

# **Submission to the Independent Pricing and Regulatory Tribunal**

**Response to the Second Discussion Paper on the *Special Review on  
Water Pricing and Licensing – Regulating Water Businesses***

***Discussion Paper No. 2 – Promoting a Customer Focus***

**20 July 2021**

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## 1. Introduction

WaterNSW is pleased to submit this response to the Independent Pricing and Regulatory Tribunal’s (“**IPART**”) June 2021 *Discussion Paper on Promoting a Customer Focus* (“**Discussion Paper**”) as part of IPART’s *Special Review on Water Pricing and Licensing – Regulating Water Businesses*.

About every four years, IPART sets the maximum prices that Sydney Water, Hunter Water, the Central Coast Council and Essential Water can charge their customers. IPART also regulates the bulk water charges that WaterNSW and the Sydney Desalination Plant can charge to their customers, and the Water Administration Ministerial Corporation’s (“**WAMC**”) charges for water planning, management and regulation services.

Also every four to five years, IPART also recommends the terms and conditions of the operating licences for WaterNSW, Sydney Water, Hunter Water, and SDP to the Minister for Water. IPART regulates the performance of these businesses by monitoring their compliance against their operating licences each year.

Water utilities are monopoly suppliers of essential services to millions of NSW households. IPART’s regulatory framework aims to ensure the water businesses’ services meet the needs of their customers and the community.

IPART’s stated intent of this review is to identify improvements in how IPART regulates the NSW ‘monopoly’ water businesses, to make the people of NSW better off.

IPART’s proposed focus areas for the review are reproduced in Figure 1 below.

**Figure 1 – IPART’s proposed focus areas for the review<sup>1</sup>**



In May 2021 IPART held a full-day public workshop with stakeholders to discuss how IPART can enhance its approach to promote incorporating customer preferences. Over the course of a day IPART:

- Heard from regulators and customer representatives in other jurisdictions and sectors about [recent changes they have experienced](#);

<sup>1</sup> Ibid. Page 7.

- Heard from some of the utilities IPART regulates about [how the utilities promote a current customer focus](#) and their [future plans to engage with customers](#); and
- Collected stakeholders' views on the [pros and cons of different models](#).

In Discussion Paper 2, IPART has indicated that it has formed preliminary positions on the following matters designed to promote a customer focus:

- IPART has taken a [light-handed approach](#) to customer centricity;
- IPART can [learn from other jurisdictions'](#) varied approaches;
- The [businesses should be responsible](#) for understanding customer preferences;
- IPART to retain a principles-based approach on [providing guidance on how IPART sees 'good' customer engagement](#) but agreed that it can refine its current guidance;
- IPART to focus on [bringing the different elements of a pricing review together](#) to support improved performance and customer outcomes; and
- IPART is considering whether its current [discretionary expenditure framework](#) can be improved considering IPART's intention to move to an outcomes-focused framework.

This submission is WaterNSW's response to Discussion Paper 2 on promoting a customer focus in the water sector.

WaterNSW's original response to the Position Paper put forward the following theme with respect to customer engagement:

- **Customer focus** - A modern regulatory framework should lead to the identification and embedding of what customers value. Businesses should drive the engagement process, while IPART should outline what constitutes effective engagement and be obliged to accept the outcomes from any such process. (*Focus area: promoting a customer focus*)

We also note that other changes have occurred (and are likely to occur) regarding **changes in accounting standards** which could potentially see expenditure previously added to the Regulatory Asset Base (RAB), now treated as operating expenditures (e.g. cloud-based software enhancements). This could result in an under investment in technology inhibiting improved customer outcomes both in terms of customer service and efficiency.

We are encouraged by the focus that IPART is placing on customer centricity and embedding customers preferences in the regulatory framework as outlined in the Discussion Paper and the associated workshop.

The remainder of this submission outlines WaterNSW's response to the specific matters raised in Discussion Paper 2 on promoting a customer focus in the water sector.

## 1.1 Summary of positions

WaterNSW's key comments on the Discussion Paper can be summarised as follows:

- WaterNSW supports IPART on its commitment to moving to **more customer-centric practices** and welcomes the open and transparent approach of this review.
- We have already kicked off an innovative and tailored "**regional kitchen conversations**" program to undertake deeper engagement to position customers and stakeholders at the centre of our planning and the development of our 2025 pricing proposal. The approach leverages off the "Citizen's Jury" methodology used by Yarra Valley Water in its pricing

proposal to the Victorian regulator (ESC-V) in 2018 , which was well received by customers and the regulator.<sup>2</sup>

- WaterNSW supports IPART’s **light-handed approach** to customer engagement. We are focussed on enhanced customer engagement to ensure we achieve the right balance of prices and services and that this forms the foundation of our future determinations.
- IPART is on the right track in its assessment of how to promote a greater customer focus, noting that none of the other jurisdictions have ‘got it 100% right’. IPART can do more to promote a customer focus by providing guidance on:
  - How IPART will **assess effective engagement** (as discussed in Section 3.1);
  - Whether IPART would **ratify proposals** that have been subject to effective engagement; and
  - What **incentives relating to customer outcomes** and engagement requirements will be applied at each determination with sufficient lead-time to address these requirements in the pricing proposal.
- WaterNSW agrees that the **businesses should remain responsible** for engaging with customers to understand their views, priorities and needs, and for the form and content of the consultation.
- We support a **mid-period check-in** (or Framework & Approach stage), but it should not occur in isolation and should be to confirm whether the utility’s engagement program (if followed) would be considered effective by IPART.
- We **do not support grading of proposals** with financial incentives. Without a sufficiently large group of peer companies, the comparisons are likely to be subjective and not meaningful.
- IPART may find value in creating **expert groups** to provide input directly to IPART on its wider functions and special reviews or to report to IPART on our engagement performance. We **do not support** establishing additional **customer ‘challenge’** panels as this would duplicate existing engagement channels at a high cost and is not likely to provide more informed or representative engagement.
- WaterNSW supports providing customers with the **information** they require, but we caution against introducing additional reporting that unreasonably adds to the regulatory burden and the costs of regulation without demonstrable benefit. There is an opportunity for IPART to consider **aligning the price review and operating licence review**, such that a more narrow, but focussed set of customer KPI’s and associated measures are better integrated to support each instrument (i.e. driving the right behaviour, utility performance and customer outcomes, for an efficient cost to the business).
- We would value guidance from IPART on **what constitutes customer preference?** For instance, does support of a project or initiative (e.g. tariff structure reform) require unanimity, consensus, a simple majority or some other measure at a valley level for it to be deemed ‘supported’ by customers and ratified by IPART? We agree that obtaining a consensus view (let alone unanimity) on any reform is unlikely to be practical. Our preference is for a simple majority and the requirement for the utility to demonstrate that the project or initiative aligns to our longer term business strategy as informed by our customers. Guidance on this matter by IPART would help shape our future engagement activities.

