

Submission to the Independent Pricing and Regulatory Tribunal

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

Discussion Paper No. 1 - Lifting performance in the Water Sector

8 June 2021



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1. Introduction

WaterNSW is pleased to submit this response to the Independent Pricing and Regulatory Tribunal's ("IPART") 3 May 2021 *Discussion Paper on Lifting Performance in the Water Sector* ("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 review¹



In the first Discussion Paper, IPART has indicated that it has formed preliminary positions on the following matters designed to lift performance in the water sector:

¹ Ibid. Page 7.

- [Support longer determination periods](#) to promote ongoing engagement and long-term planning, provided there is credible evidence that these proposals are in the best long term interests of customers;
- Develop a framework for [customer choice pricing](#) to allow for a personalised service where it would deliver a win-win for the customer and the business;
- Provide the option for businesses to [propose different forms of price controls](#) (including a revenue cap);
- Introduce a [shadow price for leakage](#) to encourage efficient water conservation; and
- [Establish a Regulators Advisory Panel](#) to promote information sharing and better regulatory decisions

In addition, IPART indicated it has not formed a preliminary view about:

- How best to [align pricing decisions and performance standard setting](#) to enable businesses to make trade-offs between the two; and
- Whether to [set performance standards at minimum levels or optimal levels](#) to ensure ongoing performance by businesses

This submission is WaterNSW's response to first Discussion Paper on lifting performance in the water sector.

1.1 Background – Who we are

WaterNSW was formed on 1 January 2015 under the *Water NSW Act 2014*, effecting a merger of the Sydney Catchment Authority (“**SCA**”) and State Water Corporation (“**SWC**”), creating a centre of excellence for raw water supply and the development and delivery of raw water infrastructure solutions for all of NSW. WaterNSW is Australia's largest water supplier and is the major supplier of raw water in NSW, delivering raw water from 42 large dams, pipelines and the State's rivers.

WaterNSW ensures that the water supplied is reliable and, where that water is to be used by end-use customers for drinking, that it is safe. We develop water infrastructure solutions to improve water security and proactively manage reliability issues and then plan, develop, operate and maintain that infrastructure.

WaterNSW also promotes improvements in achievable water quality standards and contributes to the protection of public health and the environment through enhanced catchment protection practices in declared drinking water catchments.

In the Greater Sydney area, our role is to protect 16,000 square kilometres of drinking water catchments, and manage dams, pipelines and other infrastructure that are used to supply customers with quality raw water. WaterNSW supplies raw water to urban water utilities for treatment and then consumption by Sydney, Illawarra, Blue Mountains, Southern Highlands and Shoalhaven communities. Our customers include Sydney Water, Wingecarribee Shire Council, Shoalhaven City Council and Goulburn-Mulwaree Council. WaterNSW also provides raw and unfiltered water supply to over sixty other smaller customers.

In rural NSW, WaterNSW maintains, manages and operates major infrastructure to deliver bulk water to licensed water users on the State's regulated rivers. There are approximately 6,300 customers in 14 regulated river systems. WaterNSW owns and operates 20 dams and more than 280 weirs and regulators to deliver water for town water supplies, industry, irrigation, stock and domestic use, riparian and environmental flows. We plan, investigate and develop water

infrastructure solutions to water security and reliability issues and then operate and maintain that infrastructure.

1.2 Legislative framework and pricing determinations

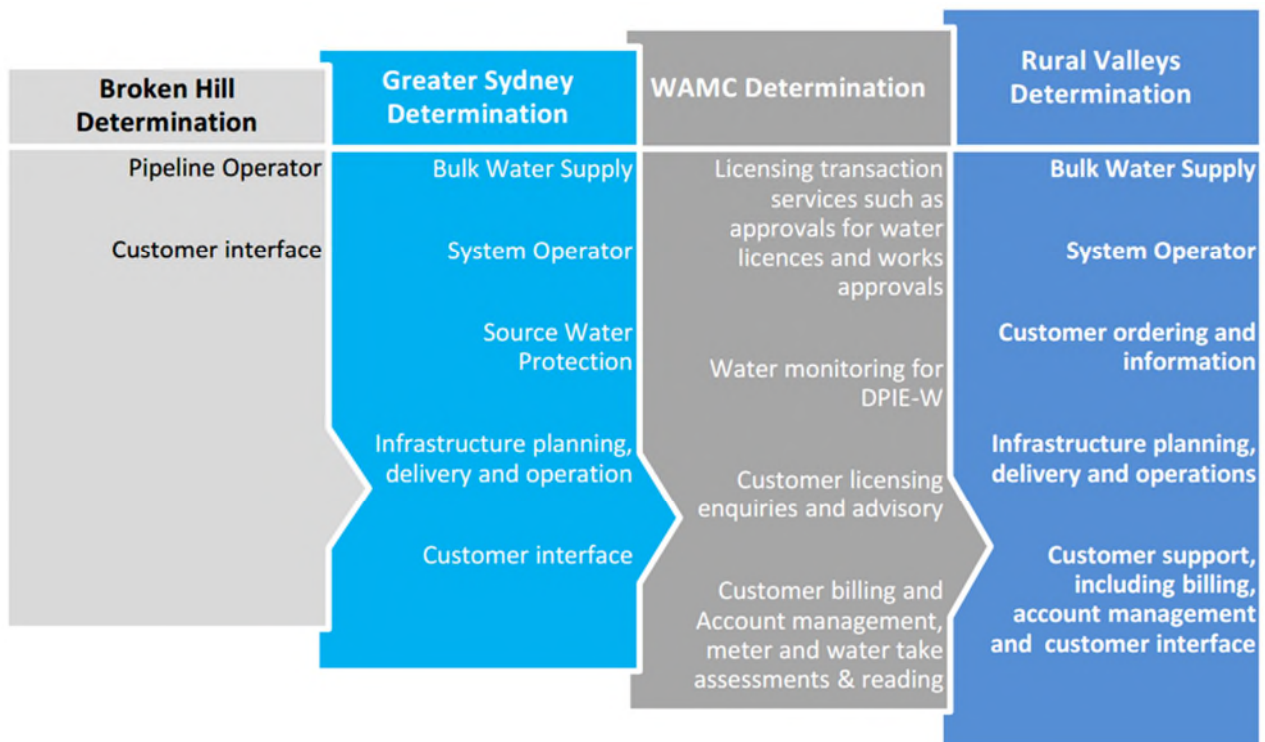
WaterNSW's pricing is subject to the following legislation:

- New South Wales price regulation for monopoly services under the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW); and
- Commonwealth price regulation in the Murray Darling Basin (“**MDB**”) under the:
 - *Water Act 2007* (Commonwealth);
 - *Water Charge Rules 2010* (WCR) made under section 92 of the *Water Act 2007*; and
 - Australian Competition and Consumer Commission *Pricing principles for price approvals and determinations under the WCIR* of July 2011 (“**ACCC Pricing Principles**”).

