

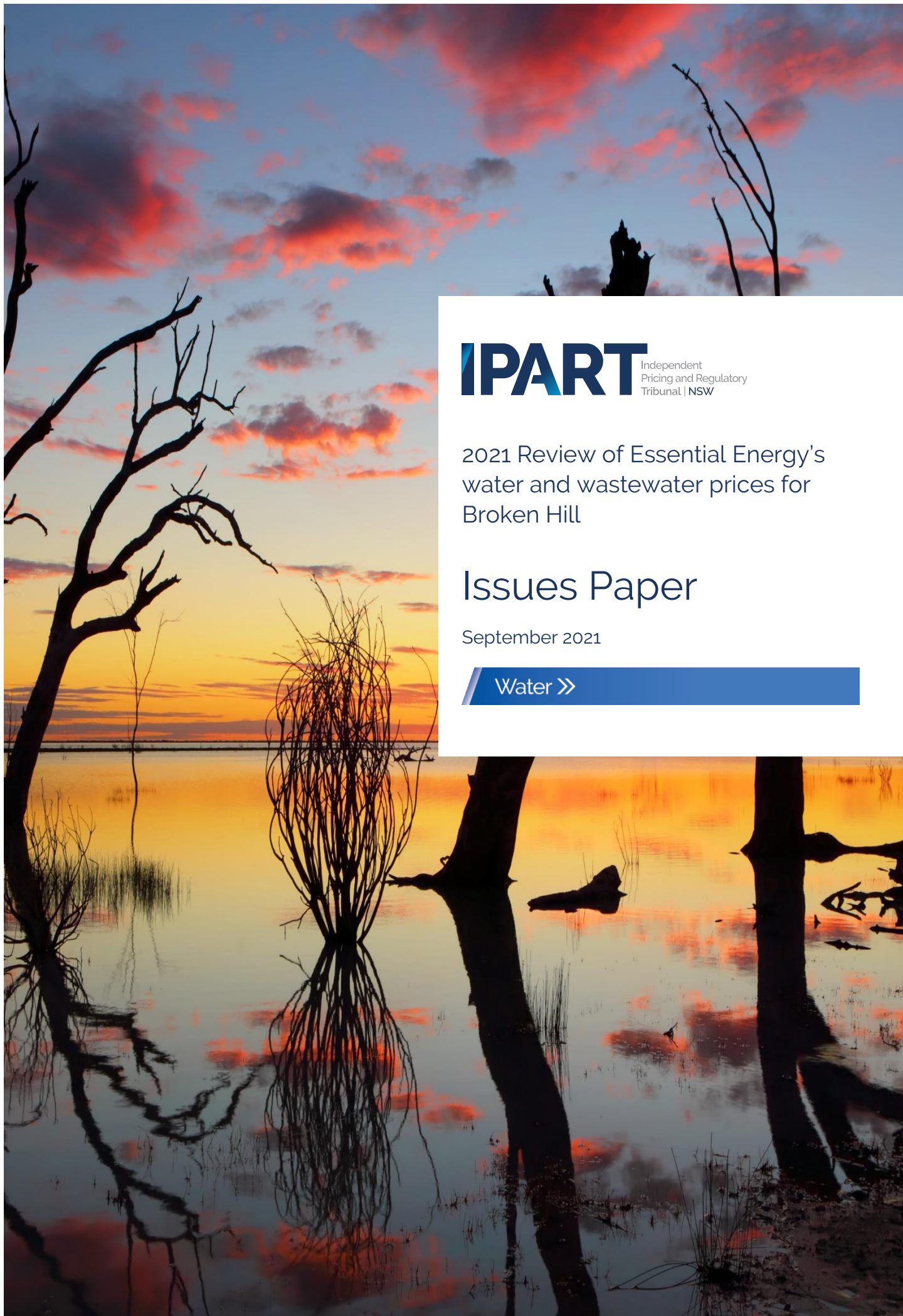


2021 Review of Essential Energy's
water and wastewater prices for
Broken Hill

Issues Paper

September 2021

Water >>



Tribunal Members

The Tribunal members for this review are:

Ms Carmel Donnelly, Chair
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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by Friday, 22 October 2021

We would prefer to receive them electronically via our online submission form [Lodge a submission](#)

You can also send comments by mail to:

2021 Essential Energy water and wastewater price review in Broken Hill
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, Sydney NSW 1240

Late submissions may not be accepted at the discretion of the Tribunal. Our normal practice is to make submissions publicly available on our [website](#) as soon as possible after the closing date for submissions. If you wish to view copies of submissions but do not have access to the website, you can make alternative arrangements by telephoning one of the staff members listed above.

