



# WATER PRICING AND LICENSING REGULATING WATER BUSINESSES SPECIAL REVIEW

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**Review update**  
Stakeholder feedback and next steps

**November 2020**

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### The Independent Pricing and Regulatory Tribunal (IPART)

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## 1. We will maintain our proposed focus areas for the review

IPART is reviewing how we regulate monopoly water businesses in NSW. This review provides an important opportunity for stakeholders to help shape the future performance of the water sector. In September 2020, we released a Position Paper outlining our proposed approach to this review, as well as the proposed focus areas we planned to use to structure discussions with stakeholders and identify improvements to our existing framework.

This paper provides an update to our review; summarising stakeholder feedback on the Position Paper, and confirming our approach and next steps for the review. The feedback we have received is the first step in an ongoing conversation with stakeholders, and we will continue to work through the ideas raised with stakeholders through our review.

We received 12 formal written submissions to our Position Paper and feedback from stakeholders. We received submissions from key regulated businesses, as well as other interested parties (including local governments, public interest groups and private-sector providers of water and wastewater services). We also received informal feedback from the Department of Planning, Industry and Environment (DPIE). Figure 1.2 outlines the key themes that came through in the submissions.

**Figure 1.1 Our focus areas**

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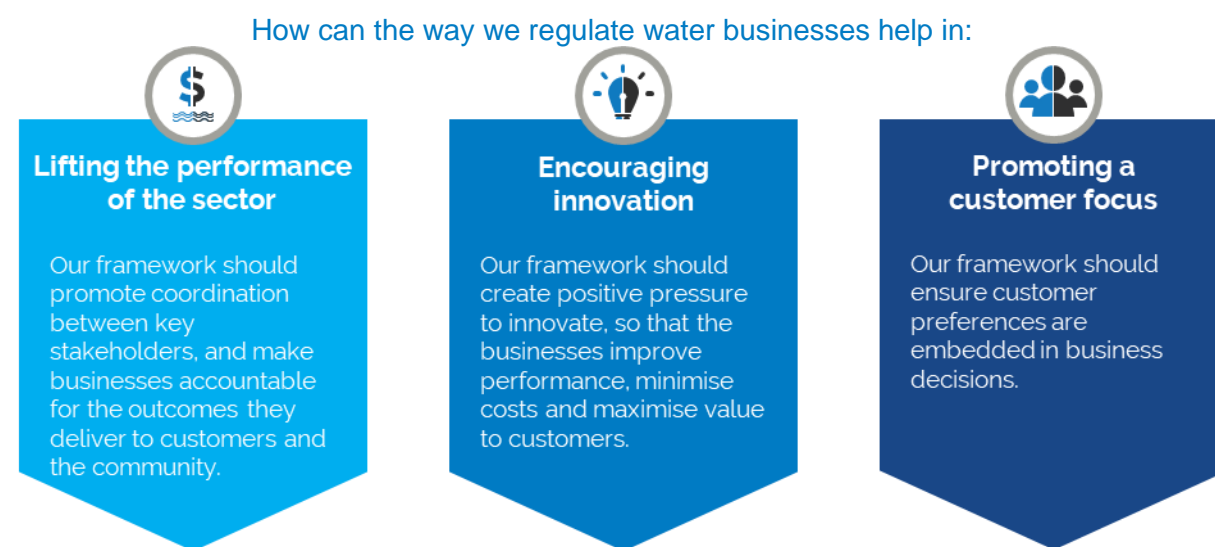


Figure 1.2 Key themes in the submissions received

Issue raised by stakeholders

IPART’s preliminary response



**Focus areas are correct**

Stakeholders agreed that the 3 focus areas proposed are the correct ones for this review:

- ▼ lifting the performance of the sector
- ▼ encouraging innovation
- ▼ promoting a customer focus.

We have maintained our 3 proposed focus areas for this review.

Chapter 4 outlines stakeholder feedback. We will continue to consider and refine the ideas raised in our Position Paper and by stakeholders throughout this review.



**Timing and review process should be adjusted**

- ▼ Stakeholders requested the proposed timetable be changed to allow more time for consultation.
- ▼ Most stakeholders requested our Weighted Average Cost of Capital (WACC) review (proposed to be run simultaneously) be postponed until after this review.
- ▼ Some stakeholders proposed that IPART create a Stakeholder Reference Group.

▼ We have amended the review timetable to allow more time for consultation.

▼ We will delay our next WACC review until February 2022.

▼ We have structured a highly transparent and extensive public consultation process for this review. A key element will be several public workshops to provide equal opportunity for discussion and input from all stakeholders, including those who proposed a Stakeholder Reference Group. We consider this meets the objectives of a Stakeholder Reference Group without the need to form a separate group of select stakeholders. Chapter 2 has further details.



**IPART should have a clear objective**

IPART should have regard to an overarching objective: that our decisions be made in the long-term interests of consumers. IPART’s regulatory framework should focus on broader ‘community’ interests.

We agree with this overarching objective. We see our 3 focus areas as a means of achieving this objective. See Chapter 3 for further details. There is a large overlap between consumers of water services and the community. Broader community interests are most often met through regulation by other agencies tasked with that responsibility, eg, environmental regulations.

## **A regulatory framework designed to meet future challenges**

A number of stakeholders noted that many elements of IPART's current regulatory framework work well. However, we consider the water sector is facing a number of challenges that have highlighted the need to review our regulatory framework.

Perhaps most prominently, our climate is changing and our water supply needs to be increasingly resilient and adaptable in a highly variable climate. Until recently, most of NSW faced severe drought, with dam levels falling at an unprecedented rate. The drought, and subsequent extreme rain events, are an example of the variability in our climate.