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<sup>2</sup> A ‘Citizen’s Jury’ was proposed by Yarra Valley Water to assist to shape future services and prices from 2018 to 2023 in Victoria as part of the Essential Services Commission’s five-yearly Water Price Review with all Victorian water utilities. Yarra Valley Water made a submission to the ESC-V describing the services and outcomes that its customers expect.

## 1.2 Our approach to engagement in 2025

WaterNSW accepts that we can improve our customer engagement and we are committed to providing earlier and more meaningful engagement in the leadup to our 2025 rural bulk water review.

The following points summarise our approach to customer engagement for our 2025 Rural Valleys bulk water determination:

- We have already kicked off an innovative and tailored “**regional kitchen conversations**” program (precursor to possible engagement similar to Yarra Valley Water’s ‘customer juries’ approach) as part of our 2025 determination.
- We are deliberately engaging with a broader and deeper cross section of customers and stakeholders and asking: “**How best can we meet your need for water and services, and what is the fair way to pay for it?**”.
- This deeper engagement will position customers and stakeholders at the centre of our planning and long term goal setting and the development of our 2025 pricing proposal.
- Our aspiration is that a new approach to engagement will result in our customers actively supporting our pricing proposal to IPART in 2025.

WaterNSW invites IPART to join us on this journey.

The following sections address the topics raised by IPART in the Discussion Paper. For convenience, the structure of our response follows that of the Discussion Paper.

## 2. IPART’s current process and what other jurisdictions do

WaterNSW agrees that over the last 5 to 10 years, regulators of water and energy industries have moved to more customer-focussed regulatory practices. These regimes have required the businesses to demonstrate a greater understanding and responsiveness to customer preferences than before, and have offered a range of incentives to facilitate this. A common thread is that businesses are required to demonstrate that their pricing proposals reflect their customers’ views and to evidence how these views have been incorporated.

IPART notes that its process has changed at a slower pace than for other regulators, but that it is committed to moving to more customer-centric practices and using its review process to encourage and support businesses to strengthen their customer focus.

### 2.1 A light-handed approach to customer centricity

IPART states that:

*“Our current approach puts the onus on the utilities to carry out appropriate customer engagement, with limited guidance and input from IPART. The businesses receive tacit feedback through the decisions we make, and the reasons for our decisions, as part of our periodic reviews.”<sup>3</sup>*

IPART notes that its assessments have not put significant weight on customer engagement as it has focussed heavily on the cost efficiency and pricing principles, which include customer preferences (e.g. customer needs and preferences are a factor in the ‘efficiency test’). IPART also cites examples of how customer centricity appears in its current framework, including those listed in the table below:

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<sup>3</sup> IPART, *Promoting a Customer Focus in the Water Sector: Discussion Paper - Special review*, June 2021, p 7.



Aspect of current approach	Description
Utilities responsible for understanding customers' views, priorities and needs	<ul style="list-style-type: none"> <li>▼ The Submission Information Package (SIP) provided by IPART early in the determination process sets out that the businesses should have a 'strong and up-to-date understanding of their customers' preferences.</li> <li>▼ A 'Plain English' summary of proposals is required to help customers engage in a pricing review.</li> </ul>
Customer engagement should be consistent with 5 broad principles.	<ul style="list-style-type: none"> <li>▼ IPART provides a set of principles in its SIP that represents good and effective engagement</li> </ul>
Customer advisory groups	<ul style="list-style-type: none"> <li>▼ Some utilities (i.e. WaterNSW, Sydney Water and Hunter Water) must form and consult with customer advisory groups.</li> <li>▼ Operating licences set out requirements for a charter and group representation. Utilities have discretion on what matters to consult on and the group can also raise issues.</li> </ul>
Customer preferences for service levels part of the efficiency test	<ul style="list-style-type: none"> <li>▼ Customer needs and preferences considered as part of the 'efficiency test', which forms the basis of IPART's expenditure reviews.</li> </ul>
Assess 'discretionary expenditure' proposals (for services / outcomes above regulated standards)	<ul style="list-style-type: none"> <li>▼ Discretionary expenditure occurs when businesses propose a level of service that is not mandated elsewhere. In 2020, IPART developed a framework to assess discretionary proposals for Sydney Water and Hunter Water.</li> </ul>

IPART also indicates that it provides feedback on specific areas where it found customer consultation was insufficient. While citing instances for Sydney Water, Hunter Water, Central Coast Council, IPART also noted the following for WaterNSW:

- The recent Draft Report for WAMC covers some areas where customer engagement should be improved, for instance, where WAMC consulted on service levels but not on the willingness to pay for those service levels; and included a draft decision to re-profile some work to allow for better planning and stakeholder consultation.<sup>4</sup>

WaterNSW accepts that we can improve our customer engagement and we are committed to providing earlier and more meaningful engagement in the leadup to our 2025 rural bulk water review. WaterNSW has already initiated its customer engagement for 2025, commencing with our **'regional kitchen conversations'** program as noted above.

**WaterNSW supports IPART's light-handed approach to customer engagement.** We are focussed on enhanced customer engagement to ensure the services and outcomes customers want (and are willing to pay for) are the foundation of our future determinations.

**Our aspiration is that customers become active advocates of our pricing proposals in our future determinations. We are committed to achieving this outcome.**

While customer engagement has been effective and has increased in prominence over the past two years, WaterNSW accepts the challenge to improve customer centricity in the regulatory setting and offers constructive options for this to occur.

