



Water Regulation review

Public Hearing Transcript

Tuesday, 16 August 2022

Water >>

Tribunal Members

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The Independent Pricing and Regulatory Tribunal

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Acknowledgment of Country

IPART acknowledges the Traditional Custodians of the lands where we work and live. We pay respect to Elders, past, present, and emerging.

We recognise the unique cultural and spiritual relationship and celebrate the contributions of First Nations peoples.

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Water Regulation Public Hearing transcript

Session 1

Introduction

Ms Livingstone: This morning, so welcome to everybody I'm just going to start with some quick housekeeping notes before I hand over to our Chair Carmel to welcome you. This is a mixed media public hearing today, so, as I said, we've got people online we've got people in the room, we want to make the session as interactive and inclusive of everybody who's participating as possible. So, we will be making sure we go to those of you who are online to hear your questions and comments and some of you even presenting to us.

For those in the room, there are bathrooms out the door in this direction and there's also coffee and tea, that you can help yourself to at any time. We will be having a lunch break. We're aiming for about quarter past 12, it might be a few minutes before or after depending on how we go through the morning.

For those of you who have joined us on Zoom keep yourselves on mute if you're not talking. But also put comments in the chat if you do want to make a comment or raise your hand and people will let me know so that we can come to you, and hear you speak. If you find we're ignoring you, don't hesitate to take yourself off mute and shout out because we do want to make sure that we hear everybody. I think that's really all I need to do in terms of housekeeping this morning, so I might invite Carmel, our Chair to come and welcome us, thanks.

Opening remarks

Ms Donnelly: Thank you Liz and hello everybody in the room and online and welcome to this public hearing. I am Carmel Donnelly and I'm the Chair of IPART and we have fellow Tribunal members Deborah Cope and Sandra Gamble here, as well as a number of the IPART Secretariat joining us today but let me start by acknowledging the traditional custodians of the land on which we're meeting both here on Gadigal land and wherever people online are working and pay our respects to Elder's past, present and emerging and all our aboriginal colleagues, stakeholders, and customers.

I thought I might just open with a few remarks about the intent of this review. Before I hand back to Liz to get us underway and you've met Liz already, Liz Livingstone who'll be our MC. We know that what continues in the space of water is that people need safe, reliable services. That hasn't changed, but there have been a lot of changes over recent years.

Some of those include both working to minimise climate change and adapt to climate change, adapting to more frequent, more intense weather events, adapting to challenges in terms of water supply and the security of water supply and new ways of working in a sustainable way. We've also had population growth and changes and some of those subtle, in people shifting in where they live, some of that's been accelerated or influenced by the pandemic. As well as evolving community and customer expectations, and I know that people working in utilities in a range of sectors that IPART regulates are detecting shifts when they're speaking to their customers.

We've also had economic shocks and volatility. We've had supply chain disruption. So, we do have a range of challenges. We've got opportunities as well, through new digital technology and opportunities for innovation and, of course, new strategies coming out of NSW Government. So, recognising all of that, the primary intent from IPART is to evolve, the way that we regulate water businesses.

In particular, we want water businesses to be able to invest prudently in new infrastructure and technology and adapt to these challenges. We want IPART to broaden our focus from cost efficiency to including cost efficiency, looking at the broader value for customers, including over the long-term. And to put that another way, while we continue to protect affordability and efficiency. What we don't want is to be inadvertently encouraging a culture of cost cutting, short-term thinking, especially if that may mean that there are increased prices and or poorer service in the future, so we do want to be embracing the long-term.

So that just gives you a bit of a sense of our intent, and I think there's a slide that might have better gone with this then. So, I'm going to actually move us on to just talking a little bit more about IPART's commitment in moving forward in this evolution of how we regulate.

We are committed to acting fairly, and to being open, having active open dialogue with water businesses. We see this as very much moving to a holistic assessment of customer value, and we do see it as having room to tailor so that we are able to work constructively with water businesses that can be quite different to each other and be focusing on different priorities at any particular time. So that we're able to customise within a fair, transparent consistent framework.

We are more strongly introducing the idea of earned autonomy, which really means that where a water business demonstrates a high quality in its regulatory proposal, a high degree of sophistication, engagement with customers, really robust proposal. Then we will focus on areas where there is greater risk, rather than continuing to have one size fits all perhaps and having a regulatory burden that doesn't respond to the sophistication of the business.

We do expect businesses to engage deeply with customers. And this will become clearer as proposals start to encompass not just the longer-term strategic objectives of water businesses and their boards, but also the insights from deeper customer engagement.

And the last thing I would just say is that we are committed to continuous improvement, and that includes for IPART, so this evolution is in fact part of our commitment to make sure that the way that we regulate water businesses is fit for purpose.

I'm very much looking forward to hearing from you today, I want to thank you sincerely for turning up whether it's online or in person. I hope we have a very constructive and open dialogue. The people from IPART, myself, Tribunal Members will be listening intently hoping that we have some good discussion and so thank you very much, on behalf of IPART for joining us today and I'll hand back to Liz.

Ms Livingstone: Thanks Carmel. Just to give you a brief outline of the agenda which is now up on the screen. We are going to have a series of presentations in this first session. First, we'll have Anthony Rush come and give us a summary of the proposed framework. Then, Eva another IPART staff member is going to tell us about some of the stakeholder feedback we've already heard. Then we will start to hear from water businesses. We'll hear from Roch who's here from Sydney Water, Darren Cleary from Hunter Water as well as Ifty from the Sydney Desalination Plant and Michael Martinson from WaterNSW.

After each of those presentations we will have time for question and answer. So, I'll jump up and facilitate discussion, questions, comments. If you are online, feel free to let us know at any time in the chat box, that you would like to speak or raise your hand and then we can go to you as part of the discussion. But for now, I'd like to introduce Anthony Rush to give us an overview of the framework, thanks Anthony.

Summary of proposed framework – IPART presentation

Mr Rush: Excellent, so I'll keep my remarks pretty short and sweet, because the aim of today is to hear mostly from the sector and from you, but I thought I'd just give a few quick remarks about the review, so that everybody's on the same page. Also, I know that most people in this room, are very familiar with what we're doing here. I thought it'd be good just to do that very quickly.

We've been reviewing at IPART how we regulate the water sector for the last couple of years. And that's coalesced to a draft report in May, where we outlined the proposed new regulatory framework that I'll talk you through in these next few slides.

Perhaps to begin, we went back and thought about how we could do our job more effectively as a regulator, we started with the idea that yes, our roles involve us setting prices every 4 to 5 years for water utilities and recommending operating Licence conditions. But those kinds of roles are tools. They're not the outcomes in law themselves, their tools to actually promote the long-term interests of customers.

In reviewing our approach, we, in particular, so came to the view that we could really improve the way we set prices for the water utilities. Moving away from the current approach which focuses a lot more on the minimum cost or the efficient costs to meet a minimum or prescribed level of service, to one that more broadly promotes customer value.

Without giving a very, very long explanation, we found that the way we currently do things whilst it certainly promoted cost efficiency as a goal, it didn't really do enough to promote a longer-term focus within the sector. It didn't really do quite enough to really link the deep conversations that water utilities have with their customers to regulatory proposals and ultimately to the performance standards and the services that customers expect, and we are regulating at IPART for the long-term.

This is why we've landed on this in our draft report, broadening the focus of our regulatory framework to one that's more broadly focussed on customer value. That's not to say that cost efficiency still isn't important, it is, but in fact as part of a framework that really encourages those deeper conversations with customers. We think that those trade-offs between affordability and service levels will actually have greater prominence.

That's the rationale to make the framework operate and work in practice, at its heart, we're really asking water utilities, water businesses to do 3 things. The first is to demonstrate that they're having the right conversations with customers and really engaging with their customers to give them the level of influence the customers desire in these regulatory proposals. Then we are asking water businesses to put in their best regulatory proposals or the best pricing proposals to the regulator every 5 years.

And then thirdly, we're asking water businesses to focus on promoting ongoing performance against a set of customer outcomes that they're proposing as part of the regulatory proposals.

From our end to make that happen we're really doing 2 key things on our side. We're firstly trying to come up with a set of outcomes focussed principles, provide broad guidance that is flexible to the needs of each business, and the needs of the customer base for each business.

Then the second thing we're doing is trying to design a set of incentives, be they financial, reputational, or procedural that actually reward businesses that do a good job in terms of putting up better proposals and improving the levels of performance, year on year. These incentives also ensure that the water businesses at its heart are also accountable for the promises that they're asking our customers to fund and the prices they're asking customers to pay for.

At the same time, we're of course retaining the elements of the framework that we think work well. The propose-respond framework, the building block model at its core, and we are really just changing how we actually approach promoting the long-term interest of customers.

On this slide I've got a little graphic here that really focuses on the guidance aspect of what we're looking to do under this new framework. I won't go through all of it in huge detail, other than to say that we think good regulatory proposals from water businesses, really promote at its heart 3 things - promote customer value, cost efficiency and they provide credibility that the proposal can and will be delivered for customers.

And to that we've designed an assessment tool and assessment rubric that provides details, flexible principles underneath each of those 3 legs. It's important here, that these principles are not meant to be a prescriptive line-by-line, kind of box ticking exercise. They really are about providing flexible tools for utilities to actually demonstrate through their proposals that they're promoting customer value. It isn't meant to be a "gotcha framework".

The other important thing that we are trying to change is to both provide more flexibility to the water businesses, and also to make sure that the businesses and its customers are really at the centre of the regulatory framework, rather than the regulator.

One of the things we're asking businesses to do is to self-assess the quality of their regulatory proposals. Whether or not their regulatory proposals are promoting the long-term interests of customers or customer value, at a standard, advanced or leading level, and to do this with reference to these overarching principles that we've proposed in our draft framework.

Then, in turn, our job is to assess whether or not we agree with the businesses' self-assessment. And it's important to note here that will be assessing proposals against the same principles that we've outlined to the businesses.

I'll skip over this slide pretty quickly, just to note that, this is, not a gotcha framework, and this is a model where we really are anticipating, really encouraging continuous improvement from both the businesses, we regulate and of IPART.

It isn't about fitting water businesses to a bell curve. It's about encouraging and acknowledging that each business has its own path and has its own customers with their own needs. And there will be different paths and pathways to get towards a leading proposal and leading performance over time.

Now I could talk about financial and economic incentives till the cows come home, so I won't. But just to say here that we've also designed a suite of incentives to make sure that good performance is rewarded and water businesses are accountable for delivering to their customers. These incentives are interlinked and work together as a package.

For example, we are asking businesses to self-assess the quality of their pricing proposal and providing reputational, financial, and procedural benefits for those businesses that do so, in the sort of form of more tailored reviews and better regulatory outcomes and processes for businesses who do a good job.

Financial payments for advanced and leading proposals that reflect the value that they're actually proposing to deliver to customers as well, of course, as the reputational signals that that provides at the same time, these are also linked to a series of incentives that promote ongoing performance.

So, this framework isn't just about rewarding glossy proposals, it's also about having mechanisms that also are in place and incentives that provide the headroom for businesses to actually deliver that innovation that will ultimately lead to long term customer value.

Just very quickly on this slide, I've just highlighted the broad process that will occur under the proposed framework to highlight a couple of things that, first, that the regulatory proposal and the process doesn't just begin when IPART receives a very long document from the water utility, the water business it actually begins before that.

At early engagement, where the business really lays the groundwork with the regulator IPART and really provide an opportunity for both the regulator and the business to have a better idea about how plans are going to actually translate into better outcomes for customers. It also means that we have, more visibility over the customer engagement process than under the current model so.

there's also that element where we're also ensuring that I guess that we want businesses to be at the centre we want to provide that ability for businesses to be able to engage deeply and meaningfully with customers before regulatory proposals come in to IPART.

Which is really important, because, in a sense, it's too late, by the time we receive a regulatory proposal if engagement hasn't been done well. So we really want to motivate that under this model and the final thing that we really want to motivate is ongoing performance.

Again, setting prices, regulatory proposals, they're just at all it's actually performance and it's actually the services and the value you deliver the customers that ultimately matter matters most under this framework.

Very quickly, to close this slide actually I just want to say thank you because I know that, over the past two years the sector has been very generous in giving their time to IPART to help us develop and shape our framework, as you can see, on this slide we've had multiple engagements and workshops, with the sector and a lot of meetings and submissions and they really have shaped our thinking and really been very helpful for IPART in developing this new proposed framework.

And just to say that, yes, we're at the public hearing today to hear your thoughts on our proposed framework and whilst we're looking to in one sense wrap up this framework with the final report later in the year in October, we do see this as a model of ongoing engagement to refine and continually improve the framework, so thank you.

Ms Livingstone: Okay, thanks Anthony for that overview. Did anybody have any questions or comments or want to clarify intent, given what you've just heard from Anthony? We have been doing a lot of consulting So hopefully it's not a surprise to you what he's just talked about, and that might be reflected in people, not having many questions. But if you do, please, please let us know. Anybody online. Okay, well, well done team you've consulted well on the broad overview of the framework so that's terrific. We will invite Eva now, another member of the IPART team who wasn't quite well enough to join us in person today but is able to present online to highlight some of the feedback that today we've heard thanks, Eva.

Stakeholder feedback - IPART presentation

Ms McBride: Thank you Liz. I'm Eva McBride and I'm a principal analyst at IPART. I'd like to thank you first for your engagement on our proposed framework and for your feedback. We value your feedback and today is another opportunity for us to hear from you. We've had a number of workshops and meetings with the sector as has been mentioned, to gather and discuss your views on our framework and what it means to each of you.

We've heard that the businesses regard the framework as a positive step to promoting customer value as a common goal for IPART and the businesses, we have heard that businesses are keen to embrace the focus on customers at the centre and that it aligns with your own corporate objectives.

We've received feedback that the reputation procedural rewards do provide strong incentives and the businesses are looking to be ambitious in a realistic way and to strive to deliver proposals that promote the outcomes customers value.

Stakeholders have expressed concerns that the assessment process is potentially subjective and carries with it, the risk that IPART will disagree with the businesses' self-assessment. In addition, the fact that there is no access to financial incentive mechanisms and alternative achieve price controls if the proposal is assessed as standard exacerbates this risk. It has been suggested that this aspect should be more flexible.

