



Who benefits from regulatory reform?

PIAC submission to IPART's price determination for Sydney Water July 2016

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Energy + Water Consumer Advocacy Program

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights;
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from NSW Trade and Investment for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumer's Advocacy Program

This Program was established at PIAC as the Utilities Consumer's Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Associate of NSW;
- Tenants Union of NSW;
- Ethnic Communities Council NSW;
- Physical Disability Council NSW;
- St Vincent de Paul Society NSW; and
- The Salvation Army Eastern Australia Conference.

1. Introduction

PIAC welcomes the opportunity to provide comment on the NSW Independent Pricing and Regulatory Tribunal's (IPART) *Review of Prices for Sydney Water Corporation* (the review).

IPART is conducting this review to set the prices for water, wastewater and stormwater drainage services charged by Sydney Water Corporation (Sydney Water) for the next price period, commencing 1 July 2016 (the 2016 determination period). The review will assess the proposed price changes against potential customer impacts to ensure only the efficient costs of providing the regulated monopoly service are passed through to customers.¹

IPART has modified the review timetable for the 2016 determination period adopting a 'propose-response' process. IPART has prepared its issues paper after receiving Sydney Water's pricing submission. IPART felt this would facilitate the stakeholder consultation process and provide Sydney Water with more freedom to develop its pricing proposal without the constraints of the issues paper.² These changes do not affect PIAC and we will provide comment with respect to both Sydney Water's submission as well as IPART's issues paper.

In its submission, Sydney Water is proposing a significant decrease in residential customer bills. A typical freestanding house that uses 220 kL a year will see a reduction of \$105 or 8.6% per annum and a typical apartment that uses 160 kL a year will see a reduction of \$86 or 7.9% per annum³. These savings are in part due to efficiencies and savings in both the operating and capital expenditure for Sydney Water. The majority (52%) of the savings are the result of external factors beyond Sydney Water's control such as the low interest rate environment.⁴

Sydney Water is proposing changes to water and wastewater service charges, customer fees, as well as a review of terminology to improve customer understanding, regulatory changes and asset sales. PIAC will provide comment on these issues as they have direct and indirect impact on customers.

PIAC welcomes this reduction in residential customer bills; however PIAC has concerns about the sustainability of the proposed price. This is because the current interest rate cannot be expected to continue indefinitely into the future. According to Sydney Water's own customer engagement we know that customers do not like price volatility.⁵ PIAC cautions against major fluctuations in bills, potentially undoing the significant work Sydney Water has done to engage its customers and reflect their wishes in the price structure.

It is important to note that one of the regulatory changes Sydney Water has proposed in its submission is a broader application of the cost pass through mechanism, the process through which Sydney Water is able to recover unexpected costs. The current rules only allow for clear and defined expenditure, such as purchases of water from the desalination plant, to be passed through to customers during a price period. If a more general cost pass through mechanism were adopted, this could allow the cost of a change in interest rates to be passed on to customers

¹ IPART, *Review of prices for Sydney Water Corporation from 1 July 2016: Water – Issues Paper* (2015) 1.

² Ibid 2.

³ Sydney Water Corporation, *Our plan for the future: Sydney Water's prices for 2016-20* (2015) 16.

⁴ Ibid 15.

⁵ Ibid 239.

within the price determination period. Sydney Water has existing methods for passing general costs through to customers within its allowance and therefore PIAC does not support the changes to the cost pass through methodology.

2. Residential customer bills

Sydney Water has proposed a number of changes to the various components of the charges and tariffs that make up the typical residential water bill. PIAC makes comments and recommendations for each of these components in this section.

2.1 Changes to water prices

The next price determination period will see a significant reduction in residential customer bills. A proportion of the reduction is the result of changes to service and usage charges.

Sydney Water has proposed reducing the water usage charge to \$1.97 per kL, a 13.9% decrease.⁶ This price is the result of both customer engagement and economic analysis of the long-range cost of supplying water.⁷ Sydney Water's consultation with its customer base revealed strong preference for customer control over bills through a higher usage price and a lower fixed service charge.⁸ The long-range marginal cost analysis resulted in a lower usage rate than what customers would prefer. Sydney Water determined a price that better reflects customer preference, rather than through the economic approach. PIAC supports Sydney Water's attempts to incorporate consumer values into the pricing structure.

