



Attachment 12

Managing Risk / Proposed cost pass-through and true-up arrangements

30 September 2025

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1. Proposed cost pass-through and true-up arrangements

1.1 Our approach to risk management

We have analysed the key risks that could impact the costs of providing services over the determination period, to determine how each is best addressed. We have sought to consider these risks holistically across the 'regulatory package', and through this determination are seeking prices and a framework that allow us to efficiently manage and – where appropriate – share risks with our customers.

Ultimately, we consider that our proposed package represents a fair sharing of risk while respecting and protecting the long-term interests of our customers and the wider community.

In determining the most appropriate approach to address each risk, we have drawn on the following principles for managing risk:

Table 1: Principles for managing risk

Allocate risks to the party best placed to manage them - a balanced approach to ensure sharing of risk between WaterNSW, government and customers)
Be fair - retaining risks with high uncertainty and maintaining appropriate incentives for WaterNSW to manage risks within their control
Risk management should not jeopardise public health or the environment, with specific emphasis on ageing infrastructure investment
Be long-term focused
Promote customer value

We have approached the management of risks for the 2026 Determination period in a holistic manner that draws on the mechanisms outlined in the 3Cs Handbook. This framework summarises our principles and approach to:

1. Ensuring risks associated with our proposal are identified and quantified
2. Identifying the mechanisms to manage those risks
3. Guiding how risks should be allocated between customers and WaterNSW

1.2 Reducing the allocation of risks to customers

WaterNSW proposes to apply IPART's key risk management mechanisms under IPART's 3Cs regulatory approach for unforeseen costs that arise during the determination period (IPART Water Regulation Handbook, July 2023).

Cost pass-throughs: When there is a known, material cost that the business cannot control, a cost pass-through may be included in the determination. If costs are incurred, the business may be able to pass these costs through to customers within the determination period. IPART's Water Regulation Handbook outlines six principles that need to be demonstrated in proposing a cost pass-through.

True-ups: A true-up allows for the recovery of 'material' cost changes at the beginning of the next determination period from customers. The costs that the business will incur can then be recovered from customers in the following period.

Targeted Reviews and Letter of comfort: These are mechanisms to provide additional comfort in proceeding with new projects/spending while waiting for an IPART review.

Replacement of the price determination (full or partial): IPART may agree to replace a determination (partially or completely) where the ability to deliver services is materially affected, and a business cannot wait for a true-up of efficient costs, and a cost pass-through has not already been set.

Targeted reviews, a letter of comfort and or a full or partial replacement of the determination are all useful mechanisms that may be sought by WaterNSW during the regulatory period, noting the specific circumstances when each would be invoked are impractical (or impossible) to identify ex ante.

WaterNSW has opted for a 5 year determination period to provide greater certainty around the future costs of the pipeline. However, a longer regulatory period means that IPART will reassess those costs less frequently, which increases the potential need for reopener or cost pass-through provisions to address unforeseen or material changes during the period.

WaterNSW has taken considerable risk in providing regulated services in a manner that balances operational and financial risk with outcomes for customers. Of note, we have designed our proposed reopener and cost pass through framework to have clear, objective triggers (as specified, e.g. event and materiality driven). This approach ensures that the mechanisms are only triggered when they are genuinely needed to avoid significant detrimental impacts on service levels. We note that the aim of our proposed framework is to respond to emerging risk within a longer-term 5-year determination in a way that does not compromise service levels and contractual obligations under our long-term supply agreement with our major customer, Essential Water.

Customer protection is enhanced by ensuring the potential costs are only passed through once they are verified and approved by IPART. WaterNSW has proposed specific form and content requirements to meet the evidentiary threshold for all reopeners or cost pass through proposals and applications.

In addition, activation of the reopener or cost pass through mechanisms would be subject to consultation with customers and approval by IPART. WaterNSW will consult with affected customers such as Essential Water prior to the lodgments of any cost pass through or reopener application to IPART.

We have responded to IPART concerns around preserving the incentives to drive efficiency and performance. Strict event driven and materiality thresholds ensure that WaterNSW can only apply for an application for a reopener or cost pass through mechanism for events that are pre-defined, material, unforeseeable and/or uncontrollable. The proposed mechanisms are not intended to address performance based outcomes. Issues related to underperformance, inefficiency or failure to meet service standards remain outside the scope of these provisions. This ensures that WaterNSW remains fully accountable for its operational performance and continues to be incentivised to deliver pipeline services efficiently and reliably within the determination period.

While our approach goes some way to addressing unforeseen risks, or addressing risks where the costs cannot be readily forecast, we support and have drawn on IPART’s framework for risk management that draws on cost pass-throughs, true-ups, letters of comfort and or partial or full replacement of the determination in establishing a fair sharing of risk between WaterNSW and our customers.

Our proposed approach to managing cost and revenue risk is outlined below.

