

Local Government
Association of NSW



Shires Association of NSW

SUBMISSION TO REVIEW OF LAST RESORT ARRANGEMENTS UNDER THE <i>WATER INDUSTRY COMPETITION ACT (NSW) 2006</i>	
DATE	<i>OCTOBER 2011</i>

1. Introduction

The Local Government and Shires Associations of NSW (the Associations) are the peak bodies for NSW Local Government.

Together, the Associations represent all 152 NSW general-purpose councils, special-purpose county councils and the regions of the NSW Aboriginal Land Council. The mission of the Associations is to be credible, professional organisations representing Local Government and facilitating the development of an effective community-based system of Local Government in NSW. In pursuit of this mission, the Associations represent the views of councils to NSW and Australian Governments; provide industrial relations and specialist services to councils and promote Local Government to the community.

In this role, the Associations represent the current 106 Local Government water utilities that provide water supply and sewerage services in regional NSW, including 97 council-owned and operated local water utilities, four water supply county councils, and one water supply and sewerage county council. Local Government water utilities service over 1.8 million people – approximately 30% of the state population.

The Associations thank the Metropolitan Water Directorate of the Department of Finance and Services for the opportunity to make a submission to its review of last resort arrangements under the *Water Industry Competition Act (NSW) 2006* and the review's discussion paper entitled *Retailer of Last Resort and Operator of Last Resort arrangements under the Water Industry Competition Act 2006*.

The Associations welcome the review and agree with the review that the retailer of last resort provisions need to be strengthened and that an operator of last resort regime need to be introduced. Local Government water utilities in regional NSW are likely to be declared last resort providers for private water service schemes licensed under the *Water Industry Competition Act (NSW) 2006* in their areas of operations. They require planning certainty and need to be protected against the risks and costs associated with failures of such schemes.

Hereunder, the Associations provide a number of general comments on what is suggested in the discussion paper as well as answers to selected questions in the paper.

2. Comments on the discussion paper

Adequacy of regime dealing with physical failure of supply source or infrastructure

The Associations have concerns about the efficacy of regulatory measures that are to precede any application of the last resort provisions in addressing physical failure of the supply source and/or infrastructure. The discussion paper suggests that adequate measures were in place for the event of physical failure such as contingency measures required by licensees in their management and operations plans as well as emergency powers of the Minister under the *Water Industry Competition Act (NSW) 2006* or the *Essential Services Act (NSW) 1988*.

The Associations believe that regulatory measures aimed at avoiding physical failure or requiring the licensee to maintain capacity to address physical failure need to be strengthened. This includes detailed requirements for the licensee to demonstrate ongoing adequacy of contingency measures and capacity of the licensee to fund them.

There is a strong possibility, notably in regional NSW where supply systems are often isolated, that physical failure of infrastructure, and particularly, the supply source might also result in a failure of the licensee triggering the last resort provisions. This is especially relevant where the licensee relies on a separate single supply source and/or infrastructure network. It is important to note that, different to the electricity sector where there is almost always sufficient alternative generation capacity, in the water supply sector, alternative supply sources might not be available or their capacity limited.

Comprehensive regulation of licensed schemes

Furthermore, regulation of licensees needs to address and counter any incentive for licensees not to invest into good practice or adequate infrastructure in order to increase short term profits and shift long term risks (e.g. ongoing infrastructure renewal) onto last resort providers. This includes comprehensive and strict regulation ensuring that licensed schemes are fit for purpose, financially viable and sustainable and comply with water quality standards. Importantly, licensees need to be required to undertake long term asset management and financial planning for capital cost (infrastructure renewal/replacement or upgrade) to avoid financial shocks when renewal/upgrade is due that might result in insolvency of the licensee and a last resort event.

Licensees as well as their customers, when entering into private water service scheme, need to be made aware of the costs and risks involved in the scheme, including those related to physical failure of the supply source or infrastructure.

The regulatory regime also needs to include the requirement for regular audits of the ongoing adequacy of the licensee's management and operations plans and financial sustainability. Furthermore, the regulatory regime needs to include a requirement of the licensee to notify the regulator early of any non-compliance with their plans and, importantly, the likelihood of both physical and licensee failure. Penalties should be available for non-compliance with the notification requirement.

Recovery of costs of the last resort provider (questions 16 to 18 and 37 to 53 in the discussion paper)

As a principle, the last resort provider should be able to recover all costs associated with the declaration as well as with any actual stepping in as a result of a licensee failure. As a general principle, costs incurred under the last resort arrangements should be borne by the licensee and his or her customers. This would ensure that licensees are fully accountable to their customers and customers are fully aware of risks and costs of private schemes. For equity reasons, these costs must not be spread across existing customers of the last resort provider.

Cost recovery arrangements should separate between costs triggered by the declaration and cost incurred as a result of an actual last resort event.

Costs associated with the declaration

Costs associated with the declaration (e.g. general contingency planning, familiarisation with the private scheme, capital expenditure required for changes in the last resort provider's system design in order build and maintain capacity to step in) are incurred regardless of the actual occurrence of a licensee failure. Depending on the nature of the required activity, these costs should be covered either by a one-off or by an ongoing cost recovery mechanism and be borne by the licensee and passed through to his or her customers. This would ensure appropriate price signals are sent to the licensee as well as his or her customers on the risk management cost associated with the private scheme (and so let the market manage the risk).

The Associations do not agree with the suggestions in the discussion paper on page 39 that licensees should not be allowed to pass through such cost to their customers. Such a restriction would distort the pricing signal to (potential) customers with regard to the risk management cost involved in the private scheme.

