WATER SERVICES
ASSOCIATION OF AUSTRALIA

WSAA submission to IPART's Review of the Regulatory Framework

October 2020

Table of Contents

Key messages

Industry performance and the case for change

- IPART is to be commended for undertaking this review of its approach.
- There have been positive developments nationally in economic regulation of urban water in Australia.
- Determinations, including those by IPART, have provided utilities with increased investment to meet customers' needs while delivering price reductions.
- However, falling interest rates and the WACC have created relatively benign conditions for regulators and utilities which are unlikely to continue be repeated.
- The water industry faces significant challenges from growth, climate change and aging assets. Capital expenditure is already increasing significantly nationally.
- These national pressures, if anything, are amplified in NSW through high population growth and the absence of developer charges for Sydney and the Hunter.
- The financial resilience of the sector has weakened as the gains from lower interest rates have been passed to customers rather than being shared between improving affordability for customers and improving utilities' financial resilience.
- In future this will imply that all parts of the water industry utilities, regulators, and shareholder will have to adapt to meet the new challenges.

Proposed changes to regulatory approach

- Utilities will need to ensure all investment is meeting customers' needs and their willingness to pay.
- Efficiency and innovation will be key to meeting the challenges of balancing service delivery with affordability.
- The regulatory regime needs to support these directions.
    - IPART's core objective should be to promote the long-term interest of customers.
    - Customer preferences should be at the centre of the regulatory regime. The onus is on utilities to understand their customers' needs and demonstrate to the regulator in a rigorous way that they are being followed through.
    - There should be much greater use of incentives to support innovation and efficiency. Incentive regimes operate both financially (ROE) and through reputation. Incentive regimes are well established and IPART can refine/evolve the best features of available regimes.
    - Discretion will remain part of the regime, so merits review for both utilities and customers is an important element of the framework. Merits review already exists in the urban water industry in Victoria, the ACT and in the UK.

1.0 Introduction

WSAA commends IPART for commencing a review of its approach to regulation.

WSAA has always been a strong supporter of independent economic regulation as a key pillar of the corporatisation model for government-owned utilities, and more generally for ensuring that monopoly industries are focused on customer outcomes.

WSAA commissioned work in 2014 on improving economic regulation in Australia, and has contributed to reviews since then in NSW, Victoria, Tasmania, South Australia, Queensland as well as nationally on different aspects of economic regulation.

IPART has highlighted three aspects of the framework in its position paper for review. These are:

- Lifting industry performance;
- Promoting a customer focus; and
- Encouraging innovation.

These are important elements of the framework and each presents opportunities for improvement. However, based on our previous work WSAA suggests that this is an opportunity for IPART take a broader view of its framework and role. In our view, the four key areas that will deliver the biggest gains for customers in the long run are:

- clarifying IPART's regulatory objective;
- placing customers at the centre of the regulatory process;
- incentives for efficiency and innovation; and
- merits review of regulatory decisions.

This submission is as much about why the regulatory regime will need to evolve as about how it should change. It is structured as follows:

- Section 1 - Examines Industry Performance, economic regulation the urban water landscape; and
- Section 2 - Examines the proposals for change.