The water service charge will also decrease in the next determination period. The annual fixed service charge will decrease to \$98.52, which is a 4.9% reduction. At the same time, there will be a 4.9% reduction in the wastewater service charge with a new annual price of \$582.34.⁹ Taken in combination, this will result in a total 9.8% reduction in the fixed portion of the residential bill. These savings will be beneficial for residents who own their home. However, this will not be the case for those who rent, as rental prices are not likely to be adjusted to reflect the decrease in the fixed charges that are paid via the rental agreement.

Recommendation 1

PIAC recommends IPART accept Sydney Water's proposed tariff structure, as it reflects the wishes of consumers.

Recommendation 2

PIAC recommends Sydney Water investigate ways to provide assistance to renters to ensure they see the maximum benefit from changes to water prices. Potential assistance might include rebates or concessions targeted towards renters. Sydney Water should work with its customer council to develop assistance packages for renters.

⁶ Ibid 17.

⁷ Ibid 52.

⁸ Ibid 47-52.

⁹ Ibid 17.

2.2 Changes to Sydney Desalination Plant cost pass through

As previously stated, Sydney Water has proposed adopting a general cost pass through methodology, which will be discussed in further detail below. Sydney Water has also proposed changes more specifically to the cost pass through methodology when water is purchased from the Sydney Desalination Plant (SDP). The proposed change is to move from a single fixed charge applied to all customers to a fixed and variable pricing structure, similar to the current water usage charge structure. Sydney Water argues that this will signal to customers the scarcity costs associated with purchasing additional water from the. It is also proposed this will give customers greater control over their bills. In addition, customers will have greater understanding of the costs associated with the SDP, given they are already familiar with the current water tariff.¹⁰

There is also a proposed additional change to the timing of the cost pass through. Currently, if water is purchased from the SDP, any costs would be passed through to customers the following year. Sydney Water believes this will provide a better-timed price signal to customers about the cost of purchasing water from the SDP.¹¹

PIAC supports the proposed restructure, as this is in line with what customers have previously told Sydney Water they want with respect to control over bills. In addition, it provides customers with more information about the costs of excess water use that leads to water purchases from the SDP.

However, PIAC notes that these changes may negatively affect renters, as they will now have an additional volume charge associated with their water bill and rent prices are unlikely to be responsive to this change. PIAC reiterates our concern over the impact of bill changes on renters.

PIAC also notes that the current price determination period for the SDP is out of sync with the price determination for both Sydney Water and Hunter Water. While this is not an issue for this price determination, IPART should consider amending the next SDP price determination to align with the metropolitan water districts.

Recommendation 3

PIAC recommends that Sydney Water work with its customer council to investigate ways of mitigating the impact of changes to its price structure on renters who are an increasing proportion of the Sydney population.

Recommendation 4

PIAC recommends that the price determination period for the SDP be brought in line with Sydney Water and Hunter Water, to reduce any potential uncertainty in calculating metropolitan water prices.

¹⁰ Ibid 240.

¹¹ Ibid 241.

2.3 Changes to wastewater prices

2.3.1 Review of residential wastewater charges

Sydney Water customers are currently charged a fixed service charge for wastewater services. Sydney Water has not made any proposals to change this; however it was indicated it is something that may be reviewed in the future, as a single fixed charge for wastewater does not fit within the current pricing principles of a user pays system and that a usage-based charge is equally appropriate for water and wastewater systems.¹² This is the case in Melbourne and other major cities around the world.¹³

In theory, this may see a reduction in overall wastewater charges for residents, especially those who use less water and thus have less wastewater to discharge. South East Water, one of three water retailers in Melbourne, calculates the volume of residential wastewater discharged using discharge factors rather than use individual meters. These are a proportion of water volume, set at 75% of water volume for houses and 85% for apartments, to estimate wastewater discharge volume.¹⁴ Using a similar method, IPART has proposed discharge volumes for Sydney set at 50% for houses and 75% for apartments. For low water using households, this could result in lower wastewater charges than they are currently paying in their bills.¹⁵

PIAC supports a review of the current wastewater charges and tariff structure to ensure residents are paying the appropriate price for both cost recovery and their actual usage. However, there remains the issue of the potential negative impact on renters, as this would shift the costs of wastewater service from the owner to the renter. This lends further weight to PIAC's recommendation three above.

