

# ESSENTIAL ENERGY'S COST-REFLECTIVE MINES PRICING PROPOSAL

## *Submissions due on 5 November 2013*

IPART has agreed with Essential Energy that its Cost-Reflective Mines Pricing Attachment 8 will be published on our website. Attachment 8, provided by Essential Energy as part of its submission in September 2013, contained information that Essential Energy considered to be commercial-in-confidence. This information has been redacted, and the Attachment is now available below.

Essential Energy's pricing submission proposes that all customers will be paying prices that are cost-reflective, with no subsidy between small customers and the mines. See [page 58 of price submission](#).

If you wish to make a submission on Essential Energy's cost-reflective mines pricing proposal, please do so by 5pm on Tuesday 5 November 2013. We would prefer to receive them electronically via our online submission form [www.ipart.nsw.gov.au/Home/Consumer\\_Information/Lodge\\_a\\_submission](http://www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission).

The following pages are Attachment 8 to Essential Energy's submission to IPART's Review of prices for water and sewerage services to Broken Hill and surrounds, September 2013.

# Essential Energy

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## Cost reflective mines pricing

Briefing: September 2013



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## 1. Overview

A mines agreement was established in 2002 which included the charges for water for mining operations in Broken Hill. The mines agreement expired in 2012, with charges to continue at 2012 levels until new arrangements are in place. An inter-government department working group recommended that mines pricing fall under the jurisdiction of IPART along with general water and sewer pricing for the Broken Hill area of Essential Water.

Essential Energy is proposing that a mines pricing regime be applied to mines operating in Broken Hill for the next regulatory period. The purpose of this document is to explain the methodology upon which this pricing regime is based and set out such information as is necessary to enable IPART to understand the background, basis and derivation of the proposed prices applying to Essential Energy's mining customers in the next regulatory period.

This submission provides the information requested in the following structure:

- Section 1 provides an overview of the requirement to provide a mines pricing regime;
- Section 2 provides a history of Mines revenue;
- Section 3 outlines the proposed mines pricing methodology;
- Section 4 provides an analysis of current charges applied to mines;
- Section 5 provides a summary of replacement cost scenarios considered; and
- Section 6 provides a recommendation.

## 2. Background of mines review

The following timeline of events provides background to the history of mines revenue:

