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18 October 2021

Water Regulatory Review
Independent Pricing and Regulatory Tribunal

Via online submission

Discussion Paper – Encouraging Innovation

Essential Water welcomes the opportunity to provide feedback to the Independent Pricing and Regulatory Tribunal (IPART) on its discussion paper (“the paper”) about how innovation in the water sector could be encouraged.

Innovation in the regulatory framework is intended to foster a greater degree of competitiveness through incentives so that the long term interests of customers are promoted.

As we have stressed throughout this review, the ability to tailor the regulatory framework is particularly important, especially for a water business such as Essential Water who provides an essential service to a small number of customers in a remote and challenging environment.

Our overarching comment about the proposed changes to the framework is of support, but tempered with an acknowledgement that changes may lead to increased costs and risks in the short term as business’ adjust to new requirements. IPART needs to be able to retain a level of flexibility to tailor the framework for the type of business that it is assessing.

Customer focussed

The change of focus so that price submissions need to be more customer-centric is welcomed – it reflects a shift in expectations across many industries. We do have some concerns about the complexity of the gradings, self-gradings of proposals, and bonus allowances – simplification to that process is recommended. Given the inherent challenges in Essential Water’s business model there is some concern that the business is unlikely to be able to attain an advanced or leading grade for any proposal submitted – further clarity on how this will be applied would be welcome.

Essential Water is supportive of the move to a base-step-trend approach for expenditure, however given the small and diverse industry, we acknowledge that there will be difficulties with benchmarking that will need to be worked through.

Innovation funding

Dedicated funding for innovation in the NSW water sector as part of a price reset, is not necessarily warranted. Given that the majority of utilities are government owned it may be more relevant to ensure that grants are available for innovation in the water sector, as required. A key requirement with any innovation funding though, is the sharing of learnings with the rest of the sector.

Incentive schemes

We agree with having a limit on incentive schemes – both a cap and collar effectively. There is merit in being able to exclude significant abnormal items though, such as redundancy payments, otherwise this will affect future baselines. And similarly the mandatory application of incentive schemes is not recommended – there may be genuine reasons that an incentive should not apply (e.g. if a base year is not efficient), and we recommend that IPART retain a level of discretion. The practicalities of assessing and paying out incentives within the regulatory period will need to be clearer. There may also be some benefit in having Nil revenue at risk for the first period of introduction of these new incentive schemes.

The new 3-3-6 model

Essential Water is supportive of the longer six year standard term with a mid-period check point. The mid-period check point allows for an assessment of delivery against plans and if a significant deviation is evident, then a price review can be brought forward. It would be useful to have some parameters set around materiality of deviation and timing for any brought forward price review. Essential Energy has had positive experiences with mid-period checks under previous regulatory frameworks.

The longer reset term does need to a more rigorous cost pass through regime to deal with unforeseen events – we commend IPART look closely at the Australian Energy Regulator’s (AER) framework for this process.

Cost pass-through refinements

Essential Water believes that the refinements to IPART’s cost pass through guideline do not go far enough to provide a utility with a reasonable opportunity to recover the efficient cost of running a water business. If a business is not financially viable, there is a risk that it will not be able to serve customers over the long term.

The requirement to provide the exact detail and potential cost of a cost pass through event in advance is counterintuitive – we believe that the events should be limited to those that are outside of the business control and are unforeseen.

Essential Energy recently experienced significant unfunded costs due to the 2019-20 bushfires – the IPART framework does not allow for these types of costs to be passed through to customers, whereas the AER does. The event was outside of the control of the business (weather related), who had made prudent decisions on risk mitigation (no insurance on poles and wires as insurance premiums excessive). The risk averse position is to insure at a higher overall cost to customer in the long run, rather than relying on charging for such an event only if it occurs.

The AER’s framework provides a level of rigour to the cost pass through process – it also recognises that the type of cost pass through events that are included in the regulations are those that are genuinely outside of the control of the business. Other events that are foreseen but not certain can be either included in robust forecasts or dealt with as a contingent event.

Essential Water strongly recommends that IPART look to amend the IPART Act as necessary to allow unforeseen material costs to be either recovered or returned to customers via a cost pass through mechanism.

Essential Water is happy to discuss these issues further. Please contact our Network Regulation Manager, [REDACTED]

Yours sincerely

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