2.0 Economic regulation and the urban water industry performance

2.1 Recent regulatory performance has been good

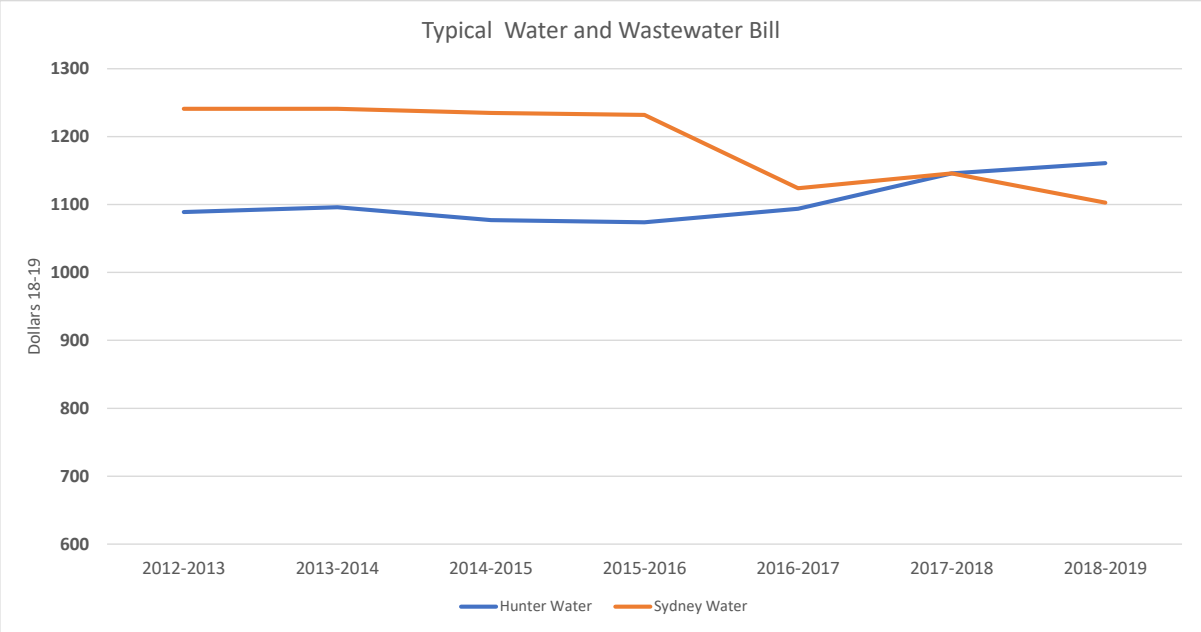
There have been positive developments in economic regulation of water in Australia over the last 5 years.

These include:

- Significant procedural improvements. Regulatory processes are much more transparent in their methods and approach. Regulators are publishing models used in the determination and consulting on key elements of the regime such as the WACC methodology in advance.
- All regulators are to varying degrees encouraging greater customer involvement in the regulatory process
- The regulatory framework is beginning to recognise the broader role water plays in the community to deliver liveable cities and regions.
- IPART, in particular, has introduced a number of pricing reforms including drought pricing and water conservation innovations, and wholesale pricing guidelines

In terms of outcomes, regulatory determinations generally struck a good balance. They have allowed utilities to deliver higher capital expenditure to fund efficient investment, improved services and falling bills. The affordability of services has been maintained or improved nationally, including for Hunter and Sydney customers (Figure 1). Utilities and regulators can both take credit for that outcome.

Figure 1: Typical water and wastewater bills for Hunter Water and Sydney Water



2.2 But there is no room for complacency

However, the future will not be as benign for utilities or regulators. The COVID-19 recession means that affordability concerns will increase in the community for essential utility services; and however sound the urban water industries performance on affordability is, it is inevitably drawn into these issues.

COVID-19 aside, future pressures and challenges make it critical for all elements of the water industry, including utilities and regulators, to evolve.

Notwithstanding the good outcomes that economic regulation has delivered, the task of setting prices over the last 6 years has been made easier for both utilities and regulators by the largest falls in interest rates in human history and the consequent falls in the cost of capital. The scope for further reductions in interest rates is far less than previously and there is less scope to cushion the impact of rising expenditure. Real price rises across many jurisdictions will be inevitable.

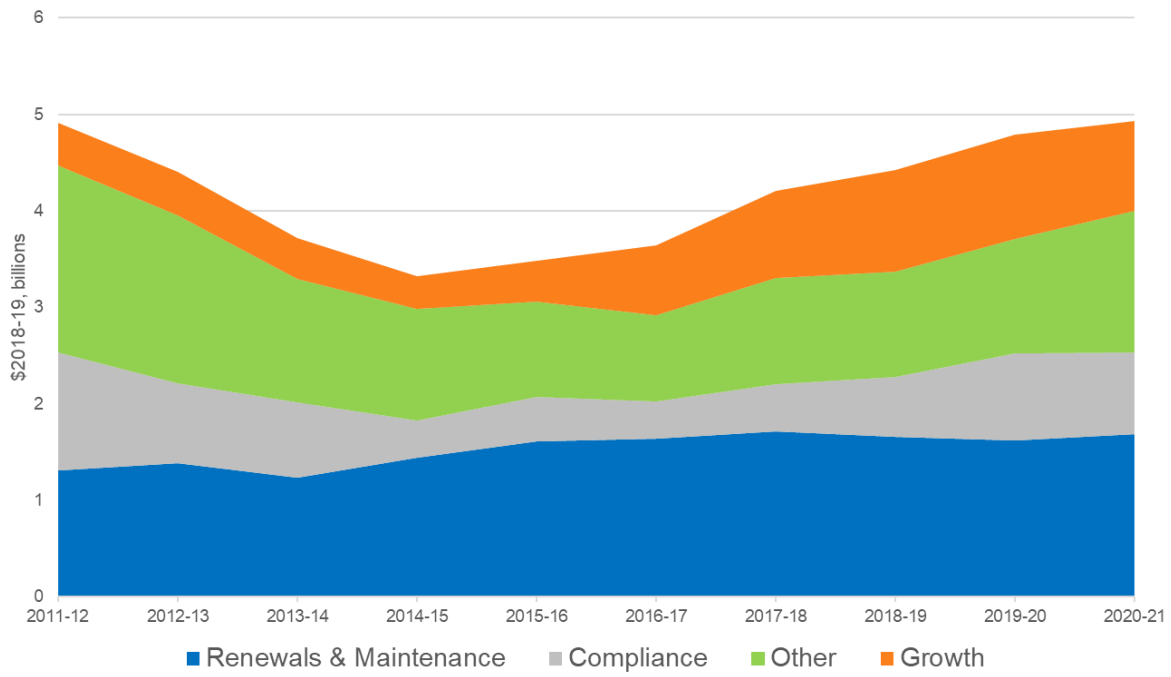
2.3 Investment across the industry is rising

