
Wholesale prices for water and sewerage

Draft Report and Determinations

Sydney Water Corporation

Hunter Water Corporation

Agenda

- ▼ Opening remarks
- ▼ Overview of our draft decisions
- ▼ Draft decisions on wholesale prices
- ▼ Break
- ▼ Draft decisions on implementation of wholesale prices
- ▼ Other questions and comments
- ▼ Closing remarks

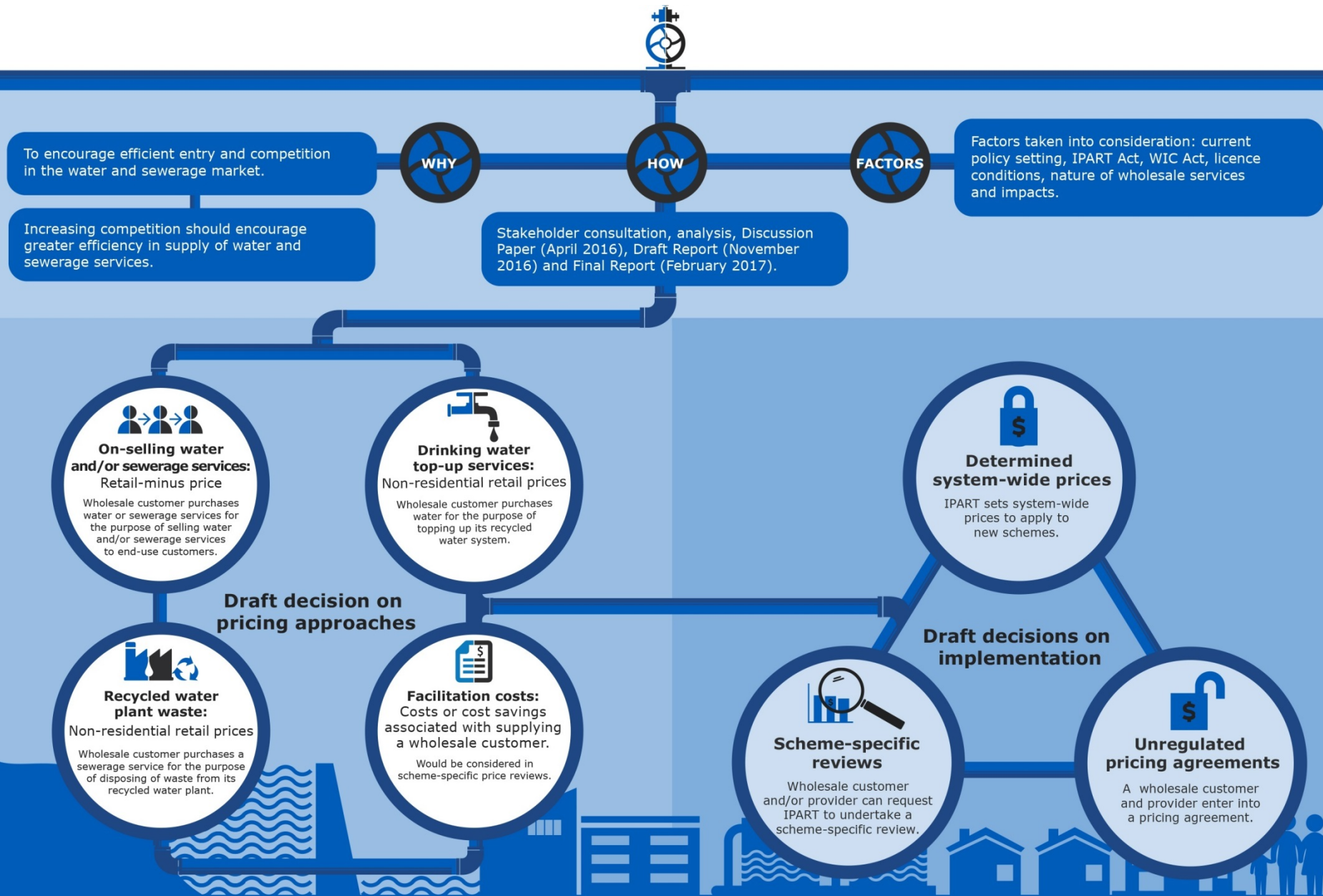
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Review timetable