We may choose not to publish a submission - for example, if it contains confidential or commercially sensitive information. If your submission contains information that you do not wish to be publicly disclosed, please indicate this clearly at the time of making the submission. However, it could be disclosed under the *Government Information (Public Access) Act 2009* (NSW) or the *Independent Pricing and Regulatory Tribunal Act 1992* (NSW), or where otherwise required by law.

If you would like further information on making a submission, IPART's submission policy is available on our website.

The Independent Pricing and Regulatory Tribunal (IPART)

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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.

IPART is reviewing water and wastewater prices in Broken Hill

IPART sets prices that Essential Energy can charge its customers for water and wastewater services provided through its Essential Water business. Essential Water provides these services to customers in Broken Hill and the surrounding areas of Menindee, Sunset Strip and Silverton.

Our most recent review was in 2019 when we set prices to apply from 1 July 2019 to 30 June 2022.¹ At this time a new pipeline from the Murray River to Broken Hill (the Pipeline) came into use, providing a more reliable water supply to the Broken Hill region after many years of drought and water restrictions.

The first step of our price review is to consider [Essential Water's pricing proposal](#) which it submitted to IPART in June 2021, and is available on our website. This Issues Paper sets out the key issues from that proposal and what prices would be if IPART was to accept the proposal. It also outlines how we will go about this review, including how you can provide input and key questions we would like you to answer.

When we set prices for a regulated business like Essential Water, we generally aim to set prices to cover the costs of providing services to customers. This means that water businesses can continue to provide safe and reliable water and wastewater services into the future. However, affordability is a key issue for customers in the Broken Hill region, and so we will need to set prices that customers can afford to pay.

In Broken Hill, water use plays an important role in managing health risks from exposure to high levels of lead. Activities that require water (such as regularly washing hands and maintaining green spaces) can help reduce exposure to lead.² Because of this, we will also consider the benefits of setting prices that encourage water use to improve health outcomes for people in Broken Hill and its surrounds.

IPART is also reviewing the [prices Essential Water pays for Water NSW to transport water from the Murray River to Broken Hill via the Pipeline](#). For more information on these prices see our [Water NSW's Murray River to Broken Hill pipeline Issues Paper](#).

Essential Water is proposing small bill increases

Essential Water has proposed to increase bills for household and business customers by around 2% a year over the next 5 years.³ We want to know whether you think these increases are affordable and whether you would be willing to pay more for better service quality (such as cleaner water and less leaks and pipe bursts). We will look closely at the costs Essential Water has proposed and decide whether they are reasonable and represent good value for money for customers. We will then use this information to set prices that apply from 1 July 2022.

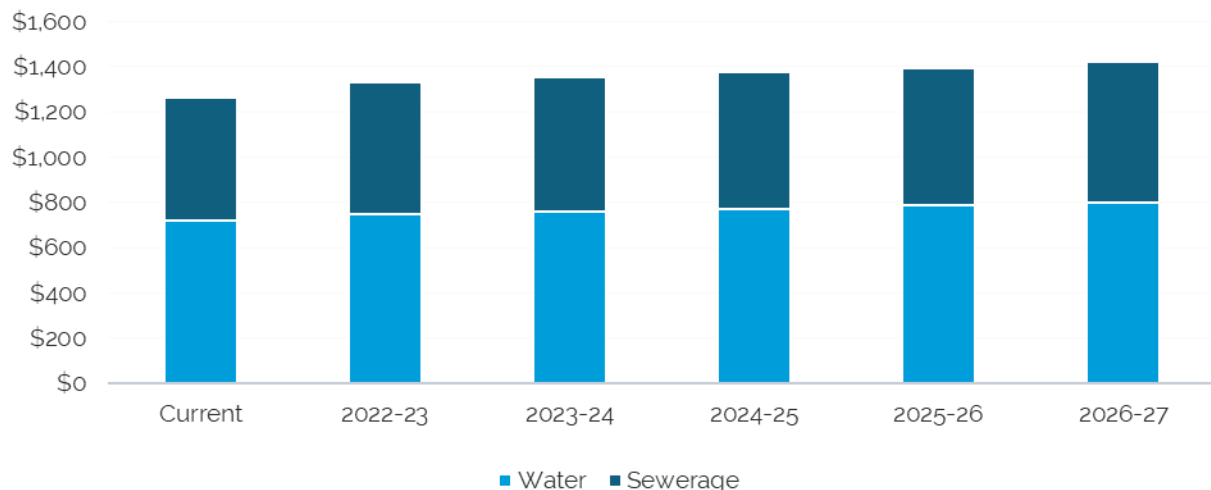
Water and wastewater bills could increase by around 2% a year

