? It's not
13 affecting basic use of water.
14
15 MR WELLSMORE: If you could put a meter inside the house
16 that addressed inside consumption, which the studies
17 suggest is incredibly inelastic, you could have another
18 meter which just dealt with the garden, sure, that would be
19 great, we could live with that. I don't know how you'll
20 fund that either. Again, we'd rather see that money being
21 spent on actual demand management.
22
23 MR COX: They think they can set it at a level that will
24 ensure that the only people above the step essentially are
25 using water for outside use.
26
27 MR WELLSMORE: I just don't think it's possible. You have
28 people in one street with a big garden and no kids, you
29 have someone next door or in the next street who has a
30 garden but doesn't have rose bushes and waters the lawn
31 once in a blue moon but has 10 kids. I don't know. In
32 practice, I think that won't happen. I have no faith
33 whatsoever in that sort of a claim, unfortunately.
34
35 MR COX: Thank you for that. The second thing I wanted to
36 mention was that in your submission you seemed to be in
37 favour of a wholesale step price. That surprised me a bit
38 because a wholesale step price to me is an agenda for
39 higher prices basically, because Sydney Water would have to
40 recover its costs from fewer units of water sold, so the
41 price per unit must go up, which would be difficult if
42 customers can't reduce their water use. I'm a bit
43 surprised about your support and I'd be grateful --
44
45 MR WELLSMORE: It's qualified support. I don't think
46 we're necessarily saying we're absolutely convinced it's a
47 great idea. We would have envisaged a wholesale step price

1 not in fact being passed through to end users. I have
2 been --
3
4 MR COX: Possibly on domestic?
5
6 MR WELLSMORE: Perhaps. That would be the basis on which
7 we'd be prepared to support it, put it that way. Yes, it
8 raises some issues for Sydney Water. On the other hand, as
9 Leigh Martin, from TEC, was saying earlier, the idea isn't
10 to actually keep Sydney Water over the limit and paying the
11 higher price; the idea is for Sydney Water to get under the
12 limit.
13
14 If you look at it the way that demand management has
15 been targeted, the electricity retail industry, the idea
16 there is that you create an incentive for a certain level
17 of expenditure on demand management in order to avoid the
18 larger outlay which comes from the penalties, if you like,
19 or in this case the higher price effectively, which is a
20 penalty. It makes for Sydney Water making serious
21 investment and, if necessary, coming to the tribunal and
22 saying, "We need an extra 50 million", or whatever it's
23 going to be, "to spend on demand management to keep us
24 under that target."
25
26 Again, yes, there might be some price response, but I
27 think consumers would be in a better position to accept a
28 price increase if they knew it was going to have some
29 effect, not just, "Let's put the price up because everybody
30 is supposed to respond to that in a rational and textbook
31 sort of way." No, if you have a wholesale step price, I
32 don't think it will be allowed to pass through directly
33 like that. That would be our position. Yes, Sydney Water
34 cops the volatility or concern about their revenue, but it
35 puts the onus on them to make some real effort in demand
36 management.
37
38 MR COX: Thank you for clarifying.
39
40 MS CIFUENTES: You mentioned earlier that the efficacy
41 really of the price signal depends on people actually
42 receiving the price signal. This is an issue that's
43 exercising the tribunal's mind at the moment, how we get
44 that price signal across to people, particularly where
45 they're not being directly billed. It is a particular
46 concern for low-income families, to the extent that a lot
47 of them are in rental accommodation and therefore aren't

1 billed at all. Do you have a view on how we might progress
2 that issue?
3
4 MR WELLSMORE: Not really because you don't really have
5 any sort of say in what landlords do, for example. So if I
6 am an individual tenant who perhaps isn't even receiving
7 the consumption part of my bill from my landlord, then what
8 I do or don't do has no impact. Let's say I respond to the
9 community education program, it's a good thing, I'll cut
10 down my use, the tribunal doesn't have the ability to focus
11 on that problem.
12
13 From our perspective, it goes to the difficulty with
14 trying to use price in this way. It's better to be able to
15 go into the house, even private rental accommodation, and
16 say, "Okay, we can reduce water consumption by 10 per cent
17 not by giving somebody a bill but by installing appliances
18 or installing equipment", installing things, physical
19 things, that will mean there's less water being used - tap
20 airways, and those kinds of things.
21
22 Based on our experience with refit in the Hunter -
23 it's only 1200 households, unfortunately - the program
24 seems to have a fairly high level of momentum or
25 persistence. People actually take the devices and leave
26 them in places and continue to use them. So, again, you
27 get a nice predictable sort of a turn - not having to worry
28 about where the money is going. We would rather break away
29 altogether from this sort of price signal thing and
30 actually just have less water being used. It's great to
31 empower consumers, I think that's a fantastic idea.
32
33 MS CIFUENTES: If you have no idea of how much water
34 you're using because you never see a bill, I think it's
35 quite surprising when you do actually look at how much
36 water you've used in a quarter.
37
38 MR WELLSMORE: I agree.
39
40 MS CIFUENTES: You think, "I'm at work, the kids are at
41 school."
42
43 MR WELLSMORE: Yes.
44
45 MS CIFUENTES: It is quite interesting even with that
46 bill.
47

