



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 Sydney Water 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 Sydney Water 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 Greater Sydney area, the Flow Group currently operates schemes at Pitt Town, Box Hill, Discovery Point, Shepherds Bay, Central Park and Green Square and retails water, wastewater and recycled water to over 6000 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.

#### **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 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

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that efficiently improve water security and ecological sustainable development, to offset increasing levels of climate and environment risk in the system.

### Application to the current review

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

#### *Chapters 2 and 3 – Capital expenditure to service growth*

Sydney Water has proposed that \$1.5 billion of capital expenditure be included over the pricing period to service new development (growth). However, Sydney Water actually anticipates that it will spend \$2.3 billion of capital expenditure to service growth over this four year period. That means that Sydney Water proposed to absorb the cost of funding the \$700 million difference between anticipated and allowed expenditure during the pricing period, before including the full capital expenditure in future prices.

Flow firmly believes that it will remain critically important for pricing settings to facilitate efficient entry of private sector WIC Act licensees to help manage down the impact of growth on Sydney Water's regulated asset base. Measures in the Sydney Water pricing review that will be critically important in achieving this level playing field include:

- (a) making sure that prudent costs are allowed for operating and capital costs to mitigate the effects of current and future adverse climate events and change (see further below);
- (b) getting to a point where the long run marginal cost (LRMC) of wastewater services (at least by catchment or system) can be understood, published and used as a basis for pricing and understanding avoided cost; and
- (c) ensuring that efficient costs of funding growth (including the funding costs of the \$700 million shortfall referred to above) are included in current pricing, so that the full cost of growth is understood and signalled to the market and policy makers.

#### *Chapter 4 – Operating expenditure should reflect ongoing climate stress*

Average weather conditions have been used to size Sydney Water's proposed operating expenditure for the pricing period to commence on 1 July 2020. This is despite current drought conditions, which are expected to continue at least through current medium term forecasts (and possibly longer). Drought response measures should be part of Sydney Water's core plan and incorporated into their pricing proposal. Sufficient revenue should be allowed for Sydney Water to take steps to avoid and mitigate drought and climate change related risks. This will both aid intergenerational equity as well as sending the right signals to allow for efficient entry of diversified and sustainable technical and commercial solutions (including, but not limited to, those offered by private sector WIC Act licensees).

Flow requests that IPART look at other acceptable methodologies for forecasting climatic conditions over the pricing period and allow for a prudent level of operational and capital spending to offset drier and warmer conditions. At the very least, it would seem reasonable to apply the same climate assumptions as have been applied in Sydney Water's demand proposal.<sup>1</sup> Applying the climate change uplift to demand but not to operating (and, potentially, capital) expenditure may result in amplified under-pricing of water. This is counter to intergenerational equity (those costs will need to flow through to consumers at a future time) and efficient price signalling (lower prices could shut out methods or entrants that are more efficient than current servicing models).

#### *Chapter 7 – Wastewater pricing*

Flow supports IPART's move toward setting wastewater usage prices with reference to the LRMC of wastewater servicing. This is because longer term capital spending will be critical in ensuring sufficient

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<sup>1</sup> See chapter 6 of the Issues Paper.

ecologically sustainable wastewater treatment capacity. Reference to the LPMC of wastewater servicing is also critical to allowing for the efficient entry of private water utilities in light of IPART's current wholesale pricing determination. As pointed out in the Issues Paper, this matter was discussed at length in the *Frontier Economics* review of *Economic regulatory barriers to cost-effective water recycling*.<sup>2</sup> A level playing field and the need to send the right price signals for efficient ecological development depend on the LPMC for wastewater services being well understood, publicly available and used as the basis for operating and capital plans. Without it, the current wholesale pricing regime will effectively block new entry to any WIC Act schemes that have any connection to the Sydney Water wastewater system (even if for very low volumes or occasional use).

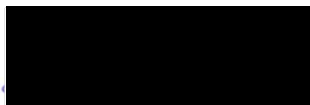
We look forward to further details regarding IPART's progress toward a meaningful LPMC for wastewater services.

## 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 IPART have any questions regarding Flow's submission, please do not hesitate to contact me by email at [REDACTED]

Yours faithfully



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<sup>2</sup> Frontier Economics, "Economic regulatory barriers to cost-effective water recycling: a report prepared for Infrastructure NSW", July 2018