- ▼ June 2015 Sydney Water & Hunter Water pricing proposals
- ▼ September 2015 Issues Papers released
- ▼ December 2015 Public hearing
- ▼ April 2016 Released Discussion Paper
- ▼ November 2016 Released Draft Report and Draft Determinations
- ▼ November 2016 Public hearing
- ▼ February 2017 Release Final Report and Final Determinations

IPART'S REVIEW OF WHOLESALE PRICES



Our approach to making draft decisions

We considered:

- ▼ The nature of wholesale services and customers
 - ▼ How do these differ from retail services?
 - ▼ What services are currently being provided?
 - ▼ What services are likely to be provided?
 - ▼ What services should be included in this review?
- ▼ The appropriate pricing approach for each service
 - ▼ Retail prices, cost of service or retail-minus prices?
- ▼ How to implement these pricing approaches
 - ▼ Average system-wide prices, scheme specific prices or a combination?
 - ▼ Should our prices apply to existing and new schemes?

Pricing decisions

We applied different pricing approaches to four different services.

Retail minus 'reasonably efficient competitor' cost prices:

- ▼ on-selling water, and
- ▼ on-selling sewerage.

Retail non-residential prices:

- ▼ drinking water top-up to recycled water plants, and
- ▼ recycled water plant waste disposal.

We also decided facilitation costs should be reflected in wholesale prices where specific criteria are met.

Implementation decisions

Setting system-wide prices:

- ▼ reduces the need for costly and time-consuming scheme-specific reviews

Prices would only apply to new wholesale schemes

- ▼ parties to existing agreements can decide whether to retain current arrangements or seek a scheme-specific review.

Our draft decision is for these prices to apply from 1 March 2017 to 30 June 2021.

We would:

- ▼ allow parties to opt out of IPART's determined prices through unregulated pricing agreements
- ▼ consider requests to undertake scheme-specific reviews.

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Nature of wholesale services and customers

We consider a wholesale service is a service purchased from Sydney Water or Hunter Water that is used by the customer to compete for 'retail' customers, and:

- ▼ is a monopoly service
- ▼ the service to end-use customers is the same or a close substitute to one provided by Sydney Water or Hunter Water, and
- ▼ the service to end-use customers is provided by a licence holder under the *WIC Act 2006*.