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1 MR WELLSMORE: If you don't get a bill at all, the thought
2 never occurs.
3
4 MS CIFUENTES: Is the minimum starting point that everyone
5 should get a bill so that they're at least aware of how
6 much water they're using so that those other non-price
7 issues, like community education, start to have an impact?
8 Otherwise you might get someone saying, "Well, I'm probably
9 an average user, who knows".
10
11 MR WELLSMORE: Yes, but again it's hard to know because
12 what's your average user? If the average householder is
13 using blah, where does my rate compare to the average
14 household? What's the mix of kids, adults, pets and
15 friends that come visiting on a Saturday and play under the
16 sprinkler, that sort of thing - they can't play under the
17 sprinkler, they turn the hose on themselves.
18
19 MS CIFUENTES: Even the comparison, knowing how much
20 you're using, should that be a starting point?
21
22 MR WELLSMORE: Yes, it might be, but then again what does
23 it cost you to get to that point where you're providing
24 that information to everybody, everyone will be
25 individually metered and billed? By the time you've done
26 that, you could have knocked a few per cent off water
27 consumption anyway by a more direct route. I understand
28 the dilemma, and I think as a consumer it's great to have
29 that information, but then what will I do with it, even if
30 I know, you know?
31
32 Particularly if I'm a consumer, I might be on a fairly
33 high income and living in one of these suburbs that uses
34 enormous amounts of water on average and my reaction to
35 that might be the same as an electricity consumer who
36 discovers their airconditioner is chewing up X amount of
37 electricity - "I don't care, I can afford it." If I'm a
38 wealthy person who's renting, well, I'm not bothered. I
39 just keep on using that sort of thing.
40
41 The real aim isn't necessarily about information.
42 Information is there. The real aim is to reduce water
43 consumption. Why don't you just go straight to it and get
44 people's consumption down? As I say, the cost of metering
45 and billing everybody could get you halfway there before
46 you even started sort of thing.
47

.25/3/0474PIAC

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1 MS CIFUENTES: The issue of affordability with any price
2 increase, of course, is an important consideration for the
3 tribunal. How adequate do you think the safety net is for
4 low-income people and then how does it address the next
5 level perhaps, not those people who have qualified for
6 safety net support, but those who are nonetheless exposed
7 to price increases, particularly in the context of Sydney
8 Water's submission that a 10 per cent increase in prices is
9 a moderate increase?
10
11 MR WELLSMORE: Yes, 10 per cent I suppose depends where
12 you sit. If you think about it, 10 per cent is 10 per cent; it
13 doesn't seem moderate. If you think your water bill is a
14 tiny part of your household expenditure, then 10 per cent
15 does look pretty moderate, I suppose. The issue for a lot
16 of households is 10 per cent of anything is still more than
17 they can afford, or more than they can comfortably stretch
18 to, I suppose, to be more accurate.
19
20 As I said before, Sydney Water has good social
21 programs in design and I'm aware that they've been very
22 slow in trying to expand the payment assistance scheme out
23 to tenants. As that picks up more, I'd be more confident
24 to say the safety net is reasonably good, but I think
25 you've hit the nail on the head of the great drawback of
26 any of these schemes. There's always that sort of
27 structural design issue of a threshold, who falls in and
28 who falls out. The way PAS is set up, as I understand it,
29 it isn't quite so trapped in sort of an absolute dollar
30 number, "Here you are eligible and here you're not." It's
31 a bit more flexible than that. Welfare agencies make an
32 assessment about need. That may not necessarily even
33 relate just to income.
34
35 On balance, I think this scheme is quite good. As I
36 say, as Sydney Water gets perhaps a bit more relaxed about
37 expanding the scope of its scheme and having more tenants
38 come and make claims against the scheme, apply for
39 assistance under the scheme, I think that safety net is a
40 reasonably good one. But, as I say, if you want to have
41 price signals, any time you're rebating people or helping
42 them make their payments, that price signal has been muted.
43
44 MS CIFUENTES: Thank you.
45
46 MR COX: Thank you very much.
47

1 MR WELLSMORE: Thanks for your time.
2
3 MR COX: That completes the hearing for today. I should
4 point out that Sydney Water and the Sydney Catchment
5 Authority are not requesting the opportunity to respond to
6 comments made. As I said at the outset, this inquiry is
7 about a direction that will feed into our price inquiry
8 towards the middle of the year. I think we've had a very
9 interesting discussion on many of the issues.
10
11 It's equally clear, at least in my mind, that a great
12 deal of work needs to be done by ourselves and others in
13 order to get a viable way forward that we can point to by
14 the middle of the year. There's a lot of work that we need
15 to do and other people need to do. Thank you for attending
16 and for your constructive participation today.
17
18 AT 2.38PM THE HEARING WAS ADJOURNED
19 ACCORDINGLY
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