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12 September 2018

Dr Peter Boxall
Independent Pricing and Regulatory Tribunal (IPART)
PO Box K35
Haymarket Post Shop NSW 1240

Dear Dr Boxall

IPART Review of Working Capital Allowance

Thank you for the opportunity to provide Sydney Desalination Plant Pty Limited's (SDP's) views on IPART's 2018 review of the Working Capital Allowance (the Policy). We commend IPART for taking the initiative to conduct this review.

IPART has sought submissions on its preliminary views on a number of aspects of its Policy as set out in its Information Paper. The Information Paper proposes refinements to the existing policy.

We generally agree with IPART's approach, however we have identified a small number of important areas which seeks to enhance IPART's proposed Policy as set out in the Information Paper.

The Attachment sets out our views on matters which are of concern to us.

We look forward to working constructively with IPART during this review.

Please direct any correspondence regarding our submission to Justin De Lorenzo, Chief Financial Officer ([redacted] or [redacted]).

Yours sincerely,

[redacted]

Keith Davies
Chief Executive Officer
Sydney Desalination Plant

Attachment: SDP's Response

Attachment

SDP’s Response to IPART’s Review of the Working Capital Allowance

IPART has included six questions for Stakeholder feedback in its Information Paper, SDP has comments on two of those questions.

1. Calculation of Working Capital as receivables minus payables plus inventory

SDP notes that IPART has removed prepayments from the definition of net working capital. The basis IPART cite for removing this balance is that measurement is difficult and/or it is not material. In SDP’s case prepayments are made up largely of insurance premiums which are paid in July each year and relate to insurance cover for the ensuing financial year. The practice of prepaying insurance premiums is generally accepted across all industries globally. The measurement of prepayments is straightforward and easily auditable.

In SDP’s case applying the post tax nominal WACC in SDP’s last determination of 7.2% to the average prepayment balance in the year ending 30 June 2019 would represent an approximate increase in SDP’s 2017-2022 annual working capital allowance of approximately 38% when in water security mode. This is a significant change in the allowance on any measure. Prepayments represent a real financing cost to SDP, its value is significant and the quantum is easily measureable.

SDP also notes that the expert report from Deloitte commissioned by IPART recommends that pre payments be excluded from the working capital calculation *“…..unless these businesses can reasonably demonstrate a requirement for prepayments to occur, and that these prepayments are consistent with the practices of a benchmark efficient firm.” (Source: <u>Return on Working Capital in the Notional Revenue Requirement, Final Report for IPART, Deloitte 5 July 2018</u>)* (page iv, Deloitte report)

SDP’s prepayment balance comprises the prepayment of an insurance premium in advance of the year in which insurance cover is provided. Prepaying an insurance premium in this way is accepted commercial practice for a benchmark efficient business. This view is also supported by SDP’s insurance broker Aon who attest that the prepayment of insurance premiums is normal commercial practice globally. Aon is the second largest insurance broker in the world.

On this basis IPART ought include its prepayment balance in the calculation of net working capital. SDP therefore disagrees with the Deloitte report that there is no *“….. compelling evidence to suggest that regulated businesses are required by some suppliers to pay in advance..”* (page15, Deloitte report)

On this basis SDP proposes that IPART include prepayments in the measure of net working capital providing a business can demonstrate that the prepayment is an efficient payment, the amount is measureable (on an objective basis) and it is material to the working capital allowance.

2. Receivables measurement for Water Businesses

SDP generally agrees with IPART’s proposed approach to measuring receivables for water businesses. However in determining the “benchmark number of days of delay” SDP advises that as it has only one customer, Sydney Water Corporation and that the timing of bill issuance and payment terms are governed by a contract between the parties, that IPART has regard to the number of days reflected in the contract. The relevant “benchmark number of days of delay” is therefore informed by the contract and the actual payment timing, the latter has been reasonably uniform over the past several years. Again this information is readily available from SDP’s records.

SDP proposes that IPART not impose on SDP a “benchmark number of days of delay” derived from across the water industry when the actual holding cost of receivables is clearly ascertainable from SDP’s contract with Sydney Water and past payment history.

We ask that IPART clarify its approach for determining a “benchmark number of days of delay” in the context of each business’ determination having regard to the business’ contractual arrangements with customer(s) and the actual payment history.

In addition in determining the <u>billing cycle</u> for SDP, IPART should have regard to the billing cycle reflected in SDP’s contract with its customer Sydney Water rather than impose on SDP an externally derived benchmark for water businesses in NSW.