

Our reference: 20/178-9

Contact Liz Livingstone

T (02) 9290 8491

E Liz_Livingstone@ipart.nsw.gov.au

29 June 2021

Roch Cheroux
CEO
Sydney Water
Roch.cheroux@sydneywater.com.au

via email

Dear Roch

Sydney Water's submission to IPART's Regulatory Review Discussion Paper

Thank you for Sydney Water's recent submission to IPART's Regulatory Review Discussion Paper on lifting the performance of the water sector in NSW.

The Tribunal has reviewed your submission and asked the Secretariat to invite Sydney Water to provide a supplementary submission with more substance around the changes you are seeking to IPART's regulatory framework.

We genuinely appreciate the goodwill that Sydney Water's regulatory team has brought to this process, and their willingness to engage in discussions with the IPART review team. However, we felt that while Sydney Water's submission raised interesting questions about the challenges of economic regulation of the water industry, it was not specific about the improvements that should be made (and why they should be made).

In this supplementary submission, we suggest Sydney Water consider:

- what specific changes to the regulatory framework it is proposing
- what supporting analysis and evidence it can provide to demonstrate that these changes would promote the long-term interests of customers.

We are flexible about the timing of this supplementary submission. We propose a due date of 16 August 2021, but we are happy to confirm this with the team.

To provide guidance, we have attached some illustrative questions on areas where we are looking for clarity or more detail on Sydney Water's proposals.

I would like to thank Sydney Water again for its participation throughout this review to date. This review provides an important opportunity for Sydney Water – and other stakeholders – to work with IPART to design a regulatory framework that addresses the current and future challenges of the sector.

IPART's contact officer for this review is Anthony Rush, Director, contactable on 9113 7790.

Yours sincerely

30/06/2021

X 

Liz Livingstone
CEO
Signed by: Liz Livingstone

Potential topics to expand on in a supplementary submission

Below we have listed some specific questions we had upon reading your submission. We would appreciate Sydney Water considering these in more detail. For each questions, we would also like to better understand how your proposed changes would create long-term value for customers.

A long-term focus

What specific changes to the regulatory framework – if any – need to occur to align the pricing review process with Sydney Water's long-term plan? For example, would it involve introducing incentive schemes for customer outcomes and financial performance, with symmetric rewards and penalties, to shift the focus of the expenditure consultant's review?

From Sydney Water's perspective, what elements of long-term planning need to be improved and what is the process and steps to improve them, in order to provide IPART with confidence that these plans will promote the long-term interests of customers at the lowest sustainable cost? This could include the internal governance around the long-term plan; the information needed to understand the maintenance needs for ageing assets; the climate change risks that need to be managed and adapted to; and how Sydney Water is working with stakeholders to promote and deliver positive environmental outcomes.

We note that Sydney Water's proposal suggests prices be set on a long-term price trajectory that considers customer insight. Read narrowly, this could imply that it is only customer preferences around bill volatility that are relevant to the framework. We do not consider this to be the case, and nor would we consider this to be the key concern in promoting the long-term interests of customers. What other types of customer insights does Sydney Water feel should be considered?

Bill smoothing and revenue caps

Our view is that price smoothing is a consideration when expenditure levels are cyclical (and forecastable). Does Sydney Water's long-term forecasts suggest that expenditure will be cyclical, or permanently higher? If there is a step-change in capital expenditure, or if growth in expenditure is expected to be sustained, why would a standard building block approach fail to sufficiently smooth the bill impacts of new investments?

Another important consideration for price-smoothing is its impact on financeability. Has Sydney Water considered the potential impacts of bill smoothing on its financeability?

With these points in mind, what price-smoothing model does Sydney Water envisage, and why? For example, we note three approaches that have been previously proposed or adopted:

- An annuity-based approach, similar to that put forward by [SunWater](#)
- Changing the regulatory depreciation allowance as suggested by WSAA
- A financial tramlines approach, similar to WICS.

We also note that Sydney Water considers there is "an opportunity to take a long-term approach to customer prices, based on a longer-term view of the regulated cost of capital". To help IPART better understand the pros and cons of such an approach, we would like more information from Sydney Water about:

-
- What constitutes a longer-term view of the WACC, and whether the proposed approach requires a departure from a market-based approach.
 - As above, how Sydney Water considered the impact of this departure on financeability. For example, what would happen in the event that borrowing rates are significantly higher than the 'longer-term' view of WACC?

Further, we note that the immediate goals of bill-smoothing and a revenue cap would typically work in opposite directions. That is, a revenue cap seeks to match revenues to costs in each year, while bill-smoothing seeks to apportion movements in costs to revenues across several years.

In this context, we would like to better understand why Sydney Water seeks both a revenue cap, and bill smoothing. To support the answer to this question, we would be interested in further detail on the specific benefits that a revenue cap would provide to your customers.

The WICS/Scottish Water model

We appreciate the research and analysis Sydney Water has taken to understand the strengths and weaknesses of other regulatory frameworks. In particular, we note the references to the WICS framework in Scotland.

We are interested in which specific elements of the WICS framework Sydney Water recommends IPART consider adopting? For example, have you considered an 'open book' approach to reviewing expenditure and business process?