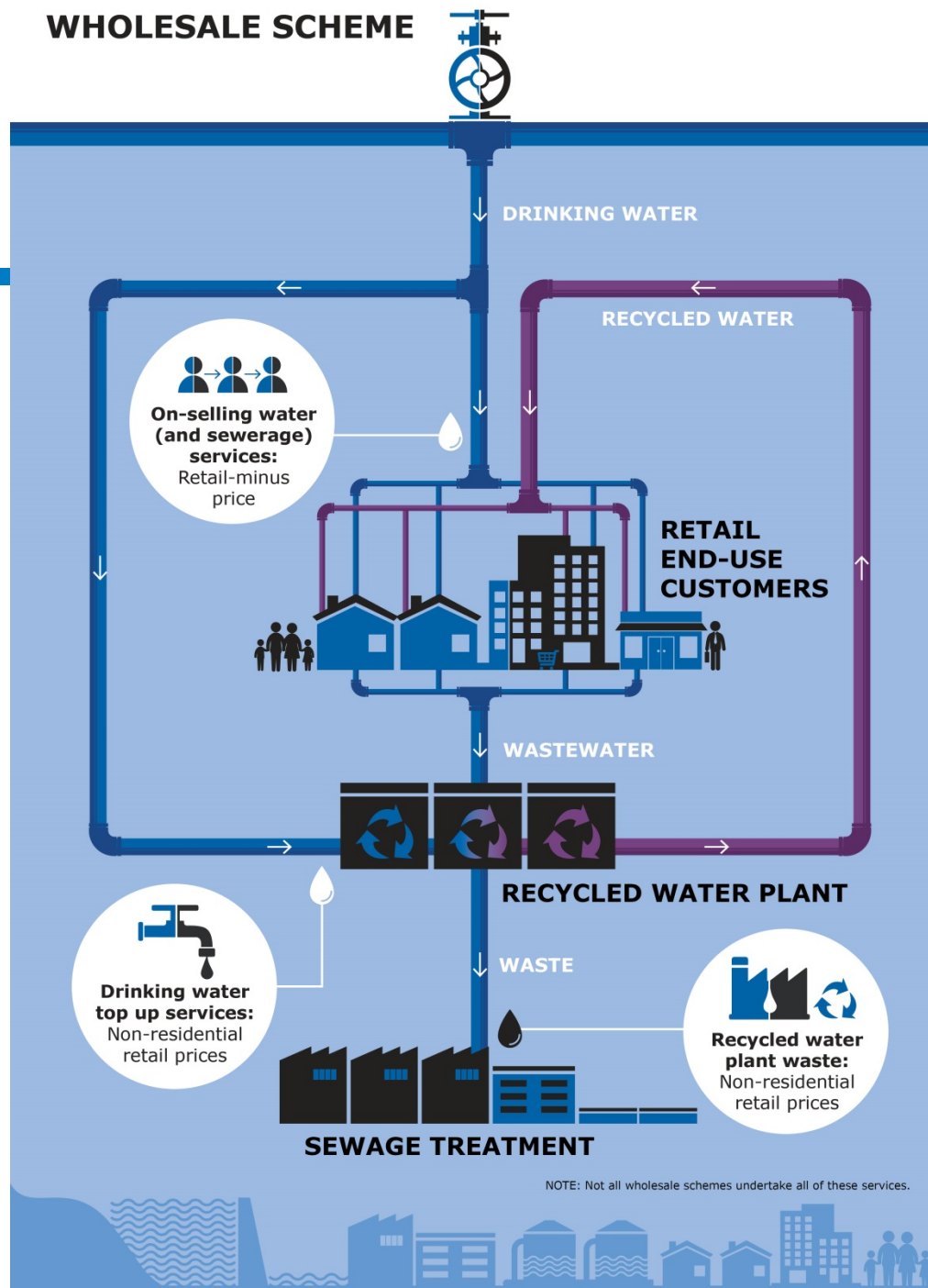
Supply by Sydney Water or Hunter Water for end-use within their respective areas of operation.

Wholesale services covered by definition

This definition covers:

- ▼ on-selling water – buying drinking water to on-sell to end-use customers
- ▼ on-selling sewerage – buying sewerage services to directly discharge end-use customers' sewage
- ▼ drinking water top-up – buying drinking water to ensure continuous supply of recycled water, and
- ▼ recycled water plant waste disposal – buying sewerage services to dispose of waste from a recycled water plant.

