

Our reference: 12/141

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Mr Brett Tucker
Chief Executive Officer
State Water Corporation
PO Box 1018
Dubbo NSW 2830

PO Box Q290, QVB Post Office NSW 1230
Level 8, 1 Market Street Sydney NSW 2000
T (02) 9290 8400 F (02) 9290 2061
ABN 49 202 260 878

www.ipart.nsw.gov.au

Contact Rebecca Bishop
T (02) 9113 7764
E rebecca_bishop@ipart.nsw.gov.au

Dear Mr Tucker

As you are aware, pricing regulation of State Water's monopoly services in the Murray-Darling Basin valleys will transfer to the Australian Competition and Consumer Commission (ACCC) from 1 July 2014. This requires IPART to consider the best approach to pricing for the coastal valleys that we will continue to regulate.

I am writing to advise that the Tribunal has decided to defer the review until 2014/15. This means that the maximum prices prevailing at 30 June 2014 will continue to apply, and will be unchanged in nominal terms, until the new price determination takes effect on 1 July 2015.

To advise the Tribunal, the Secretariat consulted with officers of State Water and NSW Treasury and this was considered the most effective option.

Continuing with a full review of pricing in 2013/14 is not considered desirable because of resourcing and sequencing issues. For example, it is likely that the ACCC's decisions on efficient operating and capital expenditure would be too late for us to use as a basis for our decisions on these matters. We would therefore need to undertake a full review, with potential inconsistencies between IPART and the ACCC and heavy demands on State Water and stakeholders.

The main advantage of a price review in 2014/15 is that it will allow a lighter-handed, more cost-effective approach to the review. IPART can leverage the ACCC's work, including

- ringfencing of revenues and costs of the Murray-Darling Basin and coastal valleys, and
- conclusions regarding State Water's operating and capital expenditure.

Another advantage is that State Water will be able to focus its efforts on the new regulator during 2013/14.

To be able to defer the full review to 2014/15, we considered an option of a short review in 2013/14 seeking stakeholder comment on a formulaic price change, for example indexation by the consumer price index. However, we would need to conduct a public hearing and consider all stakeholder submissions. This may result in our needing to look at costs and pricing parameters such as the WACC. We considered that the costs of the review would outweigh any financial benefits to State Water, and decided that prices should remain

unchanged in nominal terms in 2013/14. I understand that State Water and Treasury officers concur with this view.

Conduct of the 2014/15 review

We will need to update our requests for information and our review process to reflect the more streamlined approach. We have written to the ACCC to request its cooperation and have provided a copy of that letter to you.

We expect that our determination will use the information that State Water provides in its application for the approval of its charges under the *Water Charge (Infrastructure) Rules 2010*. This is because information on the coastal valleys needs to be on a consistent basis with State Water's total business to allow us to consider the ACCC's evidence and reasoning as a basis for our decisions on efficient and prudent expenditure.

We would also like our review process to benefit from any consultancies undertaken for the ACCC on State Water's efficient operating and capital expenditure:

- any conclusions on corporate expenditure and asset management will be applicable across the business, and
- we would like to minimise the regulatory burden by drawing upon any detailed reviews of projects in the Murray Darling Basin valleys that are similar to those in the coastal valleys.

Finally, for other matters that we will need to review, including demand forecasts and the methodology for setting them, we will consider State Water's application to the ACCC and its determination on these issues.

Where practical, we will use State Water's information returns to the ACCC. We recognise that IPART and the ACCC have different pricing models and it will be necessary for State Water to provide its information in a format suitable for the respective models. We will work with State Water to develop an Annual Information Return (AIR) and Special Information Return (SIR) that meet our needs and minimise duplication for State Water.

In September 2013 we will write to you to outline any matters that we will require State Water to address in its pricing submission to our review. For example, our policy on the weighted average cost of capital differs from that of the ACCC. We will endeavour to make our requirement appropriate to the size and complexity of the coastal valleys, and to apply the principles of light-handed regulation. The pricing submission is to be submitted to us in September 2014 and should address the issues raised in our June 2014 Issues Paper.

Future reviews

We would like to conduct future reviews of State Water's coastal valleys in a cost-effective manner. We will therefore consider the length of future determination periods so that our reviews of prices for State Water's coastal valleys can draw upon future ACCC reviews.

If you have any comments or questions relating to your 2014/15 price review, please contact Rebecca Bishop, Program Manager Water on 9113 7764.

Yours sincerely



Fiona Towers
Acting Chief Executive Officer

cc. Mr Philip Gaetjens, Secretary, NSW Treasury.