Businesses have shared their views on why they would aim for an advanced or leading grade to provide the best possible proposal. Some have commented on the fact that the advanced releasing proposals could mean higher prices for customers, due to the financial reward.

Our framework is designed to give businesses flexibility to talk to the customers and work with them on what constitutes good customer value. We recognise the water businesses that we regulate are diverse and varied in both their operations and customer base, we understand that our framework needs to be flexible, to enable businesses to pursue their own priorities and pathways to deliver a better value to their customers.

The path of each business will be different and over time, we want to accept well substantiated and leading proposals from all water businesses. As Anthony's already mentioned, and I think we've said many times, this is not a gotcha framework we're not expecting businesses to address every dot point on each of our core principles, but to drive the focus principles that will deliver the best value for money to their customers.

As most of you in the room will know, we are currently running a series of workshops it's already been mentioned as well.

To understand and improve how the model works in practice we are self-reflecting on how we can deepen engagement with the sector to better understand how businesses will respond to our framework.

We would like to understand how you intend to put the framework into action and what it means to you. We are committed to continually refine and improve this framework; and want to work with the sector to support the best possible proposals. So we are open to exploring additional flexibility for access to financial incentive mechanisms and alternative price controls under different assessment outcomes, including standard.

We'd also like to reiterate our commitment to act fairly and be transparent in our decision-making processes.

And so now I'd like to ask people to raise their hand or add a comment in the chat if they'd like to comment on how we could further improve our regulatory framework.

Just noting that we have presentations from a few of the water businesses, as Liz mentioned, and so maybe we could start with people who are not presenting today or is there any other comments that aren't going to be presented in those presentations? Thank you over to you, Liz.

Ms Livingstone: Thank you very much, Eva and Eva did a good job of targeting the discussion so if there are people who either have questions or observations about the feedback we've received today whether we've captured it, or whether you have a different view you have the opportunity to share your thoughts now. Doug and yes, there are microphones on the table for those who are in the room.

Question and answers session

Mr McCloskey: Is that working?

Ms Livingstone: Yes.

Mr McCloskey: Its Douglas from PIAC. Look, I think it's probably just worth stating at the outset from a consumer and community perspective, as we have done throughout this process that we've really welcomed the intent from IPART and from all of the participating businesses to examine a better way to undertake regulation in water.

And we really support the intent to broaden the focus of regulation. I think we've all sort of noted in the experience of the last 10 years and failings on the narrow focus that we have habitually employed and I think there is a real intent throughout the industry and through the regulator to broaden that focus, and the focus to allow that to be a means of looking more into the long-term and being guided by the consumer and the community preferences.

So, in a broad sense, we're really supportive of where this process has gone and probably reflect on the commitment of everybody involved to try and explore the issues and what is a productive way forward. So, I suppose in general terms, I think the how the input has been reflected is probably reflects our own experience of the discussions.

We would probably note that it's been reasonable for the businesses to question the approach because I think you know, there are potentially some quite substantive changes in the way the process is going to be undertaken and I think it's good to have a little bit of trepidation about that and ask those questions, how this is going to play out and my observation is that the process of responding to those questions is actually teased out some better clarity on what is intended.

I would also note that from a consumer and community's perspective, obviously we have our own trepidation around whenever people talk about flexibility and headroom for incentive that there's always the danger of that involving you know, greater costs to consumers, but we think that the way that the discussion has proceeded and where the regulatory framework is moving is actually giving us some confidence that those issues can be addressed and I think as to Anthony's point, the intent is not for this to be set in stone and then left on the on the shelf for the next 20 years, I think probably the most important experience from Victoria and other jurisdictions is that when we move to this kind of framework, it does have to be much more of an iterative process. And I think, particularly when we look at the interaction of assessment of incentives as well, that's probably our observation that we would want to concentrate on continuing to evolve that part of the process.

I didn't want to go too much into detail, but we did make some comments and we will be making some further comments around what we see as a greater opportunity to be really clear around what customer applies to and we think it would be better to explicitly refer to customer and community in relation to this interest of the of the framework and where engagement should be centred. I think that better reflects the responsibility that businesses have and what the focus of outcomes should be on. But again, I don't propose to go into too much detail on that.

In relation to the assessment framework, I suppose we would observe there are probably some tweaks to be made in relation to how incentives are or are not applied and we're relatively agnostic about where that goes. I think the focus should definitely be on ensuring that if there is greater flexibility to employ incentives, even in the standard proposal, that it is up to the business to demonstrate how that is part of a more holistic focus on achieving the outcomes that they want and that their consumers and communities have directed them to work on and how that is part of a longer-term plan.

Similarly, I think we would also say that the way that the assessment framework operates and the way the very valid issue of saying that you know some of the financial incentives for a leading or advanced business may build in increased costs for consumers. We think there's flexibility, even for a business to forego those uplifts in cost if that is part of the longer-term plan and the way that they demonstrate that they are responding to what their consumers and community wants.

So, if the longer-term focus and priority for their community is to make some of those really hard trade-offs around affordability, it's up to a business to say we think we have a leading proposal and part of that is that we were going to forgo the extra money that might be involved in that. I recognise that might be a challenging thing for a business to do, but it certainly, we think it's within the scope of the flexibility, flexibility should work up and down in relation to financial incentives.

I'll leave it there in relation to detail, but I think the questions that have been asked, and the feedback that's been given gives us kind of a good degree of confidence this process is going where it should.

Ms Livingstone: Okay, thanks, very much Douglas. Are there any other questions in the room, or comments? No, and it doesn't look like we have any online at the moment. Also give us feedback online that you're hearing us and seeing us okay, so that we can adjust if you're not. But if there are no further questions, I will now invite Roch Cheroux from Sydney Water to come up and share some of Sydney Water's feedback on what's proposed, thanks Roch.

Sydney Water presentation

Mr Cheroux: Thanks Liz, and good morning, everyone. So, my name is Roch I'm the Managing Director of Sydney Water. I wanted to start with an Acknowledgement of Country and pay my respect to the Gadigal people. We are on Gadigal Land, and I want to acknowledge that and also acknowledge the traditional owners in the room today, in the physical and virtual room as well.

So, probably starting with the journey that we've been on for some time now, and I would just want to repeat the support Sydney Water has towards IPART in introducing this new framework, we know that we want to put the customer at the centre of the framework and we want to put the customers, not only the short-term impact that we've got in the life of our customers, but really the long term. The long-term benefits of our customers and by benefits I'm not only talking about prices but I'm talking about the value the services that we are providing to our customers every day.

So, we've got on this slide a few things that have evolved since we started this discussion in August last year, so about 12 months ago and it's very pleasing to see a number of things have evolved in a very positive way in the in the discussion that we have had with the IPART team. So, you've got a number of things that are really actually critical for our customers.

Starting with the expansion review process, which is an important part of what we're doing and has an impact on the business and obviously through having an impact on business, has an impact on our customers.

The regulatory advisory panel is also really important. You all know that the water industry is the most regulated industry in the world and it's no different in Australia. We have many regulators influencing and driving what we're doing and having a discussion and the sort of coordination between our regulators is a way to deliver a lot of value for the customers, because at the end of the day, all the regulatory frameworks that we are living in, have an impact on the business and have an impact on customers, so this coordination is absolutely critical.

The 12 guiding principles and the discussion that we have had on clarification and refinement and understanding has progressed. I must say that there is still a long way to go here, because starting from the 12 principles and guidelines, there are always multiple interpretations and perspectives can be very different on principles and guidelines, and there's nothing wrong with that and it's not saying that one is right and one is wrong. It's just saying that perspectives are different and having the clearest possible definition of this will help us to progress.

The local recognition of the long-term pricing adjustments mechanism is also a clear signal for us to IPART's understanding. But we are living in the now and in the future having this mechanism inserted into the regulatory system is critical again to deliver the value that we want to deliver to our customers.

And the final one we put on the slide is the capping on the ex post incentive scheme which I guess as a business and as a leader of a business, is always an important parameter, because we have to manage the risk that the business is taking. So, a lot of things have progressed in the right way, I want to reiterate that Sydney Water, and I know it's the same other water companies customers is really at the centre of everything we do.

We've had for very long time; we have had engagement with our customers for a number of different ways, forums surveys, dark engagements, discussion with customers in the streets, in shopping malls, in all sorts of different settings. All this information interaction that we have with our customers is really driving what Sydney Water is designing and doing for their customers, this is driving the future of the business. This new framework is an opportunity for us actually to go to the next stage, and really get to the next stage of engagement and understanding, but also in some instances, really going to co-creation of the future of water in the Greater Sydney area and that's a really important one.

We have some expertise as a water business, and that's what we should have, but at the same time we are also here to provide the service and essential service to the community. And this service is provided through obviously drinking water and wastewater services, but there's also a lot of things that water is delivering in today's society. And in this interaction that we've got with our customers is telling us exactly that.

Our customers want us to evolve from a purely drinking water and wastewater services to actually looking at water in the community, in the environment. So, there is a there is a clear path for us and we've already started on this journey, to change the way that we are doing customer engagement, that we are doing community and customer engagement interactions. So that it has an even bigger impact on what we are doing every day.

And this is really important that we've got the alignment between what our customers want us to do, being more engaged with us and having a saying what we're doing, and the regulatory framework that we've got. That is not only allowing us to do it, but also supporting us in in this endeavour.

We've looked at a few further improvements that could be added to the current framework, the 3Cs framework, as it is proposed. The first one would be to the grading, one of the outcomes of the grading is the link between the grading and some new settings that would be really beneficial for customers. The incentives on one side and the pricing system, on the other sides.

And the question that we are asking is that, Why should the grading drive our customers' access to the really beneficial settings that exist in the new framework? Why should a company that would be rated or graded as standard, not be able to provide to their customers, the drive the incentive could give to the water company and why would the customers not have access to the pricing mechanism that are different from the very basic pricing mechanism that we've got today.

So, that's a that's a question where we would question the rationale between the grading or linking the grading and the benefits that would be coming out of the pricing mechanism and the incentive mechanism. So, that's one improvement that we are proposing to the current framework.

Another one is about the incentive schemes. The changes that are coming with this new framework are big, they are massive. When we look at what this new framework is bringing, not only in terms of submission of the assessment, but also in terms of incentive mechanism, there is a lot to do, between now and June or July 2025 when the new regulatory period will start.

And here, when we look at the incentive mechanisms there is one that clearly stands out and that's the capital incentive mechanism, which is probably the most difficult to implement and the most difficult to fine tune, so that it delivers value to customers.

And I will take a very simple example which is if you incentivise any company on a capital program, then the tendency will be probably to reduce investments that works, that works in the short-term. That works to satisfy the mechanism, which is in the capital incentive scheme, but that doesn't work in terms of long-term value for customers and that's one of the biggest risks that we've got with this incentive mechanism.

So as much as we support the idea, the principle of having a capital incentive scheme. Our proposal here is to take the time to think about it, and take the time to design the scheme, so that it really delivers value to the customers.

And considering what we've got on our plates between now and June 2025 knowing that as a business, we will be submitting our proposal on June 2024, so it's coming very, very quickly now it's only 24 months. We are saying well let's look at this capital incentive scheme, let's start working on it, but let's defer the implementation to the next regulatory period.

The third improvement that we wanted to suggest is linked to the review process. So, there are a lot of projects in different water companies, and there's a lot of scrutiny already embedded in our systems, in our own governance system, but also in the assurance systems that are provided by the government.

And a number of our projects will have not only been through the scrutiny of the executive, scrutiny of the board, but also will go through a number of systems coming from the government, Infrastructure NSW for the capital program, Treasury for number of projects etc, etc.

The suggestion that we've got here is that the regulatory system also takes that into account. And for the projects that are going through extra layers of governance and assurance should have a larger treatment from IPART because we've already gone through multiple level of governance and assurance.

And the fourth suggestion that we had is linked to the accountability of IPART to our customers. We are entering it to a new system, a new framework, a new regulatory framework. This is a complex framework, and this is something that is difficult to implement as any new system, when you're entering into a new set of rules and regulations. It's always difficult to implement.

And we are in the system where actually there's a lot of risk, not only for the business, but also for our customers and that's what I was saying, with the 12 principles. The interpretation that can be done on the 12 principles is actually very large and whatever level of definition IPART is giving to the principles and the guidelines there will always be different interpretations, there will always be different perspectives on things.

And there's nothing wrong with that, there is no one right perspective and one wrong perspective, but we may be coming from very different places between IPART and the water business. And what we are suggesting here is that there would be a third party that would be here to say when we come in from these 2 different perspective, this third party would be able to say, well, actually, if you look at these 2 different perspective, if you change a bit here and a bit there then that's the best way to get the best outcome for customers.

And having this external party that could get into the discussion when we get into a place where the 2 perspectives are so different that we cannot get to a good outcome for the customers. Then it would help to bring value to not only the implementation of the framework but bring value to the customers. So, they are the 4 improvements that we are suggesting could help actually make the framework even better.

But I'm going to go quickly through the next 2 slides because we've already spoken about it, but the task that we've got in the next few months between now and the submission of the and our submission in June 24 is really massive. We know that it's a complex framework. The intention is fair from IPART and from the water companies, indeed, Sydney Water to make sure that this new framework is a success. But there is a lot, a lot of things to be changed, so we should not underestimate what we have to change in this framework.

You've got here on this slide the number of things that we will have to implement in the next 2 years. The reality is that things have already started. The engagement with our customers has already started. Some time ago, actually it started 2 years ago, so we are already in the process of building the submission that we're going to put to IPART in June 2024.

If you think about that, and if you think about the fact that, at the same time, we still discussing the rules and regulation of the new framework. Then it puts everyone, IPART, the businesses and our customers in a place where things are not easy. And that's why I think our recommendation for the capital incentive scheme is just to recognise, acknowledge that there is a lot on our plates for the next 12-24 months, lot of things that we're trying to do at the same time.