The challenges across the urban water industry are well known. For example, in its 2019 Australian Infrastructure Audit, Infrastructure Australia found that:

> 'the urban water sector faces challenges, including the impacts of climate change, population growth, ageing assets, and changing needs and expectations from users. Failure to adequately address these challenges could lead to rising water bills, as well as exposing users to risks of declining service quality and reliability'.

Investment is already increasing significantly to meet the urban water sector's challenges. After the Millennium Drought the sector managed investment and pursued operating efficiencies to manage customer impacts. However, since 2014-15 capital expenditure shows a strong upward trend as set out in Figure 2. Significantly, little of that expenditure was for water security. Major water security enhancements would add to that upward trend.

Figure 2: Capital expenditure – actual and forecast ($2018-19). Data from 17 utilities.



WSAA's own analysis of the trend of rising capital expenditure is supported by recent price determinations from IPART and ESCOSA that have approved increases in capital expenditure of 30 to 40 per cent. WSAA expects these trends to continue, see table 1 below.

Table 1: Outcomes from regulatory determinations in 2020 (compared to expenditure over previous determination)

	Sydney Water	Hunter Water	SA Water	WaterNSW
CAPEX	Up 41%	Up 31.2%	Up 28%	Up 33.2%
OPEX	Down 2.4%	Up 5.9%	Up 2%	Up 1.4%*
Bill impacts	Down 7%	Down 4.3%	Down 10-15%	Down 8.3%

*estimate

The trends exclude major investment for upgrades to water security. Emerging from the recent drought the industry expects further investment in desalination and recycling will be necessary in future years.

2.4 Financial resilience is important

At a time of strongly increasing investment in the industry, financial resilience is emerging as a concern. This section draws on the analysis WSAA provided to the Productivity Commission for its current inquiry into National Water Reform.

Financial resilience across the urban water sector is fundamental to meeting industry challenges while maintaining the affordability of services. The recession associated with COVID-19 will place pressure on both utility revenue and customers' ability to pay and underlines the need for the industry to be able to withstand financial shocks.

Financial resilience is important because utilities need to be able to continue investing, while as far as possible avoiding price shocks. Financial constraints can limit investment and lead to reduced quality of services. The consequence of low financial resilience is evident in some rural and regional areas that are reliant on capital grants. In these areas we see a deterioration in performance and an inability to plan for the future. This was also the case in Tasmania prior to the creation of Taswater, where wastewater treatment plants failed to meet environmental protection standards and there were numerous boil water alerts in place for small communities.

But financial metrics are weakening

The difficulties faced by many regional areas with small revenue bases to generate sufficient funds to maintain services is well known.

However, in metropolitan areas the financial strength of utilities continues to come under pressure. A number of utilities are being downgraded by ratings agencies and are sitting close to the bottom of the investment grade range. WSAA considers that as essential services investing in long lived assets, it is in the long term interest of customers that utilities are able to maintain an investment grade credit rating.

Figure 3 sets out the problem. It shows the performance of major utilities against two key credit metrics that WSAA projects for 2019-20. The figures, based on a survey in 2019 do not include the

impacts of the price determinations noted above which will place additional downward pressure on the financial metrics.