The prices for WaterNSW's bulk water and licensing services are guided by four IPART determinations. These determinations are set out below:

- **Greater Sydney** - services we supply to Sydney Water, some councils and raw and unfiltered water customers in the Greater Sydney area are subject to the IPART Determination *Maximum prices for Water NSW's Greater Sydney Services from 1 July 2020*, which applies until 30 June 2024;
- **Rural Valleys** - services we supply to irrigators, regional councils, mines, energy companies and environmental water holders in rural areas are subject to the IPART Determination *WaterNSW, Prices for rural bulk water services from 1 July 2017*, which applies until 30 September 2021;
- **Water Administration Ministerial Corporation (“WAMC”)** - services we supply under our conferred WAMC functions are subject to the IPART Determination *Water Administration Ministerial Corporation, Maximum prices for Water Management services from 1 July 2016*. We share this revenue with the Department of Planning, Industry, and Environment, Water (“**DPIE-W**”) and, from 1 May 2018, also with the Natural Resources Access Regulator (“**NRAR**”) as all three entities share responsibility for the delivery of WAMC functions. The current determination applies until 30 September 2021; and
- **Murray River to Broken Hill Pipeline** (the “**Broken Hill Pipeline**”) - services we supply to Essential Water and a small number of landholders near Broken Hill for the Broken Hill Pipeline are subject to the maximum prices under the IPART Determination *WaterNSW Prices for water transportation services provided by the Murray River to Broken Hill Pipeline from 1 July 2019*, which applies from 1 July 2019 to 30 June 2022.

Figure 2 – IPART Determinations applicable to WaterNSW



1.3 Key themes proposed by WaterNSW for the review

WaterNSW believes that IPART’s regulatory framework as set out in the IPART Act 1992 (“**IPART Act**”) and as implemented by IPART through its reviews and determinations, has generally performed well in balancing the needs of stakeholders. It is clear, however, that the regulatory framework as set out in the IPART Act has not been holistically reviewed since its introduction almost 30 years ago and ensuring that the regulatory framework remains fit for purpose is critical in continuing to deliver value for money for customers.

We are encouraged by the opportunity of this review and suggest that it should not be viewed as a ‘once off’ exercise; rather, a review of elements of the framework should be undertaken every four to five years to ensure it operates efficiently and effectively in delivering regulated services at a fair price for customers.

While the framework has generally performed well, it is clear that the regulatory landscape has changed significantly since 1992. For example:

- Incentive regulation has become more entrenched internationally and within Australia over the past decade, with more reliance on ‘**higher power**’ **incentives** (the “carrot”) and less reliance on heavy-handed regulatory interventions (the “stick”) to drive desired behaviours. Implicit in the development of incentive regimes is that there is an inextricable link and clarity between increased performance and increased returns in driving efficiencies.
- While businesses have traditionally operated to deliver a host of technical service standards set out in various regulatory instruments, which were assumed to be what customers wanted, the **active participation of customers** in regulatory processes to identify what they actually want, and at what cost, is a key feature of all modern regulatory frameworks. While ‘how’ to best identify and embed customer preferences into the regulatory framework is still a work in progress, there is no debate on ‘if’ additional customer focus is required.

- A better understanding of **vulnerable customers** and issues of **affordability** have influenced the behaviour of utilities in setting tariffs and tariff structures.
- There is less reliance on ‘set and forget’ regulatory processes that were not designed to adequately respond to risk and uncertainty *within* a regulatory period. Most regulatory frameworks include some cost risk mitigation measures, such as contingent projects, reopeners and cost pass through mechanisms to ensure a fair sharing of risk between the business and its customers, while **building resilience** into the regulatory framework to address unforeseen events.
- Greater awareness in the community of **environmental issues** and the expectation that utilities will reduce their carbon footprint and plan their operations to minimise the impacts of **climate change**.
- **Increased customer expectations** that businesses will innovate, including through the use of technology, to increase performance and customer experience.

In considering the above factors, WaterNSW’s original response to the Position Paper put forward the following themes:

- **Overarching objective** - The regulatory framework should incorporate an overarching primary objective to operate in the long term interests of customers. (*Focus area: lifting the performance of the sector*)
- **Accountability and risk** - WaterNSW is committed to taking accountability for outcomes, but needs additional regulatory tools to manage uncertainty and ensure a fair sharing of risk. (*Focus area: lifting the performance of the sector*)
- **Incentives** - The regulatory framework should provide businesses with incentives to increase performance for the outcomes that matter most to customers. Increased performance should lead to increased returns in order to drive further efficiencies. There should also be clarity on what good performance looks like and what are the key measures of performance. (*Focus area: promoting innovation*)
- **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*)
- **Efficient investment** - The framework needs to ensure commercial returns to shareholders (e.g. ROE) are sufficient to ensure that the businesses remain financially viable and are able to attract capital to the sector. (*Focus areas: lifting the performance of the sector and promoting a customer focus*)
- **Cost of regulation** - The framework should aim to minimise the costs of regulation while targeting the long term interests of customers. The cost of complying with regulatory obligations should be assessed to ensure value for money for customers. (*Focus areas: all three focus areas*)

We are encouraged that many of these suggestions have been accepted by IPART. The remainder of this submission outlines WaterNSW’s response to the specific matters raised in the Discussion Paper regarding the topic of lifting performance in the water sector.

2. A longer term focus

2.1 Longer determination periods

WaterNSW is generally supportive of longer determination periods (i.e. longer than three years (as is the case for the current 2019 Broken Hill Pipeline Determination period) and longer than the 'usual' four years for IPART's determinations in certain circumstances). A longer determination period may appropriately balance the uncertainty of forecasts over the determination period and the regulatory burden of determinations.

A five-year determination period is a proportionate response to managing this regulatory burden. Regulatory determinations involve considerable administrative and managerial effort for regulated businesses, IPART and other key stakeholders including customers. A five-year determination period enables WaterNSW, IPART and our stakeholders to efficiently allocate valuable resources.

As IPART has noted, a longer determination period can provide a 'long term focus'², strengthening the opportunity and incentive for WaterNSW to pursue efficiency gains, and benefiting customers in the long run.

A longer determination period, however, requires appropriate risk management mechanisms to manage risks over the determination period, particularly those risks over which utilities have little control, and ensure prices reflect the costs of providing services.

It is common regulatory practice to incorporate risk management mechanisms to amend the regulatory settings if there are unanticipated, material changes in revenues and costs during the course of the determination period that are outside the control of the regulated business. This is to ensure prices remain cost reflective through the determination period, and that the utility will be incentivised to take accountability for events within their control, while not unnecessarily exposing them to risks beyond their control.

