27 April 2020

Dr Paul Paterson Chair Independent Pricing and Regulatory Tribunal PO Box K35 Haymarket Post Shop, Sydney NSW 1240



Dear Dr Paterson

Review of Prices for WaterNSW from July 2020 - Draft Determination

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in New South Wales. Established in 1982, PIAC tackles systemic issues that have a significant impact upon people who are marginalised and facing disadvantage. We ensure basic rights are enjoyed across the community through litigation, public policy development, communication and training. The Energy + Water Consumers' Advocacy Program represents the interests of low-income and other residential consumers, developing policy and advocating in energy and water markets.

PIAC broadly supports the Independent Pricing and Regulatory Tribunal's (IPART) draft determination for WaterNSW's prices from July 2020 and we are satisfied the adjusted allowances for capital and operational expenditure are likely to be efficient and facilitate responsible investment and operations over the period.

PIAC supports the introduction of dynamic wholesale water usage prices in principle. We contend, however, that in the interests of fairness and effectiveness they should be passed through to end consumers in an inclining block, without the volatility of dynamic retail prices. We are concerned the reallocation of demand risks and costs to bulk water customers, in conjunction with decisions being made in the Sydney Water draft determination, place an undue burden of risk and cost on households.

This submission will focus on issues IPART is seeking comment on, including the potential benefits and risks involved in the implementation of a dynamic wholesale water usage charge.

Issues for comment

Do you agree with our draft decision to share the efficient cost of recreational services between WaterNSW's water customers and the direct users of recreational services (or the NSW Government on behalf of the broader community)? Or do you consider there is merit in the direct users of recreational services (or the NSW Government on behalf of the broader community) funding 100% of the efficient costs of recreational services?

PIAC supports an approach where the beneficiary of a service pays the costs related to its provision. Where a beneficiary is not easily identifiable for the purposes of cost recovery, an 'impactor pays' approach is appropriate. In this case the direct users of the recreational services receive a direct benefit from their provision, and should be responsible for costs related to their

use. The community at large receives the indirect benefit of the general availability of these services. This benefit is indirect and not able to be attributed to the entire community in a way that would make recovery of costs from

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consumers appropriate. The indirect nature of community benefit means recovery of some costs in support of the general availability of the recreational services should be borne by the NSW Government. The example of National Parks is relevant in this case, where a proportion of the costs of making the facilities and services available to the community is borne by the government via the National Parks Service and the remainder is covered by the direct users through access charges. The NSW Government assuming 100% of costs related to recreational services would be an appropriate alternative.

Recommendation 1

PIAC recommends 100% of costs related to the provision of recreational services provided by WaterNSW be shared between the NSW Government and direct users of the facilities.

Do you agree with our draft decision not to introduce the option for WaterNSW to enter into UPA's with Sydney Water and the three councils?

PIAC agrees with IPART that the purpose of Unregulated Pricing Agreements (UPA's) is to help realise potential benefits for large end users by allowing suppliers to make agreements with them. As Sydney Water and the three councils are monopoly service providers, not large endusers, we do not consider it appropriate to extend UPA's to WaterNSW and support the draft decision not to do so.

Do you think we should consider excluding any voluntary supply (from SDP to Sydney Water) from the SDP exclusion factor, if such an agreement is possible, in future price reviews?

PIAC understands the current arrangements are intended to manage the potential impact of water Sydney Water is required to purchase from Sydney Desalination Plant (SDP) under the conditions of the Metropolitan Water Plan 2017 (the Plan). The mechanism to adjust the usage price of water purchased from WaterNSW to respond to demand decreases, protects WaterNSW revenue but arguably is not efficient or in the long-term interests of NSW households, who are effectively assuming the risk of WaterNSW and the costs of SDP. This arrangement is not under consideration in this review, however it would not be appropriate to consider any further extension of the mechanism.

PIAC agrees it is unlikely any future agreement between SDP or Sydney Water will result in Sydney Water voluntarily purchasing water from SDP outside the terms specified in the Plan, particularly considering the significantly higher costs of water sourced from SDP. However, this assumes any voluntary agreement between SDP and Sydney Water outside the terms specified by the Plan would not allow Sydney Water to pass through the additional operational costs of the SDP on top of usage prices. PIAC would have serious concerns were Sydney Water to pursue an arrangement with SDP to voluntarily source bulk water and use existing pass through arrangements, with consumers bearing the costs.

Voluntary supply should be excluded from the SDP exclusion factor, and we recommend IPART consider re-examining the regulatory mechanisms governing Sydney Water and SDP. It is necessary to ensure any potential voluntary supply agreement between Sydney Water and SDP is rigorously cost-tested to ensure consumers do not pay any more than is necessary.

Recommendation 2

PIAC recommends the SDP exclusion factor not be extended to any potential voluntary supply arrangement between Sydney Water and SDP. This should be subject to assurance that any such voluntary agreement would not be able to use the SDP cost pass through and lead to consumers paying more.

Do you agree with our draft decisions to introduce unrestricted and drought usage prices for all customers? What are the benefits, risks and/or constraints that could result in having dynamic water usage pricing?

PIAC supports the introduction of dynamic wholesale water prices in principle. Dynamic wholesale prices better reflect the increasing scarcity and unreliability of water resources. Where these prices are properly designed, they provide a strong incentive to Sydney Water and other bulk water buyers to facilitate ongoing conservation and water use efficiency to mitigate the risk of higher prices and scarcity.

Properly constructed dynamic prices can provide strong signals to water retailers, giving them an incentive to mitigate the future risk and costs of scarcity. PIAC considers this the key benefit of dynamic wholesale water usage pricing. These prices can be responsive to conditions, and potentially vary on a regular basis to provide the most accurate price signal to retailers.

This benefit is predicated on prices to consumers being structured to be complementary, ensuring demand risk and the cost of scarcity are managed by the retailer, as the entity best placed to do so, rather than simply being passed through to consumers. Retail prices to consumers should be structured to smooth the impact of any steep wholesale price variation, translating dynamic wholesale price signals into more stable, equitable and understandable signals to consumers. PIAC contends an inclining block water usage tariff for consumers is the most appropriate accompaniment for dynamic wholesale water usage pricing.

While we broadly support the proposed mechanism as an important step, PIAC argues it should be passed through to end consumers in an inclining block, without the volatility of dynamic retail prices. We are concerned the draft determination cites revenue certainty and risk management as a key purpose of the proposed prices. When viewed in conjunction with the proposed pricing structures for Sydney Water, PIAC contends these pricing mechanisms pass the demand risks and costs of scarcity directly to consumers through Sydney Water, without allowing for those risks and costs to be effectively managed. We do not consider this an appropriate way to share the demand risk and the potential cost impacts of scarcity, and do not support the proposed dynamic pricing where it results in scarcity costs and demand risks being passed directly through to consumers.

We will make detailed comment on the structure of retail prices in our submission to the Sydney Water draft determination.

Continued engagement

PIAC would welcome the opportunity to meet with IPART and other stakeholders to discuss these issues in more depth.

Yours sincerely,

Douglas McCloskey

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