2.3.2 Rebase wastewater charges

Sydney Water has proposed rebasing wastewater charges for non-residential customers using a 20mm connection rather than a 25mm connection. This would result in small non-residential customers contributing the same price to Sydney Water as all residential users.¹⁶ This is reflected in the higher price savings proposed for small non-residential customers with a 44.4% savings on wastewater service charges.¹⁷ PIAC notes that this change does not increase the residential wastewater service charge. PIAC is concerned that such a move will change the relative cross-subsidy between small non-residential and residential consumers. In particular, PIAC would not like to see any such change disadvantage residential consumers.

Both IPART and Sydney Water have indicated this change will make it simpler for customers to understand wastewater charges.¹⁸ PIAC disagrees for two reasons. Firstly, there is enough evidence to indicate confusion among residential consumers about the wastewater charge. Secondly, PIAC is unsure that any improved customer understanding is of sufficient value to justify the impact of the changes. PIAC notes that Sydney Water has indicated there is confusion amongst small non-residential customers and suggests that Sydney Water should spend time

¹² Ibid 254.

¹³ IPART, 149-150.

¹⁴ Ibid 150.

¹⁵ Ibid 150.

¹⁶ Sydney Water, 109.

¹⁷ Ibid 19.

¹⁸ IPART, 121-122 and Sydney Water, 109.

educating small non-residential customers about the difference in charges rather than changing the price structure.

Recommendation 5

PIAC recommends that IPART models Sydney Water's proposed changes to wastewater charges to assess the impact on residential consumers and re-consider, via a cost-benefit analysis, the value of these proposed changes.

2.4 WACC and low interest rate environment

Sydney Water has proposed significant price decreases, with 52% of the price reduction from a lower WACC down 4.6% from 5.6% due to low interest rates. Sydney Water has said in its submission to IPART, if the current interest rates change, the WACC will change and may be different what has been proposed. This will have an impact on the final water price for residents. PIAC is concerned about any potential impacts on costumers' bills from changes to the WACC either by IPART changing the rate or from increases in the interest rate.

IPART has indicated that it will not adopt Sydney Water's proposal to use a 40:60 ratio between short-term and long-term debt, rather it would make Sydney Water use a 50:50 ratio. Potentially this will also result in a different WACC and changed prices.

PIAC would like more information as to how any changes from IPART's determination or changes in interest rates would have on residential water price structure.

Recommendation 5

PIAC recommends that Sydney Water provide more detailed analysis of the impact that changes in the interest rate will have on customer bills and how any changes in cost would be passed onto consumers.

2.5 Additional price changes

2.5.1 Dual occupancy charge

Sydney Water has indicated that it wants to amend the way dual occupancy properties are charged. Currently, they are charged as two distinct properties with separate water and wastewater charges. Sydney Water has proposed charging them as one property with a shared water and wastewater charge. This is because Sydney Water has difficulties identifying these properties and there is currently an unidentified number of these properties being treated as one single property.¹⁹ Sydney Water has proposed this pricing to simplify its pricing system.

If Sydney Water were to move ahead with this change, the cost of servicing these properties would be spread across all bills, resulting in an additional \$5 to each customer's annual bill.²⁰ PIAC does not support any additional cost to residential consumers bills. However, PIAC recognises the difficulty in identifying these properties and would support further analysis of this issue to better understand the cost associated with accurately identifying these properties versus the additional costs directly associated with not charging them as separate properties.

¹⁹ Sydney Water 112.

²⁰ IPART 132.

