



Ref: 20190430MC:JC

30 April 2019

Dr Paul Paterson  
Chairman  
Independent Pricing and Regulatory Tribunal  
P O Box K35  
Haymarket Post Shop NSW 1240

Dear Dr Paterson

***Essential Water Submission on the Independent Pricing and Regulatory Tribunal ("IPART") Draft Report – Review of Essential Water's Prices for Water and Sewerage Services in Broken Hill***

Essential Energy, as operator of the Essential Water business, appreciates the opportunity to provide comments in response to IPART's April 2019 Draft Report for water and sewerage pricing in Broken Hill from 1 July 2019 (Draft Report).

Over the course of this Review, Essential Water has worked with stakeholders (including customers and IPART) to provide a comprehensive plan for the operation and financing of the business. We understand that affordability is a major concern and we were encouraged by the NSW Government's commitment to our customers that they would not face increased prices due to the construction of the Broken Hill Pipeline. We appreciate that IPART has explicitly included the requirement for a Government subsidy to be directed to Essential Water to supplement the shortfall in revenue that can be recovered from customers.

While there may be some differences with the assessment of requirements to provide effective water and sewerage services to the Broken Hill area, we have appreciated the work undertaken by IPART and its consultant Aither Pty Ltd to provide constructive feedback. Essential Water has taken this feedback on board and has engaged RM Consulting Group Pty Ltd to identify better ways of doing things, so that the business can operate more efficiently within the IPART allowances and still provide the services that our customers need and expect.

Overall, we are generally supportive of the Draft Report, with the exception of a few items of concern which have been outlined in **Attachment 1**.

This submission is provided as approved by Essential Energy's Board of Directors at its 29 April 2019 meeting and contains no changes from the draft submission submitted to IPART on 24 April 2019.

If you would like to discuss this submission in more detail, please contact Ms. Natalie Lindsay, Head of Regulatory Affairs, on ([REDACTED]).

Yours sincerely

A black rectangular redaction box covering the signature of John Cleland.

John Cleland  
Chief Executive Officer

**Attachment:** 1. Essential Water Submission in Response to IPART's Draft Report

## **Attachment 1**

# **Essential Water Submission in Response to the Independent Pricing and Regulatory Tribunal's ("IPART's") Draft Report**

**Draft Determination and Draft Report on prices for Essential Water from 1 July 2019**

**April 2019**



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## Executive Summary

Essential Water agrees with the majority of IPART's draft decisions and the associated rationale. Primarily, outstanding concerns relate to the assumptions around contributory funding from the NSW Government and expenditure allowances decisions that set precedents for future price reviews.

The main points of concern are:

- **Funding Certainty** - Essential Water and WaterNSW provide significant investments in the Broken Hill area that sustain the community. The cost of these investments cannot be borne by the residents of Broken Hill due to issues of affordability. It is reasonable that this is recognised and supported by the NSW Government in the form of a subsidy to Essential Water. Essential Water requests that the direct subsidy recommended by IPART to cover any required revenue shortfall, and on which its 2019-22 Draft Report is dependent upon, is confirmed;
- **Brine Pond Decommissioning** - The approved allowance for the decommissioning work has been allocated by IPART to capital expenditure rather than being recognised as an operating expense as required under Accounting Standards. It therefore recommend that IPART amend the category for this expenditure, so it is included in approved operating expenses rather than capital expenses;
- **Labour** - Proposed reductions to labour costs do not appear to recognise that Essential Water is unable to capitalise as much labour as recommended due to the high level of outsourcing of the capital works programs. Essential Water request that IPART review its proposed reductions to labour to better reflect the expected work practices of the capital works program;
- **Corrosion Repairs** – Essential Water requests that the cost of these repairs at Mica Street be included in the RAB, and any settlement subsequently received can be treated as a disposal.
- **Information, Communication and Technology (“ICT”) Asset Lives** - Essential Water recommends that the ICT asset lives align with those approved for Essential Energy's electricity regulator, the Australian Energy Regulator;
- **Forecast Sales and Customer Numbers** - The values used by IPART in its Draft Report appear to be optimistic to Essential Water. Essential Water recommends that IPART relies on more realistic forecasts from the Australian Bureau of Statistics, and a more average historical consumption based methodology;
- **Trade Waste** – IPART has reduced Essential Water's revenue each year to reflect the full value of the expected under-recovery in trade waste service charges. Essential Water recommends this reduction should be applied incrementally and proportionally to align with the 10-year transition to cost-reflective trade waste pricing for customers; and
- **Mine Pricing** – The pricing for mines as proposed by IPART may lead to affordability issues for these customers. Essential Water recommends that the services charges for mines should be based on their proportion of consumption, rather than on their proportion of total revenue.