Finally, the Associations object to the suggestion in the discussion paper on page 39 that last resort public utilities that have "avoided" capital investment as a result of the licensed scheme covering customers that would have otherwise needed to be serviced by the public utility, would need to offset avoided costs from the contingency planning charge on the licensee. Principally, the existing customers of the public utility would not have avoided any cost as capital investment for the new group of customers would not have be borne by existing customers of the utility but by the new group of customers by way of development contributions.

Cost associated with stepping in

Cost associated with stepping in when a last resort event occurs (e.g. operational expenditure of running the private scheme, capital expenditure required for emergency works and infrastructure renewal in the private scheme, for bringing the private scheme up to the last resort provider's standards, or for upgrades required to the last resort provider's own system to address increased demand) should be treated separately. Preferably, customers of the failed licensee would bear costs by way of their regular charges and, for additional expenditure, by way of additional charges. Additional expenditure could also be funded from any bond the licensee had to provide for this purpose and to which his or her customers have contributed to.

However, recovering all costs of stepping in might not be feasible in all instances because they are too large and/or customers of the private scheme lack the capacity to pay (e.g. renew run-down infrastructure, undertake environmental clean-ups). Costs that are not recoverable from customers of the failed schemes should be borne by an industry fund contributed to by all licensees under the *Water Industry Competition Act (NSW) 2006*. Unused funds could pay for the regulatory activity mentioned above.

Comments on specific questions in the discussion paper

The following table contains the Associations' comments on selected question in the discussion paper.

Table: Comments on selected questions

Question in discussion paper	Comment
<p>4. What provisions should the scheme include with regard to the retailer of last resort (RoLR) appointment process:</p> <ul style="list-style-type: none"> a. Should the RoLR scheme require the appointment of a RoLR? If so, on what basis should the appointment be made? For example, should it be a requirement that all retail supplier licences granted under the WIC Act have an appointed RoLR from the date the licence is granted? What should be the timing requirements of this appointment? b. Alternatively, at the point a licence is issued, should the scheme require that the Minister first determine if it is necessary to nominate a RoLR in relation to that scheme? Should there be a minimum timeframe in which the Minister must make the determination? 	<p>The Associations do not support Local Government water utilities automatically becoming the retailer or operator of last resort. This does not provide sufficient flexibility to consider specific circumstances and individual capacity of Local Government water utilities.</p>
<p>24. What provisions should the scheme include with regard to the operator of last resort (OoLR) appointment process:</p> <ul style="list-style-type: none"> a. Should the OoLR scheme require the appointment of a OoLR? If so, on what basis should the appointment be made? E.g. should it be a requirement that all network operator licences granted under the WIC Act have an appointed OoLR from the date the licence is granted? What should be the timing requirements of this appointment? b. Alternatively, at the point a licence is issued, should the scheme require that the Minister first determine if it is necessary to nominate an OoLR in relation to that scheme? Should there be a minimum timeframe in which the Minister must make the determination? 	

Question in discussion paper	Comment
<p>6a. Should the RoLR arrangements include provisions that prescribe criteria that must be considered before making a RoLR appointment? If so, what should these criteria include?</p> <p>26a. Should the OoLR arrangements include provisions that: a. prescribe criteria that must be considered before making an OoLR appointment? If so, what should these criteria include?</p>	<p>Yes, this should include consideration of individual capacity of Local Government water utilities.</p>
<p>6b. Should the RoLR arrangements include provisions that require the retailer to be consulted before being appointed as a RoLR?</p> <p>26b. Should the OoLR arrangements include provisions that require the operator to be consulted before being appointed as an OoLR?</p>	<p>Yes, to ensure adequacy of assessment of capacity (see 6a).</p>
<p>8. Should licensed retail suppliers be required to notify the Minister or IPART if it is likely that a RoLR event will be triggered?</p>	<p>Yes, see se comments above.</p>
<p>9. Once appointed, should the RoLR arrangements be permanent or should the failed licensee have an opportunity to be reinstated?</p> <p>27. Should the OoLR arrangements have the flexibility of being either a temporary or permanent arrangement?</p>	<p>This should be flexible as the retailer or operator of last resort might only want to or only have the capacity to step in temporarily.</p>
<p>12. Who should have the responsibility for preparing the contingency plan?</p>	<p>The retailer or operator of last resort should be responsible for preparing the “last resort” plan to make sure it is known what they can do and what the efficient cost are. This should be done in cooperation with licensee. As mentioned above, the licensee has preceding contingency planning responsibilities in relation to physical failure of the supply source or infrastructure.</p>
<p>13. Should the RoLR arrangements set a maximum period within which a customer of a RoLR must decide whether or not they want to remain a customer of the RoLR or switch to another retailer? If so, what should this maximum period be?</p>	<p>Any requirement must ensure ability to recover cost associated with last resort event.</p>
<p>14. Should the RoLR arrangements include provisions that govern the termination of a a. RoLR’s supply obligation/appointment? If so: should a RoLR have the ability to seek a termination of its appointment; and/or b. should the Minister have the ability to terminate a RoLR appointment?</p>	<p>Yes, in the case of (unforeseen) circumstances beyond capacity of the last resort provider.</p>
<p>21. Should the RoLR be required to have a network assets access agreement in place with the network operator as part of its contingency planning obligations?</p> <p>22. Or, should the existing agreement between the licensed network operator and the failed retail supplier automatically apply to the RoLR?</p>	<p>Access arrangements should automatically transfer to the last resort provider.</p>

Question in discussion paper	Comment
34. Should nominated OoLRs be required to have a contingency plan?	Yes, contingency planning is essential to ensure continuity of supply and customer protection in the event of licensee failure.

3. Closing Remarks

The Associations hope that their comments are of assistance and look forward to participating in the next steps of the review.