

9 December 2024

Ms Carmel Donnelly
Chair IPART
PO Box K35
Haymarket Post Shop NSW 1240

Dear Ms Donnelly

Thank you for the opportunity for WaterNSW to provide a written response to the two IPART Issues Papers relating to the current round of WaterNSW bulk water and Water Administration Ministerial Corporation (WAMC) reviews (the WaterNSW Rural Valleys and WAMC 'rural' Issues Paper and the WaterNSW Greater Sydney and Sydney Water 'metro' Issues Paper) for new pricing from 1 July 2025.

Since the Issues Papers were released, public forums have occurred for our Rural Valleys and Greater Sydney bulk water services as well for WAMC, with many of the issues raised having been discussed with our customers, community members and other stakeholders.

While the Issues Papers generally reflect a fair summary of our pricing proposal, there are a small number of matters that WaterNSW would like to bring to the Tribunal's attention. One relates to how our recent operating model changes have been the most efficient response to a changing regulatory and macroeconomic landscape. Another relates to the challenge of considering customer affordability in the final determination while also ensuring WaterNSW remains financially sustainable moving forward.

These and other matters are summarised in Appendix 1.

Yours sincerely,

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WaterNSW comments on IPART's 1 November 2024 Issues Papers: WaterNSW Rural / WAMC and WaterNSW Greater Sydney / Sydney Water

Our operating model is the efficient response to increasing regulatory and legislative obligations

On page 15 of the metro Issues Paper, IPART states that one of the key drivers of the proposed cost increase is *"Costs associated with the implementation of a new operating model. The change resulted in an overall increase in employee numbers and salary and wage expenditure. WaterNSW submits that the overall impact of the change will lead to lower costs below the level it would have been under its original model"*.

WaterNSW would like to clarify that the drivers of increased costs for our business have been meeting our regulatory and legislative obligations – both new and existing – and changes in macroeconomic factors. Our operating model is not the driver of increased costs; rather, it is the efficient response to meeting our obligations at lowest sustainable cost. As correctly noted by IPART, in the absence of the operating model changes we maintain that our underlying costs would have been higher, resulting in further upward pressures on prices.

Customer affordability

During our customer and stakeholder engagement on our pricing proposal over the past 20 months, WaterNSW has consistently and transparently highlighted the lowest sustainable costs to meet our regulatory obligations and customer commitments. Customers have told us that if the higher costs are fully passed through to customers in the form of higher prices, it would introduce affordability concerns for many segments of our customer base.

WaterNSW acknowledges that after applying the IPART building block model to our lowest sustainable cost reflective base case, the bill impacts are significant. WaterNSW does not suggest that the modelled bill impacts are acceptable, nor are they proposed.

To help address issues of affordability, while at the same time ensuring we remain financially sustainable, WaterNSW outlined three alternative scenarios in addition to our complying cost reflective base case for our rural customers for IPART's consideration to help balance these potentially conflicting concepts.

The three alternative scenarios recognise that, in a high inflationary and cost of living environment, all stakeholders may need to absorb some level of cost or price adjustment, without a significant increase in borrowings for WaterNSW, which would create risk to our financial sustainability. These scenarios present the basis upon which a 'balanced' outcome may be found.

WaterNSW recognises the challenge that the current economic and fiscal environment presents in determining fair and affordable charges for customers, within the current economic regulatory framework.

This is why we recommend that IPART, having strong regard for our customers' feedback and submissions on this proposal, engage jointly with WaterNSW and the NSW Government in an effort to collaboratively work towards finding the right balance when setting future rural bulk water charges.

Balancing the potentially competing objectives of financial sustainability and affordability will require IPART to assess:

- What are the lowest sustainable costs and what is financially sustainable for WaterNSW?
- What can our customers afford (recognising the complexity in distinguishing homogenous customer segments amongst our customers, or within valleys)?
- What is appropriate for the NSW Government (as both our Shareholder and a customer)?

The three alternative scenarios reflect reductions to our cost reflective base case and may, after further engagement with IPART and the NSW Government, guide IPART in how to achieve a more equitable balance between stakeholders.

IPART has bundled our proposed rural bulk water charges with WAMC charges

In its rural Issues Paper, IPART has combined the proposed rural bulk water and WAMC charges into a single set of price impacts. While we acknowledge that rural 'regulated' customers incur both bulk water and WAMC charges (i.e. regulated customers), 'unregulated' and 'groundwater' WAMC customers do not receive bulk water charges.

Therefore, while there is merit in combining the price impacts, there is also risk it may lead to confusion for customers over understanding the impact of another set of price impacts. WaterNSW suggests that, if bill impacts are combined in the draft and final determinations, that separate bulk water and WAMC impacts are also separately shown for clarity and transparency.