<sup>4</sup> IPART, *Review of Prices for the Water Administration Ministerial Corporation, Draft Report*, March 2021, pp 7, 31.



## 2.2 What we can learn from other jurisdictions

WaterNSW notes the regulatory models flagged by IPART in the Discussion Paper and agrees that much can be learned from successes (or otherwise) from other jurisdictions. The following table summarises a number of customer engagement models applied by other Australian and overseas regulators overseas (draws on information provided in the Discussion Paper):

Regulator	Description
Essential Services Commission Victoria (ESCV)	<ul style="list-style-type: none"> <li>▼ The ESCV introduced a new PREMO framework (standing for Performance, Risk, Engagement, Management and Outcomes) to address several limitations it had identified in its previous regulatory framework.</li> <li>▼ The ESC reviews the business's proposal and provides a rating of 'basic', 'standard', 'advanced' and 'leading'. These ratings, and the extent to which the ESC's assessment differs from the business' self-assessment, informs incentives in the framework.</li> <li>▼ Incentives (or disincentives) include an expedited review process, higher (or lower) returns on equity, comparison versus peer companies.</li> <li>▼ The PREMO approach may have some attraction in a sector where there are a large number of utilities (e.g. the 16 water utilities in Victoria) where the ESCV requires more of a benchmarking approach due to resource constraints and more businesses to compare.</li> <li>▼ It is questionable whether a similar approach is appropriate for the NSW water sector characterised by a much smaller number of utilities with few (if any in the case of WaterNSW) benchmark peers, suggesting more bespoke arrangements targeted to the size and complexity of each determination may be more appropriate.</li> </ul>
Ofwat (UK Office of Water)	<ul style="list-style-type: none"> <li>▼ For the 2019 reviews, Ofwat defined roles of the utilities, customer challenge groups and the regulator. It published a set of principles as well as a grading system that would inform the level of scrutiny it applied to proposals after an initial assessment.<b>Error! Reference source not found.</b></li> <li>▼ Each utility was required to develop a customer challenge group - Ofwat provided some guidance but generally left flexibility in membership and governance.</li> <li>▼ These groups provide independent challenge to the businesses during the proposal development. They then submit a report to Ofwat when the utility submits its proposal, which records their views on the quality of a company's customer engagement; and the extent to which the results of this engagement are driving decision making and are reflected in the company's plan.</li> <li>▼ WaterNSW considers that this approach has some attraction. We are embarking down a similar path for our customer engagement for the 2025 rural bulk water determination.</li> </ul>
Australian Energy Regulator (AER) 'NewReg' Ausnet Services trial	<ul style="list-style-type: none"> <li>▼ AusNet Services (an energy distributor) negotiated elements of its 2021-26 Regulatory Determination with a 'Customer Forum' that consisted of six members with diverse experiences. The scope of negotiations was agreed by the AER, Ausnet and the Customer Forum, but was modified during the process.</li> </ul>

Regulator	Description
	<ul style="list-style-type: none"> <li>▼ The AER provided significant feedback and information during the process to the Forum, but was not bound to accept the negotiated positions but committed to give them 'significant weight' in its review.</li> <li>▼ The AER found that AusNet Services' consumer engagement had been genuine and reflected stakeholder's interests in its revised proposal. This gave the AER more confidence in placing sufficient weight on its top-down technical assessment.</li> <li>▼ The trial process is due for an independent evaluation (after the final outcomes). It is yet to be confirmed if the AER will extend this process or a variant to other businesses it regulates.</li> </ul>
Essential Services Commission of South Australia (ESCOSA)	<ul style="list-style-type: none"> <li>▼ ESCOSA established a negotiated settlement type of arrangement to increase the involvement of customers. It required SA Water to convene a Negotiation Forum.</li> <li>▼ The negotiation process was non-binding, but where issues were successfully negotiated and consistent with ESCOSA guidance, ESCOSA stated it was likely to accept or give significant weight to these when making its determination.</li> <li>▼ In its final determination ESCOSA acknowledged important and material improvements in SA Water's engagement practices, but noted there is always room for improvement in business and regulatory systems. ESCOSA is considering amending the negotiating committee's role to more of a 'challenge' role rather than 'negotiation' role for the next price review.</li> <li>▼ WaterNSW notes that while a negotiated settlement approach to utility regulation may be the 'nirvana' in ensuring customers' views are reflected in a utility's proposal, it is not currently a viable alternative for WaterNSW's rural bulk water business. Separate negotiation processes for 13 valleys given the current 'valley-by-valley' pricing framework makes a negotiation framework for rural pricing impractical in the foreseeable future.</li> </ul>
Water Industry Commission of Scotland (WICS)	<ul style="list-style-type: none"> <li>▼ WICS moved to a 'negotiated settlement' framework for its 2015 price path that involved developing a Customer Forum to negotiate with the utility on behalf of customers. The Forum was not a representative body, but was expected to establish what customer priorities are and to seek to negotiate the best outcomes for customers as a whole.</li> <li>▼ WICS agreed to ratify outcomes that were successfully negotiated, noting WICS had significant input in the process supporting the Forum.</li> <li>▼ While the first review (2015-21 prices) was considered a success, with some ambitious targets agreed, the second review (21-27 prices) was more difficult in an environment of price increases made it more difficult for the parties to agree.</li> <li>▼ WaterNSW notes that WICS sets prices for one Government-owned utility, Scottish Water. The high administration costs and resource requirements for IPART, customers and utilities in NSW (including WaterNSW with multiple determinations) to participate in multiple negotiated settlement processes is likely to render a WICS-type negotiated settlement approach as unworkable in NSW for the foreseeable future.</li> </ul>

In summary, the following observations can be drawn from the regulatory approaches of various regulators as shown in the table above:

- All regulatory frameworks examined (including the IPART framework) have increased focus on promoting effective customer engagement in recent determinations;
- There is a general recognition that businesses (rather than the regulator) should be responsible for understanding customer preferences and to lead the engagement process. This is consistent with IPART's 'light-handed' approach to customer centricity;
- Some jurisdictions (e.g. ESCV and its PREMO approach) have put in place incentives for 'competition by comparison' and financial incentives linked to customer engagement to provide a practical means to conduct determinations for a large number of relatively similar utilities. It is questionable whether a similar approach is appropriate for the NSW water sector that is characterised by a much smaller number of utilities with few (if any) benchmark peers and where more tailored reviews may be more appropriate depending on the scale and scope of each determination;
- In jurisdictions with one large water utility (e.g. in Scotland and South Australia), there is a general trend towards negotiated settlements. While these may be the theoretical 'nirvana' to ensure customers' views are grounded in a utility's pricing proposals, this is likely a 'bridge too far' for the NSW water sector for the foreseeable future due to very high administration and resourcing costs for IPART, customers and the utilities.

