



The Hon. Kevin Anderson MP
Minister for Lands and Water
Minister for Hospitality and Racing

Our ref: B22/2430

Ms Carmel Donnelly PSM
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop NSW 1240

Dear Ms Donnelly

I write regarding the Terms of Reference for Referral of Sydney Desalination Plant Pty Ltd (**SDP**) to IPART under Section 52 of the *Water Industry Competition Act 2006*.

Amended Terms of Reference are attached to this letter.

Greater Sydney Water Strategy

The final Greater Sydney Water Strategy (GSWS) has been approved by Government and will be published in the coming weeks. The Strategy charts the long-term vision and direction for delivering sustainable and resilient water services to Greater Sydney, including the Illawarra and the Blue Mountains, for the next 20 years.

The Strategy provides for an amended operating regime for the Sydney Desalination Plant (**Plant**) to optimise its contribution to the overall system resilience including water supply security, drought management and operating flexibility. In future, the Plant will operate on a flexible basis (including with respect to the volume of water produced) rather than only at full capacity during periods of drought, in line with a Decision Framework currently being developed by Sydney Water for my endorsement.

I encourage the Tribunal to work with stakeholders to consider the implications of the new operating regime, with a view to creating a pricing framework that is in the long-term interests of customers and consistent with the Decision Framework and need for a more flexible operating regime.

The principles under which SDP is expected to operate include:

- That the Plant provides a minimum baseload volume each year to achieve the desired performance set out below
- That the Plant can respond to shocks in the network, as required by the agreements between SDP and Sydney Water
- That the volume of water produced by the Plant can be varied as needed (in line with the Decision Framework) to support the resilience of the system, including slowing down dam depletion during droughts and keeping dam levels higher when needed, but also to be decreased when dam levels are high in order to minimise the risk of spills and maintain cost effectiveness.

Energy adjustment mechanism

As has been the case for the previous price determinations, I note for clarity that the intention of the proposed energy adjustment mechanism (which includes an efficiency gains and losses carryover mechanism to accommodate significant gains and losses associated with the sale of surplus electricity and Renewable Energy Certificates (**RECs**)) is to ensure that SDP customers for water (in Sydney Water's Area of Operations) receive the benefit of significant gains and bear significant losses incurred

as a result of the difference between the cost of electricity and RECs under SDP's contracts with Infigen (now Iberdrola Australia) and the market price for electricity and RECs arising from the sale of SDP's surplus electricity and RECs.

For electricity, the mechanism would mirror the 'Calculation of Shortfall Adjustment' in SDP's Electricity Supply Agreement with Infigen (now Iberdrola Australia), with the 'market price' defined as the half-hourly spot price and/or the price of a contracted 'available block'.

For RECs, the 'market price' would be the price shown in the Nextgen Greenroom Report, or another equivalent report.

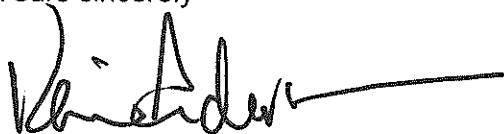
I note also that:

SDP is required by its Project Approval 05_0082 (as modified) to implement a greenhouse gas reduction plan, which incorporates the long term electricity and REC arrangements between SDP and Infigen (now Iberdrola Australia) that were entered into at the time of developing the Plant.

SDP did not know that it would be asked to operate the plant in accordance with the new operating regime when entering into those agreements with Infigen.

I ask that IPART have regard to the points above in making its price determination.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Kevin Anderson', with a long horizontal flourish extending to the right.

The Hon Kevin Anderson MP
Minister for Lands and Water
Minister for Hospitality and Racing

Date:

16.6.2022

Terms of Reference for Referral of Sydney Desalination Plant Pty Limited to IPART under Section 52 of the Water Industry Competition Act

Background

On 29 June 2010 Sydney Desalination Plant Pty Limited (**SDP**) was granted a network operator licence in relation to the *desalination plant*. The Minister for Finance and Services has, under section 51 of the Water Industry Competition Act 2006, declared that SDP is a monopoly supplier in relation to the water supply services it provides under its network operator licence.

SDP is the only supplier of non-rainfall dependent drinking water in New South Wales. Currently, the primary purchaser of drinking water supplied from the desalination plant is Sydney Water Corporation. Sydney Water Corporation purchases bulk water from two main sources, WaterNSW and, since its commissioning, the *desalination plant*.