Figure 1: Risk management and how we address major risks

Category	Risks	Impact - cost or revenue?	Mechanism	Risk allocation
Systematic risk ▶	Risks that cannot be eliminated through diversification e.g. macroeconomic factors impacting rate of return / WACC	Cost	WACC / cost of debt true-up	Business
Business-specific risk ▶	Staff, contractor and public safety in relation to operating and maintenance, breach of licence, equipment failure	Both	Cost allowance (to meet good industry practice –complying w/ legislative obligations) Self-insured to deductible limit (\$10K per claim event)	Business
	Natural disasters, major asset failure	Both	Cost allowance (insurance)	Business (via insurers)
	Water usage compared with regulatory forecasts	Revenue	Cost reflective tariff structures under price cap	Shared
	Insurance cap/credit/coverage event regulatory & service standards/tax changes	Cost	General cost pass through	Shared
	Movements in annual energy prices	Cost	Electricity cost true-up	Shared
	New projects/spending driven by ongoing customer engagement	Both	Targeted reviews / letter of comfort	Shared
	Ability to deliver services is materially affected and a true-up not suitable <small>(e.g. Low probability /high consequence events)</small>	Both	Partial or Full reopener	Shared

WaterNSW proposes applying IPART’s key risk management mechanisms that we consider meet these regulatory principles. These mechanisms are outlined in the sections below.

As illustrated above, WaterNSW has taken on considerable additional risk to help place downward pressure on our costs over the 2026 Determination period in recognition of customers affordability concerns.

Targeted reviews, a letter of comfort and or a full or partial replacement of the determination are all useful mechanisms that may be sought by WaterNSW during the regulatory period, noting the specific circumstances when each would be invoked are impractical (or impossible) to identify ex ante.

WaterNSW’s proposed approach to managing risk in through cost pass-throughs, true-ups and full or partial reopeners is identified in Figure 2 below and discussed in the following sections.

In summary, after analysing the key risks and applying these principles, we are proposing the introduction of two key risk management mechanisms that we consider meets these regulatory principles. These are mechanisms to update access and usage prices that consist of:

- Inclusion of an electricity cost true-up to manage movements in the benchmark price of electricity as originally proposed by WaterNSW in our 2021 pricing proposal and as approved in principle by IPART at the 2022 Determination. This pricing proposal outlines our proposed approach to implement the true-up for both the current and upcoming regulatory periods.

- A true-up for the costs of acquiring easements or access to infrastructure on Crown land.
- During the 2026 Determination period we propose several cost pass throughs to manage movements in the efficient costs of specified events that could occur and are beyond the reasonable control of WaterNSW during the 2026 Determination period.

Error! Reference source not found. The figure below outlines how our proposed risk management and a llocation framework for the 2026 Determination has been applied and provides our proposed cost pass-throughs, true-ups and reopeners.

Figure 2: Proposed approach to managing cost risk in the 2026 Determination period

Category	Description	Event
Cost pass throughs	<p>General events</p> <p>Activities and associated costs cannot practically be identified at the time of the determination, but the cost impacts are likely to be material.</p>	<p>7 General Events</p> <p>A regulatory change event; a service standard event; a tax change event; an insurance coverage event (costs beyond the insurance cap and beyond the reasonably available insurance cover); an insurer's credit risk event; a natural disaster event and a terrorism event.</p>
True-ups	<p>Recovery of changes in benchmark or actual costs at the subsequent determination. Appropriate when costs are material and outside of the control of WaterNSW</p>	<p>2 True-ups</p> <p>Electricity cost true-up / Easement acquisition costs</p>
Full or partial reopener	<p>Partially or completely replace a determination where the ability to deliver services is materially affected, and a business cannot wait for a true-up of efficient costs, and a cost pass-through has not already been set. To be invoked only as required.</p>	

1.3 Cost pass-throughs

In providing regulated services, WaterNSW is exposed to a range of risks that may influence the costs of providing services, or the revenues we receive from providing services. These costs and/or revenues may differ from those assumed by IPART in making its determination. This creates a risk that WaterNSW over or under recovers the efficient cost of providing services, as well as a risk that prices do not reflect the cost of efficiently providing these services.

One way to address these potential cost changes is to estimate the likelihood of a change event occurring and include a probabilistic assessment of the costs in our proposed expenditures. **The obvious drawback with this approach is that the estimates are likely to be inaccurate and would increase the costs of providing bulk water services beyond an efficient level if the change event does not occur or if the costs are lower than estimated.** A more practical approach that is common in all Australian regulatory frameworks is to pass through the efficient costs of an event (subject to an IPART review of the reasonableness of the expenditure) only if the event occurs.

Cost pass through mechanisms are a common element of incentive-based regulatory frameworks. They are used to manage the risk associated with external events that occur within a determination period that are outside the control of the business but have a material impact on costs and hence the financial position of the firm.

These risks are unable to be adequately managed through internal risk management, insurance or self-insurance. Examples can include natural disasters where insurances may only cover a portion of the total costs of addressing the event.

Cost pass throughs provide a mechanism to allow regulators to review the efficient costs associated with events (after they have occurred) that could not be accurately forecast as part of the revenue

proposal and allow regulated businesses to recover the determined efficient costs to ensure that prices continue to reflect efficient costs.

The costs associated with pass through events are those that would have been included in the 2026 Determination had WaterNSW and IPART known with perfect foresight the scope, timing and efficient costs of the pass through event in advance. For the majority of pass through events, at least one element of the scope, timing or efficient costs of the event are unlikely to be known over the 2026 Determination period.

Therefore, WaterNSW proposes a targeted cost pass through framework to address the risk of defined exogenous events occurring during the 2026 Determination period that may change the efficient costs of providing transportation services (i.e. such that efficient costs differ from those assumed by IPART in setting prices in the 2026 Determination).

