

27 March 2017



WHAT

IPART is reviewing the prices Sydney Water and Hunter Water can charge for wholesale water and sewerage services. These services are purchased by wholesale customers who use them to provide water, recycled water and/or sewerage services to their own end-use (or 'retail') customers, such as households and businesses.

We have released a Supplementary Draft Report and Draft Determinations, which:

- ▼ outline our draft regulatory framework for pricing wholesale services, and
- ▼ explain how we have set draft system-wide prices within this framework.

We invite submissions from stakeholders, which we will consider before making our final decisions.



WHY

Competition in the NSW water market has emerged in recent years due to the *Water Industry Competition Act 2006*. To support entry into the market, IPART is setting **wholesale** water and sewerage prices for the first time.

We released Final Reports and Determinations on **retail** prices for Sydney Water and Hunter Water in June 2016. These retail prices will apply from 1 July 2016 to 30 June 2021.

Since this is the first time we are setting wholesale prices, we are undertaking an extended review of this new and complex area of water price regulation.

In response to requests from stakeholders, we have extended our review until June 2017. As an extra step in our consultation process, we have released a Supplementary Draft Report (following an earlier Draft Report released in November 2016).



HOW

We are seeking to encourage entry into the market where this will ultimately deliver benefits to customers. We have set system-wide prices for the following services:

- ▼ On-selling water and sewerage services
- ▼ Drinking water top-up for recycled water schemes, and
- ▼ Disposal of waste from recycled water plants.



WHO

The **system-wide prices** would apply to new wholesale arrangements involving entities licensed under the *Water Industry Competition Act 2006*. All schemes would have the option to enter into **unregulated pricing agreements** or apply for a **scheme-specific review**.



WHEN

The key dates for this price review are:

- ▼ 1 May 2017 - Submissions due, and
- ▼ June 2017 - Release Final Report and Determinations

The Final Determinations would apply from 1 July 2017 to 30 June 2021.



WHAT NEXT

Submissions are due by **1 May 2017**.

We prefer submissions via our online [form](#). You can also send comments by fax to (02) 9290 2061, or by mail to:

Wholesale water pricing review
Independent Pricing and Regulatory Tribunal
PO Box K35
Haymarket Post Shop, NSW 1240

Unless they are identified as confidential, we plan to put all submissions on our website soon after the closing date for submissions.

We have made two key changes since our November 2016 Draft Report



Retail-minus prices would apply to on-selling, even if the wholesale customer operates a recycled water plant

We have decided that **retail-minus prices** would apply when a wholesale customer purchases a wholesale sewerage service to **on-sell** these services – **regardless of whether the wholesale customer operates a recycled water plant.**

This is because the wholesale customer is purchasing the wholesale sewerage service to on-sell it to a market where Sydney Water and Hunter Water are constrained by regulated retail prices.

Where a wholesale customer's recycled water plant reduces a wholesale service provider's costs, this would be reflected in the wholesale price via the application of **negative facilitation costs** (see below).

We have decided to apply retail-minus pricing for **on-selling water and sewerage services** because it ensures the wholesale service provider and wholesale customer compete for end-use customers on the basis of their respective costs of supplying the contestable services, rather than on the basis of an arbitrage opportunity or margin created by regulated retail water and sewerage prices.

We have refined our minus values

Under our retail minus prices, the **minus component** would be based on the costs a **reasonably efficient competitor** would incur in providing services from the point of wholesale connection to end-use customers.

We have maintained our draft decision to set **system-wide** prices for on-selling based on the costs of a reasonably efficient competitor's retail and reticulation services. Our **draft system-wide prices** for on-selling comprise the:

- ▼ sum of end-use customer retail charges¹, less
- ▼ minuses shown in the table below, applied based on the number of end-use customers and kilometres of pipeline for the applicable water and/or sewerage service.

However, we have **refined our minus values for retail and reticulation**, taking into account stakeholder submissions and the work of our consultants, Oakley Greenwood. Our revised minus values are generally higher (meaning lower wholesale prices) as:

- ▼ For the **retail services**, we have included management costs and applied a weighted average of the reasonably efficient competitor costs based on three example schemes (rather than on the basis of the largest example scheme).
- ▼ For **reticulation services**, the water minus value is lower as we have adopted lifecycle operating costs, and the sewerage minus value is higher as we have included pumping station costs.

