

23 October 2019

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 Hunter Water Corporation from July 2020

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 welcomes the opportunity to respond to IPART's *Review of prices for Hunter Water Corporation from July 2020* Issues Paper.

Noting that IPART has reserved its position on a number of key issues pending a report from an independent consultant, PIAC has focussed its response to a number of key stakeholder questions, in addition to providing input at a principle level on issues that we regard as priorities for IPART consideration. Answers to selected questions from the issues paper are presented in the attached appendix.

A better framework to respond to climate change and the scarcity of water resources

Both Sydney and Hunter Water have proposed a range of responses to the current climatic conditions, and recognise that we are in a period of extreme water shortage and sustained higher than average temperatures. PIAC contends that current conditions are more than a cyclical drought and that a return to historical average conditions is unlikely¹.

The accelerating impacts of climate change are resulting in a sustained trend of higher than average temperatures and lower than average rainfall, with compounding impacts such as accelerated evaporation. While we are currently experiencing a period of extreme drought exceeding that trend, PIAC contends it is not a discrete and isolated event.

PIAC is concerned that operating through a lens of cyclical drought is undermining the need to develop the more comprehensive, long term responses that are required to ensure a secure, sustainable and affordable urban water supply for the future.

The current extreme conditions provide an opportunity to consider a more comprehensive framework for the management of urban water services. Periods of extreme

¹ CSIRO & Australian Bureau of Meteorology. 'State of the Climate 2018'. 2018

weather are likely to be increasingly regular and intervening periods unlikely to conform to historic average conditions. This will require investment decisions, operational practices and pricing structures to be adapted and better integrated.

PIAC is concerned that the approach adopted by Hunter Water in its proposal is not an appropriate or sufficient response. Specifically:

- The current determination period saw actual sales exceed forecasts in the first 2 years, with the variance reaching 13.3% in 2017-18. While a portion of this variance relates to higher growth, a significant contributor was the dryer climatic conditions. This demonstrates the potential impact of climate on demand and sales, even without considering the impact on security of access to water resources should these conditions continue.
- Despite the current year trending towards extremely dry conditions², Hunter water is forecasting a return to 'average' in 2019-20. There is no indication that this is likely and should it not occur, the variance between the forecasts and actual usage/sales would be very significant.
- Forecasts for the 2020-25 period are predicated upon a 'return to average conditions', without any clear explanation why this is a reasonable assumption. PIAC would like to see more information on how the long-term average is calculated, and on what basis Hunter Water assumes these conditions will prevail throughout the next determination period.
- There does not appear to be any recognition of the trend impacts of climate change on rainfall, catchment levels, evaporation, and water usage generally. This is crucial, not only for modelling demand, but for linking that modelling with measures to manage demand and ensure that pricing structures support the sustainable, efficient and affordable access to water resources.

Pricing that reflects the scarcity of water

In PIAC's view, the current determination must recognise the long-term trends in climate change, and implement structures and practices to deal with the uncertainty of future water resources. Water can no longer be considered an abundant resource, where cost is related only to the infrastructure required to transport it. The finite nature of water resources has implications for the value (and cost) of water, where not all 'units' of water are of equal value.

PIAC recommends that IPART implement an Inclining Block Tariff structure (IBT) as part of an approach that recognises water as a finite resource with increasingly uncertain access, particularly when combined with rapid population growth. PIAC notes that most urban water utilities in Australia operate with an inclining block tariff structure.

PIAC highlights the following arguments in favour of an IBT:

- It clearly and transparently aligns water pricing structures with business and community messaging regarding conservation and efficiency.
- It responds to customer preferences that pricing be weighted towards usage and maximises a household's ability to reduce its bills by managing usage.

- It recognises that at higher levels of usage, units of water have a higher intrinsic value (and cost), related to the increasing impact of usage on finite water resources.
- It creates a simple, transparent framework that can incorporate signals of long-term costs, as well as responses to shorter term variations, such as extreme drought conditions. In the context of uncertainty regarding climate change impacts occurring concurrently with rapid growth, such flexibility is crucial.
- It recognises that scarcity is a long-term issue that needs to be signalled on a permanent basis, not only in times of extreme conditions where the ability to respond effectively is limited (because by the time scarcity has increased cost, there is limited scope for price elasticity of demand to make any meaningful impact.)
- It provides a pricing framework that can be better integrated with pricing for waste and recycled water services, so as to better enable their efficient implementation. This is crucial as currently wastewater re-use and recycled water schemes are often not able to demonstrate an economic case.

