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Independent Pricing and Regulatory Tribunal
PO Box K35
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To whom it may concern,

**Submission to IPART's Discussion Paper
Prices for Wholesale Water and Sewerage Services, Sydney Water and Hunter Water**

The City Of Sydney (the City) is pleased to make this submission to the Independent Pricing and Regulatory Tribunal's (IPART) Discussion Paper: Prices for wholesale water and sewerage services, Sydney Water Corporation and Hunter Water Corporation.

This issue is extremely relevant to the City as it strives for a water sensitive city that achieves the following outcomes for its community:

- Efficient use of potable water and reduced demand on the water and sewerage networks;
- Increased amenity and urban cooling through improved green space maintained by independent, climate resilient water supplies; and
- Improved quality of local waterways through reduced pollution discharged via wastewater and storm water outlets.

Water pricing plays a critical role in ensuring water sensitive city outcomes can be delivered. These outcomes are increasingly important as we respond to the demands of a growing population and changing climatic conditions including warmer temperatures and changing rainfall patterns.

The City objects to the proposed wholesale pricing methodology and believes it would have perverse outcomes for water recycling. The City disagrees with the proposed definition of wholesale services and customers, upon which IPART's entire Discussion Paper is based. The City is also of the view that the size of the issue that this review seeks to solve is disproportionately smaller than the effort required to administer the proposed solution. Hence existing non-residential retail prices should continue to be used until a broader industry review can be undertaken to ensure the fledgling recycled water market survives.

Disagree with proposed definitions of wholesale services and customers

IPART considers wholesale customers to be those that purchase water supply and/or sewerage services from Sydney Water for the purposes of on-supplying water and sewerage services to customers.

Collecting sewage from customers for treatment and reuse and discharging a residual waste stream to Sydney Water's sewerage network is not on-selling Sydney Water's sewerage services. It is providing a different service offering to customers including recycled water.

On-selling Sydney Water's sewerage services would be collecting sewage from customers and discharging that untreated sewage to Sydney Water's sewerage network without providing additional services to customers. With the exception of Sydney Desalination Plant, all *Water Industry Competition Act 2006* (WIC Act) licensees are treating effluent, industrial wastewater, contaminated groundwater and/or stormwater for reuse, not simply on-selling Sydney Water's sewerage services.

The proposed definition of wholesale *water* services and customers is more fitting, however it could be argued that water services are also not simply on-sold to customers as customers using recycled water place different demands on the existing water (and sewerage) network ie they use less water and time-of-use consumption differs.

IPART recognises that new entrants can 'enhance value' to customers through the services they provide (Discussion Paper s1.2 p3, s2.4 p19) however it is unclear how this enhanced value is recognised in the proposed pricing approach. It is also unclear to what extent sewage treatment costs as part of a recycled water scheme are considered in the proposed pricing approach. Enhancing value to customers through the provision of drought resilient recycled water to reduce potable water consumption, maintain green space to improve amenity, reduce urban heat island effect and increase biodiversity and liveability is clearly not on-selling traditional water and sewerage service delivery.

Cost to administer a price determination outweighs the benefits

The size of the issue that this review seeks to solve is disproportionately smaller than the effort required to administer the proposed solution which involves complex and time consuming pricing methodologies, calculations and/or determinations.

Flow estimated in its submission to IPART's Issues Paper: Review of Prices for Sydney Water, October 2015 that WIC licensees will have approximately 12,000 residential customers by 2020, no greater than 0.2% of Sydney Water's predicted 2020 residential customer base. Costs to administer any of the proposed options to cover WIC Act licensees will be high, especially options 2 and 3 which include scheme specific costs. They will also take a long time and additional delays to calculate costs and settle arbitration will create uncertainty and risk.

Using existing non-residential prices creates certainty

Instead of administering a complex pricing determination, existing non-residential prices including trade waste charges should continue to be used by WIC licensees. These prices are well understood and their continued use would create certainty in the market, allowing ongoing development and growth. These retail non-residential prices are proposed as interim prices by IPART in the proposed pricing options 2 and 3 while scheme specific prices are calculated and arbitration is settled. However the use of interim prices is not satisfactory as prices need certainty in order to attract investment and proceed with project development and delivery.

The City notes that IPART agrees on p25 of its Discussion Paper 'that there would be merit in an industry wide review of how to better facilitate competition in the water industry' but in order to provide certainty IPART does not consider it should delay its wholesale price determination. However, IPART also notes the potential for component pricing and broad policy changes in the future as well as its future review of recycled water pricing, all of which would affect wholesale pricing hence creating rather than reducing uncertainty.

The City would be pleased to discuss this matter further, including sharing its results of preliminary price modelling on broader application of the existing non-residential pricing regime.