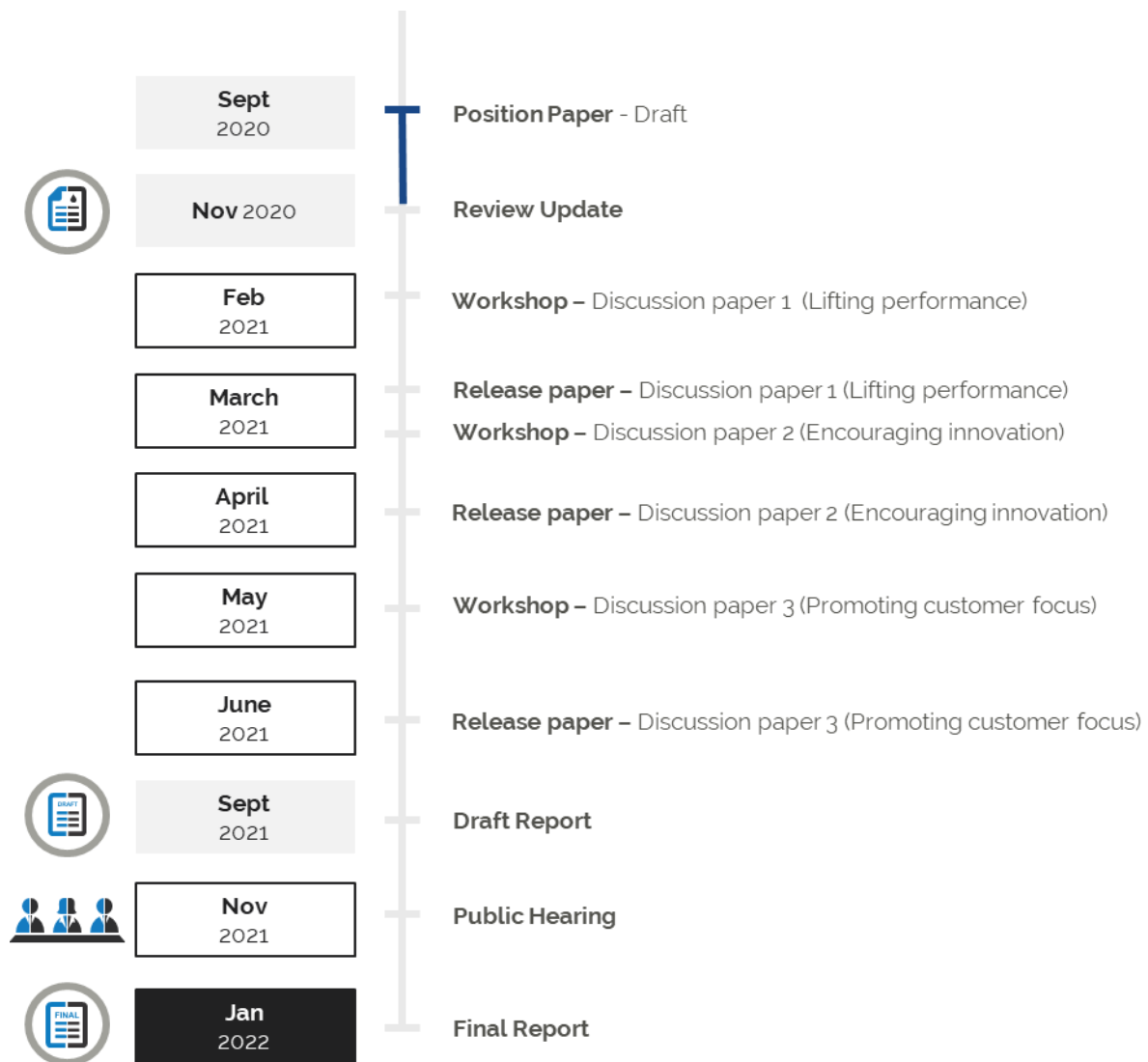
We are seeing significant population growth and development in new areas, meaning the water system needs to expand, although the full impacts of COVID-19 on population growth are uncertain. At the same time, the existing supply system is ageing and new technologies are increasingly available to deliver services differently.

Our framework also needs to ensure the water businesses respond to the changing needs of customers, to put customer preferences at the heart of the business's planning and operations. The water businesses, and our framework, need to accommodate growth and resilience without making water unaffordable.

Lifting the performance of the water sector requires a coordinated effort from government, regulators and the businesses. The regulatory and governance framework should encourage innovation, ensure the businesses consider all supply and servicing options, including the efficient use of recycled water, and promote the best supply solutions for the circumstances.

Meeting these challenges will require ambition, and a shared willingness to adapt to the challenges the sector is facing. This review aims to develop a regulatory framework that better allows the sector to respond to these challenges.

Figure 1.3 Timeline for our review



**Note:** We will provide an opportunity for stakeholders to make a submission to each of the three discussion papers, as well as to our Draft Report.



## 2. We will consider overarching issues raised by stakeholders

A number of submissions raised some overarching issues, including the need for an objective for IPART's regulation, the potential use of merits reviews and our wholesale pricing framework.

### 2.1 An objective for IPART's regulation

A common theme in a number of submissions to the Position Paper was the need for IPART to have a clear objective to promote the long-term interests of customers. Some stakeholders also asked for guidance from IPART about how we interpret our duties under Section 15 of the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act).

We received similar submissions from Sydney Water, Hunter Water, Water NSW, the Water Services Association of Australia (WSAA), the Sydney Desalination Plant (SDP) and the Public Interest Advocacy Centre (PIAC). For example, Sydney Water stated that:

“Unlike other economic regulators, IPART is not clearly and explicitly bound by a duty or objective to focus on the long-term interests of customers.”<sup>1</sup>

Sydney Water's submission also went further to question whether a review of the IPART Act would be helpful, or whether some guidance from IPART about how it interprets its duties under Section 15 of the IPART Act might be useful for stakeholders and the regulated businesses. This latter point was also made by SDP.<sup>2</sup> Water NSW suggested that in the absence of an overarching objective “there would appear to be unfettered discretion that could be applied by IPART in making a determination” in order to have regard to each of the matters listed under Section 15 of the IPART Act.<sup>3</sup>

PIAC also considered that our regulatory framework should focus on broader ‘community’ interests to include those that are indirectly impacted by or engaged with services or activities the business undertakes, rather than a narrower focus on customers.<sup>4</sup>

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1 Sydney Water submission to IPART Position Paper, October 2020, p 4.

2 Sydney Desalination Plant (SDP) submission to IPART Position Paper, October 2020, p 2.

3 Water NSW submission to IPART Position Paper, October 2020, p 11.

4 PIAC submission to IPART Position Paper, November 2020, p 1.



## IPART's preliminary response

In practice, we seek to promote the long-term interests of customers and we consider our 3 focus areas for this review are key ways to achieve this objective. We agree with submissions that our objective is to promote the long-term interests of customers, and we will make this objective more explicit in future price reviews.

We will provide guidance in this review, and further explanation in future price reviews, on how we consider the matters listed in Section 15 of the IPART Act. We note that the matters listed do not prevent our framework from having an overarching objective and legislative amendment is not required to adopt this objective.

We acknowledge PIAC's points on community interests, and note that:

- ▼ There is a large overlap between customers of water services and the community. Further, our definition of what is in the long-term interests of customers would likely capture many long-term community interests, for example, in how our approach appropriately balances long-term supply resilience and affordable services.
- ▼ We favour cost-reflective pricing and allocating costs according to the 'impactor pays' principle (ie, the party that created the need to incur a cost should pay for that cost). This promotes the optimal use of the community's scarce resources, to the benefit of the community.
- ▼ Promoting broader community interests, operationally, is often within the remit of other Government bodies and their regulatory instruments. For example, the Environment Protection Authority (EPA) regulates the water utilities' impact on the environment, to protect the community's interests. Our framework recognises the roles of these other expert regulators. We aim to ensure the water utilities receive sufficient revenue through pricing to efficiently comply with their broader regulatory requirements. And, in turn, these broader regulatory requirements are aimed at protecting the interests of the community.

## 2.2 The use of merits reviews

Sydney Water and WSAA suggested that IPART's pricing and licensing framework should be subject to merits review.

WSAA considers merits review to be a "fundamental pillar of economic regulation and administrative law making more generally", and that merits review supports the long-term interests of customers by providing a mechanism to correct regulatory errors. Its submission noted that whilst merits review has been removed from energy regulation, it has not altered WSAA's view on the need for merits review.<sup>5</sup>

Sydney Water submitted that IPART should explore how it can improve accountability in its decision-making, including the scope for review of the substance (or merits) of its decisions. Its submission suggested various options, including full merits review, arbitration or seeking independent opinions from specially constituted panels and voluntary delegation of powers to independent or consumer panels to support review and challenge of final regulatory decisions.<sup>6</sup>

### **IPART's preliminary response**

Including a merits review mechanism in the IPART Act is a decision for the NSW Government.

We agree with submissions that accountability and transparency of the IPART process is important. It is already a key element of our regulatory framework and it will continue to be.

Our standard practice is to release a draft report and determination and invite submissions, allowing stakeholders to review and make submissions on IPART's draft decisions before they are finalised. Our process allows us to hear directly from all stakeholders, including community representatives. We also release an issues paper and hold at least one public hearing for each price review as well as conducting thorough analysis of the proposals provided to us by water businesses. Our review process ensures that IPART is well-placed to consider stakeholder comments on its draft decisions and to balance the (often) competing interests of stakeholders and the considerations set out in the IPART Act.