And let's be ambitious, but let's also be realistic about what we want to achieve and that's what we have here on this slide, where we are saying as any business, you're always trying to set the priorities right. You can't do everything at the same time. You have to pick the right priorities for the customers and that's what we are trying to do here when we are flagging some improvements to the current framework that is proposed.

So that's the few things that we wanted to contribute to the to the discussion, but again a lot of support from Sydney Water to what IPART has started. It's a great way to progress and deliver something that will bring a lot more long-term value to our customers, so thank you.

Ms Livingstone: Roch, can I ask you to stay while we go to questions?

Mr Cheroux: Sure.

Question and answers discussion

Ms Livingstone: Thank you for that presentation. There was lots of really substantive comment there, which is really helpful, and I will ask Sandra if she's got a question or comment to make?

Ms Gamble: Thank you Roch, for your really thoughtful comments, that was really interesting. Can you just give me a little bit more detail on how you think the capital expenditure incentive scheme is difficult, can you sort of give me a practical example of how that creates some challenges for you.

Mr Cheroux: The difficulty is in setting the parameters, so that it drives the right behaviour. And capital programs are complex. So, if you think about capital program, when we will be submitting our submission in June 24, we will have started to work on the submission 2 to 3 years before. When we get to the last year of the capital program which will be 2030, some of the projects that we've included in our submission will be already 7 or 10 years old.

So, the incentive mechanism that you can have on the projects will be set at the start of the regulatory period, but actually the proposal will be put 7 years before the capital project takes place, is in practice extremely difficult and you can think about what is happening today in the construction markets.

We would not have been able to predict what is happening in the construction market today 7 years ago, that's just not realistic. So that's one thing about okay, so what does it mean in terms of incentive what, how can we take that into account. That's one thing.

If you think about the capital programs as we drive it, there is always a continuous reshuffling of priorities in capital program. And that's also something that is impossible to predict. So how do you how do you take that into account when you set the incentive scheme?

I take another one which is you know if you imagine growth, which is another it's really an important part of our capital program it's about 50% of our capital program in Sydney. Predicting growth 7 years in advance is also impossible. Our track records to predict growth is usually not bad, but there's always variation that you cannot predict because, for example, COVID will happen and the borders will be closed, and population growth will be changed compared to what we had.

Or there will be a government decision to implement a business district in this part of Sydney and then the impact on assets construction will be massive, because actually that's not the best way to be for growth. So it's another parameter, which is really difficult to include in it.

So, if you think about the complexity of all these different things. And if you think about the fact that there is an incentive on spending less on capital, then what will happen is there would be a short-term decision will be made so that there is no penalty, maybe not, no incentive, but at least no penalty for the business.

And then you may end up in a situation where, we've seen this the water industry in general, it has been for a very long time or at least since regulation has started, it's been a very, very short-term vision in terms of investment and that there was a lot of under investment, because actually we were trying to do something that was in the now, and not for the future.

And what a capital incentive scheme could attract is exactly the same behaviour where you end up at the end of the regulatory period, and you have had changes in growth conditions, you have had changes in the market.

And you're thinking okay, I can't penalise the business by having a penalty, or I don't want to penalise our customers by having an incentive and therefore I'm going to cut here, here and there. And that's alright because, in the next few years, that may not have an impact, but maybe it will have an impact in 10 or 20 years. So, this is the capital, please consider that we are absolutely supportive about the capital incentive scheme, but done in the right way, so it gets the right behaviour in the business.

And that's a really complex one. So, thinking about what we have to do in terms of the ODIs are a lot easier to implement, the operating expense incentive scheme is a lot easier to implement. In addition to that, we've got the building of a submission working on the 12 principles and guidelines, etc.

So, our suggestion is to say, well look this capital one is really, really complex. Let's start working on it, but probably take the next regulatory period to fine tune it and then implementation at the following regulatory period.

Ms Gamble: Just ask a quick follow up question, thank you for that Roch. One of the objectives of the efficiency benefit sharing scheme, the OPEX scheme is to smooth out over time, the incentive to reduce capex, oh sorry OPEX, so that you know there's not a low incentive at the beginning of the regulatory period and high incentive at the end, there is a smooth incentive and I guess what we're also conscious of is that that may create an incentive to move expenditure into CAPEX rather than OPEX. So that's one of the drivers of the capital expenditure incentive scheme is to try and get that balance right between CAPEX and OPEX.

If we went into a situation where the EBSS in place for OPEX but not for CAPEX, how would you see us trying, to all of us, trying to make sure that we're not been seeing a big influx of expenditure into CAPEX where it may not have the same incentives.

Mr Cheroux: Yeh, I think that's a really good point. I would think that there is a possibility to include in the OPEX scheme something about transferring funds to CAPEX basically. I would think that's possible to include that in the OPEX one so that it's taken into account, until we've got the capital incentive scheme in place.

Ms Livingstone: Thank you Sandra. Other questions or comments for Roch while we have him here? Deborah, Deborah is a Tribunal Member for those who might not know her. We'll train them before the next hearing on how to turn on microphones.

Ms Cope: Thanks very much for that Roch. I really appreciate the feedback. I do have one question on your point around delinking the grading with the incentive schemes and the flexibility. And I understand very much, including one of the points that we've heard very clearly that if you have a whole proposal built around having an advanced business and if you then get flipped back into being standard, and how do you actually manage something that's built around having all of those schemes in place, and then they are not available to you going forward.

So yes, we are thinking about that, but I'd be really interested in your views, because one of the reasons why we originally thought about linking those 2 things is the difference between and around the idea of the earned autonomy, the level of sophistication in a business that you see that's been rated as advanced, means that they have the systems and processes in place in order to be sure that the additional flexibility can be managed in a way that's in the long term interest of customers. That's not necessarily the case with the standard business.

So, my question is, if you're providing the additional flexibility, money that doesn't have, that the business is free to spend in the way that business wants to managing prices underneath the cap, what do we then need to do to be sure, for standard business, that that's being managed in a way that's in the long-term interests of customers.

Mr Cheroux: Yeah, this question is not easy to answer because there will be probably as many different cases as there is standard businesses across the state. I would think that there's probably one thing is the benefit for the customers is potentially really good with the pricing flexibility and with an incentive scheme. In the sense that they will incentivise the business to do better, even if it's a standard business. And they will give possibility to get pricing systems that are lot more tailored to the situation of the water business or the community in fact.

And when you look at these 2 benefits, is there a way to make it work without linking that to the grading. So is there a way to make it work even for standard business. I would think that's possible. Some of the standard businesses are, I would agree may not have the sophistication to be able to do it by themselves. Is there a way to do it in a way that would be guided by IPART or guided by another organisation, so that you really give the benefit of this to the customers of the standard business because at the end of the day, it's not the business that will be suffering by not having the incentive and the pricing flexibility, that will be the customers.

Shall we have customers penalised, not having these 2 good measures in place, simply because the business is standard. And I'm thinking probably not. Because at the end of the day we are trying to achieve the best for the customers, so is there a different way to do it, so that the standard business that may not be able to manage it by themselves are guided or ways, maybe some standard scheme that would be easy to implement or something different, but the delinked from the grading.

Ms Livingstone: Thank you Roch. Other questions or comments from the group, online or in the room?

Mr McCloskey: Thank you very much Roch. I think there's a really good discussion there and I think particularly the point around how incentives and pricing options for standard businesses are protected, is a really important consideration and one that's worth exploring. The one question that we do have, and the one comment that we've raised in previous forums is around the proposal for further independent assessment. And I suppose as we've sort of raised previously, we may be somewhat coloured in our opinion of that type of framework, because of our participation in limited merits review and other forums in energy.

But I suppose it's just teasing out the validity of that approach when you know, at least ostensibly IPART is an independent body and the purpose of their assessment is to be an independent assessor of the proposals that businesses are undertaking, and just to do kind of a devil's advocate is, what is, what gives any confidence that a third level of independent assessment will be any more objective than the one which is currently intended to be objective.

Mr Cheroux: It's a good question Douglas. Look I think it's something that happens, not only happens here but happens everywhere. When you've got 2 parties, each party will have their perspective on the topic that is being discussed. And, as I say this, you know, not one wrong and one right, it's just 2 different perspectives and sometimes you get to situation where the 2 perspectives will not reconcile, and most of the time they do, but sometimes they don't. And when they don't, having a third party that will be stepping back, looking at the 2 different perspectives and giving an opinion about well actually the middle of the road solution or the best solution for customers is probably in between the 2, and then invite the two parties to this solution. And that's you know that's I guess that's a very simple mechanism to resolve discussion, that can find a solution.

Mr McCloskey: I think in isolation that sounds very reasonable, I guess, I suppose, looking at this framework and what the intent is, it would seem to me that there is the scope to do that in advance and that's the way that this framework, seems to be intended to be designed, is that the engagement is at this point so that those sorts of discussions where there might be differences is able to be had before the proposal is on the table and you're being told it's not leading.

The idea is not the business thinks this is what they have, and IPART is distinct in the corner until that proposal is presented. It seems to us the point is that that case is made, so that by the time the proposal is there and the other side of this which I think is really important is that the responsibility is on the business to demonstrate because they have, they do understand their customers and community. It's part of the responsibilities on the business to say we understand our community so well, and here's how.

And the process of assessment, IPART's process of assessment is really just the testing of saying you have made your case, absolutely we agree, we can see the evidence that you have supplied. And if that's not the case, it's a case of questioning, we need, we need more information around how where there may not be enough evidence.

I'm still not sure what a further body of inquiry does, other than to put less focus on the business to concentrate on making a good case and to do engage with IPART in doing that. And again, I would observe that since they removed limited merits review in the energy space, the engagement between businesses and the regulator has been much more functional, not perfect obviously it's not a solvable for everything. I think the option to have a further review can have the effect of reducing focus on the approach.

Mr Cheroux: Yeh, I respect that. I think what you said in theory works, but in practice, you still come to places where actually the perspectives are very different. I will not take the perspective of the electricity industry because it's a very, very different industry, compared to water. The focus that's you know, we've demonstrated in the past and we want to demonstrate even more in the future is going to be there.

But it doesn't change the fact that you know, with the best intention in the world, you always come with your own perspective to a discussion and even if you've got a very, very precise defined framework, there's always ways for interpretation etc and that's where the question is, what do you do when you get to a situation where you can't reconcile the 2 parties and again, not one is right, not one is wrong, but the solution is in the middle and that we don't have today.

Ms Livingstone: Okay thank you. Sure Deb.

Ms Cope: I'd be interested to know Roch, what's your idea of what would be the skill set of that external group and how could, what process they would need to go through to have a look at the package, the proposal holistically so that you are considering the overall benefits for customers. Because I'm having difficulty reaching how you could have an efficient, effective process with the right skills for a body that was coming in as a dispute resolution.

Mr Cheroux: Look you can structure it in, many different ways from you know, having experts attending the discussions, to having an external body, where you go only when you've got when you need a resolution. There are many different ways to put that into the process.

You know it could be along the way, as having third party attending the discussions, or it could be as an external tribunal, where you go when you've got an issue. I'm not recommending any of the solutions, but having this possibility inserted into the system in my mind, in our view, would bring value to the customers. So, I think you know it's about the principle, rather than saying it should be that way or this way.

Ms Cope: Really interested in your thoughts on this a bit more because one of the things that we've heard is that the imposition of independent experts and assist which are currently our consultants, is part of what causes problems to the businesses.

So, again I'm just having difficulty envisaging a framework that could actually in practice deliver the benefits that you're talking about. Because to have somebody who can understand the whole of the proposal, given that we envisage, for IPART, to be able to do that we need to work with you over several years. And then be able to apply expertise that doesn't sit with the current decision makers. I just, I see where you're coming from in theory. I'm just having a lot of difficulty envisaging in practice any process that would actually deliver what you're saying you want, in theory.

Mr Cheroux: Which there are Deborah, and you know I don't want to take another regulator as an example, but we have had exactly the same situation with another of our regulators, not very long ago where third party came in. In a in a situation where we had 2 very different ideas about something that had happened, and the external party gave a decision that was actually a middle-of-the road decision on the situation, so it is possible, as I said, there are different ways to do it but that's something we would like to discuss with IPART and find what would be the best way to make it to make it work.

Ms Livingstone: Okay, are there any final questions for Roch? Thanks very much Roch we really appreciate not only giving the presentation but being the hot seat for a while there answering questions, that's really helpful for everybody to help tease out some of the feedback that you've provided.

We are now going to hear from Darren Cleary the Managing Director of Hunter Water. Darren will be online and his slides should appear shortly. Thank you very much Darren for joining us and I'll hand over to you.

Hunter Water presentation

Mr Cleary: Thank you Liz, good morning, everybody. I'll just give a quick overview of Hunter Water's perspective on the current regulatory framework, next slide please. Hunter Water is very supportive of the 3Cs model, certainly the principles that have been outlined. We think they really do address the challenges that we're facing as an industry about how we provide the best customer value, particularly in the long term and how we do so in delivering services that you know, do underpin the sustainability, the resilience of our regions. So that long-term view of what customer value is, we think is supported by this model.

We certainly welcome the approach that IPART are taking in developing the model around collaboration and engagement with the business. We think that's obviously essential to success. So clearly, it's a big departure from the past regulatory approaches and processes that we've had as an industry, and I think that's important to note because there's a big change in the process, we have to manage here, for both the businesses and for IPART. Now that's been recognised by IPART, but I think it's something to make sure we keep you know front of mind.

Obviously, the framework relies on genuine and meaningful engagement. And this is something that as businesses, we do on an ongoing basis but you know community engagement and customer engagement is messy, there's lots of, there's lots of different customer groups, lots of different perspectives and those perspectives will change through time.

We know we're getting a very different view from our community when we ask them about what a customer value is now and in the current inflationary environment, what we would have received 12 months or 18 months ago. So, we just need to recognise some of the complexity in all of this, and have that continual learning and flexibility built into framework. We think those principles that are really important.

We are certainly very keen to take on the responsibility to do this well, to understand customer and community value and put that in their value proposition. So, we're very, very much supportive of the principles.

The details clearly is important so we are very welcoming of the opportunity to work through what the details will look like and see that it is absolutely essential and I'll touch on this as we go through. Getting that detail understood and agreed between IPART and the business is going to be essential to the success of the framework, next slide, please.

