

PROMOTING A CUSTOMER FOCUS DISCUSSION PAPER



Tribunal Members

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 20 July 2021

We would prefer to receive them electronically via our [online submission form](#).

You can also send comments by mail to:

Review of the way we regulate water businesses
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our [website](#) as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

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If you would like further information on making a submission, IPART's submission policy is available on our website.

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The Independent Pricing and Regulatory Tribunal (IPART)

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Key points we seek feedback on



The water businesses should remain responsible for understanding their customers' views, priorities and needs

We can better encourage water businesses to put the long-term interests of customers at the center of what they do with:

- ▼ a mid- determination 'early check-in' which could include submitting a customer engagement strategy
- ▼ explicit principles/guidelines around the long-term interests of customers
- ▼ clear assessment or grading of the customer-centricity of a utility's proposal against our principles.



Our guidance around customer engagement will remain principles-based

We can improve the current guidance by:

- ▼ revising the current principles to ensure they are fit for purpose
- ▼ expanding the principles to include a clear link between customer engagement and the business's whole cycle of planning, engagement, and action.



Customer advisory or challenge groups need to clearly support customer outcomes

A mid-determination check-in could provide the business with the opportunity to propose an engagement strategy that addresses the needs of their customer base, including the role of customer and other stakeholder groups. We seek feedback about:

- ▼ whether and how current Customer Advisory Groups can be better utilised, and
- ▼ whether we should require additional customer challenge panel of experts to represent the customer perspective.



Customer outcomes would clarify how the efficiency test considers customer preferences and service levels

Proposed expenditure should be well-supported by customer preferences. In particular, expenditure proposals which define the outcomes in the long-term interests of customers, with targets and evidence of customer willingness-to-pay, would provide a clearer basis for assessing whether proposed expenditure supports customer preferences.



The role of our discretionary expenditure framework is less clear

We seek to better understand:

- ▼ the role of discretionary expenditure if focus is shifted to an outcomes-focused regime.
- ▼ if and how the discretionary expenditure framework can be improved.

1 Putting customers at the centre of what we do

As a regulator, our aim is to promote the long-term interests of customers. Customers expect a safe, reliable and affordable service. We need confidence that the water businesses which we regulate have a clear and current understanding of their customers' values, preferences and long-term interests.

We also want confirmation that the businesses are learning from their customers to respond to their changing values and preferences. Finally, there needs to be clear and transparent outcomes which demonstrate that customers' and the communities' preferences are being met at the lowest sustainable cost, including the need to respond to environmental and climate pressures.

1.1 Customer preferences are less clear due to the lack of competition

Without an understanding of what customers want, there is no way of knowing whether the businesses are delivering the right level of service at the right price. Customer insights are also needed for the business to know how it should be interacting with its customers to deliver these services.

Where there is competition, businesses need to continually strive to understand what their customers want, and structure their businesses to deliver their services accordingly. A monopoly water business receives less feedback through customers' purchasing behaviour than a business operating in a competitive market. This is because the monopoly businesses provide essential services that have few substitutes (i.e. rainwater, bottled water). As a result, customers have few options and their preferences are not revealed through their purchasing behaviour. Further, a monopoly business does not face the competitive pressures (within the market) that would otherwise force them to be more responsive to customers' preferences and demand.

We also understand the value of the regulated businesses' 'social licence' to operate. That is, they seek to provide services that are affordable and meet customers' needs to ensure they maintain credibility and trust from the community. However, this does not replace the process of discovery that happens in a competitive market to understand the changing needs of customers in a dynamic environment.

Water businesses need to be proactive to understand what their customers want, and this will require customer engagement that is tailored to the customers which they serve.

1.2 Best practice has evolved for customer engagement and regulation

We are committed to building a framework that has the right guidance and incentives in place to ensure customer preferences and customers' long-term interests are reflected in the way the businesses are run. That is, that businesses actively seek ways to elevate and enhance customer experience.

Over the last 5 to 10 years, there has been a shift in regulatory practice to a more customer centric process. We have found that our current process lacks an emphasis on customer preferences and has fallen behind other regulators.

Having said that, we also accept that regulation should not impede a well-run business. We seek to drive improvements that benefit customers by providing balanced guidance to the businesses and a level of scrutiny that allows an efficient regulatory process.

1.3 A cyclical process to understand and reflect customer preferences

To truly understand and reflect customer preferences requires ongoing engagement through various means. It also requires the business to establish robust feedback loops, which identify clear actions and accountability for those actions. We consider a continuous cycle of engagement and reflection is needed to understand customers and respond to changes, that is not simply driven by the regulatory cycle.

Figure 1.1 shows a simple diagram of how customer engagement forms a part of a continuous cycle of strategy, engagement, and action.

Figure 1.1 A cyclical process to understand and reflect customer preferences



Our process to date has largely focussed on the engagement stage. We want to enhance our process to boost and support development of strategy and action stages. In our view, this means enhancing how we:

- ▼ engage with regulated businesses to promote better planning
- ▼ assess the quality of customer engagement and how well it informs service standards and expenditure levels
- ▼ track outcomes and provide incentives for the utilities' actual performance over time.

We are not seeking to develop a one-size-fits-all approach but are exploring ways to encourage better outcomes in a flexible and proportionate way. Table 1.1 below presents the key aspects of our current framework with our views on how they could be improved.

Table 1.1 Proposed enhancements to our regulatory framework for customer focus

Aspect of our current approach	Potential improvements
The utilities are responsible for understanding their customers' views, priorities and needs	<p>Maintain the broad principle, but better encourage the utilities to put the long-term interests of customers at the centre of what they do by proposing:</p> <ul style="list-style-type: none"> ▼ a mid-determination 'early check-in' which could include submitting a customer engagement strategy ▼ providing explicit principles/guidelines around the long-term interests of customers that could be supported by a clear 'grading' of how customer-centric the utility's proposal is, as part of the review process.
Customer engagement should be consistent with five broad principles	<p>We will retain a principles-based approach, but propose:</p> <ul style="list-style-type: none"> ▼ revising the current principles to ensure they are fit for purpose ▼ expanding the principles so there is a clearer link between customer engagement and the business's whole cycle of planning, engagement, and action.
Some utilities must have a customer advisory group/s	<p>We seek feedback on whether the current licensing requirements' customer advisory groups best support a customer focus. For example, should these be expanded, or should IPART require or support the businesses (including unlicensed businesses) to develop a separate group with specific expertise to work more closely with the business.</p>
Customer preferences for service levels are considered as part of the efficiency test	<p>Our efficiency test would clearly state that proposed expenditures should be well-supported by customer preferences.</p> <p>As part of the third workstream, encouraging innovation, we will consider how incentives for improvements in service standards and customer outcomes can support ongoing improvements consistent with customer preferences.</p>
Assess 'discretionary expenditure' proposals (projects/programs that provide services/outcomes above regulated standards) against our framework	<p>Currently, the framework to assess discretionary expenditure is highly prescriptive. We seek feedback on whether this framework should continue alongside a framework for meeting mandatory services.</p>