The costs are further increased if there are multiple determinations occurring within one organisation (as is the case for WaterNSW with four determinations) or if there are multiple determinations occurring across the sector concurrently (e.g. the Greater Sydney and Hunter Water determinations or the WaterNSW and Essential Water Broken Hill determinations). In these circumstances, there is a significantly increased regulatory burden for IPART, customers and the utilities in participating in the reviews.

The above would suggest that IPART is on the right track in its assessment of how to promote a greater customer focus, noting that none of the other jurisdictions have 'got it 100% right'. We consider, however, that IPART's regulatory framework can do more to facilitate the aim of promoting a customer outcome. For instance, it would be beneficial for stakeholders to have a better understanding of:

- The approach and investment IPART would take in assessing effective engagement. It is important that utilities and customers understand what IPART considers to be effective engagement early in the review process so stakeholders have clarity on what is likely to be accepted by IPART (and what is likely not to be accepted). We support a 'light-handed' approach by IPART, but this cannot be a 'hands-off' approach;
- Whether IPART would ratify proposals that have been subject to effective engagement (e.g. as per the WICS approach as discussed above); and
- What the incentives relating to customer outcomes and engagement requirements are with sufficient lead-time (e.g. two years) prior to lodgement of the utility's pricing proposal to enable the engagement to occur and for the associated services, expenditures and prices to be developed in time to be incorporated in the pricing proposal.

### **3. The business should be responsible for understanding customer preferences**

In its Discussion Paper, IPART states that its current approach emphasises that each business is responsible for understanding their customers' preferences and responding to these in their business planning and operations. IPART states that this approach will remain the case going forward, given that the businesses remain best placed to reach out to their customers, hear feedback and design their systems and operations to respond to their preferences.

WaterNSW agrees that the businesses should remain responsible for engaging with their customers to understand their views, priorities and needs, and for the form and content of their consultation. As we have direct contact with our customers and strive to be customer centric, we are best placed to manage these interactions.

We agree that customer engagement should inform our decisions and pricing proposals and that businesses should be able to demonstrate to IPART and other stakeholders how they have achieved this at the time of their pricing proposal.

As mentioned in Section 2.2 above, WaterNSW seeks clarity from IPART as to what constitutes effective engagement and how IPART assesses this in the lead up to making a final determination. This is to ensure a ‘no surprises’ approach is in place so that stakeholders have confidence that if effective engagement has been undertaken there is a high degree of certainty that the proposed outcomes would be ratified by IPART in the determination.

IPART has indicated that, to encourage the businesses to effectively deliver customer outcomes, the following two enhancements the current framework are put in place:

- A mid-period ‘check-in’; and
- A ‘grading system to evaluate how well the businesses’ proposals meet the long term interests of customers.

These proposed enhancements are discussed below.

### **3.1 Mid-period check-in**

IPART considers that one simple change to the current process would be to have a mid-period ‘check-in’ with each business. IPART first raised this in its first Discussion Paper as a strategic meeting occurring about halfway through a determination period between the regulator and the utility, and possibly a Regulators Advisory Panel. The aim would be to promote a long-term focus by encouraging the business to develop and present robust plans earlier in the process.

At this check in, a business could talk through its plans for the next determination period, test its assumptions, and seek IPART’s feedback. IPART also indicates it could offer the option for, or require, the businesses to submit a customer engagement strategy that would inform engagement for the next pricing proposal.

IPART considers that the main benefit of the check in is that IPART could provide feedback if there were obvious omissions that could impact final outcomes, and IPART could respond to any difficulties that the business might be having. IPART suggests it would aim to maintain a ‘hands-off’ approach and not look to provide any ‘approval’ of the engagement strategy.

WaterNSW supports the concept of a mid-period check in that is consistent with IPART’s discussion in the first Discussion Paper on adding a step around the halfway point between reviews to engage with the business on its strategy and high level planning for the upcoming review period.

Obtaining feedback on whether there are any “obvious omissions that could impact final outcomes” is an important piece of information for the utility to know early in the proposal preparation phase so that these omissions can be addressed.

WaterNSW generally supports IPART taking a “light-handed” approach. However, we suggest that IPART provide clarity on the following matters to ensure engagement is targeted and achieves its desired outcome of ensuring customer preferences are the foundation of a utility’s pricing proposal:

- What constitutes effective engagement and what role will IPART play in establishing this in the lead up to the pricing proposal being developed?
- If effective engagement can be demonstrated, should IPART be required to ratify the proposed outcomes?

WaterNSW therefore suggests that IPART provides a set of principles outlining what it considers effective engagement to be and that IPART commits to accepting the outcomes from any engagement process that is demonstrated to be effective. This is discussed further in Section 4.

In our response to Discussion Paper 1, WaterNSW suggested that IPART introduce a “Framework and Approach” (“F&A”) process similar to the AER’s F&A process<sup>5</sup> prior to lodgment of the initial pricing proposals at each major pricing review.<sup>6</sup> While this F&A process and subsequent report would be non-binding, it would provide considerable guidance to stakeholders prior to the lodgment of the pricing proposals and assist in focusing on key fundamental aspects of the upcoming review.

The F&A process is the first step to determine efficient prices with the F&A facilitating early public consultation on key topics to encourage efficient expenditure. The approach to assessing effective engagement could be addressed as part of the F&A process.

WaterNSW is supportive of a mid-cycle check-in, noting we prefer a more formal “F&A” step earlier in the process to provide more clarity of key elements of the upcoming review to all stakeholders.