Not to touch on this for too long, but you know the view of delivering services that provide customer value is fundamental to our business strategy, so this is an excerpt from our current business strategy and that's very similar to many of the water businesses that IPART regulates, as you've already heard from Roch as well.

So, customers and community are the heart of what we do, that's what drives our strategy. So, it's very pleasing to see that the framework recognises this and allows us to deliver upon this and recognises that the current regulatory approach does provide some constraint to actually delivering upon what we're hearing from customers and community. Certainly, we agree that the current approach, is based upon an assumption that the current broad regulatory regime we operate within best reflects community value.

And certainly, I think everyone agrees that the current regulatory regime is really important in ensuring minimum standards are met. But is not flexible and responsive and adaptive enough to actually deliver best community value. So, allowing the water businesses to understand that, putting the responsibility on them to understand that, and then holding them accountable for delivering that, we absolutely think is the right approach, next slide please.

To again, very similar to Roch, just to really emphasise the timeframes we're talking about here. We need to have a new pricing proposal, in essence, ready by mid-2024 somewhere in mid-2024 to provide to IPART to then assess to then make a determination by mid-2025.

So, to do that and we've already started, we've started our process of engaging your customers. Now we engage with customers all the time on a range of issues. Clearly, we need to engage with them about an overall pricing proposal as a specific engagement approach, so we've started that process already.

And here's just a summary of our current approach, which we will continue to adjust and tweak as we get feedback from our community and we get further understanding of the framework. But time is of the essence, I think, is the key point here.

We are underway as a business, and we're working with collaborating with IPART on co-designing our proposal with our community, while we're collaborating with IPART around what this framework might look like. So, we do need to keep in mind that time is of the essence, next slide please.

So, it's a new framework for everybody involved, and it is a fundamental shift for the Secretariat, the Tribunal and regulated water businesses. We're very welcoming of the approach that IPART are taking to develop the guidance material for what this looks like, and we see that guidance materials absolutely essential. The risk that is clearly apparent here is really the understanding of the expectations on how to deliver customer value.

Is it well communicated and understood by the businesses, the potential of the framework won't be realised. This will end up in the old regulatory model, most likely the standard proposals not reflecting customer value and with much greater regulatory burden. We will only achieve we think the potential, if we get that detail, yet it still has to be understood by the businesses.

The real incentives for us as a business, firstly, is in being able to reflect customer and community value in our pricing proposal and then in the prices and the pricing structure that we provide, that we are allowed to implement. And, secondly, the potential for a more tailored and lighter touch regulatory process that reflects the quality of that proposal.

So, they're the 2 big incentives that we see. Certainly, we see that the current approach of this has been well discussed. The current approach of the detailed expenditure reviews within the businesses, provides a false sense of precision and is very large administrative burdens for limited customer value. So, the ability to move away from that is very much welcome but understanding how we deliver on their potential is quite important.

With respect to the model itself, there's a lot of detail to work through in the model. The financial incentives are mechanisms which we understand the logic behind them and understand the reasons that they are there. Certainly, want the opportunity to continue to work through how they will play out.

They're not a strong incentive for us as a business those financial incentives. We certainly need to understand them, but they're not the selling point they are by far the less important driver for us to the customer value.

Similar to the view expressed by Roch, the capital efficiency sharing scheme is the one mechanism, in particular, which we have the most concerns about, about how that could be correctly calibrated. We do we understand the logic around making sure we don't shift OPEX into CAPEX, but very concerned about how you calibrate that right, to also don't get the unintended outcome of you achieve an efficiency in your capital expenditure, by simply doing less or deferring capital. And that's also a real risk and how you how you manage that risk is something that we need to continue to work through to get the scheme calibrated correctly.

It's a new model, the first round for doing this and there's no precedence of this model. I mean there's certain elements obviously that have come from other regulatory regimes, but the packages entirely is a new model, and therefore there's a lot of complexity in the model that we all need to need to understand.

And reflecting on the earlier point there's a large change process to manage here. So, I think that's important to understand about the level of ambition that is taken into the new regulatory model and giving the businesses, an appropriate amount of time to respond to that model and do justice in their submission to the Tribunal in a little over 2 years. I think that's an important element to consider as we're developing these detailed guidelines, noting that there is this philosophy of continuous improvement that is built into the model as well.

The model is incentivising the businesses as it should, to put our best offer in, and so we're trying to understand as part of that detailed guidance, how we provide our best shot at doing that. Just reiterating, it's important that we get that information as soon as we can, so we can then build that into our processes over the next few years to put in our submission. That's all I really wanted to cover and provide an overview with today. I'm happy to take any questions or comments on the presentation.

Questions and answers

Ms Livingstone: Thank you Darren. Do we have any questions for Darren? Deborah...

Ms Cope: They've set my microphone up with kitty switches so that I can get it right. Just interested in your view, around the capital incentives scheme. So, the absence of a capital incentives scheme creates incentives for ways of treating CAPEX. So, is your biggest concern around it, that the concern about inappropriate incentives or it is the concern about just not being able to get the work done to put together a workable scheme in the time frame that we've got or a combination of the 2.

Mr Cleary: Deb, it's about if we get the design of it wrong then we provide potentially perverse incentives to the businesses. I think part of the challenge we have in our capital programs as Roch I think has outlined, is there's a large proportion of them are major projects that take years to develop and deliver. They're not easy, they can be challenging to benchmark. They can be benchmarked, but they're much more challenging because of the sites specific natural these programs, and in the timeframe in which they're delivered. So how you build an incentive program that measures efficiency that doesn't just incentivise businesses to underinvest and delay capital I think is the challenge.

So, again, not saying it can't be done. I think there's a level of detail that needs to be thought through around how you do that again in an efficient manner. Certainly, you know the issue about the efficiency in any individual project is one that we grapple with every time we have an expenditure review and it's something that ends up being a substantial debate between us and expenditure review consultants and it's by no means trivial.

So, designing a scheme that is workable and doesn't have a massive administrative burden across it, and it doesn't provide those perverse incentives are our concerns. So, that's what we're expressing and wanting to work through, how you design that I think is a challenge, but not saying it can't be done, but it needs some thought.

Sydney Desalination Plant presentation

Ms Livingstone: Thank you. Any other questions while we have Darren? No, and it doesn't look like we have any online either. So, I will invite Iftekhar Omar from Sydney Desalination Plant to share their feedback on the draft framework, thanks Iftekhar.

Mr Omar: Hi everyone thanks for the opportunity to present. I'm very excited about the future under this framework and happy to present SDP's view. So, the desalination plant is Sydney's only major source of rainfall independent supply, and I think it's starting to add more value than in the past but there's a growing trend locally and globally to seek more resilient water supply in the face of climate change.

It is a key way to adapt to the impact and you know around Australia, we can say that in Perth they're looking at investing in a third desalination plant, I think close to half their supply relies on desalination for drinking water.

I was recently speaking to the Chair of Melbourne Water, who said that climate patterns have changed so much in Melbourne that they think that they will need to expand the existing desalination plant and they are seeing a permanent reduction in flow rate into their dams.

I also know from global research, there's currently about 15,000 desalination plants globally and there is a projection that they'll need to be investment in a further 9,000 in the next 5 years, so you can definitely see there's a growing prominence of desalination plants globally.

So, for our part, our role is changing. We were historically conceived and designed as a drought response asset, with provisions to provide emergency response when there are public health concerns. But in the future, we are looking to provide more flexible services. It's government's intention for us to be operated in flexible full-time operation effectively, in the future.

And so, we think this is a great thing for customers because I think most people in this room would know that the costs of the desalination plant, a large component of those costs are fixed costs of the actual investment in the first place, the operation of the plant is marginal in the scheme of things. So, if we can operate more and add more value to customers, then that's a great thing.

So, moving to IPART's framework. I think that costs and credibility, have been a core feature of IPART's and other regulators frameworks for some time, and it's really this customer element that's taking much bigger focus.

And I think customers have always been the focus in the framework, but not to the extent that we are seeing now where we're getting direct customer engagement, direct representation of customers in pricing processes.

Which I think is a good thing, but it's a new thing that I think everyone's adapting to. I think customer focus more generally is emerging across the industry with a much larger focus on environmental, social and governance outcomes. And you can see other regulators moving towards more customer engagement and customer focus.

So, step outside of my Sydney Desalination role for a second and I'm keen to share a bit of my experience in the energy sector, prior to joining Desal. And the experience was as part of a move towards this new reg framework where the AER brought in a lot of customer councils and customer change panels into the process.

And that came with a lot of benefits, but I think I remember in one of the earlier sessions, I think it was Anthony or someone else mentioned this idea that IPART was looking to leapfrog other frameworks, so I think there is a real opportunity for that. Because you've got the opportunity to learn from what's happened in other frameworks.

And in the AER framework, I think the customer panels and customer councils were really valuable because we had some really experienced subject matter experts that were actually on those councils. And so that brought a level of additional scrutiny, and a different perspective that was valuable to bring out the best proposals and negotiating outcomes.

But I think overall there is still a missing piece of the puzzle. And this is much more challenging one which is to engage with the entire customer base, which is very diverse and try to understand, well, what is it that customers across this diverse cross-section will actually need and desire. That is much more difficult, when you have business customers, residential customers, different socio-economic groups.

It's very challenging and you've also got in the age of Uber and Amazon, really high expectations from your customers. So, I think that component, especially in the IPART framework can come to life through businesses own engagement with their customers. Those businesses like Sydney Water and Hunter Water and WaterNSW here on the front lines with their customers gathering all of this data through their interactions.

I think that's part of the puzzle, which is really going to bring out the best outcome for customers. So, for SDP's part, our investors are committed to ESG. They've made statements and goals to invest responsibly and invest for the future.

And they don't just make those commitments. They monitor and measure those commitments as part of our governance framework. We undertake this ESG assessment, and we've been progressively improving. I'm happy to say from 2 years ago we lifted from a 78% rating to a 92% rating and we're looking to improve every year.

So, a little bit about SDP's position in the framework. And we are, like all businesses that have unique circumstances. Our circumstance in the supply system, we really are guided by the NSW Government's policy objectives, which are reflected in the licence that they implement.

And so, the government is the representative of customers in the community, so those views are being fed through the operating licence. And of course, we supply into Sydney Water, who serve a broader customer base and they know what's going to deliver for customers and how we are best utilised as part of an integrated system of water supply.

I think the reflection we have is that we are one step removed for customers but their interests are still our focus, ultimately. And we have to keep that in mind when we are putting together our proposals.

So, our view on how we think we can deliver for customers. First and foremost, in the last couple of years we've seen that what's been most valuable from us is being able to adapt flexibly to changing conditions and continuously improve. And I think the changes in the water sector are ever present so that adaptability and flexibility is going to be important.

And then, fundamentally, we are we, we need to engage constructively with government and Sydney Water. That's core to deliver for customers. To the extent that it is useful and valuable to try and understand customer needs and preferences through Sydney Waters customer engagement, so that we can bring that into our thinking. And then, as always, provide reliable service at efficient costs and deliver credibly on what we commit to doing.

So finally, a few specific points that we wanted to raise. As this is a new framework, I think there is concern about how it's all going to work in practice and so while we think the financial incentives are powerful in driving ambitious proposals. We think there's merit in potentially reducing the range of those ex-ante incentives, at least for the first round of reviews, so that businesses have no barriers to being as ambitious as they can be.

And then, in terms of the ex post incentive schemes, a couple of points that we would raise. One is that, as part of the implementation, there should be some thought given to how that the incentives scheme should adjust to changes in circumstances. That may be that it's not formulaic, it's not all known ex-ante when setting up this scheme.

But if there's a mechanism in this scheme to allow review of whether they were intervening circumstances, exogenous factors that impacted outcomes, that'd be valuable and you can see that works symmetrically.

So, if you have a massive cost impost for example, Roch was raising these the changes in the construction sector and the additional costs there. That could be something that is outside of a business's control and could drive a potential ex-post outcome that was never in the business' control really, or too far out of the business' control to be managed. And there's the other side, where you can have a material reduction in costs for a range of reasons and customers shouldn't be paying incentive rewards to businesses where that happens. So, I think that that needs to be considered.

In SDP's case, we also have an existing outcome delivery incentive scheme, which is the abatement scheme. It's designed when we were a drought response asset, is a really strong incentive to ensure we were able to respond in drought and we think that provides a baseline, but especially considering our new role as part of a more integrated part of the system. We think there's merit in refining that scheme. Changing to a service level incentive scheme, that is capped and better for it reflects our role as a flexible full time operating plant. I was surprised to hear so much discussion about CESS but it makes sense once I heard the presentations.

I think a couple of observations, more generally, that this concern about CAPEX/OPEX trade-offs, I think is real. I think that there's the way potentially of dealing with that is thinking about a closer focus on businesses capitalisation policies. So, it can really test whether things are being appropriately capitalised. And I do agree that it's incredibly complex to try and target or get the right outcome from a CESS because it depends on the circumstances of the industry.

So, for example, if you're in a steady state operation and what you want is to get continuous unit rate efficiency, then you could have a CESS there. But if there's other bigger issues at play like a changing environment. Then I can see how there's those potential perverse incentives from a CESS that needs to be thought about.

So, I would agree that there's merit in thinking about that a bit more before it's implemented. For SDPs case in particular, I think, for us additional capital is relatively small component of the costs and there's fairly limited scope for one to shift between OPEX and CAPEX, but also limited scope to drive further efficiencies.

A lot of what we do in capital is procured externally, and so the key way to deliver efficiencies through competitive tender processes we think and efficient management of delivery. So that is, that's maybe a point more specific for SDP. So that's all I wanted to say, thank you very much, happy to take any questions if there are any.

Questions and answers

Ms Livingstone: Thank you Ifty. Are there any questions for Ifty... Sandra?

Ms Gamble: Yeah, okay Ifty, I'm going to ask a really cheeky question. If you've got really low capex, why would the administration of the capital expenditure scheme be high.