Hunter Waters proposal included an estimated range of LRMC for water between \$2.50 and \$4.00 /kL. PIAC considers that this is a reasonable starting point for the development and introduction of an appropriate IBT for Hunter Water, which can incorporate long-term price signalling of water resource scarcity.

Recommendation 1

That IPART recognise the limitations of using long-term average conditions as the basis demand forecasts and revenue requirements for Hunter Water and consider the impact of changing trends in climatic conditions in operational and pricing decisions.

Recommendation 2

That IPART implement an Inclining Block Tariff for Hunter Water, to align efficient conservation and water resource management practices and messaging with transparent pricing structures.

Continued engagement

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

Yours sincerely,

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Appendix 1 – Responses to consultation questions

15. Should we allow the proposed discretionary expenditure to be recovered from Hunter Water's service charges?

PIAC is concerned that the internet-based survey undertaken by Hunter Water is not a sufficient basis to determine their customers' preferences and willingness to pay for a range of discretionary projects. The balances inherent in water pricing require time to understand before any meaningful consumer opinion can be provided. It is not clear from the Hunter Water proposal that the willingness to pay surveys undertaken by the company provided sufficient background and development of consumer understanding to enable informed choices. We recommend that business decisions around pricing structure, pricing levels and discretionary projects that impact upon them, be grounded in face-to-face, deliberative processes that build customers capacity to provide genuinely informed indications of consumer preferences.

PIAC considers that all costs recovered from households should support household's ability to control their own costs. Should IPART permit Hunter Water to recover costs related to any of the discretionary projects proposed, PIAC recommends that this be attached to usage rather than fixed service costs, on the basis that households have scope to alter their usage to mitigate the impact of those costs on their bills. Increases to the service charge impact all households equally, with no scope for the household to adjust usage to control these costs. The impact of recovery through service charges is regressive, disproportionately impacting households with lower usage and lower incomes.

16. Is there another way to gauge support from non-residential customers who's willingness to pay has not been tested, or should non-residential customers be excluded from paying for the proposed discretionary expenditure?

PIAC reiterates that a more comprehensive and representative, deliberative customer engagement process should have been undertaken in relation to the proposed discretionary expenditure and related cost recovery, as part of broader engagement on tariffs and prices. We note that in its customer engagement processes, Sydney Water undertook a number of consultations that also sought the preferences of non-residential customers. We recommend that Hunter Water include a non-residential customer consultation as part of a program of deliberative engagement on willingness to pay.

PIAC does not consider it appropriate to exclude non-residential customers from any costs related to the proposed discretionary expenditure. Non-residential customers will be beneficiaries of the discretionary projects. Should IPART approve the discretionary expenditure, the related costs should be shared across the entire customer base.

17. Should the costs of discretionary expenditure be recovered through a separate charge on customer bills?

PIAC does not support the inclusion of a separate charge for discretionary expenditure. Transparency of this expenditure can be more appropriately provided through other business mechanisms and communications to the community.

Simplicity and clarity in billing is crucial to ensuring households understand their bills and can use them to control their usage and costs according to their needs and preferences.

Charges should only be included separately on bills where the provision of that information assists the household, for instance by providing them with information regarding how to understand and mitigate those costs. Where the discretionary charges will be required of all customers, providing separate information on this charge does not provide any additional assistance to consumers and adds to consumer confusion.

Should discretionary costs be allowed, they should be incorporated into usage charges, where the household has the ability to mitigate the impact of that charge upon their bills by reducing their usage where possible.

18. Is Hunter Water’s demand forecasting model appropriate? Are the inputs used to estimate the model also appropriate?

We note that Hunter Water’s demand forecast is predicated upon a return to ‘average’ climatic conditions. We question whether this is an appropriate or prudent approach. Climate change has already seen a sustained trend to hotter, drier conditions that is likely to worsen over time. We question whether a return to historic ‘average’ conditions is likely.