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<sup>5</sup> WSAA submission to IPART Position Paper, October 2020, pp 15-16.

<sup>6</sup> Sydney Water submission to IPART Position Paper, October 2020, p 5.

## 2.3 The next review of our wholesale pricing framework

In 2017, we completed a wholesale pricing review. This review set out the prices that apply to water and/or wastewater services purchased by wholesale customers (WICA<sup>7</sup> licensees), from Sydney Water or Hunter Water, to on-supply to their own end-use (or 'retail') customers. The wholesale pricing framework encourages entry by WICA licensees to compete against Sydney or Hunter Water, where competition would deliver benefits to end-use customers.

Our regulatory framework for wholesale prices comprises three components:

- ▼ WICA licensees seeking to receive water or wastewater services from Sydney or Hunter Water, to then on-sell these services, are encouraged to enter into an 'unregulated pricing agreement' with Sydney or Hunter Water.
- ▼ If either party cannot reach agreement on an unregulated pricing agreement, they can ask IPART to set a price through a scheme-specific price review, which IPART would complete in four months.
- ▼ For WICA schemes on-selling water and wastewater services that do not have a recycled water plant, limited, system-wide retail minus<sup>8</sup> prices apply from 1 January 2018.<sup>9</sup>

We received some submissions to our Position Paper about our wholesale pricing framework. Specifically, Flow Systems considers that retail minus pricing creates an undue barrier for new suppliers to enter the market and compete with incumbent suppliers.<sup>10</sup> Similarly, the City of Sydney considers that retail minus pricing is increasing the cost of recycled water operations, reducing Sydney's ability to become more resilient.<sup>11</sup>

### IPART's preliminary response

Our wholesale pricing framework aims to promote efficient new entry and investment, recognising the importance of recycled water and the system-wide benefits it can provide.

In Box 2.1, we clarify a few aspects of our wholesale pricing framework in response to stakeholder feedback. It explains:

- ▼ that a retail-minus approach ensures a level playing field between wholesale service providers (incumbents) and wholesale customers (new entrants) who on-sell potable water or wastewater services.
- ▼ That IPART has not imposed a price or surcharge on private water utilities' recycled water plants. Instead, our framework encourages parties to enter into an unregulated pricing agreement, or to seek a scheme-specific review by IPART, to reflect the unique benefits and costs of individual recycled water schemes.

<sup>7</sup> The *Water Industry Competition Act 2006*.

<sup>8</sup> Under retail minus pricing, neither the wholesale customer nor provider is advantaged or disadvantaged by regulated retail price structures. Rather, both compete on their respective costs of supplying the services.

<sup>9</sup> See our [2017 Final Report](#).

<sup>10</sup> Flow Systems submission to IPART Position Paper, October 2020, pp 3-4.

<sup>11</sup> City of Sydney submission to IPART Position Paper, October 2020, p 1.

We consider our wholesale pricing framework does not create an additional barrier for efficient new suppliers to enter the market and compete with the incumbent supplier. Rather than considering wholesale pricing in this review, we intend to undertake a comprehensive review of our approach to wholesale pricing following the completion of this review of how we regulate water businesses. This is because:

- ▼ We see value in a standalone, holistic review of wholesale pricing (rather than being a component of this review).
- ▼ In the meantime, wholesale suppliers and/or customers can seek a scheme-specific review from IPART at any time if they can't reach an unregulated pricing agreement. In such a review, we would consider all proposals, views and information put forward by stakeholders.

### Box 2.1 A selected summary of our wholesale pricing framework

#### **Retail minus can promote efficient entry and maximise benefit for customers**

Under a retail-minus approach, the wholesale price for on-selling a service is based on the total postage stamp retail price of that service (or the regulated retail price), minus the costs of the contestable service (or services). The contestable services are the services the wholesale customer provides to its end-use customers from the point at which it purchases wholesale services (eg, this may include some reticulation and 'retail' services – such as billing and answering customer queries).

If a wholesale customer is on-selling ('retailing') water or wastewater services in the same market as the wholesale supplier, and that wholesale supplier's retail prices are regulated, we have said we would favour retail minus pricing for wholesale services.

This approach ensures a level playing field between wholesale service providers (incumbents) and wholesale customers (new entrants), and therefore efficient entry and competition for the benefit of water consumers. It does so because it creates a margin for the new entrant (the minus) that reflects the cost of the contestable services. The wholesale service provider (incumbent) and wholesale customer (new entrant) are therefore competing on the basis of their respective costs of supplying the contestable services, rather than on the basis of an arbitrage opportunity or artificial margin created by virtue of the nature of regulated retail prices.

In contrast, if the WICA licensee is not purchasing these services to on-sell them in such a market – eg, if it is just purchasing potable water to top up its recycled water plant or wastewater services to dispose of waste from its recycled water plant – then we have said we would favour non-residential pricing. This is consistent with prices to all other non-residential customers receiving an equivalent service.

#### **We have not set a price for recycled water plants operated by WICA licensees**

To date, we have **not** set retail minus wholesale prices for WICA licensees with recycled water plants. Further, we do not currently regulate WICA licensee's recycled water prices to their own end-use customers. Therefore, IPART not has imposed a price or surcharge on private water utilities' recycled water plants.

While, in 2017, we determined 'system-wide' retail minus prices for on-selling wholesale services, we explicitly decided that these would not apply to WICA licensees with recycled water plants. This was because we would only set wholesale prices to such schemes after being able to assess and factor in the system-wide benefits (known as avoided costs) of the recycled water plant. The 'system-wide' retail minus prices are therefore only a small part of our regulatory framework for wholesale prices. In fact, we

### Box 2.1 A selected summary of our wholesale pricing framework

are not currently aware of any instances where these retail-minus prices actually apply in practice.

Instead, our pricing framework encourages wholesale service customers and providers to enter into unregulated pricing agreements to reflect the specific service characteristics of each scheme, or (if they can't agree) to request a scheme-specific review by IPART at any time. As part of a scheme-specific review, IPART would consider any benefits of a wholesale customer's recycled water operations on the wholesale supplier's network (avoided costs), and account for these through a commensurate reduction to the wholesale price. We would also consider all other views, proposals and information provided by stakeholders during the course of such a review.

Further information on scheme-specific reviews and processes for them are set out in our 2017 [Final Report here](#) and on [IPART's website here](#).

### 3. We have revised the review timeline to promote stakeholder consultation

Stakeholders proposed changes to our review process and timing, requesting:

- ▼ the proposed timetable for this review allow more time for consultation
- ▼ our WACC review, which we proposed to run in parallel with this review, be postponed until after this review
- ▼ that IPART create a Stakeholder Reference Group for this review.

We outline stakeholder feedback, and our responses, to these points below.

#### 3.1 Amend review timeline

Our Position Paper proposed structuring the review process to allow:<sup>12</sup>

- ▼ six months to consult on the scope and our initial views
- ▼ six months to solve problems and make decisions, drawing on discussions in workshops and feedback on Discussion Papers on specific focus areas, to culminate in a Draft Report
- ▼ six months to present, explain and refine our draft decisions with stakeholders, and after due consideration of stakeholder feedback and a Public Hearing, to release our Final Report by December 2021.

We received submissions requesting changes to the review process and consultation elements of the review to:

- ▼ avoid holding workshops in late December/January as many people will be on leave
- ▼ provide advance notice of publications and extend the time for response to six weeks<sup>13</sup>
- ▼ allow eight months in lieu of six, for the second phase of the review process to provide sufficient time to consider the key issues of the review and deliver a more considered Draft Report.<sup>14</sup>

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<sup>12</sup> Our initial timeline for the review can be seen in our Position Paper, *Regulating Water Businesses*, p 40.