A longer determination period exposes the business to the risk that the return on equity in the latter years is below the market's expectations at that time (noting the cost of debt is recalculated annually) which may occur if the currently low returns are locked in for a five year period and interest rates rise over the next few years as global economies recover from the global pandemic. Locking in a lower return on equity for a longer period would make it more difficult to attract efficient investment to the sector in the latter years of the determination. This risk is exacerbated if forecast inflation tracks below actual inflation, thereby locking in a lower 'true' WACC over a longer period.

Common risk management mechanisms include periodic reviews of specific components, mechanism to address 'contingent' or unforeseen projects, cost pass-through processes and demand volatility adjustment mechanisms.

The inclusion of appropriate risk management mechanisms is fundamental to underpin longer determination periods.

2.1.1 Interaction between determinations

WaterNSW notes that in some instances one IPART regulatory determination may necessarily intersect with another. For instance, WaterNSW's Greater Sydney bulk water charges are currently an input into Sydney Water's customer charges and our Broken Hill Pipeline transportation charges are an input into Essential Water's water and wastewater charges for the Broken Hill region.

² IPART, *Lifting Performance in the Water Sector: Discussion Paper -Special review, May 2021*, p6.

On the surface, aligning the timing of determinations has some obvious attraction. This includes ensuring underlying consistency in assumptions and alignment of regulatory and consultation processes. Stapling the determinations, however, fails to recognise that the circumstances of the businesses over time may change, and that appropriate risk mitigation mechanisms may not uniformly apply to each business. All else being equal, this could lead to high risks that are not adequately addressed over the latter years of a regulatory period.

For instance, if one organisation faces an event that is material enough to seek an early determination, should an early determination also be necessarily imposed on the other business if the determinations are stapled? Setting aside other risk management mechanism that might address the event (such as cost pass throughs or contingent projects), the stapling of the determinations may lead to a preference for shorter determinations to address forecasting risk in the latter years.

It is not necessary, however, to staple the timing of these determinations, and WaterNSW notes that there are numerous regulatory precedents that provide a more appropriate model for the charging of infrastructure across a vertically disaggregated supply chain that are superior in their ability to manage risk.

For example, in the electricity industry, regulatory reviews for regulated transmission businesses and the regulated distribution businesses that include transmission changes in their prices do not coincide. Similarly, when IPART regulated retail electricity and gas prices it did not seek to align these determinations with those made for the distribution and transmission businesses.

WaterNSW encourages IPART to consider these and other models that would enable the timing of WaterNSW charges to coincide with other determinations, but would not mandate this in order to address the individual circumstance of each entity.

2.2 Strategic meeting early in the regulatory cycle

In its Discussion Paper, IPART proposes 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. In particular, how the business's strategy would be informed by and ultimately reflect customer preferences.

In advance of a pricing review, IPART suggests that the business would present its vision for the review to IPART, and potentially to a Regulators Advisory Panel ("**RAP**") (see discussion in Section 7 below).

This process would benefit by having an engagement process which supports the inclusion of customers in the development of the vision.

IPART considers that the business could talk through its plans for the next determination period and test its assumptions, and IPART/the RAP could provide feedback on whether this vision is in line with the regulators'/government's thinking. This would provide the business with more certainty (without being binding) when building its proposal, and allow it an opportunity to raise any concerns it has with meeting any of its regulatory obligations.

WaterNSW is supportive of the establishment of the RAP (discussed in Section 7) and a non-binding strategic meeting early in the regulatory cycle. We support increasing engagement with our regulators and steps that would ensure greater awareness between the regulators of the impacts of their decisions on the businesses.

We consider that IPART could go one step further and introduce a "Framework and Approach" ("**F&A**") paper prior to lodgment of the initial pricing proposals at each major pricing review.

While this F&A paper 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.

WaterNSW points IPART to the Australian Energy Regulator's ("AER") F&A paper that is the first step in a process to determine efficient prices for electricity distribution and transmission services.³ The F&A facilitates early public consultation on the incentive schemes that will encourage efficient network expenditure.

The F&A paper sets out information around incentive schemes that will apply to network service providers to encourage efficient investment and performance. It also sets out how the AER will apply the Expenditure Forecast Assessment Guidelines and the depreciation methodology for the next regulatory control period.

The F&A is important because it provides an opportunity for interested parties, including consumers, to have a say. The sorts of issues the AER will consider in the F&A include:

- Whether (or which) incentive schemes will apply, for example, to service quality, improvements in network reliability or capital and operating expenditure; and
- Whether depreciation for establishing the regulatory asset base of the network service provider's opening regulatory asset base, for the next regulatory control period, is to be based on actual or forecast capital expenditure.

WaterNSW considers that the above list of matters for the F&A paper should also include the following:

- Form of price control (e.g. price caps or revenue caps, with the latter discussed in more detail in Section 5) and other (non-expenditure related) matters that may be specific to each determination; and
- Tariff principles or structures that would apply to each upcoming determination.

Another benefit of the (non-binding) F&A paper is that consumers would have an additional opportunity to discuss the appropriate regulatory framework to apply to each upcoming determination prior to (and separate to) discussions around proposed expenditures and prices.

2.3 Framework reviews

In the Discussion Paper, IPART indicates that it will continue to look for opportunities to publish information papers and complete 'framework' reviews of specific elements of pricing determinations outside of the main review periods.⁴ For instance, IPART already establishes frameworks for the weighted average cost of capital ("WACC") and other financial parameters.

IPART indicates there may be scope to remove more elements of the pricing review, including:

- In principle-decisions on price structures; and
- Long run marginal cost – IPART could review that approach to long run marginal cost (LRMC), noting WaterNSW maintains that, as a capital-intensive bulk water provider, the most appropriate approach to setting tariffs is to align fixed and variable charges to our (predominantly fixed) cost structure.

³ 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>.

⁴ IPART, *Lifting Performance in the Water Sector: Discussion Paper -Special review*, May 2021, p8.

IPART indicates that these separate reviews could provide more certainty for businesses in preparing their pricing proposals and could also facilitate more targeted consultation with special interest groups.

WaterNSW is supportive of addressing key framework issues outside of each determination. As we currently have four determinations, the status quo is for WaterNSW and our customers to participate in each IPART water utility determination to ensure a material issue does not form a precedent and become locked-into the framework for the next WaterNSW review. The status quo places a high regulatory burden on businesses and their customers that could be lessened through consolidated framework reviews.

As outlined in the previous section, the introduction of an F&A paper would be a complementary step that would ensure sector-wide framework reviews are translated and decoded for each determination in recognition of the individual circumstances of each price reset.

2.4 Managing risk

In order to move to longer determination periods, it is essential that IPART provides appropriate risk management tools as noted above. IPART indicates in its Position Paper that the regulated business should be responsible, and held accountable, for delivering outcomes to their customers and the community, consistent with their licence conditions, regulatory requirements and the preferences of their customers.

WaterNSW agrees and strongly supports this review objective. However, for a water utility to be fully accountable for the outcomes envisioned in a regulatory determination requires sufficient regulatory tools to address the risks that may arise during a determination period.

