



Delivering customer value

Draft Water Regulatory Framework

May 2022

Water >>



Tribunal Members

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Invitation for submissions

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

Submissions are due by Friday, 12 August 2022

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

You can also send comments by mail to:

Water Regulatory Review
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

If you require assistance to make a submission (for example, if you would like to make a verbal submission) please contact one of the staff members listed above.

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.

We may decide not to publish a submission, for example, if we consider it contains offensive or potentially defamatory information. We generally do not publish sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please let us know when you make the submission. However, it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

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

The Independent Pricing and Regulatory Tribunal (IPART)

Further information on IPART can be obtained from [IPART's website](#).

Acknowledgment of Country

IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, past, present and emerging.

We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

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Message from the Chair

The people of NSW need good water services. We can't do without reliable, safe drinking water and good wastewater and sewerage services and, in general, we have no choice about who provides us with water services.

Given this lack of choice, NSW laws give IPART powers to protect consumers by regulating the licences and prices for water supply authorities in NSW. IPART ensures water customers pay only what an efficient water business would need to deliver quality water services.

In this draft report IPART proposes improvements in how we regulate water businesses. Our aim is to hold water businesses accountable in a way that delivers good short, medium and long-term customer outcomes.

IPART's proposed changes recognise that water businesses and their customers face some significant challenges. The COVID pandemic, climate change, bushfires and floods have reinforced how important it is for water businesses to have resilient, sustainable capability so they can deliver reliable, safe water services during tough times. Good long-term plans, innovation and prudent investment will ensure water and wastewater services are resilient to drought and natural disasters, protect the environment, reduce greenhouse emissions and make cities more liveable. Water businesses also need to respond to changes in population and evolving customer and community expectations.

While IPART will continue to protect consumers from unjustified prices for water services, in this challenging context we do not want to see short-term thinking and cost cutting that would only lead to higher prices or poor water services in future. Our proposed new regulatory tools will encourage prudent investment in infrastructure and new technologies so water businesses can deliver better long-term customer value.

IPART's proposed new regulatory approach will more strongly and clearly require water authorities to bring customers into decision-making about the design of services and setting of priorities. Customers can expect that water businesses will communicate and consult with them directly and listen and respond to their views.

IPART's regulatory approach will reinforce NSW Government water strategies by holding water authorities accountable to plan and deliver short, medium and long-term customer outcomes, efficiently.

IPART intends that water authorities will make those plans visible to IPART and the public as part of pricing reviews. This will strengthen regulation of prices so neither the customers of today, or future generations, are asked to pay more than their fair share to fund new infrastructure or technology.

1 Executive summary

Safe, reliable and affordable water is critical to our communities, our environment, and our economy. Water must be managed sustainably as our population grows and we face increasing challenges from climate change. The NSW Government is currently developing long-term water strategies, aimed at delivering sustainable and resilient water services over the long term.

IPART regulates the costs and performance of several NSW monopoly water businesses. We are reviewing how we do this to ensure water businesses deliver water services that are sustainable, efficient, and meet customer and community expectations.

We are proposing a framework that supports water businesses investing prudently in the infrastructure and technology needed for the future and providing services that their customers value and can afford. It does so by:

- broadening our focus from cost efficiency to customer value
- enabling businesses to promote customer value with a flexible approach driven by the business's proposal
- providing incentives to promote customer value, which encourage businesses to earn autonomy by demonstrating accountability for delivering better customer outcomes.

IPART will continue to regulate monopoly water businesses in line with our role under NSW legislation¹. In fulfilling this role, we propose applying more refined tools – similar to those successfully adopted by regulators elsewhere in Australia and overseas – to implement a more customer-centric framework. It has been designed to support NSW water businesses to deliver the NSW Government's water strategies and meet the future needs of customers as technology and preferences evolve.

1.1 A draft framework focusing on customer value

We have developed a proposed framework and guiding principles centred around customer value. These enable water businesses to focus on efficiently providing services that their customers value. We do not want price regulation to drive a culture of cost cutting and short-term thinking, particularly if this leads to higher costs and prices, or poor water services in the future.

Our proposed framework focuses on customers, costs and credibility – which we refer to as the “3Cs”. We have developed 12 guiding principles (see Figure 1).

To apply these draft guiding principles, each business will actively involve and engage with its customers to develop a set of outcomes aligned to their preferences.

Figure 1 The 3Cs framework and guiding principles



1.2 A flexible, proposal driven approach

All water businesses will be expected to understand their customers' preferences in developing their pricing proposal to meet a 'Standard' assessment. While proposals will not be required to go above a 'Standard' assessment, our proposed framework is designed to motivate water businesses to develop 'Advanced' and 'Leading' proposals.

Water businesses have told us that our current one-size-fits-all approach to setting prices is not outcomes focused and limits their ability to identify and deliver customer value. Our proposed approach is flexible. It recognises that businesses differ in size, maturity, the services they provide, the environments in which they operate and their customers' expectations. The new approach will allow IPART to support water businesses to identify and deliver customer value, while maintaining a base level of expectations and scrutiny of water businesses' pricing proposals.

Each business will self-assess their proposal as either 'Standard', 'Advanced' or 'Leading' against the 3Cs framework and guiding principles, reflecting the value being delivered to customers. IPART will confirm whether the pricing proposal promotes long-term interest of customers at a 'Standard', 'Advanced', 'Leading' level, using the same criteria. We will require a business that submits a 'Sub-Standard' proposal to submit a revised proposal that will deliver better customer outcomes.

1.3 Enhanced incentives to promote customer value

Our proposed framework includes a range of incentives aligned to customer value. Through our assessment process, we propose to provide reputational and financial rewards for high-quality pricing proposals (Table 1).

Table 1 Annual revenue adjustments based on the quality of pricing proposal

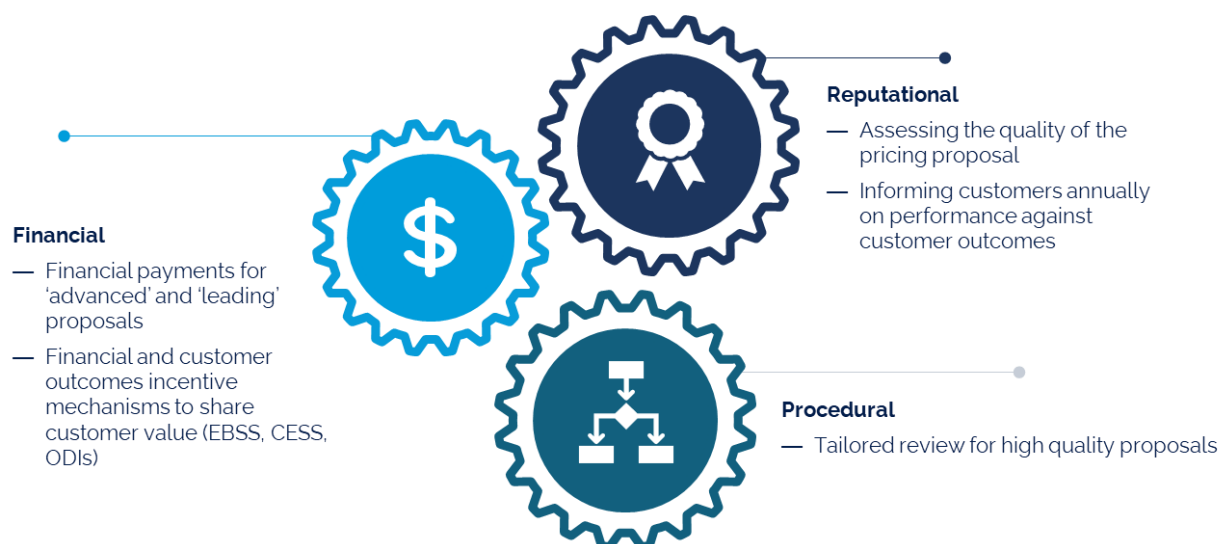
Price review IPART assessment	Business self-assessment		
	Leading	Advanced	Standard
Leading	2.5%	1.75%	n/a
Advanced	1%	1.25%	0.5%
Standard	-1%	-0.5%	0%
Sub-standard	Business to review proposal and resubmit		

