



public interest
ADVOCACY CENTRE

Special Review: Water pricing and licencing
Regulating water businesses
Position Paper
4 November 2020

About the Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney.

Established in 1982, PIAC tackles barriers to justice and fairness experienced by people who are vulnerable or facing disadvantage. We ensure basic rights are enjoyed across the community through legal assistance and strategic litigation, public policy development, communication and training.

Energy and Water Consumers' Advocacy Program

The Energy and Water Consumers' Advocacy Program (EWCAP) represents the interests of low-income and other residential consumers of electricity, gas and water in New South Wales. The program develops policy and advocates in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives input from a community-based reference group whose members include:

- NSW Council of Social Service;
- Combined Pensioners and Superannuants Association of NSW;
- Ethnic Communities Council NSW;
- Salvation Army;
- Physical Disability Council NSW;
- Anglicare;
- Good Shepherd Microfinance;
- Financial Rights Legal Centre;
- Affiliated Residential Park Residents Association NSW;
- Tenants Union;
- The Sydney Alliance; and
- Mission Australia.

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The Public Interest Advocacy Centre office is located on the land of the Gadigal of the Eora Nation.

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Introduction

PIAC welcomes the opportunity to provide input in response to IPART's first position paper (the paper) commencing the 'Water pricing and licencing, regulating water businesses special review'.

PIAC welcomes this review and supports IPART's commitment to a detailed assessment of the performance of the current framework, and investigation of more effective means of regulating NSW water businesses.

An objective focus for water regulation

Water is unique in its role as an essential foundation for the health, wellbeing and prosperity of the community and environment. Regulating water businesses must integrate the needs of human health, social responsibility, affordability, efficiency, and environmental sustainability. Responding to the risks imposed by climate change, and the increasing insecurity of water resources is also a central consideration.

The current framework for water regulation has helped improve the efficiency of water businesses and allowed scope for community preferences to shape the services they provide. However, it has not been effective in enabling a focus on long-term community outcomes, and integrating aspects of community and environmental value.

Water regulation needs a strong statement of objectives and principles. This would guide development of the framework and assist businesses operating within it to act in the long term interests of the community. A clear statement of objectives should be central to the regulatory framework IPART creates, and reflected in other legislative, regulatory and operational instruments that impact upon water businesses.

We recommend that this review prioritise creating an overarching objective for water regulation, focusing on the long term interests of the community with respect to:

- Efficiency of investment and operation of water businesses
- Affordability and equity in pricing and service delivery
- Valuing and conserving water resources
- Sustainability of systems and resilience of the community in the face of climate change
- Quality of water sources and the health of the community.

Pricing that recognises values and supports objectives

PIAC strongly supports water pricing reform. Operational and investment decisions made now have long term price implications. Pricing that does not value water appropriately may lead to business decisions that result in poor outcomes for the community. Re-use, recycling, desalination and other technologies increase our water security, but they do so at significantly higher cost, impacting affordability. The opposite is also true. Dynamic prices may accurately reflect the cost of water at a particular time, but may end up preferencing supply augmentations that do not accord with community preferences, or support equity and sustainability in the long term.

Water pricing must be broader than the recovery of the costs of each component service. Pricing mechanisms must be assessed by considering the factors that influence investment, yield and usage in the long-term. The expectations of the community regarding the value of water, equity of access to water, and the way that costs are shared must be integrated into water pricing.

Pricing must be framed by the objectives of regulation, and integrated with the regulatory framework so that it plays its part in driving better long term outcomes for the community.

Comments on position paper

PIAC makes the following comments on elements of the paper

- Throughout the paper there are references to ‘the customer’ and the necessity for businesses to engage with and understand customers. PIAC considers this too narrow a focus, and recommends the regulatory framework reference ‘the community’, so that businesses recognise their responsibility in understanding and responding to the preferences of the community. This includes direct customers, but also others in the community who are indirectly impacted by or engaged with services or activities the business undertakes.
- The paper characterises the role of regulation as ‘mimicking the outcomes of a competitive market’. This focusses on the mechanism (the competitive market) at the expense of outcomes for the community, which may be better realised through mechanisms other than competitive markets. This is an important difference as outcomes relating to equity and sustainability may not have a practical proxy within the competitive market.
- The paper describes elements of IPARTs decision making as seeking to ‘recover efficient costs’ or ‘reflect the efficient costs of meeting requirements.’ We understand this represents a focus on driving efficiency. However, it may also contribute to a culture of ‘sufficiency’ and a level of inertia observed in business practices. The ability to introduce other lenses for assessment, through the implementation of an overarching regulatory objective, could help to address this.
- In exploring pricing flexibility, the potential to regulate through a revenue cap is noted as an alternative. While all options should be considered at this time, we note that a revenue cap in energy regulation has resulted in pricing flexibility but with a complexity and volatility that has not been good for the community. Any consideration of reform to the form of regulation should not be done in isolation, but in conjunction with other pricing and regulatory changes, and in the context of contribution to the overarching objective of regulation.
- In making observations on the current approach, the report notes that it implicitly assumes businesses are risk-neutral. This may not a reasonable assumption where water businesses have an effective revenue guarantee and an expectation to deliver profitable returns to government shareholders.