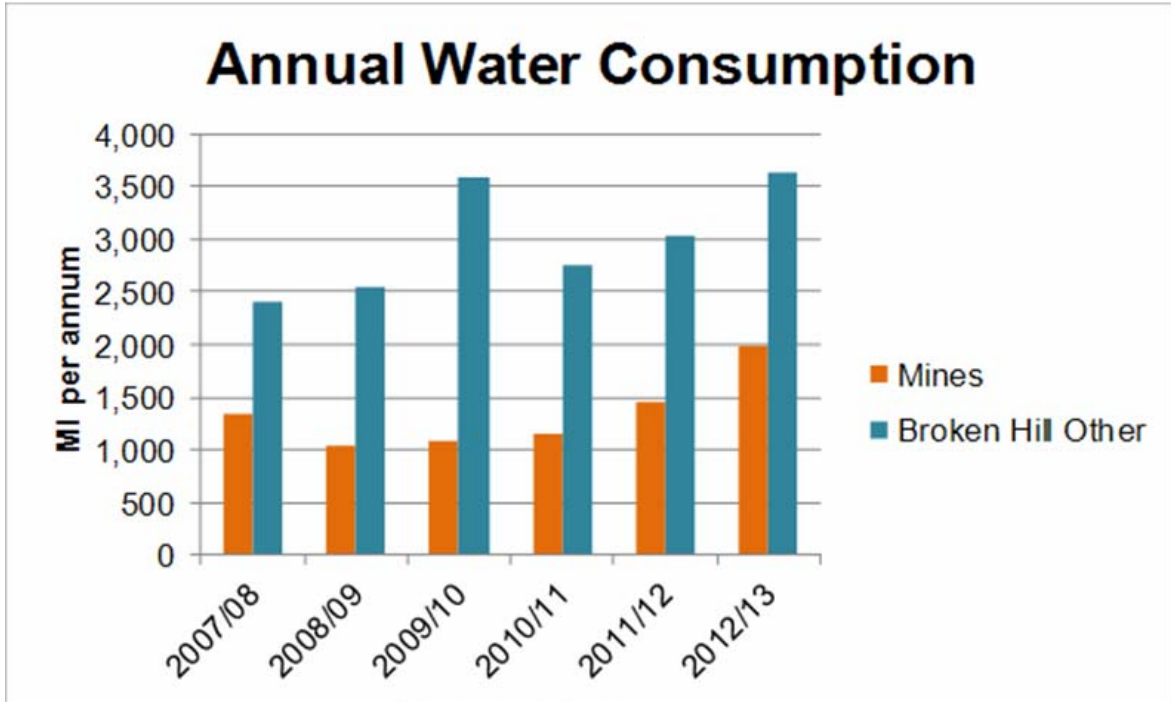
Date	Event
May 2002	Premier's Department wrote to the Department of Land and Water Conservation outlining: <ul style="list-style-type: none"> <li>• the new charges proposed for water for mining</li> <li>• 2013 mines cost set to zero based on the assumption that mining activity was to cease</li> <li>• A review to be undertaken if mining continued past 2013</li> <li>• Until outcomes of the review are known, charges to be maintained at 2012 levels</li> </ul>
May 2002	Premier's Department wrote to Perilya outlining the annual charges and arrangements for 2012 and beyond in line with the Premier's Department letter to the Department of Land and Water conservation.
August 2012	Herbert Greer, acting on behalf of Perilya, wrote to IPART stating: <ul style="list-style-type: none"> <li>• Perilya's view that an early transition to a commercial tariff is the best way forward</li> <li>• Dissatisfaction that the "review" as outlined in the original agreement had not commenced</li> <li>• A request that new arrangements should start within the year</li> </ul>
September 2012	IPART responded to the Herbert Greer letter stating: <ul style="list-style-type: none"> <li>• A summary of the 2012 agreement, specifically a "review" and that charges will be held at 2012 levels</li> <li>• Treasury will liaise with Department of Premier and Cabinet to consider future arrangements</li> </ul>
January 2013 – April 2013	Based on outcomes from IPART's discussions with several government departments a mines working group was established consisting of representatives from: <ul style="list-style-type: none"> <li>• Office of Water</li> <li>• IPART</li> <li>• Department of Resources and Energy</li> <li>• Department of Finance and Services</li> <li>• Essential Energy</li> <li>• Treasury</li> </ul> The first working group meeting was held 18 January 2012. Stan Korudusic (Department of Finance and Services) was the chair of the working group.
April 2013	The recommendations/outcomes of the working group were: <ul style="list-style-type: none"> <li>• Mines fall under the scope of IPART in setting its determination for Broken Hill</li> <li>• The mines agreement would not be renewed</li> <li>• Cost reflective prices developed based on cost reflective pricing principles applied to large electricity users</li> <li>• The prices developed indicated that:               <ul style="list-style-type: none"> <li>○ a cost reflective price would be predominantly fixed due to the fixed cost nature of the water business</li> <li>○ Perilya, though the mines agreement, is currently paying a roughly equivalent level for water services to the amount derived from cost reflective prices</li> </ul> </li> </ul>

Date	Event
12 April 2013	<p>A teleconference was organised with Perilya to communicate directions from the working group. Stan Kordusic chaired the teleconference and also attended by representatives of Perilya and Essential Energy. The teleconference included:</p> <ul style="list-style-type: none"> <li>• An overview of the proposed way forward for mines – falling under jurisdiction of IPART and in scope for the upcoming review of prices for Broken Hill</li> <li>• [REDACTED]</li> <li>• [REDACTED]</li> <li>• [REDACTED]</li> </ul>
June 2013	<p>IPART releases its issues paper for the review of prices for water, sewerage and other services in Broken Hill. Chapter 5 of the issues papers discusses pricing for the mines. IPART has also indicated that Essential Energy should consult with Perilya on proposed prices (with view to reaching agreement) prior to submitting our initial submission to IPART in September.</p>
September 2013	<p>Consultation occurred with Perilya in regards to pricing principles and outcomes outlined in this paper.</p>

Following on from the timeline of events displayed in the table above, and in consideration of the Working Group outcomes, Essential Energy plans to introduce a separate pricing regime for mining operations.

### 3. Analysis of current charges

For the 2012/13 year, Perilya and Broken Hill Operations (BHO) were charged \$ [REDACTED] for their water usage. Consumption has increased significantly from previous years as shown in the chart below.



