WATER INDUSTRY COMPETITION AMENDMENT (REVIEW) BILL 2014

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Bill introduced on motion by Mr Kevin Humphries, read a first time and printed.

Second Reading

Mr KEVIN HUMPHRIES (Barwon—Minister for Natural Resources, Lands and Water, and Minister for Western NSW) [5.08 p.m.]: I move:

That this bill be now read a second time.

I am pleased to introduce the Water Industry Competition Amendment (Review) Bill 2014. The Water Industry Competition Act 2006, or WIC Act, was introduced to enable new market entrants to access existing water industry infrastructure and to create a licensing regime to ensure that new entrants operate in a manner that protects public health, consumers and the environment. The aim of the Act is to harness the innovation and investment potential of the private sector and to put the responsibilities and powers of private sector providers on a similar footing to public water utilities.

The Act commenced in 2008 and currently 10 schemes are licensed under the Act. Two of these are providing non-potable recycled water and sewerage services to residential developments on the outskirts of Sydney. A large scheme at Rosehill provides recycled water to industrial and irrigation customers, while another at Botany also involves industrial recycling. Three sewer mining schemes are providing non-potable water to commercial buildings in Sydney, while a further two sewer mining schemes are providing non-potable recycled water to high-rise residential developments at Central Park and Discovery Point. Licences have been granted in relation to the Sydney Desalination Plant.

The introduction of this bill represents an important milestone for the Urban Water Regulation Review, the impetus for which was the statutory five-year review of the Water Industry Competition Act. As required under section 104 of the Water Industry Competition Act, the five-year review report was tabled in Parliament in November 2012. The report found that the Water Industry Competition Act framework differs in key ways from requirements under the Local Government Act 1993. These differences create an uneven playing field in which public and private entities undertaking similar activities are subject to different standards. This can create distortionary effects. In regional New South Wales, for example, one private proponent sought to have the local council take responsibility for complex water infrastructure so that the private entity would not need to obtain a Water Industry Competition Act licence.

The risk of such outcomes is even greater in metropolitan areas, where local councils are not subject to any regulatory requirements, unlike their regional counterparts. To address these and other issues, the report recommended further consultation about the wider regulatory framework. A discussion paper followed in late 2012 covering the Water Industry Competition Act and key provisions of the Local Government Act. Feedback on that paper

informed the development of a package of reforms, which were outlined in a position paper released in February this year. That position paper also recommended changes to the last resort provisions in the Water Industry Competition Act, following earlier public consultation on these arrangements.

In all, the Urban Water Regulation review has been informed by three separate public consultation processes. More than 240 stakeholders have participated in seven public workshops, 97 written submissions have been provided, and innumerable meetings and discussions have been held with stakeholders. Input from stakeholders has been central to shaping the bill before us today, which seeks to address gaps in the current regulatory framework, improve customer protection, streamline requirements, cut unnecessary red tape and remove barriers for new entrants. Importantly, this bill ensures improved customer protection by providing a last-resort framework that will ensure continuity of customer services in the event of either a retailer or operator failure. I will now detail the reforms.

The bill addresses the lack of an objects clause in the current Act. Building on the licensing principles now set out in section 7 of the Act, the new clause includes as objectives the facilitation of competition with a view to encouraging innovation and improved efficiency, and the provision of efficient, reliable and sustainable water and sewerage services, having regard to financial, environmental and social considerations. Another important objective is better protection of public health and safety, the environment and the interests of consumers, including in the longer term.

A key change made by the bill is to narrow the scope of the Act's licensing regime. Under the current regime, a licence is required to construct, operate or maintain "any water industry infrastructure" unless one of the limited exemptions applies. A licence is also required to provide water or sewerage services by means of any water industry infrastructure—again, unless an exemption applies. The result is a licensing regime which, while robust, is too far reaching. It entails costly requirements, including for small-scale, low-risk schemes. Such schemes are often governed by other frameworks, such as the Work Health and Safety Act 2011, and do not warrant additional oversight under the Water Industry Competition Act.