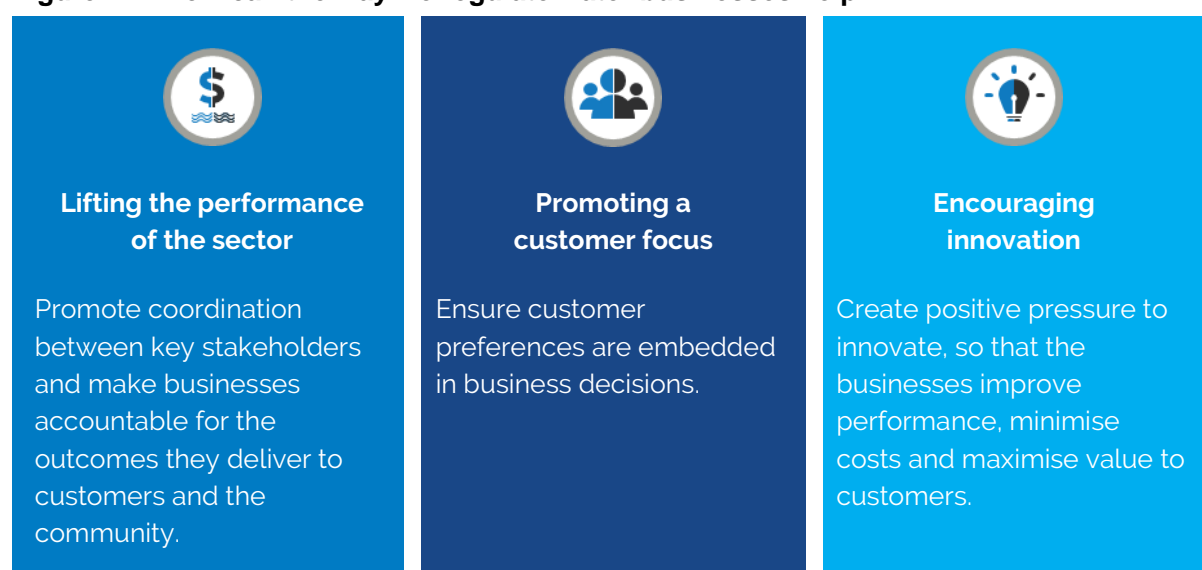
1.4 This is one part of our broader review on how we regulate the water industry

Since the 1990s, we have regulated the price of water, wastewater and some stormwater services. Subsequently, we have recommended and managed compliance with operating licence conditions which set service standards.

We are now reviewing how we regulate monopoly water businesses in NSW. This review provides an important opportunity for stakeholders to help improve our framework, and to support these water businesses in meeting the changing needs of their customers and the community.

Early in our review, we established 3 focus areas through which we will identify improvements to our framework (Figure 1.2). This paper is our second Discussion Paper of 3, and we will also consult on a Draft Report.

Figure 1.2 How can the way we regulate water businesses help in:



In May 2021 we held a full-day public workshop with stakeholders to discuss how we can enhance our approach to promote incorporating customer preferences. Over the course of a day we:

- ▼ heard from regulators and customer representatives in other jurisdictions and sectors about recent changes they have experienced
- ▼ heard from some of the utilities we regulate about how they promote a current customer focus and their future plans to engage with customers
- ▼ collected stakeholders' views on the pros and cons of different models.

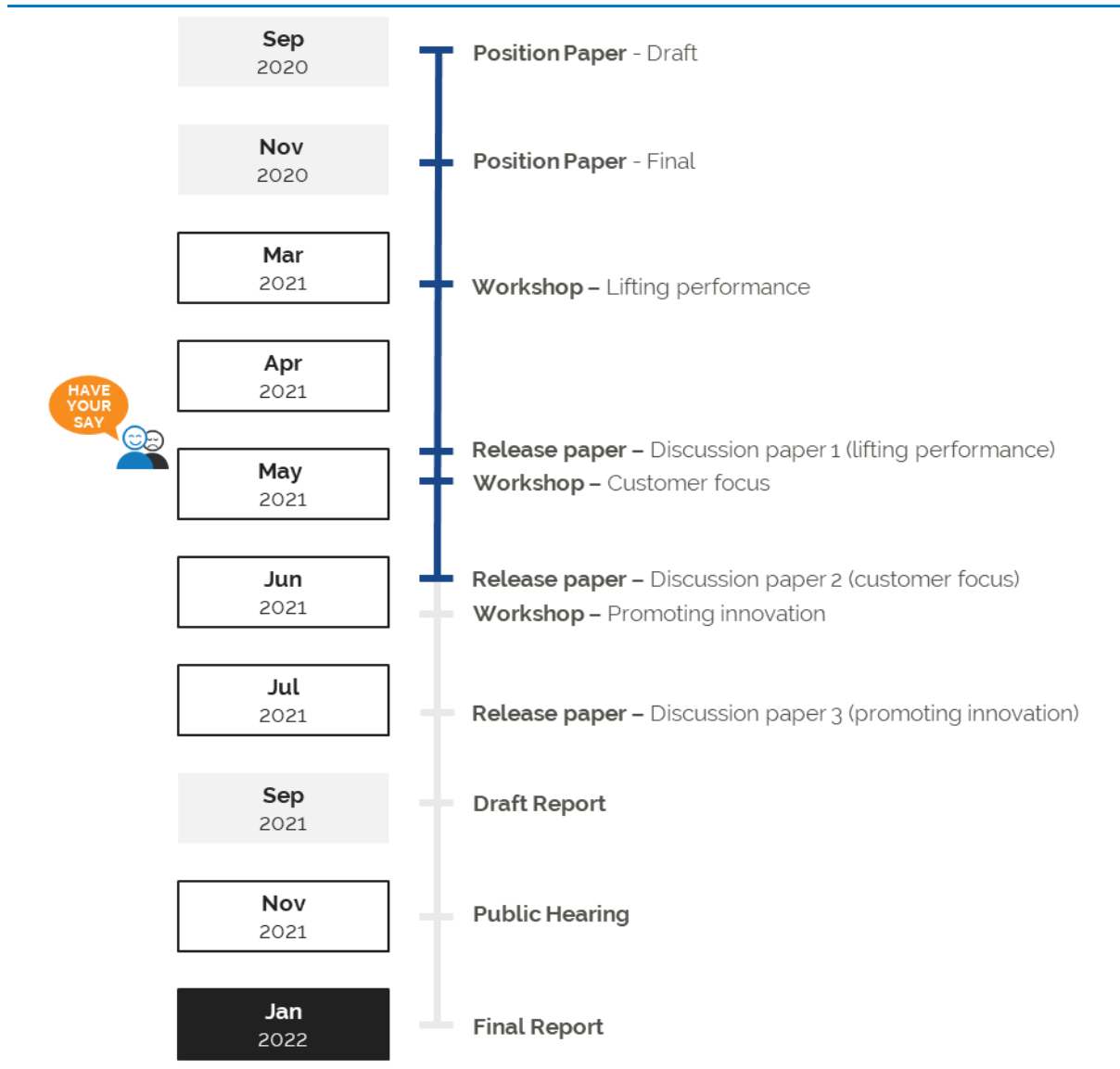
This Discussion Paper summarises what we learned through the workshop and meetings with stakeholders, as well as submissions received in response to a [Position Paper](#) released in September 2020.