IPART correctly notes that risks should be shared between the business and its customers, but finding the correct balance is a challenge and that the risk should be assigned to the party best able to manage it, and benefit to the business from reduced risk should be shared with its customers. If a business is assigned to manage a risk, it needs to be appropriately compensated as in many cases managing risk is not costless.

The IPART Position Paper outlined that over time, IPART has introduced mechanisms to manage the cost and revenue risks that the water utilities face, and price structures that assign volume risk between the business and customers (the proportions of revenue collected through fixed and usage charges). This includes, for example, end of period true-ups and cost pass throughs in some circumstances. These mechanisms also increase the overall complexity of the regulatory framework.

WaterNSW is of the view that the current regulatory framework includes a number of mechanisms to address volume risk, but has introduced relatively few mechanisms to address cost uncertainty. This makes the proposition of moving to longer determinations more risky and would place a disproportionately high level of risk on WaterNSW.

The following sections address managing costs uncertainty. Mechanisms to manage volume volatility are discussed in Section 5 – ‘Allowing different forms of price control’.

2.4.1 Managing cost uncertainty

WaterNSW has been a strong advocate of the need for the introduction of additional regulatory ‘tools’ to help manage cost uncertainty of major capital projects, which was set out in detail in our

original Pricing Proposal⁵ and Issues Paper response as part of IPART's Greater Sydney 2020 Determination for WaterNSW. The key risk facing WaterNSW and its customers at the time of the Greater Sydney was the potential for one or more major drought-related projects to be introduced within the 2020 Determination period.

The financial risk imposed on WaterNSW if one or more of major projects was significant if the costs are not recovered through IPART's determination (and or via Government funding). Uncertainty around these significant expenditure programs required that WaterNSW consider risk mitigation strategies to address the financial and revenue uncertainty.

It was clear in our assessment of how other jurisdictions addressed cost uncertainty associated with large capital projects required that additional mechanisms needed to be introduced into the IPART regulatory framework to address cost uncertainty, particularly *within* a regulatory period. The longer the regulatory period, the more important it is to have appropriate risk mitigation mechanisms in place to address forecasting risk in the latter years of the regulatory period.

WaterNSW considers that IPART should assess the merits of a 'contingent projects' mechanism and other similar mechanisms for inclusion in the regulatory framework to address the cost and timing risk associated with unforeseen major capital projects. Currently **contingent projects** and capital expenditure **reopeners** are included in the National Electricity Rules ("NER") for electricity networks in the National Electricity Market ("NEM") for managing the risk of large, uncertain capital projects. We consider that similar mechanisms should be considered for inclusion into the regulation of water utilities in NSW:

- The **contingent project mechanism** allows the regulator to exclude from the forecast expenditure established in the review a project which is uncertain, but which has a clearly defined trigger event, but to include it later if it is required; and
- The **capital expenditure reopener mechanism** in the NER allows for the inclusion of additional capital when the network business spends at least 5% more than the opening RAB.

While the concept of a contingent project framework has merit and would appear to be a candidate for addressing the WaterNSW major projects, it does not currently form part of IPART's regulatory framework and was not supported by IPART in the 2020 Greater Sydney Determination.⁶ We request that IPART reconsider its approach to addressing the uncertainty associated with large capital projects both *within and across* regulatory periods as part of this review.

WaterNSW notes that managing uncertainty has not been an agenda item at the IPART Workshops. Discussions with IPART staff provide comfort that managing uncertainty is a key focus for this review and we look forward to this matter being addressed at an upcoming workshop.

The two main approaches for managing investment uncertainty that WaterNSW considers though form part of the review are summarised below:

⁵ See WaterNSW Pricing Proposal for Greater Sydney Bulk water pricing, 1 July 2019.

<https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-water-services-metro-water-review-of-prices-for-waternsw-greater-sydney-from-1-july-2020/legislative-requirements-review-of-prices-for-waternsw-greater-sydney-from-1-july-2020/waternsw-pricing-proposal-for-regulated-prices-for-greater-sydney-2020-to-2024.pdf>

⁶ Refer to IPART submission to AEMC's Rule change process – *Economic regulation provisions within the National Electricity Rules*. April 2012. Page 7.

2.4.2 Managing investment uncertainty through a contingent projects regime

WaterNSW proposed to include a separate mechanism in the 2020 Greater Sydney determination that would allow the costs of a major capital project to be assessed within the determination once the need for the project and the costs have been established with more certainty.

If the regulator does not factor forecast expenditure for uncertain projects into the revenue requirement and the expenditure proves necessary, the infrastructure operator will be undercompensated for its provision of water infrastructure services. This may lead to reduced quality of services for customers and underinvestment in the infrastructure operator's infrastructure. This outcome is not in the long term interests of customers. By not incorporating the costs of a major project within the regulatory period, potential price shocks are exacerbated in the subsequent regulatory period due to the step change in the RAB at that time.

Importantly, in many cases, businesses are not in a position to include the costs of contingent projects in their capital expenditure program at the time of preparing their pricing proposals. This is because the uncertainty around if or when these projects will take place and how much these projects will cost would result in prices that are significantly higher than efficient costs if the costs were included in the determination and the projects did not go ahead.

WaterNSW suggests that it is appropriate to include a separate mechanism in the determination that would allow the costs of a contingent project to be assessed within the determination period. This would occur **only if or when** the need for the project and the associated costs have been established with more certainty *during* the regulatory period.

WaterNSW considers that the existing ability to seek an 'early' determination for unforeseen events, while an important regulatory tool to manage risk, is overly restrictive as all elements of the determination are opened up. A contingent projects framework is a practical mechanism to allow the regulator to review the efficient costs of an unforeseen project within the regulatory period and to examine the relevant (rather than all) factors.

The application of a contingent projects regime is a common feature of many well-functioning regulatory frameworks. As outlined in detail in the WaterNSW Greater Sydney Pricing Proposal⁷ and as summarised by IPART in the Issues Paper (Section 10.2.3), the NER applies a robust framework for contingent project and 'reopener' provisions for Australian electricity distribution and transmission network service providers.

WaterNSW provides the following summary of how uncertain projects are addressed in other jurisdictions and industries (primarily water) in Australia and overseas and cites examples of effective contingent projects regimes in place for:

- The Australian Energy Regulator's regulation of energy networks through explicit contingent projects provisions in the NER;
- The Australian Competition and Consumer Commission's regulation of water utilities through contingent projects provisions in the new Water Charge Rules;
- The Essential Services Commission of Victoria's regulation of water utilities through the 'uncertain and unforeseen events mechanism';
- The Essential Services Commission of South Australia's regulation of SA Water through the introduction of the new 'intra-period review mechanism'; and
- The Office of Gas and Electricity Markets' regulation of gas and electricity networks in the United Kingdom.

⁷ See WaterNSW Pricing Proposal for Greater Sydney Bulk water pricing, 1 July 2019. Section 4.5, page 44.

