



public interest
ADVOCACY CENTRE

**Submission to IPART Discussion Paper
Lifting water performance in the water sector**

8 June 2021

About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- Affiliated Residential Park Residents Association NSW;
- Anglicare;
- Combined Pensioners and Superannuants Association of NSW;
- Energy and Water Ombudsman NSW;
- Ethnic Communities Council NSW;
- Financial Counsellors Association of NSW;
- NSW Council of Social Service;
- Physical Disability Council of NSW;
- St Vincent de Paul Society of NSW;
- Salvation Army;
- Tenants Union NSW; and
- The Sydney Alliance.

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Introduction

PIAC welcomes the opportunity to respond to IPART's discussion paper: Lifting performance in the water sector (the Paper). PIAC commends IPART for its approach to this review, including the commitment to increase the scope and impact of engagement with stakeholders through the mix of workshops and written discussion papers.

The benchmark for good practice engagement across the essential services sectors is set higher each year. It is important IPART continues to improve its engagement with stakeholders and the community to keep pace with this change and ensure the decisions of water businesses and regulators understand and respond to the preferences, needs and long-term interests of the community.

This review process comes at an opportune time, with a number of closely related review and reform processes in train. This provides IPART with the opportunity to incorporate the findings and recommendations of these processes and the accumulated lessons of regulators with equivalent roles across Australia and internationally.

The National Productivity Commission recently released a draft report (the Draft Report) as part of its review of National Water Reforms¹. PIAC recommends IPART examine the Draft Report's recommendations and consider their applicability to this review of water regulation. Particular consideration should be given to the expanded objective for water reform and improved principles to guide water policy and regulation to ensure they better incorporate and promote social, economic and environmental priorities.

PIAC reiterates our recommendation IPART develop an overarching objective to inform water regulation and business activities. The discussion in the first two workshops, and the proposals considered in these workshops, indicate the need for an overarching regulatory objective. Specifically, a regulatory objective could:

- Improve the links between Government policy and planning and the ongoing regulation and operation of businesses.
- Help direct a longer-term focus for planning, pricing and operational decisions of businesses.
- Support consistency between IPART and other relevant regulators by providing a common reference point.
- Create a consistent language across regulators, businesses and the community to improve understanding and engagement between all parties.
- Improve the co-ordination between policy, regulation, licencing and pricing.
- Allow for greater flexibility and innovation in approach from businesses where it can be demonstrated that alternatives contribute to the objectives.

We highlight the National Electricity Objective (NEO) as a useful example of the utility of an objective for regulation. Energy market governing institutions are required to support the NEO in

¹ Productivity Commission, ['National Water Reform 2020: Productivity Commission Draft Report'](#) February 2021.

rule-making, regulatory, and operational decisions. Similarly, IPART, or the NSW Government, should seek to legislate or otherwise implement an overarching objective for water regulation, informed by the recommendations of the Productivity Commission. We recommend the objective focus on the long-term interests of consumers and the community with respect to:

- Quality of water sources and the health of the community.
- Sustainability of water systems, and the resilience of water supply, in response to a changing and uncertain climate.
- Valuing and conserving water resources.
- Affordability and equity in pricing and service delivery.
- Efficiency of investment and operation of water businesses.
- Contribution of water to liveability.

PIAC also draws attention to the Victorian Essential Services Commission work in developing improved regulatory frameworks for Victorian water businesses, which were implemented in 2018² and independently reviewed in 2019³. This approach was implemented with 3 key focus areas PIAC regards as relevant to IPART's objective for water regulatory reform, specifically:

- Engagement – businesses must identify the concerns and priorities of their consumers and express their proposals in terms of the outcomes valued and preferred by their consumers.
- Incentives – businesses should be rewarded according to their focus on delivering outcomes sought by consumers, outcomes that accept and manage risks on behalf of communities, and services delivered as efficiently as possible. This was implemented through an incentive framework called PREMO (Performance, Risk, Engagement, Management and Outcomes) which aims to link the rate of return for a business to the ambition of their regulatory proposal and ability to demonstrate delivery on the outcomes preferred by their customers and community. Business proposals were assessed by:
 - Performance – have the performance outcomes committed to by the business (informed by engagement with their community and centred on their preferences) been met or exceeded? This is a backward looking consideration incorporated into forward looking proposals.
 - Risk – has the business sought to allocate risk to the party best positioned to manage that risk, and have they sought to assume or manage risk on behalf of consumers and the community?
 - Engagement – how effective and meaningful was the business's community engagement?
 - Management – is there a strong focus on efficiency? Are controllable costs increasing, staying the same or decreasing?