Essential Water has proposed to increase water and wastewater prices for most customers by around 2% a year on average over the next 5 years, on top of inflation.^a This means:

- Most prices would be around 11% higher by 2026-27 than they are currently.⁴
- Residential wastewater prices would increase by slightly more because of a proposed change in how bills are calculated.^b

The comparisons we present in this Issues Paper between current and proposed prices include expected inflation. This is different to the comparisons presented in Essential Water’s pricing proposal which exclude expected inflation. We consider our approach of including expected inflation provides a more complete picture of the changes in prices customers can expect to see from 1 July 2022. For more information please see **Box 1** on page 14 of this paper.

Figure 1 Proposed typical residential water and wastewater bills (\$2022-23)






The proposed price increases are to cover the costs of Essential Water providing water and wastewater services to customers. These price increases would **not** pay for the costs of the Pipeline. Essential Water has requested the NSW Government provide a subsidy to cover these costs, which is discussed below.

^a Price changes proposed by Essential Water have not factored in the impacts of inflation. IPART sets prices to update automatically each year to factor in inflation, based on the Consumer Price Index (CPI). See **Box 1** on page 14 for further details.

^b Currently we assume Essential Water wastewater customers discharge 90 kilolitres of wastewater into the wastewater system. Essential Water has investigated this assumption and estimates its customers actually discharge around 110 kilolitres on average. To better reflect this higher usage in prices while supporting affordability, Essential Water proposes customers should pay the cost of discharging 100 kilolitres a year (Essential Water, [Essential Water Pricing Proposal](#), June 2021, p 10). This change increases residential wastewater prices by around 3%.

While Essential Water has proposed price increases, it recognises that affordability is a key issue for its customers.⁵ We are interested in hearing from you about how we should look at setting prices that are affordable for people in the Broken Hill region. For example, we may consider the following factors:

 <p>Broken Hill is ranked in the lowest 10% of communities in NSW for socio-economic disadvantage</p>	 <p>Residential water and wastewater bills typically comprise 2.5% of household income in Broken Hill</p>	 <p>Broken Hill's population is decreasing by around 1% each year</p>
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Seek Comment



1. Setting prices that customers can afford is a key concern for this review. What are the factors should we consider to ensure the prices we set are affordable for customers?

The same price increases could apply to mining customers

Essential Water has proposed to increase prices for mining customers by around 2% a year on average, the same rate for household and other customers. It has also proposed maintaining the current price structure for mining customers.⁶ This means mining customers would:

- Pay a water usage charge – set at the same rate as other customers for treated and untreated water.
- Pay a fixed charge – based on the share of Essential Water's revenue that comes from mining customers.⁷ We last updated this information in 2014 and so it may not reflect current information.⁸

As part of this review we will need to consider if proposed prices reflect the impact mining customers have on Essential Water's costs. We plan to look at how their share of water use compares to other customer groups and whether this has changed since our last review.

Seek Comment



2. What factors should we consider to ensure prices for mining customers reflect a fair share of costs and are affordable?

Chlorinated and some untreated water prices could increase at a higher rate

In our last review we recommended gradually increasing the price for chlorinated customers in Silverton and Sunset Strip, as well as untreated water customers on the Stephens Creek and Umberumberka pipelines. We considered these prices should eventually be the same as those paid by Broken Hill customers for untreated water, since the cost of supplying them is similar.⁹

To make prices the same, Essential Water has proposed higher price increases for these customers:



Seek Comment



3. What do you think about the proposed price increases for chlorinated and untreated pipeline water customers?

Essential Water has proposed the NSW Government pay a larger subsidy to keep prices affordable

NSW taxpayers currently subsidise water prices in Broken Hill to offset the significant cost of building the Pipeline.