Note: The table shows the financial reward businesses can earn for high-quality proposals. For instance, if a business submits a proposal it considers as Leading, and IPART agrees it is Leading, the business will earn a reward equivalent to 2.5% of its annual revenue. On the other hand, if a business submits a proposal it considers Advanced, but IPART grades it as Standard, the business is penalised by 0.5% of its annual revenue.

Our proposed monitoring, reporting and accountability framework ensures that businesses are delivering and promoting customer value. The use of financial and service performance incentive mechanisms within this framework allows businesses who demonstrate a strong understanding of their customers to share value created from sustained improvements in performance and reduced costs.

Similarly, these incentives hold businesses to account and penalise those that do not meet their commitments.

Figure 2 Incentives that promote customer value



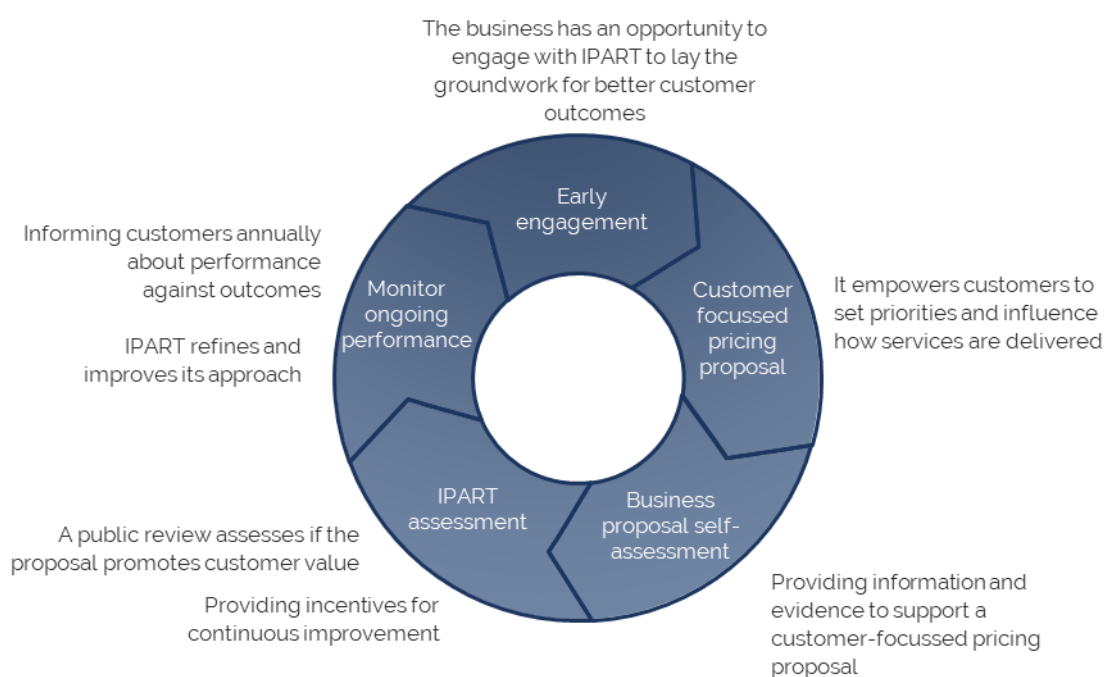
Note: The proposed financial incentive mechanisms are explained in the draft Technical Paper.

1.4 Business proposals drive how we employ our regulatory tools

Our draft framework asks each water business to submit a proposal every five years, that demonstrates it is promoting customer value. Figure 2 shows how it improves on our current approach:

- with a focus on delivering better customer outcomes
- by providing opportunity for each business to engage with IPART before price reviews commence to support high-quality pricing proposals
- with an assessment process that reflects the value proposition presented
- by holding each business accountable for their commitments.

Figure 3 5-year cycle of engagement and price setting



We propose maintaining some core elements of our current approach. We will continue to apply a building block approach, but it will be streamlined and simplified. For example, by reducing the number of asset categories, businesses can smooth price changes between periods where it is in customers' long-term interests. By implementing financial and service performance incentive schemes, IPART can place less reliance on expenditure reviews by consultants. We explain these proposals in our draft Technical Paper.

Our proposed framework provides businesses with clearer tools to manage uncertain and unforeseen costs. We also propose to establish a Regulators Advisory Panel to promote better collaboration between all the water sectors regulators – NSW Health, the Environment Protection Authority (EPA), and IPART, with scope for other regulators, the Department of Planning and customer advocacy groups to participate as guest members.

1.5 A tailored approach to price regulation

We will assess and tailor our approach based on the quality of the business's proposal. While our approach for Standard proposals remains similar to IPART's existing approach, the 3Cs principles provide an opportunity to streamline processes by allowing a Standard proposal to show that it meets customers' expectations.

Businesses that submit an Advanced or Leading proposal, which demonstrate they are delivering customer value through strong outcome commitments, will earn greater autonomy and flexibility, and less rigid regulatory processes. This provides confidence for the business to promise and deliver more for their customers, shifting the focus from short-term costs to long-term customer value. It also provides a more flexible approach that adapts to each business's distinct customer base.

The differences in our approach are reflected in Table 2. For instance, Advanced and Leading proposals can expect a stronger focus on outcomes and scope to provide differentiated service offerings for customers, while Standard proposals should expect to have a higher level of scrutiny over internal processes and maximum prices set for all customers.