<sup>13</sup> Sydney Water submission to IPART Position Paper, October 2020, p 13.

<sup>14</sup> SDP submission to IPART Position Paper, October 2020, p 14.

## IPART's response

We agree with stakeholders that allowing adequate time for consultation is important, which is why we proposed an 18-month period for this review. And, in response to stakeholders' requests, we have revised our timetable to provide further opportunity for stakeholder feedback. Some changes we have made include:

- ▼ beginning workshops in February 2021 to avoid the December/January 'summer holiday' period when many people are on leave
- ▼ extending consultation times for the Discussion Papers where possible to enable stakeholders to better consider the key issues of our review.

We will publish the dates for these workshops on our website, and inform stakeholders. We will also provide an opportunity for stakeholders to make submissions to our three Discussion Papers, as well as our Draft Report.

We also support stakeholder requests to provide more time for consideration of the issues that will inform the Draft and Final Reports. We have revised our timetable to now:

- ▼ release the Draft Report in September 2021 rather than July 2021
- ▼ release our Final Report in December 2021 or January 2022.

## 3.2 We have delayed the WACC review for one year

Submissions strongly supported deferring the WACC review for one year, which we had initially proposed to start in December 2020.<sup>15</sup> While stakeholders supported our intention to focus the WACC review on key aspects of the WACC, they thought a 12 month delay would allow better focus on the wider regulatory framework review in the first instance.

## IPART's response

We have therefore postponed the WACC review, to commence February 2022, as requested by stakeholders.

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<sup>15</sup> Sydney Water submission to IPART Position Paper, October 2020, p 13, Water NSW submission to IPART Position Paper, October 2020, p 31, Central Coast Council submission to IPART Position Paper, October 2020, p 14 and SDP submission to IPART Position Paper, October 2020, pp 12-13.



### 3.3 We will lead a consultative and transparent review process

Some submissions called for establishing a Stakeholder Reference Group.<sup>16</sup> Stakeholders proposed the group for the following reasons:

- ▼ to increase the involvement and exposure of other stakeholders to this review, ensuring their views are included and to promote stakeholder buy-in<sup>17</sup>
- ▼ to promote transparency of the review process
- ▼ to help canvas key priority areas for developing a strategic approach based on best regulatory practice.

Sydney Water proposed that the membership for this group include customer groups, government, regulated businesses, private utilities and business customers, including developers. Sydney Water proposed that the group would:

- ▼ provide input into the strategic direction of the review
- ▼ provide input into the structure, content and participants at workshops and the public hearing
- ▼ assist IPART in synthesising the discussion from the workshops and public hearing
- ▼ provide feedback on the content and scope of the discussion papers
- ▼ assist IPART in testing its draft decisions and recommendations including by discussing the practical outcomes of IPART's proposed approach.<sup>18</sup>

These stakeholders also promoted the merits of an initial workshop to canvass the key priority issues for the review before dealing with the detail of specific issues.<sup>19</sup>

Similarly, Water NSW suggested that IPART may wish to determine a 'road map', with separate consultation processes for the matters that arise from this review that may require significant stakeholder input, for example on any new incentive mechanisms proposed.<sup>20</sup>

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<sup>16</sup> Sydney Water submission to IPART Position Paper, October 2020, p 2 and Hunter Water submission to IPART Position Paper, October 2020, p 1.

<sup>17</sup> Sydney Water submission to IPART Position Paper, October 2020, p 12

<sup>18</sup> Sydney Water submission to IPART Position Paper, October 2020, p 12

<sup>19</sup> Hunter Water submission to IPART Position Paper, October 2020, p 25 and SDP submission to IPART Position Paper, October 2020, p 14.

<sup>20</sup> Water NSW submission to IPART Position Paper, October 2020, p 31.

## **IPART's response**

We have structured the review to allow multiple opportunities for stakeholders to have their say. The process will allow us to consider information and views from all parties, in a transparent way, and ensure all stakeholders have an equal say.

This review – by its nature – is an opportunity for all interested and relevant stakeholders to provide comment on, and suggest improvements to, the way IPART regulates water businesses.

We have structured a series of workshops that will explore ideas from a cross-section of stakeholders, including representatives from the same groups that Sydney Water suggested for a Stakeholder Reference Group, but without limiting attendance or participation to specific groups.

We have also held comprehensive two-way meetings and workshops and continue to liaise with key government bodies, customer representative groups, regulated business and other regulators on priority areas for this review. This has been beneficial for all parties involved, providing valuable feedback to IPART and enhanced stakeholder buy-in to our process.

To date, we have critically reviewed our framework to identify its strengths and weaknesses, and synthesised developments in other regulatory frameworks with the help of an external consultant. Our Position Paper used this initial work to identify three focus areas for the review, which reflect the areas where we consider there is most opportunity for improvements to our framework. Overall, the response to our Position Paper has been very positive, and in particular, stakeholders have agreed with the focus areas we identified.

Our review process will allow us to achieve the objectives of a Stakeholder Reference Group, without needing to establish a separate group comprised of select stakeholders.

We note that, beyond this review, we may seek to form working groups, which include staff from the regulated businesses, to work through the detail and implementation of any major reforms arising from this review.

## 4. We received submissions on the three focus areas for the review

In this chapter we summarise specific feedback from stakeholders on our three proposed focus areas to identify improvements to the current regulatory framework. Stakeholders largely emphasised incremental improvements to our framework rather than suggesting a complete overhaul of our current approach, noting that many features of the current system that should not be changed.

### 4.1 Lifting the performance of the sector

One of the focus areas for this review is looking for ways to lift the performance of the water sector in NSW. In our Position Paper we also shared some initial ideas for how we could adjust our framework and asked for feedback.



#### Lifting the performance of the sector

Our framework promotes co-ordination between Government, other regulators and the water businesses to deliver a resilient and efficient water sector. It also ensures the businesses are held accountable for the outcomes they deliver to customers and the community.

Stakeholders were largely supportive of our proposed initiatives to lift the performance of the water sector. Specifically, there was a strong appetite to explore a revenue cap pricing framework, widespread support for increased collaboration between regulatory bodies, and interest in incorporating higher powered incentives into the performance framework. Specific responses are outlined below.

#### 4.1.1 Using pricing to boost accountability

In the Position Paper we suggested that reviewing how we set prices could be beneficial. For example, we could explore moving from setting maximum prices to setting a revenue cap, or using a weighted average price cap. These alternatives could provide more flexibility for businesses and remove any incentive to sell water beyond what is efficient. The feedback we received was largely supportive of exploring alternative ways of setting prices. The regulated businesses largely agree that they should be accountable for their performance, and that flexibility in prices could be a part of enabling them to be accountable.<sup>21</sup>

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<sup>21</sup> Sydney Water, Hunter Water, Water NSW and Sydney Desalination Plant all took this view in their submissions.

Sydney Water was interested in a revenue cap, particularly noting that it would help address uncertainty created under the current system where demand fluctuations are only addressed at the end of a regulatory period.<sup>22</sup> Hunter Water also saw merit in a revenue cap, suggesting it could be used to facilitate the management of risk and promote water conservation.<sup>23</sup>

Water NSW agreed that being accountable for outcomes was desirable, but noted it needs further tools to manage uncertainty. It considers the current pricing model puts too much risk on the business, and a revenue cap could help address this.<sup>24</sup> Unlike Sydney Water, Water NSW cautioned against the use of strict side constraints, arguing they could turn the revenue cap into a de facto maximum prices approach. It suggested an alternative model could be to keep using the maximum prices framework, but to add a contingent projects mechanism and relax cost pass through criteria to account for uncertain costs.<sup>25</sup>

Much like Water NSW, SDP considered that businesses need tools and flexibility in order to be accountable for performance. Specifically, it requested the cost pass through criteria be relaxed.<sup>26</sup>

The only submission arguing against a revenue cap we received was from PIAC, which argued that revenue caps, when used in the energy sector, brought about complexity and price volatility which was not good for the community.<sup>27</sup>

### **IPART's preliminary response**

We agree that businesses should be accountable for their performance, and will continue to consider the possibility of a revenue cap for future price reviews. We do, however, note that a revenue cap may not be appropriate for some of the smaller businesses with fewer resources available for pricing. We will continue to consult on this issue, and weigh up the advantages of moving to a revenue cap with its costs.