This far-reaching regime is not what was originally envisaged. When the Act was first conceived during the millennium drought the intention, as stated in policy documents, was to regulate private companies providing reticulated water and sewerage networks. The idea was to put private utilities on a similar footing to public water utilities. While some utility-like schemes have been licensed under the Act, the Act's terms are so wide that other schemes are also being caught in its net. The current Act even requires licences to be obtained for schemes that have already been approved by local councils under section 68 of the Local Government Act. This is unnecessary red tape imposing unwarranted costs on business and government. The bill removes this duplication by creating an exemption for such schemes.

As well as removing this significant duplication, the bill narrows the current licensing regime by clearly articulating the kinds of schemes that are to be regulated under the Act, rather than

casting a wide net and relying on exemptions to narrow its reach. Section 5 sets out three kinds of schemes that will require approvals and licences under the Act. The first category is integrated schemes providing water or sewerage services to 30 or more individually metered small retail customer premises, by which we mean residential premises and small businesses.

The focus of this category is on the identity of the customer base and the essential nature of the services provided to those customers. Our objective is to protect the interests of small customers and to ensure that services that are vital to public health meet appropriate standards. This is particularly important, given that water and sewerage infrastructure has strong natural monopoly characteristics: for example, only one set of sewerage pipes connects each home to the sewerage network and one cannot switch provider if one is not satisfied with the physical service provided.

Such schemes will need to be operated by a licensed operator and those billing customers for services will need a retailer licence. Operator licensing is intended to ensure that operators are competent and that public health and safety are protected. Retailer licensing is intended to ensure that customer interests are protected. This first category is the only one that will trigger the requirement for a licensed retailer. The Government considers that commercial and industrial customers are able to protect their own interests and there is no need to prescribe the terms on which services are provided to them.

The threshold of 30 or more small retail customer premises has been chosen with a view to balancing the costs and benefits of being regulated under the Water Industry Competition Act. We can reasonably expect the costs of regulation to be passed on to customers, so we need to ensure that those costs are warranted having regard to the resulting benefits. Requiring licences for all such schemes, regardless of size, would impose unjustifiable costs on customers and make the regulatory task unmanageable. A balance has to be struck and stakeholders have been supportive of the approach adopted in the bill.

The bill provides that in determining whether or not a scheme is to be regulated under the Water Industry Competition Act regard will be had for initial and planned future stages of development. Smaller schemes that do not trigger the threshold will not fall into a regulatory void. Sewerage systems will be regulated under section 68 of the Local Government Act and the requirements of the Public Health Act will apply in relation to reticulated drinking water systems and drinking water suppliers. The second category of scheme that will be regulated under the Act is large drinking water facilities, such as a water filtration or desalination plant, with a capacity to produce more than 500 kilolitres per day. This second category is designed as a fallback to catch any drinking water facilities that do not form part of a scheme directly providing services to 30 or more small retail customer premises. Such schemes will be subject to design and operational approval—as with the first category—and will need to be operated by a licensed operator.

These requirements are designed to ensure that the infrastructure complies with the Australian Drinking Water Guidelines and that the operator is competent to operate it.

However, no retail licence will be required as there will be no direct relationship with small customers. If there are direct relationships with 30 or more small retail customers, the scheme will be regulated under the first category outlined earlier. Private drinking water facilities that fall below this threshold, as is currently the case, will be subject to regulation under the planning legislation and the requirements of the Public Health Act. However, such facilities are few and far between as most drinking water facilities are provided by public water utilities.

A notable exception is the Sydney Desalination Plant, which is licensed under the Water Industry Competition Act. It is an example of a private drinking water facility that does not involve the provision of services direct to small customers but nonetheless warrants regulation. The plant will continue to be regulated under the Act. The third category of scheme to be regulated under the Act is large sewerage facilities with a design capacity of more than 750 kilolitres per day. The intention is to catch any sewerage facilities that do not form part of a scheme directly providing services to 30 or more small retail customer premises.

As with drinking water facilities, such schemes will require design and operational approval and will need to be operated by a licensed operator. However no retail licence will be required as there will be no direct relationships with small retail customers. The 750 kilolitres per day threshold has been selected to align with the environment protection licence threshold in the Protection of the Environment Operations Act. As I mentioned earlier, the amendments made by this bill seek to complement rather than duplicate other regulatory frameworks. While environment protection licences focus on limiting pollution discharges, Water Industry Competition Act approvals and licences will ensure that infrastructure designs comply with appropriate industry and public health standards, that assets are maintained over time, that private operators are competent, and that a last resort framework is available if a licensee operating essential infrastructure fails.