We also suggest that, in the final determination, IPART separately presents the approved costs of each WAMC organisation and identifies where any adjustments have been made to the respective business's proposed expenditures. This will enable customers to assess the total costs of providing WAMC services

and the costs and efficiency of each organisation in providing WAMC services as well as enable reporting of any differences between actual expenditures and regulatory allowances moving forward.

Revenue cap is a fair and equitable approach to manage volume volatility

Over the past 20 months, WaterNSW has engaged extensively with our customers, through our Customer Advisory Groups, large customers and environmental customers on the form of control and tariff structures.

Challenge - our costs are approximately 95% fixed but most rural valleys only pay 40% fixed charges (80% in Greater Sydney). This creates volume risk and revenue volatility when actual water usage differs from regulatory forecasts. This volume risk is not good for customers or WaterNSW.

Solution - Supported by customer feedback, WaterNSW proposes a revenue cap for nine rural valleys with a 5% pricing side constraint (2% for Sydney Water) that applies to fixed and variable charges (not only variable as suggested in the Greater Sydney metro Issues Paper). Environmental water holders are proposed to move to fully fixed charges, with Lachlan Valley to move to 80% fixed charges.

We discussed two broad options with customers for managing volume risk:

- Keep the current form of control (price cap) with higher fixed charges
- Move to a revenue cap and maintain the fixed portion of charges for most customers. A side constraint to help manage pricing volatility, based on customer feedback, has been added as a design feature.

Our engagement identified that the status quo is not sustainable. Based on our customer survey responses:

- 66% of survey respondents think there is a problem with how prices are currently set
- 86% of those surveyed are in favour of a revenue cap with a side constraint
- There is some interest in exploring a regional approach to pricing

In the rural Issues Paper, IPART asks whether the customer survey should be relied on to inform discussion on the form of control given the relatively small number of responses. Customer surveys were only one part of our overall engagement process, the outcomes of which are consistent with what we've heard consistently through our extensive engagement on the form of control and tariff structures over past 20 months.

WaterNSW would also like to draw the Tribunal's attention to Question 20 in the rural Issues Paper:
"Would you prefer prices to remain stable over the determination period or do you support WNSW's

proposal for a revenue cap where prices adjust by up to 5% per year in response to changes in water sales?.

WaterNSW considers that the 'Hobson's' choice provided in IPART's question does not provide the full context for what we have discussed with our customers to address volume risk. While the current price cap would indeed ensure prices remain stable over a determination period, it necessarily (except where actual water usage exactly matches the forecast usage in the determination) results in an over- or under-recovery of revenue.

Our customers have consistently told us that WaterNSW should have the opportunity to recover its efficient costs (as set by IPART in the determination), no more and no less. WaterNSW recovering more than the regulatory allowance suggests customers are paying too much for regulated services, while recovering less suggests WaterNSW may not receive sufficient funding to meet its obligations, putting pressure on service delivery.

A form of control that allows WaterNSW to earn considerably more or less than the regulatory allowance (as is the case with the current price cap with no adjustment mechanism for demand volatility) is therefore not in customers' long-term interests.

Customers also told us that a pure revenue cap that could result in potentially large pricing increases or decreases within a regulatory period, was not acceptable – this feedback led directly to WaterNSW proposing to introduce a 5% pricing side constraint to the revenue cap in the rural valleys to help address concerns over pricing volatility. Customers told us that including a 5% pricing constraint appeared reasonable in addressing this risk.

Therefore, IPART's question may inadvertently have been phrased in way that could lead to responses from stakeholders that are inconsistent with what we heard over the last 20 months that our proposal is a more effective way to manage volume risk than the current price cap with no demand volatility adjustment.

WaterNSW bulk water costs as a proportion of Sydney Water's total costs

In its metro Issues Paper on page 13, IPART states that "*Around 17% of Sydney Water's proposed operating costs relate to buying bulk water from WaterNSW*". While that proportion appears correct based on the total costs in the respective WaterNSW and Sydney Water pricing proposals, WaterNSW notes that the composition of our bulk water costs – which is a combination of capital and operating investments – suggests that the more relevant comparison is total WaterNSW Greater Sydney bulk water costs as a proportion of total Sydney Water costs as measured by the total revenue requirement.

On this basis, WaterNSW's proposed bulk water costs represent approximately 8.5% of Sydney Water's total costs which remains largely consistent with the current determination. As stated in our pricing proposal, WaterNSW's proposed costs for Greater Sydney result in an increase of \$0.80 per week for a typical Sydney Water residential customer to support an ongoing reliable bulk water supply over the next five years.