In further observations the report cites difficulty in creating incentives rewarding higher levels of performance due to the cyclical and short term nature of cost changes. PIAC notes that a regulatory objective focusing on long term stability, resilience and reflecting consumer

preferences in addition to efficiency could help address this. For instance, a business may implement processes and pricing that smoothed short term fluctuations in costs, and reduced risks related to external factors such as weather and climate. PIAC has previously raised the introduction of an inclining block tariff structure as an example of this.

Responses to Position Paper questions

1. **Are the focus areas we have identified the most important? Are there other issues we should focus on?**

PIAC agrees the areas proposed by IPART provide the appropriate scope for review, however, we consider many aspects of water regulation would be more effective if framed with reference to an overarching objective. While IPART has principles and directions it must respond to, and individual businesses have licencing conditions and legislative instruments directing their purpose, there is no overarching objective framework that guides the integration and applications of these, potentially conflicting, mechanisms. There is also no clear statement of the intent of water regulation and what it seeks to achieve for the community that can be referenced when priorities are potentially in conflict.

The National Energy Objective (NEO) at the centre of the National energy law and rules framework is an example of the important role an objective can play.

To promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to:

- price, quality, safety, reliability and security of supply of electricity
- the reliability, safety and security of the national electricity system.

The NEO is a consistent, central reference point and direction for the development and application of regulation in energy. Other principles can be introduced, but this objective determines how they interact and provides a framework for implementing them and assessing their outcomes.

PIAC recommends developing and implementing an overarching objective for water regulation.

2. **What mechanisms can we put in place to ensure the water businesses are accountable for the prices, services and outcomes they deliver to their customers and the community?**

As outlined above, ensuring that regulation is framed by objectives that focus on key outcomes for the community, is an essential enabling mechanism for accountability. Performance outcomes and the mechanisms for monitoring them, should be clearly informed by and linked to this objective.

3. How can we better co-ordinate with other stakeholders (including the Government's strategic water plans and the requirements of other regulators) to help lift the performance of the water sector?

PIAC supports water regulation that is better integrated with other related regulatory frameworks, and long term government planning and policy. The objectives of regulation in water should be shaped by long term water planning and help provide an ongoing, practical link between policy and the way that businesses respond to it for the benefit of the community.

We support considering new co-ordination mechanisms as part of this review process, and recommend IPART examine ways that the requirements of other stakeholders can be internalised in the objective framework of water regulation.

4. Should we use a broader range of incentives to encourage innovation? If so, what would these be? For example, can we inspire 'competition by comparison?'

PIAC supports considering a range of options supporting and incentivising innovative measures to deliver better outcomes for the community. Where the long term interests of the community are the objective focus for the business we consider there is a strong incentive for innovation and improvement to become business as usual. We are not convinced that additional financial incentives are necessary or likely to provide any additional encouragement for innovation. Where any incentives are considered, they should be clearly linked to delivery of outcomes informed by the objectives of water regulation.

5. Does our discretionary expenditure framework create the right incentives for the business to pursue (and deliver) service outcomes above mandatory levels?

PIAC supports IPART's framework for assessing discretionary expenditure by water businesses. It is appropriate to consider whether discretionary expenditure should be framed in reference to 'mandatory' service levels. Existing regulatory frameworks tend to encourage a culture of 'sufficiency' and focus upon the elements of performance required in regulation, rather than the best outcomes for the community.

It may be more appropriate for discretionary expenditure to be a mechanism for delivering community outcomes that are not related to mandatory or minimum service levels. For instance, regulatory objectives that are not able to be linked to the efficiency of investment or services provided to consumers, may be better regulated through discretionary expenditure frameworks. These frameworks could provide businesses scope to pursue innovative projects promoting community equity, sustainability of community water resources, and other projects that align with expressed community preferences and priorities.

PIAC recommends exploring opportunities for the discretionary expenditure framework to be expanded to focus on community outcomes that may be independent of mandatory service levels

6. What changes to our approach would enhance efficient new entry and competition in the supply of water and wastewater services?