We are seeking stakeholder views on these proposed reforms by **20 July 2021**.



Have your say on
these proposed reforms
 Submissions close 20 July 2021.

Figure 1.3 Timeline for this review



2 Our current process and what other jurisdictions have shown us

Over the last 5 to 10 years, regulators of water and energy industries have moved to more customer-centric regulatory practices. They have required the businesses they regulate to demonstrate a greater understanding and responsiveness to customer preferences than before, and have offered a range of incentives to facilitate this.

Our process has changed at a slower pace than other regulators, but we are committed to moving to more customer-centric practices and using our review process to encourage and support businesses to strengthen their customer focus. Below we outline our current practice and provide examples from other jurisdictions that we can learn from.

2.1 We have taken a light-handed approach to customer centricity

Our current approach puts the onus on the utilities to carry out appropriate customer engagement, with limited guidance and input from IPART. The businesses receive tacit feedback through the decisions we make, and the reasons for our decisions, as part of our periodic reviews.

Our framework is contained in various documents that have changed iteratively over the last 5 to 10 years. Further to this, our assessments have not put significant weight on customer engagement. They have focused heavily on the cost efficiency and pricing principles which include customer preferences (e.g. customer needs and preferences are a factor in the ‘efficiency test’).

Table 2.1 shows a summary of the key features of our current process.

Table 2.1 Summary of how customer centricity appears in our current framework

Aspect of our current approach	Description
The utilities are responsible for understanding customers’ views, priorities and needs	The Submission Information Package (which we send to the businesses about 7 to 8 months before their pricing submission is due) clearly states that the business should have a strong and up-to-date understanding of their customers’ preferences. We suggest that customer engagement could be used to propose changes to price structures, changes to service levels and discretionary expenditure. We also require them to publish a Plain English summary of their proposal to help customers engage in a pricing review.
Customer engagement should be consistent with 5 broad principles	We have a set of principles that represent good and effective customer engagement, developed for the 2019 round of pricing reviews. We provide these in our pricing Submission Information Package.
Some utilities must have a customer advisory group/s	Sydney Water, Hunter Water and Water NSW must form and consult with customer advisory groups

Aspect of our current approach	Description
	<ul style="list-style-type: none"> ▼ Sydney Water must form a customer council (under the <i>Sydney Water Act 1994</i>), and Hunter Water must consult with customers at regular intervals (under the <i>Hunter Water Act 1991</i>). ▼ Respective operating licences for the 3 businesses set out requirements for a charter and the types of customers that should be represented by the group members. The utilities have discretion on what projects to consult on and the group can also raise issues.
Customer preferences for service levels are considered as part of the efficiency test	Customer needs and preferences are considered in the 'efficiency test' that businesses should apply when making decisions. This efficiency test forms the basis of our expenditure review, which is a major component of periodic pricing reviews.
Assess 'discretionary expenditure' proposals (projects/programs that provide services/outcomes above regulated standards) against our framework	<p>Discretionary expenditure occurs when the businesses provide a level of service that is not mandated elsewhere.</p> <p>In 2020, we developed a framework to assess discretionary expenditure proposals with an assessment of Sydney Water's and Hunter Water's proposals for discretionary expenditure.</p>

During our pricing reviews, we have provided feedback on specific areas where we found customer consultation was insufficient, for example:

- ▼ The 2019 Final Report for the Central Coast Council recommended that the Council take steps to improve its customer consultation. This followed a failure to inform or consult its customers on significant changes to stormwater pricing prior to submitting their proposal.ⁱ
- ▼ The 2020 Final Report for Hunter Water prices discussed issues with consultation relating to changes in trade waste prices, removal of discounts for some large water users, and discretionary expenditure.ⁱⁱ
- ▼ The 2020 Final Report for Sydney Water prices discussed that discretionary expenditure proposals could be better focussed on the customers' willingness to pay for the outcomes of the expenditure rather than the specific engineering solution, and noted that ongoing improvement is still needed.ⁱⁱⁱ
- ▼ The recent Draft Report for WAMC covers some areas where customer engagement should be improved, for instance, where it consulted on service levels but not on the willingness to pay for those service levels; and included a draft decision to re-profile some work to allow for better planning and stakeholder consultation.^{iv}
- ▼ The recent Draft Report for Water NSW rural prices, where we found that Water NSW needs to improve the quality of its customer engagement and consultation and encouraged it to further engage and provide more information to stakeholders.^v

2.2 We can learn from other jurisdictions' varied approaches

As mentioned, other regulators have moved to more customer-centric frameworks in recent years. Even though our regulatory environment is unique – in terms of the number and types of businesses we regulate – we believe it is important that like other regulators, we move to a more customer-centric framework.

We have an opportunity to learn from the tools and systems other regulators have employed and to design a system appropriate to NSW. Five of these are outlined below. While other models have generally been considered successful, we are mindful that many of these arrangements have only been employed once or twice and some are yet to be fully evaluated.

The process of ongoing discovery is important. The methods and processes the business's employ to understand of customer preferences, and to find service improvements that would otherwise not come to light, need to remain current.

We also learn that the design is important and is likely to be iterative. Success requires a credible commitment from the business and regulator and open and transparent communication. It also requires an acknowledgement that there may be room for improvement and the journey should be taken together.

Further, some models are particularly resource intensive, especially the negotiated-settlement type options. In practice, these have relied on ongoing input from the regulator and significant time from specially-formed customer representative groups, as well as the utility's time.

