



Independent Pricing and Regulatory Tribunal

IPART's Achievements

A speech for the conference

Regulation and Reform: IPART after 20 years

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Speech

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Introduction

Twenty years ago the Greiner Government established the first independent economic price regulator in Australia. Perhaps the boldness of that step is not fully appreciated. We were established prior to the Hilmer report and its recommendations for the establishment of independent price regulation. Importantly, our focus was on the regulation of prices of **government** businesses. The US had a long history of regulation of **privately-owned** utilities. Chile and the UK separately established the independent utility regulatory bodies **as part of the process of privatising their utilities**. In these cases, taking Ministers out of price setting was considered necessary to establish investor confidence.

But in NSW the government did not link independent price setting to privatisation. In effect it was saying: “We have previously set utility prices and the outcomes have been poor. Prices have been highly politicised and under-recovered costs, and the businesses have not performed well. We need to take the politicians out of the price setting process and entrust the function to an independent agency operating transparently. Our role is to set the broad objectives that this regulator must consider.”

Since our establishment, independent economic regulation of government utilities has become the norm in Australia. Independent regulation of government monopolies has also become far more common overseas, often with the encouragement of international agencies such as the World Bank. These agencies have supported the independent regulation of government monopolies because they think it is likely to provide pricing decisions that are based on evidence and consistent through time. The community’s expectations of price regulators can be expressed in simpler, but more demanding terms: fair and balanced decisions.

So after 20 years what have we achieved? Have the Government’s initial hopes been fulfilled and how has our role, and the Government’s objectives, changed over time?

I would like to start by providing a quick overview of our achievements. After this I will focus in more detail on three areas in particular:

- ▼ prices, productivity and investment
- ▼ price reform, and
- ▼ restraining regulation and promoting competition.

In brief we have:

1. de-politicised pricing and made it more rational
2. improved transparency and public information
3. acted as a 'lightning conductor'
4. balanced certainty and improvement of regulatory regimes
5. provided stronger incentives for performance improvement by regulated businesses
6. depoliticised licensing
7. set standards of service
8. promoted competition in electricity, gas, transport and especially water
9. administered environmental programs
10. undertaken an expanding range of functions
11. provided a mechanism for policy development - regulatory review, tax review and local government.

One of IPART's very considerable successes has been to de-politicise pricing and make pricing more 'rational'. Later I will talk in more detail about the reform of urban water pricing that has been achieved. But I think our role in energy pricing has also been important. A considerable degree of rationalization in the structure of electricity prices has occurred. The initial large cross-subsidies from business to residential customers were largely unwound through reductions in business electricity charges in the 1990s. Recent years have seen very substantial increases in electricity bills that have been passed onto consumers without intervention by Governments to artificially reduce consumer prices. However, we have been less successful in transport, where fares have at times been set below the levels we have determined.

So how has this been achieved? I believe there have been several important factors:

- ▼ The objectives in the IPART Act largely reflect the community's expectations. We do not have a single objective under the IPART Act. Rather we are required to take into account a range of objectives including economic efficiency, financial sustainability, and the impacts on consumers, the environment and the state government and taxpayers. In practice, we give considerable weight to economic efficiency. Having regard to a number of objectives makes the regulator's task more difficult, but requires us to consider all the factors that the community thinks are important. The recent difficulties which the Murray Darling Basin Authority experienced in gaining acceptance for its draft recommendations highlights the risks of giving primacy to a single objective.

- ▼ Transparent processes and public information. Some would say our decisions take too long and our reports are too long. I have some sympathy for this view, although we make considerable efforts to ensure that our reviews are completed in a timely manner, and our reports are as clear as possible. However, our processes ensure that there is a greater understanding of the issues, an ability for stakeholders to participate, and a careful explanation of decisions. Stakeholders may – and do – still disagree with the decisions but they will have had a chance to participate and gain a better understanding of why we have made the decision.
- ▼ Our processes enable the Government to allow debate and discussion to run at arm’s length rather than to react immediately to initial proposals that may be controversial. In effect, we become a ‘lightning rod’. As noted above, hopefully our processes lead to carefully considered proposals and greater community acceptance.

Over time, our regulatory approach has become clearer and more consistent in its application. We have put considerable effort into documenting our approach. Its foundations are the ‘cost building blocks’ and our financial models. The IPART Act gives us considerable discretion which has been of concern to some, including asset owners. We have taken the view that as Parliament has given us this discretion, it is for Parliament, rather than ourselves to limit that discretion. However, we have documented our approach on the key issue of the cost of capital in considerable detail and published papers setting out how we will consider issues of financeability, affordability, and environmental impacts. We have been careful to consult with shareholders in developing our approach to these issues and to follow these approaches when we make pricing decisions. The intention is to give greater certainty on how we will exercise our discretion.

As I will set out in more detail later, for most of our first decade we saw the regulated businesses improve their efficiency. I will argue that the regulatory regime was a contributing factor to this. Subsequently, productivity has deteriorated, with considerable upward pressure on prices, primarily as a result of large increases in capex for improved reliability, water security and other government imposed requirements. To some extent, this problem arose when governments circumvented the established regulatory process.

Our first role was to set prices, but as the Government has increasingly used licences to specify the rights and responsibilities of the service providers, and impose community objectives, we have also been given the task of recommending the issuance of licences and monitoring the performance of licence holders. One of the spurs to this was the Sydney Water quality episode, the other was the increasing involvement of the private sector. Like pricing, there was a need to de-politicise licensing and make it more transparent – which we have achieved. We have put in place a very professional, risk-based approach to monitoring licensing performance with comprehensive independent audits. Some key licence conditions are audited annually, while others are audited less frequently depending on the level of risk.

We are now seeing the start of competition in the urban water markets under WICA. New private providers are entering the water markets providing, for example, recycled water to large industrial and commercial users as well as recycled water and sewage services to residential estates. The de-politicisation of regulation and licensing was an important pre-condition for the development of these innovative and competitive supply solutions. Again, I will discuss these developments in more detail later.

In 2003, we were given the task of implementing and administering the world's first greenhouse gas emissions trading regime. Over the last 9 years, certificates equivalent to reductions of 143 million tonnes of carbon have been created. It has provided important incentives for existing power stations to reduce their carbon emissions, existing low emission generators to expand, and new low emission generators to enter the market. It has played a very important role in developing innovative technologies, such as the production of electricity from methane gas drainage at waste sites. With the introduction of a national carbon price, we are closing the Greenhouse Gas Abatement Scheme (GGAS). But its energy efficiency equivalent, the Energy Savings Scheme (ESS) is expanding and providing new challenges as new energy efficient technologies are rolled out using innovative business models.

Increasingly, the Government has asked us to undertake special reviews of policy. In many cases these have made important contributions to policy development. Our review of regulation and red tape led to the establishment of the Better Regulation Office. The review of the finances of local government and rate pegging led to reform of rate-capping. Responsibility for the setting of the rate cap and approval of exemptions ("special variations") was transferred to IPART and made more transparent. Our review of NSW taxes formed the basis of the NSW Government's submission to the Henry review and anticipated a number of important findings of that review. Tax reform is controversial and often requires a long time frame. Pleasingly, the recently announced review of the emergency services levy on insurance policies is consistent with our recommendations.