The credit metrics are Funds from Operations to Interest and Funds from Operation to Debt. Funds from Operations (FFO) is a cash measure of profit, and the ratios show how much headroom utilities have to cover their interest payments and the level of FFO in comparison to total debt.

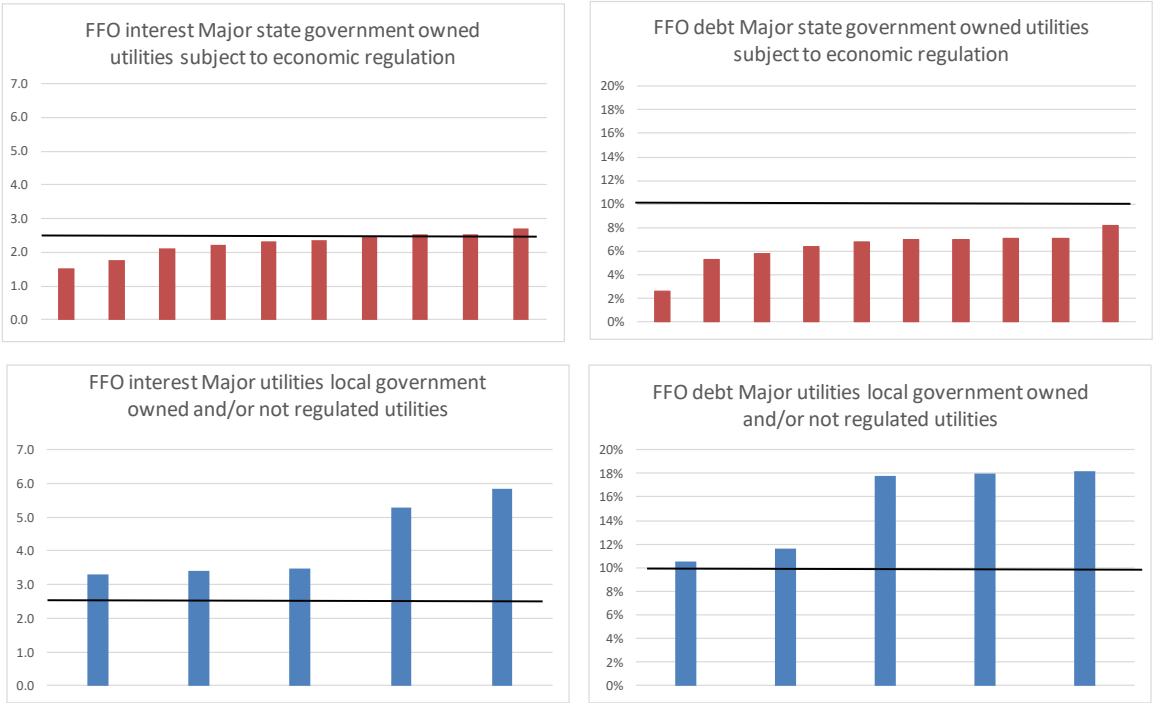
Ratings agencies set target bands for each ratio. While these ratios are not deterministic — the credit metrics comprise only 40 per cent of the credit rating score — they nevertheless indicate the financial strength or resilience of the utility.

Figure 3 shows that major state government owned utilities that are subject to independent economic regulation have reduced financial flexibility and have reduced ability to withstand shocks. The average FFO to interest ratio for these utilities is 2.3 times, which is just below the target range for investment grade. The average FFO to debt percentage is 7%, well below the investment grade target of 10%.

By way of comparison, the average FFO to interest for the utilities regulated by Ofwat in the UK in 2018-19 (the latest data) is 3.87 times and the FFO to debt is 10%. State Government owned utilities subject to economic regulation have less financial resilience than their UK counterparts. (Note, a fuller comparison would show higher gearing ratios in the UK offset by greater revenue to service that gearing).

However, another dominant feature in figure 3 is the difference in financial outcomes between state government owned utilities with economic regulation and other utilities. These other utilities are either local government owned utilities (whether they are subject to regulation or not), and state government owned utilities that are not subject to regulation. These other utilities have significantly greater financial headroom and resilience.