The Essential Services Commission, Victoria (ESC)

The ESC introduced a new PREMO framework (standing for Performance, Risk, Engagement, Management and Outcomes) to address several limitations it had identified in its previous regulatory framework. As part of the customer engagement element of its framework, the ESC gave the businesses autonomy to undertake the engagement. However, it set out that engagement should be broad, deep, and start early, with a tool for self-assessment. It also set out 5 guiding principles relating to the form and content of engagement, and how well customer insights were incorporated into the pricing proposal.^{vi}

Under PREMO, the businesses self-rate their price submissions in terms of, among other things, how well it engaged its customers. The ESC also reviews the proposal and provides a rating. The ratings are 'basic', 'standard', 'advanced' and 'leading'. These ratings, and the extent to which the ESC's assessment differs from the business' self-assessment, informs incentives in the framework. The incentives (or disincentives) include:

- ▼ an expedited review process (or increased scrutiny) after the initial assessment.
- ▼ higher (or lower) returns to equity.
- ▼ looking better (or worse) than peers as ratings are published (competition by comparison).^{vii}

Informed by their engagement programs, the businesses generally looked to improve customer outcomes by providing better communications, extending support for vulnerable customers, and improving water quality and reliability in regional areas.^{viii}

The overall PREMO framework was considered to successfully promote the intended outcomes and promote the long-term outcomes for customers, in the first review period. In particular, it was found to have challenged the businesses to think differently and to put customers at the centre of their operations. The 'performance' and 'outcomes' elements of the framework will be implemented at the next round of reviews (ie, achievement of outcomes).^{ix}

Ofwat (UK Office of Water)

As part of its 2014 price reviews, Ofwat made customer views a key input in its decision-making process, with clear principles, processes and incentives for companies to incorporate those views. Its processes have evolved over the last 2 price reviews.

For the most recent reviews (2019), it defined roles of 3 key players – the utilities, customer challenge groups, and the regulator. It published a set of principles as well as a grading system that would inform the level of scrutiny it applied to proposals after an initial assessment.^x

For customer engagement, each utility was required to develop a customer challenge group. Ofwat provided some guidance but generally left flexibility in membership and governance. These groups provide independent challenge to the businesses during the proposal development. They then submit a report to Ofwat when the utility submits its proposal, which records their views on the quality of a company's customer engagement; and the extent to which the results of this engagement are driving decision making and are reflected in the company's plan. For the 2019 reviews, Ofwat also required an increased focus on the governance and funding process of these groups, to help build trust and transparency.^{xi}

Ofwat also receives input and advice from the independent Consumer Council for Water across all utilities.^{xii}

For the 2019 round of price reviews, Ofwat found that companies conducted more research than ever before, but there were some issues with the collection and use of the evidence.¹ It will continue to focus on customer engagement into the next price reviews, and expects businesses to increase the sophistication, focus and efficiency of their customer insight strategies. It also considered the option for negotiated settlements but found the scope to be modest as Government and other regulators decide on much of the required level of service improvement.^{xiii}

¹ For example, in some cases, customers felt they were not well placed to provide views on technical issues. Ofwat also found that the results from different company's research on customers' valuations of common issues sometimes varied significantly, with no clear underlying reason.

Australian Energy Regulator – the ‘NewReg’ Ausnet Services trial

Under this trial regulatory approach, AusNet Services’ (an energy distributor) negotiated elements of its 2021-26 Regulatory Determination with a Customer Forum. The Forum consisted of six members, including a former state minister, consumer advocates, an academic, and a former utilities executive. Ausnet developed an ‘early engagement plan’. The scope of negotiations was agreed by the AER, Ausnet and the Customer Forum, but there were significant additions during the process.

The AER provided significant feedback and information during the process to the Forum. The AER was not bound to accept the negotiated positions but committed to give them ‘significant weight’ in its review.

In its final Determination, the AER found that AusNet Services’ consumer engagement had been genuine and reflected stakeholder’s interests in its revised proposal. This gave the AER more confidence in placing sufficient weight on its top-down technical assessment. It found that the Customer Forum played a significant role in the business proposing lower capital expenditure than in the previous period.^{xiv}

The trial process is due for an independent evaluation (after the final outcomes). It is yet to be confirmed if the AER will extend this process or a variant to other businesses it regulates, but it notes that consumer engagement models “will continue to mature over time”.^{xv}

The Essential Service Commission of South Australia (ESCOSA)

ESCOSA established a negotiated settlement type of arrangement to increase the involvement of customers. It required SA Water to convene a Negotiation Forum. This had 3 people from SA Water and a 3-person Customer Negotiation Committee (CNC). The CNC was established with the goal of representing all SA Water’s customers to challenge and negotiate SA Water’s business plan prior to its submission to ESCOSA. It was led by an independent Chairperson with one member appointed from the Consumer Experts Panel and another from SA Water’s Customer Working Group. An Independent Probity Advisor, appointed by the Commission, provided oversight.

The negotiation process was non-binding, but where issues were successfully negotiated and consistent with ESCOSA guidance, ESCOSA stated it was likely to accept or give significant weight to these when making its determination.

In its final determination ESCOSA acknowledged important and material improvements in SA Water’s engagement practices, but noted there is always room for improvement in business and regulatory systems. It noted the CNC generally expressed a degree of concern about the transparency and detail provided by SA Water throughout the process, including the contents of its Business Plan. Its early view was that SA Water could improve the way it undertook its consultation. It should consult earlier and more extensively; and provide more transparency around long-term plans, to allow for more effective consultation.^{xvi} ESCOSA is considering amending the CNC’s role to more of a ‘challenge’ role rather than ‘negotiation’ role for the next price review.^{xvii}

The Water Industry Commission of Scotland (WICS)

WICS moved to a 'negotiated settlement' framework for its 2015 price path. This involved developing a Customer Forum to negotiate with the utility on behalf of customers. The Forum was not meant as a representative body of customer types but was expected to devote time and resources to establishing what customer priorities are, and to seek to negotiate the best outcomes for customers as a whole. It consisted of a Chair and nine members selected for their breadth of expertise, such as the water industry, consumer affairs, environmental affairs, public policy, business, and academia.

WICS agreed to ratify outcomes that were successfully negotiated. However, it had significant input in the process supporting the Forum. It:

- ▼ undertook an early review of the proposal and identified issues for negotiation
- ▼ provided guidance papers to the Forum on key issues with information as well as a range of acceptable outcomes
- ▼ commented on information that Scottish Water provided to the Customer Forum and provided potential questions.^{xviii}

The first price review (for 2015-21 prices) under this method was considered a success. Some of the outcomes negotiated between WICS and the Customer Forum were more ambitious than the range of outcomes that WICS had recommended to the Customer Forum.^{xix} The second review (for 2021-27 prices), while still viewed favourably, faced the additional challenge of price increases being proposed by Scottish Water, which were more difficult for the Forum to agree to.^{xx}

3 The businesses should be responsible for understanding customer preferences

Our current approach emphasises that each business is responsible for understanding their customers' preferences and responding to these in their business planning and operations. This will remain the case going forward, given that the businesses remain best placed to reach out to their customers, hear feedback and design their systems and operations to respond to their preferences.

At the recent workshop, some stakeholders queried the distinction between IPART's role, as an independent regulator, to protect and represent the customer and that of the business. Our position is that while we work in the best interests of the customer, the utilities are ultimately best placed to find out what their customers want.