I would now like to focus on the three specific areas mentioned earlier:

1. Prices, productivity and investment.
2. User pays and efficient pricing.
3. Restraining regulation and promoting competition.

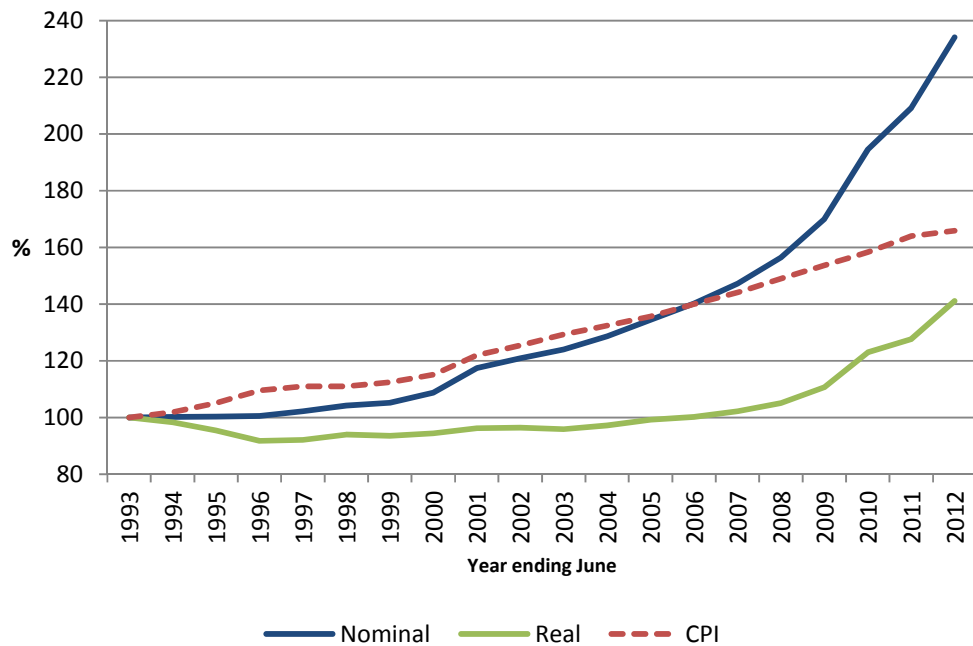
1 Prices, productivity and investment

Prices

Back in 1993, we introduced an index of household charges to monitor the impact of our price determinations on households. Each year the index measures the weighted average change in the prices of the services we regulate, where the weights are derived from Australian Bureau of Statistics (ABS) data on household expenditure on electricity, gas, water and public transport (rail, bus and ferry services).

A graph of the composite index is shown in Figure 1.1.

Figure 1.1 Composite index of household charges and CPI



Data source: IPART Analysis.

The main points are:

- ▼ Average household charges increased by **11.9%** in nominal terms (**10.6%** in real terms) in 2011/12.
- ▼ By comparison, in 2010/11, the average household charges increased by only **7.6%** in nominal terms or **3.8%** in real terms.
- ▼ But this was low compared with the previous year, 2009/10, where the index rose **14.5%** in nominal terms (**11.1%** in real terms).
- ▼ Since 1992/93, the index of household charges has risen a cumulative **134.1%** in nominal terms while the general price level has risen by **65.9%**.

- ▼ The rise in the index after adjusting for inflation has been **41.1%**, which is often stated as the rise “in real terms”.
- ▼ The average annual nominal rise has been **4.6%** per annum (**1.8%** in real terms), although much of the rise has been concentrated in the past few years.

Looking at the figures a bit closer, we can see that the past 20 years can be divided into 2 distinct periods.

During the 1990s, the index generally rose slower than inflation so that prices fell in real terms. This occurred mainly in the water and energy sectors, due to efficiencies brought about, in part, as a result of pressure from IPART. Public transport fares tended to rise during this period.

Since 2000, charges begun to rise faster than inflation in response to a number of (largely cost) pressures, such as the need for greater infrastructure investment, including investment in the electricity networks and the desalination plant. By 2005/06, prices in real terms were back to their 1992/93 levels. Greater cost pressures have unfortunately caused larger cost rises in recent years, especially in the last 3 years.

Capital expenditure

But has downward price pressure from IPART been responsible for keeping prices *too* low, to the extent that necessary infrastructure investment has not taken place, and now, urgently needed investment is causing the more recent price increases - especially in the electricity sector?

Is it IPART which has prevented electricity networks from making prudent, gradual and timely investment over the past decade, and therefore putting them in a position where urgent ‘catch-up’ expenditure is now required?

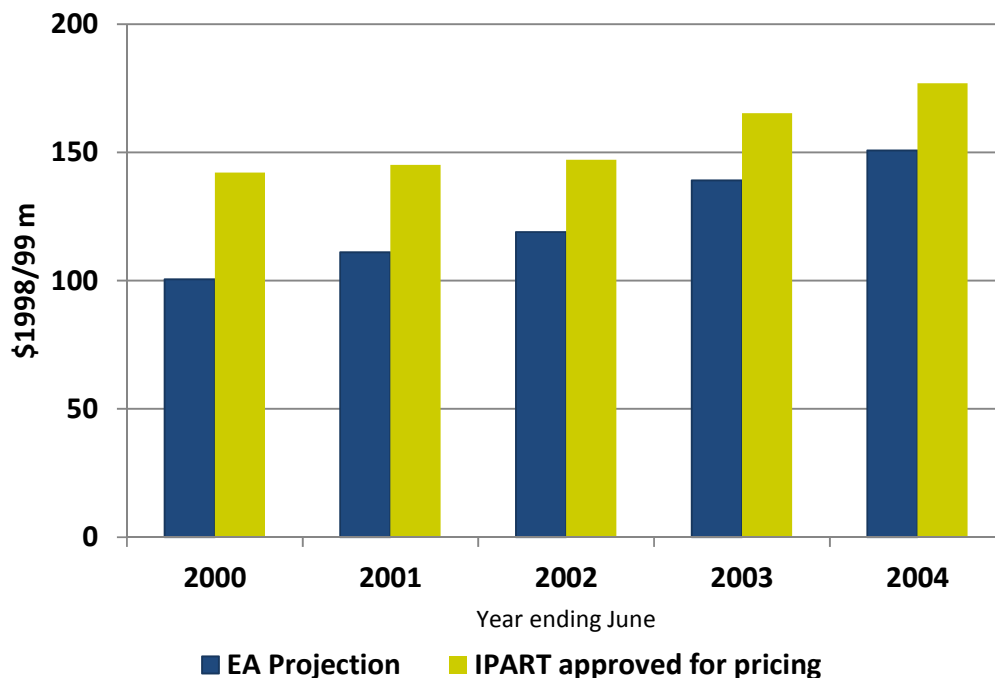
This is the view, put forward by George Maltabarow, until recently, the Managing Director of Ausgrid (formerly EnergyAustralia).¹

¹ Presentations at AEMC Public Forum, Brisbane, 23 November 2011, and the Australian Energy and Utility Summit, Sydney, 28 June 2012.