Requirements in the bill will ensure that the Environment Protection Authority [EPA] is consulted regarding applications that also trigger requirements for environment protection licences, thereby facilitating a coordinated regulatory approach. Consistent with the approach under the Protection of the Environment Operations Act 1997, sewerage facilities that fall below the Water Industry Competition Act threshold will continue to be regulated by councils under section 68 of the Local Government Act and councils will generally also be the regulatory authority for such systems under the Protection of the Environment Operations Act. This streamlined approach means that private sewerage facility operators will generally deal with only one regulator—the local council—where their facility does not trigger the Water Industry Competition Act threshold.

Where larger facilities trigger the threshold, they will deal with the Environment Protection Authority in relation to environmental matters and the Independent Pricing and Regulatory Tribunal [IPART] in relation to Water Industry Competition Act approvals. This is appropriate, given the size of such facilities and the different focus of each regulatory regime.

I note that, as with drinking water facilities, large sewerage facilities are typically operated by public water utilities. Nonetheless, it is important that in the event a private party invests in facilities on this scale, and where such facilities do not form part of a scheme directly servicing small retail customers, there is a framework to ensure that appropriate infrastructure standards are met, that operators are competent and that continuity of essential services is assured. For schemes falling into the above categories, the bill requires IPART to grant two kinds of approvals: design and operational.

Design approvals will be granted prior to construction. This is a new step that aims to ensure that schemes are well conceived from the outset, and that proposed designs will achieve compliance with appropriate standards. It will help to prevent situations that have arisen under the Act where proponents have built schemes only to be told at the eleventh hour that the infrastructure is not adequate to meet water quality standards. This has caused costly reworking and delays. The new approach will significantly reduce this risk.

Operational approval is in practice and is already required under the Act. The purpose is to ensure before a scheme starts commercial operation that water and recycled water provided by the scheme meet nationally agreed public health standards. Like the design approval, this approval will be granted by IPART rather than the Minister, as is currently the case. The bill requires these approvals to be obtained by infrastructure owners, whereas the current licensing regime focuses exclusively on operators. This exclusive focus on operators is out of step with other Acts. It has proved problematic as there is no means to require owners to maintain infrastructure in accordance with appropriate standards under the Act.

Conditions of approval will ensure that infrastructure is both appropriately designed and constructed at the outset and maintained over its life. While owners will be required to obtain approvals, such approvals can subsequently be transferred to other parties, including licensed operators. This provides flexibility as well as a means to ensure appropriate asset maintenance over time. Licences will still be granted by the Minister, but in an important change from the current system they will now be granted on an entity-wide basis. That is, licences will apply statewide and for operators will specify the class of water industry infrastructure that the licensee is authorised to operate anywhere in New South Wales. This means that licensees will no longer need to apply for a new licence each time they wish to undertake a scheme, which will save time and money for both business and regulators. However, design and operational approval will still be required for new schemes so that IPART can ensure appropriate standards are met.

This approach separates out the licensing of entities—a process that focuses on the suitability and capacity of licence applicants—from the technical approval of schemes, which focuses on whether designs are appropriate and water quality is fit for purpose. Consistent with this move to entity-based licences that apply across New South Wales, authorised persons will no longer be listed on licences. This addresses concerns with the current system that such parties are not subject to the same level of scrutiny and accountability as licensees. This creates potential problems where the authorised person plays a key role in undertaking the activities

authorised by the licence. Authorised persons who are currently listed on licences will be included in a consultative transitional process—which I will come to later—enabling them to be granted licences on appropriate terms.

The bill includes a new test as to the suitability of parties seeking to be granted a licence or approval. This brings the Act into line with similar legislation, such as the Protection of the Environment Operations Act, and will ensure that approvals and licences are granted only to appropriate entities. In addition to considerations as to good character and solvency, the bill also requires, consistent with the Act, that applicants have the technical, financial and organisational capacity to undertake the activities for which authorisation is sought. This will help to decrease the likelihood that last-resort provisions will be required. In assessing an applicant's capacity, consideration must be given to the degree of reliance on contractors and subcontractors. This will enable regulators to consider whether proposed business models pose any risks in relation to the effective and efficient administration and enforcement of the Act.