The businesses will remain responsible for engaging with their customers to understand their views, priorities and needs, and for the form and content of their consultation. However, we want to set the expectation that this should inform their decisions and pricing proposals. They should be able to demonstrate to IPART and other stakeholders how they have achieved this at the time of their pricing proposal.

While we also undertake a consultation process at the time of our review, this only occurs periodically. The businesses have a closer and ongoing connection to their customers.

We aim for our regulatory framework to support and encourage the businesses to effectively deliver customer outcomes. To this end, we propose two enhancements to the current framework:

- ▼ a mid-period 'check-in'
- ▼ a grading system to evaluate how well the businesses' proposals meet the long-term interests of consumers.



We seek feedback on:

- 1 Should we require a customer engagement plan to be submitted in the lead-up to a pricing proposal? How far in advance of the proposal due date should it be submitted? Should this be published?
- 2 Should we move to a system of grading the quality of proposals?

3.1 We could have a mid-period check-in

One simple change to the current process would be to have a mid-period ‘check-in’ with each business. We raised this in our first Discussion Paper as a strategic meeting occurring about halfway through a determination period between the regulator and the utility, and possibly a Regulators Advisory Panel.² The aim would be to promote a long-term focus by encouraging the business to develop and present robust plans earlier in the process.

At this point, a business could talk through its plans for the next determination period, test its assumptions, and seek feedback. We could offer the option for, or require, the businesses to submit a customer engagement strategy that would inform engagement for the next pricing proposal.

The main benefit of doing this is that we could provide feedback if there were obvious omissions that could impact final outcomes, and we could respond to any difficulties that the business might be having. We would aim to maintain a ‘hands-off’ approach and not look to provide any ‘approval’ of the engagement strategy.

This step seeks to embed customer engagement into the businesses processes and make the businesses accountable for planning their engagement. It also addresses some concerns expressed by businesses about receiving regulator feedback in the development stages of the pricing proposal. It should not prevent the businesses from beginning to implement the plan or undertaking earlier and ongoing engagement.

We are also considering the merits of publishing either the strategy, or our short response to it. This would create a level of transparency and accountability for the business to its customers. However, it could inadvertently hamper their flexibility to evolve and innovate in response to new information as the strategy is implemented.

3.2 We could assess how well the businesses incorporate customer preferences

Stakeholders have told us that IPART should have a clear objective to promote the long-term interests of customers, supported by a set of principles.^{xxi} Symmetrically, the principles we develop could be used to explicitly assess how well each businesses’ proposal promotes the long-term interests of consumers. Calibrated correctly, these principles would provide the businesses a stronger signal about our expectations, and reference points to support continual improvement. And, they could be tied more strongly to reputational and financial rewards and penalties. These would provide the business with strong incentives to submit proposals – and deliver the outcomes – that better promote the long-term interests of consumers.

² See [IPART Discussion Paper - Lifting performance in the water sector](#), Section 2.2.

Assessing how well pricing proposals promote the long-term interests of customers could be a standalone process, or it could take the form of a grading system, similar to those used in Victoria's PREMO framework and Ofwat's framework.³ Under these systems, the water businesses self-assess how well they meet the key principles – which would consider customer centricity alongside other markers of a good quality proposal (e.g. evidence of cost efficiency over the life-cycle of assets). Guidance on each principle is provided by the regulator – with a rubric setting out expectations of the businesses at different grades, and test questions to guide this self-assessment.^{xxii}

The proposals are then judged by the regulator on how well they meet the key principles, with an overall score, or grade. For example, the ESC grades the quality of the pricing submissions as to whether they are 'leading', 'advanced', 'standard' or 'basic'.

The business's self-assessment and the regulator's grading are used to inform a range of financial, reputational and administrative incentives. These incentives seek to promote 'ambitious' proposals. The ESC judge this by assessing the degree to which a business has challenged itself through better customer engagement, more efficient management practices and rigorous self-assessment, to identify and deliver better customer outcomes.^{xxiii} For example, one incentive is to provide a higher rate of return for a leading proposal compared to a standard one. Calculated correctly, the higher return effectively shares the benefits of the more ambitious proposal between the customer and the business. In addition, in some grading schemes there are formal incentives to ensure that the business continues to meet its proposed performance commitments on an ongoing basis.

Formally assessing how well a proposal meets customers preferences has other benefits. Assessing customer centricity would inform other aspects of our review – including the scope for incentive mechanisms or tailoring the questions and focus of the expenditure review.

³ For further information, see Section 3.4 of [CEPA, Economic regulation of water utilities – a report for IPART](#).

4 The guidance we provide

The businesses have asked for more guidance about how we see ‘good’ customer engagement.^{xxiv} To date, our guidance has generally been high level and principles based, with some additional specific assessments contained in Final Reports.

Suggestions at the workshop included extending IPART’s involvement across the determination period; providing approvals at various stages throughout the business’s engagement processes; and providing better explanation of what is considered acceptable and not acceptable.

We agree that we can refine our current guidance. We intend to retain a principles-based approach in doing so. This would need to allow flexibility for each business to develop proportionate approaches to their unique operating environments and promote innovative approaches to reveal customers’ preferences. Setting overly prescriptive requirements could encourage the regulated business to only meet regulatory requirements, which may not be in the interests of customers.

As outlined earlier in Figure 1.1, we view the discovery and response to customer preferences as cyclical, and divided into 3 stages. The suggestions posed in the previous chapter seek to support:

- ▼ strategy and planning, with the mid-period check-in
- ▼ the action stage, with more guidance on how the customer engagement should be addressed in the proposal.

In this chapter, we explore how IPART’s framework can support improved engagement by the businesses.



We seek feedback on:

- 3 Are our customer engagement principles current and fit for purpose? How could they be improved?
- 4 Do you agree with our additional 3 principles relating to incorporating customer preferences and performance? Is something missing?

4.1 Our current principles describe how engagement should be undertaken

Our current principles outlined in Box 4.1 focus on the engagement stage. They provide expectations for clear, honest and proportionate engagement.

Box 4.1 Current principles for effective engagement

Engaging with customers should be consistent with specific principles, including that they are:

Relevant

The utility targets its engagement at the issues it is seeking input on and makes the engagement relevant to the circumstances of the utility and its customers.

Representative

The utility gives a representative sample of customers potentially affected by the proposal meaningful opportunity to participate and sufficient time to provide their views.

Proportionate

The utility conducts engagement that is proportionate to the potential impact on service and/or price and does not place an undue burden on participants.

Objective

The utility's engagement is objective and not biased towards a particular outcome.