***In any case, we consider that a mid-period check-in is likely to be too late in the determination preparation process, as (if this occurs after the second year of a four-year determination period), it would provide only 12 months for WaterNSW to engage (or re-engage) with customers depending on the outcomes of the check-in.***

Following this engagement (or re-engagement) after the check-in, WaterNSW would then need to:

- Finalise the proposed services to meet customers’ preferences;
- Develop the expenditure programs to efficiently deliver these services; and
- Calculate the revenue and pricing outcomes to recover the efficient costs of delivering the services.

To undertake the above steps and then to incorporate the outcomes into a pricing proposal to be lodged within a few months (so that the proposal is lodged 12 months before the new determination takes effect) suggests a timeline that is too constrained.

***We propose that confirmation of whether the utility’s engagement process is likely to be deemed effective by IPART should occur 24 months prior to the lodgment of the utility’s pricing proposal*** (i.e. after the first year of a four-year determination period) to provide sufficient time to implement any changes and incorporate customers’ preferences into the pricing proposal.

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<sup>5</sup> See the AER’s F&A paper for TransGrid’s 2023-28 determination at <https://www.aer.gov.au/system/files/AER%20-%20TransGrid%20Framework%20%26%20Approach%20-%20Decision%20to%20Amend%20-%20December%202020.pdf>.

<sup>6</sup> See WaterNSW response to IPART Discussion Paper 1, pg X.

### 3.2 Grading the proposal against how it meets customers' long-term interests

In the Discussion Paper, IPART provides examples from the ESCV PREMO approach:

- Under these systems, the utilities self-assesses how well they meet the key principles – which would consider customer centricity alongside other markers of a good quality proposal (e.g. evidence of cost efficiency over the life-cycle of assets). Guidance on each principle is provided by the regulator – with a “rubric” (i.e. a set of instructions or rules) setting out expectations of the businesses at different grades, and test questions to guide this self-assessment.
- The proposals are then judged by the regulator on how well they meet the key principles, with an overall score, or grade. For example, the ESCV grades the quality of the pricing submissions as to whether they are ‘leading’, ‘advanced’, ‘standard’ or ‘basic’.

The business’s self-assessment and the regulator’s grading are used to inform a range of financial, reputational and administrative incentives (e.g. one incentive is to provide a higher rate of return for a leading proposal compared to a standard one).

WaterNSW acknowledges that there may be other benefits of assessing customer centricity (e.g. scope for incentive mechanisms or tailoring the questions or focus of the expenditure review). However, we do not support financial incentives and the grading of proposals that are based on arbitrary and subjective measures and without a sufficiently large group of peer companies to make any comparisons meaningful.

## 4. The guidance provided by IPART

In the Discussion Paper, IPART correctly acknowledges that the businesses have asked for more guidance about how IPART sees ‘good’ customer engagement. To date, IPART’s guidance has generally been high level and principles based, with some additional specific assessments contained in Final Reports.

IPART has stated the following regarding the guidance it currently provides:

*We agree that we can refine our current guidance. We intend to retain a principles-based approach in doing so. This would need to allow flexibility for each business to develop proportionate approaches to their unique operating environments and promote innovative approaches to reveal customers’ preferences. Setting overly prescriptive requirements could encourage the regulated business to only meet regulatory requirements, which may not be in the interests of customers.<sup>7</sup>*

IPART indicates that it intends to “stretch the focus of the framework to include explicitly the way customer’s views are reflected in business decisions and in the pricing proposal”. IPART would be looking for evidence that the businesses have responded to the information they discovered during the engagement process. This step is not adequately covered by the existing principles.

IPART’s preliminary view is that this evidence could be captured by the following four new principles:<sup>8</sup>

1. Business decision-making processes should appropriately integrate the outcomes identified through customer engagement;

<sup>7</sup> IPART, *Promoting a Customer Focus in the Water Sector: Discussion Paper - Special review*, June 2021, p16.

<sup>8</sup> *Ibid*, p18.



2. The pricing proposal should clearly demonstrate links between customer preferences and the proposed service levels and projects;
3. (In some cases, this might mean a change in services, but not always. Many actions the businesses undertake may already align with customers preferences. However, when this is confirmed or otherwise, it should be clearly explained with evidence provided.)
4. The business should develop clear and measurable customer-driven outcomes and appropriate monitoring processes.

While we generally support the inclusion of the above three principles into IPART's current principles for effective engagement, we consider that additional guidance is required to provide clarity on how IPART will assess the outcomes from the engagement process. We consider that guidance by IPART would assist in meeting the overarching outcome of promoting a greater customer focus.

While WaterNSW is generally supportive of IPART's proposed "light-handed" approach, it would be beneficial for stakeholders to have a greater understanding of:

- How IPART will assess effective engagement. It is important that utilities and customers understand what IPART considers to be effective engagement early in the review process so stakeholders have clarity on what is likely to be accepted by IPART (and what is likely not to be accepted). We suggest that IPART is present during the engagement process as an observer, so that it is informed when assessing effective engagement ;
- Whether IPART would ratify proposals that have been subject to effective engagement (e.g. as per the WICS approach as discussed above); and
- What incentives relating to customer outcomes and engagement requirements will be applied with sufficient lead-time (e.g. two years) to include in the pricing proposal. This is to enable engagement to occur and for the associated services, expenditures and prices to be developed in time to be fully addressed in the pricing proposal.

WaterNSW agrees with IPART that, in practice, the quality of customer engagement would fall along a spectrum of quality that depends on the characteristics of each business's customer base, shifting over time as engagement practices evolve and improve.

## 5. Customer advisory or negotiation groups

IPART suggests that customer representative groups or customer panels could promote a better understanding of customer preferences, and promote a better reflection of these preferences into the businesses' regulatory proposals and IPART's decisions. IPART sought feedback, including at the recent workshop, on the role that customer advisory representative groups could take in our process and received mixed responses.

### 5.1 Are the current advisory groups fit-for-purpose?

IPART is seeking feedback on how well current customer advisory groups support the long-term interests of customers. That is, whether they accurately represent preferences across the customer base and whether they provide an effective discipline for the businesses to deliver and behave in a way that meets the needs of customers, particularly vulnerable and non-English speaking customers.