However, a reading of our pricing Determinations and Reports², and analysis of the figures will show that:

- ▼ IPART’s revisions to EnergyAustralia’s proposed capex programs were small and mostly involved revisions in the timing of projects.
- ▼ IPART has, in one instance, encouraged the electricity distributors, including EnergyAustralia, to spend *more* than they requested in their capex proposals. Looking back to IPART’s 1999 Determination and Final Report, Figure 1.2 shows how the capex we approved to be included in our pricing decisions was higher than that which EnergyAustralia forecast in its submission.
- ▼ Thirdly, actual capital expenditure has been much greater than what the utilities themselves proposed, even in the first year of a regulatory period. This is especially evident since the announcement of new energy rules (which I’ll address shortly), that offer no penalty for distribution networks who spend more than their approved amounts, and arguably encourage them to do so.

Figure 1.2 EnergyAustralia (Ausgrid) projected, and IPART-approved capex - IPART electricity pricing Determination, 1999



Data source: IPART, *Pricing for Electricity Networks and Retail Supply - Report, Volume 1*, June 1999.

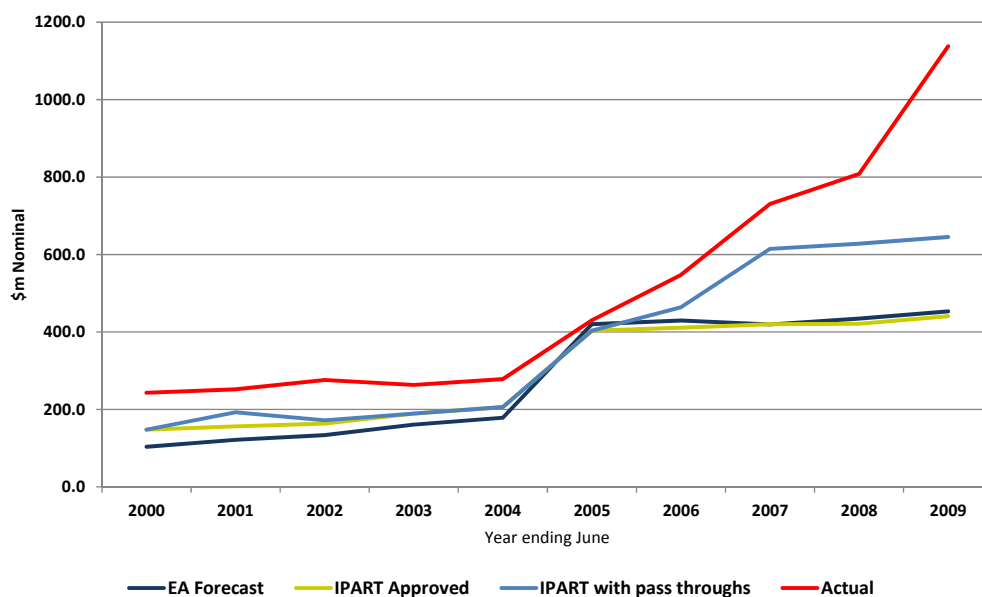
For example, in the last 3 years of the 2004/05 to 2008/09 regulatory period, the NSW distribution businesses’ actual capital expenditure was significantly higher

² IPART, *Pricing for Electricity Networks and Retail Supply - Report, Volume 1*, June 1999, pp 83-85, IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09 - Draft Report*, January 2004, p 34, IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09 - Final Report*, June 2004, p 31.

than the regulatory allowances, which are determined prospectively. Just during the 2008/09 financial year, EnergyAustralia invested almost \$500m in capital more than the regulatory allowances. It should be noted that the regulatory allowances in the 2004/05 to 2008/09 period were largely based on the proposals submitted by the businesses themselves.

In fact, for every year of the entire 2000-2009 regulatory period, EnergyAustralia's actual capital expenditure outpaced both the proposals which EnergyAustralia submitted and IPART's approved limits – as can be seen in the graph in Figure 1.3.

Figure 1.3 EnergyAustralia (Ausgrid) capital expenditure 2000-2009



Data sources: IPART, *Pricing for Electricity Networks and Retail Supply - Report, Volume 1*, June 1999.
 IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09 - Draft Report*, January 2004.
 IPART, *NSW Electricity Distribution Pricing 2004/05 to 2008/09 - Final Report*, June 2004.
 IPART Analysis.

Figure 1.3 shows EnergyAustralia's proposed capex expenditure schedule, IPART's approved expenditure levels, IPART's decision after taking into account approved cost pass throughs as a result of the Full Retail Contestability (FRC) costs in 2000/01 and 2001/02 and government's changes to reliability standards in later years.

The fourth line shows what EnergyAustralia actually spent.

As this graph shows, the much more significant question, is **why did actual capex run so far ahead of EnergyAustralia's own capex forecast?** Was it because of problems in the planning process, or an inability to control expenditure, or incentives inherent in the National Electricity Rules and the NSW planning framework?

In 2005/06 it became known that IPART would no longer regulate the prices for electricity networks. When the prevailing regulatory period ended, this

responsibility would be transferred to the Australian Energy Regulator (AER), who would operate under different guidelines, known as the National Electricity and Gas Rules.

Coincidentally or not, from the time the decision was made to transfer network regulation from IPART to the AER, the networks' capital expenditure started to dramatically increase. We consider that the new rules, rather than the change in regulator, was the more important factor.

In part, the higher expenditure levels may reflect the NSW distribution businesses obligations to meet reliability of supply conditions imposed by the former NSW Government. However, the network electricity rules are likely to be encouraging this increased expenditure and resultant price rises.

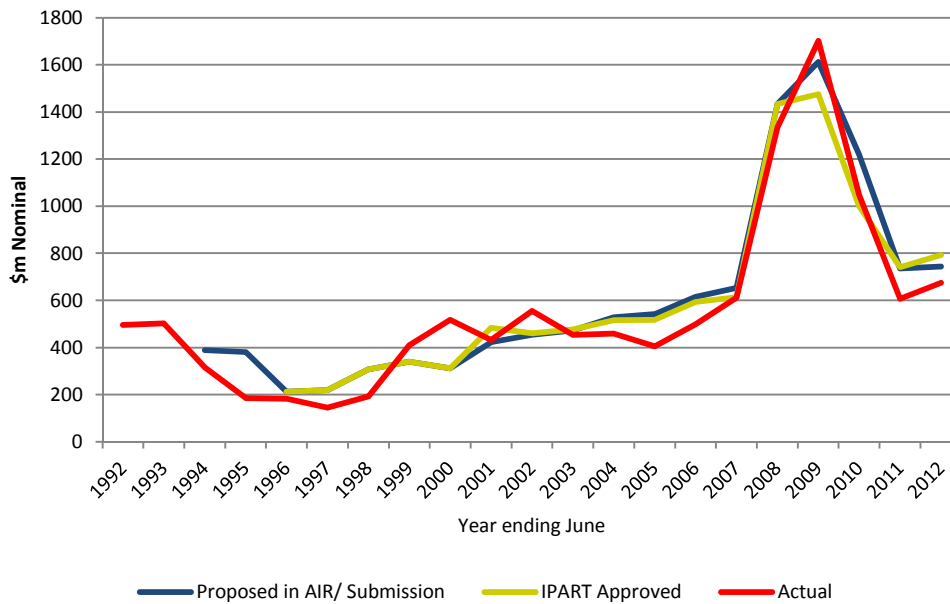
In our view:

- ▼ The current regulatory framework makes it difficult for the regulator not to accept the network business' spending proposals. The Rules constrain the AER's ability to apply what it considers to be the best estimate of the efficient operating and capital costs.
- ▼ The Rules provide strong incentives for network businesses to invest capital in the network because the prescriptive requirements of the Rules may yield excessive returns.
- ▼ The Rules allow the businesses to earn a return on all capital invested regardless of its efficiency and prudence, by requiring the AER to roll all capital expenditure - **even if spent without being approved** - into the asset base used for calculating required returns.
- ▼ They provide opportunities for the businesses to target particular issues through the appeal process.