The Greater Sydney Water Strategy (GSWS) charts the long-term vision and direction for delivering sustainable and resilient water services to Greater Sydney, including the Illawarra and the Blue Mountains, for the next 20 years. The GSWS replaces the 2017 Metropolitan Water Plan. The *desalination plant* is a key element in Sydney's water security plan and the Greater Sydney Water Strategy.

The GSWS provides for an amended operating regime for the Sydney Desalination Plant (**Plant**) to increase its contribution to water supply security and drought management, and not only as a drought-response service. A Decision Framework is being developed by Sydney Water for my endorsement and will guide the flexible operating approach. It adopts a principle-based approach aimed at enhancing resilience and is intended to remain adaptive to the changing circumstances and needs across Sydney Water's network. As part of IPART's review of SDP's network operator's licence, reference to the Decision Framework in the licence will provide additional information about the intended operation of SDP, and will be consistent with the Government's objectives stated in the GSWS.

Prices set by the Independent Pricing and Regulatory Tribunal (IPART) should therefore reflect the water supply services provided by SDP set out below:

- (a) the supply of non-rainfall dependant drinking water to purchasers (noting the potential range and variation of production required under the Decision Framework) and
- (b) the making available of the *desalination plant* to supply non-rainfall dependant drinking water.

Matters for consideration - pricing principles

Unless indicated otherwise each *price determination* is to be consistent with the following pricing principles:

1. Maximum prices should be set so that expected revenue generated will recover the efficient costs of providing the services described at (a) and (b) above over the life of the assets. Costs include operating costs, a return on the assets and return of assets (depreciation).
2. In calculating the return on invested assets:
 - i. The rate of return (or Weighted Average Cost of Capital) should reflect the commercial risks faced by the asset owner in providing the services.
 - ii. IPART should determine an appropriate opening asset value.
3. Return of assets (depreciation) is to reflect the economic lives of the assets.

4. The structure of prices should encourage SDP to be financially indifferent as to whether or not it supplies water. As such the structure of prices should comprise separate charges for the different water supply services described at (a) and (b) above.
5. The amount of any adjustments under the mechanisms in principle 8 should each be separately quantified and published by IPART.
6. The charges for water supply services in (b) above should be a periodic payment and should reflect fixed costs including, return on assets, return of assets, and the fixed component of operating costs. SDP is to be entitled to charge for providing the water supply services in (b) above irrespective of levels of water in dam storages servicing Sydney or availability of water from other sources.
7. The charges for water supply services in (a) above should reflect all efficient costs that vary with output, including variable energy, labour costs, and maintenance costs.
- 7A. The SDP Project Approval under former s 75J of the *Environmental Planning and Assessment Act 1979* (05_0082) required the development of a greenhouse gas reduction plan (**GGRP**), to be approved by the Director-General, prior to the commencement of operation of the plant. The GGRP details a strategic plan for the management, minimisation and off-set of greenhouse gas generation associated with electricity supply for the plant. As part of the approved GGRP, certain contracts were entered into with Infigen (now Iberdrola Australia) to acquire electricity and RECs (**GGRP Contracts**). The price determination should consider SDP's ability to recover all costs it incurs in complying with the GGRP and the GGRP Contracts other than costs related to surplus energy in relation to which the energy adjustment mechanism described in paragraph 8 (iii) applies.
8. For each *price determination* other than the first price determination:
 - i. SDP should be allowed to carryover demonstrated efficiency savings, net of efficiency losses, in operating expenditure in providing the water supply services specified at (a) and (b) above for a period of 4 years following the year in which the efficiency saving was achieved.
 - ii. In calculating the notional revenue requirement, IPART should determine the demonstrated efficiency savings and treatment of energy gains or losses in accordance with the Methodology Paper; and
 - iii. A mechanism(s) is required to allocate the costs or benefits to SDP customers (in Sydney Water's area of operation) of actual gains or losses beyond a core band that result from the difference between SDP's costs of electricity and RECs under its contracts with Infigen (now Iberdrola Australia) and revenues from the sale of surplus electricity and RECs. The mechanism would only operate at times when SDP complied with its requirements to maintain and operate the desalination plant under clause A2 of its network operator licence.
9. Any other matters that IPART may consider relevant

Methodology Paper

IPART must publish on its website a methodology paper setting out its approach to implementing pricing principle 8 above (**Methodology Paper**). IPART may update the Methodology Paper from time to time.

Timing

The determination period is to be confirmed as part of the IPART review process. For each successive price determination period, IPART is to make the price determination before the expiry of the current determination period.