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EnergyAustralia

LIGHT THE WAY

Ms Deborah Cope
Ms Sandra Gamble
Mr Mike Smart
Review of Water NSW rural bulk water services
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

EnergyAustralia Pty Ltd
ABN 99 086 014 968

Level 19
Two Melbourne Quarter
697 Collins Street
Docklands Victoria 3008

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

Lodged electronically: <https://www.ipart.nsw.gov.au/>

Dear Tribunal Members

Lifting performance in the water sector – Discussion Paper – May 2021

EnergyAustralia is one of Australia's largest energy companies with around 2.4 million electricity and gas accounts across eastern Australia. We also own, operate and contract a diversified energy generation portfolio across Australia, including coal, gas, battery storage, demand response, wind and solar assets, with control of over 4,500MW of generation capacity.

As IPART would be aware, we have a direct stake in its approach to setting regulated prices for WaterNSW as we are a large holder of entitlements in the Fish River Scheme. The cost recovery arrangements are such that we pay approximately half of WaterNSW's costs while contributing to around 20 percent of annual usage. As per our recent submission¹ we have various perspectives relating to cost allocation and pricing outcomes, and so our comments below largely respond to questions raised in chapters 4 and 5 of IPART's discussion paper.

Several elements of the regulatory framework relate to the desirability for water conservation, with IPART suggesting a shadow price for leakage. Different price control mechanisms also have varied incentives on businesses to encourage customers to conserve water, with varied impacts on revenue and financial sustainability that need to be accounted for.

As part of the current WaterNSW bulk water review we observe that IPART appears to have a direct role in determining pricing structures, particularly the differentials between fixed and variable charges, that provide signals directly to customers on their own efficient water usage. The extent of this control could remain irrespective of whether businesses are regulated under revenue or price caps. To the extent IPART were minded to give businesses higher degrees of freedom in determining pricing relativities (for example, under a weighted average price cap), this would tend to create an incentive for businesses to load up fixed price components in order to manage volume risk. In turn,

¹ <https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-water-services-rural-water-waternsw-rural-bulk-water-prices-from-1-july-2021/submissions-draft-report-waternsw-rural-bulk-water-prices-from-1-july-2021/online-submission-energyaustralia-l-irlam-16-apr-2021-170942099.pdf>

this would weaken price signals for customers to conserve water, as well as work against other demand management signals that could reduce costs over the longer term.

Irrespective of the price or revenue control mechanism, there is a need to have some regulatory oversight of what customers are actually charged. Doing this via pricing principles and side constraints can be problematic. Pricing principles typically include concepts like long-run marginal cost, which can be difficult to operationalise, or in the case of stand-alone and avoidable costs, set boundaries that support a very wide range of outcomes.

The 'efficiency' of pricing can best be examined where methods of allocating shared costs are transparent, and revenue pools can be compared to associated costs of particular services or of serving customer cohorts. The role of side constraints will be greater, and problematic for regulated businesses trying to recover efficient costs, where underlying costs and prices are structurally misaligned. Any such misalignment may reflect customer preferences for usage or volumetric versus fixed pricing. Customers should therefore be appropriately informed of different efficiency impacts, including those on future customers, when their preferences are directly reflected in regulatory proposals. This should be a feature of any of IPART's new measures towards 'promoting a customer focus'.

As it relates to the length of regulatory determinations, IPART correctly notes that it may be more appropriate to maintain shorter periods to avoid material divergences between costs and revenues, which in a large part depends on price structures being settled. A further factor to consider is whether the regulatory regime is more mature, with businesses and customers having more confidence that determination inputs are robustly set, and features such as pass-throughs and incentive mechanisms that deal with future events are appropriately tested and calibrated.

IPART notes that postage stamp pricing is a key feature of its pricing framework, and proposes a 'customer choice' element that allows customers to directly pay for additional service benefits. This appears reasonable although several practical issues would need to be addressed:

- The underlying presumption appears to be that customers are already paying prices at levels that reflect a 'baseline' level of service quality. Our expectation is that the pricing of any regulated entity will involve considerable cross subsidies, such that the willingness to pay for better service will reflect how the individual customer sits with respect to averages. At a minimum, it will be necessary to gauge customer awareness of their existing service entitlements and whether these are being adequately satisfied, relative to what they pay.
- IPART has identified the importance of ring-fencing arrangements and information provision such that customers have transparency on how additional funding is eventually used. The higher administrative burden in policing cost allocation down to fine levels of detail may mean that flexible price service offerings are limited to discrete products, like carbon offsets or smart meters as IPART suggests, as well as fee-for-service type arrangements.
- The most common (and likely important) service outcomes will be less discrete and divisible between customers or customer segments, and so worth better integrating these into the price-quality trade-offs that IPART is also exploring. Businesses should be encouraged to identify innovative cost and service quality

trade-offs when engaging customers in preparation of their proposals. These can be reflected in a deterministic manner, such that customers have a static expectation of what they will pay, and get in return, over the length of regulatory periods. More sophisticated approaches can be accommodated in incentive mechanism payments, ideally based on willingness to pay research, which IPART has already canvassed.

- In exploring incentive mechanisms and revenue adjustments, IPART should also consider the prospects of customers being able to express a preference to accept commitments to lower than average service quality in return for reduced prices. Conversely customers might expect or be entitled to compensation where out-turn performance is worse than minimum or agreed standards.

If you would like to discuss this submission, please contact me on [REDACTED]
[REDACTED]

Regards

Lawrence Irlam
Regulatory Affairs Lead