Table 2 Our 3Cs framework tiers regulation based on a business's proposal

Standard proposals	Advanced/Leading proposals
<ul style="list-style-type: none"> Pre-set maximum prices to meet customer outcomes Scrutiny of internal processes and proposed expenditure An expectation for pre-review engagement with IPART 	<ul style="list-style-type: none"> Options for different price structures (e.g. revenue cap, weighted average price structure) Scope for differentiated pricing for specific customers Financial flexibility to deliver customer value through incentive schemes A focus on outcomes rather than internal processes Optional pre-review engagement with IPART
Changes to the regime for all businesses	
<ul style="list-style-type: none"> A stronger focus on customer outcomes Self-assessment of proposals against IPART's 3Cs criteria IPART assessment of proposals as either Standard, Advanced or Leading Better collaboration between water sector regulators by establishing a Regulator's Advisory Panel 5-year regulatory periods to promote better long-term planning 	

1.6 Ongoing monitoring of performance

Over time, IPART will focus on demonstrated performance against credible outcomes. We are asking each business to propose the most effective means of communicating to customers on its annual progress against customer outcomes.

In responding to financial and service performance incentive mechanisms, the business demonstrates that it is promoting customer value over time.

1.7 Next steps

We have extensively consulted with stakeholders over the past 18 months to develop this draft framework. We released a series of working papers and held four stakeholder workshops.

We will continue to work with stakeholders, hearing what they have to say about the aspects of the proposed framework they support and which aspects could be improved further. We will engage closely with the sector to build understanding of the regulatory changes. Through a series of workshops, we will work with water businesses and other stakeholders to develop a water regulation handbook that provides the right level of guidance to support customer-centric pricing proposals. We will also hold a Public Hearing.

We intend to implement our proposed framework in 2024-25 with the upcoming reviews of Hunter Water's, Sydney Water's and WaterNSW Greater Sydney's costs.

We invite your feedback on the Draft Report and supporting draft Technical Paper which will inform our Final Report in late 2022.

 Have your say

Have your say on the new water pricing framework

[Submit feedback »](#)

Submissions close 12 August 2022

2 Why are we reviewing how we set water prices?

Our current regulatory framework has enabled water businesses to supply safe, reliable and affordable services for NSW water customers. However, customers' expectations are increasing and the NSW Government's State Water strategy has highlighted the growing challenges the sector must address. To support water businesses to navigate the challenges ahead and continue to deliver the products and services that maximise long-term customer value, IPART needs to adapt its regulatory framework and approach.

2.1 Our regulatory approach

We regulate in the long-term interests of customers. As our 2023 strategy states, "Our purpose is to make the people of NSW better off through independent decisions and advice."² Water is an essential service, delivered to customers who mostly have no choice in who they buy services from. IPART works to ensure that customers pay fair prices for the water services they receive.

We currently use two complementary tools to achieve this objective:

- We recommend operating licence conditions, and monitor compliance with these conditions, to ensure that water businesses deliver safe and reliable services.
- We provide incentives for the water businesses to operate cost-efficiently, by setting maximum prices for water services.

Our water pricing focus has been on providing incentives for water businesses to deliver required service levels at least cost. To do this, we have undertaken detailed expenditure reviews, allowing us to set affordable water and wastewater prices across NSW.

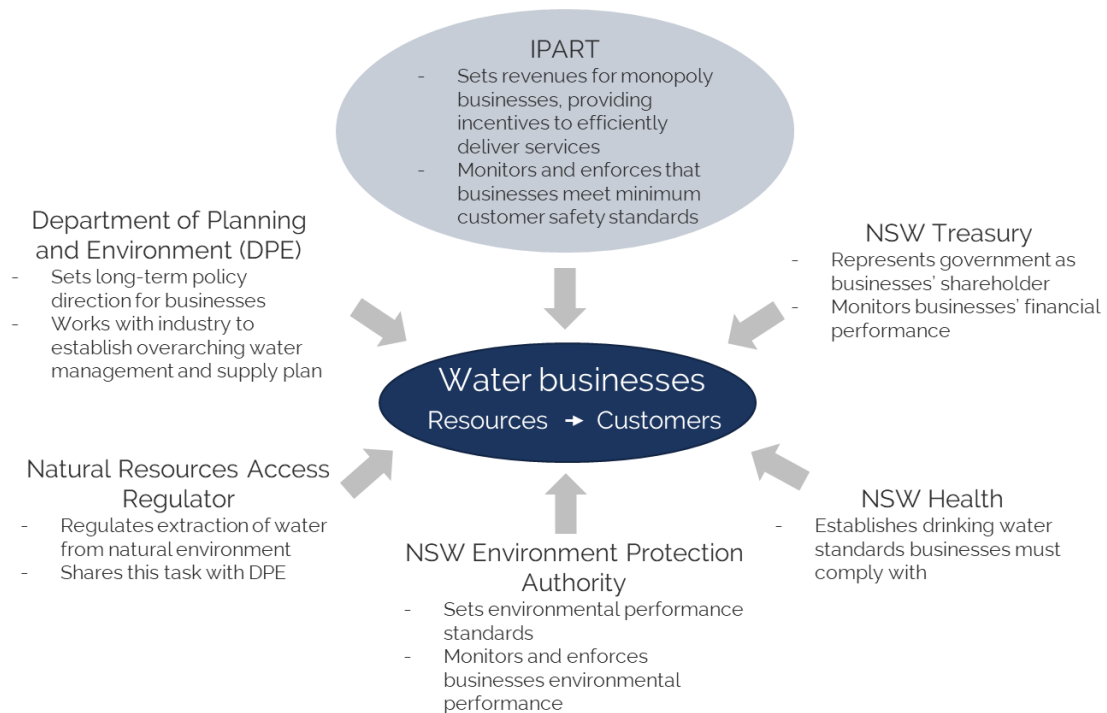
Box 1 The NSW regulatory space for the water industry

IPART is an independent regulator established by the IPART Act.³ We make the people of NSW better off through independent decisions and advice. IPART's independence is underpinned by an Act of Parliament.⁴

IPART plays an important role in managing the delivery of safe, affordable water and wastewater services to customers. But the water sector in NSW is complex, and we regulate in conjunction with other government agencies (see the figure below).

The DPE, NRAR, EPA and NSW Health regulate the businesses' performance across environmental and safety metrics. The broader NSW Government (led by DPE), sets the long-term strategic direction for water policy which the businesses work to implement. The NSW Treasurer and the Minister for Finance are shareholders of State Owned Corporations (including many of the water businesses we regulate), so they are responsible for monitoring financial performance and deciding the dividend payments that taxpayers receive.

Figure 4 Agencies that regulate NSW water businesses



2.2 The challenges we face

While our approach to setting prices has maintained affordability, it needs to evolve to support and accelerate the work already underway so that water businesses invest prudently in the infrastructure and technology needed for the future to provide services that customers value.

Water businesses need to have meaningful conversations with customers, to understand their priorities and needs, and to promote the outcomes which best deliver customer value. Customer expectations are becoming more sophisticated and complex. Ongoing and meaningful engagement with customers is the only way to ensure these needs are met, and that services can dynamically respond to changing customer, community and environmental needs.

Our regulatory framework has focused too much on cost and service forecasts over discrete four-year periods. Predominantly focussing on cost efficiency limits the scope for businesses to pursue innovation because they are rewarded by achieving least cost outcomes in the short term. This can be at the expense of customers' longer-term interests. Pricing regulation should maintain a focus on cost efficiency, while promoting and rewarding innovation that leads to better long-term performance.