Mr Omar: I think it's about, well for us as a very small business of 11 people at the moment, focusing our efforts on trying to grapple with the CESS may not be expensive to administer, but it's about the time cost, I think the resource effort focused on potentially trying to target a response to the to the CESS. It may be that in reality, it's not actually going to deliver real efficiency because that type of scheme may not deliver the type of efficiency you need from us. So, it's not necessarily a means of characterisation like that, it's probably not that cost of it, but maybe the time effort, if that makes sense.

Ms Livingstone: Douglas

Mr McCloskey: Ifty, I'm going to test your assumption there that your engagement or potential engagement is indirectly via Sydney Water, and I think this probably goes to the larger question of the focus and why we were really keen to have that clear customer/community focus and it's probably given us a really good example to test that is that.

There are a lot of assumptions in the way that the business is operating and not necessarily, is that responding to consumers in the communities as preferences or needs or interest or even their input.

And I think a really good example of that is that we've collectively tied ourselves in knots around the communities' views around recycling. And no one's ever really talked a hell of a lot about desalination. I'm not saying they should be worried about it, but there are definitely community concerns and interests in when and how it is employed.

And I think while I agree that it's not going to make necessarily a huge material change to the way that you might operate your business, I think the assumption that your key customer is Sydney Water, and your key stakeholder is NSW Government.

It's potentially an example of where actually, the regulatory framework should encourage you to think larger than that, because while the impact on you might be relatively small, in the short term. In the long term, it might be quite large and we would sort of suggest that there is a direct responsibility to try and connect directly with consumers and the wider customer base.

It's kind of more of a comment than a question but it's more just like, you gave me a really good example of one of the points that we've been trying to make. If you do have some thoughts on that in response that would be interesting.

Mr Omar: Yeah sure. I think this is a real challenging one for us to grapple with. When we talk to our board, they're constantly saying we should be at out there consulting with customers and the community about the benefits we are adding but there are challenges in that now.

We have a long-term lease with Government and a lot of the contractual relationship we have, we have to respect that it is Government's ultimate policy decision that drives what we do. And so, we want, we are constantly grappling with how we approach that.

We've done some broader customer research, but then we have to bring that through, I think the forum of the Government's Greater Sydney Water Strategy engagement, as us doing it independently is maybe not appropriate, given our position. But I do appreciate the comment, and I think it'd be worth more discussions in coming years.

Ms Livingstone: Okay, good question and helpful response, thank you Ifty. And thank you for sharing your thoughts on the framework that's great. And for those of us in the room, you've probably got a sense that lunch isn't too far away, you can actually see it now.

But before that Michael has the job of holding our attention to give us feedback from WaterNSW. Then we will invite the EPA in particular to make some comments. We will have a lunch break after that we do have a short presentation, but we have a fairly long period for additional discussion, so don't feel this is your last opportunity to make comment. If you're storing up questions, we can talk through them after lunch as well, thanks Michael.

WaterNSW presentation

Mr Martinson: Thanks Liz. I don't know what's a worse session, actually presenting right before lunch or presenting right after it so look thanks everyone for the opportunity to present today. I'm Michel Martinson. I head up the economic regulatory team at WaterNSW.

Thanks for the opportunity to present today. Andrew George and Fiona Smith send their apologies. As another matter has pulled them away from being here at the start of the session, but they hope to be able to join us for the discussion after lunch. So, you're stuck with me, but hopefully I can keep you engaged.

Okay, I passed the first test, so I guess, like the other businesses WaterNSW supports IPART's intent to ensure the regulatory framework leads to greater customer engagement, innovation and efficiency in the water sector that enables efficient outcomes that are in the long-term interests of Consumers.

We're also very supportive of the framework because it supports the delivery of and aligns to our corporate strategy strategic objectives. And our annual strategic initiatives. It provides the flexibility for WaterNSW to be able to deliver services valued by customers within a long-term business planning horizon.

And so, while we support the delivery of benefits to customers at the earliest opportunity. We've proposed a number of improvements to the framework which I'll touch on some of them today, conscious of time, but we'll touch on them, some of them have been covered today in the various presentations but we might provide our perspective on some of those.

And we seek to enhance the outcomes proposed with a broader range of water businesses across NSW. And we're keen to ensure that the new framework results in improved outcomes for customers that outweigh the additional cost of implementation as soon as possible and as soon as is reasonably practicable to implement.

And one of the things I'll touch on in a later slide is that we're proposing to prepare for our next round of reviews, which has been highlighted today is in effectively, 2 years, maybe not from today, but 2 years from roughly this time frame, which isn't which isn't a lot of time.

So, we're looking to provide a single proposal across a number of services that address 3 current determinations and there are some challenging, you know challenges in aligning our processes to the new timeline, but we think it aligns well with IPART's 3 C's framework, that will ultimately result in benefits to customers, business and IPART as well.

I won't spend too much time on this but like the other businesses that have presented here, we think that IPART's 3Cs framework aligns very closely with what the business is looking at doing from a corporate strategy perspective.

So, our purpose is water delivered when and where it matters. And we think our approach to regulatory management including the IPART determination process has been designed to both inform and reflect our corporate objectives and priorities.

So, the determination process as evident from IPART's framework really has a close link with what the community expects us to deliver as an organisation and regarding and ultimately in a lot of cases, providing funding for building a sustainable future, delivering operational excellence, developing our people and capabilities, working together in partnership, and being respected by the customers and the communities that we serve.

Now it's I guess useful for our unique operating circumstances and it's useful to highlight that WaterNSW is unique for the water utilities that IPART regulates. And the services that we provide are regulated services that are set by IPART across 4 separate determinations.

And each of those determinations is really unique in terms of the diversity of the customer base, the operating environment and the asset intensity of the service and the maturity of the regulatory framework.

So as an example, we provide both water services to Sydney Water, 3 Councils and approximately 60 small raw water and unfiltered water customers that is regulated by IPART in our Greater Sydney determination. So out of that, the vast majority of the revenues that are collected by Water NSW in the Greater Sydney determination it's about 99% via Sydney Water.

We also provide bulk water services to thousands of rural customers, including town water supplies, industry, irrigation, stock and domestic use, and environmental flows across 13 separate valleys in regional and rural NSW as part of our rural valleys determination.

And I think the fact that there are thousands of customers, but within the rural valley's determination, there's separate pricing and revenue, effectively mini-determinations across 13 valleys in our rural determination. So very different from the Greater Sydney determination in terms of the customer makeup and dare I say, the maturity of the regulatory framework applying to each of those.

We also provide licensing and water monitoring and billing services to the Water Administration Ministerial Corporation or WAMC. WAMC is a very interesting beast, it's really the services that are provided by WaterNSW, DPE and NRAR. Each of the organisations provides different services. But with a combined proposal or a combined determination for WAMC services. Very different in terms of asset intensity. There's not a lot of capital involved, but a lot of fee-for-service type activities. Particularly when we're looking at the licensing side of things and water monitoring activities so again 3 kind of quite different components.

We also provide transportation services to Essential Water and a handful of off-take customers in Broken Hill and the surrounding communities through the Murray River to Broken Hill pipeline which we own which is 270 kilometres pipeline provides water to those communities.

That process or that determination is currently ongoing with IPART with a draft decision that's been out currently and a final determination expected by later this year for new prices from January next year.

So, why am I flagging all of these things. I guess I'm flagging these different services because the current approach of one medium sized utility infrastructure company providing a range of services across 4 current determinations is probably not the most efficient model.

For us, for our customers, for IPART there's high compliance costs, there's high engagement costs from processes like this that would have to be run across 4 separate determinations. So, we're planning to address some of those concerns, or a lot of those concerns by preparing a single regulatory proposal that covers Greater Sydney, rural valleys, and our component, we will touch on our component of WAMC recognising there will be a separate WAMC proposal that sits on its own.

Broken Hill we will kind of park that for now, because the determination currently will be set on the current set of rules and I guess we anticipate that the next Broken Hill determination in 4 or 5 years would also be adopted under the new framework.

So, preparing and consulting on one combined proposal for 2024 compared to undertaking bespoke reviews on an ongoing basis, requires our internal processes to be reviewed and streamlined which on its own is a considerable task.

I guess if we layer on top of that the fact that we now have a new framework that IPART is introducing, which we're very supportive of. But it does reflect the fact that we're on a journey to get to advanced and leading status across all of our separate determinations.

And it highlights, though, that combining our processes, we do think it is something where we're very supportive of, and we think it will deliver the appropriate results for customers in the long term, hopefully medium and short term, but it is likely to introduce some challenges along the way.

Now we have, I guess, some specific things we want to talk to you, and some of them I'll leave for some of them for questions after I suppose, but I guess, one of the themes that's been touched on today is that while the consultation on the framework review has been very collaborative and we certainly are very supportive of IPART reviewing the framework and certainly agree that it shouldn't be a one off to be parked for another 20 or 30 years to be reviewed in another time.

But we did flag that consultation on the overarching framework, while that's been going on for 2 years, the detailed implementation elements are actually probably need more time than what's currently been envisaged.

And I guess and I'll touch on this and then come back to maybe a predictable question after but as an example the AER, the Australian Energy Regulator when it was looking at introducing its better regulation package. Just on the areas of the efficiency benefits sharing scheme, so the EBSS and the capital expenditure sharing scheme, the CESS. When they introduced that they started consultation in December 2012 and that ran for 12 months.

So that was on one element of the overarching framework, and I guess I just highlight that while there's certainly been a lot of very good consultation on elements of the framework to date, there are a lot of areas around the implementation of the incentive mechanisms, many of which they touched on today, and again I've got some thoughts on that we can tease out in question time about whether or not we're trying to, we want to make sure that we get it right, as opposed to just having something put in place to meet the timeline of a final determination.

I think there's also elements of and why I guess we spend a little bit of time; I spent a little bit of time earlier on the different services that we provide is one of the areas that we're really keen to explore with IPART and stakeholders is whether or not there should be differential grading for different services provided by WaterNSW.

And I guess when I'm saying services, we're talking about the services that are currently provided under 4 separate determinations. And this is really to take account of the fact that the diversity of the customer base and reflective of the fact that each of those current determinations and the services under those are really at a different a different state of maturity, and if we were looking at having differential grading potentially across those areas.

What that does is it potentially avoids the situation of the lowest common denominator of saying well, maybe one part of your business could be considered advanced or leading but if another part of your business is really considered standard, then there's a risk that the incentive created under the current framework and a single proposal. The incentive could be to have a single standard proposal across everything.

Now that's problematic, and we think that also what that does is it locks in potentially a lower grading for customers of the other services. And picking up on some of the themes earlier is what you know, potentially, and particularly when there's services that are not available for a particular grading.

So, if we're talking about EBSS and CES and ODI as not being available to a standard business and the form of price controls, which I'll come back to you. If that's not available to a standard business, then there is this pressure or this risk that if you are a standard business and, in our case, if we were a standard business across 4 determinations, then it's pretty difficult to break out of that. Because the areas that you need to actually put you in a position where you were advanced or leading, if you're not getting experience with those in the next 5 years, it just makes it challenging to try and improve. So, we think that's really an interesting or a necessary element of the framework moving forward.

And other elements in a streamlined framework. A streamlined and tailored framework to be applied to the services provided by WAMC, I won't go into that in a lot of detail, other than its flagged earlier with 3 organisations, providing services. How do you determine whether it's a standard, advanced or leading if one or two or at least one of the businesses, maybe standard, advanced, or leading, but not all of them are at the same grading, how do you get a proposal that's consistent?

So, it's a bit challenging across WAMC, certainly something where a sensible solution can be put in place, but I think it just highlights and I think IPART has been supportive and has recognised this that the framework does need to be tailored for the services that are provided.

Form of price control, that was touched on by Roch earlier and others earlier. We look at the form of price control, really, it should be considered in the wider context of managing volume risk and revenue volatility to enable our business to recover its efficient costs while providing opportunities to encourage greater tariff offerings for customers.

Now there's a bit in that, I think in terms of the fact that if you were starting from a blank sheet of paper and you had 2 businesses that we're providing similar services, side by side. And if the view was that the form of price controls should be x to say that the form of price control should be something different for different organisation, purely because of other elements of the grading framework we don't think that necessarily is the right answer.

So, we think it's something that should address the underlying issues around volumes and volume volatility and also, I think provides some ability for businesses to be able to look at some different tariff offerings that maybe is precluded if you're more disadvantaged I suppose if you didn't have access to some other forms of price control.

And lastly, we will provide a response in terms of modelling issues in our written response. We think there's a couple of elements around how depreciation is calculated and unregulated income but I won't touch on that and happy to take any take any questions.

Last slide and our lunch is getting a little bit cold or warm as it may be, but I thought it would be kind of useful to highlight what this slide outlines really what we are viewing as success at the upcoming determinations. What it looks like and that it reflects the objectives and outcomes from what we're looking at internally but how it really seamlessly aligns to and is in sync with IPART's framework review.

So, we're looking at success through the next round of reviews, by making sure stakeholders' preferences are embedded in our proposals. There's downward pressure on costs, commercial success for the business, there's effective risk management, recognising that it is a dynamic environment that that we live in, and with longer regulatory periods.

Picking up on maybe one of the comments Ifty flagged, that within a 5 year period, it is a dynamic environment and things may need to change, so we want to make sure that the regulatory framework itself is able to cope and adapt to that change within a period and without the big hammer of saying, well you always have an option of just opening the whole determination and starting over again, which may not be a practical outcome for some things that can be addressed.

And lastly, in this list of 5 pillars is that reporting on deliverables and outcomes. And I guess this is just really a cue for us internally, that I think we've been quite okay at or in previous determinations of setting out where we're going to spend money, where we have our actuals have departed from previous regulatory allowances, and what we're proposing moving forward.

But I think as an organisation that's something where we can improve in terms of being able to communicate with customers, this is what you're getting for your money so, you're paying in the tariffs that you pay, this is what you're actually getting in terms of outcomes, and I think that's something that as an organisation we can improve on and ensuring that we're meeting customers preferences. So that's it from me. I'm happy to take any questions and thanks for the opportunity to talk to you today.

Questions and answers

Ms Livingstone: Thanks very much Michael and I think I fell into the trap of calling you Michael Parkinson before instead of Martinson, apologies for that. Sandra...