IPART correctly points out that three businesses already maintain customer advisory groups with varying requirements and constitutions. WaterNSW has a regulatory requirement through our Operating Licence to consult with our customers. Sydney Water and Hunter Water have



requirements to consult with their customers, with additional specific requirements added in the Operating Licences.

WaterNSW's ten customer advisory groups (“**CAGs**”) are established from our Operating Licence requirement, and governed by a CAG Charter outlining the group's role, membership criteria, and roles and responsibilities of the members and the business. We have applied best endeavours to include at least one member from a range of customer ‘categories’.<sup>9</sup> CAG meetings occur regularly (minimum of but not limited to three times annually; 30 valley specific meetings) and are timed to meet the requirements of the CAG members (e.g. not impacting rural members during harvest season).

The CAGs are a valuable forum whereby in-depth interactions take place with WaterNSW and its customers and robust discussion is encouraged. Customers regularly contribute topics for discussion on a range of water-related matters specific to the performance of WaterNSW services delivered to customers. A standing invitation to the CAG meeting is extended to NRAR and DPIE-W, who regularly attend, to present on topics related to their own activities that may affect customers.

IPART has previously commented that CAGs generally represent the engaged and water-articulate medium to large irrigator, LGAs and Environmental customer. Although this is an important and valued group, it is not fully representative of the WaterNSW customer base. The role of the CAGs could be enhanced through an additional engagement method that reaches beyond the CAG membership to include users of the groundwater community, unregulated customers and other smaller users (who make up the largest number of customers in our customer base).

WaterNSW has recognised the need to gain greater involvement from these segments, and has recently launched our **kitchen conversation** program as discussed earlier. Starting with the CAG community, we are extending a deliberative engagement approach to start a conversation feeding into the 2025 Pricing Determination preparation, giving a wider community across NSW the opportunity to get involved.

This approach shares four challenges and trade-offs that contribute to our cost base and ultimately customer prices (via IPART), and asks water users to consider some information (authored by WaterNSW and water market stakeholders) and then share an informed comment. We anticipate this approach will assist us in understanding a broader range of our customer base, and identify a prioritised list that our customers believe WaterNSW should devote time and resources to.

## 5.2 Options to amend or enhance customer groups

IPART is considering whether these CAGs could be amended or added to, or whether the businesses planning and our review process would be enhanced by additional expertise.

For instance, IPART has canvassed:

- Whether it would be beneficial for a customer representative group to report directly to IPART with its views on the pricing proposal and the degree to which it reflects customers preferences or whether the current option for members to make a submission sufficient?

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<sup>9</sup> For Water NSW, the customer categories stipulated in our Operating Licence are stock and domestic water users; regulated river water users; unregulated river water users; groundwater users; environmental water users; industrial and commercial water users; Local Water Utilities; major utilities; volumetric categories of water users (small/medium/ large); Aboriginal cultural heritage water users.

- Do members receive sufficient information and time to present the views of their community?

As an alternative to amending the current customer advisory groups, IPART asks whether a separate group could sit alongside these groups. This could include members with expertise in the water industry, market or social research, who could work to challenge the business in a more technical manner to understand and address customers' needs and preferences. This could be constituted in the lead-up to proposal development for a time-limited period while the existing groups remain on-going.

WaterNSW notes that the energy sector has been particularly active in introducing various customer representative bodies and customer groups or panels as part of the determination and wider review processes. Some of these bodies are identified in the table below:

Consultative Body	Description
<b>Energy Consumers Australia (ECA)</b>	<ul style="list-style-type: none"> <li>▼ (ECA is a consumer advocacy body established in January 2015 as an initiative of the COAG Energy Council.</li> <li>▼ ECA promotes the long-term interests of consumers with respect to the price, quality, safety, reliability and security of supply of energy services.</li> <li>▼ It conducts research and analysis, identifies issues and works with other consumer organisations, ombudsmen, energy companies, regulators and governments to improve outcomes for consumers and aims to be the national voice of residential and small business energy consumers.</li> <li>▼ In FY2020, ECA had a significant operating budget of approximately \$8 million funded through an industry levy collected by AEMO.</li> </ul>
<b>NewReg Trial</b>	<ul style="list-style-type: none"> <li>▼ Consisted of the selection a six member customer forum that reported to the AER.</li> <li>▼ Members were selected based on their expertise (not on the basis of being representative of the customer base), and tasked with seeking out and representing diverse customers' views in negotiation with the utility (Ausnet).</li> <li>▼ The trial was resource intensive and while there were some positive outcomes, the results of the trial have yet to be assessed or adopted for future reviews.</li> </ul>
<b>Consumer Challenge Panel (CCP)</b>	<ul style="list-style-type: none"> <li>▼ The inaugural (CCP) was established in July 2013 as part of the AER's Better Regulation reforms.</li> <li>▼ The CCP was developed to assist the AER to make better regulatory determinations by providing input on issues of importance to consumers.</li> <li>▼ The expert members of the CCP are appointed to bring consumer perspectives to the AER to better balance the range of views considered as part of its decisions.</li> <li>▼ The AER is not obliged to act on the views expressed by CCP members, but will give due weight and consideration to the advice provided.</li> </ul>
<b>Customer Reference Group (CRG)</b>	<ul style="list-style-type: none"> <li>▼ A CRG was established by the AER for the 2020 Inflation Review and the 2022 Rate of Return Instrument. The group was designed to play a critical role in representing the perspectives and interests of consumers in these review processes.</li> <li>▼ The role of the CRG during these reviews is to provide independent advice to the AER on its consumer engagement and to actively engage with consumers themselves and provide AER with its insights.</li> <li>▼ The AER is not obliged to act on the views expressed by CRG members, but will give due weight and consideration to the advice provided..</li> </ul>

Consultative Body	Description
<b>Customer Consultative Group (CCG)</b>	<ul style="list-style-type: none"> <li>▼ The CCG provides advice to the AER in relation to AER’s functions under the energy laws affecting energy consumers across participating jurisdictions.</li> <li>▼ The inaugural CCG was appointed in 2009 to enable informal consultation on the development of retail guidelines and to assist the AER in developing an understanding of retail issues prior to the commencement of the National Energy Retail Law and Rules in relevant jurisdictions on 1 July 2012.</li> <li>▼ By providing advice on the above issues, members assist the AER in carrying out its functions under the national energy legislation.</li> </ul>

Energy Consumers Australia is a standalone organisation established by the Council of Australian Governments to be the national voice of residential and small business energy customers that is funded by an industry levy. A similar body does not exist in the NSW water sector, thereby resulting in a potential gap in advocacy that is required to be filled by the utilities and IPART.