IPART has established cost pass through principles in place and have discretion under the IPART Act to define a cost pass through mechanism.

WaterNSW has applied a framework for cost pass throughs based on general events. The approach provides a mechanism to allow regulated businesses to recover efficient costs associated with events that could not be forecast with certainty as part of the revenue proposal and ensure that customers do not pay higher prices over the period should the events not occur.

[Is this passing through all risk to customers?](#)

No. Any change event should pass the threshold test of *“if the event was known at the time of the determination, would the associated costs likely have been included in revenues and prices?”*. If yes, then a pass through is simply a process to incorporate the efficient costs of providing bulk water services if or when the event occurs, rather than forecasting the costs at the start of the period or tracking the costs until the subsequent regulatory period.

1.3.1 General pass through events

General pass through events are those where activities and associated costs cannot practically be identified at the time of the determination, but the cost impacts are material.

Our approach to identifying general cost pass through events consists of:

- Identifying potential changes to our operating environment and regulatory and legislative framework that may create risk over the 2026 Determination period.
- Assessing the certainty, likelihood and consequence of each risk to determine whether risks can be accounted for in expenditure forecasts or in the case of low consequence risks, absorbed internally.
- Reviewing the available risk management measures that may be used to mitigate or prevent risks, including opex, capex, insurance, self-insurance, WACC and specific pass through events.

Water NSW proposes general cost pass throughs to manage the risks of defined exogenous events. IPART has long-standing cost pass through principles in place and have discretion under the IPART Act to define a cost pass through mechanism. We are seeking a mechanism that:

- Defines seven general pass through events: a regulatory change event; a service standard event; a tax change event; an insurance coverage event (noting that this addresses costs beyond the insurance cap and beyond the reasonably available insurance cover); an insurer’s credit risk event; a natural disaster event and a terrorism event. The proposed events are detailed in Appendix 1 to this attachment.
- Provides for IPART to determine the efficient pass through amount and the recovery period for the pass through amount at the time of the event (i.e. within the determination period rather attempting to specified unknown costs in advance in the determination). This aligns with the standard implementation approach for cost pass throughs across a number of regulatory regimes, including the national energy regulatory regime for electricity and gas networks.

Is this passing through all risk to customers?

No. Any change event should pass the threshold test of “*if the event was known at the time of the determination, would the associated costs likely have been included in revenues and prices?*”. If yes, then a pass through is simply a process to incorporate the efficient costs of providing bulk water services if or when the event occurs, rather than forecasting the costs at the start of the period or tracking the costs until the subsequent regulatory period.

1.4 True-ups

A true-up allows for the recovery of changes in benchmark or actual costs as relevant at the subsequent determination period. A true-up is appropriate when the costs for an activity are material and outside of the direct control of WaterNSW and there is a risk that including an estimate of costs in customer charges may result in prices that over- or under-compensate for the costs of the activity. In some cases, the true-ups rely on other regulators’ decisions (for example in the case of electricity costs) or market data (for example a cost of debt true-up).¹

Table 2: Proposed true-ups

Pass through event	Description
Electricity cost true-up	<p>Due to the highly uncertain and potentially volatile future of energy prices and infrastructure, WaterNSW is seeking a mechanism that shares the risk of forecasting these costs where actual network charges, benchmark wholesale electricity costs and environmental costs over the 2026 determination period are “trued up” in the subsequent (i.e. 2031) determination.</p> <p>The proposed true-up relies on publicly available information and updated benchmark data and decisions by other Australian regulators as relevant</p>
Easement acquisition costs	<p>Easements and other access rights are also required over Crown land to ensure appropriate access conditions to the remainder of our infrastructure. WaterNSW will need to secure access to 17 additional parcels of Crown land. While negotiations are ongoing, WaterNSW has forecast easement acquisition costs over Crown land during the 2026 Determination period.</p> <p>We propose a “true-up” of actual easement acquisition costs to be included in the subsequent determination period, subject to IPART’s review of the prudence of the expenditure.</p>

¹ As a cost of debt true-up is applied as part of IPART’s standard WACC method, it is not discussed further in this section.

1.4.1 Electricity cost true-up

The cost of electricity is highly uncertain given that key components of electricity prices are determined by dynamic market forces, or independent regulators and/or market authorities. This represents a risk which is not practically controllable by WaterNSW.

We have considered this risk holistically, and compared to alternative options we consider this to be the most efficient means of managing this forecast price risk. For instance, we do not believe that it is in a customer's best interest to set an energy cost allowance that includes a positive adjustment or uncertainty premium to the price for potential unforeseeable increases in market prices and/or network charges. Nor do we believe it is in a customer's best interest to provide WaterNSW with additional compensation (outside the WACC) for bearing the risk of annual movements in wholesale and/or network prices.

Changes in electricity costs are designed to ensure WaterNSW is incentivised to take accountability for events within their control, while not exposing them to risks beyond their control - particularly where it may not be efficient for WaterNSW to manage this risk.

WaterNSW proposes an electricity cost true-up mechanism to apply to the current 2022 Determination period and the upcoming 2026 Determination. The detailed methodology for our proposed electricity true-up mechanism can be found in Attachment 9 and is summarised below. The proposed electricity true-up calculation is provided in Attachment 10.