When we set prices for Essential Water in 2019, the NSW Government committed to subsidising Essential Water's prices for four years, so prices would not increase as a result of the Pipeline.¹⁰ Essential Water indicates there is not a clear commitment on this subsidy after 30 June 2023.¹¹

While any decision about the subsidy will ultimately be made by the NSW Government, we expect it will continue to provide some form of subsidy for this next pricing period. Therefore, we plan to consult with stakeholders and provide a recommendation to the NSW Government about what costs to include in the subsidy.

Essential Water has proposed NSW taxpayers fund an expanded subsidy of around \$27 million a year over the next 5 years to keep prices affordable.¹² This is around \$3 million a year more than the subsidy the NSW Government currently provides. The expanded subsidy would comprise:

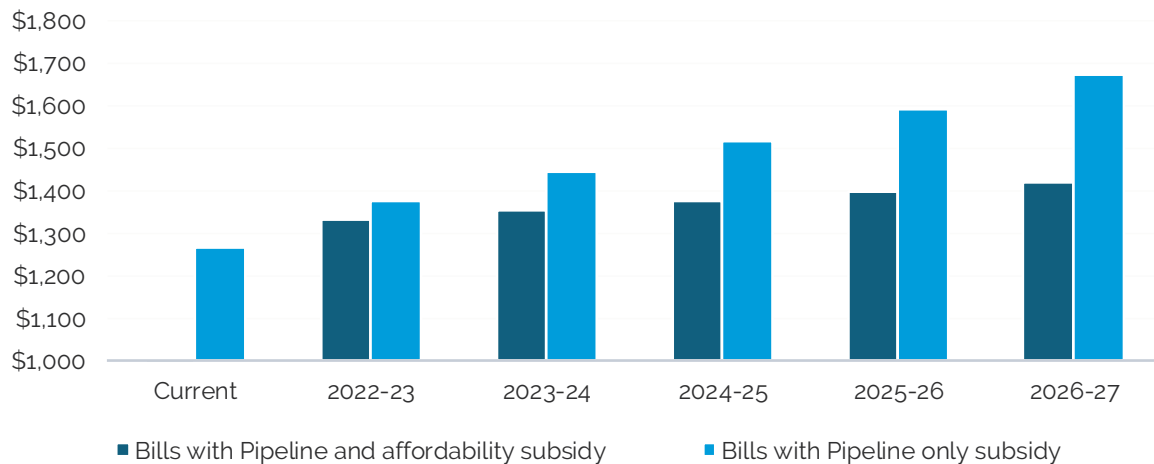
- The existing infrastructure component, covering Pipeline costs.
- A new affordability component, covering some of Essential Water's other costs.

While Essential Water's Pipeline costs are decreasing, it has proposed a larger subsidy to cover more of its other costs

An expanded subsidy would limit bill increases

Under Essential Water's proposal for an expanded subsidy, typical residential water and wastewater bills would increase by around 2% a year on average.¹³ If the NSW Government maintains the current approach and only subsidises Pipeline costs, bills would increase by around 6% a year on average (see **Figure 2**).

Figure 2 Impact of expanded subsidy on residential water and wastewater bills



Source: IPART analysis.

Essential Water has proposed applying the expanded subsidy equally to all customers, including businesses and mines. Targeting an expanded subsidy to specific customers may better address affordability concerns. For example, the subsidy's components could apply to different groups:

- Infrastructure (Pipeline costs) – all customers, including businesses and mines.
- Affordability (other Essential Water costs) – all residential customers. Alternatively, this component may only cover these costs for low income customers (e.g. those receiving income support payments, such as pensions or unemployment benefits).

At this stage, the NSW Government has not committed to expanding the scope of the subsidy when it expires on 30 June 2023. We note the NSW Government frequently provides funding to regional water utilities to build new infrastructure.¹⁴ However, it does not normally provide ongoing subsidies to make water prices more affordable (other than pensioner rebates).^c

If we are to recommend an expanded subsidy, stakeholders need to demonstrate the subsidy is targeted to those who need it the most, and the price increases (without a subsidy) would cause these customers hardship. In our view, Essential Water's proposal did not provide this evidence.

We are interested in your views on what costs to include in our recommended subsidy, and which customers need it most.