¹ Based on the prevailing water and sewerage retail price Determination for Sydney Water or Hunter Water.

The table below outlines our current decisions on the minus values compared to those in our November 2016 Draft Report.

Draft reasonably efficient competitor cost minuses (\$2016-17)

	Service	November 2016 Draft Report	Supplementary Draft Report
Water	Retail (\$/customer/year)	69.60	129
	Reticulation (\$/km /year)	4,227.91	3,945
Sewerage	Retail (\$/customer/year)	46.40	80
	Reticulation (\$/km/year)	7,692.63	7,742

Pricing for services to recycled water plants where there is no on-selling



We have maintained **non-residential retail prices** where there is no on-selling. That is, where the wholesale customer:

- ▼ discharges waste from a recycled water plant into Sydney Water's or Hunter Water's sewerage network, but does not supply retail sewerage services, and/or
- ▼ purchases drinking water only to top up its recycled water plant.



Who do these wholesale prices apply to?

Our draft decision is to set **system-wide prices** for these services to apply to **new** wholesale arrangements. Setting system-wide prices reduces the need for potentially costly scheme-specific price reviews.

Scheme-specific reviews and unregulated pricing agreements are alternatives where the system-wide prices are not appropriate.

For existing and new wholesale arrangements, customers and service providers would have the option of seeking a scheme-specific price review from IPART or, if both parties agree, entering into an unregulated pricing agreement. This means that:

- ▼ For a **new scheme**, parties may seek a scheme-specific review by IPART, if either party considers the system-wide prices do not reflect the characteristics of the scheme and they cannot reach agreement on prices.
- ▼ For an **existing scheme**, a wholesale customer or service provider may seek a scheme-specific review if they cannot reach agreement on prices.

We would consider requests to undertake scheme-specific reviews

The system-wide prices in our Draft Determinations and methodologies and principles outlined in our Supplementary Draft Report would serve as the starting point for determining prices in any future scheme-specific review.

Our proposed process for undertaking scheme-specific reviews is outlined in the box below. IPART would use its best endeavours to complete a review within twelve months

IPART's process for determining scheme-specific prices

1. IPART considers a request to undertake a scheme-specific review and decides whether to undertake a review.
2. Wholesale service provider submits a Wholesale Pricing Proposal.
3. IPART publishes the Proposal and a preliminary view on the Proposal. Stakeholders can make written submissions and/or attend a public hearing to provide views.
4. IPART releases a draft report and determination for stakeholder comment.
5. IPART releases a final report and determination.

Scheme-specific reviews would consider facilitation costs

Our wholesale pricing framework allows for recognition of facilitation costs.

Facilitation costs can be positive (costs) or negative (cost savings) – see box below. They should be included in wholesale prices where they are:

- ▼ **additional** to what the wholesale service provider would have otherwise incurred in the absence of servicing the wholesale customer, and
- ▼ **not reflected elsewhere** in the wholesale price or recovered via another charging or funding mechanism of the wholesale service provider.

While we have done further work investigating the impact of recycled water plants on Sydney Water's and Hunter Water's costs, we have not included facilitation costs in our system-wide prices. This is because, at this stage, they can only be determined with a reasonable degree of accuracy on a scheme-specific basis.

Wholesale customers may impose additional costs or cost savings on wholesale suppliers. We refer to these as **positive (costs) or negative (cost savings) facilitation costs**.

For example:

- ▼ a **positive facilitation cost** may arise if a wholesale service provider needs to upgrade or extend its water or sewerage network to provide services to a wholesale customer, and
- ▼ a **negative facilitation cost** may arise if a wholesale customer produces recycled water that allows the wholesale service provider to defer its next scheduled water supply or sewage treatment augmentation.

Unregulated pricing agreements



Wholesale customers and wholesale service provider would be able to agree to opt-out of IPART's determined prices through unregulated pricing agreements. This provides **flexibility for parties to agree** to prices that reflect scheme-specific characteristics without having to incur the costs associated with a scheme-specific review.