To manage significant uncertainty around energy prices, WaterNSW proposed in its 2021 pricing proposal that the benchmark energy allowance be subject to an end-of-period true-up for movements in the benchmark price/allowance to reflect movements in network and wholesale costs:

"...we are proposing to share with customers the risks associated with movements in energy costs that are beyond WaterNSW's reasonable control through an end of period true-up mechanism of movements in network and wholesale components of the benchmark electricity price."²

The proposal was underpinned by the following principles:

- retain incentives to procure and use electricity as efficiently as possible
- capture material movements in costs (increases and decreases) to ensure prices reflect costs that would be incurred by a prudent and efficient benchmark entity in providing these services over the 2022 Determination period
- apply simply and mechanically.

For the draft 2022 Determination, IPART agreed with the support of their consultants (The Centre for International Economics (CIE)) – in principle – to applying an end-of-period true-up. This true-up would adjust the revenue requirement to reflect differences between wholesale and network components of benchmark energy prices that were forecast for the 2022 Determination and wholesale and network components that occurred during the regulatory period. That is, the differences between forecast and actual outcomes for these benchmark energy costs would be passed-through over the next (i.e. 2026) determination period.

² WaterNSW, Pricing Proposal to the Independent Pricing and Regulatory Tribunal: Regulated prices for the Wentworth to Broken Hill Pipeline, 30 June 2021, p.122.

WaterNSW noted that a clear methodology was required from IPART to identify risks that needed to be managed. CIE agreed with WaterNSW's draft decision response that it would be better able to manage the risk associated with uncertain energy costs if greater clarity was provided as to IPART's intentions. In its 2022 Final Report, IPART invited WaterNSW to provide further justification for its proposed energy true-up mechanism. IPART indicated that it was:

"open to working with WaterNSW prior to its next submission to develop a true-up mechanism that appropriately balances energy cost risk between WaterNSW and its customers, with the intent that this mechanism would apply to energy costs over the 2022 Determination period."³

Critical to this was for WaterNSW to demonstrate this mechanism would "reflect the prudent behaviour of a benchmark efficient entity, and the extent to which WaterNSW will be incentivised to efficiently manage its actual energy costs".⁴

WaterNSW engaged Frontier Economics to provide expert advice on meeting IPART's criteria for the electricity cost true-up. Our detailed workings for the proposed true-up is provided in Attachment 9 and are summarised below.

Our approach includes the following six steps:

Step 1: Determine relevant time period.

Step 2: Determine which costs or other assumptions are subject to true-up.

Step 3: Collate updated assumptions, including movements in the relevant cost items.

Step 4: Calculate cost over/under-recovery for each year of period.

Step 5: Calculate total cost over/under-recovery over period, including the time value of money, and consider any materiality threshold.

Step 6: Calculate revenue increment/ decrement to be recovered over 2026 Determination period.

While each of the above steps is discussed in detail in Attachment 9 *Frontier Economics report on electricity costs*, the key threshold decision is to determine which costs or other assumptions are subject to true-up.

Determine which costs or other assumptions are subject to true-up (Step 2)

We identified 3 options for elements to be included in the true-up and propose that **wholesale, network and environmental** costs be included. These costs accounted for 94% of total energy costs incurred over the 4-year Determination period. Using all costs (e.g. including ancillary and market fees, retail operating costs, etc.) may result in additional administration costs that outweigh the impact on the likely under- or under-recovery. Alternatively, environmental cost variances have the potential to be material over the period and can be calculated with minimal additional effort.

While this approach departs somewhat from the 2022 Determination whereby the true-up was to apply to wholesale and network costs only. However, given the level of environmental costs cannot be controlled by WaterNSW and since these costs are determined by the market and regulators/independent authorities, our proposed approach aligns with the cost-pass through principles applied by IPART in their 2022 final decision.

³ IPART, Murray River to Broken Hill Pipeline Final Technical Report, November 2022, p.40.

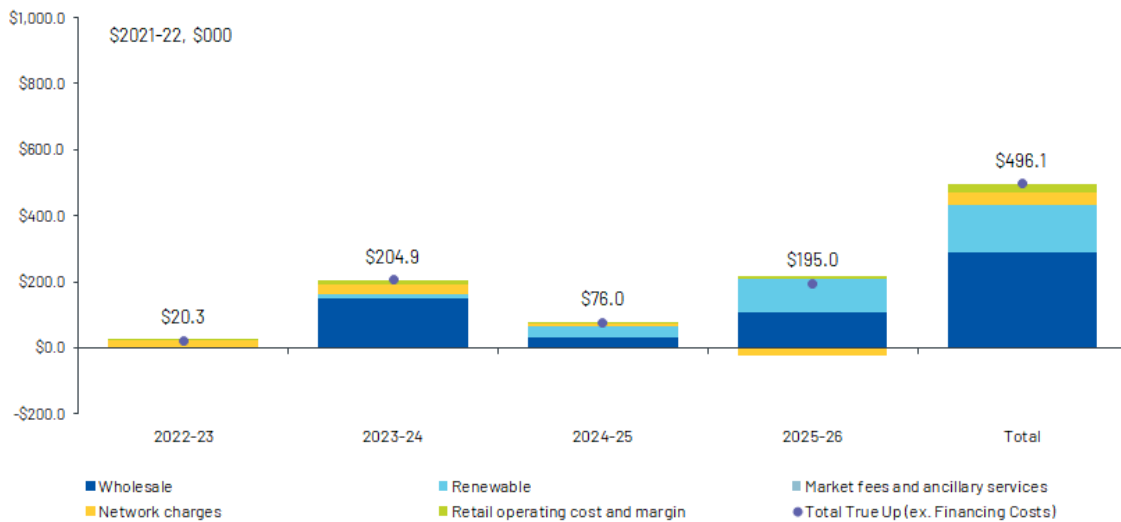
⁴ IPART, Murray River to Broken Hill Pipeline Final Technical Report, November 2022, p.39.