WaterNSW considers that IPART may find value in creating expert groups such as the AER’s Customer Reference Group and the AER’s Customer Consultative Group to provide input directly to IPART on its wider functions and special reviews. WaterNSW notes that a key aspect of these groups is that the AER is not obliged to act on the views expressed by group members, only that it will give due weight and consideration to the advice provided. We encourage IPART to discuss with the AER the value of establishing these groups.

Regarding the Customer Challenge Panel, WaterNSW considers that there is limited benefit to be gained by introducing another engagement body into the determination process and that customers (and the utilities) may experience consultation fatigue if the requirements become duplicative and too onerous. WaterNSW considers that the current CAG process, supplemented by our ‘customer conversations’ and other bespoke engagement processes are sufficient to ensure customer preferences are identified for including in a pricing proposal.

### 5.3 Tailoring the approach to different businesses

In its Discussion Paper, IPART indicates that the role of customer groups could be partially addressed by IPART’s proposed mid-cycle check-in (e.g. after the second year of a four-year regulatory period), in advance of the next regulatory review. IPART suggests that the customer engagement plan provided by the business at this point could outline how the various elements of its strategy - including customer groups and advisory panels – would deliver a better understanding of customer preferences. This approach would give sufficient flexibility to the businesses to:

- Tailor the scope and depth of customer engagement to the needs and preferences of their customers; and
- Encourage more innovative approaches to reveal preferences, including potential scope for negotiated outcomes between the customer and the business to be accepted by IPART.

IPART suggests that the strength of the plan – including the level of autonomy given by the utility to empower its customers to decide elements of its pricing proposal – influences the role of the regulator as a decision-maker, and the level of independent verification IPART requires (either in advance of, or during the pricing and expenditure review processes).

WaterNSW's views on tailoring the approach to different businesses is outlined in Section 5.1 and Section 5.2 above.

## 6. Incorporating preferences and measuring outcomes

IPART seeks stakeholder views on how outcomes from customer engagement would be incorporated into the determination process, including the weight they would be given in regulatory assessments such as incentives tied to customer engagement.

IPART states that incorporating these preferences and incentives is part of the third 'stream' of its review and will be addressed in its third Discussion Paper on incentives. WaterNSW will comment on any such incentives at that time.

Regarding the tracking of outcomes, WaterNSW notes that each of our four regulatory determinations contains a suite of 'output measures' that are focused on the key elements of IPART's decision. Including a customer engagement output measure(s) may be a useful inclusion in future decisions.

### 6.1 Assessing customer centricity

IPART is considering the option of grading how well proposals reflect the long-term interests of consumers. This would provide a way to:

- Track performance changes over time; and
- Connect different levels of performance to different incentives.

As outlined in our response in Section 3.2, WaterNSW acknowledges that there may be benefits of assessing customer centricity (e.g. scope for incentive mechanisms or tailoring the questions or focus of the expenditure review).

However, we do not support financial incentives and the grading of proposals that are based on arbitrary and subjective measures and without a sufficiently large group of peer companies to make any comparisons meaningful. The lack of benchmark peers for WaterNSW has been well established in IPART expenditure reviews and also holds for our customer engagement activities.

Our customer base varies across determinations (from a handful of direct customers in Greater Sydney and for users of the Broken Hill Pipeline) to thousands for Rural Valleys and WAMC services. Comparing our engagement for four very different determinations to the Sydney Water, Hunter Water, Central Coast Council, Essential Water and SDP determinations (the water utilities regulated by IPART) would likely not produce meaningful engagement results. This is due to the small number of comparison firms, none of which compare directly with the services we provide and therefore our customer bases.

Rather, we support tracking our own performance over time as this is likely to produce better and more targeted outcomes for our customers recognising our specific circumstances.

### 6.2 Tracking and publishing outcomes

IPART states that it is also drawn to reputational incentives. These can be used in various ways; however, one simple approach would be to track outputs, and hold businesses to account by publishing performance against them.

IPART notes that, to some degree, it already does this. For example, IPART publishes licence

audit reports and the results of quarterly satisfaction surveys as well as its periodic pricing reviews.

However, IPART considers there is value in developing a more customer-focussed reporting scheme. This could involve:

- An annual collection of customer outcome data including measures of customer satisfaction, complaints data, and bespoke measures for each utility. These could be collected through a random annual survey, as well as utility data and other sources; and
- Publishing the results in an easily accessible format, such as on a simple webpage or included as part of the customer's bill. This would allow customers and other stakeholders better access to the business's ongoing performance and to monitor improvements.

WaterNSW notes that IPART already collects information on performance against output measures that it sets in each of its determinations as highlighted above. As this information is generally not suitable for public disclosure, there may be an opportunity to develop a more customer-focussed reporting scheme.

WaterNSW also has an extensive array of customer measures that we are required to report on through our Operating Licence Reporting Manual. The Reporting Manual is a 49 page document that outlines all of WaterNSW's reporting requirements under the Licence and it is a condition of WaterNSW's Licence that it must comply with the reporting obligations set out in the Reporting Manual.<sup>10</sup> This Reporting Manual identifies:

- When Water NSW must report;
- What information WaterNSW must report;
- To whom WaterNSW must report, and
- How WaterNSW must report.

WaterNSW considers that there are greater parallels with our operating licence obligations, the Reporting Manual and the large number of customer metrics and measures we have to monitor and report against. There is an opportunity for IPART to consider aligning the price review and operating licence review, such that a more narrow, but focussed set of customer KPI's and associated measures are better integrated to support each instrument (i.e. driving the right behaviour, utility performance and customer outcomes, for an efficient cost to the business).