WaterNSW's analysis highlights that a contingent projects regime is a common feature of many well-functioning regulatory frameworks in Australia and overseas. Based on our analysis, we suggest that IPART consider the merits of a contingent projects (or similar) mechanism with *intra period* adjustments as part of this review to manage the uncertainty of large capital projects where insufficient visibility of the associated timing and or costs exists to reasonably include in prices at the time of a determination.

The absence of a contingent projects or reopener mechanism raises concerns over the financial risk placed on WaterNSW in the latter years of a longer regulatory period.

2.4.3 The role of cost pass through mechanisms

We consider that a well-functioning regulatory framework needs to ensure a reasonable sharing of risks so that a business can recover its efficient costs, meet customer obligations and remain financially viable. An important element of the regulatory framework is the inclusion of regulatory mechanisms that allow for significant unforeseen costs that are triggered by uncertain events to be addressed during the regulatory period. If the underlying costs of service provision are increased by an event (such as new legislation or a new service), firms operating in a competitive market would be expected to include the associated costs into their price service offerings.

WaterNSW considers that any cost pass through mechanism should be symmetric and that any cost reductions arising from cost pass through events should be passed onto customers as soon as possible and not retained until the subsequent regulatory period.

Under the current regulatory model, IPART sets WaterNSW's prices on a forward-looking basis for a defined period. Prices are set to be sustainable over the regulatory period. However, there will inevitably be uncertainties during the period where it is impractical (if not impossible) to forecast the efficient costs of these uncertainties at the time prices are set.

It is in customers' interests for infrastructure businesses to have the reasonable opportunity to recover the efficient costs they incur as a result of unexpected events. Cost pass through mechanisms can provide an appropriate balance in the allocation of risks between WaterNSW (to recover costs to attract sufficient investment in its infrastructure) and customers (to ensure that prices are no more than necessary to provide an appropriate level of service).

As noted in the Position Paper, IPART's regulatory framework does include cost pass throughs, although their use is generally much more limited than in other jurisdictions. While WaterNSW acknowledges the role of cost pass throughs and IPART's concerns over the fair sharing of risks, we note the following with respect to the current pass through arrangements:

- **IPART's criteria** – IPART states that a cost pass through mechanism should only be applied in situations where (amongst other things) the *“resulting efficient cost associated with the trigger event can be fully assessed including whether there are other factors that fully or partially offset the direct cost of the event”* and includes a footnote stating *“The costs to be passed through must be specified in the price determination”*.⁸

Unfortunately, for most events, detailed cost information is not available at the time of the price determination, given that an event may not have been foreseen at that time (e.g. the case of a new legislative obligation introduced during the regulatory period). In these cases it is not possible to assess the costs in advance and therefore it is not possible to include the event and its costs in the determination.

⁸ Position Paper, Box 2.1, page 15.

- **Adjusting prices within the regulatory period** – IPART’s ability to adjust prices for the efficient costs of a new pass through event that occurs within a regulatory period is arguably constrained.
- **Firms in a competitive market** – Firms operating in a competitive market would not be expected to absorb the efficient costs of complying with a new tax or legislative obligation and would seek to include these costs in their price / service offerings. It would therefore be entirely consistent with firms operating in a competitive market to provide costs pass throughs for certain events (including legislative changes) within the determination period.

By providing water utilities with the tools to manage their costs within the regulatory period and the appropriate use of incentives (discussed in the following section), businesses would be provided with greater ability to effectively manage risks and to accept accountability for the determination outcomes during the regulatory period. This would support a move to longer determination periods.

3. Understanding price-quality trade-offs

In the Discussion Paper, IPART indicates that the services delivered by the water businesses need to balance a number of objectives. Customers’ preferences for higher levels of service need to be balanced against their willingness and ability to pay for these services. Investments need to be made in the context of a changing climate, and the need to contribute to positive environmental outcomes.

To prepare a targeted pricing proposal that is in the long-term interests of customers, the businesses need a full understanding of the trade-offs between service standards and costs.

IPART seeks feedback on the following matters:

- How should performance standards be set, for businesses with, and without, an Operating Licence?
- How best to align pricing decisions and performance standard setting to enable businesses to make trade-offs between the two. For businesses with an Operating Licence, should IPART’s Operating Licence and Price review processes be run concurrently?

IPART has two main functions when regulating public water businesses: recommending operational standards for the businesses (and ensuring compliance with them), and setting maximum prices the businesses can charge customers for services.

These two functions are closely related. IPART recommends licence conditions that define the service levels that the businesses must deliver to customers, and sets prices to recover the efficient costs of delivering these services.

IPART recommends to the Minister the operating licences for certain public water utilities, including WaterNSW. Customer engagement by businesses on key performance standards can help inform the trade-offs between service standards and costs, and any service standards with potentially competing outcomes.

3.1 Minimum or optimal standards

IPART suggests that a key question is how performance standards in operating licences should be set to ensure that customers are protected, while providing the right incentives for the utility to deliver higher levels of performance where it is efficient to do so.

WaterNSW supports a **minimum standard** in the operating licence to protect customers, with optimal standards being incentivised through separate mechanisms, and potentially implemented through the pricing review. We propose these standards are updated on an exception basis once initially established in order to minimise the costs of compliance.

As stated in the Discussion Paper, this approach has been widely adopted in the energy industry. For example, in addition to having to an operating licence, the Australian Energy Regulator (“**AER**”) has developed a number of incentive mechanisms, most relevantly a ‘Service Target Performance Incentive Scheme (“**STPIS**”)’ that provides electricity distribution networks with the incentive to maintain and improve network performance, to the extent that consumers are willing to pay for such improvements.

WaterNSW supports IPART’s statement that encouraging an optimal level of performance through pricing mechanisms, rather than only through operating licence requirements, would lessen regulatory compliance costs. It would also promote consistency between the businesses that IPART regulates who have an operating licence, and the businesses who do not have an operating licence.

WaterNSW is concerned that any attempt to set ‘optimal’ standards may lead to a stifling of, not an increase of, innovation, as the operating licence standards would effectively cap outcomes (by definition).

The introduction of optimal standards would increase the scope of the operating licence review and is unlikely to provide any additional guidance to the business when developing its pricing proposal, given it would still need to engage with customers on whether the optimal standard could be affordably met and would require minimum standards to be set in any case should the optimal standards not be attainable.

WaterNSW is concerned that the potentially significant additional scope required for the licencing review to incorporate minimum and optimal standards would add to the regulatory burden, which would increase costs for customers for little benefit.

WaterNSW considers that setting minimum standards based on outcomes rather than relying on audits to assess performance would be a positive move. We suggest that the minimum standards replace the operating licence’s prescriptive clauses so that utilities are measured against performance against what customers value, rather than compliance for compliance sake. Performance standards, and the assessment of those standards, should be outcomes-based and not prescriptive. This supports a more agile and flexible business that can respond to customer and business needs more effectively.