We also consider that these costs should be included as part of the true-up mechanism because of their relative materiality. Given that environmental costs are a material proportion of total costs (9% of total energy costs over the 2022 Determination period) and prices for environmental certificates are volatile, the impact on efficient costs of changes in the prices of environmental certificates could be as material as the impact of changes in wholesale or network prices.

Proposed true-up amount for 2026 Determination

Based on the approach described above and in Attachment 9, the total true-up amount over 2022-23 to 2025-26 has been calculated by WaterNSW as a positive adjustment (over-recovery) of \$496,110 (in \$2021-22) compared to the benchmark price allowance. **Figure 3** The major components of this over-recovery are changes in benchmark wholesale electricity costs and environmental costs compared to the assumptions in the 2022 Determination.

Figure 3: WaterNSW electricity under-over recovery year-on-year and total by cost component (\$000s, \$2021-22)



The true-up adjustments, as shown above, are escalated to \$571,810 (in \$2025-26) and are to be returned to customers over the proposed five-year period. Assuming placeholder WACC of 3.1%, the net present value of these adjustments is **\$560,976** (in \$2025-26) or \$128,083 per annum returned to customers (in \$2025-26).

Electricity cost true-up mechanism for variations in the 2026 Determination period

WaterNSW proposes to adopt the same electricity cost true-up as outlined in the previous section and as set out in Attachment 9 for any variances between forecast and actual benchmark costs over the 2026-27 to 2030-31 determination period for adjustment to the revenue requirement in the subsequent (i.e. 2031) determination period.

1.4.2 Easement and access right acquisition cost true-up

WaterNSW attributes a large proportion of its capital cost to land acquisitions required to place infrastructure such as pump stations, bulk water storage and access to place pipe on private and Crown land.

As discussed in Section 9.2.1.2 of our main submission document, while the investment in easements over private land is largely complete, easements and other access rights are also required over Crown land to ensure appropriate access conditions to the remainder of our infrastructure. WaterNSW will need to secure access to 17 additional parcels of Crown land. While negotiations are ongoing, WaterNSW has forecast easement acquisition costs over Crown land during the 2026 Determination period.

We propose a “true-up” of actual easement acquisition costs to be included in the subsequent determination period and for the costs and associated holding costs to be rolled into the RAB at the subsequent (i.e. 2031) determination, subject to IPART’s review of the prudence and efficiency of the expenditure.

1.5 Full or partial reopeners

WaterNSW has opted for a 5 year determination period to provide greater certainty around the future costs of the pipeline. However, a longer regulatory period means that IPART will reassess those costs less frequently, which increases the potential need for reopener or cost pass-through provisions to address unforeseen or material changes during the period.

Replacement of the price determination (full or partial) is an option whereby IPART may agree to replace a determination (partially or completely) where the ability to deliver services is materially affected, and a business cannot wait for a true-up of efficient costs, a cost pass-through has not been established for the event and or the efficient costs of the event are not otherwise covered by insurance.

WaterNSW will only seek a full or partial reopener during the determination period if an event, or a combination of events, impacts our ability to deliver services and /or the financial consequences are such that it is not possible to wait for the 2031 Determination.

Possible changes that might be suitable for a full or partial reopener include the following:

- event causing material, unforeseen shift in demand, e.g. the significant reduction in water usage by Essential Water that leads to a significant impact to the annual revenue requirement (i.e. 5%)
- emergency management events such as:
 - a natural disaster or significant climate event
 - pandemic event (or other broadscale event constraining movement or logistics – for example, cyber or military events materially impacting imports and/or transport for a protracted time)
- changes to water sharing plans that have or could have a material impact on how the system is managed, water is used or how much water is available to be transported

- the introduction of new regulatory or legislative obligations or changes in service standards not captured in other pass-through mechanisms that have a material financial impact.
- an event causing unexpected material cost savings compared to the IPART operating and capital expenditure allowances (e.g. in the case of a regulatory change event, service standard event or a tax event as defined in Appendix 1).

Appendix 1 – Proposed general cost pass throughs

We propose that a general pass-through mechanism apply for the 2026 Determination period for the Wentworth to Broken Hill Pipeline that specifies the following pass through events:

- A regulatory change event;
- A service standard event;
- A tax change event;
- An insurance coverage event (noting that this addresses costs beyond the insurance cap and beyond the reasonably available insurance cover);
- An insurer's credit risk event;
- A natural disaster event; and
- A terrorism event.