Our cost pass through principles aim to provide the appropriate balance of risk between businesses and customers. We maintain that risk should sit with the party best equipped to deal with it but we will continue to consult on this.

### **4.1.2 Increased coordination in the sector**

Our Position Paper suggested that greater coordination and collaboration between different regulators and policy makers could help to optimise outcomes, and promote better long term planning in the sector.

All submissions were strongly in favour of increased coordination between different regulators in a broad sense.<sup>28</sup>

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<sup>22</sup> Sydney Water submission to IPART Position Paper, October 2020, p 19.

<sup>23</sup> Hunter Water submission to IPART Position Paper, October 2020, p 1.

<sup>24</sup> Water NSW submission to IPART Position Paper, October 2020, p 14.

<sup>25</sup> Water NSW submission to IPART Position Paper, October 2020, p 14.

<sup>26</sup> SDP submission to IPART Position Paper, October 2020, p 5.

<sup>27</sup> PIAC submission to IPART Position Paper, November 2020, p 2.

<sup>28</sup> See submissions from Sydney Water, Hunter Water, Water NSW, SDP, PIAC and Central Coast Council, for example.

Specifically, Hunter Water noted it is very interested in engaging its board more heavily in pricing proposals, and both Sydney Water and Hunter Water are in favour of developing a 'Regulators Working Group' where regulators could discuss common issues and better understand each other's priorities.<sup>29</sup>

### **IPART's preliminary response**

We are pleased to see the high level of interest in a Regulators Working Group and will work through logistics of setting up such a group. We note that a group like this would require buy-in from other regulators, as well as policy makers. At this stage we have had feedback from some parts of government that this group would be welcome, but we will need to engage further with other regulators. We will continue to seek this engagement.

### **4.1.3 The regulatory burden of IPART's processes**

IPART plays two key roles in water regulation: pricing and licensing. In our Position Paper, we suggested that we could better align our two functions to reduce uncertainty and regulatory burden for businesses. We proposed that pricing and licensing reviews could be conducted simultaneously so that performance standards are determined in conjunction with the prices that result from those standards.

There was support for better coordination between the pricing and licensing review processes, but there were different opinions about the extent to which their timing should be aligned.

Hunter Water considered that under IPART's current approach, beneficial trade-offs between standards and prices are missed. However, resourcing constraints mean that running both reviews concurrently would not be feasible. Instead, it suggested moving key performance standards out of the licencing review and instead setting them as part of the price review.<sup>30</sup>

Water NSW was interested in further exploring the idea of aligning the two reviews to reduce duplication of effort. However, it noted that if the standards set in the licence review are not accepted by government, this would prolong the pricing review.<sup>31</sup>

The Central Coast Council noted that the regulatory burden of the current pricing framework is significant, particularly for smaller regulated businesses. It suggested that the process could be tailored to reflect the different circumstances experienced by smaller players.<sup>32</sup>

### **IPART's preliminary response**

We will continue to consult on the optimal timing/sequencing of pricing and licensing reviews, and also look for other opportunities to better align our two functions.

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<sup>29</sup> Sydney Water submission to IPART Position Paper, October 2020, p 28 and Hunter Water submission to IPART Position Paper, October 2020, p 15.

<sup>30</sup> Hunter Water submission to IPART Position Paper, October 2020, p 18.

<sup>31</sup> Water NSW submission to IPART Position Paper, October 2020, p 27.

<sup>32</sup> Central Coast Council submission to IPART Position Paper, October 2020, p 5.

We will also look at how to best target or tailor our approach. For example, there may be merit in implementing some form of graded system, where businesses can expect the approach and focus of the pricing (and licensing) reviews to reflect the capacity of the business and the quality of the business' proposal.

### 4.1.4 Boosting performance incentives

In our Position Paper, we asked stakeholders to consider the implications of tying business performance to financial incentives. Overall, there was support for this concept, though the extent of the support did vary.

Sydney Water suggested that the framework needs to be amended so as to better align customer and shareholder interests, and that this will incentivise performance above minimum standards. It argued that:

The best regulatory regimes today ... seek to encourage the company to reveal its efficient costs through the incentives built into the review process.<sup>33</sup>

Water NSW argued that stronger financial incentives would improve performance, but this would be a major change (and expensive to implement). It considers more work needs to be done to understand what value this change would deliver for customers.<sup>34</sup>

Hunter Water also supported enhancing incentive mechanisms, arguing that exceeding customer standards is a key issue in achieving customer satisfaction.<sup>35</sup> The Central Coast Council and Kingspan Water and Energy also agree that there is merit in exploring how incentives tied to better outcomes could promote better performance.<sup>36</sup>

### IPART's preliminary response

IPART's approach should focus on promoting the outcomes that customers value. However, our framework needs to be able to reveal and measure what these outcomes are. We need to consider the combination of financial and non-financial incentives that would best promote performance. We consider this issue further in section 4.2 below.

### 4.1.5 Promoting water conservation

In our Position Paper, we put forward a number of ideas on how we could provide better incentives for businesses to conserve water. Interestingly, we received very few submissions that commented on this issue.

Kingspan Water and Energy suggested that the Economic Level of Water Conservation (ELWC) methodology should be reviewed, and appropriate conservation targets should be partly informed by BASIX targets.<sup>37</sup>

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<sup>33</sup> Sydney Water submission to IPART Position Paper, October 2020, p 17.

<sup>34</sup> Water NSW submission to IPART Position Paper, October 2020, p 26.

<sup>35</sup> Hunter Water submission to IPART Position Paper, October 2020, p 21.

<sup>36</sup> Central Coast Council submission to IPART Position Paper, October 2020, p 10 and Kingspan submission to IPART Position Paper, October 2020, p 1.

<sup>37</sup> Kingspan submission to IPART Position Paper, October 2020, p 3.

Water NSW commented, in the context of better coordination between regulators, that water conservation signals can currently work against each other. It submitted that the drought pricing IPART implemented in recent price reviews undermines non-market mechanisms such as water restrictions, in that it signals to water users that the higher price negates the need for conservation because all costs are internalised.<sup>38</sup>

### **IPART's preliminary response**

We understand that a review of the ELWC methodology is currently being considered by Government, and we stand ready to contribute to that review. We do not believe that our drought pricing works against water restrictions. Water restrictions limit demand by controlling what water can be used for, and drought pricing limits demand by providing a price signal to customers which encourages water conservation. These are complementary initiatives that help to conserve water.

We received very little feedback on how we could provide financial signals to promote better water conservation. Regardless, we will continue to pursue these ideas, particularly the concept of a shadow price for leakage, as this review progresses.

## **4.2 Encouraging innovation**

Our Position Paper outlined that to 'encourage innovation', our framework aims to replicate the positive effects of competition in regulating monopoly businesses.



### **Encouraging innovation**

Our framework creates positive pressure for the businesses to improve performance, minimise costs and maximise value to customers, both now and in the future. Investments should address the risks of climate change, enable improved environmental performance, and deliver affordable services to customers.

