

31 January 2020

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Draft terms of reference for an IPART price determination relating to a potential expansion of the Sydney Desalination Plant

Dear Anthony

I refer to the draft terms of reference, issued to IPART in December 2019 by the Minister for Water, Property and Housing, for an investigation of the prices that can be charged by the Sydney Desalination Plant (SDP) for an expansion of their facilities at Kurnell. We are currently SDP's only customer and we take an important interest in their service and costs, particularly as we need to recover SDP's costs through the bills of our customers.

As noted in the letter to IPART's Chair, an expansion of the desalination plant is an important component of the NSW Government's Drought Response Strategy. According to the terms of reference, the overriding objectives of the expansion would be to:

- Produce drinking water to a standard consistent with the existing plant;
- Deliver the expansion as quickly as practicable, in a prudent and efficient manner, with levels of design reliability, robustness and availability that are the same as the existing plant; and
- Provide flexibility for different operating modes for the existing plant and the expansion.

These are appropriate objectives to guide the design and construction of an expanded plant. The project objectives should also guide IPART in applying the terms of reference.

Although not explicitly mentioned in the above objectives, the availability of desalinated water will become increasingly important as the drought deepens. We recommend IPART also consider the need to minimise disruptions to the supply of desalinated water during construction of an expanded plant, accepting that some level of disruption is likely to be unavoidable.

We agree that a separate determination for the expansion is a sensible way forward, noting that the determination for the existing plant runs to 30 June 2022 and a decision to proceed is still to be made by Government.

While there is an intention to ultimately merge the two SDP determinations, it is conceivable that completion of the expansion may extend past 30 June 2022. This could result in the current SDP determination remaining in place beyond June 2022, which may provide a financial advantage to SDP. We suggest IPART should consider the various incentives faced by SDP in delivering the expansion in a timely manner.

Some other issues that might be considered by IPART during their investigation include:

- The timing of any increase in customer prices to pay for the expansion. For the existing plant, customer prices did not increase until after the plant had been completed;
- The source and cost of energy for the expansion. The existing plant was not required to use renewable energy during construction and commissioning; and
- Any agreements between SDP and another party that might affect their ability to recover costs associated with the expansion.

The introduction of desalinated water has fundamentally changed the way our network is operated. As you will be aware, our November 2019 price proposal included details of expenditure we will need to incur should an expansion of the desalination plant go ahead. As the volume of desalinated water increases, Sydney Water will face greater challenges in managing the network and this may require additional investments.

In order to optimise costs on a whole-of-system basis, IPART's analysis needs to consider the design, construction and operation of the expanded plant and its implications for our network. For example, the availability of storage capacity at the Kurnell facilities could influence the extent of works required in Sydney Water's network to manage a range of operational scenarios. These are material issues because the investment that we need to undertake to support a greater volume of desalinated water flowing through our network from Kurnell could amount to a cost of 50% or more on top of the cost of the expansion itself. A view of the cost implications for the water value chain as a whole will therefore be helpful in ensuring that the costs allowed for the expansion of SDP are the efficient long run costs for which customers should pay.

We look forward to participating in IPART's review to ensure that any expansion of the Sydney Desalination Plant is an efficient, effective and value-for-money addition to Greater Sydney's water supply network.

Yours sincerely

Philip Davies
Head of Regulatory Economics