Process and mechanism for passing through efficient costs (or savings) associated with eligible pass through events

It is proposed that the process would involve:

1. An eligible event occurring that results in a material increase (**Positive Change Event**) or decrease in costs (**Negative Change Event**) of providing WaterNSW's water transportation services (**Pass Through Water Services**)
2. WaterNSW applying to IPART (or IPART initiating) and substantiating the increase (or decrease) in costs of providing the water transportation services (**Eligible Pass Through Amount**). **WaterNSW must demonstrate that the costs are not covered by insurance or other mechanisms.**
3. IPART reviewing the WaterNSW application to determine the efficient increase or decrease in costs to be passed through to customers (**Approved Pass Through Amount**)
4. IPART notifying WaterNSW (and stakeholders) of the decision and the prices to apply in each remaining year of the regulatory period within which the eligible event occurs.
5. The proposed mechanisms are not intended to address performance based outcomes. Issues related to underperformance, inefficiency, or failure to meet service standards remain outside the scope of these provisions. This ensures that WaterNSW remains fully accountable for its operational performance and continues to be incentivised to deliver pipeline services efficiently and reliably within the determination period

Box 1 sets out definitions that will be required to specify the process and mechanism for passing through efficient costs (or savings) associated with eligible pass through events. These have been developed in line with the following regulatory principles:

Ensuring the trigger event is clearly defined and can be identified in any cost pass through application.

Requiring WaterNSW to substantiate the efficient increase (or decrease) in costs associated the eligible events (within a reasonable timeframe, e.g. 90 business days, following the event), including actions taken to reduce the magnitude of any increase in costs.

Ensuring IPART (and potentially stakeholders) have sufficient time to review, consult on and assess the proposal (e.g. no more than 120 business days) to ensure that only material.

WaterNSW proposes a trigger mechanism for general cost pass-throughs of 5% of annual net revenue requirement or \$1 million increases or decrease in the efficient costs associated with the event are passed through to customers that recognises the scale and scope of operations of the pipeline.

Allowing prices to be updated, following IPART's decision, within a reasonable timeframe (or ensures WaterNSW is not worse off for any delays) to allow WaterNSW to continue to invest, operate and maintain a water transportation service.

Where possible, drawing from other regulatory precedents, including in Australia.

We would welcome engagement with Essential Water, IPART and other stakeholders in developing the process and mechanism for passing through efficient costs (or savings) associated with eligible pass through events. This would include the items discussed in Box 1, as well as specification of other matters such as:

- Information provision requirements on WaterNSW as part of any pass through application.
- The timeframe and decision-making process – including matters to be considered by IPART in determining the efficient increase (or decrease) associated with the event are passed through to customers⁵ – and reporting requirements on IPART in making a decision on any pass through application.

⁵ One of the matters for IPART's consideration may be the implications for efficient costs of WaterNSW's decisions and actions, including whether (in the case of a Positive Change Event) WaterNSW has failed to take any action that could reasonably be taken to reduce the magnitude of the Eligible Pass Through Amount.

Box 1: Other definitions necessary for refining the process and mechanism for passing through efficient costs (or savings) associated with eligible pass through events

We have developed definitions that will be required to specify the process and mechanism for passing through efficient costs (or savings) associated with eligible pass through events. For the avoidance of doubt, it should be noted that these are the definitions for the pre-defined triggers and the form and content requirements for the application. Once these definitions are met and an applicable claim is lodged, IPART can then assess the prudence and efficiency of the cost to be included in the pass through mechanism.

These definitions include:

- **Approved Pass Through Amount** means the amount which the Tribunal determines should be passed through to customers in respect of that Positive Change Event or Negative Change Event
- **Eligible Pass Through Amount** means in respect of a Positive Change Event or Negative Change Event the increase (or decrease) in costs in the provision of Pass Through Water Services that WaterNSW has incurred since 1 July 2026 and is likely to incur until the end of the Regulatory Control Period as a result of that Positive Change Event or Negative Change Event.
- **Materially** means 5% of the annual net revenue requirement for the year in which the event occurs or \$1 million with the threshold defined on a per event basis
- **Negative Change Event** means a General Pass Through Event which entails WaterNSW incurring Materially lower costs in providing Pass Through Water Services than it would have incurred but for that event.
- **Pass Through Water Services** means the water transportation services provided by WaterNSW.
- **Positive Change Event** means a General Pass Through Event which entails WaterNSW incurring Materially higher costs in providing Pass Through Water Services than it would have incurred but for that event.
- **Relevant Tax** means any Tax payable by WaterNSW other than:
 - income tax and capital gains tax;
 - stamp duty, financial institutions duty and bank accounts debits tax;
 - penalties, charges, fees and interest on late payments, or deficiencies in payments, relating to any Tax; or
 - any Tax that replaces or is the equivalent of or similar to any of the Taxes referred to in sub-clauses (a) to (c) (including any State equivalent tax), and also includes any fee payable by WaterNSW in respect of a Licence.

Definitions of pass through events

We have developed definitions of the eligible events that we propose be included in a pass-through mechanism to apply for the 2026 Determination period. Where possible, these events have been defined consistent with other regulatory determinations that apply to infrastructure services in Australia.

Regulatory change event

A regulatory change event occurs when a change that is made to a regulatory obligation that is imposed on WaterNSW, e.g. by the Commonwealth or State Government, that materially changes WaterNSW's costs (increasing or reducing WaterNSW's costs). Examples could be the imposition of more stringent cyber security compliance requirements or a levy (e.g. a new Dam Safety Levy).

Events that change the standards or nature of WaterNSW's Pass Through Water Services are addressed separately, by the service standard event defined below.