² Victorian Essential Services Commission, [Water pricing framework and approach: implementing PREMO from 2018](#) (October 2016).

³ Farrierswier, [Victoria's water sector: the PREMO model for economic regulation](#) (28 March 2019).

- Outcomes – do proposed service outcomes represent an improvement, the status quo or a withdrawal of service standards (while still meeting all required minimums)?
- Flexibility – Businesses have flexibility to ensure the pricing approach matches the nature of their business and can effectively deliver outcomes preferred by their customers and community.

This framework determines the level of ambition of proposals, assessing them from basic to leading, after requiring water businesses to offer the same self-assessment, with 'best offers' incentivised. The resulting assessment is used to determine the rate of regulated return on equity for that business.

There is merit in assessing where some of the key principles and mechanisms in this framework may be adapted as part of reforms under consideration in IPART's review. PIAC is not recommending the Victorian framework for adoption as a whole, but commend aspects that are in line with priorities identified by IPART and recommend further consideration.

In the remainder of this submission we respond to the aspects of the Paper and reference where an overarching objective or elements of the Victorian regulatory framework are relevant.

Lifting the performance of the water sector

PIAC supports IPART's focus on lifting performance in the water sector in NSW and welcomes the elements under consideration in the Paper.

We welcome the strengthened recognition of the centrality of the consumer, and the need to ensure that better outcomes for consumers - as determined by them - must be integral to business decisions and how they address the objectives of regulation. PIAC strongly recommends reference to 'the community' be added to this focus, in recognition of the essentiality of water, not only as an essential service, but as a community resource and expectation. Many of the key drivers for operational decisions and service design for retail water businesses are shaped by community expectations, such as those of equity, fairness and universal availability. Businesses must be encouraged to understand and be guided not only by the outcomes sought by consumers they serve, but by the community they service.

The priority focus on risk is welcome. It is appropriate to encourage businesses to focus on managing and minimising long-term risks for consumers and the community. We disagree this should be narrowly expressed as revenue risk to the business. Instead, it should be linked to the objectives of water regulations. Accordingly, the focus should be consumer and community priorities, such as risks to the adequacy, quality, security, sustainability, affordability, equity and resilience of an essential service for the community.

Enabling a long-term focus

PIAC supports measures to encourage a longer-term focus in the operation of NSW water businesses. We consider the role of an overarching objective for water regulation to be a key component of this improved focus. We also note the Victorian regulatory framework's success in

encouraging proposals for longer determination periods and recommend further consideration of aspects of the framework as part of development of proposals in this priority area.

PIAC agrees there should be opportunity for businesses to propose longer determination periods where it can be justified as part of the business's response to deliver preferred consumer and community outcomes. This does not mean the community must express a preference for a longer determination period, as this is unlikely to be a priority consumer concern. However, a business may propose a longer determination period where a longer period is part of a strategy to reduce risks to consumers in the delivery of preferred community outcomes; for instance, by making lower demand assumptions and undertaking a long-term plan to target and reach that demand by the end of the period, while maintaining capped prices for essential services. Longer determination periods could be an acceptable feature of a wider strategy of the business to meet the needs and identified outcome preferences of the community.

We are concerned that IPART's criteria in box 2.1 of the paper does not include any direct consideration for the interests of the community or consumers. A more integrated criteria, such as the Victorian framework, would consider the role of determination length in the assumption and management of risk on behalf of the consumer and community. For instance, a longer determination period could be assessed according to its role in ensuring price stability over the period and include innovative means to link demand assumptions with tariff designs (such as inclining block tariffs), cost recovery, ambitious targets for leakage reduction, usage efficiency or other expressed consumer preferences.

Forecasts are another area where a more nuanced approach should be considered. The existing approach sees the risk of demand forecast inaccuracy borne by the consumer through the operation of a demand volatility adjustment. This undermines the long-term incentive provided by a price cap and places undue risk on consumers and the community, who have no ability to manage that risk in the absence of a forward-looking incentive to use water in a manner that minimises volatility. PIAC recommends IPART consider alternative means to augment the price cap to encourage more innovative responses from business rather than simply 'passing through' the revenue differences caused by demand variation which consumers have little ability to influence.

Standards and trade-offs

Water is an essential service and resource for the community and some foundational standards for quality, safety, affordability, equity, sustainability and reliability apply that are set outside processes that can be traded-off. PIAC agrees there is value in a business being able to use 'optimal' standards and targets to drive innovation and best practice and overcome the tendency for some businesses to regard minimum standards as 'the' standard.

