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22 October 2021

2021 Review of Essential Energy's water and wastewater prices
for Broken Hill
Independent Pricing and Regulatory Tribunal

Via online submission

Essential Water submission to the 2021 Review of Essential Energy's water and wastewater prices for Broken Hill

Essential Water welcomes the opportunity to provide feedback to the Independent Pricing and Regulatory Tribunal (IPART) on its Issues Paper ("the paper") for Essential Energy's water and wastewater prices for Broken Hill.

Essential Water's pricing submission was prepared against a backdrop of greater certainty around bulk water use from the Broken Hill Pipeline ("the pipeline"), but also wider socio-economic changes from the COVID-19 pandemic. The Broken Hill community's reliance on a secure water supply is greater than for many other communities, due to the lower rainfall levels as well as the need to limit rainfall collection for issues with lead in the environment and associated health issues. We worked proactively with stakeholders and customers to prepare a proposal that included deferred expenditure on aging critical infrastructure, balanced against affordability issues for the population of Broken Hill.

Expanded subsidy

Setting prices that customers can afford is a key concern for Essential Water. The current pipeline subsidy provided by the NSW Government is not targeted but applied across the entire customer base – the additional affordability subsidy proposed by Essential Water follows that same precedent. Whilst any subsidy is entirely a decision for the NSW Government, without an expanded subsidy, the following outcomes could result:

- Essential Water would be required to reduce expenditure to a level that would result in no bill increases – this will mean reduced service levels, reduced water availability and possibly quality; or
- Customer bills would increase by around 6 percent per year

Essential Water urges IPART to be pragmatic in their assessment on the expanded subsidy. The Broken Hill community relies on our water and wastewater services but is limited in its ability to pay for the required infrastructure overall - not just the pipeline costs. As current population trends continue and maintenance costs increase with asset age, this issue will become even more pressing, with the cost per customer ratcheting up. Essential Water suggests that an affordability subsidy should be included due to the size and nature of the community and infrastructure requirements. Consideration is also needed in relation to the long term ongoing need for subsidisation of water.

We note that any targeting of the affordability subsidy will result in a significant divide in prices paid, between those eligible for a subsidy and those not. The paper outlined two examples of potential targeting of the subsidy; those on low-incomes, or just residential customers. Essential Water will face administrative difficulties with any targeting, but particularly with a subsidy targeted only to those on a low incomes. Customers will need to be able to supply evidence of initial eligibility to Essential Water, but also of continued eligibility for those customers not on permanent government support – that means extra costs for Essential Water to monitor eligibility. There is also the potential for perverse

outcomes with the significant water discount becoming possibly an incentive to remain on low income support longer than necessary.

Whilst the application of higher prices to the cohort of all non-residential customers would be relatively easier to administer, the Broken Hill business community is likely to pass on these higher prices to their customers in various forms – ultimately leading to all customers paying more in the long run. The costs of everyday goods and services in this community are already higher than many other areas in NSW, due to high transportation costs, and lower competition.

If IPART intend to recommend progressing with the targeting of an expanded subsidy, then significant community engagement will be needed as it fundamentally changes the impact on subsets of customers, from that proposed by Essential Water.

Longer review period

Essential Water proposed a longer review period of five years, which aligns with that also proposed by Water NSW in their pricing submission. The current regulatory period of three years is too short a time to show any progress against a determination, particularly when preparation for the next review begins close to two years in advance. We note that IPART is reviewing its regulatory framework for water, with a view to setting a standard six year price review term (with a mid-period check). A longer period of time between reviews is welcome, as it reduces regulatory costs and ensures the business can focus on delivering anticipated outcomes for customers.

Cost pass-throughs

With a longer term, however, comes a higher risk that the external environment changes significantly from forecasts used to set prices/revenue. The ability to pass through higher or lower costs of genuinely unforeseen, material, external events, that may impact a business over the longer price review period, is very important and is in the long term interests of customers. The Australian Energy Regulator (AER) uses cost pass-through events included in the National Electricity Rules. Any use of a cost pass-through, however, is based on:

- a specific approved event occurring
- the additional associated costs being material (such as a 1% variance to allowed revenue for a year)
- thorough assessment of the costs being claimed, to ensure that they are only related to the event and have been prudently and efficiently spent.

The AER review the application and only approve the values that it considers reasonable and justified – there is no assurance of cost recovery regardless of the utility's actions.

Essential Energy has recent experience of this. The 2019-20 NSW bushfires will cost the electricity business \$75 million. This amount has been claimed as a cost pass-through, as 'natural disaster' was an approved event in our 2019-24 determination. We had to prove it was material - we spent nearly 6 percent of the 2019-20 revenue allowance in responding to the event and restoring the network. From an insurance point of view, the poles and wires are not insured due to difficulty in sourcing coverage – this is consistent with other distributors. The cost pass-through mechanism allows the possible cost of an event to be recouped, only if it occurs. This compares to the certainty of customers paying excessive insurance premiums built into much higher network charges. The AER has stated that it considers that this type of risk trade-off decision making to be prudent and efficient.

IPART's paper does not reflect on the symmetrical nature of a cost pass-through mechanism, which works for events that could result in price increases or price decreases. An example of where a price decrease could be passed through, could be the abolition of, say, a payroll tax.

Essential Water suggests that if IPART does agree to include any cost pass-through events, that any subsequently claimed and approved value should be included as part of a true-up in the next regulatory period, to eliminate intra-period price changes. We refer to our 18 October 2021 submission to IPART on Encouraging Innovation for further discussion on the use of cost pass-throughs for risk mitigation.

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Essential Water is happy to discuss these issues further. Please contact our Network Regulation Manager, [REDACTED].

Yours sincerely

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