In developing this proposal, PIAC would like to see more analysis on the demographics of who lives in dual occupancy properties. Are these residents more likely to be elderly parents, people with disabilities or renters? This additional information will help Sydney Water understand the potential impacts of any changes in charges that may affect vulnerable groups. The review should also examine any benefits from the removal of cross-subsidies by charging these properties as two dwellings rather than one.

Recommendation 6

PIAC recommends additional research and analysis to further understand the true costs associated with dual occupancy properties and the potential impact on vulnerable groups by any change in pricing structure.

2.5.2 Stormwater pricing

Sydney Water has indicated that the costs of providing stormwater services will increase in the future. IPART has identified this issue as a future concern, to ensure there is time to understand how to better allocate the costs across the customer base to reflect the broader benefits from stormwater drainage that the wider Sydney community enjoys.

Sydney Water has conducted initial customer engagement on this issue and tested two scenarios

- A. Stormwater service charges are spread across its entire customer base.
- B. Everyone in LGAs containing designated stormwater areas equally bear the costs of increased stormwater infrastructure investment ²¹

The majority of the respondents supported Option A; however, there were mixed responses with many not wanting to share costs as they already pay their local council for stormwater services. Preliminary consultations indicated that many consumers believed the current charge system to be inequitable.²²

Stormwater pricing was modified to be area-based charges during the previous price determination. Customers pay a stormwater fee based on the billable area by customer type. IPART's analysis of this suggests that residential customers in apartments are paying more than they should while large non-residential customers are paying below what they should. Residents in apartments contribute 16.5% of revenue but make up only 8.4% of the area, while large non-residential customers contribute 1.7% of the revenue and make up 6.3% of the area.²³

Stormwater services provide a greater public good beyond the individual property. As Sydney Water has mentioned, the costs of providing this service are set to increase as urban areas increase and climate change impacts are felt. Therefore, PIAC welcomes a review of this pricing structure to determine if it is reasonable. However, PIAC cautions that the pricing should be

²¹ Ibid 154.

²² Sydney Water, 112-113.

²³ IPART, 156.

equitable and, if pricing remains area-based, efforts must be made to ensure residents in apartments are paying an equitable share of the cost of stormwater.

Recommendation 7

PIAC recommends IPART and Sydney Water use the next four years to undertake cost-benefit analysis on stormwater provision. To ensure that an accurate picture is developed of who contributes to stormwater and who benefits to ensure the costs are accurately determined.

2.5.3 Wholesale pricing

The *Water Industry Competition Act 2006* (NSW) was introduced to promote competition in the New South Wales water industry. To date, third party entry has been limited. This is in part due to uncertainty regarding the regulation of pricing for third party wholesale buyers from Sydney Water while maintaining postage stamp pricing.²⁴ During this price determination, IPART will regulate wholesale prices for the first time.

Sydney Water has proposed a 'retail price minus avoidable costs' approach to wholesale pricing. In the issues paper, IPART indicates this would be its preferred method as well. Under this method, Sydney Water would charge the wholesale entity the

retail charges that it would otherwise levy the houses, apartments and businesses being serviced by the wholesale customer minus an estimate of the costs that Sydney Water avoids as a result of the wholesale customer servicing these retail customers.²⁵

This approach factors in the long-term costs that Sydney Water would avoid because a third party is operating in the area. The Australian Competition and Consumer Commission (ACCC) ruled in a price dispute between Sydney Water and Services Sydney that the pricing methodology in this case be retail price minus avoidable costs.²⁶

Given the ACCC is required to consider the broader public interest in its determinations and supports the retail minus avoidable costs methodology, PIAC feels comfortable that this methodology will minimise cost issues for customers of third party suppliers and unintended pressure on the wider system given the use of postage stamp pricing.²⁷ IPART has also sought comment on whether IPART should regulate the wholesale price or prices be determined through a voluntary access agreement under the WIC Act. PIAC believes that this should be done by IPART, which already regulates water prices in NSW rather than through voluntary access agreements to ensure customers supplied by third parties are protected just as any customer supplied by a major utility.

²⁴ Sydney Water, 244.