PIAC notes that the setting of targets and higher standards is an area where aspects of the Victorian framework could be employed. Businesses could use engagement with the community to determine a range of preferences and priorities for standards above the minimum and propose innovative means of delivering higher standards. This would provide an opportunity to see where consumers want to drive business improvement in the interest of the community and potentially

accept more innovative and optional pricing (that does not impact essential service pricing) to support achievement of optimum standards.

It may be that as part of longer-term focus and objectives of water regulation to minimise consumer risk, that a business opts to put revenue at risk as part of a target for optimum performance. However, consumers must not carry risk of costs associated with failure to achieve a performance target.

Trade-offs will primarily, but not only, be between outcomes and price. There may be opportunities to deliver price and standards outcomes that matter to the community by trading off and varying aspects of operation that are of less direct interest to the community, but more significant to the business. For instance, a business may propose to assume more risk, setting higher standards for elements of its service where the cost to consumers of doing so does not exceed community willingness to pay. This could, for example, be in the form of a proposal for a longer determination period to achieve outcome targets, with a clear strategy for achievement and demonstration that the business can maintain affordability and predictability of price within the cap for essential services over that period.

Customer choice pricing

PIAC is cautiously supportive of the concept of customer choice pricing. However, any implementation of customer choice pricing must be subject to very clear parameters regarding where it is and is not appropriate. Specifically, customer choice pricing must:

- Not compromise the delivery of an essential water service, or create a premium service offering that undermines the community's expectation of equity in essential water services.
- Be outside or additional to essential service delivery. Any implementation should require a business to demonstrate how impacted consumers and communities continue to receive an equivalent essential service and equivalent price, with equivalent protections.
- Contribute to expressed consumer and community preferences and be able to demonstrate a contribution to outcomes prioritised by impacted consumers and communities.
- Be integrated with other key aspects of the business strategy to reduce risk to the community and meet the overall objectives of water regulation. It should not simply be an exercise in creating 'premium service' offerings for the sake of product differentiation alone.
- Apply only where consumers and communities have explicitly expressed a preference for it, with service offerings that reflect the nature these preferences.

For some businesses, customer choice pricing may have a role in wider measures to assume and manage risk on behalf of the community and consumers, as long as the above criteria are still met.

Method of control

The method of control must align with and respond to the expressed preferences and priorities of the community as determined and validated by meaningful engagement.

PIAC welcomes a fuller assessment of the role the method of control plays in contributing to the priority outcomes and objectives of water regulation. We reiterate the need for IPART or the NSW Government to set an overarching objective for water regulation as framing for selecting the method of control.

There could be greater scope for business flexibility in selection of a method of control that is most appropriate for their particular operation, their chosen strategy for the determination period, and the identified priorities and preferred outcomes of their community.

PIAC highlights the Victorian regulatory framework approach to encouraging businesses to present ambitious proposals that can demonstrate delivery of preferred community outcomes and the assumption of consumer risk. The method of control should be selected as part of the business proposal to minimise the risks borne by individual consumers and provide incentive for the business to incorporate innovative ways to manage key risks for consumers, the community and for itself. PIAC notes consumers and communities often favour measures that seek to reduce or smooth the risk over time.

For businesses that operate residential consumer-facing services, PIAC considers price-caps to be the most appropriate and effective basis for pricing control. It may be that other water businesses providing bulk services and operations could select other forms of control, recognising that the relative risks between bulk water businesses and retail water businesses, and their ability to manage those risks, are more equal.

It is important that the overarching objective of regulation also informs the supporting measures implementing the method of control. For instance, PIAC considers a key objective for businesses is to ensure that risk is managed by those best placed to do so, and where possible to minimise the risk borne by consumers. Application of this objective would preference the selection of a price cap, but would also suggest that a demand volatility allowance is inappropriate, as it transfers demand risk on to consumers and the community when they have less capacity to manage aggregate demand. A more appropriate approach, better integrated with the objectives of regulation and the strategy of the business, may use lower demand forecasts, demand targets, and conservation measures, in conjunction with tariff reforms (such as inclining block tariffs) to better manage risks without transferring them to consumers.

PIAC considers some aspects of IPART's proposed alternative approach have merit and warrant further consideration as part of the suite of measures that a business may implement with a community informed strategy. For instance, PIAC supports the use of a conservative 'low demand' forecasts as the basis for pricing control as it has an aspect of risk management to it and encourages businesses to base cost recovery on low consumption. However, any such approach should be supported by business targets and other measures to meet the assumed demand levels within the price cap and some assumption of risk that demand may be higher. PIAC considers that other measures considered in this submission could be employed in support of this, such as improvements to leakage pricing signals.