The current approach to licence reporting comes at a high cost and WaterNSW considers the regulatory burden on utilities could be reduced. For example:

- Under the operating licence we provide IPART with 18 reports at different times throughout the year. We question the value add of such extensive and intensive reporting; and
- There is duplication of data and information being reported to other regulators and agencies.

We consider that customers should have a voice in setting the minimum standards to ensure the standards are set at appropriate levels. We also suggest that outcomes relating to standards above the minimum are more appropriately addressed through the determination process, where price and service trade-offs are best addressed through the associated consultation processes.

WaterNSW therefore proposes that the operating licence contains minimum standards and are at least consistent with (if not a refinement of) the performance indicators that WaterNSW already report on to IPART. We also propose that the licence be reviewed to ensure it only contains those conditions that are critical for the delivery of a safe and secure supply of water to our customers. Any other matters can and should be addressed as part of the proposed service levels as part of the pricing proposal process, where additional engagement with customers necessarily occurs.

We also consider that the setting of minimum standards should be on an exception basis. This would lessen the costs of compliance, while ensuring that only those matters that require minimum standards to meet customer performance requirements are included in the operating licence.

3.2 Aligning pricing and licensing standard setting

IPART generally recommends licence standards one to two years before it sets prices. However, the level of service (or standards) that a customer wants a business to deliver is a function of the price the business will charge to deliver the service. This suggests there may be a benefit to running both processes in parallel, or looking at other ways to enhance understanding of the relationship and optimal balance between price and service levels.

However, there would also be costs of concurrent reviews of licence conditions and prices, potentially adding regulatory costs or burden to the regulated businesses. Further, the licence conditions IPART recommends may not be adopted by government, which creates a risk that IPART's prices are then not cost reflective.

IPART has indicated it is keen to explore the benefits and costs of different approaches to enhance integration and outcomes of our licensing and pricing functions.

WaterNSW considers that there is merit in ensuring the timing of the operating licence review is set to enable the outcomes to be understood and the costs included in the business's pricing proposal. This would ensure that the prices charged are reflective of the service standards and that there is no mis-alignment. We note, however, that there are likely to be efficiencies in undertaking the operating licence review and expenditure review in a coordinated manner.

For example, the operating licence audit and the expenditure reviews for the WaterNSW bulk water and WAMC / Rural Valleys determinations were conducted at the same time, but were not part of a fully integrated process. This resulted in a significant level of duplication in the review process by WaterNSW staff and IPART's consultants, leading to higher costs. Better alignment of the review processes in future is likely to result in less duplication and therefore more efficient and effective outcomes.

As noted above, the timing of the operating licence and pricing reviews are not aligned. IPART recommends the operating licence including performance standards to the Minister. The review of performance standards has usually been held as part of the operating licence review, at least a year before the pricing reviews. IPART considers that there could be value in having the performance standards review and the pricing review occurring at the same time.

IPART has outlined some benefits of reviewing performance standards and prices simultaneously (i.e. price-quality trade-offs assessed in real time, customer engagement undertaken once and economies of scope), WaterNSW considers that any perceived benefits are more than offset by the challenges created and the risks to this approach observed by IPART:

- The Government may not agree to IPART's recommended performance standards. This would delay the review process, while new prices are established. IPART indicates that working with the businesses to establish the recommended standards early in the review

process should help to reduce this risk. WaterNSW notes that the time to prepare expenditure proposals to meet the standards is at least six to twelve months, which is likely to delay the review process or lead to prices that do not reflect the efficient cost of the service.

- There may be a resourcing concern in that more work needs to be done at once. IPART considers this could be addressed by completing more elements of pricing ahead of time, or perhaps by targeting resources on the most important elements of the pricing or licencing reviews. WaterNSW considers that a core element of a pricing proposal is the expenditure programs that require extensive lead time once the standards are known. WaterNSW does not consider work on expenditure programs could be brought forward to prior to when the standards are set.
- Businesses may feel they cannot effectively plan and cost projects without knowing what the standards are. IPART suggests that the counterpoint is that this implies that there is an opportunity to push the businesses to think more deeply about price-quality trade-offs, rather than waiting to price options until quality is fixed. WaterNSW does not consider this to be a pragmatic solution and while IPART indicates that quality levels should be determined through customer engagement, WaterNSW considers that having a core set of minimum standards on which to base a pricing proposal is fundamental to ensure the prices reflect efficient costs of providing the service. We do not think it is practicable to set standards and develop efficient expenditures to meet these standards in parallel.
- Creates practical difficulties for utilities such as WaterNSW with more than one pricing determination to have simultaneous operating licence reviews. For instance, which pricing determination would the licensing review align with (i.e. Rural Valleys, Greater Sydney or WAMC)? Alternatively, a move to one overarching determination process for all of WaterNSW's regulated assets may address the timing issues with the operating licence, but would create potential peak resourcing issues.

4. Customer choice pricing

In its Discussion Paper, IPART proposes to develop a new 'customer choice' framework. IPART considers customer choice pricing as the natural evolution of Unregulated Pricing Agreements (UPAs), which in some cases enable large non-residential customers to enter into an agreement with their utility to receive different service/prices than the determination specifies, provided all costs and revenues are ring-fenced.

IPART has indicated it wants to expand this approach to other customers, provided the same ring-fencing occurs. To date, there has been limited uptake of these schemes. IPART suggests that awareness is likely low, and it may be difficult for consumers to identify the specific examples where they would negotiate on with the business. Further, there is a legal risk that IPART may override a commercial arrangement should regulation become necessary, which may discourage the water businesses from pursuing customer choice pricing.

4.1 Allowing customers to 'opt-in' to higher service

IPART considers that the 'customer choice' framework encourages water businesses to identify and pursue opportunities for their customers to choose the level of service they get from their water provider, and to pay for that service according to their personal choice.

As customer choice pricing arrangements are developed and introduced, IPART considers it is appropriate to defer price regulation and instead to monitor prices. IPART considers it is unnecessary to immediately introduce price regulation because customers can always exercise the option to remain on the default regulated tariffs. Instead, IPART would monitor the prices, revenues and costs of the schemes, and pay close attention to ring-fencing arrangements. IPART

considers that a lighter touch regulatory approach will encourage the businesses to pursue innovative pricing options.

WaterNSW is supportive of any approach that would allow customers to be provided with options to receive a higher level of service. We also support the approach of moving towards price monitoring rather than direct regulatory intervention.

We note that there are challenges to achieving customer choice pricing that include demonstrating customers' willingness to pay or trade off service levels for price. For instance, as it is rare that an initiative would affect only one customer in a region or valley, demonstrating customer willingness is challenging (i.e. is unanimous support required or is majority of customers sufficient?).

