

4 May 2016

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

Email: [REDACTED]

cc: [REDACTED]  
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**Sydney Water opex – estimated additional electricity opex of \$10m in light of Australian Competition Tribunal decision on electricity pricing determination**

Dear Dr Boxall

In our submission to IPART in response to the Draft Determination on 18 April, Sydney Water believes we may have created confusion about our position on electricity opex. It may have appeared we accepted the \$20m reduction in electricity opex recommended by Atkins-Cardno. The \$20m reduction in opex was based on outcomes of the AER pricing determinations for both Ausgrid and Endeavour Energy – the two electricity distributors serving our area of operations. This is not correct and was not our intention.

In the submission we noted that by using a bottom up budgeting process in February 2016, we proposed an alternative reduction in opex of \$56m – as opposed to the \$80m reduction recommended by Atkins-Cardno. This figure though included the \$20m reduction recommended by Atkins-Cardno, as it was estimated prior to the Australian Competition Tribunal's (ACT's) decision on the Australian Energy Regulator's (AER's) electricity determination on 26 February 2016. Sydney Water believes that in light of the ACT's finding, IPART should now re-consider the appropriateness of the \$20m recommended reduction in electricity opex.

To undertake a revised estimate, Sydney Water has made a number of limiting assumptions. In particular, we assumed price structures would not vary from those approved by the AER. We accept in practice price structures may change in response to higher revenues. However, we believe that given the inherent uncertainty associated with the estimates, such additional analysis would present a false level of precision in relation to our estimates.

Based on the ACT's decision, our indicative estimate is that the electricity opex (which is a function of Ausgrid and Endeavour Energy's revenues) could increase by \$10m. This is the mid-point of our estimated range for the additional electricity opex of \$8m-\$12m. This implies that rather than the \$56m reduction in our submission, our proposed reduction in opex relative to our Pricing Proposal would instead be \$46m.

This indicative estimate of \$10m of additional electricity opex took into account three key decisions made by the ACT that could increase the revenue allowance for Ausgrid and Endeavour Energy. The key decisions of the Tribunal relate to:

- **the gamma value, or valuation of imputation credits.** The ACT rejected the AER's methodology for valuing imputation credits and considered that a value of 0.25, rather than 0.4, is appropriate. This change increases the tax building block revenue that both Ausgrid and Endeavour Energy receive, which all other things being equal, will increase the prices and our opex relative to the AER determination outcome.
- **the cost of debt estimate.** The ACT set aside the AER's decision and ordered the decision to be remade in relation to the introduction of the trailing average approach in accordance with the Tribunal's reasons. In particular, the Tribunal found the AER was wrong to automatically conclude the debt management approach of Ausgrid and Endeavour Energy. On that basis we have simply adopted the higher cost of debt from the proposal by Ausgrid and Endeavour Energy. This in turn increases the return on capital building block to the providers, the prices they can charge, and our opex relative to the AER determination outcome.
- **the opex allowance, given concerns raised about the benchmarking process.** The ACT has found the AER failed to discharge its rule obligations through undue reliance on one model as a determinative factor in the opex allowance setting process for NSW and ACT electricity distribution businesses. Using \$2013-14, this approach resulted in Ausgrid experiencing a 25.6% decrease in opex, and Endeavour Energy a 16.9% reduction. While the AER has been requested to remake this element of its decision with a greater focus on broader modelling and bottom-up approaches, there are wide range of possible outcomes from such a redetermination process. On that basis, we have simply modelled the indicative effects from three opex scenarios. We have then taken the mid-point of the range of figures as the basis for our estimate.

For the purposes of transparency, Sydney Water has also provided IPART staff with an excel spreadsheet entitled "Sydney Water OPEX for electricity network charges", which captures the calculations we have undertaken to estimate these indicative additional electricity opex costs.

We would be happy to follow up any queries you have about the attached spreadsheet or the issues raised in this letter. Please feel free to have IPART staff overseeing our pricing determination to contact Dr Kris Funston at [REDACTED].

Yours sincerely



Kevin Young  
Managing Director