Prudent management of risks on behalf of consumers, both of increased demand, and of increased water resource insecurity, should be reflected in demand forecasts. In circumstances where the impacts of climatic change indicate increased likelihood of sustained dryer conditions, we consider that forecasts assuming average conditions are an imprudent ‘best case scenario’ that invite unacceptable risk.

20. Do you agree with Hunter Water’s forecast that per capita water consumption will decrease by 2.8% over the next 5 years under long-term average weather conditions?

PIAC questions the basis for this forecast. The Hunter Water proposal shows that over the course of the current regulatory period, actual demand has significantly exceeded forecasts, largely as a result of hotter and drier conditions. It is not clear from the Hunter Water proposal what data underpins their assumption of a return to average conditions for the remainder of the current period, and throughout the next.

PIAC contends that Hunter Water should be linking long-term climate adaptation planning with a ‘conservative’ approach to managing costs and risk in the short to medium term. This would incorporate customer base growth ranges into future planning, as well as assumptions for a range of climate impacts including variation from average rainfall, and increased long term average temperature conditions beyond the current period. Such an approach would demonstrate the range of operational, pricing and investment decisions that are intended to impact upon consumption over the course of the determination, allowing IPART to test the strength of the assumptions the forecasts are based upon. Other than the problematic assumption of a return to long-term ‘average’ conditions, it is not clear what the forecast reduction of consumption is based upon.

PIAC recommends that IPART interrogate Hunter Water’s forecasts and request further detail linking Hunter Water pricing, operational and investment decisions to the forecasts relating to consumption and demand. PIAC also recommends that IPART request updated forecast ranges that more prudently account for potential climate related risk.

23. Is Hunter Water's proposed increase in the usage charge of 1% in real terms and 5% cumulative over the regulatory period to \$2.51 per kL in 2024-25 reasonable?

PIAC reiterates our concerns about the quality of the engagement undertaken by Hunter Water, and whether it serves as an appropriate indication of informed consumer preferences.

Setting aside the quantum of the increase in usage charge, PIAC strongly recommends that IPART consider the introduction of an inclining block tariff structure for water usage charges. We note that Hunter Waters' proposal included advice from consultants Marsden Jacob Associates (MJA) that the LRMC of water supply was in a range from \$2.50 to \$4.00/kL. We consider this as a reasonable basis from which to implement an IBT that more comprehensively represents the LRMC of water supply, including recognition of the relative value of water supply at higher usage levels. Such a structure can be developed to support the range of messages and measures, including those in response to immediate drought conditions.

25. Should Hunter Water's water usage charges vary to make drought-response costs more transparent to end-use customers (ie. by reflecting the per KL cost of any drought cost pass-through?)

PIAC does not support the introduction of separate 'drought response costs', and does not consider drought as an appropriate trigger for a cost pass-through. PIAC strongly recommends the implementation of Inclining Block Tariffs as a more comprehensive and effective structure in response to scarcity issues. We have responded further in relation to the inappropriateness of drought as a cost pass-through in our answer to question 46.

26. Is a phase-out of location-based prices over 5 years warranted or could it be done sooner, given the customers impacted are large users and may benefit from water conservation measures?

PIAC supports the phase-out of location-based prices for the identified large users. In assessing the relative benefit of accelerating this phase-out, we would like to see more detail regarding the impact upon each of the effected users, including what impact would result if there was no change in usage, and how usage compares to other comparable users.

30. Are Hunter Water's proposed wastewater usage charges reasonable?

While PIAC is not able to comment on the quantum of the proposed wastewater usage charge, we disagree in principle with an approach that rebalances charges towards fixed wastewater service charges, and away from usage charges.

While wastewater has historically been regarded as an unwanted bi-product that imposes fixed costs related to its removal and treatment, this is changing. Technology improvements in conjunction with rapid population growth and limitations on secure access to traditional water resources, is leading to a changed perspective on 'wastewater' that will increasingly regard it as a resource to be used efficiently. PIAC contends that the current and future costs of wastewater are not 'fixed', and related not only to the cost of transporting and treating wastewater, but also to the potential value of the wastewater as a 'raw' resource. We understand that there is a significant transition in infrastructure and operational practice required before the value of wastewater can be fully realised, we contend that current pricing structures for wastewater can provide a foundation for this transition.