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<sup>38</sup> Water NSW submission to IPART Position Paper, October 2020, p 10.



Stakeholders supported ‘encouraging innovation’ as a focus area for the review. There was broad support for exploring the options we highlighted in the Position Paper, and the key themes from submissions were that stakeholders:

- ▼ agreed with IPART that the expenditure framework needs reform
- ▼ support exploring more effective incentives, particularly stronger financial rewards and penalties, and the appropriate balance of financial risk and return
- ▼ want greater guidance from IPART regarding our expenditure review process
- ▼ consider that greater market competition and contestability would enhance innovation

The following subsections summarise what we heard from stakeholders, and our preliminary responses.

### 4.2.1 Current expenditure framework is not outcomes-focused

While stakeholders consider the current expenditure framework works well generally,<sup>39</sup> most highlighted areas where the framework could be improved.

In our Position Paper, we highlighted that our current method for establishing efficient costs, which includes assessing a range of the business’s proposed projects and processes through an expenditure review, can become heavy-handed and time consuming, and focus undue attention on individual projects or programs.

#### **Focus on outcomes and not inputs**

In response, stakeholders considered that the expenditure review framework should focus less on controlling costs and more on ensuring the utilities achieve the right outcomes for customers. Sydney Water, Hunter Water and The Central Coast Council expressed the view that IPART’s current approach provides an incentive for the business to spend less than its allowance to achieve a reduction in short-term costs, for example, by reducing maintenance activities, which can be assessed as an efficiency even if it is detrimental in the long term (in terms of asset life and failure rates). The Central Coast Council also expressed the view that the current assessment framework is heavy handed and places considerable burden for smaller utilities that have less resources to respond than larger utilities.

#### **Current incentive mechanisms can be improved**

A number of stakeholders considered that IPART’s current incentive mechanisms could be improved. Box 4.1 explains how IPART’s current framework provides incentives for the businesses to innovate.

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<sup>39</sup> SDP submission to IPART Position Paper, October 2020, Hunter Water submission to IPART Position Paper, October 2020, and Water NSW submission to IPART Position Paper, October 2020.

**Box 4.1 How our current framework encourages the businesses to innovate**

Our building block framework creates a financial incentive for the businesses to innovate to reduce costs during a pricing period, and discourages inefficiency by providing a financial penalty if costs rise. This is because the business gets to 'keep' (or 'bear') any cost savings (increases) it identifies relative to the cost allowances IPART used to set prices, before IPART reviews its proposed costs in the next pricing period, at which point IPART would reflect the efficient costs in the prices paid by customers over future periods.

As the water businesses invest in long-lived assets, this approach shares the efficiency gains made by the business between the business and its customers.

To sharpen the financial incentive for the businesses to reduce operating costs, we introduced an Efficiency Carryover Mechanism in 2016. This mechanism removes an incentive for the business to delay implementing operating expenditure savings. It does so by allowing the business to 'keep' any operating cost savings for the same number of years as the length of the determination period (e.g. 4 years), irrespective of when in the determination period the business realises these savings

More recently, we have developed a Discretionary Expenditure framework. This framework encourages the businesses to deliver projects and programs to exceed regulatory minimum standards, provided there is sufficient evidence that the customer base is willing to pay. The objective is to encourage higher levels of performance that are consistent with customers' preferences, and for utilities to consider a broad range of projects that it could undertake on a cost-benefit basis.

PIAC submitted that the discretionary expenditure framework should be expanded to better-deliver community outcomes while the Central Coast Council believes that this framework focuses too much on projects with a short-term return, discouraging projects that have longer-term benefits.

Kingspan also raised concern that the current framework is creating a bias towards capital solutions over lower cost alternatives, citing the large increases in capex allowance for Sydney Water over time. WSAA noted that innovation is important in being able to deliver less capital intensive solutions through new technology, which can extend the life of existing assets.

**IPART's preliminary response**

In our Position Paper, we indicated we would consider how the current expenditure framework could be improved. We broadly agree with stakeholder feedback on the direction and priority areas for review. To reiterate what we said in our Position Paper:

While our current approach provides a financial incentive to reduce costs and allows for the recovery of discretionary expenditure where there is evidence of customer willingness to pay, it does not provide a financial reward to deliver higher levels of performance to customers. We will consider such incentives in this review.

It is important that the regulatory framework achieves the outcomes that customers want at an efficient and affordable level of costs. Moving to an expenditure review process that is more focussed on broader customer outcomes will require the businesses to credibly establish:

- ▼ through robust customer engagement, including evidence of customer willingness to pay, what outcomes best promote the long-term interests of consumers
- ▼ through its business plans and processes (which we currently ask consultants to review) that these outcomes will be delivered at least cost.

### 4.2.2 Stronger financial and non-financial incentives to innovate, and a better balance of risk and reward, are needed

To address the shortcomings described above, stakeholders supported exploring stronger financial and non-financial rewards for the business to reduce costs and improve performance.

#### **Financial returns should be commensurate with financial risks**

Some stakeholders suggested that IPART should consider and estimate the expected level of risk placed on the business through its decisions. For example, Sydney Water emphasised the need for higher financial rewards for taking on any additional risks associated with innovating, and that we should be careful about the type of risks businesses are exposed to under the framework:

Well-designed regulatory regimes seek to maximise the controllable risk and minimise the uncontrollable risk to which the company is exposed, subject to the need to keep the total risk of underperformance within an envelope that mitigates exposure to miscalibration of performance targets...

...the higher the risk borne by the company, the greater the likelihood this will impact on the company's cost of capital. Therefore, the regulator must have regard to the total amount of risk placed on the company and calibrate the potential equity return accordingly.<sup>40</sup>

Water NSW and SDP made a similar point about ensuring a return on capital commensurate with the risks involved, indicating that there should be returns for baseline performance that adequately compensates debt and equity holders, and greater financial incentives for outperforming regulatory targets.

#### **Support for considering a mix of financial and non-financial incentives**

In our Position Paper we also highlighted that this review could explore:

- ▼ direct funding for innovative projects that would not otherwise occur under a price determination (which could also be encouraged through innovation sandboxes)
- ▼ linking performance outcomes to financial rewards (or penalties)
- ▼ benchmarking utilities' performance against each other to inspire competition by comparison.

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<sup>40</sup> Sydney Water submission to IPART Position Paper, October 2020, pp 6 and 18.

Stakeholders supported IPART considering direct funding for innovation, given the risks involved with innovating and that the benefits may not be realised in the short-term. SDP believes utilities should be permitted an allowance for investment in research and development, and Sydney Water pointed out that explicit funding for research and innovation would enable risky innovation activities to be prioritised over other expenditure. Flow Systems noted that the innovation funds should be open for all participants in the market to access.

There is also interest in using non-financial incentives, including leveraging reputational rewards through competition by comparison. Benchmarking (competition by comparison) had general support, though some stakeholders are cautious of how it will be implemented. City of Sydney supported benchmarking NSW water monopolies against those outside of NSW to help encourage innovation. The Central Coast Council indicated that benchmarking should take into account the nature, size and scale of the utility for fair comparison. SDP made a similar point, noting that competition by comparison may be less useful in NSW given there are few operators and they face different operating environments.

There was also interest in further exploring incentive mechanisms used by other regulators, including the PREMO model used by the ESC in Victoria, and the RIIO-2 model used by the energy regulator in the UK (Ofgem).<sup>41</sup>

While there is broad support for these ideas put forward in our Position Paper, some stakeholders are wary of the regulatory burden that may arise from more complex incentive mechanisms.<sup>42</sup> For example, Water NSW Water NSW suggested that a 'regulatory investment test' should be undertaken to assess the likely benefits and costs of introducing any substantial changes to the existing regulatory framework.