Clearly communicated and accurate

The utility provides clear and accurate information to customers during the engagement process. The utility presents information in a form that makes clear: what the purpose of the engagement is; how the utility will use the results; any potential trade-offs between service and price; and the impacts (including cumulative impacts on services and/or bills) of the options being considered. Customers are provided with feedback on how the results of the customer engagement have informed the utility's position.

IPART may also have regard to other relevant matters, depending on the nature of the proposal and regulatory decision.

Our preliminary view is that these remain relevant to guide and assess the ways in which businesses engage with their customers.

4.2 Expanding the principles to reflect the discovery and action cycle

We intend to stretch the focus of the framework to include explicitly the way customer's views are reflected in business decisions and in the pricing proposal. We would be looking for evidence that the businesses have responded to the information they discovered during the engagement process. This step is not adequately covered by the existing principles.

Our preliminary view is that this evidence could be captured by the following 3 principles:

- ▼ Business decision-making processes should appropriately integrate the outcomes identified through customer engagement.
- ▼ The pricing proposal should clearly demonstrate links between customer preferences and the proposed service levels and projects.

(In some cases, this might mean a change in services, but not always. Many actions the businesses undertake may already align with customers preferences. However, when this is confirmed or otherwise, it should be clearly explained with evidence provided.)
- ▼ The business should develop clear and measurable customer-driven outcomes and appropriate monitoring processes.

We understand that business decisions need to find a balance between addressing the preferences of customers today and satisfying other considerations. For example, there may be a disconnect between short-term cost reductions against long-term asset performance and its impact on future customers' affordability. It is also important that the costs of customer engagement are proportional to the needs and size of the customer base.

Developing a grading rubric (mentioned earlier) could also support how these principles, as well as other considerations, are reflected in our decisions. It also reinforces that the quality of customer engagement is not binary. In practice, the quality of customer engagement would fall along a spectrum of quality that depends on the characteristics of each business's customer base, shifting over time as engagement practices evolve and improve.

5 Customer advisory or negotiation groups

Customer representative groups or customer panels could promote a better understanding of customer preferences, and promote a better reflection of these preferences into the businesses' regulatory proposals and IPART's decisions. We previously sought feedback, including at the recent workshop, on the role that customer advisory representative groups could take in our process and received mixed responses.

These kinds of groups have been a key feature of some regulatory regimes (see Chapter 2), with different models adopted. Generally, these groups are expected to:

- ▼ work with the utility for the duration of their customer engagement and proposal development
- ▼ represent the customer perspective and/or challenge the business on their customer engagement and whether the planning reflects engagement outcomes
- ▼ report to the regulator on the business's customer engagement activities and the extent to which these are incorporated into the business's plans.

In some cases, the groups have been empowered to negotiate outcomes (this includes, to various extents, the models adopted by WICS, ESCOSA, and the AER's NewReg trial). At our workshops, we received feedback which suggested interest in exploring this avenue. There was also some support for independent customer representative groups and a discussion of who would participate in these groups.



We seek feedback on:

- 5 How fit for purpose are the current customer advisory groups? How could they be enhanced?
- 6 Is there a need for a subsidiary customer advisory group developed with expert skills to represent customers?
- 7 Should non-licensed utilities adopt a form of customer advisory panel? Why or why not? How would this be run and funded?

5.1 Are the current customer advisory groups fit-for-purpose?

We seek feedback on how well current customer advisory groups support the long-term interests of customers. That is, do they accurately represent preferences across the customer base? And do they provide an effective discipline for the businesses to deliver and behave in a way that meets the needs of customers, particularly vulnerable and non-English speaking customers?

Three businesses already maintain customer advisory groups with varying requirements and constitutions. Both Sydney Water and Hunter Water have legislative requirements to consult with their customers, with additional specific requirements added in the Operating Licences; for Water NSW it is required through the Operating Licence.^{xxv}

These customer advisory groups have a constitution outlining the group's role, membership criteria, and roles and responsibilities of the members and the business. For Sydney Water the group includes members from formally constituted non-profit entities (amongst other criteria to be met), while Hunter Water and WaterNSW make best endeavours to include at least one member from a range of customer 'categories'⁴. These customer advisory groups generally have regular (quarterly) interactions with the utilities. In some cases, we also hear directly from some participants during our pricing reviews through our consultation process.

5.1.1 Options to amend or enhance customer groups

We are considering whether these groups could be amended or added to, or whether the businesses planning and our review process would be enhanced by additional expertise.

For instance, would it be beneficial for a customer representative group to report directly to IPART with its views on the pricing proposal and the degree to which it reflects customers preferences? Or is the current option for members to make a submission sufficient? Do members receive sufficient information and time to present the views of their community?

As an alternative to amending the current customer advisory groups, a separate group could sit alongside these groups. This could include members with expertise in the water industry, market or social research, who could work to challenge the business in a more technical manner to understand and address customers' needs and preferences. This could be constituted in the lead-up to proposal development for a time-limited period while the existing groups remain on-going.

⁴ For Hunter Water, these categories are business; organisations representing low income customers; customers living in rural and urban fringe areas; residential; local government; pensioners; customers with disabilities; Indigenous Australians; and customers from culturally and linguistically diverse backgrounds, and it may include at least one member from representing business consumers, residential consumers and environmental groups.
For Water NSW, the customer categories are stock and domestic water users; regulated river water users; unregulated river water users; groundwater users; environmental water users; industrial and commercial water users; Local Water Utilities; major utilities; volumetric categories of water users (small/medium/ large); Aboriginal cultural heritage water users.

An example is the customer forum developed for the AER's NewReg process. This consisted of 6 members selected for their expertise rather than as representative of the customer base. The members were tasked with seeking out and representing diverse customers' views in negotiations with Ausnet (electricity distributor). The approach was resource intensive as the forum worked with customers and the utility and reported directly to the regulator.

At our workshop, there seemed to be support for a group of experts, although there was no clear view on its role or composition. Some participants also queried whether these groups could better represent the customers' views than the current customer advisory groups.

5.1.2 How could this be expanded to other businesses?

Effective customer engagement could be enhanced with regular interactions and feedback from a designated group. We are exploring whether this format should be expanded to other utilities, particularly the Central Coast Council as the largest utility without an operating licence.

We may not have the legislative powers to require customer advisory groups for unlicensed utilities. However, we see no reason why businesses could not pursue this idea independently to develop their understanding of customer preferences.

In practice, these groups could remain optional, but would be encouraged if IPART decided to assess the overall quality of customer engagement (see Chapter 3).

5.1.3 Tailoring the approach to different businesses

The role of customer groups could be partially addressed by our proposal of a mid-cycle check-in, in advance of the next regulatory review. The customer engagement plan provided by the business at this point could outline how the various elements of its strategy – including customer groups and advisory panels – would deliver a better understanding of customer preferences. This approach would give sufficient flexibility to the businesses to:

- ▼ tailor the scope and depth of customer engagement to the needs and preferences of their customers
- ▼ encourage more innovative approaches to reveal preferences, including potential scope for negotiated outcomes between the customer and the business to be accepted by IPART.