Fortunately, these issues are currently being reviewed by the Australian Energy Market Commission (AEMC) and we hope that a favourable outcome will benefit the electricity consumers of New South Wales by moderating future prices.

By contrast, expenditure in the water sector has generally been in-line with, or below IPART's approved levels, as can be seen in Figure 1.4.

Figure 1.4 Sydney Water capex 1992-2012



Note: Includes desalination plant.

Data source: SWC submissions to IPART Reviews, SWC Annual Information Returns, IPART Final Reports and IPART analysis.

Productivity

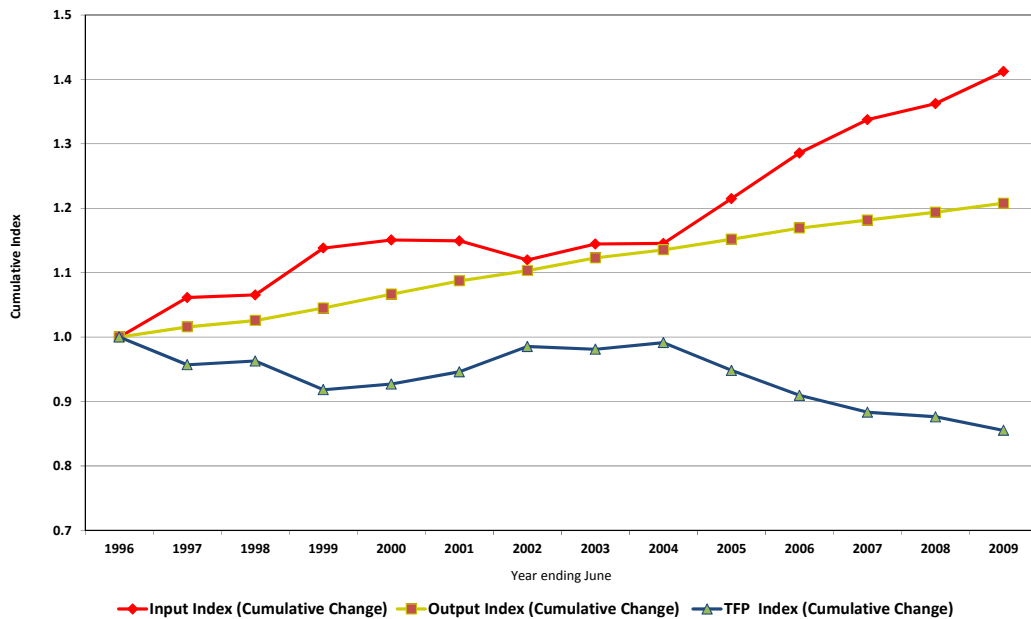
It is not only retail prices and utility expenditure which IPART has been concerned with over the past 20 years. From time to time, the NSW Government has called on IPART to conduct other reviews.

In October 2009, the Government commissioned IPART to review the productivity of selected State-Owned Corporations (SOCs). These included the ports corporations, water utilities, Landcom, electricity generators, and electricity network service providers.

Our detailed analysis showed some telling trends in different sectors.

First, it should be noted that most SOC's we reviewed are heavily capital intensive, and capital investment naturally occurs in cycles. Due to the way Total Factor Productivity (or 'TFP') is measured, this 'lumpiness' can skew results. For example, Hunter Water achieved improvements in productivity in early years before they were reversed by a wave of capital investment in 2003/04. A similar increase in capital expenditure set back Sydney Water's TFP, as can be seen in Figure 1.5.

Figure 1.5 Sydney Water change in TFP 1995/96 to 2008/09



Note: Opportunity cost of capital is included.

Data source: IPART SOC Review.

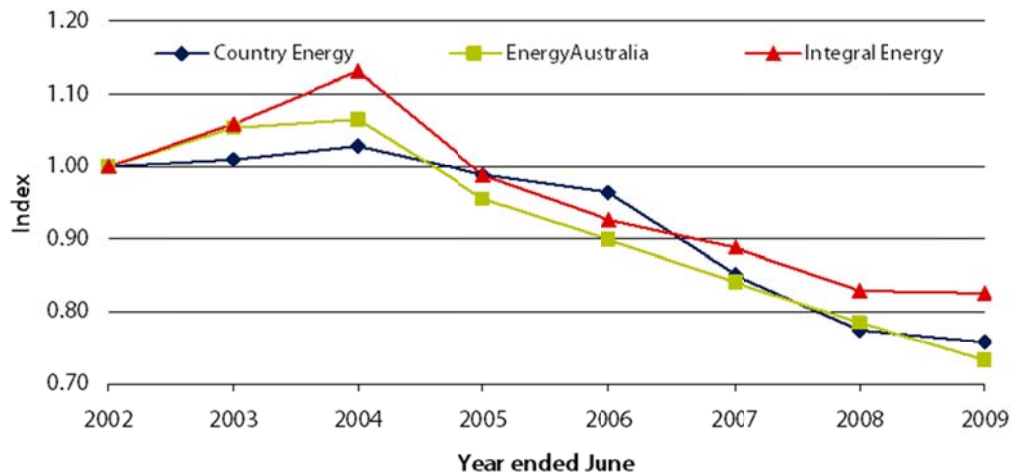
However, even with measured productivity decreasing due to increasing investment, labour staff productivity over the analysis period of 1995/96 to 2008/09 substantially increased³. In the case of Sydney Water, labour productivity increased by 90%, and in the case of Hunter Water, 103%⁴

TFP at TransGrid declined between 1997/98 and 2008/09, mainly due to substantially increased capital expenditure on its transmission network. Reflecting this, its capital productivity declined. Nevertheless, labour productivity increased by 52%.⁵

In contrast, not only has capital productivity declined in electricity distribution network service providers (see Figure 1.6), but, **labour productivity also declined. Over the period 2001/02 to 2008/09, labour productivity in the electricity networks fell by between 27% and 29%.⁶**

³ IPART, SOC Review 2010, p 5.
⁴ IPART, SOC Review 2010, p 28.
⁵ IPART, SOC Review 2010, p 47.
⁶ IPART, SOC Review 2010, p 55.

Figure 1.6 TFP of electricity distribution networks



Note: Opportunity cost of capital is included.

Data source: IPART SOC Review.

In our report, we made a number of recommendations on governance of SOCS to enhance and then maintain their autonomy, and ensure clear accountability for performance.

We believe transparent reporting of performance is an important discipline and incentive for government entities.