The regulatory change event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 2: Definition: Regulatory change event

A change in a regulatory obligation or requirement (Act of Parliament, Subordinate Legislation, Delegated Legislation, Regulations, Statutory Rules, by-laws, and or other Laws made by the Executive, Administrative Instruments, Operating Licence or other formal authorisation by a Government Agency or Regulator, Binding Statutory Guidelines, State Owned Corporation Act Direction that is binding on the Regulated Entity, or a Court or Tribunal Ruling that:

- (a) falls within no other category of pass through event; and
- (b) occurs during the 2026 Determination period; and
- (c) substantially affects the manner in which WaterNSW is required to provide Pass Through Water Services; and
- (d) materially increases or materially decreases the costs of providing those services.

Note: a change in guidelines (e.g. non-statutory guidelines or 'policies') that set out how regulators interpret the law and provide compliance expectations to regulatory entities are considered persuasive but are not deemed regulatory change events for the purposes of this mechanism if they are not binding on the regulated entity.

Service standard event

A service standard event relates specifically to changes in WaterNSW's Pass Through Water Services, including changes to the minimum standard of service, scope of services, or way services provided. The service standard event may occur as a result of a change to legislation, administrative act or a decision e.g. government. An example of a service standard event could be a change to the nature of the water transportation services provided by WaterNSW.

The service standard event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 3: Definition: Service standard event

A legislative or administrative act or decision (which can include changes to a formal authorisation from a Government Agency or Regulatory e.g. the Operating Licence that overwrites the minimum standards set out in the WaterNSW Supply Agreement with Essential Water or a renegotiation of supply standards under the existing water supply agreement with Essential Water) that:

- (a) has the effect of:
 - (i) imposing minimum standards on WaterNSW in respect of the provision of Pass Through Water Services that are different from the minimum standards imposed on WaterNSW in respect of the provision of Pass Through Water Services immediately prior to that event;
 - (ii) substantially altering the nature or scope of the services that, immediately prior to that event, collectively comprise the Pass Through Water Services; or
 - (iii) substantially varying the manner in which WaterNSW is required to undertake any activity forming part of the Pass Through Water Services; and
- (b) results in WaterNSW incurring Materially higher or Materially lower costs in providing Pass Through Water Services than it would have incurred but for that event, but does not include:
 - (i) the making of the 2026 Determination period
 - (ii) any other category of pass through event.

This includes the renegotiation of supply standards set out in the existing water supply agreement with Essential Water

Tax change event

A tax change event relates to changes to relevant taxes, as defined in Box 4 that have a material impact on WaterNSW's costs.

The tax change event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 4: Definition: Tax change event

A tax change event occurs if:

- (a) any of the following occurs during the course of the 2026 Determination period:
 - (i) a change in (or a change in the application or official interpretation of) a Relevant Tax, in the rate of a relevant tax, or the way in which a Relevant Tax is calculated;
 - (ii) the removal of a Relevant Tax; or
 - (iii) the imposition of a Relevant Tax, and
- (b) results in WaterNSW incurring Materially higher or Materially lower costs in providing Pass Through Water Services than it would have incurred but for that event.

For example, the Sydney Catchment Authority was provided with a tax allowance to fund the Commonwealth Carbon Tax in 2012. Sydney Catchment Authority rebated the Carbon Tax allowance to customers following the repeal of the Carbon Tax. This event would meet the definitions of a Tax change event for the purposes of this mechanism.

Insurance coverage event

An insurance coverage event addresses the risk of incurring liability losses that exceed WaterNSW's insurance coverage. The insurance coverage event addresses costs that are incurred above

WaterNSW's insurance policy limit (an insurance cap event) or beyond the limits of WaterNSW's coverage (an insurance coverage event).

The second element of the insurance coverage event addresses changed circumstances in the insurance market that are beyond WaterNSW's control, but mean that it is no longer possible to take out an insurance policy or set of insurance policies at all, or on reasonable commercial terms. This second arm of the coverage event has been included in cost pass through mechanisms for energy network businesses in the national energy markets. This is in recognition that there have been changing conditions in insurance markets that have made previously available insurance more expensive and difficult to procure.

A particular concern for energy networks were the adverse changes in the bushfire insurance market following bushfire events in Australia and overseas. Similar adverse changes may be seen in relation to cyclone and flood insurance in Australia.

The insurance coverage event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 5: Definition: Insurance coverage event

An insurance coverage event occurs if:

1. WaterNSW:

- a) makes a claim or claims and receives the benefit of a payment or payments under a relevant insurance policy or set of insurance policies; or
- b) would have been able to make a claim or claims under a relevant insurance policy or set of insurance policies but for changed circumstances; and

2. WaterNSW incurs costs:

- a) beyond a relevant policy limit for that policy or set of insurance policies; or
- b) that are unrecoverable under that policy or set of insurance policies due to changed circumstances; and

3. The costs referred to in paragraph 2 above materially increase the costs to WaterNSW in providing Pass Through Water Services.

For the purposes of this insurance coverage event:

'changed circumstances' means movements in the relevant insurance liability market that are beyond the control of WaterNSW, where those movements mean that it is no longer possible for WaterNSW to take out an insurance policy or set of insurance policies at all or on reasonable commercial terms that include some or all of the costs referred to in paragraph 2 above within the scope of that insurance policy or set of insurance policies.