We have also heard from businesses that our regulatory processes are time and resource intensive, and overly rigid. There has been too much focus on developing proposals that tick the box on regulatory expectations, and less on maximising the value proposition for customers.

Water businesses should earn autonomy, with less prescriptive regulation, by providing confidence to the community that they are accountable for efficiently delivering the services that customers want. To support this, we can provide incentives that share the benefits of sustained improvements in customer value. These encourage water businesses to directly engage with customers to develop pricing proposals that promote customer value, and to ultimately deliver better services over time.

There is strong recent precedent for moving to a more customer centric regulatory framework. Reforms in Victoria under the PREMO framework for water pricing saw a stronger focus on customer engagement and delivering customer outcomes, coupled with a continued focus on cost efficiency.⁵ Similar reforms have also been delivered in the UK's energy and water sectors. We have an opportunity to build on the most successful elements of approaches in other jurisdictions to achieve similar outcomes in NSW.

Box 2 Encouraging innovation in customer engagement

The Essential Services Commission's PREMO framework in Victoria places customers at the centre of the price setting process, through meaningful engagement to deliver better value for money. The PREMO framework does not prescribe a specific form for customer engagement, instead allowing each business to choose the strategy most appropriate for its circumstances and customers.

In the 2018 water price review, proposals that achieved a Leading rating for engagement demonstrated that customers were able to have a significant level of influence over key elements of pricing proposals.

For example, **Goulburn Valley Water** (GVW) recognised that service quality varies across the region and that consumer outcomes are likely heterogenous. GVW undertook extensive direct engagement in all its 54 towns to better understand the needs of its customer base, and designed activities such as interactive 'Water Cafés' to empower customer voices. The water business also established a customer-led annual performance review. GVW incorporated customer feedback in its price submission, for example by introducing a trial for a new tariff structure.

Similarly, **Barwon Water** (BW) consulted extensively with its customers and sought feedback on their needs and expectations. BW's engagement strategy consisted of surveys, group discussions, and focus groups. BW established a Community Panel that acted as a 'citizen's jury' and agreed on preferences and priorities for the water business.

Yarra Valley Water (YVW) used conjoint choice modelling (a technique where customers rank different packages of services and associated costs) and a citizen's jury to understand customer needs. The citizen's jury was formed with a 'blank page', in that YVW did not ask for feedback on a predetermined agenda, instead allowing the committee to create a report from scratch. YVW subsequently accepted all recommendations provided by the Jury.

Source: Essential Services Commission (2018), *Water price review 2018*

2.3 Our vision

Our vision is that our pricing regulatory framework creates an environment where customers have the level of influence they desire, over the issues that matter most to them. Regular, ongoing conversations with customers allow businesses to respond dynamically to their needs and ensure that their expectations are being met. As a result, businesses are led to prioritise prudent investments in the infrastructure and technology needed for the future.

By demonstrating continued value creation through strong proposals and by delivering on customer commitments, businesses will operate with less regulatory burden. We propose to tailor our role to best support these outcomes, and provide guidance, support and assessment processes that businesses need to succeed.

The regulatory framework supports each business to improve on its performance year-on-year. It incentivises innovation in products, services and prices, supporting continuous improvement in longer term performance across the sector. Efficiency will be achieved through a continued focus on cost, resource allocation and longer-term sustainability.

Our framework will adapt to emergent and future challenges, as we continually refine and improve our approach to reflect better ways of delivering customer value over the long term.

3 Delivering customer value with a new pricing framework

Our proposed new pricing framework is designed to promote a genuine shift to customers influencing the way businesses deliver services and the way that we regulate.

It encourages water businesses to engage directly with customers to drive its long-term priorities. Under the framework, a water business' pricing proposal should demonstrate that its activities and expenditures promote customer value.

IPART's water pricing review becomes much more about ensuring businesses are reflecting customers' preferences and are held accountable for delivering on customer priorities.

The key components of our proposed pricing framework are:

- focusing on customer value
- moving to a flexible proposal driven approach
- harnessing incentives to deliver customer value
- businesses' proposals driving our reviews and how we employ our regulatory tools
- ongoing monitoring of performance.

This chapter outlines the proposed pricing framework and how it will work. We welcome feedback on the framework and ways we can improve it.

3.1 Focusing on customer value

We have based our proposed pricing framework so that a business delivering better customer value would excel across three pillars:

- **Customers** – Businesses are focused on identifying and delivering customer outcomes, including broader community and environmental outcomes.
- **Costs** – Businesses demonstrate they are delivering these outcomes efficiently and sustainably.
- **Credibility** – Businesses are accountable for delivering on the outcomes that customers want. Pricing proposals contain concrete strategies for monitoring progress and adjusting as needed to ensure plans and outcomes are achieved.

Each of these pillars is supported by guiding principles, which set out how water businesses can demonstrate that its proposals can support and contribute to the long-term interests of customers.

3.2 Proposed '3C' guiding principles

We have developed 12 guiding principles that businesses should use to develop pricing proposals, and that we will use to assess them. For each principle, there are different performance expectations depending on whether the proposal is assessed as Standard, Advanced or Leading.

For example, all proposals need to include a customer engagement strategy that sets out how customers are consulted on business plans, while Advanced proposals also show that customers had significant influence and that the consultation methods used were best practice.

The proposed principles are designed to provide water businesses with guidance on our regulatory expectations. Each business can assess how its performance compares against these expectations. Providing this guidance within our proposed framework enables water businesses to design their **own** customer-centric pricing proposals and engagement strategy.

This recognises that, perhaps more so than in other jurisdictions, the NSW water businesses we regulate differ in their size, maturity, the services they provide, the environment they operate in, and their customers' expectations. Our proposed guiding principles allow our framework to expand or contract depending on the needs of each business's customers. And they allow our assessment of pricing proposals to be proportional to how well the business's proposal justifies it is promoting customer value, by showing how it will meet the principles.

The 12 principles are summarised in Table 3, and the accompanying draft Technical Paper provides more detail about our expectations for each principle, and at each level. We welcome feedback on this guidance.

Table 3 The proposed 3Cs guiding principles

Customer principles

Customer centricity	How well have you integrated customers' preferences into the planning and delivery of services, over the short and long term?
Customer engagement	Are you engaging customers on the what's most important to them, and using effective methods, to add value?
Customer outcomes	How well does your pricing proposal link customer preferences to proposed outcomes, service levels and projects?
Community	Are you considering broader community objectives, including traditional custodians of the land and water, while ensuring services are cost-reflective and affordable today and in the future?
Environment	Are you delivering environmental objectives, including to address climate change, in a cost-efficient manner across the short and long-term?
Choice of services	Are you providing opportunities to reflect customers' varied preferences for the tariffs and additional services they are willing to pay for?

Cost principles

Robust costs	How well does your proposal provide quantitative evidence that you will deliver the outcomes preferred by customers at the lowest sustainable cost?
Balance risk and long-term performance	How well do you weigh up the benefits and risks to customers of investment decisions, and how consistent are they with delivering long-term asset and service performance?
Commitment to improve value	How much ambition do you show in your cost efficiency targets and what steps have you taken to demonstrate commitment to deliver on your promises?
Equitable and efficient cost recovery	Are your proposed tariffs efficient and equitable and do they appropriately share risks between the business and your customers?