Furthermore, while fully tailored pricing solutions might be desirable, the systems investment, process changes and the resourcing required to move away from current pricing arrangements to more tailored solutions is likely to be cost prohibitive on a wider scale. Striking the balance between costs for customers and offering a greater suite of services is a key focus area for WaterNSW.

WaterNSW acknowledges that if IPART is to defer the regulation of customer choice pricing that some overarching principles would be helpful to stakeholders. While WaterNSW is generally comfortable with the proposed list of pricing principles for customer tailored solutions, we note that the requirement for full ring-fencing of costs and associated reporting presents a high regulatory hurdle that would likely only result in the largest initiatives being cost effective.

WaterNSW encourages IPART to establish a set of principles to guide the exploration of future customer choice options

For WaterNSW, it is unlikely that the larger scale UPAs would form a significant component of our customer price offerings over the next few years in recognition of the size and scale of our customer base. We consider that more value for stakeholders would be derived from our future review of rural bulk water tariff structures in the leadup to the 2025 determination. The extent that tariffs could be redesigned will need to address several issues including customer bill impacts, affordability, the desire to set efficient tariffs, revenue volatility, climate change and other environmental considerations and the likely forms of price control available in IPART's regulatory framework.

4.2 Addressing revenue sharing

At the workshop, businesses did identify a practical challenge to developing new products – revenue sharing over shared infrastructure. In particular, there was a suggestion that IPART may need to exercise more clarity and discretion depending on circumstance, as opposed to the existing guidance of 50:50 sharing.

WaterNSW is encouraged by IPART's statements that the 50:50 sharing is a 'guide' and that IPART has shared non-regulated revenue at a different sharing levels (an example of biodiversity offset credits with a 90:10 split in IPART's 2020 reviews of pricing for Sydney Water and Hunter Water was cited).

Depending on the nature of a potential use of shared infrastructure, alternative revenue sharing arrangements may need to be discussed with IPART to ensure that higher utilisation of infrastructure occurs through leveraging monopoly infrastructure, which is beneficial to the State, while ensuring the long-term interests of customers are maintained.

5. Allow different forms of price control

WaterNSW welcomes the discussion at the workshop and the views expressed in the Discussion Paper on the potential introduction of alternative forms of price control (and in particular revenue caps).

Currently, IPART sets the maximum prices a business can charge for its water services. This is a relatively prescriptive approach, and while it has its benefits, the lack of flexibility could impact on water businesses' incentives to encourage their customers to conserve water. IPART notes that a lack of autonomy for the businesses to set prices potentially discourages them from taking ownership of their prices. WaterNSW agrees that providing additional price control options would likely lead to pricing solutions that are more targeted to the specific circumstances of each business and their customers.

IPART notes that in determining the most appropriate option, or options, an important underlying principle is that risk should be assigned to the party best able to manage it, and benefit to the business from reduced risk should be shared with its customers. In practice, the form of price control is relevant when setting water prices, as the water usage price recovers a significant portion of the costs of providing this service. In contrast, fixed charges recover the majority of costs for wastewater and stormwater services for some utilities, and the businesses would not face significant revenue volatility under any form of price control.

WaterNSW has had direct exposure to the limitations of charging maximum prices when actual volumes are materially below the levels forecast by IPART at the determination. For our Rural Valleys determinations, this has led to the introduction of various approaches to managing volume risk so that WaterNSW has a reasonable opportunity to recover its efficient costs, while also sending efficient price signals to customers. This has resulted in varying approaches to managing volume risk, primarily by introducing and 'unders and overs mechanism' (ACCC in 2014) and allowances for a risk transfer product ("RTP") (IPART in 2017).

In our view, neither of these approaches have been ideal, as WaterNSW has either been exposed to revenue shortfalls during drought (in the case of the UOM) or has experienced a shortfall between IPART's allowance for volume volatility and the actual competitively-sourced costs of the product (in the case of the RTP). IPART has recently signalled that it is considering moving to a volatility allowance (similar to self-insurance) to address volume risk, that would provide a much lower allowance to manage volume risk with little comfort as to how this mechanism would work in future determinations. This places a disproportionate level of revenue risk on WaterNSW and has the potential to negatively impact our credit metrics if actual volumes are below longer term trends. A higher cost of capital for WaterNSW due to reduced credit rating would not be in the long-term interests of our customers as it would impact on the incentive to attract efficient investment to the sector.

The relatively high proportion of variable charges compared with our cost structure is contributing to the problem, as variable charges have increased, not decreased, in some valleys over the past few decades. Moving to a greater proportion of fixed costs is a possible solution, but this is not always supported by customers, who have previously supported a UOM to manage volume risk.

WaterNSW considers that a UOM or an RTP are second best options to managing volume risk. While ensuring the forecast volumes used to set prices are the best estimate of likely volumes over the determination period, IPART's use of a 20-year rolling average of historic usage has not been an accurate predictor of future usage in our rural valleys. Therefore a more holistic approach to risk management that includes consideration of a revenue cap is required and we are supportive of any form of price control that effectively manages revenue risk.

While we are generally supportive of revenue caps, we note that the form of price control should not be a 'one size fits all' approach and that businesses should be able to propose the

appropriate form of price control (e.g. revenue cap, maximum price cap, weighted average price cap) based on its individual circumstances.

While our thoughts on revenue caps are outlined in the following section, WaterNSW notes that revenue caps have been the form of price control for electricity networks in the NEM and are a tried and tested approach to setting infrastructure charges that is in the long-term interests of customers. The NEM has also shown that 'efficient prices' can be set under a revenue cap.

WaterNSW notes that IPART has outlined a 'within-period revenue cap' option to manage volume risk. WaterNSW does offer an opinion on the relative merits of this option, as we are cautious about lending support for an untried product when other mechanisms (i.e. revenue caps and WAPCs) have worked in other jurisdictions. IPART's option should be available for businesses to propose at each determination, but should not be mandated.

5.1 Managing volume risk through a revenue cap

IPART has turned its attention to managing volume risk in regulatory determinations, through the use of tariff structures, demand volatility adjustment mechanisms, risk transfer products and the introduction of dynamic water usage prices. The use of the 20-year rolling average of water sales for setting variable charges by IPART (in our Rural Valleys and WAMC determinations) should be revisited due to the effect it has in driving up prices after periods of drought, when volumes decrease and it is unlikely to provide an effective approach to setting efficient prices.

WaterNSW considers that at least some of these mechanisms and issues noted above could also be addressed through the form of price control, for instance the option of proposing a revenue cap.

We note IPART's views on a revenue cap were identified in the Position Paper, which drew the following conclusion:

The advantages of a revenue cap include a strong incentive to reduce costs and to use demand side management to reduce costs. However, we would have to think through some potential challenges as well. For instance, that average prices would be adjusted each year, which creates the risk of price volatility for customers. This could be addressed by introducing side-constraints.⁹

WaterNSW is supportive of a revenue cap as part of the review.