²⁵ IPART, 181.

²⁶ Australian Competition and Consumer Commission, *Access dispute between Services Sydney Pty Ltd and Sydney Water Corporation Final determination Statement of reasons* (2007) 2.

²⁷ Ibid 20 and IPART, 183.

Recommendation 8

PIAC recommends the adoption of the 'retail minus avoidable costs' methodology for calculating wholesale costs for third party suppliers under the WIC Act and that IPART regulates wholesale prices beyond this price determination period.

3. Customer fees

3.1 Late fee

Sydney Water has proposed a late free of \$4.10, or interest accrued on overdue bills (whichever is the greatest), to recover operating costs associated with late payment. Late fees would not be applied until the bill is 28 days overdue. The late fee would not be applied to customers who have been identified as facing hardship, who are participating in various hardship and bill assist programs, or where the Energy and Water Ombudsman (EWON) has asked Sydney Water to waive the fee.

PIAC reiterates its view that as long as the late fee does not negatively impact those who are facing hardship, or for whom late payment is due to financial difficulties, such a late fee is acceptable. PIAC supports Sydney Water's attempts to reduce the impact of the late fee on those already facing hardship. PIAC proposes that this process be monitored during this price determination to ensure that efforts to protect vulnerable customers are adequate.

Recommendation 9

PIAC recommends that the introduction of a late fee be monitored over the coming price determination to ensure that efforts to protect vulnerable customers from negative impacts of a late fee are effective.

3.2 Credit card fee

Sydney Water has indicated that it will charge customers a credit card fee of 0.4% from 1 July 2016, to recover the costs of credit card merchant fees. Sydney Water has indicated this fee is lower than the typical utility credit card fee at 1%.²⁸ Sydney Water has also indicated that the NSW Treasury will review this process as it is implemented.

While PIAC agrees that not all customers use credit cards to pay their bill and that the broader customer base should not pay for those who do. However, PIAC is again wary of any unintended consequences for those already experiencing hardship. A credit analysis in the United States found that as many as 40% of low- to middle- income households surveyed used credit cards to pay for basic living expenses, including utility bills when they do not have enough money in their savings/cheque accounts.²⁹ In Australia, during 2014-2015, one in five people relied on a credit card to get by until the next pay day.³⁰ While the Australian research does not consider the more specific question whether households are using credit cards to pay utility bills, it does reveal that

²⁸ Sydney Water, 160.

²⁹ Demos. *The plastic safety net. Findings from the 2012 national survey on credit card debt of low- and middle-income households* (2012) 9.

³⁰ Choice. *Consumer Pulse: Australians' attitudes to cost of living 2014-2015*, (2015) 14-16.

households are struggling and this may be one of the coping methods relied on. Therefore, the proposed credit card fee may have an additional cost burden for these households who are struggling to balance basic living costs. This is particularly the case for those households with very little savings or resources to rely on when multiple bills occur at once.

An additional fee, although small, may have long-term impacts on these households, particularly given that these households tend to have multiple debts at any time. PIAC would like to encourage Sydney Water to review this policy and implement protections for those customers experiencing hardship. Those protections should be similar to those that have been suggested with the implementation of the late fee.

Recommendation 10

PIAC recommends Sydney Water investigate the use of hardship protections similar to those applied to late fees, to avoid unintended consequences for low-income households who have no choice but to use a credit card to pay their water bill.

4. Communication with customers

4.1 Rewording ‘service charge’ terminology

Sydney Water has found there is confusion among customers about the term ‘service charge’ and what service is actually being provided. In the issues paper, IPART has asked for feedback on alternative terminology that would improve customer clarity about the role of the service charge. PIAC supports any move to improve customer understanding of water pricing, as this will lead to improved outcomes for customers and improve transparency.

PIAC does not agree with IPART that ‘availability charge’ is the most appropriate term or that it ‘better represents the customers’ ability to use the system (ie that they are connected to the system), rather than the actual use of the system’.³¹ Of the suggested terms, PIAC recommends one of the following:

- fixed charge
- network charge
- distribution charge.