Credibility principles

Delivering	Can you provide assurance that you have the capability and commitment to deliver?
Continual improvement	Does the proposal identify shortcomings and areas for future improvement?

3.3 Harnessing incentives to deliver value to customers

We will continue to hold water businesses accountable for being efficient and delivering value for money. Under our proposed pricing framework we will adopt tools similar to those adopted by regulators elsewhere in Australia and overseas, to provide businesses with balanced incentives to support improved performance and service delivery. Our proposed incentives are:

Reputational incentives

Requiring businesses to self-assess their proposals before IPART conducts its own assessment provides a reputational incentive to put forward pricing proposals that deliver on customer preferences.

Where we provide an Advanced or Leading assessment, and when that matches a water business' self-assessment, customers can be confident that their water business is delivering customer value.

Process incentives

We propose to tailor our regulatory approach depending on our assessment of a water business's pricing proposal. We would tailor expenditure reviews, the form of price control and level of pricing flexibility. Pricing proposals that demonstrate improved performance and a program that efficiently delivers the services that a business's customers prefer can expect a more streamlined price review. This incentive should strengthen over time as we repeat the review process and businesses learn more about how best to demonstrate performance achievements within the 3Cs framework.

Financial incentives

Where we agree with a business that its proposal is Advanced or Leading, we will allow the business to share in the customer value created through a financial reward. This up-front payment provides the business with additional financial headroom to support it in delivering innovative/ambitious proposals.

For the purpose of financial incentives, each business is considered 'Standard' until its first price review under the 3Cs framework. Following this, the rating from the last review will be the starting point for the next review.

Table 4 and Table 5 below show the proposed payments. For instance, a business with a previously Standard proposal that self-assesses its new proposal as Advanced can earn an additional 1.25% of its annual revenue requirement up-front if IPART agrees the proposal is Advanced. Further information is provided in our draft Technical Paper.

Table 4 Our proposed assessment table for a business previously assessed as having a standard proposal (% of annual revenue requirement)

IPART's assessment	Business's self-assessment		
	Leading	Advanced	Standard
Leading	2.5%	1.75%	n/a
Advanced	1%	1.25%	0.5%
Standard	-1%	-0.5%	0%

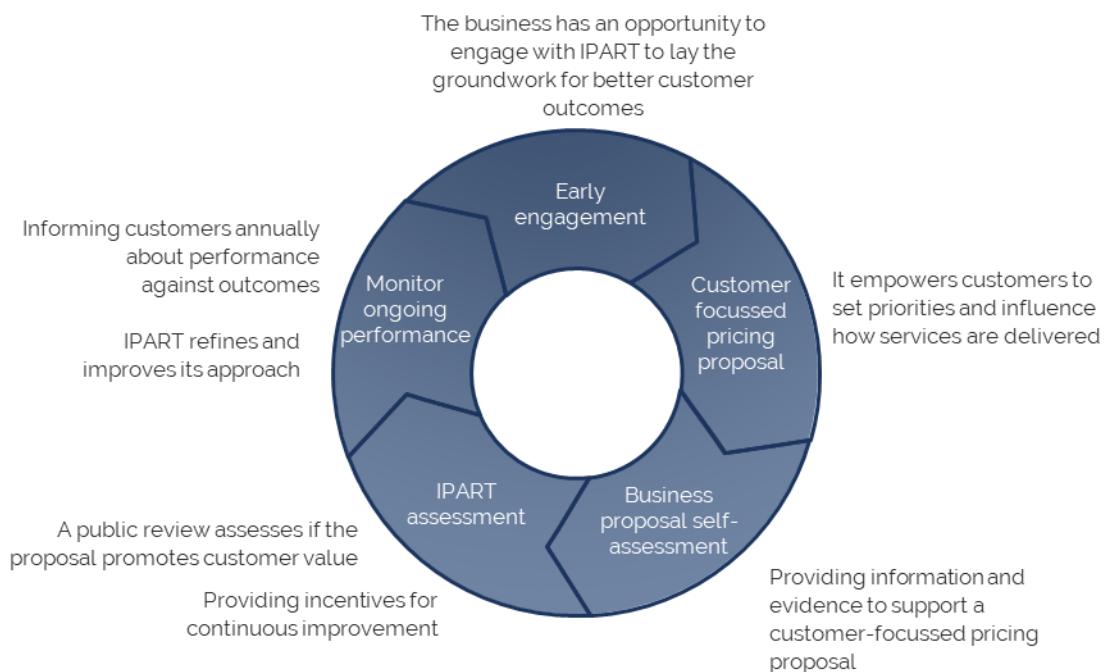
Table 5 Our proposed assessment table for a business previously assessed as having an advanced/leading proposal (% of annual revenue requirement)

IPART's assessment	Business's self-assessment		
	Leading	Advanced	Standard
Leading	1.25%	0.5%	n/a
Advanced	-0.25%	0%	-0.5%
Standard	-2.25%	-1.75%	-1.25%

3.4 Businesses proposals drive our reviews and how we employ our regulatory tools

Figure 5 summarises how we propose to apply the framework across a regulatory cycle – from planning and early engagement, through developing a pricing proposal and regulatory review, to ongoing monitoring.

Figure 5 A proposed 5-year cycle of engagement and price setting



Early engagement

Our proposed pricing framework offers early engagement between the business and IPART one to two years before its pricing proposal is due, to support better customer outcomes. This builds on our commitment under the 3Cs framework to encourage businesses to check in with IPART as they develop pricing proposals.

Early engagement provides an opportunity for us to have a structured discussion with water businesses, so that we have a clear understanding of how they are responding to our 3Cs pricing framework, and how effectively the framework promotes customer outcomes.

Over time, early engagement may be optional for Advanced and Leading businesses, potentially creating another process incentive for streamlined reviews. Conversely, for a Standard business, if we identify areas of particular concern in our previous review, we may also conduct an additional systems and processes review in advance of the following pricing review.

Developing and self-assessing customer focused pricing proposals

Following early engagement with IPART, the businesses will engage with customers to develop pricing proposals. This will involve working with customers to develop long-term plans, identify outcomes for the forthcoming regulatory period, and engaging on associated expenditure priorities. We need water businesses to adapt and ensure water security, resilience and safety as our climate changes. This will require good long-term plans, innovation and prudent investment.

An important aspect of the proposal is to propose and justify the cost efficiencies the business is planning to achieve over the forthcoming regulatory period.

Having developed its pricing proposal, businesses will self-assess against the 3Cs framework and guiding principles. In so doing, businesses will justify that their proposal satisfies the requirements of Standard, Advanced or Leading, overall.

We do not expect all regulated businesses to strive to be Advanced or Leading in the short term. Rather, the framework is tailored to encourage each business to improve on its performance year-on-year, from its own starting point.