The Government, through Treasury, previously published an annual performance report on the SOCs, but this was discontinued in 2004. We encourage the Government to resume publication of these reports.

Service quality

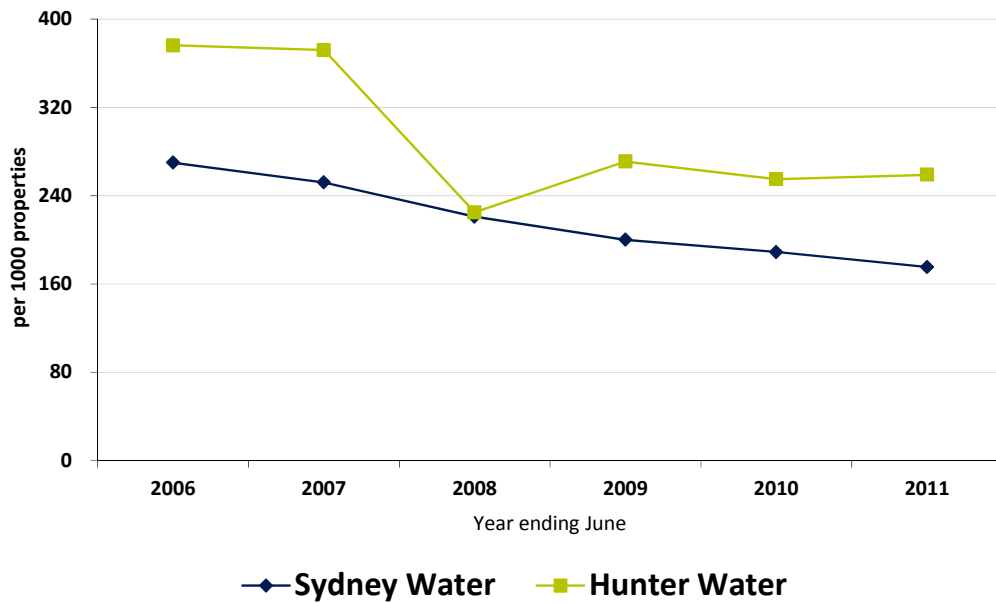
Price matters to the consumers of these essential services but so does quality.

Our report “NSW Water Utilities Performance” provides a number of indicators of service quality for the urban water suppliers. Some of the important quality measures for end-users are the duration of unplanned water interruptions, sewer chokes and breaks, and customer complaints.

The overall picture that emerges in water is one of stable or improving quality of service. Since 2003 complaints, such as those on water quality, have remained at low levels (compared to its peers) for Sydney Water and declined for Hunter Water to levels that are above Sydney Water’s, but comparable to its peers. The frequency of unplanned water interruptions (per 1000 households) declined from 2005/06 to 2007/08 and has remained broadly stable since then (see Figure 1.7). The number of

sewer main breaks and chokes has remained broadly stable over the period for both Hunter Water and Sydney Water.

Figure 1.7 Frequency of unplanned water interruptions

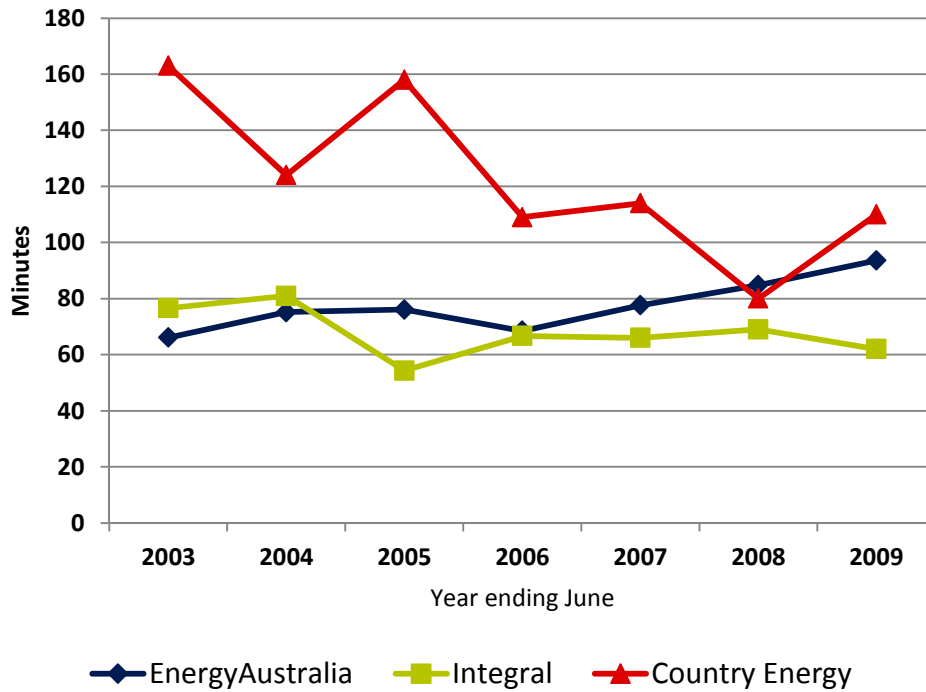


Data source: IPART Analysis.

Two of the most commonly used measures of service quality for electricity networks are the average duration and frequency of interruptions. The data on these indicators needs to be handled cautiously. Firstly, statistical variability may well hide underlying trends or suggest trends that are not really there. Secondly, we do not know what the trends would have been if the network investment had not been undertaken and the benefits of the increased network investment may well lag behind the actual spending.

In broad terms, though, the data suggests clearer evidence of an improvement in service quality (as measured by SAIDI) for Country Energy (now Essential Energy). The evidence is less clear for EnergyAustralia (now Ausgrid) where the average duration of interruptions on urban feeders has tended to increase. It should be noted that the SAIDI on EnergyAustralia’s rural feeders has come down. The data for the CBD shows a higher degree of fluctuation from year-to-year that makes it difficult to interpret. See Figure 1.8.

Figure 1.8 System Average Interruption Duration Index (SAIDI)



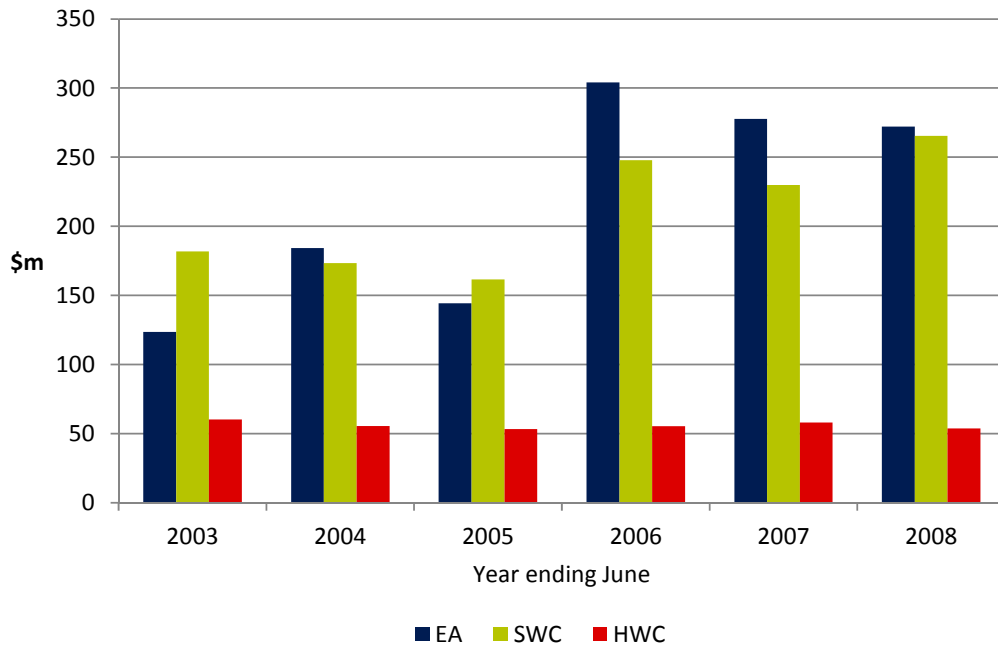
Data source: IPART SOC Review.