## 1. Introduction

This submission is provided to IPART to assist in its Final Determination on prices that will be applied for water and sewerage services in Broken Hill and the surrounding areas over the period 01 July 2019 to 30 June 2022.

It is provided on an exception only basis, with issues not referenced in this document either supported or accepted by Essential Water.

The following conventions have been adopted throughout this document:

- All dollar amounts presented in this document are in \$2018-19 terms, unless otherwise stated;
- The Draft Determination and Report are both referred to as the “Draft Report”; and
- Essential Water is an operating Division of Essential Energy but is referred to as Essential Water throughout this submission.

## 2. Notional Revenue Requirement

Essential Water is encouraged by IPART’s approach to the allocation of costs and risks between the business, customers, and the NSW Government. IPART refer to Government commitments to subsidise the full efficient costs of the Broken Hill Pipeline (for four years from 2019), so that prices for end use customers do not rise in real terms as a result of the Pipeline.

Essential Water needs to cover the costs associated with:

- Supplying water and sewerage services through its existing network;
- Any consequential works required to service customers as a result of the Pipeline; and
- The transportation costs charged by WaterNSW for bulk water through the Pipeline.

Under IPART’s Draft Report, Essential Water will only recover \$75M from customers but the Notional Revenue Requirement (NRR) for the cost of running the business is in the order of \$153M. The recommendation that the NSW Government directly contribute the difference of \$78M to Essential Water over the three-year period, ensures that the business can recover the efficient cost of supplying water and other services to its customers.

However, Essential Water remain concerned about the certainty of the funding commitments from the NSW Government as well as the mechanism and the timing of the payments - at the time of writing this had not yet been finalised.

There is also some ambiguity about the division of funding for the Pipeline between customers and the NSW Government. IPART’s report appears to identify the efficient costs of the Pipeline (transportation costs and consequential works) being \$89M, and yet the amount being funded by the Government is \$78M, indicating that customers are funding these works with \$11M over the 2019-22 period.

## 3. Operating Expenditure

### 3.1 Brine Pond Decommissioning

IPART and its consultant Aither Pty Ltd (“the Consultant”) have agreed with the requirement for the decommissioning of the brine pond as part of the consequential works and allowed \$8.5M over 2019-21. Essential Water queries the allocation of this expenditure to capital expenditure (“capex”) rather than operating expenditure (“opex”). Essential Water’s proposal did not specify that the expenditure was capex or opex, as Consequential Works were not included in the revenues or prices. Essential Water had expected that these costs would be classified as opex as the expenditure is related to the derecognition of the brine pond asset. Essential Water has been advised that under Accounting Standards this work must be expensed rather than capitalised. Essential Water requests that the allowance for brine pond decommissioning be allocated to opex rather than capex.



## 3.2 Labour

Essential Water proposed labour costs of \$18.6M over the three-year period 2019-22. IPART has accepted the Consultant's recommendation to reduce this by \$3.4M for a number of reasons, some of which Essential Water would like to comment further on:

- *The large capex program implies a higher proportion of labour would be allocated to capital expenditure, rather than operating expenditure.*
  - The majority of Essential Water's labour costs are not able to be capitalised as almost all of these new capital projects will be outsourced. Labour that can be capitalised has already been included in the proposal, and these relate to ongoing planned programmes for Water Reticulation Replacement and Sewer Reticulation Repairs. Most labour for Essential Water is allocated to maintenance and operation of the existing network. Essential Water believes that the assumed significant shift from Opex to Capex by IPART has been significantly overstated. The proposed reduction will place substantial strain on the ability of the business to undertake ongoing maintenance and operations.
- *Sewerage labour forecasts for FY18/19 varied by 32 per cent over a three-month period, leading to doubts in forecasting reliability*
  - Essential Water has a small pool of resources and staff are required to cross-over various roles for sewerage and water, therefore the business does not estimate staff resources down to the divisional level. The 32 per cent variation referred to relates to a re-allocation of one FTE (or \$170k) between sewerage and water and does not fairly reflect on the forecasting reliability of the business.