Ms Gamble: Thanks, Mike very much. I'm really interested in what you make about a consolidated proposal, one that includes everything except Broken Hill. From a consumer perspective what do you think that a consolidated proposal could do that you've not been able to do in the past, and perhaps also from a WaterNSW point of view, what are the benefits of putting that together?

Mr Martinson: Sure, thanks for that. Look, I think some of the challenges that we have faced, which have also been reflected in challenges that our customers would have would have faced is that in having I guess a series of determinations. I've been with WaterNSW three and a half years, and it's been a constant real time determination process.

So, it started with Greater Sydney, then rolled into rural valleys, and WAMC and then Broken Hill. And when you are kind of going from determination to determination, to determination to determination, it gets very challenging to be able to improve and align your processes internally.

So, from just a starting with an internal view of the world. Looking to make sure that we're increasing our efficiency and our effectiveness of our internal processes. We're much better able to achieve that through having a consolidated proposal.

In terms of what it means with our customers. Again, when we're asking our customers to, I guess be involved with us on the journey of the determination process. But we're asking customers 4 times and in sometimes with rural customers, were asking them 3 times in terms of rural valleys, WAMC and Broken Hill, depending on where the customers are. Customers have a lot on their plate at the moment. They don't want to be engaging every year on regulatory issues.

Our customer engagement that we have been undertaking, has indicated a high level of engagement fatigue, in terms of "stop coming to us asking us what we want, we've told you what we want, get on and deliver it".

And so, I think the fact that having a consolidated proposal really puts the focus where it needs to be in terms of getting the customer preferences, being able to embed those into our proposal, minimising the impact on the community and allowing us to get our proposals and our processes in place, I think really provides a lot of benefits to us.

Now there's some challenges in terms of and it's certainly an area that we will need to be working with IPART as we go forward. What does it mean in terms of determinations itself, how do we structure those kind of things? I think those discussions can be had early on in the piece, but I think from our perspective there's a lot of positive attributes in terms of looking at consolidating at least the majority of our individual determinations.

Ms Gamble: I can certainly see it's a really interesting idea especially the treatment of common costs which has often been a problem for us both. So yeah, I can certainly see the benefits you are talking about there is also going to be some unavoidable complications that we need to work through and that's where early engagement probably comes in, so we can work through some of those entanglement issues.

Mr Martinson: Yes.

Ms Gamble: Together

Mr Martinson: Thanks for that.

Ms Livingstone: Douglas.

Mr McCloskey: [inaudible] to observe that it will create some complications in the sense that there are pretty disparate customer and community bases between the 2 major groups which is Greater Sydney and rural valleys. There's pretty divergent consumer and community interest potentially there.

But setting that aside, I think the point you raise around engagement fatigue is a really useful example of how we should be responding to this framework in the longer term, which is kind of goes back to the principles of engagement around demonstrating to people that are engaging on things that are meaningful to them and demonstrating that it has an impact.

I think what we've all struggled with is and we've certainly struggled with it on the other side, is how you can help structure engagement so that it is doing that. So that you don't just end up with a whole lot of frustrated people that you're talking to them all the time, and they don't know why.

Which is I think what we are certainly seeing in the energy space. Not to use that example too many times but I think it kind of goes down to and this is probably more of a general comment around the framework, and the challenge of putting customer and consumers at the centre is how do you do that in a meaningful way that doesn't overburden them to the point where you end up not being able to get anything meaningful from them. And I don't propose to have an answer for that, but I think it is a challenge that is worth putting on the table, because it is one that was raised by your current experience

And while I have the mic, I'm just going to really quickly say, the comment on the grading. I think it's a valid one to tease out, I suppose, what I would comment on is that the grading, as we see it, is not necessarily grading of the business per se, it's a grading of the businesses case and how they are demonstrating their understanding of the customers and communities and demonstrating the evidence of how they responded to it.

Taking on board the difference in maturity of different aspects of the business. I don't think, we wouldn't say that the difference in maturity means that you might have a laggard part of the business. The overall case is the key theme, and that shouldn't necessarily depend upon the level of maturity of different aspects of the business as we see it.

Mr Martinson: Yeah, no thanks Douglas. Look, I think on the last point. First, I guess it is an interesting one to tease through. So, if we look at, I guess, in terms of different customer diversity, as opposed to between our different determinations. So, if you look at our Greater Sydney determination, and if we looked at an element around the areas in terms of whether we are you know standard, advanced or are leading.

If we're looking at the customer engagement element of that, so there'd be elements, where we would say well. the relationship and we can, setting aside whether or not we have a relationship with end customers, but let's say our customer, our primary customer is Sydney Water, won't say let's say, because our primary customer in terms of size is Sydney Water its 99%.

So, if we're saying look, we think we could have engagement processes that are very well established and that fully understand the issues faced by our largest customer and their customers, that might lead us to say look, we think on you know potential grading for that business could be this.

But then, if we're looking and saying let's look at rural valleys and we have you know 13 valleys as I flagged. And I think one of the differences within the valleys, as well as have such a diverse makeup in terms of customer type, that consensus on virtually any issue is extremely difficult, if not impossible.

So, engagement in terms of first, the makeup, in terms of how we actually talk with them, the frequency of those discussions, how we're teasing out what those customers want recognising its very challenging to get consensus or unanimity on anything.

So, if you just look at the engagement elements, which are factors in terms of IPARTs ultimate grading. You could get 2 very different outcomes which might, in the absence of differential gradings pull you down to the lowest common denominator.

And I guess that's when you also consider that maybe access to incentives and maybe access to the form of regulation is linked to what that ultimate grading is, we think there is a risk of that lowest common denominator effect happening, if you don't consider some differential grading.

But fully accept the fact that there's still issues we have to work through. But I guess we just wanted something that is available when we put our proposal in, in 2 years' time in the lead up to that with discussions with all of you.

Ms Livingstone: Thanks very much Michael. We might leave it there because we are due to hear from Jacinta at the EPA who can only join us for a short window today. But we will have discussion after lunch and I'm pretty sure Michael's staying around for that time, so if there are more questions for him then, we'll take them then. So, thank you very much for that Michael and Jacinta thank you for joining us, and we'll hand over to you to make some comments now, thank you.

EPA presentation

Ms Hanemann: Thank you very much. So, Jacinta Hanemann, I'm one of the Acting Directors of Regulatory Operations at the NSW Environment Protection Authority. As you probably already will be aware NSW EPA is the state's primary environmental regulator and we regulate the environmental impacts of the activities of the public water utilities, which includes the sewerage treatment systems and sewerage treatment plants, through environmental protection licences, which we issue to the operators.

So, we've actually been working very closely with IPART over a number of years with the objective of securing appropriate investment in sewerage infrastructure to prevent environmental impacts and also to allow investment in programs to deliver improvements for environment and community as well.

So, I just want to highlight a couple of things in terms of I guess some of the principles and things that the EPA is interested in and they make a couple of comments on the proposed framework going forward as well.

So, I guess, for us, we just like to stress the importance of long-term investment in sewerage infrastructure to allow the public utilities to achieve compliance with environment statutory obligations and look for long term environmental outcomes and community outcomes.

And so, at a minimum we see that there needs to be sufficient funding to allow the public water utilities to effectively meet their statutory obligations for environmental protection, which includes the requirements that exist under their environment protection licences.

I guess we'd also say that it's important that the public water utilities are permitted and even incentivised to go beyond compliance to deliver outcomes for the community and environment. And one of the things that we see is critical, is that environmental externalities are adequately considered and costed in the consideration of what might be customer value, and where we feel that they aren't there's a lack of that consideration. Then what it can lead to is a lack of investment in terms of inspection, maintenance, and then renewal of the critical infrastructure.

And we feel that if customers i.e., the community were actually aware of what that can lead to in terms of environmental performance and environmental degradation or impacts that they might well be willing to pay more for that continued investment.

So, with respect to IPART's draft revised water regulatory framework, a couple of things we'd say, we're absolutely supportive of the intent of the revised framework, which I guess fundamentally is looking at supporting the water businesses to invest prudently in the infrastructure and technology needed for the future and we see this is an excellent outcome because we're looking at investment in the longer term, rather than looking at the traditional sort of price path timeframe, so very supportive of that.

EPA is absolutely delighted that the environment is one of the 12 guiding principles that must be considered by the water businesses in the framework. We note that the pricing proposals by water utilities are going to be graded, the leading, advanced, standard, and substandard which have the financial and administrative incentives given to the advanced and leading proposals, and while we're absolutely supportive of this and, as I mentioned earlier, in terms of incentivising beyond compliance and good performance.

I guess we just want to raise a potential concern if the standard and substandard utilities potentially have less money to improve their performance, does that lead to us perpetuating the poor performance in that area. So just an encouragement for consideration of the grading and charging format to ensure that we don't get some perverse outcomes, as a result of that.

We know IPART is also proposing the creation of a regulatory advisory panel which would include the EPA. We've already confirmed our, in principle, support for inclusion on that panel and just indicated that we'd like to discuss a little bit more about the panel and what format that actually takes, and what the Charter might be prior to formally agreeing to that.

I guess in conclusion, we just wanted to say that we look forward to continuing to work with IPART and to enable the public water utilities to be able to go about doing their business and delivering some really good outcomes for environment and the community, thank you.

Question and answers

Ms Livingstone: Thanks very much Jacinta, were there any quick questions for Jacinta, Sandra?

Ms Gamble: Thanks Jacinta, Sandra Gamble here. Thank you very much for that range of insights, it's been really valuable. I just wanted to ask you about the scope of externalities that you're talking about there. Do you have a defined list of externalities that you're interested in water businesses pursuing and improving, or are you open to you know, a broad range of things? I mean it could include anything from carbon emissions and global things to local things like dry weather overflows.

You know, are you able to give us some sort of guidance about the areas of externality you think water businesses should be focusing on?

Ms Hanemann: It does feel like it's a bit like how long is a piece of string with environmental externalities, and I suppose there's a whole suite of things that would be great if they could be considered, but I think we were thinking more of some of the more local components.

So yes, there's big environmental issues, as you said, carbon emissions and a whole range of those things, and certainly there's interest in the broad environmental issues from the EPA, but I guess when we were talking about it more explicitly, it was yes in relation to things like yes, the dry weather overflows, the wet weather overflows. Looking at you know, the compliance or the impacts, where we don't get the full compliance with environmental protection conditions and those sorts of aspects.

But more broadly, I suppose, when we're looking at the long-term, we need to consider some of those factors as well, because of course they're driving the business as well in terms of the resilience of the business and how it needs to actually change to cope and be resilient to climate change factors and those sorts of things as well.

So we're very open to discussing that further, and you know, helping if it would to put together, I guess, a list of some of the things that we think are higher priorities in terms of consideration, and others that might be considered that could be of a lesser order of priority.

Ms Gamble: Just one more question Jacinta. To what extent do you think there might be value to both the EPA and IPART in talking about a framework of sustainability accounting. You know this is an area globally that's very new, but there's potentially opportunities for us and the businesses to be able to understand each other better, if we have a common language around how externalities and sustainable investment is described and accounted for and recorded. Have you given much thought to that?

Ms Hanemann: I have to say that I haven't in terms of our team, but I think more, there are people more broadly in the EPA that work on these sorts of things and I think it would absolutely be a benefit for IPART and the EPA to have a discussion about this.

Ms Gamble: Thank you.

Ms Livingstone: Thanks. Any other questions for Jacinta? No, well thank you very much, Jacinta for joining us, we really appreciate that, and thank you again to all the water businesses who have presented and answered questions this morning.

I think it's a reflection of the level of engagement. The issues were substantial and we were able to tease out a few of them, so that is a really helpful part nearing the end of us finalising the framework, at least initially, given the focus on continuous improvement over time.

We will break for lunch now it's right on 12:30pm, so we will have a half hour break until 1 pm. After lunch we've got a short presentation and then discussion focused on how do we make this framework work to get better outcomes for customers so it's a really forward-looking discussion.

We can cover off on things that you've wanted to touch on today, but we haven't quite got there yet, as well, but enjoy lunch in the interim, and will re-join with our online participants as well at 1 pm.

LUNCH BREAK

Session 2

Ms Livingstone: We'll get going in about 30 seconds. Okay, the rooms starting to settle, we do have those online have re-joined us, thank you for your patience with us in the room. We had a nice lunch and hope you were able to get something decent where you are and we have just under an hour now to really think about how this framework is going to drive better outcomes for customers. So, we are going to have a short presentation from Matt Mansell, which will give us some thought starters. Then most of our time will be discussion about that how he sees going to drive that change that I think all of us agree, we want to achieve for customers in the long run, so Matt over to you and then we'll have some discussion, thank you.

Delivering better customer outcomes – IPART presentation

Mr Mansell: Thanks very much Liz, and good afternoon, everyone. I'll just start with a quick mic check; can everyone hear me? Yes, excellent. Thank you so my name is Matthew Mansell and I'm one of the directors in IPART's Pricing and Policy Division. This session is about how the new framework can help businesses deliver better value and outcomes for their customers, can we go to the next slide please, thank you.

IPART's purpose is to make the people of NSW better off through independent decisions and advice. When it comes to reviewing and setting maximum prices for regulated water services, we want to promote solutions that are in the best long run interests of customers and communities.

Our approach to date has focused on cost efficiency and I think it's fair to say this approach has delivered benefits to customers. But we recognise it's time to broaden our focus and move to a more comprehensive and flexible approach, one that recognises customer value can take many forms. One that is flexible to the needs of each regulated business, and one that facilitates and rewards each business's efforts to identify and deliver better outcomes for their customers.

The new approach attempts to align and strengthen the incentive structures about regulatory framework and rewards businesses that respond positively to these incentives, with greater flexibility ownership and autonomy.

We want to assure you that we are committed to working with all members of the water sector, including the regulated businesses, customer representatives, and other regulators, to help ensure the successful implementation of the new framework and approach, next slide please.

So, in terms of aligning incentives, we think the proposed approach should broadly align with each water businesses' own objectives. For example, this slide shows how Hunter Water has mapped the 12 principles that sit under the 3Cs framework, to its own strategic objective, as you can see, there is a high degree of overlap.