Seek Comment



4. Based on current information, bills would increase by about 6% a year if the subsidy is not expanded to include both Pipeline and other Essential Water costs. If this occurs:
 - would bill increases be affordable?
 - how would it impact on household and business customers?
 - which customer groups would be most impacted by bill increases?

Proposed prices are increasing because Essential Water proposes to spend more money supplying services

To provide good quality and reliable water and wastewater services, water businesses need to spend money maintaining and replacing their infrastructure (such as pipes and treatment plants), purchasing water to supply to customers and paying their employees. As discussed above, Essential Water is proposing to increase prices by around 11% by 2026-27. There are two factors causing higher prices, which are:

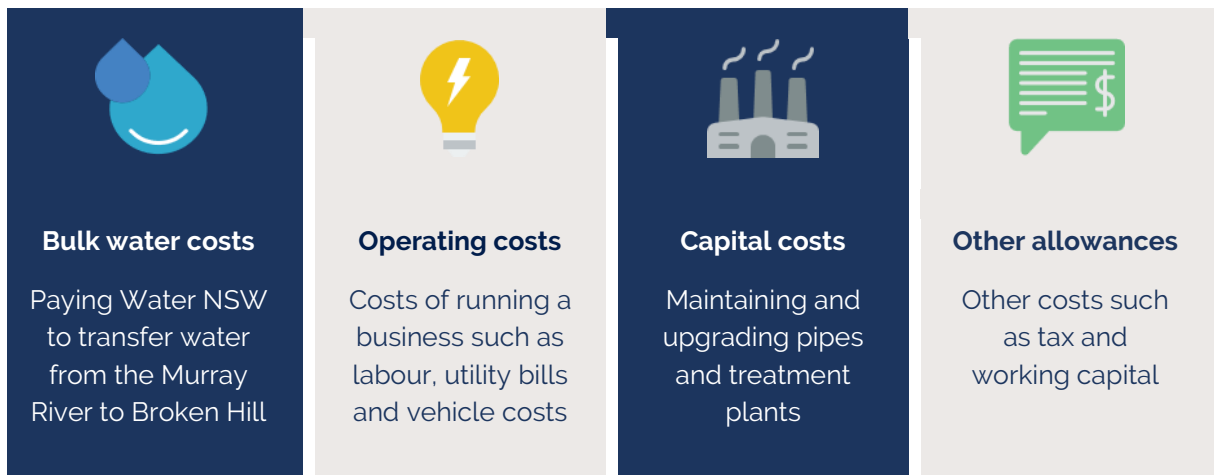
- higher overall costs compared to the last time we set prices¹⁵
- lower water use due to a declining population in the Broken Hill region, which means there are fewer customers to share these costs.¹⁶

When setting prices that represent good value for money for customers, we will look at whether Essential Water's costs are reasonable and no higher than they need to be for both:

- money spent by Essential Water over the last 3 years
- money that Essential Water proposes to spend over the next 5 years.

^c The NSW Department of Planning, Industry and Environment is currently exploring alternative options to this funding model. For more information, please refer to its [Town Water Risk Reduction Program](#).

Essential Water's costs include:



Note: Using IPART's standard building block method, capital costs are recovered over time through depreciation allowance and return on assets. This Issues Paper does not discuss depreciation or return on assets. It also does not discuss other allowances for tax or working capital. For more information, please see Essential Water's pricing proposal.

This Issues Paper focuses on the key costs from Essential Water's proposal that we are seeking your views on.

Repair and replacement of pipes and treatment plants in Broken Hill

Over the next 5 years Essential Water plans to spend around \$180 per customer on upgrades and improvements.^d Although the Broken Hill Pipeline has improved water supply, the pipes and treatment plants that Essential Water owns and manages are relatively old and need to be repaired or replaced. Money that Essential Water spends on these repairs and replacements will be recovered over time through water and wastewater prices paid by customers.

