

Thank you for the opportunity to respond to the consultation paper on the way utilities estimate their Long Run Marginal Cost (LRMC).

We preface this review in the context of our next Price Review. We are implementing an ambitious agenda of changes to the way we do business and investigating a range of regulatory innovations for our customers. Together with the breadth of changes in IPART's new regulatory framework, this agenda will pose significant challenges. Notably, we are putting the customer at the centre of everything we do. Customer engagement will form the lens through which our business plan and proposals will proceed. Consequently, we will be testing our proposals with customers to understand and apply their preferences. With respect to pricing, we intend to test innovations such as water conservation pricing and other efficient pricing arrangements, revenue caps, and long-term pricing. One potential result of co-designing innovations with customers is that their preferences may diverge from traditional concepts. It is within the context of customer engagement and implementation of the ambitious reform agenda that we query whether changes to the way we estimate LRMC will add further complexity to an area we have historically believed to be fit for purpose.

In addition, IPART's 3C's framework encourages utilities to demonstrate their sophistication and maturity through their understanding of costs (including LRMC), and how they seek and embed customer feedback into the business' decision-making. If IPART were seeking consultation on their proposed LRMC methodology to prescribe an identical approach for all utilities, this may be inconsistent with the flexibility that forms part of its objectives under the 3Cs model. Therefore, we consider this new LRMC methodology should be used as guidance and adopted at the discretion of utilities.

With regards to the technical aspects of IPART's proposal, we consider a single formula is difficult to apply given the range of practical issues involved:

- IPART's methodology implies that augmentation options must be assessed in order of least-cost and that doing otherwise would overstate LRMC. In principle, we agree. However, we are unclear what this implies for supply augmentations that are prioritised for reasons other than contribution to yield in the context of a large network. For example, building an Illawarra Desalination Plant may be more costly per ML than expansion to the Sydney Desalination Plant, but may be prioritised for water security considerations.
- In our 2020 Price Review, some of the portfolios we used to estimate LRMC did not provide sufficient yield to meet demand. This required either ending the analysis period early or having a supply gap towards the end of the analysis period. As IPART recognises in this review, this could bias LRMC. However, the shortage of well-costed options is not a problem inherent to the methodology and models we use. Rather, it is a problem with the available inputs. We are unclear whether IPART's methodology combining the available augmentations adequately solves for this issue.

Furthermore, we already address some of the purported issues IPART raises in its paper:

- We understand that IPART's methodology aims to overcome a purported bias where future supply benefits are truncated for investments made towards the end of the analysis period. Our current approach involves annuitising the costs of supply augmentation options such that the model captures an equal fraction of the lifetime costs of that investment and the lifetime supply it contributes to system yield. We consider this

approach avoids the bias IPART alludes to.

- Like IPART's proposal, our current approach makes an adjustment for the difference between the commissioning of the asset (when annuitised costs begin) and the contribution to system yield. We do not consider there is an issue with our current approach with respect to this.

We are also investigating a range of the other pertinent marginal cost (including LRMC) issues. We look forward to engaging IPART on our findings and proposals in our 2025 Price Review. Please let me know if you would also like a letter submitted to this effect.

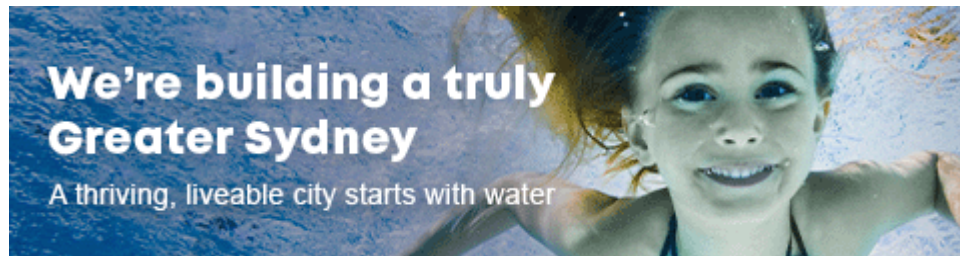
Kind regards,

Flavio

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Sydney Water respectfully acknowledges the traditional custodians of the land and waters on which we work, live and learn. We pay respect to Elders past and present.

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