It has also been very reassuring to hear similar messages from other water businesses during the presentations today, and we are very keen to continue these discussions about how the new approach aligns with and can help facilitate each business's pursuit of its own strategic objectives, next slide please.

We think there are several compelling reasons for businesses to engage positively in this new approach into and aim for advanced and leading proposals. First and foremost, aiming for an advanced and leading proposal demonstrates the businesses genuine commitment to identifying and delivering customer value.

Other benefits include opportunities for the business to build trust and reputation, to earn greater ownership of prices, to enable flexibility and innovation, and ultimately to better align the interests of all parties, including regulated business, customers, and regulators. I'll now back to Liz to facilitate the discussion, thank you.

Questions and answers

Ms Livingstone: Thanks very much Matt. And so, we do have a bit of an open canvas for this discussion, but I thought I might start us off by asking people to think about what change in businesses is going to result in a different outcome for customers, from this framework.

So, in the presentations this morning, we heard that there are a lot of things that the businesses are keen on in our framework, we also heard some things that we might need to do more thinking about together, but it'd be really helpful if people could start to articulate what change do you think this is going to drive and how will that translate to customer outcomes. I'm happy for anybody to kick us off on that, Douglas.

Mr McCloskey: This is more of a hope for the intent, that what we're looking for from this framework is greater scope to focus on the outcomes for the customer and community defined by the customer and community.

I think to sort of link back to the opening gambit bit here around the broadening of the scope, what we've the way that we've interpreted IPART's role and the way that regulation to date has operated has really focused on, and I know IPART doesn't like to define itself like this, of standing in instead of the customer but with a narrow view of their interests.

That the narrow view of their interest is that they're paying no more than they need to, and that the services that they are provided are efficient and reliable and that is a very worthy, if limited remit for the interest of the customer and community.

What this new framework does, it says very definitively, we want you to define what is in the interest of your customers and community, and we want you to engage directly with them in order to do that, and then come back to us with a demonstration of what that is.

And I think what that theoretically does is give the businesses real scope to say, these are the outcomes that are important to our community, and this is how we're going to deliver them. I would say that while we have views on what we observed, we think customers and communities are generally interested in, it's not for us to say that.

We hope to have a perspective in the engagement the businesses will run, and in the processes that will flow from this, but what I would hope this framework is doing is setting up the scope for the variability in the businesses to say our customers care about efficiency like this, our customers care about affordability in this framework, but they also want us to balance that with generational equity and with the resilience and they want us to do it in this way, and we are going to prove our progress against these outcomes in this way over the next 5 years. In a nutshell, that's what we hope this framework provides the flexibility to do.

Ms Livingstone: Thanks Douglas, that's a really good kickstart for all of us to think about. Other thoughts from businesses about what you're already changing doing differently, given the long gestation period we've had developing this framework that's making a difference to how you operate and deliver for your customers. Michael?

Mr Martinson: Look over the last couple of years and, in particular the last 12 to 18 months, certainly the emphasis on how we embed customer preferences into proposals has really taken on a much greater emphasis and focus than what I've done previously.

That's, not to say that previously the organisation probably consistent with other organisations I've been in, not to say that they weren't focused on wanting to deliver positive outcomes that customers wanted.

I think the challenge has been how do we demonstrate that we've done that. So, I think previously there was view that say, yes, we've talked with our customers, and here's their views and we're putting that forward.

And it's quite a different proposition to be able to say, well, this is the process we've gone through to identify what those preferences are, this is how we've taken them on board, and this is how our programs and proposals have been addressed by it. So, there's been much more meaningful discussion and significantly more emphasis placed on that over the process that this review has been conducted.

Ms Livingstone: Thanks Michael. I guess one of the dimensions to this is it's challenging, we talk about putting customer preferences at the centre or customers at the centre, but I don't think anyone claims to have perfected that, so also interested in the challenges businesses are thinking about as we take this framework forward, and any insights about what you're learning or what you think needs to be learnt to do that better.

Ms Towers: Liz, Peter Shields has his virtual hand-up.

Ms Livingstone: Peter.

Mr Shields: Hi Liz, so I'll just reflect on you know how we've done engagement the last couple of price proposals. And you know we do engagement on topics and issues. And you know, last time around we've got guidance from IPART about discretionary expenditure, so you know we came up with a list of things that were above a licence or not licenced and you know we generated a list of topics internally and we went out to customers and asked them about various things and we took a couple of those forward.

I guess the difference here is that we're asked you know, we were going to customers in different ways and asking them about you know, our long-term investment plans, asking them about affordability, asking about what's important, so it's not it's not doing customer...it's doing engagement on specific issues but it's also asking them about the broader package as well at the same time.

And the outcomes element is important, it's the centrepiece to all this. There is going to be work to do. But you know hearing firsthand from customers can be really powerful, not just for the comms teams, but it's for exec teams and boards to listen to customers and hear firsthand accounts of what's important and what they expect from the water businesses and I guess that affordability conversation overlays it as well.

So big picture is, engagements hard and messy and untidy and there's never a clear consensus on things. But our customers have no choice in who provide services to them, we're doing engagement over various phases using multiple different techniques and it's our first time doing it, so you know we will reflect on what we hear from customers, we will turn that into outcomes and outcome measures and incentive schemes and we'll get better at this in subsequent price reviews.

Ms Livingstone: Thanks Peter. Any other comments in that space. Douglas?

Mr McCloskey: I guess it's actually highlighted for us something that's really important, particularly for the customer engagement piece. But probably for how we take this framework full stop. I've said it to some of the team at IPART that expectation management is going to be really important and I'm sure anybody who's worked in the engagement space will be able to reflect this.

You can't go from zero to 100, as much as we want the ambition for everybody to be to do that, what will be key is to focus on delivering on the principles and delivering on the intent and demonstrating that.

I think there has to be an acceptance of that, it is an evolutionary piece, because it takes time for, one for it to permeate through the culture and our understanding of the business, and then there are lessons learned about how to reflect how things can be done well or not. I would and again sorry to be the broken record, but we've had extensive involvement throughout the energy space right in the middle of it at the moment and observing the pitfalls of engagement with the best intent.

And what it will be, I think it goes a little bit to Peter's point around how you focus on the outcomes and working through with the engagement, what those outcomes mean. And then, how you translate it and then retesting those things. I would kind of give a shout out to Hunter Water, because I think my involvement in the Lower Hunter Water Plan engagement and the way that that was handled was actually a really good example of how challenging some of the assumptions around what communities want and what outcomes are important was actually part of that process. and delivered some really positive outcomes. Notwithstanding the fact that there were lots of different stakeholders involved, including some political ones.

I think I would go back to that expectations management piece and say that, for this first round, particularly and I guess it's not just for the businesses, but for IPART I think what we'll be looking for in our engagement with the proposals will be demonstration of the principles and intent, and the ambition and probably the honesty of where it's not there yet.

And I think that goes to the assessment piece of we all want to say that we are leading or advanced and that will be a relative term, but it will be one that changes over time and evolves over time. What will be accepted as leading or advanced first time around I would assume will be very different next time around because the understanding of consumers and communities will be different, the maturity of reflecting that and translating it and committing to it will be different, hopefully.

So, I guess at the outset having some real some really good expectations management and a realistic view around how that will be evolved over time is really important for the success of particularly the first round, I think:

Ms Livingstone: Jamie.

Mr Hollamby: It's been a really interesting 12 months. I was going back to look at a presentation from last year, just to see how our thinking changed or not. It's probably 2 things that I think we're really focusing on as far as outcomes goes. One is being able to build for the growth of the city. And the second one is, having a discussion on resilience and the social and environmental outcomes we deliver.

And I think that for us there's 2 focus areas internally that we're working on around that. One is the long-term planning view. And what our long-term capital investment profile and how we're going to manage the business long term and the second bit is getting closer to the customers and the customer engagement to inform the priorities of that so that's probably my reflections over the last year.

Ms Livingstone: Thank you. Are there...apologies if you would tell...

Mr McInnes: It's an intelligence test isn't it?

Ms Livingstone: Yeah, could I ask you to introduce yourself?

Mr McInnes: Rod McInnes, consultant, I've worked for most of the major utilities and also for customer groups like irrigators. So, on the customer value point, I just wanted to come back to something that Jacinta from the EPA, she used 2 words which no economist in this room has used, externalities and willingness to pay.

And it was IPART's practice in the past to try not just to consult with customers, but to try and measure their willingness to pay, particularly for externalities. Services which there is no price signal, such as the degradation of our waterways Sydney Harbour, Hawkesbury, the Hunter. There seems to be an opening in this approach to again measure customer value. Is that over interpreting what the guidelines here are saying?

Ms Livingstone: Is your question that IPART would be measuring customer value or is your question about the practices of what the businesses propose and how they evidence customer value in that?

Mr McInnes: I think it's the latter. So will you be, will IPART be welcoming proposals that have consulted in a workshopping way, got surveys of people's opinions, but also attempted to measure what a cleaner Sydney Harbour might be worth to them.

Ms Livingstone: Yep, I think that's a good question for our Chair to answer.

Ms Donnelly: I'm nodding over here, I know we're on the other side of the room, you may not have been able to see, but certainly the intent of the framework is for the water businesses to assess themselves against all of these 12 principles, which include environment, include community, and other elements of customer involvement, customer choice, empowerment, etc.

That would be driving the businesses to be assessing what are the customers value, including protection of the environment, including assessing the externalities more broadly. I can reassure you that IPART in its legislation is required for a number of our roles, including regulating water to consider ecologically sustainable development, which specifically if you work your way through the legislation that the different provisions refer to, includes innovative ways of valuing impact, valuing how to protect the environment, having good, informed decisions.

And we have during the period that we've been consulting on the improvements to the way we regulate water, issued a statement on climate change, for instance, and how we would factor that in so, it is part of our approach generally, and it is absolutely encouraged and allowed for in the proposed approach to regulating in the water businesses. And now I have to learn how to turn this off.

Ms Livingstone: Yeah, and I have to figure out if I've got, can you hear me on this one. I've figured it out, that's good. Okay, are there any other thoughts, perspectives that people have been reflecting on the day on customer outcomes and what difference this framework will make and how you can see that happening? No, okay. We covered a fair bit of ground this morning and businesses raised different issues in their feedback on our framework, as did PIAC and the EPA.

Are there topics that were raised this morning that you want to tease out a bit more and have more discussion about now. We talked about a whole range of things from different types of incentives and when they should and shouldn't apply, about the grading system and whether there should be a direct link between that and different forms of incentive. We talked about a third-party review. There are a whole bunch of issues that you might not have fully explored yet but you might have had thoughts about since the earlier discussion. Any questions or comments. Looks like Sandra has got one.

Ms Gamble: I've even turned the microphone on first. I guess, this may be a question on notice for the businesses. And this goes back to the point I made earlier about OPEX and CAPEX incentives and a bit of a request for ideas if how could we employ, have the right incentive for CAPEX in either a simplified or potentially the absence of a capital expenditure incentive scheme, when we are increasing quite a lot of the incentives to reduce OPEX.

You know, we'd want some confidence that by increasing the incentives on OPEX, we didn't just have an instantaneous bulging CAPEX and what Ifty's point about CAPEX policies, it's a good one. that's it a fairly blunt instrument. It's actually quite invasive to figure out whether businesses have applied their own capital expenditure policy on a consistent basis year to year, so yeah, this is a call for ideas.

Ms Livingstone: Thanks Sandra. I was having similar thoughts as well, particularly if we get to a stage which we propose to do of pulling back on the forensic review of expenditure consultants and so forth. Where's the discipline on CAPEX coming from without those incentives. Is there a simpler version of a CAPEX incentive that people have thoughts about?

Mr Omar: My thought would be at least in the first instance to gather the data so potentially you've got one regulatory period without a CESS applying, but you almost do a shadow CESS, so you observe what would the CESS have done, and the outcomes that you'd get, what has actually driven those outcomes, so you can really assess, is there a problem that needs an incentive solution.

Ms Livingstone: Thank you. Any other thoughts to build on that? Michael.

Mr Martinson: I'll wait for the delay to kick in. I mean there's a number of potential solutions, one is that if there is a strong concern about the incentives, you could align the timing of the EBSS and CESS in a later period, you could look at paper trials, I think, maybe as Lfty was suggesting for the first period. I think if the track record in terms of other jurisdictions looking at introducing an OPEX incentive first, instead of prior to capital incentive I don't know if my recollection is that there wasn't a lot of material bump up in the change of allocations between OPEX and CAPEX.

I think the fact that if IPART is signalling that it will be looking at introducing the CAPEX regime it's just testing to make sure that it's actually, one that is reasonable, is a strong incentive to say when combined with a view of saying that would be an obvious blip in someone's capitalisation policy that would be noticeable, if IPART was minded to look that way.

I think the sense is that if there is a CESS that is signalled that it would get around those issues of saying this is just making sure we got it right, it's not whether or not there will ultimately be a solution.

And I think a lot of the capital decisions. I know there are some things where you have to have and we all have to have attention to the capitalisation policy on elements, but there are some solutions to these particular things that are long-lived with our capital aren't going to change because of that certainly in the short-term.

If we're on the subject of CESS, one of the things that I think discussions in the energy sector originally around CESS was about whether it would make sense for it to apply to recurrent expenditure, so for most capital expenditure its large, lumpy projects that are externally market tested.

So, from the perspective of are they efficient, you've got the best test because they're going out to market in any case. So, if you're looking at a stripped-down version of it that would apply and meaning meaningfully would apply to businesses could look at things that are more recurring recurrent expenditure, so there's potentially avenues like that IPART could consider, if it was looking at introducing something for next time, or have a paper trial in that first period, recognising ultimately a full-fledged CESS at the subsequent review.

Ms Livingstone: Thank you Michael. Any other thoughts on that topic noting that there's plenty of opportunity to give it more thought as you prepare final submissions? Sandra.