## 4. Capital Expenditure

### 4.1 Mica St Water Treatment Plant – Corrosion Works

Essential Water spent \$1.1M in 2018-19 on concrete corrosion repairs at the Mica Street water treatment plant, and a further \$1.8M was proposed for expenditure in 2019-22. IPART and its Consultant did not agree that the cost of these repairs should be borne by customers because of a view that Essential Water should have better specified requirements at the time of construction.

Essential Water is currently pursuing the original contractors to make good on the works. The business strongly believes that the construction requirements were well specified, the projects themselves were prudent and efficient, and the business should not be penalised for the failure of a contractor to deliver correctly. A solution would be to include these costs of repairs in the RAB as proposed by Essential Water, with the caveat that if any funds can be obtained from the original contractors that these funds will be included in the RAB as a disposal to offset the expenditure going forward.

### 4.2 ICT Assets

IPART has agreed with Essential Water's proposed asset lives apart from those for ICT assets. IPART agreed with its Consultant that the proposed ICT asset life of four years was too short and was inconsistent with the 10 years adopted for Sydney Water. It indicated that 15 years was an average life for new systems and Enterprise Resource planning assets, and five years for other systems – hence 10 years was recommended.

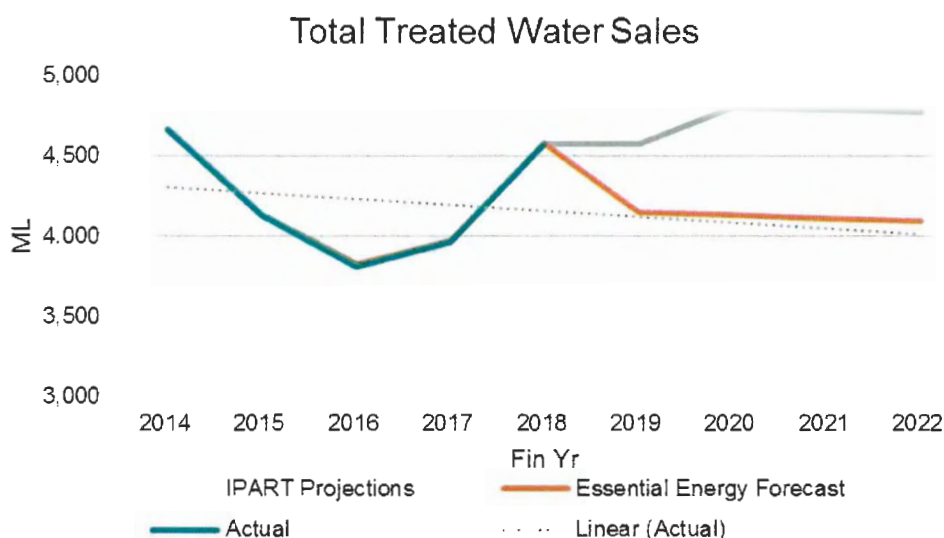
Essential Water is an operating division of Essential Energy, which is itself regulated by the Australian Energy Regulator ("AER"). IPART has confirmed that it views corporate capital expenditure by Essential Water as essentially a contribution to Essential Energy for the provision of corporate capital assets. It is therefore distinctly different from Sydney Water or other water utilities regulated by IPART. The AER applies a five-year asset life for ICT systems for Essential Energy and for other Distribution Network System Providers ("DNSPs"). It is therefore submitted that IPART should apply a consistent asset life of five years to these ICT system assets rather than 10 years.

## 5. Forecast Sales and Customer Numbers

IPART has proposed that forecast customer numbers be kept around current levels. Essential Water does not agree with this given the Australian Bureau of Statistics (ABS) population data predicts a population decline of between 1.1 and 1.2 per cent per annum for the Broken Hill area. While there may not be a proportional decrease in the number of residences, the average water usage per household is likely to decline with fewer people per household as residents leave the area.