However, any changes to the service charge terminology should be made in consultation with customers and community representatives to ensure these changes achieve the stated goal of improved customer understanding.

Recommendation 11

PIAC recommends that any changes to billing terminology be done in consultation with customers to ensure that this change achieves the stated goal of improved customer understanding.

³¹ IPART, 133.

Recommendation 12

PIAC recommends that IPART adopt one of the following terms to replace 'service charge'

- *fixed charge*
- *network charge*
- *distribution charge.*

5. Proposed regulation changes

Sydney Water is proposing a series of changes to the regulations that determine cost recovery and pricing structure. PIAC cautions that it is important to allow time for stakeholders to provide comment and ask questions about these changes early in the process before moving ahead with any significant changes.

5.1 Weighted average price cap (WAPC)

Sydney Water has proposed the adoption of flexible pricing through a weighted average price cap (WAPC), which would allow it to alter prices during a price determination period and create different tariff structures for different services and customer groups. This approach has previously been adopted in the energy market in NSW and energy and water utilities in the UK.³² This method would allow Sydney Water the ability to set different tariffs with the aim of encouraging more efficient use of water. Possible tariffs include a green tariff, seasonal tariffs, peak demand, and second home tariff.³³

Sydney Water has proposed that the methodology for setting the WAPC should include a cap on prices for each service; water, wastewater and stormwater, set by IPART at the beginning of each price determination period. Each year, Sydney Water would propose changes to the prices for the upcoming 12-month period to IPART for approval.³⁴ This would occur over a five-month period to allow time for comments. Sydney Water has proposed that this would be applied to both residential and non-residential customers. IPART has indicated it would prefer to trial the process on large non-residential customers first.³⁵ IPART has also suggested Sydney Water would need to develop clear pricing principles and IPART would set side constraints to ensure customers are not disadvantaged by such a pricing structure.³⁶

While PIAC supports efforts to promote the efficient use of water and to use pricing structures that better reflect customer preferences, PIAC has concerns about the application of a WAPC in the NSW urban water sector. In particular, as IPART has already said:

- limited competition exists in the market,
- metering technology is not widespread enough to support this approach, and the quarterly billing process does not provide customers with information about their water use prompt enough to effectively use flexible tariffs,
- postage pricing policy would limit the application of WAPC.³⁷

³² Sydney Water, 248.

³³ Ibid 253.

³⁴ Ibid 252.

³⁵ IPART, 100.

³⁶ Ibid 103.

³⁷ IPART, 100.

In addition, this pricing structure may shift some of the burden of regulation onto consumers. In order to benefit, consumers would need to be more actively involved in monitoring use, placing additional burdens on a household. Water use, particularly indoor water use, is relatively price inelastic and there is limited scope to move water use activities to non-peak times to benefit if tariffs were structured with a peak/off-peak emphasis.³⁸

PIAC's final concern is that the application of WAPC in the NSW energy sector was abandoned, due in part to perceived gaming of the system by the electricity networks. In addition, as the Australian Energy Regulator (AER) stated in a submission to the Productivity Commission, WPAC and LRMC produce conflicting incentives for distribution network businesses.³⁹

If a WAPC were to be introduced, PIAC supports IPART's recommendation that Sydney Water develop clear pricing principles and a statement of intent for the WAPC. In particular, the pricing principles should make explicit reference to the impact on low-income households, pensioners, renters and participants of the hardship/bill assist programs. In addition, IPART should set side constraints to ensure that a WAPC does not negatively impact residential customers and produce conflicting incentives for Sydney Water. Overall, PIAC does not consider it prudent to implement a WAPC into the NSW metropolitan pricing methodology given the constraints and history of WAPC in the NSW energy market.

Recommendation 13

PIAC recommends that IPART not introduce a WAPC into the pricing methodology. However, if one is introduced, PIAC supports the use of clear pricing principles with explicit reference to the impact of a WAPC on low-income households, pensioners, renters and participants in the hardship/bill assist programs. In addition, IPART should set clear side constraints to ensure the WAPC is efficient and equitable.

