



18 October 2019

Dr Paul Paterson
Chair
Independent Pricing and Regulatory Tribunal
Level 15, 2-24 Rawson Place
SYDNEY NSW 2000

Dear Chair

Review of prices for Hunter Water Corporation from 1 July 2020 – Issues Paper

Flow Systems Pty Ltd (**Flow**) is grateful for the opportunity to provide submissions in response to the Issues Paper published by the Independent Pricing and Regulatory Tribunal (**IPART**) in respect of its review of prices for Hunter Water Corporation from 1 July 2020 (the **Review**).

Flow is a next-generation alternative utility providing water, wastewater and recycled water services in communities within the Sydney and Hunter Regions. Flow is a licenced retail supplier under the *Water Industry Competition Act 2006* (NSW) (**WIC Act**) and Flow Group companies hold network operators' licences under that Act. Within the Hunter Water area of operations, the Flow Group currently operates schemes in Huntlee and Cooranbong and retails water, wastewater and recycled water to over 600 customers. With the right policy settings, Flow believes that private water utilities have an important role to play in helping communities with their water needs, for the benefit of all consumers (including customers of Hunter Water).

Key Principles

In line with the matters that IPART must consider in making pricing determinations under section 15 of the IPART Act, Flow supports pricing that is cost reflective and champions pricing regulation that achieves the following objectives:

- **A Level Playing Field:** In times of climate uncertainty it is critical that Hunter Water's pricing be set in such a way as to promote competition in the supply of water services. Effective competition fosters innovation, security through diversity, options for consumers and, in the longer term, protection for consumers from monopoly pricing.
- **Equity over time:** This means that costs of operating, maintaining and growing the network over the long term should be born as evenly as possible between generations (or at least pricing periods). Ensuring that prices in the current pricing period are sufficient to fund the medium to long run costs will ensure that later pricing periods are not left with disproportionately large burdens or, on the other hand, lower levels of service and water security.
- **Effective price signalling to drive long term efficiency and the need to maintain ecologically sustainable development:** Pricing mechanisms should encourage activities in the market generally that efficiently improve water security and ecological sustainable development, to offset increasing levels of climate and environment risk in the system.

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Application to the current review

Flow is pleased to provide the following specific comments in relation to the Issues paper:

Chapter 3 – Operating and Capital Expenditure

Flow supports Hunter Water's approach to determining its operating and capital expenditure following a review of its organisational risks, including for works to ensure reduction of water losses and compliance with environmental protection requirements.

Ensuring appropriate levels of spending on water conservation and compliance are important to ensure a level playing field as well as intergenerational equity. WIC Act licensees are subject to strict compliance requirements that they must meet the cost of from a very small customer base. We welcome Hunter Water's efforts to properly cost in their compliance costs. Acting now and appropriately spending capital also provides for costs to be expended (and prices to increase) to reflect current needs, instead of deferring these actions for later generations to bear the cost and risk of failure to act.

Chapter 4 – Regulated Asset Base disaggregation and more accurate asset lives

Flow supports Hunter Water and IPART in their move to more accurately estimate asset lives. This is a critical element of intergenerational equity. In this regard, setting the depreciation allowance (and NRR) as accurately as possible now should be the priority.

Chapter 5 – Discretionary spending other than recycling schemes

Flow supports innovation and services to ensure an integrated approach to water management that brings greater levels of sustainability and liveability to our communities. We agree with Hunter Water and IPART that projects for which customers have expressed a willingness to pay can have costs met through additional customer charges. To ensure customers are aware of the work being done and can evaluate discretionary expenditure appropriately, it would be helpful if any discretionary expenditure recovered were expressed as a separate charge on customers' bills. We believe that this level of visibility will improve customer understanding about what their water charges cover and that valuable benefits can be achieved for a modest impost.

Chapter 7 – Pricing

While Flow supports water usage prices that reflect the long run marginal cost (LRMC) of water supply, we query why only the very lower bound of the LRMC estimate has been used. Little commentary has been made by IPART on this matter, but it would seem that choosing the lower bound of the LRMC could simply be adding risk to future water security costs. That is, by only recovering the very lowest estimate of the LRMC of water, little revenue is available for proper contingency planning and prevention works that could be critical in minimising the impacts of the current or future droughts. Flow would welcome more detail from IPART of its reasons for adopting the low bound estimate as the price target.

Similarly, for wastewater usage prices, in light of the recommendations of the *Frontier Economics* review of economic barriers to water recycling,¹ and the importance of the LRMC of wastewater services to provide efficient price signals to the market, Flow support's IPART's initiative to gain a better insight into Hunter Water's LRMC of supplying wastewater services.

Chapter 10 – Drought cost pass through

Average weather conditions have been used to size Hunter Water's proposed operating expenditure and capital expenditure for the pricing period to commence on 1 July 2020. This is despite current drought

¹ Frontier Economics, "Economic regulatory barriers to cost-effective water recycling: a report prepared for Infrastructure NSW", July 2018

conditions, which are expected to continue at least through current medium term forecasts (and possibly longer). Drought response measures should be part of Hunter Water's core plan and incorporated into their pricing proposal.

As set out in IPART's Issues Paper regarding the *Review of Prices for WaterNSW Greater Sydney from 1 July 2020*² it is not clear that increased costs arising from drought are not capable of being influenced now by Hunter Water by prudent and efficient spending during the next pricing period. Use of pass through events where the cost could be influenced by Hunter Water sends the wrong price signals and results in lower and lower levels of water security over time. Accordingly, we believe that IPART should treat pass through events for drought response with caution and carefully apply its criteria (as set out in box 10.2) to Hunter Water's request.

Chapter 11 – Recycling Schemes

Recycled water schemes offer a real opportunity to improve liveability and water security in communities throughout the Hunter Water area of operations. It is critical that the opportunities to provide wastewater recycling are open to effective competition so that consumers can enjoy the benefits of competition in their own communities.

Flow supports Hunter Water's initiative to implement new recycled water schemes for parks and public open space where the necessary expenditure is supported by customers' willingness to pay.

Flow submits, however, that allowing public utilities to meet the costs of higher cost recycled water schemes by levying the broader customer base (in certain instances) does give rise to issues in respect of a level playing field. Like Hunter Water, WIC Act licensees do, where permitted by licences and environmental requirements, provide water for parks and public open spaces within their areas of operations. Hunter Water has demonstrated that customers within the Hunter Region have a willingness to pay for those types of services. However, under the current wholesale pricing determination, the starting point would be that the revenue that could otherwise be collected and used by the WIC Act licensee to cover the efficient costs of providing the public irrigation service would need to be remitted (at least up to the price cap allowed for Hunter Water) to Hunter Water (on the basis that they would, if the end customer were theirs be able to recover that amount from the end customer). The result is that, even though Hunter Water has demonstrated that customers would be willing to pay for the public irrigation service within their community, it will effectively be unfunded in WIC Act communities. This perverse result would need to be corrected within the calculation of the minus by recognising the benefit that the WIC Act licensee is bringing (and that the broader customer base has agreed is something they are willing to pay for).

Conclusion

We thank IPART for the opportunity to provide our feedback to the Issues Paper and look forward to engaging further in respect of the Review. If you or the Tribunal have any questions regarding Flow's submission, please do not hesitate to contact me by email at [REDACTED]

Yours faithfully

[REDACTED]

Mark Edler
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² See, in particular, page 71 of that Issues Paper.