As with the Act, public water utilities will continue to be exempt from the Water Industry Competition Act because they are governed under other frameworks. This includes the larger public water utilities like Sydney Water and Hunter Water, and local councils providing water and sewerage services in regional New South Wales. To date, metropolitan councils in greater Sydney and the lower Hunter have been excluded from the Water Industry Competition Act because they have fallen under the exemption relating to public water utilities. Such councils are also exempt from the usual approvals required of local councils by section 60 of the Local Government Act.

When the Local Government Act was developed, it was envisaged that services in metropolitan areas would be provided by the larger utilities rather than by councils. As a result, metropolitan councils were exempt from the usual requirement to obtain approval before undertaking certain water and sewerage works. This exemption even applies in the anomalous situation in which a metropolitan council, rather than Sydney Water, is providing sewerage and recycled water services to homes and businesses in Western Sydney. This regulatory gap creates risks to public health in addition to the distortionary effects mentioned earlier. The bill addresses this by changing the definition of public water utilities so that metropolitan councils are no longer included in the public water utilities exemption.

As a result, metropolitan council schemes and privately run schemes that trigger the new thresholds will now be on an equal footing. Where a council does not wish to obtain a licence itself, it can engage a private licensee to operate a scheme on its behalf. This approach has already been adopted by the City of Sydney which has engaged a private licensee to establish and operate a stormwater reuse scheme at Green Square. In addition to the three categories of infrastructure outlined earlier, the bill also enables other water industry infrastructure prescribed in the regulations to be brought into the Water Industry Competition Act framework. As outlined in the position paper released earlier this year, the Government intends to develop a supporting regulation that will bring into the Water Industry Competition

Act higher-risk recycled water and stormwater harvesting schemes.

All such schemes are currently caught in the Act's wide net, unless an exemption applies. The Act's one-size-fits-all approach imposes high costs and stakeholders tell us these are acting as an unwarranted barrier to developing lower risk schemes. The Government wants to remove unwarranted barriers and has adopted a risk-based approach to refocus the scope of the Act. Consistent with this, the bill focuses on those schemes involving the greatest risks for public health and safety and leaves other more appropriate frameworks to regulate lower-risk schemes.

The supporting regulation will focus on water recycling and other schemes that warrant regulatory oversight to protect public health and safety. Duplication with other regulatory frameworks will be avoided. For example, the regulation will not deal with schemes involving only occupational risks because such schemes are already covered by work health and safety requirements. The Government is mindful of the need to keep regulatory costs down, particularly in relation to stormwater irrigation schemes that reduce pressure on rain-fed supplies and improve urban amenity. Such schemes represent the bulk of metropolitan council schemes that will be brought into the Water Industry Competition Act once the supporting regulation has been developed.

The Government acknowledges the concern expressed by some councils about regulatory costs arising from these reforms but is unapologetic about the need to protect public health. The urban water market has changed rapidly since the Local Government Act was introduced two decades ago, and the regulatory gap it created must now be addressed. The Government considers that bringing metropolitan councils into the Water Industry Competition Act is the best way to do this.

It will develop the supporting regulation in consultation with stakeholders, consistent with the Subordinate Legislation Act, and care will be taken to avoid unwarranted costs. For example, the Government envisages that stormwater irrigation schemes typically will require an operational approval to ensure that treatment and access controls are adequate, but because most schemes involve relatively straightforward technology they will not require a licensed operator. Costs associated with auditing schemes will also be kept as low as practicable, which was an issue of concern for some councils during the consultation period.

I turn now to another critical reform introduced by the bill. The current Water Industry Competition Act contains provisions enabling a "retailer of last resort" to take over in the event of a licensee failure. However, there are no provisions to enable an "operator of last resort" to step in and operate infrastructure if a licensed operator were to fail. The bill addresses this gap, creating a new and stronger framework that responds to the potential for both retailer and operator failure. The approach adopted builds on the lessons learnt in the energy sector, where two retailers have failed, triggering the last-resort arrangements under the National Electricity Retail Law. Stakeholders unanimously agree about the need for such provisions but, as can be expected, there are a range of views about how best to implement

them, particularly in relation to the issue of cost recovery in the event that a licensee fails.