While WaterNSW would be generally supportive of reporting that provides customers with the information they require, we caution against introducing additional reporting requirements without reducing other reporting requirements (and ensuring the information is not already published elsewhere) in order to not add to the regulatory burden and the costs of regulation that ultimately are borne by the business and its customers.

If there are to be increased reporting to meet regulatory requirements, we would expect that these costs are included in the efficient costs of the utility at each determination.

IPART notes that it is also considering a range of financial incentives. IPART has a view that these should be symmetrical, providing a penalty for underperformance as well as a reward for delivering a better long-term outcome to customers. As financial incentives are ultimately borne

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<sup>10</sup> IPART Water NSW Reporting Manual Operating Licence 2017-2022.

<https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/investigation-working-papers-water-reporting-manuals-all-public-water-utilities/reporting-manual-waternsw-operating-licence-2017-2022-%e2%80%93-july-2018.pdf>

by customers, their use should be carefully balanced with real improvements and customer expectations. IPART indicates that it will explore these in greater depth in its third Discussion Paper. WaterNSW will respond to these matters at that time.

## 7. Discretionary expenditure and defining customer support

IPART describes 'discretionary expenditure' as expenditure on services that go beyond the utilities' mandatory services. IPART may allow recovery of the costs of additional discretionary projects via regulated prices subject to clear evidence that it would be efficient and beneficial for customers to pay to exceed mandated standards.

For instance, IPART would consider whether:

- The proposal best fits with the business's responsibilities or whether it would better fit with another party's responsibilities; and
- Customers have the capacity and willingness to pay for the discretionary expenditure (based on information or evidence the businesses provide).

In 2020, IPART developed and implemented a framework to assess discretionary expenditure proposals for Sydney Water and Hunter Water. The framework sets a high bar for evidence of customer willingness to pay and sets out mechanisms to ensure transparency and accountability.

IPART states that the current discretionary expenditure framework creates a risk of projects being developed on an ad hoc basis rather than considered as part of a package with other expenditure projects. IPART also found that some of the projects it reviewed in 2020 had too great a focus on a specific engineering solution rather than customer outcomes.<sup>11</sup>

WaterNSW has not proposed 'discretionary' projects to date in its regulatory proposals. This is a result of several factors, including:

- The nature of our bulk water business (in Greater Sydney) did not lend itself particularly well to implementing discretionary projects for Sydney Water or councils;
- For our rural customers who have experienced drought, flooding and a global pandemic over the past few years, identifying discretionary projects that would increase the cost of water has to date not been our top priority. WaterNSW has been primarily focused on becoming more efficient and putting downward pressure on water prices in recognition of affordability concerns for our customers and the community.
- The high regulatory 'hurdle' to demonstrate, amongst other things, customers' willingness to pay for the project. In the majority of instances that we face, discretionary projects affect multiple customers and obtaining unanimity on a particular outcomes is often difficult if not impossible due to the diverse makeup of our customer base.

### 7.1 Defining customer preference at a valley level

While WaterNSW has not proposed discretionary projects to date, we have experienced instances where we have not obtained IPART approval for an initiative due to lack of clarity around what defines a 'customer preference'.

For instance, in the leadup to the 2017 rural bulk water determination, WaterNSW had undertaken detailed discussions with our rural valley customers on potential tariff structure

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<sup>11</sup> IPART, *Promoting a Customer Focus in the Water Sector: Discussion Paper - Special review*, June 2021, p25.



changes, where some reforms that we considered 'agreed' were not ultimately accepted by IPART.

For example, a proposed change to tariff structures in the Lachlan valley was not accepted by IPART in 2017 due to concerns over the following:

*"In our Draft Report, we sought comment on what set of requirements would need to be satisfied for a change to a valley's tariff structure within a determination period. That is, what should be required to allow a valley to opt out of one schedule of regulated prices (eg, determined on a 40:60 fixed to variable ratio) and opt into another schedule of regulated prices (eg, determined on an 80:20 fixed to variable ratio).*

*Specifically, we asked:*

- To apply an 80:20 fixed to variable price structure to a valley, would 100% of customers in that valley need to express written support for the change, or would a majority suffice? If a majority would suffice, then would a majority be based on number of customers or the volume of entitlements in that valley? If based on entitlements, should HS entitlements receive greater weighting? Or*
- Would it be reasonable to apply an 80:20 fixed to variable price structure if all the members of a Customer Service Committee (CSC) for the valley were in support, or would majority support be sufficient? Under this, we would expect that all customers in the valley would at least need to be informed of the potential change."*

...

*"While we support the principle of providing customers with choice, we have concerns on how to effectively implement choice at the valley level (ie, the tariff structure would apply to all customers in the valley regardless of their individual preferences). Given the mixed views on what would be a reasonable basis upon which WaterNSW could apply different tariff structures to a particular valley, we have decided to not allow choice at a valley level within the 2017 determination period.*

*We note that it is unlikely to be practical to achieve consensus in a valley to determine a different tariff structure for the whole valley. We also note that WaterNSW's initial proposal for enabling tariff choice at the valley level was a 'stepping stone' to introducing tariff choice at the 'individual' customer level as part of the 2021 Determination."<sup>12</sup>*

We agree that obtaining a consensus view (let alone unanimity) on any reform is unlikely to be practical. Our preference is for a simple majority and the requirement for the utility to demonstrate that the project or initiative aligns to our longer term business strategy as informed by our customers.

However, we note that this matter has not been resolved and uncertainty remains as to "implementing choice at a valley level" moving forward for the rural valleys. Gaining clarity on what constitutes customer preference for matters such as tariff reform (e.g. a simple majority, consensus, unanimity or some other measure) would be helpful to guide our engagement activities.

This would assist in identifying the types of projects or initiatives that may be reasonable candidates to meet IPART's threshold to demonstrate a customer preference. It would also provide a useful measuring stick to identify early on whether initiatives will have a reasonable opportunity to meet the approval test before too much time and resources are committed by the business and our customers and to 'weed out' those initiatives that are unlikely to pass.

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<sup>12</sup> IPART 2016 *Review of prices for rural bulk water services from 1 July 2017 to 30 June 2021*, Pages 121-122.