The strength of the plan – including the level of autonomy given by the utility to empower its customers to decide elements of its pricing proposal – influences the role of the regulator as a decision-maker, and the level of independent verification we require (either in advance of, or during the pricing and expenditure review processes).

6 Incorporating preferences and measuring outcomes

Several submissions sought clarity on how outcomes from customer engagement would be incorporated into determination processes. For example, the weight they would be given in regulatory assessments along with other considerations, and the incentives that would be tied to better customer engagement.^{xxvi}

We agree that this is a key component of our overall framework. The third ‘stream’ of work in our review primarily focuses on bringing the different elements of a pricing review together to support improved performance and customer outcomes. In doing so, we will consider the incentives we provide in encouraging these outcomes, and how these link to the pricing review process. As noted by the Public Interest Advisory Centre (PIAC), a list of incentives runs the risk of becoming a tick-box exercise. We also want to avoid rewarding ‘business as usual’ activities and focus instead on encouraging and supporting genuine and effective improvements. Below, we discuss some options to promote a customer focus. Our next workshop and the third Discussion Paper will consider this further and more broadly.



We seek feedback on:

- 8 Do you agree we should be tracking outcomes? What kind of outcomes should we track? Would these vary by business?

6.1.1 Assessing customer centricity

As mentioned earlier, we are considering the option of grading how well proposals reflect the long-term interests of consumers. This would provide a way to:

- ▼ track performance changes over time
- ▼ connect different levels of performance to different incentives.

It could also provide a basis to reduce the current review process. For instance, where part of a proposal is well linked and aligned to customer preferences or needs, and appropriately balanced with other considerations (such as efficiency) then we may more readily accept it.

This approach has been used by other regulators and could address some concerns about the current expenditure review process. We would clearly set out expectations in the rubric and, as a regulator, be held accountable to implementing this.

6.1.2 Tracking and publishing outcomes

We are also drawn to reputational incentives. These can be used in various ways, however, one simple approach would be to track outputs, and hold businesses to account by publishing performance against them.

To some degree, we already do this. For example, we publish license audit reports⁵ and the results of quarterly satisfaction surveys⁶ as well as our periodic pricing reviews. However, we consider there is value in developing a more customer-focused reporting scheme. This could involve:

- ▼ An annual collection of customer outcome data including measures of customer satisfaction, complaints data, and bespoke measures for each utility. These could be collected through a random annual survey, as well as utility data and other sources.
- ▼ Publishing the results in an easily accessible format, such as on a simple webpage or included as part of the customer's bill. This would allow customers and other stakeholders better access to the business's ongoing performance and to monitor improvements.

Some customer satisfaction metrics to apply across utilities could include:

- ▼ Customer scores (e.g. out of 10) for:
 - overall satisfaction with each type of service - water, wastewater and stormwater (as applicable)
 - satisfaction with value for money for each service type
 - level of confidence that the utility is effectively managing long-term supply risks including drought, climate change and growth pressures
 - satisfaction with customer service and the amount and complexity of information they receive from the business.
- ▼ Complaints data collected by the business and the NSW Energy and Water Ombudsman.

This could also allow the experience of NSW customers to be compared with the experience of customers in other jurisdictions, provided the same questions are asked.

While useful, there are limitations to conducting 'customer perception' surveys for customers of monopoly utilities. Unlike in a competitive market, customers do not have the full information set to 'discover' their true perception of the service they receive. To varying extents, water utilities in recent years have faced similar operating conditions – relatively stable investment needs and falling interest rates, which have supported stable or falling bills (which is a point that was made in our workshops). The customer scores may reflect favourable macroeconomic conditions, rather than a comparison to what other businesses could offer the customer, which is what would occur in a competitive market.

⁵ For Sydney Water, Hunter Water, Water NSW and the Sydney Desalination Plant.

⁶ For Sydney Water, Hunter Water and Central Coast Council only.

At the same time, there is likely a place for bespoke metrics related to each utilities' proposal and the outcomes of their customer engagement. For instance, if the proposal includes a change to service level or expenditure, primarily to address customer preferences, then an outcome measure can be developed to monitor this. This could be an ongoing measure, or one-off completion status report, based on the nature of the project.

We are also considering a range of financial incentives. We have a view that these should be symmetrical, providing a penalty for underperformance as well as a reward for delivering a better long-term outcome to customers. As financial incentives are ultimately borne by customers their use should be carefully balanced with real improvements and customer expectations. We will explore these in greater depth in our third Discussion Paper.

7 Discretionary expenditure

‘Discretionary expenditure’ is expenditure on services that go beyond the utilities’ mandatory services. We may allow recovery of the costs of additional discretionary projects via regulated prices subject to clear evidence that it would be efficient and beneficial for customers to pay to exceed mandated standards. For instance, we would consider whether:

- ▼ the proposal best fits with the businesses responsibilities or whether it would better fit with another party’s responsibilities.
- ▼ customers have the capacity and willingness to pay for the discretionary expenditure (based on information or evidence the businesses provide).

In 2020, we developed and implemented a framework to assess discretionary expenditure proposals. The framework sets a high bar for evidence of customer willingness to pay and sets out mechanisms to ensure transparency and accountability.



We seek feedback on:

- 9 Is the discretionary expenditure framework fit for purpose?
- 10 Should this framework be retained separate to a framework for mandatory services?

7.1.1 Better integration of ‘discretionary’ projects

We are considering whether the framework can be improved considering our intention to move to an outcomes-focussed framework. The current discretionary expenditure framework creates a risk of projects being developed on an ad hoc basis rather than considered as part of a package with other expenditure projects. We also found that some of the projects reviewed by IPART in 2020 had too great a focus on a specific engineering solution rather than customer outcomes.

The option for discretionary expenditure could potentially be better married with a framework for mandatory services, where pricing proposals would:

- ▼ clearly determine the outcomes customers’ want
- ▼ provide evidence about customers’ willingness to pay for these outcomes
- ▼ identify targets, and potentially the rewards or penalties that would apply depending on whether the targets are met.

In part, the answer depends on whether it is possible, and helpful, to distinguish between a set of mandatory services that the business must deliver, and a set of discretionary services the business *should* deliver given the preferences of customers.

If it is, our discretionary framework could sit alongside a framework for defining and delivering outcomes for mandatory services. To the extent that this distinction is unclear, it could be better to integrate the discretionary expenditure framework within a customer outcomes-focussed framework. Such a framework could encourage projects to be developed as part of an overall package, rather than on an ad hoc basis.

Previous stakeholder feedback has been that the framework should be expanded to better deliver community outcomes, and that the current framework focuses too much on projects with a short-term return, discouraging projects that have longer-term benefits.