The bill requires last-resort providers to be appointed for infrastructure that IPART determines is "essential". For example, last-resort providers will be appointed for peri-urban schemes providing sewerage services to homes so that service continuity can be assured. Last-resort providers may also be appointed where, although alternative infrastructure is available, a legal mechanism is needed to facilitate the transfer of small retail customers and associated contracts. Primary consideration will be given to appointing public water utilities as last-resort providers. However, private licensees who have indicated their willingness to be last-resort providers can also be considered.

As outlined in the position paper, development of the supporting regulation will provide an opportunity for further consultation with stakeholders, including on the detail of the last-resort arrangements. However, the underpinning framework for last-resort arrangements is, of necessity, set out in the bill since certain matters cannot be deferred in their entirety to regulations. The bill includes a number of provisions to ensure that last-resort providers will not be out of pocket in the event they incur costs associated with a last-resort event. They strike an appropriate balance between the interests of public water utilities, who would prefer to have all their costs covered upfront, and those of new entrants, for whom such an approach would likely present an insurmountable barrier to entry.

I now turn to other market barriers that this bill addresses. The current Act, developed in the midst of drought, includes a requirement that licensees source sufficient quantities of water other than from a public water utility. As stated in the second reading speech of 2006, the objective of this requirement was that new entrants contribute a "new commercial source of water". This in turn was to "ensure that existing water resources are not compromised through the introduction of competition". This requirement to source water other than from a public water utility is imposed only on Water Industry Competition Act licensees. As such, licensees incur costs that are not shared by public water utilities, creating an unlevel playing field and making it harder for new entrants to compete with incumbent utilities.

Such market barriers limit the potential for competition to deliver innovation and improved efficiency. The bill removes this requirement to create a more level playing field but does so in a way that honours the original policy intent of not compromising existing water resources. In particular, the bill requires that retailers provide services only in connection with a scheme approved under the Act and pursuant to an agreement with the owner of the infrastructure. Retailers will not be allowed simply to cherrypick small retail customers from existing utilities, as occurs in the electricity market, and provide retail services to them without there being any investment in physical infrastructure.

In so doing, the bill seeks to avoid the adverse implications that can arise where markets introduce "full retail contestability". This market model can undermine efforts to promote efficient consumption and create an incentive for retailers to increase sales in order to increase profits. Such outcomes could impact water security and impose high costs on

customers, particularly in the longer term—an outcome that would be contrary to the objects of the Act. While it has been considered, full retail contestability has not been introduced in any urban water market of which the Government is aware, locally or internationally.

The bill also makes other changes to put private utilities on a similar footing to public utilities. These include the introduction of provisions, similar to those in the Sydney Water Act and Hunter Water Act, whereby contracts are deemed to exist between a licensee and the owner of a property serviced by the licensee. To ensure customer interests are protected, the terms of these implied contracts will be prescribed in the regulations. However, licensees and customers will be free to vary the terms of these contracts if both parties agree.

The bill also amends the Environmental Planning and Assessment Regulation 2000 to ensure that parties are informed, before buying a property, that the property may not be serviced by a public water utility, and purchasers are advised to inform themselves as to who services the property and on what terms. This will be achieved by including additional information in the planning certificate that is required to be included in a contract of sale for land.

The bill implements tougher penalties where the prosecution establishes that non-compliance was intentional and resulted in potential or actual harm to health or safety. Higher penalties are considered appropriate having regard to the potential risks associated with the infrastructure being regulated under the Act's more targeted licensing regime and the consequences for public health and safety if market participants do not comply with regulatory requirements. For example, if a licensee's intentional actions result in poor quality water being delivered to customers and illness results or could result, a maximum penalty of $5 million can be imposed.

The bill provides for a transitional process to bring existing licensees into the new framework. Before the amendments commence, IPART will undertake a consultative process, involving infrastructure owners, licensees and authorised persons, to identify who will be licensed under the new framework. The transitional provisions also enable the regulations to establish a process for bringing metropolitan council schemes into the Water Industry Competition Act. This bill will streamline and strengthen the Water Industry Competition Act, address regulatory gaps and provide robust customer protection. I commend the bill to the House.

Debate adjourned on motion by Ms Tania Mihailuk and set down as an order of the day for a future day.