

19 August 2024

Xanthe Smith
The Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop
NSW 1240

Dear Ms Smith,

RE: WaterNSW response to IPART's July 2024 Draft Report on 'Dams Safety NSW levy review'

WaterNSW welcomes the opportunity to contribute to a robust discussion on IPART's design of a dam safety levy. As the largest dam-owner in NSW, it is important for WaterNSW that IPART ensure the levy design is appropriate, affordable and fair. WaterNSW thanks IPART for their work on the development of a draft dam safety levy design in their 2024 July Draft Report.

WaterNSW has been an active participant in discussions to-date, providing a written submission to IPART's Paper 'Designing a levy for regulation dam safety in NSW' in April 2024 and engaging in a stakeholder consultation workshop with IPART in May 2024.

As part of our further feedback in response to the Draft Report, WaterNSW suggests that further work is required on the following matters:

- Determining an appropriate cost-share between the Government and dam-owners
- Determining the efficient costs of Dams Safety NSW
- Fair weighting of the fixed direct and indirect activity costs to dam owners
- Fair allowance of economies of scale to dam owners

If you have any further questions in relation to this submission, please contact [REDACTED]

Yours sincerely,

[REDACTED]

[REDACTED]

[REDACTED]

WaterNSW Response to IPART's Draft Report July 2024 'Dams Safety NSW levy review'

1. Determining an appropriate cost-share between the Government and dam-owners

In our April 2024 submission, WaterNSW recommended that IPART calculate an appropriate and affordable dam owner and government cost-share upfront. The intent was to ensure simplicity of design whilst also considering an equitable cost-share of Dams Safety NSW's (DSNSW) efficient costs.

We acknowledge IPART's suggestion to do so. However, the cost-share proposed by IPART in the July 2024 Draft Report is a 95-5% dam owner-government cost share. This represents a significant change in cost shares for the cost of DSNSW, moving away from the current, 100% Government funded cost share to only a 5% Government cost share.

IPART has proposed limiting the Government cost share to those activity costs which are "unrelated to declared dams". These activities make up only 5% of DSNSW's total costs. In the Draft Report, IPART has proposed that the Government pay 100% of the cost of these activities. Examples of such activities are said to include the provision of advice to the Minister or Government and the processing of mining development applications.

This approach aligns with section 67(ii)(a) of the *National Water Initiative*, which requires States and Territories "to exclude water access entitlement holders from paying charges for activities undertaken for the Government (such as policy development, and Ministerial or Parliamentary Service)". However, the "development and interpretation of regulatory frameworks, policies, procedures and guidelines; the annual dams safety standards report; and other reporting to Government" could equally be classified as activities that are undertaken for Government or are policy development and therefore should be included in the Government share, consistent with the requirements of the *National Water Initiative*. We note that these activities have not been included under the Government share in the Draft Report.

IPART proposes that the remaining 95% of all DSNSW's efficient costs be recovered under a 100% dam-owner pays model. This includes a 100% dam-owner cost share for all direct and indirect costs. IPART has not proposed any government contribution to the cost-share of any direct or indirect costs. Historically, IPART has divided indirect costs between users and the government in its pricing determinations. Indirect costs include overhead costs such as IT systems, rent and certain labour costs. The move towards a 0% government cost share, particularly for indirect costs, is a significant

change from other IPART pricing models such as for the WaterNSW and WAMC pricing determinations.

Finally, not all impactors will be captured under the proposed model. The reason being that the impactors of dam safety extend beyond the customers who pay for water released from a dam. This should be reflected in the cost share. For instance, WaterNSW has a legislative obligation under the *Water NSW Act 2014* and our water supply works approvals to provide flood management and (in some cases) mitigation functions for the benefit of downstream communities. While the downstream community for other dam owners ordinarily includes the paying customers of a Council or Local Government Area, the same is not necessarily true for the downstream communities of WaterNSW dams. Not all members of the downstream community are necessarily paying customers of WaterNSW (e.g. a licensed water entitlement holder), nor are they necessarily included as a retail customer of a Council or Sydney Water. Despite being an impactor of dam safety, given the establishment of dams - at least in part - for flood management purposes, these community members would not be required to contribute to costs as is ordinarily the case under an impactor pays model. The most practical and effective way to represent this dual purpose for dams is to include consideration of the flood management component in the government share.

2. Determining the efficient costs of Dams Safety NSW

If the proposed changes to cost shares from Government to dam owners and ultimately, our customers is adopted, then it is imperative that only the efficient costs of DSNSW are included in the levy.

IPART has not proposed an assessment of DSNSW's efficiency. Rather, the Draft Report found that DSNSW's 2023-2024 costs are likely to represent the efficient costs of DSNSW delivering its services to dam owners because there is no other available indication to show that this is unreasonable. IPART did not undertake a detailed performance review as part of their analysis in the Draft Report, nor did they undertake comprehensive benchmarking of DSNSW to arrive at this conclusion.

It's also not clear how much of DSNSW current costs are related to one off 'establishment' costs, associated with developing the new regulation and associated regulatory functions necessary following DSNSW's creation. Those 'establishment' costs wouldn't be expected to re-occur in the future, however these inherent policy and regulatory costs appear to have been built into the "efficient" costs that form the levy. A potentially perverse outcome that is inconsistent with the *National Water Initiative* pricing principles, due to there being no activity-based costing.