Profitability

Although we encourage the utilities we regulate to be efficient and productive, and to minimise their prices, we also have a responsibility to the shareholders of those agencies, in most cases the NSW Government, to ensure those entities are run in a business-like manner, are profitable and earn a reasonable return on their investment.

Figure 1.9, constructed from data in the Auditor-General's reports to Parliament, show distributions to the NSW government - a combination of dividends and tax paid - by some of our largest regulated entities. It is clear that Sydney Water, Hunter Water and EnergyAustralia have been able to operate their businesses successfully, and make tax and dividend payments to the NSW Government.

Figure 1.9 Distributions to government



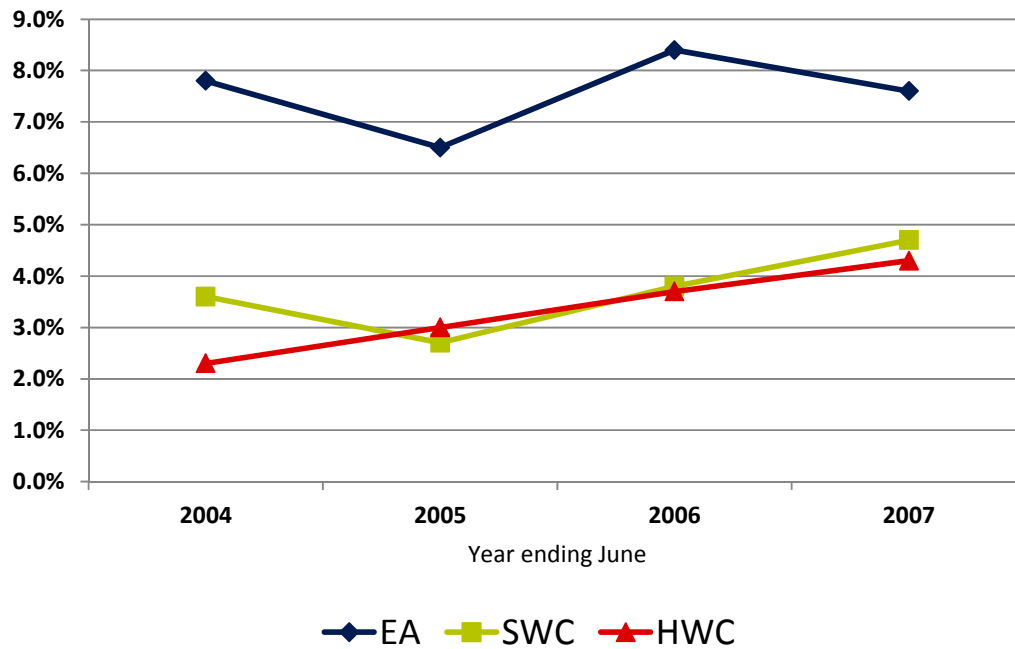
Note: Includes both dividends and taxes.

Data source: Auditor-General's reports to Parliament.

In recent years, both Sydney Water and EnergyAustralia have managed to pay dividends of around \$100m to \$200m per year.

Expressed as a return on investment, this figure is not excessive by commercial business standards. As Figure 1.10 shows, the Auditor-General's reports show returns for the water utilities have been around 2% to 4%, while that for EnergyAustralia has been somewhat higher.

Figure 1.10 Return on assets



Data source: Auditor-General's reports to Parliament.

2 User pays and efficient pricing

Price restructure

Water pricing

When determining prices, the IPART Act directs us to consider the 'cost of providing services' and 'the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers and taxpayers'.

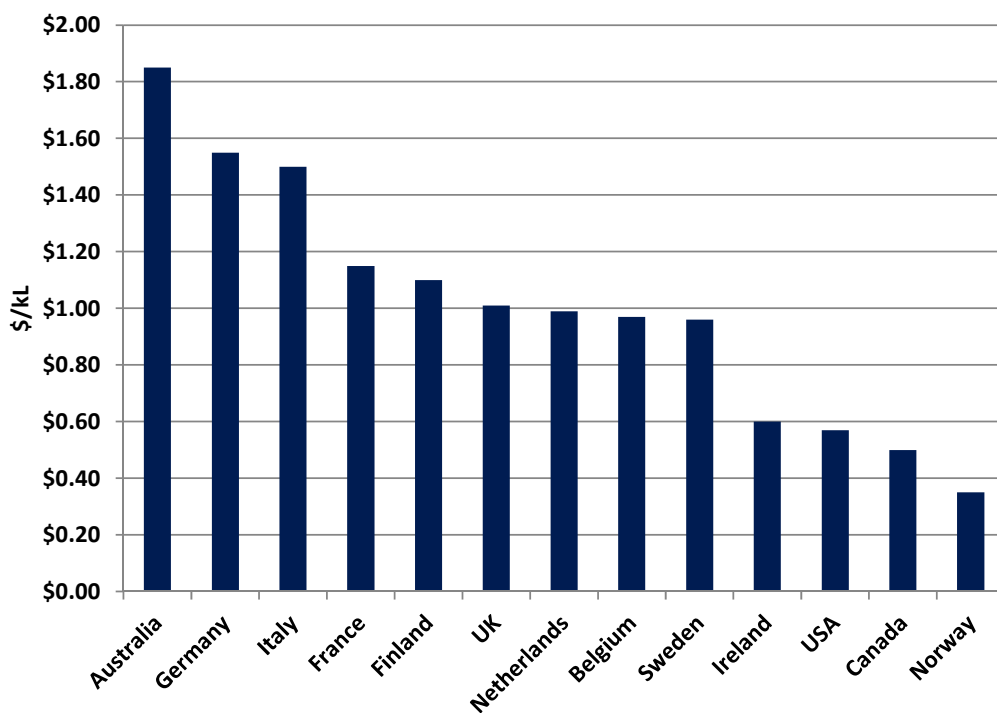
In other words, a price structure should be cost-reflective and equitable.

For over 100 years, there was very little relationship between what water consumers paid for their water and sewerage services and the use they made of those services.