PIAC recommends that IPART consider the role of wastewater pricing in signalling not only the cost, but potential value, of wastewater as a raw water resource. PIAC notes the potential to significantly rebalance charges towards usage, and link deemed rates to a percentage of actual usage rates.

42. Is Hunter Water's proposed declined and dishonoured payment fee reasonable?

While supportive of the reduction in declined and dishonoured fees, PIAC questions whether such fees are warranted, and whether the quantum fairly reflects the impact upon Hunter Water beyond standard operational costs already accounted for.

Technical Paper 9 shows that more than 90 per cent of declined or dishonoured payments are related to direct debits. These circumstances can arise for reasons that are not directly in the customers' control (for example multiple payments being withdrawn at the same time). Customers will be penalised by their financial institution when such circumstances arise, and we do not consider it appropriate that they also face a substantial penalty from the withdrawing entity (in this case Hunter Water).

The indicative costs related to identifying and dealing with dishonoured and declined payments do not seem reasonable when taken in the context of general operational costs that are already incorporated into the customers' bills through the allowance for operational expenditure. PIAC recommends that IPART reconsider the proposed fees both in principle and in quantum.

45. Is Hunter Waters proposed 5-year determination period appropriate?

PIAC does not support a 5-year determination for Hunter Water at this time. PIAC recommends retention of a 4-year period on the basis that:

- Hunter Waters determination period was aligned with Sydney Water in the current period to ensure better consistency and alignment between the two major urban water utilities. PIAC supports the continuation of this alignment.
- Many of the forecasts contained in the current determination were exceeded, including capital expenditure, operational expenditure and demand. PIAC considers that this variance is material and indicates a degree of ongoing uncertainty. We note that in requesting a 4-year determination, Sydney Water cites this uncertainty. Extending the determination would significantly increase risk of material variance from forecasts underpinning the revenue determination. PIAC regards this increased risk as unacceptable and unnecessary.

46. Should we introduce a cost pass-through mechanism for Hunter Water's proposed drought cost pass-through?

PIAC does not consider drought to be an appropriate trigger for a cost pass-through, particularly in the context of Hunter Water using average climatic conditions as the basis for their demand and revenue forecasting. We note the following in reference to IPART's guidance on when pass-throughs may apply:

- The trigger event for a cost pass-through should be able to be clearly defined and identified. Where climate change is having escalating long-term impacts upon rainfall and temperature trends, PIAC considers it increasingly difficult to identify the discrete periods of 'below average' rainfall that identify drought. We contend that longer term

structural price signals that recognise long-term water scarcity, and support efficient conservation, such as inclining block tariffs, are more appropriate measures of dealing with such uncertainty.

- Hunter Water is able to have some influence on the costs resulting from drought, as it can implement operational and pricing structures, such as an inclining block tariff, that recognise the ongoing nature of water resource scarcity. Such mechanisms, in conjunction with related investments and operational practices that improve efficiency of use, improve conservation and signal the higher value of units of water usage at higher levels, are more effective and appropriate than temporary pass throughs.

The purpose of reflecting drought and resource scarcity related costs in prices is not simply cost-recovery, but also price signalling of the value of the resource, its finite (and insecure) nature, and supporting other mechanisms for conservation and efficiency. Regarding drought as trigger for a cost pass-through recognises only the short run costs related to drought measures, and provides no structural incentive towards long-term efficiency. It is also ineffective as a price signal in that it is triggered at a point after conservation and efficient usage is likely to have the most impact.

51. What should a review of our regulatory framework look at or focus? When is the best time to conduct such a review?

PIAC supports undertaking a comprehensive review of the regulatory framework, through a consultative process independent of the pricing and regulatory determinations for Hunter Water, Sydney Water and WaterNSW. At a point where technology, climate and consumer expectations are undergoing a dramatic shift, a wide-ranging review of the regulatory framework has merit. We see no reason why IPART cannot signal an intent to commence such a review prior to the end of the current pricing process, and for the review process to commence with consultation regarding what the review should encompass.