Finally, before submitting its pricing proposal, the business will be required to obtain board (or equivalent) approval of the pricing proposal. This is to encourage greater accountability within the businesses, and to ensure boards are involved in developing long-term plans to deliver customer value. A business failing to deliver on its own, board endorsed, proposal will have to provide an appropriate explanation to its shareholder and the community.

IPART's assessment of the pricing proposal

We will assess the business's proposal based on the 3Cs framework and guiding principles. In so doing, we will consider each of the principles and evaluate its proposal based on the information and evidence provided in the proposal. Ultimately, we will decide whether we agree with the business's self-assessment.

To assess the pricing proposal, we will:

- Streamline the expenditure review process where there is clear evidence of customer support for expenditure proposals if they lie within appropriate benchmarks – see Box 3.
- Review the business's proposed customer outcomes and expenditure in deciding the revenue an efficient business would need to deliver water services, meet operating licence conditions, and promote customer value.
- Determine the prices (or a method the business applies to set prices) for water services to ensure they are cost-reflective and sustainable, promote efficient use of and investment in the associated infrastructure.
- Establish incentives for the business to deliver improved customer service performance outcomes and become more cost-efficient over time.

We have designed the incentive schemes to enable Advanced and Leading proposals to show that they are responding efficiently to balanced incentives for improved service performance and financial outcomes. This will allow IPART, in subsequent reviews, to place less reliance on expenditure reviews by consultants for these businesses.

At the end of our pricing review, we will publish a pricing determination, a legal document that sets out maximum prices for regulated services (or a formula for setting these prices). It reflects our assessment of the revenue required to deliver customer value over the regulatory period, including any sharing of benefits between the business and customers.

Box 3 Changing the expenditure review process

Our expenditure review process is an important component of the regulatory framework. However, it has become increasingly onerous and we agree with the businesses it is delivering less value for customers than it used to.

For this reason, we propose a number of changes to the process, to enable both the businesses and IPART to focus on the elements of the expenditure review that matter most to customers:

- adopting a base-step-trend approach to operating expenditure
- streamlining information returns the businesses need to complete
- making greater use of cost benchmarking
- working with the businesses to develop predictive models of longer-term capital expenditure needs
- only reviewing historic capital expenditure by exception
- requiring expenditure review consultants to recommend a range of efficient expenditure
- simplifying our building block model without compromising the quality of outcomes.

These are described in more detail in our draft Technical Paper.

Ongoing monitoring of performance

After setting revenues, performance targets and incentives, we will monitor ongoing performance using a range of tools to make sure businesses deliver on their commitments to customers.

These tools include:

- each water business notifying customers of their progress against outcome commitments
- publishing business performance results in an online dashboard
- conducting annual licence audits
- collaborating with other regulators through a Regulators Advisory Panel to ensure a consistent regulatory setting for businesses.

Requiring water businesses to provide ongoing information to customers about its performance is a central part of our proposed pricing framework. These proposed additional reporting requirements are designed to boost transparency and accountability within the sector and allow businesses to show customers how they are delivering for customers.

While not a new addition to our regulatory framework, conducting annual licence compliance checks is another powerful tool we will use to incentivise businesses to deliver on service performance outcomes. Breaches of an operating licence can result in strong reputational penalties.

Finally, we propose to address concerns about inconsistent regulatory settings for water businesses by creating a Regulators Advisory Panel. The Panel will meet periodically, and aim to align regulatory expectations to deliver on customer value.

Box 4 Public reporting of customer outcome performance

Reporting how businesses perform on customer outcomes can boost accountability and help improve the services available to customers. Public access to this information allows both businesses and customers to compare businesses within an industry.

For example, Energy Consumers Australia undertakes surveys of residential and small business energy consumers every six months. These studies explore what consumers think about the energy market and how they behave in it. Similarly, the Productivity Commission releases a report to rate the performance of Australian governments in delivering services such as education, justice and health. These reports improve accountability in industries where consumer outcomes are extremely important.

Businesses can use these results to help gauge their progress within the industry. This shines a light on areas where businesses should improve, but it also draws attention to areas in which they are outperforming. This can inspire better knowledge sharing within the industry and improve business performance across the industry.

Source: Energy Consumers Australia (2021), [Sentiment and Behaviour Surveys](#)
Australian Government Productivity Commission (2022), [Report on Government Services](#)

3.5 Our commitments under the proposed pricing framework

Our proposed pricing framework aims to change how businesses interact with customers and how we fulfil our regulatory responsibilities. The framework is designed to:

- support the water industry to deliver better value for money to customers, and be rewarded for it
- be predictable, without presupposing the specific outcomes that customers want
- reward innovation and sustained performance improvement
- avoid unnecessary regulatory intervention.

We want each business to improve on its performance year-on-year and become a leader in the industry. This is success for IPART under the framework. To give the industry confidence in how we intend to interact under the proposed pricing framework, we provide the following commitments in Table 6 in applying our new framework.

Table 6 IPART's commitments under the proposed framework

<p>Act fairly</p>	<p>While IPART will make decisions at arm's length, we need to support each business for this framework to be successful.</p> <p>We expect water businesses to propose their strongest customer value proposition. Our assessment will reflect the quality of the proposal, not our historical experience with the business.</p>
<p>Openness</p>	<p>We will maintain an open-door policy during the regulatory period up to the point of lodging a pricing proposal and encourage businesses to check-in with IPART as they develop pricing proposals.</p> <p>We will seek to proactively engage with board directors, executive leadership teams and regulatory teams, to ensure businesses understand the objectives behind this framework and have confidence in its application.</p>
<p>Tailored approach</p>	<p>We will focus on matters that materially impact customer value. We will not conduct line-by-line examinations to try to bring costs down, or downgrade proposals.</p> <p>Businesses will be rewarded for their efforts, rather than penalised for small oversights or errors.</p>
<p>Earned autonomy</p>	<p>We commit to streamline reviews where a business can demonstrate better customer value for money and provide well-justified and transparent plans.</p> <p>High standards of performance will also be rewarded with lower regulatory burden. IPART's focus will be on areas where improvement may be needed. This supports businesses in taking responsibility for customer outcomes over the long-term.</p>
<p>Customer-centric</p>	<p>We expect each water businesses to engage with its customers. We will not unnecessarily pre-suppose what is in the long-term interests of customers. The businesses will agree with its customers how these long-term interests are met.</p> <p>We will hold businesses to account for their commitments and ensure that engagement is genuine and provided all customers appropriate influence on the outcomes and value for money.</p>
<p>Continuous improvement</p>	<p>We are committed to listening to feedback on the regulatory framework from water businesses and customers, and to continuously improve how it is applied to improve outcomes for customers into the future.</p>

4 Benefits from the proposed 3Cs framework

The 3Cs pricing framework encourages a stronger customer voice in how services are delivered. It allows businesses to demonstrate that proposals and decisions are efficient and supported by customers and the broader community. By streamlining the regulatory process and providing incentives that share the benefits of improved performance, the 3Cs framework encourages innovation and a shift in the sector from short-term costs to long-term customer value.