Figure 3: Projected Funds from Operation to Interest and Funds from Operation to Debt by ownership and regulation. (Each column is a separate utility. Below the black lines indicate breaches of investment grade rating for that metric)



Note: excludes 3 utilities which did not participate in WSAA's survey

2.5 Industry wide challenges are amplified in NSW

The industry-wide challenges posed by growth, water security, asset renewal and maintaining financial resilience apply equally in NSW. Indeed, in a number of respects they are amplified in NSW. This is because:

- NSW metropolitan utilities are facing some of the highest population growth in Australia necessitating increased capital expenditure.
- In Sydney, growth is occurring inland in where waterways are sensitive to additional wastewater discharges. This requires additional treatment costs to meet the community's environmental expectations as set out in EPA regulations.
- Unlike most other jurisdictions, Sydney and Hunter currently does not have a system of developer contributions to offset this growth.
- There are potential further water security costs in the future that are not incorporated into current capital expenditure.
- Current prices contain relatively little provision for renewal and maintenance of ageing assets.

Most of these issues are well understood, but it is worth expanding on the implications of the last point.

Renewal of ageing assets

NSW utilities face twin pressures in relation ageing assets. One is related to the life cycle of assets and the second is a product of the regulatory regime itself.

First, is the situation where assets that have been in place for many decades are reaching an age where they will begin to require more investment in renewal and maintenance than previously. This is a natural part of the investment cycle for long lived assets, and will see increasing capital expenditure for renewals and maintenance.

The second pressure is a product of the regulatory regime itself. Customers water bills contain a relatively small amount for the renewal and maintenance of assets, even compared to the amount utilities have traditionally been spending. In regulatory terms, levels of regulatory depreciation are relatively low given the size of the assets base.

This is a consequence of the way the Regulatory Asset Base (RAB) was initially set in 2000. The RAB was set at a level that current prices could sustain rather than on an estimate of the replacement cost of that assets. In Sydney Water's case the initial RAB was set at around $5 billion compared to a depreciated replacement cost of $13 billion. WSAA understands there were similar orders of magnitude for Hunter Water and the then Sydney Catchment Authority. This approach to setting the RAB is known as the *line in the sand* and was widely used by regulators in the transition to economic regulation. It should be stressed that there is no inherent problem with adopting a line in the sand. However, adopting a line in the sand does imply that prices will face upward pressure, rather than remain steady, just to maintain existing service levels.

One way of looking at this is that the previous generation paid for the assets and the current generations has been able to use those for free until they need to be replaced – that need for replacement is imminent.

In technical terms, the implication of the line is the sand is that the level of regulatory depreciation included in prices is relatively low in relation to capital expenditure for renewal and maintenance. A consequence of this is a rapid increase in the RAB even before growth investments are taken into account.

For customers this translates to the counterintuitive fact that there will be significant pressure on prices to rise to simply maintain the same service level. This effect has been underway for some time but has been more than offset by reductions in the WACC from lower interest rates.

2.6 There are also opportunities

While the challenges identified above are real, there are also significant opportunities. The growth in Hunter and Sydney presents opportunities to adopt integrated water cycle management to improve the amenity and liveability of new areas. The Aerotropolis in Western Sydney is a transformative opportunity to incorporate water into the landscape and embed access to green space to residents and businesses.

Innovation and new technology can extend the life of existing assets and reduce the capital investment required. Just as the challenges require new approaches from regulators and utilities, so too do the opportunities.

3.0 Implications for the regulatory framework

These pressures, challenges and opportunities mean there needs to be a refresh of the regulatory framework. As service delivery in the urban water environment will become more challenging so too will economic regulation. If utilities are to achieve higher levels of performance, the regulatory framework will also need to incentivise higher levels of performance.

For utilities, success in balancing investment needs with affordability of services will be driven by three factors:

- a strict focus in aligning investment to provide the suite services that customers and the community want and are willing to pay for;
- an ongoing focus ongoing operating efficiency; and
- greater levels of innovation to drive lower costs over time in capital expenditure and operating costs.

The regulatory regime has a key role to play in promoting each of these outcomes. WSAA has consistently argued the importance of best practice regulation. For example, in 2014 we released a report commissioned from Frontier Economics on *Improving Economic Regulation in Australia* and Frontier released its own statement on economic regulation at the same time.

In our view the key elements of the regulatory regime that need to evolve to support great customer outcomes are:

- Clarity of Objectives to promote the Long-term interests of customers;
- Customer engagement at the centre of the framework;
- Incentives for efficiency and innovation; and
- Merits review of regulatory decisions for firms and customers.

3.1 Objective of Economic Regulation

Drafted in 1992, the IPART Act does not have an objective clause. In section 15s the Act sets out all the matters IPART must have regard to. While many of these are unobjectionable, they do not provide clarity of purpose for the Act.