WHOLESALE SCHEME

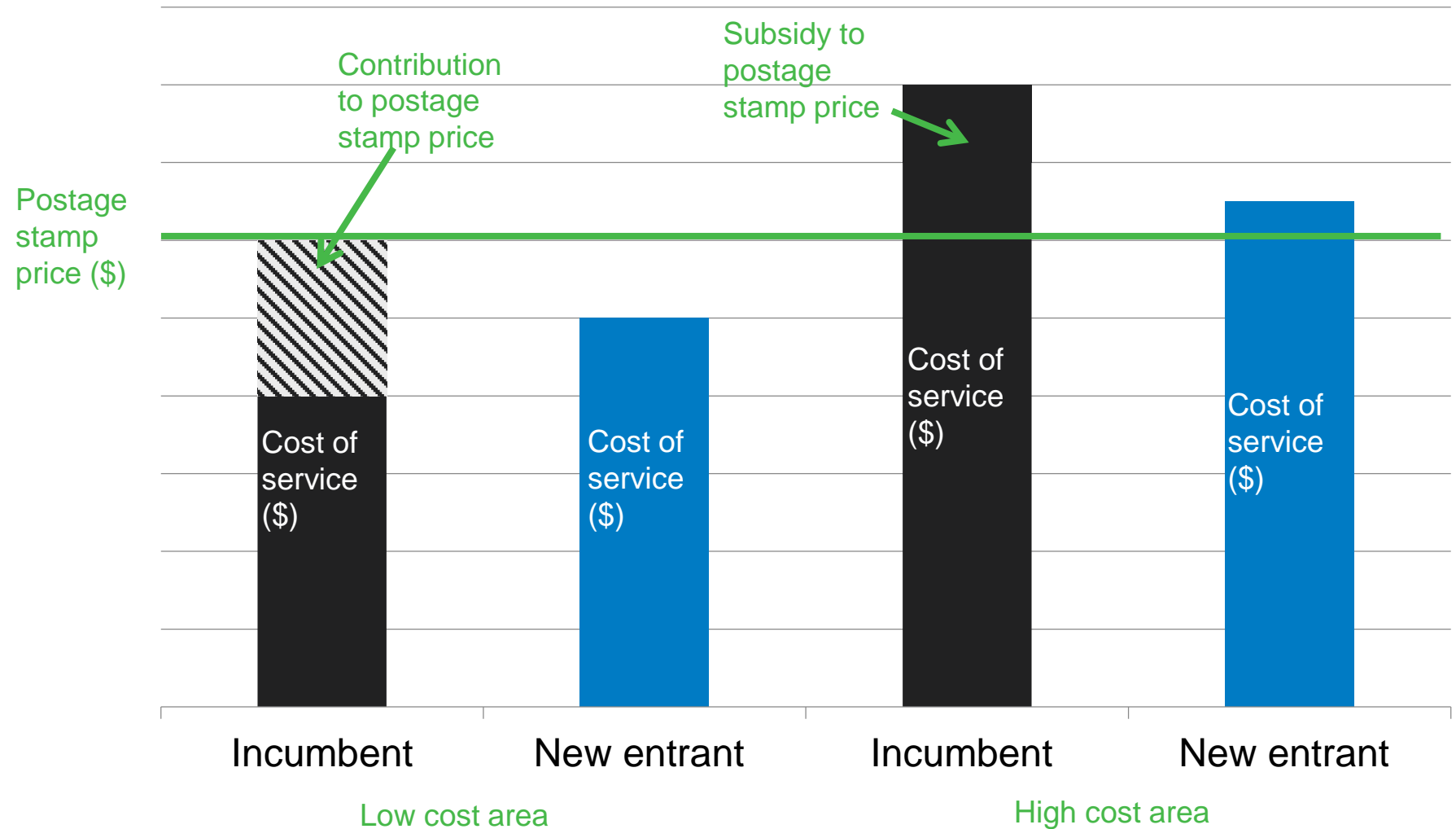


Options considered for on-selling water and sewerage

We considered:

- ▼ Retail-minus prices
- ▼ Cost of service prices
- ▼ Non-residential retail prices

Postage stamp pricing



Retail-minus prices



- ▼ Retail-minus prices allow wholesale customers to compete for end-use customers in the provision of contestable services
- ▼ Neither party is advantaged or disadvantaged by postage stamp pricing or price structures
- ▼ Our draft decision is to use a 'reasonably efficient competitor' cost minus component

Retail-minus what?

We considered four ways to estimate the minus component:

- ▼ Retail minus avoided cost
- ▼ Retail minus avoidable cost
- ▼ Retail minus 'as-efficient competitor' costs
- ▼ Retail minus 'reasonably efficient competitor' costs

IPART's draft decision:

To set system-wide prices for on-selling services using **retail minus reasonably efficient competitor** cost approach:

- prices are based on the contestable services (ie, services provided by the wholesale customer from wholesale connection point to end-use customers) being **retail** and **reticulation** services
- Minus components expressed as **\$ per customer (retail)** and **\$ per km (reticulation)**

Reasonably efficient competitor costs

Service	Retail-minus the below (\$2016-17, per year)
Water	
Retail	\$69.60 per customer
Reticulation	\$4,227.91 per kilometre of reticulation
Sewerage	
Retail	\$46.40 per customer
Reticulation	\$7,692.63 per kilometre of reticulation

Calculating reasonably efficient competitor costs

To calculate these reasonably efficient competitor costs we:

- ▼ Calculated an entrant's building block costs for a 125-year period, using new assets and lifecycle operating expenditure
- ▼ Calculated the annual average building block costs in net present value terms over the first 50-years, and
- ▼ Applied the annuitized average building block cost based on the number of customers and length of reticulation.