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<sup>41</sup> Water NSW submission to IPART Position Paper, October 2020, pp 18-19 and p 23.

<sup>42</sup> SDP submission to IPART Position Paper, October 2020 and Water NSW submission to IPART Position Paper, October 2020.

## IPART's preliminary response

We are keen to explore providing stronger financial incentives in our framework. In doing so, our view is that any financial incentives we provide should be symmetric, in that if we allow a business to earn a higher return if it outperforms in terms of its costs and the level of service it provides, equally, it should face the risk of a lower rate of return if it underperforms.

It is also important that incentives are calibrated so that we do not provide an 'economic' profit to a business for simply delivering a 'business-as-usual' level of service. In particular, we provide a return based on the WACC, which incentivises the business to innovate and reduce costs. And, in our most recent WACC review, we explicitly set the WACC with reference to an "efficient benchmark firm operating in a competitive market and facing similar risks to the regulated business".<sup>43</sup>

In other words, our benchmark rate of return provides commensurate economic rewards for a certain level of financial risk encountered by a regulated utility as part of their standard business operations. This includes the risks of innovating, to deliver cost savings and improved services at minimum costs, that an efficient business operating in a competitive market would face.

We are keen to understand better the reasons why current financial rewards embedded within the WACC are considered low-powered and insufficient to drive innovation and cost reductions. We will endeavour to further consult on this issue while continuing to explore the mix of financial and non-financial incentives that would best encourage innovation to promote the long-term interests of customers, including those which we outlined in our Position Paper.

### 4.2.3 Greater clarity and guidance from IPART would improve transparency

The regulated businesses asked that IPART provide greater guidance on the expenditure review process, and how IPART applies and interprets the financeability test in pricing reviews.

#### Guidance on the expenditure review process

The regulated businesses have asked that IPART provide greater guidance on its expenditure review process, both to the businesses directly and to the consultants which IPART engages to review the businesses' proposals. They requested more guidance about how IPART will assess expenditure proposals, ahead of pricing reviews.

The water businesses indicated that they would like more clarity on how IPART assesses expenditure proposals to reduce the uncertainty of whether expenditure would be deemed inefficient. Water NSW, SDP, and Hunter Water make the point that they would like IPART to specify the principles or factors that it will take into account when assessing the efficiency and prudence of their expenditures. For example, Hunter Water noted that:

... the factors or circumstances that will be taken into account in determining whether certain past or proposed expenditure is efficient are not specified. This creates uncertainty and risk for the business when developing our expenditure plans since we are

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<sup>43</sup> IPART, *Review of our WACC method – Final Report*, February 2018, p 21, available [here](#).

unable to properly assess whether expenditure will be considered efficient and included in our revenue allowance.<sup>44</sup>

Furthermore, SDP and Hunter Water suggested that IPART's ex-post review of capital expenditure – that is, our review of the business's actual investment in assets over the previous regulatory period – creates 'stranding risk' for its investments, suggesting that only clear cases of inefficiency should be disallowed from being entered into the RAB.

SDP and Water NSW expressed a desire for more guidance on the information that the consultants look for in order to reduce compliance costs. For example, Water NSW asked for more guidance from IPART to its consultants on "the level and type of information requests and the application of top down efficiencies".<sup>45</sup>

### Applying the financeability test

SDP and Hunter Water indicated that IPART could better explain how the financeability framework is applied, and to clarify the process it intends to follow when interpreting the results of the test.<sup>46</sup>

### IPART's preliminary response

There may be scope for greater clarity, including 'standardisation' of the expenditure review process, to enhance investment certainty and reduce regulatory burden. In this review we will look at all options for more clarity.

Our principle has always been that customers should only pay for efficient costs. Our efficiency test is based on the information available to the utility at the relevant point in time. That is:

- ▼ for forecast operating and capital expenditure, we assess whether the proposed expenditure is efficient given currently available information
- ▼ for historical capital expenditure, we assess whether the actual expenditure was efficient based on the information available to the utility and the circumstances prevailing at the time it incurred the expenditure.

We explain how we have implemented this principle through our reports and our consultants' reports. In our June 2020 Final Report on Sydney Water's prices, we explained our approach to assessing Sydney Water's efficient operating and capital expenditure.<sup>47</sup>

Similarly, we have sought to explain other elements of our framework through specific methodology papers – such as our paper on financeability<sup>48</sup>. Then, in our pricing reviews, we have explained how we applied these methodologies. For example, how we assessed Sydney Water's financeability and how we interpreted the results of the financeability test.<sup>49</sup>

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<sup>44</sup> Hunter Water submission to IPART Position Paper, October 2020, p 19.

<sup>45</sup> Water NSW submission to IPART Position Paper, October 2020, p 28.

<sup>46</sup> SDP submission to IPART Position Paper, October 2020 and Hunter Water submission to IPART Position Paper, October 2020.

<sup>47</sup> See, for example, appendices E, F and G of the [Sydney Water Final Report](#).

<sup>48</sup> IPART, *Review of our financeability test – Final Report*, November 2018, available [here](#).

<sup>49</sup> See Appendix K of the [Sydney Water Final Report](#).



At the same time, there may be a limit to how much guidance we can provide without running counter to the objective of giving the utilities greater accountability and responsibility for the operation of their businesses. We also note that firms in competitive markets have no ex ante guarantee that their revenues will match their actual costs, which provides important incentives for them to ensure their expenditure is well considered and efficient.

We are keen to continue to work with stakeholders on what specific factors or additional detail would be beneficial to stakeholders and the long-term interests of customers.

### 4.2.4 Increased competition and contestability

In general, stakeholders consider that greater competition could promote innovation, emphasising the importance of private sector expertise and the need for greater diversification of water sources.

In particular, Flow Systems encouraged this review to include an assessment of contestability throughout the value chain of water services (from bulk water, through wholesale water services, to the customer meter). It indicated that such an approach (component costing) would allow a better understanding of pricing structures and enable the private sector to provide 'off grid' solutions to water system infrastructure, such as in wastewater.

PIAC, though, struck a more cautious view in its submission, noting that:

Competition and new participant entry should be encouraged and enabled only where it contributes to the achievement of water regulatory objectives and improves consumer and community outcomes overall.<sup>50</sup>

### IPART's preliminary response

We agree that the **efficient** entry (and exit) of firms would enhance innovation and the long-term interests of customers. The *Water Industry Competition Act 2006* (the WIC Act – known as WICA) has a third party access regime and IPART has established a wholesale pricing framework to facilitate this efficient entry.

As highlighted in our recent submission to the NSW Productivity Commission's *Review of Infrastructure Contributions in NSW*, we consider that the policy of zero water and wastewater developer charges in Sydney and the Hunter effectively creates a cost disadvantage for private sector providers of water services (WICA utilities); limiting their ability to compete to service new development within the Sydney and Hunter regions. Because WICA utilities often provide recycled water services, this policy therefore also acts to discourage the uptake of recycled water. Furthermore, Frontier Economics reviewed the barriers to the take-up of cost-effective water recycling in NSW, and found that rescinding the Government's policy of zero water and wastewater developer charges (ie, re-introducing cost-reflective developer charges) would remove a clear bias against recycled water and new entrants and, more broadly, provide locational price signals.<sup>51</sup>

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<sup>50</sup> PIAC submission to IPART Position Paper, November 2020, p.5.

<sup>51</sup> IPART submission to the NSW Productivity Commission's Issues Paper, Review of Infrastructure Contributions in NSW, August 2020, pp 23-25.