'costs' means the costs that would have been recovered under the insurance policy or set of insurance policies had:

- i. the limit not been exhausted; or
- ii. those costs not been unrecoverable due to changed circumstances.

A relevant insurance policy or set of insurance policies is an insurance policy or set of insurance policies held during the regulatory control period or a previous regulatory control period in which WaterNSW was regulated; and

WaterNSW will be deemed to have made a claim on a relevant insurance policy or set of insurance policies if the claim is made by a related party of WaterNSW in relation to any aspect of WaterNSW's Pass Through Water Services; and

WaterNSW will be deemed to have been able to make a claim on a relevant insurance policy or set of insurance policies if, but for changed circumstances, the claim could have been made by a related party of WaterNSW in relation to any aspect of WaterNSW's assets or business.

Note for the avoidance of doubt; in assessing an insurance coverage event, the Tribunal will have regard to:

- i. the relevant insurance policy or set of insurance policies for the event
- ii. the level of insurance that an efficient and prudent business would obtain, or would have sought to obtain, in respect of the event;
- iii. any information provided by WaterNSW to the Tribunal about WaterNSW's actions and processes; and
- iv. any guidance published by the Tribunal on matters the Tribunal will likely have regard to in assessing any insurance coverage event that occurs.

Insurer credit risk event

This is an event where costs are incurred as a result of an insurer becoming insolvent.

The Insurer credit risk event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 6: Definition: Insurer credit risk event

An insurer credit risk event occurs if an insurer of WaterNSW becomes insolvent, and as a result, in respect of an existing or potential claim for a risk that was insured by the insolvent insurer, WaterNSW:

- (a) is subject to a higher or lower claim limit or a higher or lower deductible than would have otherwise applied under the insolvent insurer's policy; or
- (b) incurs additional costs associated with funding an insurance claim, which would otherwise have been covered by the insolvent insurer.

Note: in assessing an insurer credit risk event pass through application, the Tribunal will have regard to, amongst other things:

- i. WaterNSW's attempts to mitigate and prevent the event from occurring by reviewing and considering the insurer's track record, size, credit rating and reputation; and
- ii. in the event that a claim would have been covered by the insolvent insurer's policy, whether WaterNSW had reasonable opportunity to insure the risk with a different provider.

Natural disaster event

The cost impact of a natural disaster can be significant. Potential natural disasters that could cause significant property damage include, but are not limited to earthquakes, storms and floods. WaterNSW's insurance cover provides a level of protection against property damage caused by natural disasters. However, the cost impact of a natural disaster could materially exceed the coverage provided by these policies.

The natural disaster event is complementary to the insurance coverage event specified above, addressing the unexpected, material costs that an insurance policy would not ordinarily cover.

The relative infrequency and material financial costs of a natural disaster creates significant practical challenges for self-insuring such events. A pass through mechanism provides a more appropriate arrangement for managing the cost impacts in the event that a natural disaster event occurs and causes a material increase in costs. We consider that managing costs through a nominated pass through event is in the long-term interest of consumers.

Any pass through amount claimed in a pass through application for a natural disaster event would be net of any insurance payout made to WaterNSW and any amounts recovered through an insurance coverage event pass through application.

The natural disaster event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules). WaterNSW considers that addressing a potential natural disaster event is more appropriate and potentially less administratively complex than the alternative of seeking a reopener (which currently would be the only viable risk management tool within IPART's regulatory framework to address the impacts of such an event within a determination period).

Box 7: Definition: Natural disaster event

Natural disaster event means any natural disaster including but not limited to cyclone, fire, flood or earthquake that occurs during the 2026 Determination period that changes the costs to WaterNSW in respect of the provision of Pass Through Water Services, provided the cyclone, fire, flood, earthquake or other event was:

- (a) a consequence of an act or omission that was necessary for the service provider to comply with a regulatory obligation or requirement or with an applicable regulatory instrument; or
- (b) not a consequence of any other act or omission of the service provider.

Note: In assessing a natural disaster event pass through application, the Tribunal will have regard to, amongst other things:

- i whether WaterNSW has insurance against the event;
- ii the level of insurance that an efficient and prudent business would obtain in respect of the event.

Terrorism event

As with a natural disaster event, a terrorism event may impose cost that materially exceed the limits of prudent insurance policies.

Any pass through amount claimed in a pass through application for a terrorism event would be net of any insurance payout made to WaterNSW and any amounts recovered through an insurance coverage event pass through application.

The terrorism event definition below is based on the definition on the national energy market regulations (including the National Electricity Rules).

Box 8: Definition: Terrorism event

Terrorism event means an act (including, but not limited to, the use of force or violence or the threat of force or violence) of any person or group of persons (whether acting alone or on behalf of or in connection with any organisation or government), which:

- (a) from its nature or context is done for, or in connection with, political, religious, ideological, ethnic or similar purposes or reasons (including the intention to influence or intimidate any government and/or put the public, or any section of the public, in fear); and
- (b) changes the costs to WaterNSW in providing Pass Through Water Services.

Note: In assessing a terrorism event pass through application, the Tribunal will have regard to, amongst other things:

- i whether WaterNSW has insurance against the event;
- ii the level of insurance that an efficient and prudent business would obtain in respect of the event; and
- iii whether a declaration has been made by a relevant government authority that a terrorism event has occurred.