Ms Gamble: I don't want to hog the microphone so, please put up your hand if you've got a question. My next call for ideas is around how we deal with the externalities. It's a really big and potentially expansive area of endeavour, it goes from everything from waterway health to social licence, to public welfare and equity. What are the businesses seeing, and I think Jacinta thank you, for focusing on some of the local issues. Are businesses seeing things the same and I can see Doug interested in this question as well, and perhaps wanted to give him the opportunity to expand on my question if it wasn't specific enough. Where do we start and where do we stop with that, to make it manageable?

Ms Livingstone: We'll go to Doug. I know Darren from Hunter Water is itching to start responding.

Mr McCloskey: I'll let Darren go first.

Ms Livingstone: Darren, over to you Darren.

Mr Cleary: I noticed Peter Shields had his hand up and he's put it down so unfortunately you are going to get the uninformed non-reg review of this and I'm answering the question about CAPEX, not the externality one. So, I'm not sure if Peter's got some views on externalities.

Look the only comment I'm making, is that there are already other mechanisms in the framework around you're requiring businesses to actually provide a view about how they're delivering the efficiencies and efficient costs, and their own efficiency targets.

And there's the opportunity for targeted review, so if there is the big blip in CAPEX there is absolutely the opportunity, I understand of the framework, to assess whether that is warranted and is there a shift between CAPEX and OPEX. We'll certainly provide some more thought about what other mechanisms, but I suppose I just like to emphasise, in our view, in the framework, there are already some safeguards that can be managed around CAPEX.

And I think the other challenge to just put out there with respect to CAPEX, it's the area of biggest risk to the business as Roch sort of pointed out in his presentation. These are predictive forecasts 5-7 years in advance. And I can certainly attest to the challenge in our business of course in managing, and I suspect it's the challenge throughout most of the businesses the actual cost of capital programs, is a very challenging thing to get right that far in advance.

So, it's a significant risk on individual products that we are running and having to manage on an annual basis, so that variability is the real challenge, so I think a broader mechanism about that upfront review is, I think where there's some potential to get surety that we're not you know inappropriately shifting costs from CAPEX to OPEX.

And I suppose the last point I'd make is there's also a focus on the renewal expenditure of our assets, where it is more repeatable, more of a good benchmark, that could provide some value as well.

Ms Livingstone: Thank you Darren, and Peter has put his hand up again, not sure Peter if you're sticking with CAPEX or wanted to leap into the externalities question.

Mr Shields: I'll go externalities Liz. So, it is something you know as well, to a couple of major projects that we've been heavily involved in the last 2 or 3 years is the Lower Hunter Water Security Plan, so I think that's a full cycle cost benefit analysis that does look at the externalities of different supply and demand side measures.

So, looking at looking at dams, we look at loss of biodiversity, we look at greenhouse emissions with those options that require a lot of energy. So, you know, was again full societal the multiple different externalities that we did our best job at trying to quantify and monetize. That ultimately led to putting forward a portfolio of actions that included all of those externalities, you know cost benefit that led to a preferred portfolio and so that's on the water side.

On the wastewater side, you know we're looking at the Hunter River estuary plants, and there's a bunch of externalities there as well. So, ultimately that will lead to a discussion with the EPA around licensing and loads over the next 10,20,30 years. So, externalities are taken into account when licences are set and when Water Plans are finalised, so they are a key factor in inputs into investment decisions.

Ms Livingstone: We'll go to Roch and then Doug.

Mr Cleroux: Yeah, I'm going externalities as well. I think it's very much the dialogue with customers, that is telling us what to do in terms of externalities and so the building of the plans, the capital plans, the long-term plans is part of it, but actually it's also the engagement that we are having with our customers every day and that our customers are telling us what do you do in terms of recycling, what are you doing in terms of carbon emissions, "what do you do in terms of all these other things, and that's where we engage with our customers. About well, actually, this is what we're doing, we could do this, what do you think?"

And our customers are saying well that's good, you should do that, and when we come back to them and say well okay, but it means that it's going to be \$1 more on your bill, would you be okay to pay for it and they're returning us well actually no. But if it is 50 cents, I'm okay, what can you do for 50 cents? And that's the sort of thing through the customer engagement process that our customers will drive us, how much, how far they want us to go in terms of externalities.

So, net zero is a good example of that, naturalisation of some of our creeks or stormwater channels or assets is another good example of that. So, this is really where the customer engagement is important and that's why it's really pleasing to see that in this new framework, this is taken into account because in the past, it was not.

So, when we had our I'll take some projects, naturalisation projects, that we had in the past, where it was not a given that or that was not fitting into the economic regulation framework that we had. So, having this now considered by IPART because this is requested or demanded by our customers and they say they're ready to pay for it, then it is absolutely fantastic.

Ms Livingstone: Thank you Roch. Some of your comments there are a reminder of all we need to look forward to how we practice our craft in the future rather than how things may have been done in the past. Douglas, did you want to comment on that?

Mr McCloskey: It sort of follows actually from Roch a little bit. I guess the first point I would make as the bridge between what we have done, what we should do, is the first thing we should do is not think of them as externalities. Because as Roch was sort of alluding to actually what we're talking about is things that are important to the community and it's about varying relative levels of priority and urgency for those interests.

I guess what we were doing, some people have heard me say it before, is that we kind of think of these various aspects of things that are important to customers and community as needs, interests, and preferences.

And the needs kind of go to the basic standards of environmental and health performance, and some of the key economic measures which are kind of nonnegotiable, and they are the base level of the foundation, that will for all intents and purposes the regulatory frameworks have focused on.

And what we're now looking at is the interests and preferences. And the interests go to, they often expand upon some of those needs, they may go to levels of environmental sustainability or implementation or extensions of those existing standards of environmental performance and those can be reflected by various stakeholders via engagement with the community and consumers directly.

And then there are interests. And the interest is the last level of preference. It's the last level of expression that sort of Roch was talking about where you go back and say look you've told us and the stakeholders have told us this and we think this is important and we come back to you with a whole range of things that we think need to be delivered that relate to what we traditionally think of as externalities.

And then it's a question of how do you prioritise these? How do you trade these off? And the proposal will be demonstrating this is how our community has traded these issues off, and this is how we're demonstrating that we can meaningfully prove that.

To go back to your question of how do we think about externalities. I would say we don't think of them as externalities, we think of them as things that are important to the community, and we think of them as things that we need to try to tease out a level of priority and importance. And I think to Peter's point it may be that we find it useful to try and quantify the impact of some of those things, and it may not be. I would note that I participated in the process that Peter is talking about with the Lower Hunter Water Plan, and the presentation of those things which we might think of us as externalities.

It wasn't the issue of cost which made people prioritise those things. It was we believe this is right, this is important to us as a community, that was particularly so in relation to new dams and other options like that. So, I would say that it may not necessarily be that we need to find an economic solution to externalities, that might just be a re-categorisation of them that fits into this framework.

Ms Livingstone: Thank you. Are there any other areas that people wanted to delve into a little bit more while we have everybody together? We've got a hand up on screen it's Tas Water, is that right?

Ms Kelly: Absolutely and it's just an observation from a very wet Tasmania, but it sort of goes to the point of what we were talking about before and the opening gambit was that you know we've invested in odour mitigation, because communities had identified that as a priority and it's in our long-term strategic plan.

It's a big investment, we've just gone through that regulation process and on paper and the independent analysis was why on earth are you spending that money there, that like I said, that justification in the community was already there, they know what they wanted but on paper, in terms of pure investment, you would sort of look from a CAPEX and OPEX perspective and think well where's the benefit? There's community value, but is there value in that expenditure?

And another comment that I think I'd make that, probably something that the water utilities aren't as good at, but I think it's something that we need to do more is, the governance systems that we have in place, and it was touched on before.

I mean that's why we have boards that have their extremely skilled people who represent the Vox Populi. And so, we're all customers. I'm here at work in Tasmania today, we're all Tas Water customers, because we all pay bills as well. So, we don't actually harness that really well we forget that we're actually customers

And just on engagement it was really interesting when our regulator down here released the very first assessment of where the determination was going. The input was really only on equivalent tenements, and they weaponised it, like it was really interesting, it wasn't what we thought, given that we were proposing an increase in water bills, and the response back from communities was around ET's. So, it's really, I agree wholeheartedly with what everyone has said so far, but as I said, it's some things are nice on paper, but in reality, there needs to be more flexibility.

Ms Livingstone: Okay, thank you, we can relate to the feeling wet, we're not today up here, but most days this year we felt that, so I hope you guys dry out soon. Any other thoughts on those topics, or something else that people want to raise, Emma from Hunter Water, I can see your hand up.

Ms Turner: Thanks Liz. I just wanted to explore the issue of the outcome delivery incentives, of the 3 incentive schemes that sort of work together based on your performance throughout the period. We think that the outcome delivery incentives are really important because they're another way of helping to deliver value to customers, rather than just through reducing costs, but actually improving the service levels that you're delivering.

It's quite complex to think about and, in some ways, because they're less familiar than perhaps EBSS and the CESS as numerical incentives. We're still working our way through how they would operate in practice. I just had a couple of questions about that, noting that there are some workshops to flesh out the guidance handbook and some of it might be able to be unpicked there:

But in my mind, I'm not quite clear whether there's an 80:20 sharing of benefits for the outcome delivery incentives in the same way there is with finances and aside from water conservation and leakage, where we've got quite a clear idea of a financial value that we can compare our performance to, not quite sure how we would work out the financial reward or penalty for each of the outcome delivery incentives. Is it anticipated that we would do a willingness to pay study that captured all of those outcome delivery targets and the incentives how would we go about working out how much was at risk?

Ms Livingstone: I think that's an excellent question, Emma I wondered why you hadn't talked so much about this today but Anthony Rush is going to be the first person to start to answer that.

Mr Rush: Thanks Emma. Great question. So, I guess, in answer to that question around how do we operationalise these outcomes as part of the incentive's regime, the first I guess perspective is just around the engagement with customers that actually informs customer outcomes, that then gets linked through in regulatory proposals to a set of outputs, activities and expenditure.

So as part of that kind of process, in the papers we gave water conservation and leakage is one example, but there could be other examples around the value of reliability or the value of better customer service when people call up the water utility there's a whole range of things where through different choices in different investments, you could deliver better outcomes and better customer value.

What we're looking for in these ODIs is for whether there's real opportunities to shift the dial for customers, to actually identify these key outputs, think about and monetise the value of increased performance to customers and then design the incentives around those estimates.

So, I think what you need to do as part of that is probably come up with a range of tools to make sure that you've got the right number. I mean I'm a technocrat, so I love willingness to pay studies, but I also realised that there are limits to any one type of engagement. And there's a few limitations, but not get into too much, but coming up with a reasonable and defensible value estimate of the customer value that you're driving by pursuing this customer outcome is what we're looking for.

Then what the incentive schemes do is ensure that if you're making a decision between whether or not you invest an extra dollar of CAPEX or OPEX versus not. The increase in performance that you're generating from that over the long term is greater than the cost. So what that means in practice is that the incentives are aligned, in that there is the same incentive rate, but in practice, you'll invest and do more to promote customer value where the pay-off for the customer is greater than or equal to the cost and that's the way the incentive scheme kind of equalize that.

It probably works better, through a series of spreadsheets which is possibly something that actually we might need to do as a follow up from this conversation, is how the 3 schemes actually work together as a package. I'll just leave it there for now.

Ms Livingstone: Thanks Anthony. And I know Anthony's really keen to get stuck into the spreadsheets so you might look out for a special invitation for a session with those.

We're getting close to the end of our time, are there any other kind of burning questions or issues or things that you haven't had a chance to say that you did want to say in this forum. Sandra?

Ms Gamble: It's the question for the businesses, we've been working on this framework for a while and it's been really clear right from the start that deeper, more meaningful consumer engagement it's going to be necessary for the next round of proposals.

I was wondering whether the businesses could tell us a little bit about their experience so far in preparing for that. And what you're sort of learning about the expertise, the data, the insights the strategy, that could help us in thinking about these things.

Ms Livingstone: Any volunteers? Thank you, Jamie.

Mr Hollamby: We're still early on our journey so just from a status perspective we've reconstituted our customer and community reference group and have been looking at members and appointing a chair with our first meeting in September, and so we've been doing a lot of research in what they've been doing interstate and what our program is going to look like, what parts of that program will be in the timeframes.

So, it's probably a little bit early for us to pull insights yet out of that, but obviously we're really excited about the opportunities it presents for us because of that, we're expecting that to really drive what we do internally and having that connection is going to be really important for us. So, it's probably a little bit early for us Sandra to answer that question at the moment.

Ms Livingstone: Thanks Jamie. Peter Shields, did you have some comments on that as well.

Mr Shields: Yes, we were at the very start of this, I guess. The first thing we did was start talking to some of our Victorian regulatory colleagues and asking them about PRIMO and how PRIMO has worked and how the engagement part of PRIMO has worked.

And we got positive feedback from a number of businesses. You know we've gone with an engagement partner who's had experience with a number of the Victorian water businesses over what's now 2 PRIMO proposals.

So, we've got an 18-month plan, we're just launching into the first steps of phase one. This is all new to us in terms of trying to develop, to do engagement across an entire proposal and develop our outcomes along the way. Yeah, we are using some expertise, we're talking to Victorians, we're talking to energy people, so this is a learning experience. We'll do our best, on a first set of ODIs, but that you know, like we've seen in UK they'll evolve over time as well.

Ms Livingstone: Thank you Peter. Okay any final questions, comments, thoughts? Well, we will wrap up there, let me finish by saying again, thank you, it has been a long journey this for some of us is a fifth session almost like this and others may have joined us for the first time, but we know that you've also responded to a lot of issues papers, had a lot of discussions with our team, some of you with the Tribunal as well. It's all been incredibly valuable.

There's still another opportunity before we finalise what I'll call the first iteration of the framework. So, submissions are due on 26th of August. You may have looked at our website this morning and saw it was the 23rd, we've just given you a few extra days and so we'd love to see your submissions then.

We will finalise a framework to release in October, but as we've discussed, we are all going to learn a lot, as we apply the first time, the second time, third time, and so we thank you for your engagement with it, and we look forward to implementing it and see what it can do for your customers, thank you very much.