In addition, consulting with the community about their preferences for the use of purified recycled water as an option for drinking water supply could potentially remove an additional barrier to competition in this space. Currently, additional costs are incurred to build and maintain an additional pipe network that keeps purified recycled water separate from the drinking water network.

While vertical disaggregation of Sydney Water (and Hunter Water) could also enhance the potential for competition to provide services upstream and downstream of the natural monopoly pipe network, the benefits of this would have to be assessed against any loss of economies of scope. Similarly, geographical disaggregation could promote potential competition for the market and encourage competition by comparison, but the benefits of this would have to be assessed against any loss of economies of scale. Consideration of such potential large scale reforms of the industry are beyond the scope of this review.

In the recent Sydney Water pricing review, we published estimates of Sydney Water's long-run costs of providing wastewater services by area, to help signal where it may be most beneficial to invest in recycled water schemes and facilitate the efficient entry of private sector water providers into the market. In future price reviews, we propose to continue to work to get a better understanding of Sydney Water and Hunter Water's long run marginal costs of wastewater services, and to publish this information.

Beyond this regulation review, we will also consider the benefits and costs of further progressing component costing of Sydney Water and Hunter Water's supply chains. This could enhance our understanding of their costs, including the scope for benchmarking, and provide useful information to the market, including potential new entrants. However, it could also be costly to implement and administer.

### 4.3 Promoting a customer focus

Our Position Paper outlined that our objective for this focus area was to replicate as much as possible the outcomes of a competitive market, where firms continually strive to understand what their customers want and structure their businesses to deliver their services accordingly.



#### Promoting a customer focus

Our framework and processes ensure that the long term interests of customers are embedded in all major decisions of the regulated businesses. Customers are objectively consulted in language that they understand.

Stakeholders overwhelmingly agreed that customer engagement should be the centre of regulatory processes and that businesses should be responsible for customer engagement as they are responsible for delivering for their customers.<sup>52</sup>

Stakeholders sought clarification or commented on a number of issues related to:

- ▼ the level of expectations/guidance that IPART provides to the businesses on customer engagement
- ▼ how outcomes from engagement would be treated as part of the price review process including:
  - linking incentives to engagement outcomes
  - the use of customer representative groups in the decision-making process.

Our responses to specific issues are detailed below.

### 4.3.1 Clarify expectations around role of customer engagement

Several stakeholders sought clarification on our expectations of businesses related to customer engagement. For example, Sydney Water noted that:

...greater clarity around the expected role of customer engagement in regulatory processes will benefit everyone, including the regulator, customer groups and regulated businesses. It will also minimise potential duplication.<sup>53</sup>

Water NSW also sought clarification on what constitutes effective engagement,<sup>54</sup> albeit some other stakeholders, for example, SDP (and Sydney Water) noted that establishing principles for sound and effective engagement rather than prescriptive requirements was preferable for achieving outcomes in line with the long-term interests of customers.<sup>55</sup>

#### IPART's preliminary response

Currently, our expectations regarding customer engagement are outlined in our [Guidelines for Water Agency Pricing Submissions](#).

We will continue to pursue ways in which we can clarify our expectations of businesses to inform what constitutes effective customer engagement. However, we are aware that setting overly prescriptive requirements can create a perverse incentive for the regulated businesses to meet regulatory requirements which may not be in the interests of customers. In addition, if IPART is overly prescriptive in what constitutes 'good' customer engagement, we might stifle innovation in how the business consults with their customers. We want to work with stakeholders over the course of this review, to strike a balance between

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<sup>52</sup> Hunter Water submission to IPART Position Paper, October 2020, p 2, Central Coast Council submission to IPART Position Paper, October 2020, p 13, Sydney Water submission to IPART Position Paper, October 2020, p 22, WSAA submission to IPART Position Paper, October 2020, p 12 and PIAC submission to IPART Position Paper, November 2020, p 6.

<sup>53</sup> Sydney Water submission to IPART Position Paper, October 2020, p 25.

<sup>54</sup> Water NSW submission to IPART Position Paper, October 2020, p 10.

<sup>55</sup> SDP submission to IPART Position Paper, October 2020, p 11.

clarification that is useful and meaningful while acknowledging that businesses are better placed to understand the evolving preferences of their customers.

### 4.3.2 Linking customer engagement to outcomes of price reviews

A number of submissions sought clarity on how outcomes from customer engagement would be incorporated into determination processes, for example, in terms of the weight they would be given in regulatory assessments and the incentives that would be tied to them.<sup>56</sup> Some stakeholders also observed that in some jurisdictions, customer representative groups play a role in the outcomes of price reviews.<sup>57</sup>

#### Linking customer engagement to incentives

Hunter Water noted that to incentivise engagement, IPART should shift its focus to customer outcomes, giving weight and financial incentives for improving customer satisfaction.<sup>58</sup> SDP also considered that using incentives to implement customer engagement requirements was preferable to enforcement.<sup>59</sup>

The Central Coast Council pointed to the incentive mechanisms other regulators employ as an example.<sup>60</sup>

We observe that PIAC did not necessarily agree with providing regulatory incentives to businesses for customer engagement independent of the outcomes of that engagement, as there is a risk that it could lead to a 'box-ticking' exercise by the businesses.<sup>61</sup>

#### The role of customer representative groups in the price review process

Stakeholders indicated that they were open to exploring the use of customer representative groups or customer panels in the decision-making process for price reviews.

WSAA outlined the models used by Scottish Water and the ESC in Victoria (ie, the PREMO model ) noting the wide spectrum between a model where a high level of decision-making authority is vested in a customer representative group and a model that does not use customer representative groups to make decisions.<sup>62</sup>

Sydney Water suggested that (as an alternative to a merits review, see Chapter 2), IPART could agree to voluntarily delegate powers to an independent or consumer panel, to support reviewing/challenging final regulatory decisions.<sup>63</sup>

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<sup>56</sup> Water NSW submission to IPART Position Paper, October 2020, p 10, SDP submission to IPART Position Paper, October 2020, p 11, Hunter Water submission to IPART Position Paper, October 2020, p 14.

<sup>57</sup> Sydney Water submission to IPART Position Paper, October 2020, p 25, WSAA submission to IPART Position Paper, October 2020, p 25 and Water NSW submission to IPART Position Paper, October 2020, p 24.

<sup>58</sup> Hunter Water submission to IPART Position Paper, October 2020, p 14.

<sup>59</sup> SDP submission to IPART Position Paper, October 2020, p 11.

<sup>60</sup> Central Coast Council submission to IPART Position Paper, October 2020, pp 13-14.

<sup>61</sup> PIAC submission to IPART Position Paper, November 2020, p 5.

<sup>62</sup> WSAA submission to IPART Position Paper, October 2020, pp 12-13.

<sup>63</sup> Sydney Water submission to IPART Position Paper, October 2020, p 5.

The City of Sydney considers there are opportunities for water utilities to work with customer proxies in specific areas such as stormwater and local councils. It noted that it had recently had a positive experience in using a deliberative democracy panel.<sup>64</sup>

### **IPART's preliminary response**

As part of the review process, and in consultation with stakeholders, we will consider how we can tie financial incentives to measurable improvements in customer satisfaction and customer engagement. However, we are aware that we could run the risk of rewarding 'business as usual' customer engagement, whereas our aim is to reward utilities undertaking on-going and improved customer engagement that genuinely informs their operations and their pricing proposals.

We are also keen to continue exploring with stakeholders the role of customer representative groups in the price review process.

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<sup>64</sup> City of Sydney submission to IPART Position Paper, October 2020, p 2.