4.1 Enhanced focus on customer value

The key benefit of the proposed 3Cs pricing framework is to accelerate a shift across the sector to delivering customer value.

Water businesses will show they are genuinely led by customers, including those who are difficult to reach. Rather than engaging to 'tick a box', each business will gain insights from customers through a variety of methods as standard practice. Involving customers to set the priorities and outcomes that matter most is essential if water businesses are to identify better ways of delivering services and to successfully navigate the challenges faced by the sector.

4.2 Stronger customer voice in decisions

The proposed 3Cs framework asks each water business to provide customers with an increasing level of influence in how services are delivered. Rather than surveying customers on specific engineering solutions or financial parameters, businesses demonstrate that decision-making processes at all levels are structured to promote customer outcomes.

This provides confidence to the business that it is providing a high-quality proposal supported by its customers. Tying reputational and financial rewards to high-quality pricing proposals, we encourage each business to promise and deliver more for their customers.

In turn, IPART has confidence that proposals accurately reflect customer preferences and promote cost efficiency and long term planning. This supports a more streamlined and efficient regulatory process for all stakeholders.

4.3 Improved performance and cost efficiency outcomes

Working collaboratively with customers, we expect each business to increasingly align its performance outcomes with customer needs. This supports innovation to deliver customer service and outcome commitments at the lowest sustainable cost as technology and preferences evolve.

Financial incentives support a focus on longer-term outcomes. First, they align financial performance to sustained improvements in customer value. Second, they allow future review processes to be streamlined because they allow businesses to demonstrate they are acting efficiently (reducing IPART's reliance on expenditure review consultants). This increased autonomy provides more scope for the business to deliver longer-term customer outcomes.

Customers have confidence that we hold businesses accountable over time as demonstrated and credible outcomes become our focus. While pricing reviews will remain an important tool for holding water business to account, reviews should become less intrusive over time as annual performance against outcomes increases in importance.

4.4 Tailored regulatory approach to enable innovation

In applying the 3Cs pricing framework, we propose tailoring elements of our regulatory process to the scale and sophistication of each pricing proposal. The more advanced a proposal, the more flexibility the regulatory regime provides.

Tailoring our approach supports better outcomes for customers:

- It supports the efficient allocation of the businesses' time to the 'key' issues that matter most to customers.
- It provides an additional incentive for businesses to submit high-quality proposals so they can earn the flexibility offered to Advanced and Leading assessments.
- By adapting our decisions to the needs of each business, businesses can customise their service offerings for customers.
- The incentives for ongoing efficiencies allow us to streamline future reviews. This is because they provide confidence that a business's historical expenditure is efficient and reliable for setting future prices.

Box 5 Reducing the use of external consultants during price reviews

The use of financial incentives, when well-integrated into a broader regulatory framework, reduces a regulator's reliance on external consultants to assess the efficiency of a business's proposed expenditure.

Schemes used by the Australian Energy Regulator's (AER), such as the Efficiency Benefit Sharing Scheme (EBSS) and the Capital Expenditure Sharing Scheme (CESS) incentivise businesses to improve efficiency by rewarding them when actual expenditure is lower than forecast. However, these efficiency gains are only genuine if expenditure forecasts reasonably reflect the efficient cost of providing services. The AER uses a range of tools and techniques to improve confidence in its expenditure forecasts.

For operating expenditure, the EBSS calculates forecasts based on actual expenditure in the base year. The AER also uses economic benchmarking to test whether base year expenditure is efficient, reducing the need for additional scrutiny of costs by the AER.

As capital expenditure is less recurrent in nature, the AER undertakes a top-down assessment of a network's total capital expenditure. In part, it reflects that the CESS supports businesses in demonstrating historical decisions and expenditure were efficient. This reduces the need for further scrutiny at the project level for forecast or historical expenditure.

Sources: Australian Energy Regulator (2021), *Review of incentive schemes for network Discussion paper*
Australian Energy Regulator (2021), *AusNet Services Determination 2021-26*

4.5 A framework that evolves to support water businesses to meet the challenges ahead

The 3Cs framework reflects that the businesses we regulate provide different services to disparate customer bases. It is designed to provide flexibility for each business we regulate, based on how well its pricing proposals promote customer value.

The framework has been designed so that it adapts, and evolves, over time to meet our objective of promoting long-term customer value. As we receive feedback on the framework from water businesses and customers, and take on board lessons from other regulators, we will improve how it is applied to deliver better customer outcomes into the future.

5 Next steps

Over the last 18 months we have held extensive discussions with stakeholders and produced a series of working papers to ensure we develop this framework through ongoing and public consultation. Table 7 summarises the work we have done so far, as well as the next steps we plan to take to implement our proposed new regulatory framework.

Table 7 Timeline for this review

Date	Activity	
September 2020	Position Paper	Sought feedback on the scope of the review and IPART's proposed focus areas for the review: lifting the performance of the sector, encouraging innovation, and promoting a customer focus.
November 2020	Review update	Summarised the feedback we received on our preliminary positions. Stakeholders broadly supported the focus areas and proposed specific policy changes to help achieve these goals.
March 2021	Lifting performance workshop	We met with water businesses, government and customer groups to discuss specific ideas on how to lift performance in the water sector.
May 2021	Discussion Paper 1	Laid out our preliminary positions on lifting performance in the water sector, including revenue caps, a shadow price for leakage and a Regulators Advisory Panel. Stakeholders supported many of these changes, which have been maintained in this Draft Report.
June 2021	Customer focus workshop	We met with stakeholders and worked through limitations of the current approach to customer engagement and ways to make customers the heart of our new framework.
June 2021	Discussion Paper 2	Outlined our proposed improvements to promote a customer focus, including customer outcomes, mid-determination check ins and the idea of assessing the quality of proposals. Stakeholder feedback was largely positive, though businesses asked for more clarity on how IPART would assess the quality of proposals.
June 2021	Innovation workshop	We discussed with stakeholders on how to promote innovation and sustained improvements in efficiency across the sector.
August 2021	Discussion Paper 3	Outlined key elements of our proposed 3Cs framework, such as guiding principles, targeted use of incentive schemes, and 6-year regulatory periods with a mid-point check in. Following stakeholder feedback on these ideas, we have made changes to the framework presented in this Draft Report.
September 2021	Draft framework workshop	We discussed businesses' feedback on the proposed framework. While supportive, businesses were cautious about implementing incentive schemes and the risks of a 6-year model for regulatory periods.
May 2022	Draft Report	The Draft Report and draft Technical Paper sets out the proposed framework in full for stakeholders to comment on.

Date	Activity
July 2022	Public hearing A public hearing will be held on the proposed reform package.
October 2022	Final Report The final report will confirm details of the new framework, and highlight changes made since the draft report package.
May 2022 onwards	Implement change We will work with businesses to implement the new framework and begin to apply it.

5.1 Working with industry

We will continue to work with stakeholders as we finalise and implement the new framework.