5.2 Efficiency benefit sharing scheme (EBSS)

The second major regulatory reform that Sydney Water has proposed is an efficiency benefit sharing scheme (EBSS). At the moment, any efficiency savings can either be passed directly onto the customer or held until the next price determination period and then passed onto customers. If businesses keep these savings for the remainder of the price determination period, it encourages the business to develop and deliver efficiency savings over the regulatory period. However, the incentive reduces over the price determination period as savings must be passed on sooner to customers and the business benefits less. Sydney Water has proposed the EBSS to allow Sydney Water to hold efficiency savings for a set period of time regardless of when they occur during the price determination period. It argues this will more effectively encourage efficiency savings throughout the entire regulatory period.

Sydney Water has proposed to apply an EBSS to a portion of both the operating and capital expenditure for the company. IPART has suggested that there is benefit in adopting an EBSS to a portion of Sydney Water's operating expenditure, but not to the capital expenditure.⁴⁰ This is due to the different driving forces and the non-recurrent nature of capital expenditure.

³⁸ American Water Works Association, *Principles of water rates, fees and charges* (6th Edition) 2012, 217

³⁹ AER Productivity Commission's *Electricity Network Regulatory Frameworks Draft Report* (2012), 16.

⁴⁰ IPART, 89.

In principle, PIAC supports this approach. However, PIAC would like to provide comment through the customer council on the development of the final methodology to ensure that customers receive the maximum benefit from such an approach.

Recommendation 14

PIAC recommends that the EBSS be adopted but that the methodology be developed in consultation with the customer council to ensure that customers receive the maximum benefit from such an approach.

5.3 Cost pass through mechanism review

Cost pass through mechanisms provide a way for regulated utilities to recover uncertain or unknown costs that occur during the price determination period. An example is the cost pass through mechanism for purchases from the SDP. This is a specific application as it is a clearly defined case with a well-defined trigger event. Sydney Water is proposing the adoption of a general cost pass through mechanism to recovery costs associated with more general risks such as:

- material variance': risk that costs of existing projects could vary materially more than already allowed for under the price determination.
- new obligation': risk that material costs emerge that are not included in the regulatory allowance.
- shipwreck': risk that costs will increase due to fire, earthquake, or pandemic.⁴¹

IPART has provided initial analysis of Sydney Water's proposal in the issue paper. IPART did not consider there to be a case for developing a broad cost pass through mechanism.⁴² PIAC also does not consider there to be sufficient reason to adopt this proposal as Sydney Water should have mechanisms for dealing with uncertainty in its corporate structure and long-term pricing mechanism. A general cost pass through mechanism would be harder to regulate given the indeterminate nature of some of the risks and associated costs.

Recommendation 15

PIAC recommends that IPART not adopt a broad cost pass through mechanism.

6. Assets sales

6.2 Asset disposal process

Sydney Water has proposed that capital gains tax liability should be applied to the 50% of any profits made from the sale of land that is passed onto consumers.

⁴¹ IPART, 91 and Sydney Water, 266.

⁴² IPART, 95.

PIAC does not support this proposal as capital gains tax constitutes business operating expenditure and, as IPART has stated, Sydney Water should pay any tax obligations from the regulatory profit it retains and the 'business bears the risk of any profits or losses arising from the sale of an asset and customers are not affected'.⁴³

Recommendation 16

PIAC recommends that IPART not implement the proposed application of capital gains tax to the 50% customer share of profits from the sale of assets.

7. Conclusion

PIAC thanks IPART for the opportunity to contribute to the review of prices for Sydney Water services.

PIAC welcomes the reduction in bills for residential consumers but cautions against any significant price increase that results from external changes in interest rates in the future.

PIAC also cautions against major regulatory changes without significant customer engagement and modelling to understand the impact of these changes on residents, in particular renters and low-income households.

PIAC acknowledges that Sydney Water has a strong commitment to customer engagement and reflecting customer input in the pricing structure. PIAC hopes this approach will be used in understanding the proposed regulatory changes and the issues that have been flagged for consideration in the following price determination period in 2019.

⁴³ IPART, 63.