

18 August 2020

Ms. Liz Livingstone
Chief Executive Officer
Independent Pricing and Regulatory Tribunal of NSW
Level 15, 2-24 Rawson Place
SYDNEY NSW 2000

Dear Ms Livingstone,

IPART consultation on WaterNSW rural bulk water prices – length of determination period.

On 28 July 2020, IPART published a Fact Sheet seeking feedback from stakeholders and the public on whether IPART should set prices for one year or four years for the Rural Valleys determination commencing 1 July 2021. This submission provides WaterNSW's views on this matter as outlined in our 30 June 2020 Rural Valleys pricing proposal ("**pricing proposal**").

Background

Our rural customers are undergoing a period of significant uncertainty and challenge. At the time of preparing our pricing proposal, and noting the much needed recent rainfalls in parts of NSW, drought conditions remain in many valleys and storage inflows remain low. WaterNSW is undertaking a number of drought supply options in close collaboration with the NSW Government to secure water supply for our rural customers. We are committed to ensuring a safe and secure water supply during one of the worst droughts on record.

COVID-19 is also disrupting normal consumer and business behaviour, further contributing to the uncertainty faced in rural areas. We have proposed a one-year determination period to provide short-term pricing relief for our customers and to take the opportunity to undertake additional customer engagement to better understand the practical impacts for our customers of these uncertainties and challenges and to inform our next proposal. .

Our customer engagement suggests that customers are supportive of a one-year determination period as, in addition to drought relief and COVID-19, it would allow sufficient time to undertake consultation to ensure our customers have an active say in the development of our next pricing proposal. This will help us better understand our customers' expectations and shape our future price-service offerings.

A one-year determination period will also assist WaterNSW to determine and assess the long term sustainable costs moving forward and customers' willingness and ability to pay for these levels of service, to fully inform our 2022 Determination.

WaterNSW intends on seeking full cost recovery of our long term sustainable costs at the subsequent 2022 Determination in order to meet our customers' expectations of appropriate service delivery.

Our proposal

The unprecedented combination of drought, bushfires and a global pandemic motivated our proposal for a one-year determination period. This also allows time to undertake a consultation process with our customers about the impacts of the current events and to examine customers longer term views of the sustainable deliver of water in rural valleys. This customer engagement will

empower us and our customers with the information and data necessary to actively respond to our customers' longer term service delivery needs while also better understanding their willingness and ability to pay.

A one-year determination period involves WaterNSW:

- Maintaining our revenue requirement in real terms and passing through uncontrollable costs, thereby avoiding larger price increases for our customers, who are already struggling with the impacts of drought and the uncertainty posed by the ongoing pandemic; and
- Continuing to undertake meaningful customer engagement so that we can continue to deliver services in a way that reflects customer preferences and the longer term sustainable cost of bulk water delivery.

While WaterNSW seeks a one-year determination period that attempts to 'mirror' a deferral by keeping our proposed revenue requirement constant in real terms, we are unfortunately not in a position to extend this approach to our revenue requirement beyond one year. This is due to the significant financial pressures on our business resulting from the higher costs of providing bulk water to rural customers relative to the current regulatory allowances and a significant fall in the WACC, with the nominal post-tax return on equity falling from 6.8% to 5.1% for MDB valleys and from 8.8% to 7.5% for Coastal valleys between the 2017 and 2021 Determination periods.

A one-year determination is consistent with Section 24 of the *Water Charge (Infrastructure) Rules 2010* ("**WCIR**") that allows a rural determination of less than four years to be approved by the regulator if it aligns with the determination period of a water supply determination of the same organisation (in this circumstance the Murray River to Broken Hill Pipeline) in order to reduce regulatory costs for the community.

Other options

WaterNSW's preference is for a determination period of less than four years. As such, we do not support the four-year determination period as canvassed by IPART in its Fact Sheet. We consider that a four-year determination period based on the forecasts provided in June 2020 would not adequately incorporate:

- An assessment of the long term sustainable costs of operating and maintaining the rural bulk water network;
- The outcomes from customer engagement into what services customers value and the costs of providing those services;
- Any longer-term impacts on costs and service delivery associated with ongoing drought and COVID-19;
- WaterNSW's capital and operating expenditure programs in the latter years of the determination period, as this was beyond what was required to support our proposal to keep our revenue requirement constant in real terms in 2021-22; and
- The financial, organisational and customer pricing outcomes associated with potential NSW Government water industry reforms, including the impacts of the non-urban metering reform program.

Based on the ability for WaterNSW to be in a materially better position to forecast its future efficient costs, a one-year determination period was strongly supported relative to a four-year period. Following lodgement of our pricing proposal and the release of the Fact Sheet, IPART has suggested there may be benefit in exploring the merits of a two-year determination period, assuming certain conditions are satisfied.

While WaterNSW initially explored the possibility of a two-year determination period, this was not ultimately not our proposed position due to:

- The need for a change to the *IPART Act 1992* ("**IPART Act**") and or to extend the timing of the current Broken Hill Pipeline Determination period, noting the latter was not supported from our major customer (Essential Water). WaterNSW considered that neither altering the Broken Hill Pipeline Determination period nor amending the IPART Act was practical or possible in the current circumstances; and
- The significant financial impact of proposing to keep our revenue requirement constant in real terms for a second year (i.e. 2022-23) given the serious impacts on our financeability.

The combination of the above factors contributed to WaterNSW proposing a one-year (rather than a two-year) determination period.

We note that there are potential benefits of a two-year determination period, including providing an additional 12 months to:

- Defer the administrative costs of WaterNSW preparing (and IPART reviewing) our subsequent Rural Valleys pricing proposal;
- Provide a one-year 'break' to customers by removing the need to participate in Rural Valley regulatory determinations in back-to-back years;
- Better assess the long-term sustainable costs of providing rural bulk water services;
- Undertake additional customer engagement on what services customer value;
- Better understand and assess the impacts on customers of drought and COVID-19; and
- Provide better visibility of the costs and impacts of the current NSW Government reform initiatives that may impact the way services are delivered in future.

If the legislative or regulatory constraints on the length of the determination period were removed, and if the financial pressures on funding the efficient costs of providing bulk water services in the second year were addressed, WaterNSW would be open to exploring the merits of a two-year determination period.¹

Finally, we note IPART's comment in the Fact Sheet regarding the potential to bring all rural water determinations into alignment in the future. WaterNSW supports this approach and looks forward to consulting with IPART and other stakeholders in achieving this much needed regulatory reform.

If you would like to discuss this submission further, please do not hesitate to contact [REDACTED]

Yours sincerely,

[REDACTED]
Joseph Pizzinga
Chief Financial Officer

¹ WaterNSW notes that IPART's 18 June 2020 determination for Greater Sydney bulk water services (an urban water service) incorporated a determination period length of four years, ending on 30 June 2024. A determination period of three years (ending on 30 June 2024) for Rural Valleys that would align to the Greater Sydney determination may be possible under the WCIR. The benefits of a three-year determination period have not been considered further as they do not materially improve outcomes for customers or the business compared with a one-year or four-year determination period.