Maximum price for On - Selling Water Service (Schedule 1)

=

“Retail” component (clause 3)

minus

“Minus” component (referred to as “Reasonably Efficient Competitor Costs” in Draft Determinations) (clause 4)

=

=

Volume of water supplied by Sydney Water/ Hunter Water (kL) to the Wholesale Customer

X

Water usage charge (\$/kL)

+

Sum of water service charges for each property supplied by the Retail Supplier downstream of the wholesale connection point

Set under the retail determination

The water service charge that would apply under the retail determination if Sydney Water/Hunter Water supplied the property directly

No. of Properties downstream of connection point

X

Per Property “minus” (C_{Retail} in Table 1)

+

No. of km of pipeline downstream of connection point

X

Per km “minus” for reticulation service ($C_{\text{Reticulation}}$ in Table 1)

This is the number of km of pipeline operated by a licensed network operator under the WIC Act

Maximum price for On – Selling Sewerage Service (Schedule 2)

“Retail” component (clause 3)

minus

“Minus” component (referred to as “Reasonably Efficient Competitor Costs” in Draft Determinations) (clause 4)

=

=

Sum of
sewerage
usage
charges for
each
property
upstream
of the
connection
point

+

Sum of
sewerage
service
charges for
each
property
upstream
of the
connection
point

+

Sum of trade
waste
charges for
each
property
upstream
of the
connection
point

The sewerage
usage charge
set under the
retail
determination

The sewerage
service charge
set under the
retail
determination

The trade waste
service charges
under the retail
determination
(with some
exclusions)

No . of
Properties
upstream of
connection
point

X

Per
Property
“minus”
for retail
service
(C_{Retail} in
Table 2)

+

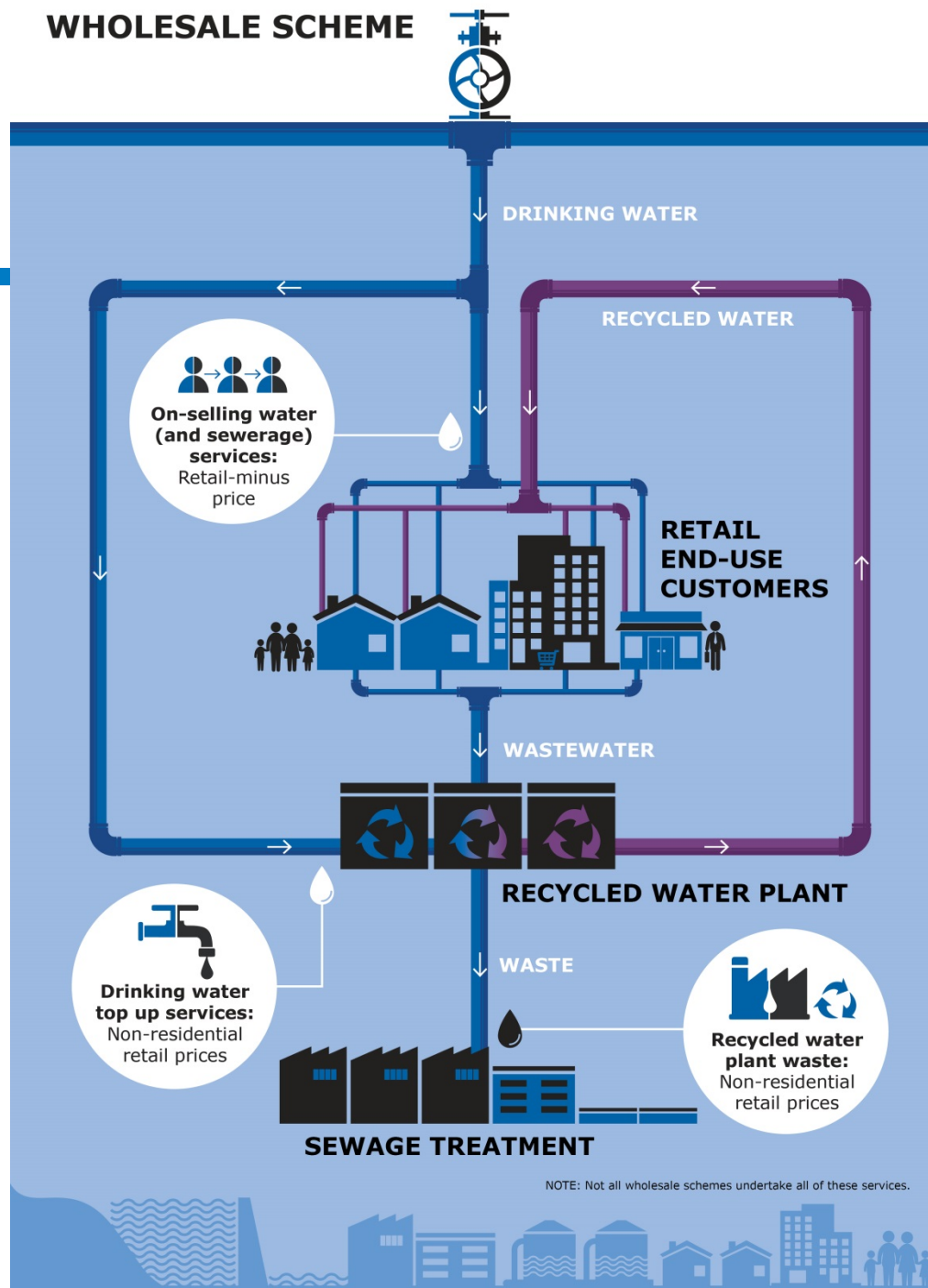
No . of km
of pipeline
upstream
of
connection
point