We recognise that there may be a need for pricing principles (such as the AER's Tariff Strategy Statement guidelines) and side constraints, although we caution against the introduction of restrictive pricing side constraints that can act as the *de facto* form of regulation if set too tightly.

Side constraints were previously applied by IPART in its regulation of the NSW electricity distribution network service providers (DNSPs), as noted below:

The Tribunal proposes that the side constraints on network prices be applied only to residential tariffs including rural residential tariffs. Increases in the bill of any individual residential customer for the same pattern and volume of electricity consumption may not exceed the bill for the corresponding period of the preceding year by more than the greater of CPI or \$20. Increases to the residential class as a whole must not exceed the CPI.¹⁰

⁹ See IPART's 29 September 2020 *Position Paper on the Special Review on Water Pricing and Licensing – Regulating Water Businesses*. Page 18.

¹⁰ See IPART Pricing for Electricity Networks and Retail Supply Report Volume I, June 1999. Page xviii.

The DNSPs at the time were concerned that a side constraint of the greater of CPI or \$20 for a residential customer and CPI for the residential class as a whole was overly restrictive and would not allow prices to be adjusted to recover the efficient costs of the business if the cost of providing regulated services was increasing. Similarly, restrictive side constraints in future could effectively become the form of control in cases where the efficient costs of providing regulated services are increasing, as the side constraints may not allow a reasonable opportunity for the approved revenues to be recovered through regulated charges.

WaterNSW also notes that another form of price control, weighted average price caps (“**WAPC**”), were in place for the NSW electricity networks when regulated by IPART and then the AER. We note that a WAPC is no longer the form of price control for electricity networks as the framework has moved to revenue caps due to several factors, including concerns over the underlying ability of the networks to earn revenues above regulatory allowances. This concern could be addressed by setting pricing guidelines addressing how prices could be amended, noting that the more restrictive the guidelines are, the more likely efficient tariffs may be stifled, thereby limiting the potential merits of the WAPC.

6. Shadow price for leakage

In the Discussion Paper, IPART states that using water efficiently must be a key focus for water businesses and consumers in NSW. WaterNSW strongly supports this view.

In promoting water efficiency, IPART has proposed a new idea for businesses to better manage leakage, whereby IPART sets a water usage price with reference to the long run marginal cost (“**LRMC**”) of producing water. IPART notes that water businesses receive a signal based on the short run marginal cost (“**SRMC**”) of water supply and has canvassed whether LRMC or SRMC should form the basis of a shadow price for leakage.

IPART’s approach to setting a shadow price for leakage is that a target (static or dynamic) could be established whereby the business would have to pay the water usage charge for that water, as if it were the customer for that water. This would be done through a revenue adjustment in the next determination.

Conversely, if the business reduced its leakage below its target, IPART would provide additional revenue at the next reset equal to the value of the water saved. IPART intends that its shadow price would be symmetric.

WaterNSW considers that there should be stronger incentives for businesses to reduce leakage, but that any incentive needs to recognise the circumstances of the individual business and that financial incentives should only be in place following a rigorous data collection process to set appropriate targets.

WaterNSW generally supports IPART exploring mechanisms that would increase incentives to deliver outcomes that are in the long-term interests of customers. We consider, however, that setting a shadow price of water for WaterNSW in the near term is premature for several reasons:

- This incentive did not “feature heavily” at the workshop, and as such there has not been sufficient discussion around key elements of the proposed scheme to warrant its introduction for the next round of determinations for WaterNSW;
- Establishing the water ‘target’ would take considerable time and would need to be tracked for many years before financial incentives should be set;
- The ‘revenue at risk’ for a shadow price for leakage would need to be consulted on extensively to ensure businesses and customers understand how much emphasis IPART expects businesses to place on this incentive;

- The basis of the shadow price (e.g. LRMC or SRMC) would need to be established, noting that robust estimates of LRMC would take time and cost for WaterNSW to undertake this analysis; and
- IPART indicates that “As with all adjustments of this kind (eg, the Demand Volatility Adjustment Mechanism), the Tribunal retains discretion not to make the adjustment at the time it determines prices for the next period. The Tribunal would indicate its intention, but not bind itself to a future outcome”.¹¹ As the Tribunal could not guarantee that financial rewards from the operation of the incentive would be provided, committing significant resources without a reasonable opportunity for recovery is unlikely to be prudent. This may lead to only small scale improvements and ‘low hanging fruit’ being targeted, which may not be the efficient outcome.

For WaterNSW, establishing the relevant target and incentive arrangements would require extensive data collection and engagement with customers. While WaterNSW would be happy to work with IPART to further develop its thinking on a shadow price for leakage, we would not support financial incentives being applied until the scheme has been trialed for at least one regulatory period (i.e. we would not support financial incentives for the 2025 Rural Valleys Determination).

7. Regulators Advisory Panel

IPART suggests that the goal of the Regulators Advisory Panel (“**RAP**”) would be to support efficient decision-making by the businesses through improved co-ordination. A RAP would be a platform for regulators and policy makers, in the water sector, to share information and contribute to better regulatory decisions.

IPART considers that a more formal approach to information sharing between policy makers and regulators could promote the long-term interests of customers, by encouraging better long-term planning in the sector and improving how the inherent trade-offs between costs, health and environmental outcomes are balanced.

7.1 Who might participate in the RAP

IPART’s preliminary view is that the panel should include IPART, the NSW EPA, NSW Health and DPIE. IPART asks whether there is merit in also including a broader range of regulators as ‘associate’ members of the RAP, to support the exchange of new ideas. This could include other infrastructure regulators – such as the AER and the ACCC – and regulators in other sectors more broadly. WaterNSW supports including other regulators as associate members or observers with the ability to present on specific topics as requested by the RAP to promote cross-jurisdictional perspective as relevant.

While the regulated businesses would not be members, the RAP could provide an opportunity for the businesses to present ideas, test assumptions, and bring conflicting directions to the attention of the group. It is important for businesses to be able to contribute to the RAP.

IPART has indicated that it is not inclined to include customer advocacy groups as permanent panel members.

WaterNSW considers that, while businesses will thoroughly engage with their customer bases, there may be cases where the RAP would want to hear directly from customers or their representatives on particular matters. This could occur through RAP inviting customer

¹¹ See Discussion Paper, footnote 8, page 21.

representatives to present on specific topics from time to time. We encourage IPART to ensure the RAP is able to adequately reflect customers' views and concerns.

7.2 How the panel would operate

IPART envisages most meetings would have officer level representatives from the various government agencies to hear from water businesses, and deal with specific issues as they arise. WaterNSW supports this approach.

While an open invitation to the CEOs should be extended to attend the RAP meetings, WaterNSW considers that separate six-monthly or annual strategic meetings could be established with CEO-level staff invited. The purpose of these meetings would be for the RAP to outline its findings from its deliberations to date and to seek feedback from the CEOs on emerging trends and the RAP forward work program.