There is general agreement that promoting the **Long-term interests of customers** should be at the core of economic regulation. It is found in some form across energy, water and telecommunications in Australia and internationally.

WSAA considers that IPART should recast its framework to focus on promoting the long-term interests of customers as its core objective. This may be able to be achieved without changing the Act, but if not, this issue is of such importance that amending the Act should be contemplated.

An area where there are legitimate differences of opinion, is on the question of whether the long-term interest of customers should stand alone or be supported in an object clause with other criteria. For example, the National Energy Objective as expressed in National Electricity Law emphasises economic efficiency:

> “to promote efficient investment in, and efficient operation and use of, electricity services for the long-term interests of consumers of electricity with respect to:
>
> - price, quality, safety and reliability and security of supply of electricity
> - the reliability, safety and security of the national electricity system."

Arguably, however, efficiency is inherent in the long-term interest of customers. Efficiency over time is essential to maintaining the affordability of services. For example, a research paper prepared for the Energy Consumers Association on Interpreting the long-term interest of customers concluded that:

> "The Long-Term Interests of Consumers is best promoted through economic efficiency. An economically efficient outcome (in either an effectively competitive market or a regulated monopoly) is one in which consumers pay no more than they need to for the quality, reliability, safety and security of supply they want."

In the UK, Ofwat's duties include the long-term interest of customers. A core function of the national regulator Ofwat is to maintain the financeability of the sector. This means that the sector is able to raise finance from equity and debt markets to maintain its services. WSAA understands that this requirement is stronger in water than in other regulated sectors to recognise the critical nature of water as an essential service.

While WSAA considers that the financial viability and resilience of the industry is a critical issue, and may need to be elevated in the regulatory regime, it is questionable whether it needs to be specified as a separate objective. Again, the long-term interest of customers would appear to fully encompass the need for utilities to be able to continue to invest to provide essential services. There may be legitimate arguments to supplement the long-term interest of customers objective with other criteria, but there is some attraction to letting this simple but powerful statement do the heavy lifting.

3.2 Customer preferences at the centre of the regulatory process

One of the largest changes in the urban water industry is explicitly putting customers at the heart of utility operations. This has involved much greater and deeper customer engagement and realigning planning and delivery around these outcomes.

IPART's position paper asks three relevant questions in relation to promoting a greater customer focus through the regulatory framework:

- *What level and type of engagement are customers looking for from water businesses?*
- *How do we provide the right incentives for the businesses to genuinely engage with their customers, understand what they want and incorporate this into the heart of their operations?*
- *Who is best placed to undertake customer engagement? Is it the business, IPART or another independent third-party?*

WSAA strongly supports regulatory approaches that support greater customer focus.

A threshold question for designing effective customer engagement is *'who is responsible for understanding what customers want and delivering those outcomes?*'

As the position paper sets out 'regulators are increasingly seeking to remove themselves from undertaking or supervising customer engagement'. WSAA supports this trend. It represents a recognition that regulators cannot assume that they are the custodian of customer interests. As utilities are responsible for delivering for customers the prime relationship must be between the customer and the utility.

However, within this trend there appears to be two conceptually different models on how that engagement should take place. At one end of the spectrum, the first model effectively brings customer representatives to the table as decision makers in determination process under the

guidance of the regulator. The clearest example of this is Scottish Water where a panel was created with customers, the utility and the regulator to reach a regulatory settlement. Stephen Littlechild summarised the process as follows:

> "The Customer Forum was set up in 2011 to carry out customer research, represent the interests of customers to Scottish Water and the economic regulator WICS, and to seek to agree a business plan with the company. It was set up with the agreement of all parties. The aims were to improve on previous price control approach, to find a new way of challenging the company and to bring greater customer input to bear. The constitution, expectations and timetable of the Forum were specified in some detail. WICS also provided many Guidance Notes about its own expectations. Financial tramlines were established to monitor performance during the forthcoming price control period. The process worked well, all parties worked constructively and agreement was reached on a business plan upon which the regulator subsequently proposed a price control. There is scope to apply the process in future and in other sectors."

The other model is exemplified by PREMO and the ESC in Victoria. Under this model the regulator has answered the question posed above by placing the full responsibility on the utility to engage with customers and to frame their regulatory proposals around the findings. The role of the regulator is to rigorously assess the quality of that engagement and how well business plans deliver on customer preferences. Explaining the rationale for the change the then chair of the ESC Ron Ben-David stated:

> 'The technical nature of the current model self-evidently disenfranchises customers and encourages water businesses to spend too much time attending to the regulator and its regulatory processes. Our framework will pivot the businesses' attention squarely towards their customers. There will be no successful regulatory outcomes for the businesses if they do not understand the concerns, priorities and preferences of their customers — and then take those matters into account in developing their pricing proposals.'