PIAC cautions against a narrow regulatory focus on facilitating new entry and competition in water and wastewater services as it may not improve overall outcomes.

We note reforms in the energy market seeking to introduce competition to the roll out of new metering technology and services. This process did not consider how the competitive provision of metering would interact with the wider energy market and regulatory framework, and the likely impacts upon the long-term interests of consumers. The result has been a slow and disjointed roll-out of metering technology, and the need for ongoing expensive regulatory reviews to deal with complications and inefficiencies created by competition in metering. Early consideration of how metering arrangements interact with technology, service provision and other energy market relationships, may have determined retail competition in metering would not deliver the best outcomes for consumers.

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.

7. What level and type of engagement are customers looking for from water businesses?

Water is an essential service and water businesses are a critical stakeholder for their communities. While all businesses have an obligation to their customers, water businesses must also understand their communities. This must be founded on ongoing, meaningful engagement that is not just focussed upon responding to regulation, but integral to the decision-making processes of the business. The means and method of engagement should enable an understanding of community preferences and priorities, and facilitate a clear response by the business to those preferences.

While it is common practice for businesses to engage consultants to undertake engagement activities, we have observed that changes to business culture and practice are better achieved by integrating engagement capabilities into the business's own resources. This encourages businesses to better integrate engagement into ongoing operations and not just become a discrete task in a regulatory project.

PIAC recommends IPART consider the range of established frameworks for assessing engagement. PIAC highlights our own work developing criteria for effective engagement¹ in the energy industry.

8. How do we provide the right incentives for the business to genuinely engage with their customers, understand what they want and incorporate this into the heart of their operations?

PIAC does not consider it necessary to provide incentives for businesses to genuinely engage with their customers and the community. Incentives that rely upon businesses demonstrating a 'level' of engagement, independent of the outcomes of that engagement, are in danger of becoming a parallel process and an exercise in 'box-ticking'.

PIAC recommends that any measures that require or incentivise engagement are integrated with decision-making and clearly linked to measurable outcomes that contribute to the long term objective of regulation in water.

¹ PIAC ['Evaluation of Consumer engagement by NSW DNSPs 2018-19'](#). 8 August 2018. 8-11.

9. Who is best placed to undertake customer engagement? Is it the business, IPART or another independent third-party?

Businesses must incorporate direct engagement into all key decision-making, to ensure they reflect the preferences and priorities of their customers and community. Ensuring that businesses continue to develop this capacity and integrate engagement into their core business should be a priority of regulatory reform.

It is not sufficient for only businesses to pursue engagement, and there is merit in this review considering additional mechanisms to enhance and embed community and stakeholder engagement into all aspects of water regulation and business. PIAC recommends:

- Identifying of areas of water business operation where consistent principles and objectives are appropriate. These areas may be more effectively considered through engagement on behalf of all stakeholders (businesses and IPART), rather than through separate engagement by each. PIAC considers that pricing principles, standard supports for vulnerable households, and principles for optimising conservation may be appropriately determined in this way.
- Developing IPART's capacity to engage with the community and stakeholders to build an independent understanding of the issues relevant to the community. PIAC considers this could improve IPART's capacity to ensure regulatory decisions reflect community perspectives and preferences.

10. When should we conduct our next WACC review? What are your views on the scope of the review and when should the outcomes of a new WACC method apply to future pricing reviews?

PIAC supports an IPART review of WACC being undertaken independently of this current process. It is important that the scope and timing of the WACC review and its implementation contributes to consistency and stability of approach, and that its timing does not unreasonably prejudice its outcomes.

It is essential that the WACC be determined according to consistent principles intended to enable stability, and not unreasonably respond to transitory market perceptions regarding the investment climate.

PIAC also advocates that the timing of WACC reviews and their implementation minimise the incentive for businesses to 'cherry pick' and use WACC determinations as an avenue for improving their short term position. For instance, the timing should not provide an incentive for businesses to alter their proposals for the duration of determination periods to benefit from differential applications of WACC.

PIAC recommends WACC determinations are made on principles that are consistently determined, agreed and applied, allowing businesses to focus on improving their underlying performance and delivering better outcomes for the community.

11. Do you have any comments on our proposed review process and timeline?

PIAC supports IPART's proposed process and timeframe. It is important that the timeline provides scope for implementation of reforms to the regulatory framework that are practical and aligned with the forward schedule of determination processes for water businesses.

The proposed process appears to provide opportunity for deeper exploration of key aspects of water regulation, with opportunities to engage in different ways.

PIAC looks forward to more detail regarding the workshop components, and encourages IPART to structure these elements in a way that brings key stakeholders together to share and discuss perspectives, rather than separating stakeholders according to their roles.