We also appreciate that the framework could be simplified. For instance, we are considering whether the requirement to have additional RABs for each discretionary project is too burdensome and whether there is a better alternative.

Table 7.1 provides an overview of the current framework.

Table 7.1 Overview of our discretionary expenditure framework

Phase	Description
Phase 1: Project definition	<ul style="list-style-type: none"> ▼ The project or outcome is adequately described and defined. At a minimum, the project or outcome specification must include the following characteristics and conditions: Location, customers/users benefiting from (or creating the need for) the project, delivery timeframes, whether it will be replacing another service and outcomes expected. ▼ The project or outcome fits within the utility's responsibilities and is related to its monopoly services. ▼ The project is discretionary.
Phase 2: Willingness to pay	<ul style="list-style-type: none"> ▼ Survey participants are given sufficient context and information on the proposed project or outcome. This should align with the characteristics and conditions of the project definition identified in Phase 1. ▼ The survey identifies customers' maximum willingness to pay in dollar amounts. These will be the upper limit to the customer share of the cost of the project/outcome estimated in Phase 3. ▼ The survey used to elicit customer willingness to pay is well designed and the results are statistically valid. ▼ Bill impacts should be shown in the context of the broader bill impact.
Phase 3: Efficiency test	<ul style="list-style-type: none"> ▼ The project/s is prioritised and optimised within the utilities' broader responsibilities. ▼ The project/s is the most efficient way of achieving the outcome. ▼ Total efficient cost estimates should transparently net off any avoided costs and/or grants.
Phase 4: Recovery & delivery incentives	<ul style="list-style-type: none"> ▼ The proposed prices to customers recover only the efficient cost of the outcome or project determined in Phase 3. ▼ Bill impact per household is equal to or less than willingness to pay from Phase 2. ▼ Charges are recovered from customer categories whose willingness to pay was assessed in Phase 2. ▼ Separate RAB with appropriate asset lives to enable discretionary expenditure to be tracked. ▼ Transparent and accountable – utility to develop and propose approaches to ensure accountability. ▼ Next period adjustment will consider whether any underspend is returned to customers or retained by the utility for other projects or as an efficiency gain.
Phase 5: Implementation & performance commitments	<ul style="list-style-type: none"> ▼ Capture the program as an output measure to ensure sufficient reporting on what is achieved. ▼ Ex-post adjustment mechanism to ensure only investments in line with project definition in willingness to pay survey are added to the RAB. ▼ Where proposed expenditure is not carried out or outcomes are not delivered, funds collected through the discretionary charge may be returned to customers in the subsequent determination period. ▼ Outline expectation that the charge remains equal to or below demonstrated willingness to pay amount over the long term.

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- ⁱ IPART, [Review of Central Coast Council's water, sewerage and stormwater prices](#), May 2019, p 12.
- ⁱⁱ IPART, [Review of prices for Hunter Water Corporation from 1 July 2020, Final Report](#), June 2020, pp 101, 130, 131, 147.
- ⁱⁱⁱ IPART, [Review of Prices for Sydney Water from 1 July 2020, Final Report](#), June 2020, pp 119-122.
- ^{iv} IPART, [Review of Prices for the Water Administration Ministerial Corporation, Draft Report](#), March 2021, pp 7, 31.
- ^v IPART, [Review of Water NSW's Rural Bulk Water Prices, Draft Report](#), March 2021, p 11.
- ^{vi} Essential Services Commission, [Water pricing approach and framework Implementing PREMO 2018](#), October 2016, pp15-17.
- ^{vii} Essential Services Commission, [Water pricing approach and framework Implementing PREMO 2018](#), October 2016, pp 10 – 13, 47.
- ^{viii} Essential Services Commission, ['Price submissions were informed by customers'](#), viewed online 28 May 2021.
- ^{ix} Farrierswier, [Victoria's water sector: The PREMO model for economic regulation](#), March 2019, p 20.
- ^x Ofwat, [Ofwat's customer engagement policy statement and expectations for PR19](#), May 2016, p 3.
- ^{xi} Ofwat, [Ofwat's customer engagement policy statement and expectations for PR19](#), May 2016, p 4.
- ^{xii} Ofwat, [Ofwat's customer engagement policy statement and expectations for PR19](#), May 2016, p 6.
- ^{xiii} Ofwat, [PR24 and beyond: Creating tomorrow, together](#), May 2021, pp 57, 60.
- ^{xiv} Australian Energy Regulator, [Final Decision Ausnet Services Distribution Determination 2021 to 2026 Overview](#), April 2021, pp 3, 34.
- ^{xv} Australian Energy Regulator, [Final Decision Ausnet Services Distribution Determination 2021 to 2026 Overview](#), April 2021, p 5.
- ^{xvi} Essential Services Commission of South Australia, [SA Water Regulatory Determination 2020 Final Determination: Statement of reasons](#), June 2020, p 9.
- ^{xvii} Essential Services Commission of South Australia, [SA Water Regulatory Determination 2024: Framework and Approach](#), February 2021, p 21.
- ^{xviii} Water Industry Commission for Scotland, [Strategic Review of Charges 2015-21: Innovation and choice](#), p 13; Water Industry Commission for Scotland webpage 'Customer Forum', viewed 8 June 2021; Water Industry Commission for Scotland, [Strategic Review of Charges Methodology refinements and clarifications](#), pp 68-70.
- ^{xix} Water Industry Commission for Scotland, [The Strategic Review of Charges 2015-21: Final determination](#), p 4; The Customer forum for Water in Scotland, [Legacy report](#), February 2015, p 28.
- ^{xx} Alan Sutherland, Presentation at IPART workshop, May 2021.
- ^{xxi} See, for example, [SDP submission to IPART](#) Position Paper, October 2020, p 3; and [Sydney Water submission](#) to IPART Position Paper, p 2.
- ^{xxii} See, for example, KPMG [Implementing PREMO](#), September 2016, p 10.
- ^{xxiii} Essential Services Commission, [Water pricing approach and framework Implementing PREMO 2018](#), October 2016, p 9.
- ^{xxiv} [Hunter Water submission](#) to IPART Position Paper, October 2020, p 3; [Sydney Water submission](#) to IPART Position Paper, October 2020, p 25.
- ^{xxv} [Sydney Water Act 1994](#) s 15; [Hunter Water Act 1991](#) s 13(2); Sydney Water, [Operating Licence 2019-2023](#), p 18; Hunter Water, [Operating Licence 2017-2022](#), p 11; Water NSW, [Water NSW Operating Licence 2017-2022](#), pp 16-17.
- ^{xxvi} [SDP submission to IPART](#) Position Paper, October 2020, p 11, [Hunter Water submission](#) to IPART Position Paper, October 2020, p 14.