The ESC then stated:

> 'We do not propose to prescribe how a water business should engage with customers. We consider that each business is much better positioned than the regulator to determine what its customers expect and need from their water business, and how best to interact with its customers to this end. Businesses will be free to develop their own engagement strategies and techniques to allow their customers to be more involved in informing business decisions on services and prices.'

Between each of these conceptual models there are likely to be hybrids. For example, in Energy, New Reg is a joint initiative between the AER, Energy Networks Australia (ENA) and Energy Consumers Australia (ECA). The goal of this initiative is to ensure that customers' preferences drive energy network businesses proposals and regulatory outcomes. Under the New Reg process the most significant departure from traditional practice is that a Customer Forum negotiates aspects of the regulatory proposal in advance of lodgement with the AER. AusNet conducted a trial of the process of the Forum and the negotiation outcomes have been incorporated into AusNet's 2022-2026 proposal, which is being considered by the regulator. In doing so, the Forum understood, and represented to AusNet, the perspectives and preferences of AusNet's customers.

Each of these engagement processes are relatively recent. PREMO is in its first cycle and the New Reg trial is underway. It would be premature to attempt to judge what works best in what situations. However, the clear direction and intent of all approaches is to align the regulatory framework better with customer preferences. Overall, IPART has an exciting opportunity to develop its framework to support the role of the customer at the heart of utility operations.

3.3 Incentives for efficiency and innovation

IPART has always sought to provide an incentive for efficiency. Typically, this has involved setting Opex allowances for the period of the determination and allowing the utility to keep any efficiencies for the duration of the determination. These efficiencies are then provided back to customers in subsequent periods. Efficiency reviews have also been a feature of the regulatory framework to provide discipline on utility expenditure. Unless capital and operating expenditure can be demonstrated to the reviewers to be efficient and prudent it may not be allowed to be recovered in the prices.

However, this could not be described as a high-powered incentive regime and much greater use could be made of incentive frameworks.

The IPART position paper is correct to highlight the role of innovation. In particular innovation by utilities offers the prospect of addressing the challenges identified above, while maintaining affordability and financial viability. A regulatory regime for the future will include strong incentives for innovation. For example, in addition to the elements of the Ofwat's incentive regime set out below, in PR19 Ofwat made available a £200 million fund for innovation across the sector. (https://www.ofwat.gov.uk/regulated-companies/innovation-in-the-water-sector/water-innovation-competitions/).

Incentive regimes generally provide a greater return on equity for superior performance or reduce returns for weak performance. They can also rely on reputation as a driver of performance.

Reputation is an important element of the PREMO framework in Victoria, but reputation is also a component of the incentive framework even when utilities are privately owned such as in the UK.

One size does not fit all for incentive regimes and can be context specific. However, there are enough frameworks employed that IPART could use to enhance its own incentive framework. These include:

- In the UK, Ofwat has introduced financial incentives linked directly to customer outcomes. These are known as C-Mex and D-Mex (see box 1) (We note IPART itself has commenced measuring customers perception and satisfaction through surveys). Ofwat also employs a system of Outcome Delivery Incentives (ODI's). These comprise both industry wide and company nominated measures of performance. Companies are rewarded or penalised depending on their performance. Box 2 sets out how one company – Severn Trent – describes ODI's as operating.
- In the New Reg Ausnet trial, Ausnet and the Customer Forum is effectively co-designing the incentive scheme for customer experience including the incentives rates that will apply.
- The PREMO model adopted in Victoria relies on both financial and reputational incentives. Utilities that align their submission and subsequent activities best with customer preferences are rewarded with both higher financial returns but also designated as a 'advanced' or 'leading' utility. The structure of the sector in Victoria where there are a number of regional and metro utilities may enable greater competition by comparison across the sector than in NSW, however, IPART has the advantage in the timing of this review in that it can learn from the experience of others and design an incentive regime tailor made for NSW utilities.

Box 1 Customer incentives mechanisms in the UK

The customer measure of experience (C-MeX) is designed to incentivise water companies to provide an excellent customer experience for residential customers, across both the retail and wholesale parts of the value chain.