X

Per km
“minus” for
reticulation
service
($C_{\text{Reticulation}}$
in Table 2)

This is the number of km of
pipeline operated by a licensed
network operator under the
WIC Act

WHOLESALE SCHEME



NOTE: Not all wholesale schemes undertake all of these services.

Pricing drinking water top-up



- ▼ Postage stamp pricing does not apply to recycled water
- ▼ Drinking water top-up is a minor (but crucial) input into recycled water production
- ▼ Stakeholders supported non-residential prices

Combination schemes

In some instances a wholesale customer will both on-sell drinking water and use drinking water top-up:

- ▼ drinking water on-selling – **retail minus reasonably efficient competitor cost price**
- ▼ drinking water top-up – **non-residential price**

If there is not a separate meter for top-up, the recycled water system will be deemed to have a 100mm meter for the purpose of applying the service charge.

Pricing recycled water plant waste



- ▼ Sewerage services are an input to producing recycled water
- ▼ Wholesale customers may have a choice of service provider for the disposal of waste from a recycled water plant
- ▼ Seeking to incentivise efficient choices by wholesale customers.

Recycled water plant bypass or shutdown

The **non-residential price** only applies while waste is being treated and for the waste that is being treated.

- ▼ Where waste from some end-users bypasses the plant – **retail minus reasonably efficient competitor cost** price applies, based on number of end-users whose waste bypasses the recycled water plant
- ▼ When a recycled water plant is shut down – **retail minus reasonably efficient competitor cost** price applies, based on end-users.

Facilitation costs

Net facilitation costs are the costs that Sydney Water or Hunter Water incur in supplying the wholesale customer **less** any cost savings resulting from the wholesale customer's activities.

IPART's draft decision

In principle, prudent and efficient facilitation costs 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)
- **not reflected elsewhere** in the wholesale price or recovered via another charging/funding mechanism

In addition, facilitation costs should:

- reflect the status of water and sewerage developer charges
- include positive (costs) and negative costs (cost savings), where appropriate
- exclude initial transaction costs
- exclude ongoing administration costs, except where they are material

Facilitation costs

Facilitation costs are additional net costs to the wholesale service provider that it wouldn't incur without supplying the wholesale customer.

For system-wide prices, facilitation costs are zero. This reflects:

- ▼ they cannot be accurately set on a system-side, average basis
- ▼ each party should bear its own initial transaction costs, and
- ▼ ongoing admin costs are unlikely to be material.

Further, with zero developer charges, positive infrastructure facilitation costs should be zero if they are consistent with the wholesale service provider's prudent & efficient business as usual growth plans.

Facilitation costs would be considered in scheme-specific reviews of wholesale prices

Questions for discussion

- ▼ What are your views on our draft decisions for:
 - ▼ On-selling water and sewerage
 - ▼ Drinking water top-up
 - ▼ Recycled water plant waste, and
 - ▼ Facilitation costs?