Conservation and leakage

PIAC supports improvements to the management of leakages and stronger incentives for conservation and water system efficiency. Mechanisms to reduce leakage and encourage greater conservation should be better integrated with policy, performance standards, and pricing and control methods.

There should be further consideration of the proposal in 6.1 of the Paper to expose the business to a more appropriate 'price' for leakage that reflects the impact upon the community and consumers. PIAC agrees that the real cost of leakage is closer to the actual cost of water delivered to the consumer. Indeed, there is an argument a more accurate cost is up to the full marginal cost of water sourced from desalination. For instance, during the recent extreme drought conditions the desalination plant was responsible for 15-20% of Sydney's water needs; roughly equivalent to leakage rates.

More consideration should be given to how target levels of leakage are set, how the cost of leakage above this level is determined and how both of these settings are integrated with other aspects of regulation and pricing. There is merit considering whether the target level of leakage could be set according to lower system yield assumptions, with the target leakage amount a factor in determining the demand target for the business. That target should ideally assume demand equivalent to drier conditions. With the cost for exceeding this target set according to cost of water for consumers, or the marginal cost of desalination, the business has a strong incentive to meet this target.

If IPART are to adopt aspects of the Victorian framework's incentive for flexibility and ambition in business proposals, there is scope for businesses to set more ambitious long-term targets, where this is an expressed preference of the community. Any such proposal should also come with a business's commitment to assume the revenue or cost risk of not achieving any targets.

Governance and regulatory co-ordination

PIAC supports measures to increase co-operation between regulators. Regulators with impacts on water businesses should act consistently and ensure that the objectives and principles of their decisions and actions are aligned to the greatest degree possible. In any case, it is crucial that the actions of regulators are not in conflict with each other and do not lead to circumstances where meeting the requirements of one or more regulatory framework impacts negatively upon a business's ability to comply with other relevant frameworks.

Implementing a mechanism for improved regulatory alignment, co-ordination and co-operation is an opportunity to do much more than the minimum proposed in the Paper. A regulatory advisory panel (RAP) or similar arrangement, could be an effective mechanism for the development of a coherent objective for water regulation that aligns with strategic water policy and planning, and embeds long-term consumer and community interests across all facets of regulation impacting water businesses. A shared overarching objective would support these outcomes and provide a common reference and language across the varied priorities of the involved entities.

What would be the goals of the Regulatory Advisory Panel (RAP)?

The goals of the RAP would be to develop, implement and support an overarching objective for regulation of water businesses that promotes the long-term interests of the NSW community and affordable, efficient, sustainable, resilient, safe and equitable access to water. The RAP should also seek to improve the effectiveness of co-ordination and communication between regulators, in the interests of achieving the overarching objective. The RAP should seek to ensure that any prospective changes to regulatory frameworks are signalled and consulted on in advance of implementation.

Who might participate in the RAP?

It is vital there is community and consumer stakeholder representation on this body. In some cases, agencies and other bodies can act as a proxy for the interests of the community – for instance seeking to ensure services to the community are safe, environmentally sustainable and provided accessibly and efficiently at a cost that supports affordability. The role of the RAP is to better co-ordinate the actions of regulators in the interests of consumers and the community, therefore, a key contributor to this co-ordinating and communicating role must be consumers and the community themselves. It is not appropriate or acceptable for the perspective of consumers and the community to be translated only through the regulated business, or public consultation processes. The perspectives of consumers and the community have an important role to play at all levels and should be incorporated into the RAP.

PIAC considers it would be appropriate for the RAP to include as key members:

- IPART;
- Department of Planning Infrastructure and Environment (DPIE);
- Office of Local Government;
- Natural Resource Access Regulator (NRAR);
- NSW Health;
- NSW Environmental Protection Agency; and
- Public Interest Advocacy Centre – on the basis that PIAC is funded by the NSW Government to represent and advocate for the interests of NSW households.
- Representative of large-use businesses and/or chambers of commerce.

PIAC's experience in the energy sector demonstrates the value of co-operation and communication between regulators across jurisdictions. There is also merit in allowing opportunities for co-operation with other regulators in other jurisdictions, who undertake similar functions and have a standing invite for them to participate in an 'observer' or 'associate' capacity. This would allow them to participate and add their experience and perspectives to specific conversations by invitation, rather than provide direct recommendations. These could include:

- Essential Services Commission Victoria
- Essential Services Commission South Australia
- Australian Competition and Consumer Commission
- Australian Energy Regulator

Continued engagement

PIAC would welcome the opportunity to meet with IPART and other stakeholders to discuss these issues in more depth.