Instead, IPART has recommended that DSNSW use activity codes and a cost recording/allocation process to enable future assessment of efficient costs. This system and the associated data should

be designed so that it enables a comprehensive review of the assumptions relating to cost drivers and cost allocation to each dam owner in the future, for instance as part of the periodic review.

This does not prevent IPART from applying a continuing efficiency adjustment on DSNSW's total efficient costs, to encourage continuous improvement as is the case for other IPART regulated agencies. For example, WaterNSW's continuing efficiency adjustment is currently 0.7% in the rural bulk water determination (2021-2025). IPART applies this efficiency adjustment to WaterNSW's costs "to take account of the ongoing improvements that even efficient utilities should be able to make over time".¹ The application of a continuing efficiency adjustment to DSNSW's costs would be consistent with this approach. It could commence in the second year, after the levy's establishment and would compound on an annual basis to drive efficiency gains across DSNSW. This would be appropriate in the absence of a thorough efficiency assessment.

3. Fair weighting of the fixed direct and indirect activity costs to dam owners

In our April 2024 submission, WaterNSW endorsed a levy design that divides levy prices according to dam consequence category. We acknowledge that IPART has adopted this concept.

Consequence category can be a useful means of differentiating between the regulatory burden and efforts of different dams. It is expected that, for certain activities, the regulatory burden of an extreme consequence category dam would be higher than that of a low consequence dam, and that this would be reflected in the pricing structure. Examples of activities that may have a higher regulatory burden for higher consequence dams include audit and non-compliance activities.

While the regulatory burden for higher consequence category dams may be greater for some of DSNSW's activities, it will not be higher for all activities. For instance, an extreme consequence category dam will not be likely to incur more IT costs than a low consequence dam. Similarly, the cost of assessing a dam owner's safety maturity level or educating dam owners does not differ according to the consequence rating of the dam. It is also unlikely that DSNSW's indirect costs differ substantially based on a dam's consequence category. IPART acknowledged this in their Draft Report. However, "in the absence of data to the contrary" (i.e. activity-based costing data) IPART agreed with FTI's recommendation to develop a cost model that accords all direct and indirect costs based on the perceived "effort ratio" of a dam's consequence category. This would require extreme consequence category dams to pay double the indirect costs of a low consequence dam, even though the share of these indirect costs is arguably the same.

WaterNSW recommends that IPART determine a levy design with a fixed cost component, irrespective of dam consequence category and that all dam owners pay it, regardless of the

¹ IPART, Review of Water NSW's rural bulk water prices from 1 October 2021 to 30 June 2025, p 34.

number of dams they own. As part of this, the levy design would attribute indirect costs equally between dam owners, irrespective of consequence category. This would ensure DSNSW's indirect costs are shared fairly between dam owners until such time as the data associated with DSNSW's activity codes and cost allocation system provides evidence to the contrary.

WaterNSW also recommends that IPART reconsider the effort ratio applied to the direct costs as part of the three-year periodic review. For instance, FTI's finding that the audit compliance costs for an extreme consequence category dam are seven times higher than the cost of a low consequence dam may be different once actual data from cost-codes is used to measure the effort required. If it is not possible to accurately assess the effort-ratio of dam categories within the initial levy design, then it is important that this be reviewed as part of the periodic review in three-years' time.

4. Fair allowance for economies of scale to dam owners

WaterNSW recommended the use of a sliding scale as part of IPART's levy design.

This is consistent with the model that was proposed by the Centre for International Economics (CIE) in their 2020 Report. The CIE Report proposed a cost model which assumed the costs of regulating subsequent dams owned by the same owner was likely to be 30% lower. In contrast, in this current review FTI considered that there was insufficient evidence to prove that DSNSW costs vary when dam owners own multiple dams and IPART have accepted their recommendation. We do not agree with this conclusion.

DSNSW's activities are aimed at regulating a single entity for its entire portfolio of dams, not at regulating each individual dam in a portfolio. DSNSW conducts at most 6 audits of WaterNSW per year but has never audited all 40 of WaterNSW's declared dams in a single year. Furthermore, a large part of these audits is reviewing our dam safety management system (DSMS) to assess its consistency with the international standards and its implementation. We have one DSMS that applies to all 40 of our declared dams. This does not get audited 40 times. As a result, the cost of regulating WaterNSW is unlikely to be 40 times higher than the cost of regulating a dam owner with a single dam. Other examples of DSNSW functions that are not directly multiplied by 40 would include strategic planning, dam safety maturity assessments, design of the sector-wide risk-based compliance program and schedule, developing audit scopes and focus areas, legislative reform and interpretation, sector-wide communication, liaison, education and reporting (each dam owner submits a single dam safety compliance report as required by the regulations). This cost and effort occurs at the agency level and does not increase to 40 times that of a single dam owner for WaterNSW.

WaterNSW encourages IPART to reconsider the use of sliding scale for dam owners with multiple dams as part of the dam levy design.