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Approach to implementing wholesale prices

We have decided to:

- ▼ Determine **system-wide prices for specific services** for new wholesale schemes
- ▼ Allow wholesale customers and wholesale service providers to opt out of our determinations and opt into **unregulated pricing agreements** (where both parties agree)
- ▼ Consider requests to undertake **scheme-specific price reviews** and determinations.

Determination length

Our decision is for the determination to apply from 1 March 2017 to 30 June 2021.

- ▼ This allows prices to apply soon after our scheduled February release of our Final Report and Determinations.
- ▼ The current retail determinations cover the period 1 July 2016 to 30 June 2020.
- ▼ System-wide wholesale prices would be replaced one year after the retail price determinations

Application of system-wide prices to new schemes

Sydney Water and Hunter Water currently supply to wholesale customers in their areas of operation. We decided **system-wide prices should not apply to existing services**.

- ▼ These supply arrangements have been privately negotiated between the parties.
- ▼ If current arrangements are unsatisfactory to either party they can seek a scheme-specific price review and determination.
- ▼ A service comes within the 'existing service' exception if:
 - ▼ Sydney Water or Hunter Water has commenced supplying the wholesale service to a customer, and
 - ▼ the price levied for that service (under an agreement with the customer) is different to the price set out in IPART's draft wholesale price determinations.

Our process for determining scheme specific prices – part one

Step one – The wholesale customer or provider writes to IPART to request a price review and determination for an existing or proposed wholesale scheme. IPART considers the request and decides whether to undertake a review.

Step two – IPART initiates the review by asking the wholesale service provider to submit a Wholesale Pricing Proposal by a specific date. This Proposal would be informed by consultation with the wholesale customer(s). IPART also advertises the price review in the relevant local newspaper.

Our process for determining scheme specific prices – part two

Step three – On receipt of this Proposal, IPART prepares a summary and forms a preliminary view on the Proposal. IPART would then publish the Proposal and its preliminary view on the IPART website, and invite stakeholders to make written submissions – including wholesale customers. IPART holds a public hearing to discuss the Proposal and stakeholder submissions.

Step four – IPART considers the Proposal and stakeholder comments, makes draft pricing decisions, and releases a draft report and determination for stakeholder comment.

Step five – IPART considers submissions and makes final pricing decisions, and releases a final report and determination that sets out the maximum prices for each wholesale service supplied to the scheme.

Key issues - scheme specific reviews

Wholesale pricing proposals

The wholesale service provider would be expected to consult with the wholesale customer(s) in making its pricing proposal.

No interim prices

For new schemes, system-wide prices would apply until they are replaced by scheme-specific prices. Similarly, no regulated interim price would be set for existing schemes.

No true-up mechanism

A true-up mechanism would increase uncertainty.

System-wide prices

We will be guided by the principles and prices used in our system-wide determination when conducting scheme-specific reviews.

Length of scheme-specific determinations

The length will be a factor of:

- ▼ stakeholder views
- ▼ confidence in forecasts
- ▼ need for price flexibility, incentives, certainty and financial stability.

Unregulated pricing agreements

Wholesale customers can use unregulated agreements:

- ▼ Requires mutual agreement
- ▼ Current agreements will be considered unregulated agreements
- ▼ Any change in revenue must be ring-fenced by Sydney Water and Hunter Water.

Draft decisions

Application of determination

1. Determination period of 1 March 2017 to 30 June 2021.
2. Apply determination only to new wholesale schemes.

Scheme-specific reviews

3. Use a five step review process completed within 12 months.
4. Do not apply interim price or a true-up mechanism.

Unregulated pricing agreements

5. Allowed where both parties agree

Questions for discussion

- ▼ What are your views on our draft decisions on:
 - ▼ the coverage and duration of the draft determination of system-wide prices (ie, to apply to new schemes only, from 1 March 2017 to 30 June 2021)
 - ▼ the process for scheme-specific reviews and determinations
 - ▼ no interim prices and no true-up mechanism
 - ▼ unregulated pricing agreements?

Questions for discussion

- ▼ Any other comments on IPART's Draft Report and Draft Determinations?

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Submissions are due 7 December 2016

We prefer submissions via our online form, go to
www.ipart.nsw.gov.au

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

Our Final Report and Determinations are due for release
in February 2017.