In addition, the starting point used for forecast sales of treated water appears to be the 2018 level – this was an unusually high year for water consumption due to drought conditions. Essential Water's forecast was based on an average historical consumption level which shows a slight downward trend.

The graph below shows the high forecast for treated water sales used by IPART compared to Essential Water's forecast which takes into account declining population numbers.



Essential Water therefore recommends that IPART aligns the forecast customer numbers with the ABS forecast population trends, and that the base year for forecast treated water sales is changed to reflect a more 'average' year, rather than a drought year with high sales.

## 6. Customer Prices

### 6.1 Trade Waste

IPART has confirmed that it would like Essential Water to begin consultation with affected trade waste customers and transition them to the relevant NSW Department of Industry's recommended default prices, over a ten-year period. IPART has also removed \$377,000 per year from the NRR to reflect its estimate of revenue the business could be recovering if it was already charging the default prices.

Essential Water believes that a more equitable response would be to remove:

- 10 per cent of this value in 2019-20 – reduction of \$37,700
- 20 per cent in 2020-21 – reduction of \$75,400; and
- 30 per cent in 2021-22 – reduction of \$113,100.

A continuing reduction can then be re-assessed at the next determination and adjusted as necessary. This would result in an alignment with the 10-year transition to the default prices that is recommended for customers and is a more proportionate response.



## 6.2 Mine Pricing

IPART has set the prices for the mines based on their proportion of revenue compared to total revenue for Essential Water using 2015-16 to 2017-18 data. IPART maintains that, as the mines' proportion of revenue increased over those years, this is a good indication of their water usage as a proportion, and therefore their water charges should increase over the 2019-2022 period. This method uses the proportion of historical revenue as the basis of calculations, not the proportion of the mines' usage and total revenue required in the future.

This method has led to draft increases of around 20 per cent for the mines' service fee (fixed daily charge) in 2019-20, and a nine per cent increase in their overall water bills. Non-mine customers in general are observing a real price decrease at this time, as the total revenue IPART has determined Essential Water may recover is decreasing.

Essential Water disagrees with this methodology and maintains that the mines' water charges should change in line with all other customers. Considerable effort went into calculating prices specific for the mines in 2013 and used their water usage as a proportion of total water usage as the basis, among other factors. As the mines are already on prices specific to them, Essential Water believes that those prices should change in line with overall price changes.

In addition, Essential Water believes it is important to take into consideration that the proportion of water that the mines use, is forecast to decrease over time according to IPART's forecast figures. This is summarised in Table 1 below.

**Table 1: Proportion of Water Sales by Mines**

ML per annum	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actuals					Projections			
Total Billed Consumption	4,294	3,925	3,554	3,785	4,700	5,870	5,967	5,955	5,938
Mines Consumption	1,922	1,797	1,779	1,795	1,841	1,841	1,817	1,817	1,817
Proportion	45%	46%	50%	47%	39%	31%	30%	31%	31%

Source: '[Essential Water Pricing Model - DRAFT REPORT MODEL - for Essential Water.xlsm], Pricing Assumptions tab

Essential Water does not consider it is appropriate to significantly increase service charges for the mines when their expected proportion of water usage out of total billed water consumption is decreasing and is forecast to be a lower percentage of total water sales over the 2019-22 period than it has been historically. IPART has indicated that any actual change in proportion can be corrected in the next regulatory period, however, Essential Water considers that this delay in more correctly reflecting the forecast share of consumption will result in a disproportionately negative impact on the mines.

There is also a circularity argument with using proportions of total revenue, rather than total consumption. If all else remains equal going forward, the mines' proportion of revenue will increase following this regulatory period due to the price increases, with a similar pattern likely to re-occur again in subsequent periods.

Essential Water understands, from discussions with IPART staff, that amending the mines' prices by the same percentage as other customers will not impact the price for all other customers. Any reduction in revenue would be added to the amount to be subsidised by the NSW Government – to ensure that prices do not increase in real terms as a result of the Broken Hill Pipeline.