A broader review is required to facilitate competition in the water industry

The City notes that IPART is conducting a number of separate reviews into water pricing including:

- the current review of water, sewerage and stormwater prices for Sydney Water from 1 July 2016;
- this wholesale pricing review for Sydney Water and Hunter Water; and
- the future full review of its approach to regulating recycled water scheduled for 2017-18.

In addition, matters relating to levels of service and the obligations to service will be captured in the future review of Hunter Water's operating license to apply from July 2017. Sydney Water's operating license will not be reviewed again until 2020-21.

The fact that several separate reviews are occurring at different times demonstrates the lack of integrated water cycle management that currently exists. Separate narrow reviews do not allow interrelated water issues to be considered in a broader context to ensure efficient investment outcomes prevail.

For example, in IPART's recent Draft Report: Review of Prices for Sydney Water, there is reference to liveable cities, integrated water cycle management and avoided costs, however discussion on these topics is deferred until IPART's 2017-18 review of recycled water. Similarly, this wholesale prices review does not include the supply of wholesale recycled water services. Nor does it consider the effect of developer charges, despite the significant impact developer charges have on investment decisions.

Broad review to include developer charges and postage stamp pricing

Developer charges for water, sewerage and stormwater were set to zero in 2008 while developer charges for recycled water schemes remain in place. This means the costs of recycled water schemes have to be recovered directly from customers serviced by those schemes while the cost of water and sewerage infrastructure is spread across the entire customer base. Beneficiaries of recycled water are the broader customer base, not just those that receive recycled water product. Broader benefits of recycled water include increased diversity of supply and water security through the provision of drought resilient water supplies to support increased greening, amenity, and biodiversity and reduced urban heat.

The City notes that fixed costs of Sydney Desalination Plant are covered by all of Sydney Water's customer base on an ongoing basis and in shutdown mode these costs represent about \$94 of a typical annual residential bill. IPART's Draft Report: Review of Prices for Sydney Water indicated a likely increase in water usage charge to cover the additional variable costs associated with the supply of desalinated water during water scarcity. As recycled water schemes also increase water security, IPART should consider also allowing recycled water costs to be covered by the broader customer base, consistent with the current postage stamp pricing policy.

The current disparity in cost recovery creates barriers to recycled water schemes being developed. IPART notes in its Discussion Paper that the combined effect of postage stamp pricing and zero developer charges gives incumbent utilities a competitive advantage over competitors. Yet developer charges will not be considered until IPART's 2017-18 review of recycled water.

A broader industry review is required for IPART to consider how to enable the delivery of liveability outcomes by both public and private water sector suppliers. This review should precede a wholesale price determination to ensure the WIC market survives.

Prices should not start with retail-minus

Retail-minus efficient competitor costs (plus net facilitation costs) is not an appropriate pricing approach to facilitate new entry for several reasons:

- New entrants have no control over the retail price and under a retail-minus model, reductions in the retail price such as those proposed in the current review of Sydney Water prices would directly result in reduced margins for competitors;

- Retail-minus as a starting point implies entitlement to customers by the incumbent monopoly provider. Future recycled water schemes in the City of Sydney's urban renewal areas involve new customers that are not existing Sydney Water customers hence starting with retail prices appears to favour the incumbent monopoly provider;
- It would be difficult to define and calculate reasonably efficient competitor costs for sewerage services when differing service levels are offered by competitors. For example, high levels of treatment to produce recycled water for local reuse compared to primary treatment for ocean discharges by Sydney Water;
- Incumbent utilities have a competitive advantage through ownership of the majority of existing water infrastructure (funded through postage stamp pricing);
- New entrants are required to provide services of equal quality to the incumbent's retail operations but how is the provision of higher service levels or enhanced value considered and calculated in the proposed pricing approach?
- Calculation of 'facilitation costs' relies on provision of information from the incumbent monopoly provider to calculate augmentation costs and savings, promoting monopoly power. Is Sydney Water's costing methodology for calculating augmentation costs reliable and accurate?

Prices should be cost reflective

Costs to discharge waste into Sydney waters sewerage infrastructure should be cost reflective, ie they should reasonably reflect the cost to Sydney Water to manage that waste stream. This is consistent with the pricing principle of the WIC Act s41(2) that:

'the price of access should generate expected revenue for the service that is at least sufficient to meet the efficient costs of providing access to the service, and include a return on investment commensurate with the regulatory and commercial risks involved'

Conclusion

The City does not support IPART's proposed wholesale pricing. A broader review is recommended which should precede any wholesale price determination. Existing non-residential retail prices should continue to apply to WIC licensees until a broader industry review is complete.

We would welcome the opportunity to discuss these important issues with you further. To arrange a meeting or for any questions in relation to this submission, please contact Lisa Currie, Manager Water Strategy by telephone on [REDACTED] or by email at [REDACTED].

Yours sincerely

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Monica Barone
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