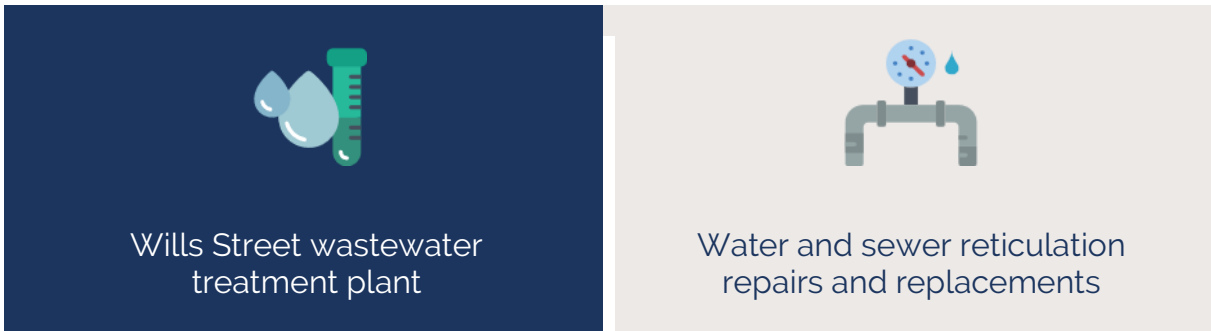
The two largest projects Essential Water plans to do are:

- Replacing the Wills Street Wastewater treatment plant¹⁷ which would cost around \$100 per customer over the next 5 years^e
- Repairing and replacing water and sewer reticulation to prevent main bursts,¹⁸ which would cost around \$30 per customer over the next 5 years.^f

^d This includes all capital costs included in Essential Water's pricing proposal such as IT and capitalised overheads. \$180 per customer is based on cost information submitted to IPART by Essential Water and IPART calculations.

^e Based on cost information submitted to IPART by Essential Water and IPART calculations.


^f Based on cost information submitted to IPART by Essential Water and IPART calculations.



To help us understand whether these projects are important to you we want to know what you think about the quality of Essential Water’s water and wastewater services. For example, service quality can include the number of water main breaks, bursts and leaks, and sewer breaks and chokes that occur in the community. We will consider your views on quality in deciding how much money Essential Water needs to spend to meet your service expectations.

For more information on some of the smaller projects Essential Water plans to do please see Essential Water’s proposal.

Seek Comment

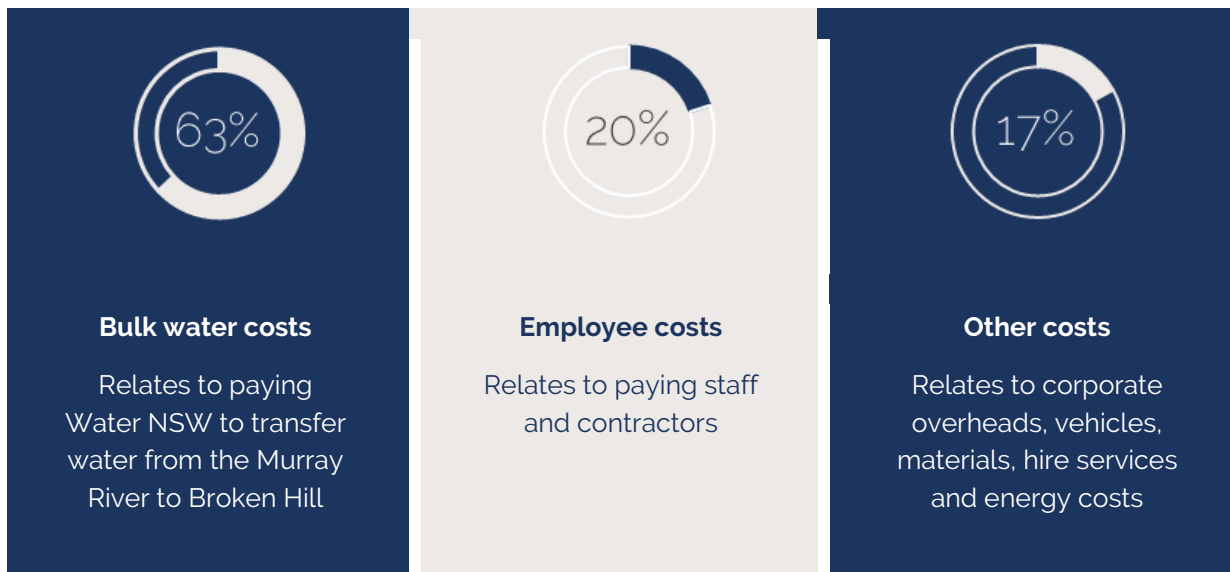
 5. Tell us what you think about Essential Water’s service standards for water and wastewater. What does good quality service mean to you?