C-MeX comprises two surveys – the customer service survey of residential customers who have recently contacted their company in relation to that recent contact and the customer experience survey of random members of the public in relation to their experience of their water company.

In both cases customers are asked how satisfied they are with the service provided and how likely they would be likely to recommend the water company to family or friends. This net promoter score result is measured and reported separately to the C-MeX score which is used to calculate financial incentives.

Box 2 How are Outcome Delivery Incentives (ODI's) administered

The majority of ODI rewards and penalties are taken in period through revenue adjustments.

However, some ODIs that are measured over the course of the whole AMP have the net reward or penalty reflected through Regulatory Capital Value adjustments or future revenue at the end of the five year period.

Severn Trent reports on its ODI performance annually, and claim its net ODI reward or penalty for the year with a two year delay.

This allows Severn Trent's actual performance to be independently verified by its auditors, and give Ofwat opportunity to approve the changes to price limits through the scheme of charges.

This system is intended to match the change in bills as closely as possible with the service delivered to trigger that change.

However, Severn Trent can choose to defer payment of these rewards in order to reduce volatility in bill charges.

In the AMP7 Final Determination of December 2019, Ofwat determined that, from then onwards, any rewards in excess of 3% Return on Regulated Equity in any given year need to be split fifty-fifty with customers.

Source – Severn Trent (https://www.severntrent.com/investors/our-investment-proposition/outcome-delivery-incentives/)

3.4 Merits Review of regulatory decisions

IPART does not have merits review as part of its regulatory framework.

WSAA considers that merits review is a fundamental pillar of economic regulation, and administrative law making more generally. Properly constituted, merits review supports the long-term interests of customers by providing a mechanism to correct regulatory errors. For example, the appeals against Ofwat's PR19 determinations concern whether the determinations sufficiently allow the utilities to finance their operations. Putting any outcomes aside, it is important to the long-term interests of customers that utilities are financially viable and mechanisms to ensure this are important. Equally, a mechanism for customers to appeal if a determination provided excessive returns to utilities is also consistent with the long-term interests of customers.

The removal of merits review from energy regulation has not altered WSAA's view on the need for merits review. Indeed, merits review exists in two jurisdictions for water in Australia — in Victoria and the ACT. As noted, it also is part of Ofwat's framework. The experience of merits review over

PR09, PR14 and PR19 demonstrates its importance to securing a sound regulatory settlement of businesses and consumers in the UK. Critically, the merits review process has been used, but not overused, and has not been subject to the same accusations of cherry-picking or lawfare that have occurred in the energy sector.

The importance of merits review extends beyond raw statistics on whether and how often it has been used in particular circumstances. In WSAA's view it plays an important role in ensuring regulators provide sound analysis to support their decisions. In this way it supports the ongoing integrity of the regulatory regime.

The arguments for merits review are not new, but nor have they changed. In 1999 the Administrative Review Council set out the following and it is still the key source referred to on Australian government websites:

> 2.1. As a matter of principle, the Council believes that an administrative decision that will, or is likely to, affect the interests of a person should be subject to merits review. That view is limited only by the small category of decisions that are, by their nature, unsuitable for merits review, and by particular factors that may justify excluding the merits review of a decision that otherwise meets the Council's test.
>
> 2.4. The Council prefers a broad approach to the identification of merits reviewable decisions. If an administrative decision is likely to have an effect on the interests of any person, in the absence of good reason, that decision should ordinarily be open to be reviewed on the merits.
>
> 2.5. If a more restrictive approach is adopted, there is a risk of denying an opportunity for review to someone whose interests have been adversely affected by a decision. Further, there is a risk of losing the broader and beneficial effects that merits review is intended to have on the overall quality of government decision-making.

In 2012 the Review of the Limited Merits Review Regime (the Yarrow Review) found in relation to energy.

> 'We are convinced of the contribution that merits review can make to better regulatory decision making, and, more specifically, we consider it to be an important component of a system of checks and balances that supports the independence of delegated regulation.
>
> It is because the Australian Energy Regulator (AER) can exercise significant discretionary powers that merits review has such an important potential role to play.'

All regulatory regimes should be consistent and predictable but WSAA does not believe that it is possible, nor desirable to remove discretion on the behalf of the regulator. As the review noted it follows from having discretionary powers that merits review is so important.

Next steps

WSAA thanks IPART for the opportunity to provide this relatively high-level submission. We would welcome the opportunity to discuss these issues further with you as the review progresses.

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