Prior to 1990, all customers were given a certain ‘water allowance’ and only paid for water by volume if this allowance was exceeded. This meant that ratepayers using less than their “water allowances” or whose properties were unmetered, confronted a zero price for the next unit of water they consumed. As this zero price was obviously less than the marginal cost of supplying that additional unit, the charging arrangements did nothing to ensure the efficient use of water. At the beginning of the 1990s, a significant part of a customer’s water bill was related to the value of their property. The use of rates which were partially based on property values gave rise to a pricing system where virtually every water user had a different average cost of water.

This inefficient and ineffective pricing arrangement caused a cross subsidisation of the residential sector by the commercial and industrial sectors, and resulted in a situation where Sydney had one of the cheapest residential water and wastewater bills in Australia and the most expensive non-residential bills in the world – as shown in Figure 2.1.

Figure 2.1 International commercial water prices, 1991



Data Source: NUS Consulting Group, International Water Survey 1991.

One submission to our 1993 price review, from a small business owner in Circular Quay, argued that it would be cheaper for him to use champagne than water for the small amount he used.

It was estimated that the cross subsidy from the non-residential sector to the residential sector in Sydney amounted to \$140m in 1987/88, \$215m in 1991/92 and \$300m by 1993/94.

It was no accident that the first major inquiry undertaken by the Tribunal involved a review of urban water and sewerage charging arrangements.

In 1992, the Tribunal launched a major inquiry into water pricing covering the Sydney, Newcastle, Central Coast, Illawarra and Blue Mountains regions, releasing its report in late 1993.

The Tribunal's 1993 proposals articulated a program of longer term reforms to be put in place by the metropolitan water agencies of NSW. Key elements of the reform process were:

- ▼ The elimination of water allowances where this had not already occurred.
- ▼ The progressive elimination of property value based rates as a source of revenue with priority to be given to the reform of the non-residential sector.
- ▼ The move to a simple two part tariff with a uniform usage charge to apply to all water used.
- ▼ The rigorous pursuit of efficiency gains by the water supply agencies accompanied by real revenue reductions over the short to medium term. This was accompanied with a recommendation that water agencies benchmark their activities against similar agencies internationally.
- ▼ The adoption of charging arrangements for land developers which ensure that costs of infrastructure provision are fully recovered through a combination of common periodic charges and upfront contributions.

Complicating the reform task was the need to ensure that restructuring prices did not impose excessive transitional burdens on low income and disadvantaged groups. The Tribunal called on the water businesses to develop, fund and implement assistance measures to aid the transition to more rational pricing processes.

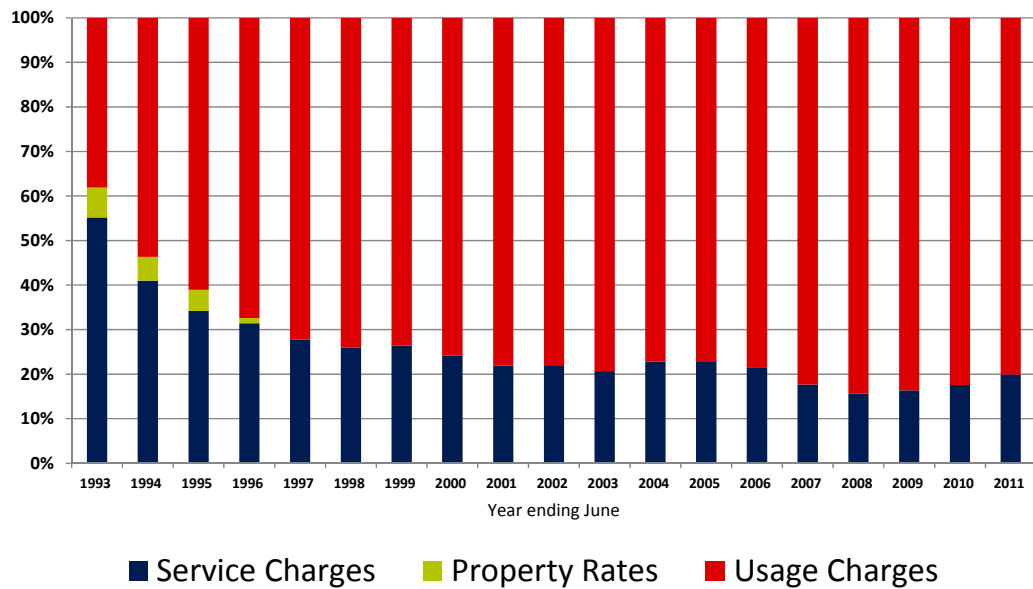
With the abolition of water allowances, and reduction of fixed charges, one of the first actions of the Tribunal was to introduce a more realistic price for water of 65 cents per kilolitre effective from mid-1993. Prior to this, some households were paying less than half this price.

Over time, water prices have increased, so that by 2004/05 water was sold at \$1.16 per kilolitre, and now sells for \$2.13 per kilolitre, reflecting the marginal cost of producing each kilolitre.

Over the intervening period, the composition of customers' bills has undergone a profound change. No longer are fixed service charges the dominant feature of the typical residential water bill. Between 1993 and 2009, the water usage component of residential bills increased from 30% to over 75% of the total water bill.

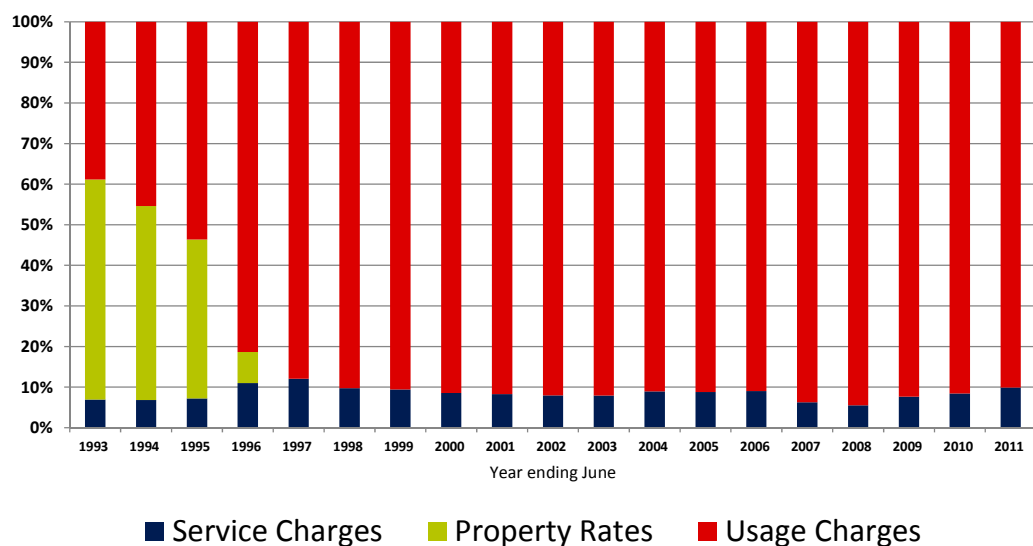
Figure 2.2 and Figure 2.3 illustrate how, in the first few years of IPART's existence, the proportion of Sydney Water's revenue in both residential and non-residential sectors relating to water use has drastically increased at the expense of fixed charges and property rates.

Figure 2.2 Components of SWC water revenue - residential



Data source: SWC Annual Information Return 2011.

Figure 2.3 Components of SWC water revenue - business



Data source: SWC Annual Information Return 2011.