Operating costs are increasing

Essential Water expects that its operating costs will increase.¹⁹ These costs include buying water from the Pipeline to supply to customers, paying employees, utility bills and vehicle costs.

Figure 3 shows that around two thirds of Essential Water’s proposed operating costs relate to buying water from the Pipeline to meet water demand in the Broken Hill region. Since the Pipeline came into use, Essential Water has sourced almost all water from the Pipeline, rather than its own water storage sources. For example, Essential Water indicated that it sourced about 1.5% of water from Stephen’s Creek due to the drought.²⁰ To understand if sourcing almost all water from the Pipeline gives customers good value for money, we want to know if you have noticed any improvements in water quality since the Pipeline came into use.

Figure 3 Essential Water's proposed operating costs



Source: IPART analysis.

Seek Comment



6. Have you noticed any changes in water quality since the completion of the Pipeline in 2019?

The remaining third of Essential Water's operating costs relate to its direct costs such as paying employees, corporate overheads and other costs (such as vehicle costs). Essential Water is a large employer in the Broken Hill community and so it faces some challenges in lowering employee costs.⁹ Essential Water also plans to spend more money on vehicles to upgrade its fleet and improve safety.

Overall, Essential Water expects to spend less money on buying water from the Pipeline since the cost of water from the Pipeline is decreasing, but expects to spend more on its direct costs.²¹ We will look at the operating costs Essential Water has proposed to ensure they are reasonable and no higher than they need to be.

Proposed prices are also increasing because Essential Water expects water use to decrease in Broken Hill

Once we have decided if Essential Water's costs are reasonable, to set prices we will divide those costs by the amount of water we expect people in Broken Hill to use over the next 5 years. Our expectations about water use need to be reasonably accurate so that prices generate enough money to cover costs.

⁹ For example, in 2019 Essential Water received a direction from the NSW Government preventing forced or voluntary redundancies for 12 months. See [Essential Water Pricing Proposal](#), June 2021, p 8.

Essential Water expects water use to continue to decrease over the next 5 years (see **Figure 4**). It also expects no changes in the amount of water used by commercial and industrial business customers (such as mining customers). In our 2019 review we considered that people in Broken Hill would use more water once the Pipeline came into use and water restrictions were lifted. However, over the last 3 years people have used less water than we predicted.²²

Figure 4 Comparison of historical and proposed water consumption



Source: IPART analysis.

There may be many reasons why households and businesses are using less water than we expected, for example:

- the declining population in Broken Hill may result in a declining number of people per household which could lower the total amount of water used per household
- households and businesses may use less water to manage their water bills and keep them affordable
- people may be using more water efficient appliances (e.g. shower heads, washing machines) or conserving water for environmental reasons.

While using less water can be good for the environment, in Broken Hill it is particularly important to encourage people to use water to reduce exposure to lead. Tasks that involve using water (such as frequently wash hands, cleaning with damp cloths and growing plants to cover bare soil)²³ can reduce lead exposure, providing health benefits to the community. For this review, we want to understand how you use water to make sure the prices we set:

- encourage people in Broken Hill to continue doing activities that reduce exposure to lead
- generate enough money to cover costs.

Seek Comment



7. What affects how you use water? Why might you be using less or more water? For example:

- has the Pipeline changed how much water you use?
- do you use water to reduce lead exposure to protect your health?
- have you been using more water since water restrictions in Broken Hill were lifted?
- do you use less water for environmental reasons such as climate change?
- has the COVID-19 pandemic affected the way you use water?



8. If you are a commercial or industrial customer, are you expecting a change in your water use in the future? If so, how much more or less water would you expected to use over the next 5 years? How certain are you with this change?

We may set Essential Water's prices for a longer period

We will need to consider how long the prices we set should apply for, as there are both benefits and risks in setting prices for a longer period. In our last review, we set Essential Water's prices for 3 years. Since then, the Pipeline has been in use and Essential Water considers its operating conditions have become more stable, allowing it to forecast water use and costs with more certainty. It has proposed that prices from 1 July 2022 should apply for 5 years.²⁴

We see the following benefits in setting prices for 5 years:^h

- It locks in prices for longer, so customers can budget their future bills.
- It provides funding certainty for Essential Water, so it can better plan its projects.
- It encourages Essential Water to lower its costs, which will benefit customers through lower prices in future periods.