As part of releasing this Draft Report package, we will:

- Consult with stakeholders including hosting meetings with key stakeholders.
- Conduct workshops so that industry and Government develop a deeper understanding of our proposed approach, IPART receives feedback on any issues with our proposals, and that we work together to successfully implement key aspects of the proposed framework.
- Hold a public hearing to allow an opportunity for all interested stakeholders to provide comment on our proposed framework.

We will then release a final report containing our decisions on the new framework.

Through these workshops, we want to work with the businesses to develop a 'better water regulation handbook' to replace our current guidelines for water business pricing proposals. Our intent is to work with the sector to shape the specific topics that require more detailed guidance. We do not want to be overly prescriptive about how the framework is implemented as this may take the focus away from businesses delivering value for customers.

We propose to apply the finalised 3Cs framework for the next Sydney Water, WaterNSW Greater Sydney and Hunter Water regulatory reviews, where prices commence 1 July 2025.

5.2 Continuing to improve the framework

We recognise that our framework needs to continually improve and evolve to reflect better ways of delivering on customers' changing preferences and reflecting the lessons from our and other regulators' frameworks.

We propose to review our framework for regulating the water sector every five years with a transparent and consultative review process. We anticipate doing so after completing each round of pricing reviews under the new framework.

While we will consult with stakeholders on the focus areas for future 'framework' reviews, we expect to:

- share lessons and improve how customer outcomes are promoted under the framework
- review and update our guiding principles
- identify improvements to the design of financial (and other) incentives in the framework, having had the opportunity to apply these incentives
- identify further opportunities to streamline our process as businesses demonstrate they are delivering customer value.

We propose commissioning an independent review of our new framework after the first round of pricing reviews.

Appendices



A List of draft decisions

Below we have listed our draft decisions for this review. Our accompanying draft Technical Paper has more detail on each of these decisions.

Draft decisions

Update IPART's pricing framework to promote customers, costs and credibility

1. IPART will update our water pricing framework to better promote customer value, cost efficiency and credibility. These elements are referred to as the 3Cs. They are supported by individual principles that:
 - water businesses will use to guide pricing proposals that promote the long-term interests of customers
 - IPART will use to assess pricing proposals, and as a basis for its decisions, in a pricing review.
2. IPART will engage with the water businesses to develop a handbook that provides the level and type of guidance required to support water businesses' proposals under the 3Cs framework. It will be updated over time.

Engage early with water businesses to support customer outcomes

3. Water businesses can engage with IPART one to two years before a pricing proposal. 'Early engagement':
 - aims to ensure water businesses are supported and accountable for developing their pricing proposals, delivering their plans and engaging with their customers.
 - is expected for a water business that previously submitted a Standard proposal, and optional if it previously submitted an Advanced or Leading proposal

Enable water businesses to promote customer value through pricing proposals

4. Water businesses will demonstrate how well their pricing proposals promote customer value, encourage cost efficiency and whether they can be credibly delivered, by self-assessing whether their pricing proposals meet the 3Cs framework at a Standard, Advanced, or Leading level.
5. Water businesses will provide information to support self-assessments, including:
 - proposed customer outcomes and performance targets, and as applicable, how these are complemented by operating licence conditions and/or incentive schemes
 - a nominated efficiency factor, that is substantiated with activities to deliver on this commitment
 - supporting evidence that its focus principles are consistent with customer priorities
 - Board (or equivalent) endorsement that the pricing proposal best promotes the long-term interests of its customers

Provide incentives for water businesses to promote customer value and tailor decisions in a pricing review

6. IPART will assess whether we agree with the water business's self-assessment that its proposal meets the 3Cs framework at a Standard, Advanced, or Leading level.
 - IPART will require a water business that submits a sub-standard pricing proposal to resubmit within six months.
7. IPART will provide financial rewards and penalties depending on our assessment of the water business's proposal against the 3Cs framework. We will provide a financial reward – calculated as a percentage of the revenue requirement – where we agree with the water business that its proposal is Advanced or Leading.
8. IPART's assessment of the water business's proposal against the 3Cs framework will be used to determine our approach to expenditure reviews and to tailor key decisions in a review.

Encourage ongoing customer value through financial incentives

9. IPART's assessment of the water business's proposal against the 3Cs framework will determine the financial incentives we provide for ongoing performance. We will use financial and service performance incentive mechanisms for Advanced and Leading proposals. Where the benefits exceed the costs, these proposals will have an incentive regime comprising:
 - an operating expenditure benefits savings scheme
 - a capital expenditure savings scheme, and
 - a customer outcomes delivery incentive scheme for key customer outcomes.
10. IPART will implement a shadow price for leakage to encourage efficient reductions in leakage. This will apply for water businesses with Advanced or Leading proposals who serve retail customers.

Update common elements of the price review process to promote effective and efficient regulation

11. IPART will set 5-year regulatory periods, and conduct price reviews over nine months, unless another timeframe is agreed in advance.
12. IPART will update how we assess proposed operating expenditure by:
 - implementing a base-step-trend approach
 - streamlining information returns to support greater use of benchmarking.
13. IPART will update how we assess proposed capital expenditure review by:
 - working with the water businesses to develop predictive models of longer-term capital expenditure needs
 - conducting reviews of historical capital expenditure by exception.
14. IPART will require expenditure review consultants (where used) to recommend a range of efficient expenditure.
15. IPART will update our regulatory approach around the 3Cs framework:
 - The criteria IPART will apply to test the prudence and efficiency of proposed expenditure will be included in the 3Cs framework and guiding principles, rather than in separate guidelines.
 - As water businesses will promote the service improvements that their customers want and value by proposing customer outcomes, IPART will not apply a separate discretionary expenditure framework.

- Our proposed customer choice pricing model promotes differentiated service offerings and broadens the scope for unregulated pricing agreements.

16. IPART will simplify the building block models without affecting the quality of outcomes, as outlined in Appendix A of the draft Technical Paper.

Provide flexibility to address changing revenue needs where it promotes the long-term interest of customers

17. IPART will provide water businesses with mechanisms to manage changing revenue needs over the short and long-term, where these promote better customer outcomes. We will outline principles which we will consider when assessing proposals:
- to account for uncertain and unforeseen costs within a pricing period with a cost pass-through, ex post-true up, letter of comfort, or a partial or a full re-opening of a pricing determination
 - to smooth revenues between pricing periods with accelerated depreciation, annuities or escrow accounts.

Increase the importance of ongoing performance monitoring

18. Each water business will publish its performance against customer outcomes annually and communicate this information to customers.
19. IPART will publish and maintain an online performance dashboard on water businesses' performance against customer outcome commitments.
20. IPART will establish a Regulators Advisory Panel to promote better collaboration between regulators of NSW water businesses.
21. IPART will review and update the 3Cs framework every five years. This will include an independent review of the framework, after the first round of reviews under the new framework.

¹ *Independent Pricing and Regulatory Tribunal Act 1992.*

² IPART, *Strategy on a page*.

³ *Independent Pricing and Regulatory Tribunal Act 1992 s 5.*

⁴ See e.g. *Independent Pricing and Regulatory Tribunal Act 1992 s 7*

⁵ FarrierSwier, *Victoria's water sector: The PREMO model for economic regulation*, March 2019.