So our first major achievement in price restructure was to see water utilities transformed from what were effectively tax raising statutory authorities, to more commercially-focused businesses with cost-reflective pricing, that now face real competition from rival private sector service providers.

SWC Determination 2012

While water pricing reform marked the early achievements of IPART, we did not stop there.

In the past 2 years, we conducted a review of price structures for Sydney Water, Hunter Water, Gosford City Council and Wyong Shire Council.

We found that there was a lack of consistency and cost-reflectivity in the structure of water and sewerage charges across the 4 water utilities. This has resulted in a number of inequities in the pricing arrangements for different customers. Firstly, customers located in the 4 water utilities service areas, that create similar costs within the networks, paid significantly different prices. Secondly, there were inconsistencies within each water utility so that customers that create similar costs within the network would pay considerably different prices.

Some of the changes we have made include that:

- ▼ Sydney Water introduce a **standard** water service charge for all residential dwellings (such as houses, townhouses, flats and units). Until now, the service charges paid by houses were subsidising the services received by flats and units. We consider all residential customers receive equal benefits from the availability of water supply services in their home, and so should all pay the same price for this availability.

This is similar to the residential sewerage usage charge, where we proposed to maintain the current method of setting a single fixed charge for all residential sewerage customers regardless of property type. This reflects the principle that all residential customers who receive the same service pay the same price. We have not found evidence to prove that there are different costs for providing sewerage services to different residential properties.

- ▼ For non-residential customers, we have decided to change the drainage charges from a fixed charge per property to an area-based charge. Area based charges reflect that land area is a key determinant of the costs of a drainage system, and can be used as a simple proxy for a property's contribution to runoff. Area-based charges would be more cost reflective.

Retail electricity⁷

Retail electricity is another area where IPART has focused on a review of price structures. Although current community concern exists over high electricity prices, our Report on regulated retail tariffs for 2004/05 – 2006/07 found that in prior years, retail prices (but not network prices) in many cases have been lower than the full cost of supply. We recognised that this would be a barrier to efficient competition and discourage efficient investment in new generation capacity.

In addition, some tariffs were higher than justified. In other words, customers on higher tariffs were subsidising those on lower tariffs.

To solve this problem, we set target tariffs which were cost reflective, with our Determination guiding retailers to move customers over time to those targets.

Pricing externalities

The IPART Act directs us to consider ‘the social impact of [our] determinations and recommendations’. In our pricing reviews we give considerable effort to quantify, where relevant, the value to the community in general of services provided, and use that information in our price determinations.

As well as providing direct benefits to their users, CityRail’s passenger rail services generate substantial indirect benefits that accrue to the wider community – such as reduced road congestion, traffic accidents and greenhouse gas emissions.

CityRail services also provide social benefits by improving mobility and social inclusion, particularly for disadvantaged groups.

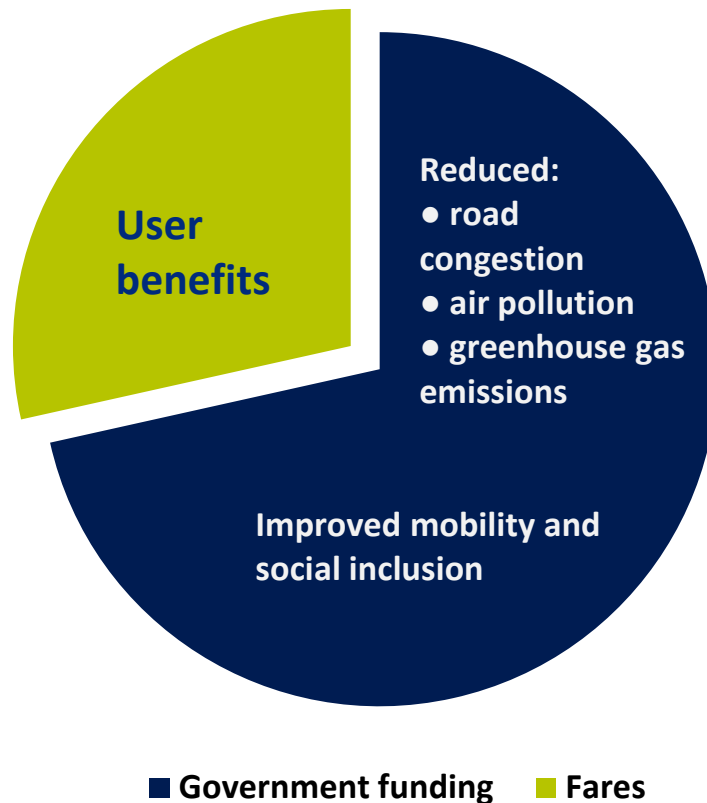
There is general agreement in Australia and other jurisdictions that these external benefits justify government subsidisation of passenger rail fares. For this reason, the value of CityRail’s external benefits was one of the key factors IPART considered in determining the appropriate shares of CityRail’s revenue requirement to be funded by taxpayers (through government subsidies) and by passengers (through fares).

In our most recent review⁸, we concluded that the value of these external benefits in 2008/09 would be approximately \$1.7 billion, increasing to over \$1.9 billion per annum in 2011/12. Overall, this represents 71.5% of CityRail’s revenue requirements. Hence only 28.5% of costs are funded directly by passengers, as shown in Figure 2.4.

⁷ See IPART, *NSW Electricity Regulated Retail Tariffs 2004/05 to 2006/07 - Final Report and Determination*, June 2004.

⁸ IPART, *Review of CityRail fares, 2009-2012 – Final Report*, December 2008, p 106.

Figure 2.4 CityRail target cost recovery



Data source: IPART, *Review of CityRail fares, 2009-2012 – Final Report*, December 2008.

3 Restraining regulation; promoting competition

In the early days of IPART, competition in the telecommunications industry had only just begun. Then, competition to Telecom Australia, now Telstra, was a new concept. Little did people realise than in a few years' time, we would be able to choose our electricity supplier, that eventually there would be competition in the water industry, and that IPART would move from being a regulator of monopolies such as Sydney Water, to being the administrator of licensing of private water utilities in NSW under the Water Industry Competition Act (known as WICA).

Although our principal role is that of regulator, we have always supported the premise that regulation should not be overly burdensome for the regulated entities, but be as 'light handed' as possible. This is the philosophy behind our risk-based compliance auditing for WICA licensees.

We also maintain that regulation should only occur where necessary – such as to prevent abuses of power.

In the case of electricity, we consider that competitive market forces are strong enough to allow the removal of regulated retail tariffs.

We consider that retail competition offers the best guarantee to customers that retail prices will reflect the efficient costs of supplying them. Price regulation by IPART could be replaced by price monitoring. This would enable us to continue to provide information to the community.

We have also repeatedly suggested to government that we not be required to set fares for private ferries. In our latest Sydney Ferry review, we proposed the option of not regulating Manly ferries.

4 Conclusion

In conclusion, the past 20 years has been quite a journey. IPART's achievements have been many:

- ▼ Moderating price increases and increasing productivity.
- ▼ Encouraging responsible investment.
- ▼ Making price structures fair and cost reflective, and
- ▼ Promoting competition.

I'm sure the next 20 years will see even greater challenges and achievements.