## 4. Proposed pricing methodology

Essential Energy has calculated the total revenue requirement for Essential Water by adopting IPART's 'building block' methodology to calculate revenue requirement over the determination period.

The 'building block' costs of service provision include:

- Operating costs – there are the on-going expenses to run and maintain the utility, including maintenance and administration costs;
- Return OF capital (depreciation) – this is calculated with reference to the Regulatory Asset Base (RAB) that includes all prudent and efficient capital expenditure; and
- Return ON capital – this is calculated with reference to the RAB.

The process proposed for setting site specific prices for Broken Hill mining companies is:

- Use the current replacement value of assets (as calculated by GHD) that are used to supply water to the Mines;
- Historical records indicate the Mines paid for 78 per cent of the Menindee Pipeline through the Broken Hill Water Board (BHWB), so this portion of Menindee Pipeline assets is excluded;
- Apportion the return on and of these assets (WACC and depreciation);
- Include a maintenance charge based on annual maintenance for a year over total the asset value multiplied by the asset replacement value relating to the Mines; and
- Costs have been apportioned on Water usage (average over past two years).

The pricing process used to derive a price for the Mines is in line with commonly accepted regulatory practices and is also similar to the method for calculating specific pricing for large customers for electricity (~ 25 customers in Essential Energy's distribution area).

Other methods, including using RAB and apportioning maintenance charges based on water usage, were modelled but resulted in more expense for the Mines, so were discounted as viable options.

Essential Energy also engaged the NSW Department of Public Works to review the proposed methodology and supporting calculations.



## 5. Replacement cost scenarios considered

In selecting the proposed replacement cost, the following scenarios were considered:

1. Mines contribute to the cost of the entire asset base as a proportion of their water usage across all customers.
2. Mines contribute 100 per cent to the asset costs associated with the Menindee pipeline and a further contribution of all other assets based on their proportion of water usage.
3. Mines contribute 100 per cent to the unfunded portion of asset costs associated with the Menindee pipeline. It is recognised that the mines originally contributed 78 per cent of capital costs to the original construction of the Menindee pipeline meaning they would only be required to pay for the return on and of the remaining 22 per cent of those assets, as well as a contribution to all other assets based on their proportion of water usage.

Option 1 is not appropriate as it does not accurately align the underlying Water assets primarily consumed by the mines or recognise that the Menindee Pipeline was originally built in order to provide water for the Mines.

Option 2 is not appropriate as this option does not recognise that the mines originally funded 78 per cent of all Menindee pipeline construction costs.

Options 1 and 2 highlight significant increases in costs to the mines.

Option 3 recognises the past capital contribution to the Menindee pipeline and hence is considered the most equitable option.

### For the 2013/14 Year Based on Replacement Cost

No.	Scenario	Fixed	Variable Filtered	Variable unfiltered	Total Charge
1	Percentage of all assets based on usage	████████	████████	████████	████████
2	100% Menindee Pipeline plus percentage other costs	████████	████████	████████	████████
3	Assuming Mines paid % of Menindee	████████	████████	████████	████████

## 6. Conclusion on proposed prices

Essential Energy proposes that prices for mines will be set to recover \$ [REDACTED], as discussed in section 5 above. This is the most cost reflective of the options considered in respect of the mines.

The revenue is proposed to be converted into a fixed and variable price as set out in Section 5. This means that \$ [REDACTED] is to be recovered through fixed charges, via a monthly or daily charge, to reflect that fact that the costs of supplying water to the Mines is largely a fixed cost and does not vary significantly if consumption changes. The remaining \$ [REDACTED] is to be recovered through variable charges, via a KI charge.

Essential Energy believes it is appropriate to apportion the total fixed charges to each mine that consumes water in Broken Hill on the basis of water usage. For example if a mine consumes 75 per cent of total mines water usage, 75 per cent of the fixed charge would be attributable to that mine.

Variable charges for filtered and untreated water will be set based on the total 2012/13 mines actual water consumption.

A table of proposed mines charges are listed below.

Description	Daily fixed charge	Treated Water (c/KI)	Unfiltered Water
Proposed Tariffs for Mines	\$ [REDACTED]	[REDACTED]	[REDACTED]

Note: The fixed charge component above is to be apportioned between mines based on water usage.