However, a long pricing period also creates some risks:

- If Essential Water's forecast water sales differ from its actual sales, the prices we set may turn out to be higher or lower than Essential Water needs to cover its costs.²⁵
- If unexpected costs arise during the pricing period, Essential Water may not be able to cover them through its existing prices.

^h We are currently reviewing the way we regulate water businesses and set prices. As part of that review, we are seeking feedback on moving to a 6-year determination period, with a formal 'health check' at the 3-year mark. For further information, please refer to our [Discussion Paper](#) on encouraging innovation in the water sector. Since we will not finalise the regulation review until 2022, we are not looking to bring in a 6-year determination period for the Essential Water review.

If some unexpected costs arise, Essential Water proposes to recover them from customer bills

Essential Water wants to reduce the risks it faces from a longer pricing period by setting out specific events that would allow it to increase its prices. If these specific events occur, Essential Water proposes to 'pass-through' any unexpected costs to its customers.²⁶ These specific events include:

- Changes to its regulatory environment, taxes or service standards
- Natural disaster or terrorism events
- Issues with its insurance coverage or an insurer becoming insolvent.ⁱ

Essential Water considers this will allow it to recover the costs of events beyond its control.



Essential Water's cost pass-throughs increase its customers' exposure to risk and may lead to price increases if certain events arise

These cost pass-throughs are similar to measures other water businesses have requested in recent pricing reviews, which we did not allow. At this stage, Essential Water has not provided us with new information which would appear to change our position from previous reviews.

Allowing costs that are so unknown to be passed through unconditionally would create poor incentives for the businesses – they are assured of cost recovery regardless of their actions. Customers risk paying too high a price for an event that is vastly different to what was expected when the pass-through was allowed.

The risk of unexpected events occurring is not new. Rather than implementing cost pass-throughs, it is important for Essential Water to manage these risks through planning for regulatory changes, insuring against risks where possible and taking actions to limit the impact of events if they occur.

If an unexpected event does have a large negative impact on Essential Water's financial position, it may be more appropriate for it to request an early price review.

Seek Comment



9. Should we set Essential Water's prices for 5 years?



10. Do Essential Water's cost pass-through events place too much risk on customers?

ⁱ Essential Water has also requested an adjustment to its prices if we allow any cost pass-throughs requested by Water NSW for the Pipeline. We discuss these cost pass-throughs in a separate [Issues Paper](#).

We will consider your views in our price review for Essential Water

We are seeking submissions to this Issues Paper from all interested stakeholders by 22 October 2021. Page ii at the front of this document explains how to make a submission. In March 2022 we will release a Draft Report with our draft prices for Essential Water. In setting draft prices we will consider stakeholders' submissions and responses to the questions in this Issues Paper (see list below), and the results of our analysis of Essential Water's proposal. All stakeholders, including Essential Water, will have another opportunity to provide comments on our draft prices and participate in our public hearing.



Seek Comment

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Box 1 IPART's approach to converting prices to account for inflation

We conduct the review of Essential Water's prices over the current year (the 2021-22 financial year). Therefore, we present final prices and costs in this financial year's dollars (\$2021-22). However, since the prices we set are for the 2022 determination period and will start applying next year, we will need to inflate the prices to the next financial year's dollars (\$2022-23).

The applicable rate we will use to inflate the prices are based on the March inflation rate (which will be released April 2022). At this point we do not know what the March inflation rate is, so we have assumed it to be 2.5%.

In this Issues Paper, we have presented the prices and bill impacts consistent with the pricing approach that we will use to set prices in the Final Report. That is, current prices are presented in \$2021-22 and future prices (for years 2022-23 to 2026-27) in \$2022-23 (including a 2.5% inflation rate).

Our price increases are different to those presented by Essential Water because in its proposal, Essential Water has restated current prices including the forecast 2.5% inflation rate. This has the effect of removing the impact of inflation between current prices and next year prices (and beyond).

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- ¹³ Essential Water, *Essential Water Pricing Proposal*, June 2021, p 89.
- ¹⁴ NSW Productivity Commission, *Productivity Commission White Paper*, May 2021, p 204.
- ¹⁵ Essential Water, *Essential Water Pricing Proposal*, June 2021, p 8.
- ¹⁶ Essential Water, *Essential Water Pricing Proposal*, June 2021, p 9.
- ¹⁷ Essential Water, *Essential Water Pricing Proposal*, June 2021, pp 48-49.
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