

Mr Hugo Harmstorf
Chief Executive Officer
Independent Pricing and Regulatory Tribunal
PO Box K35, Haymarket Post Shop NSW 1240

Dear Mr Harmstorf

Prices for WaterNSW Greater Sydney Area – WaterNSW submission to IPART Issues Paper

WaterNSW is pleased to provide a submission to IPART in response to the recently released *Review of prices for WaterNSW Greater Sydney Area Issues Paper*.

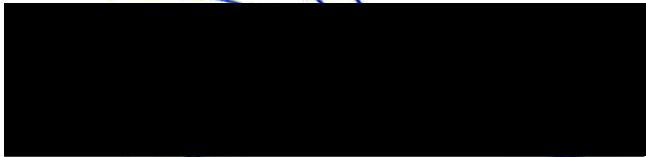
As IPART has adopted a 'propose-respond' approach to the 2016 price review, and WaterNSW has already provided its position on many of the questions raised in the Issues Paper in its Pricing Proposal of 30 June 2015, this submission focuses on areas where WaterNSW feels additional clarity will be useful to stakeholders and IPART.

Specifically, we respond to the following issues raised in the Issues Paper:

1. **Operating Expenditure:** We have provided updated forecasts of our Greater Sydney efficient operating costs for the 2016-17 to 2019-20 period which were not available at the time of our submission in June 2015. These updated forecasts lower operating costs for the period by a total of \$20.7 million (\$2015-16), driven by \$25.2 million (\$2015-16) lower employee costs than previous forecasts, partially offset by an additional \$4.5 million (\$2015-16) expenditure for Portfolio Risk Assessment.
2. **Capital Expenditure and Output Indicators:** We have provided suggested output measures for IPART to assess delivery of our capital program over 2016-17 to 2019-20.
3. **Asset Disposals:** We support IPART's proposed new methodology.
4. **Efficiency Schemes:** We reiterate our support for an opex EBSS and welcome IPART's support of a water quality incentive arrangement with Sydney Water.
5. **Shoalhaven Transfer Pumping Costs:** We support a pass-through mechanism for drought related Shoalhaven pumping costs.
6. **Price structure to Sydney Water:** We reiterate our proposal for a 80:20 ratio of fixed to variable volumetric bulk water prices to Sydney Water.

We look forward to continuing our engagement with IPART over the course of the review.

Yours sincerely,

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David Harris
Chief Executive Officer

1. Executive Summary

Our response to the IPART Issues Paper is structured as follows:

2. Operating Expenditure;
3. Price Pass Through for Shoalhaven Transfers and Fish River;
4. Output Indicators;
5. Asset Disposals;
6. Efficiency Benefit Sharing Scheme;
7. Raw Water Quality Incentive Payment Scheme; and
8. Price structure to Sydney Water.

2. Proposed operating expenditure

2.1. IPART Issues Paper questions

Question 3: *Are WaterNSW's proposed operating costs for the 2016 determination period efficient, taking into account the drivers of this expenditure?*

Question 4: *What scope is there for WaterNSW to achieve efficiency gains over the 2016 determination period?*

2.2. WaterNSW response

WaterNSW is committed to providing bulk water services to its customers at the lowest possible cost. In our submission to IPART in June 2015, we proposed achieving progressive efficiency savings such that by 2019-20 opex would be 3% lower in real terms than 2015-16.

We are pleased to now be in a position to update the Greater Sydney operating cost forecasts to include \$25.2 million (\$2015-16) of savings from the implementation of the new integrated organisational structure. WaterNSW now forecasts opex in 2019-20 to be 9% lower in real terms than in 2015-16.

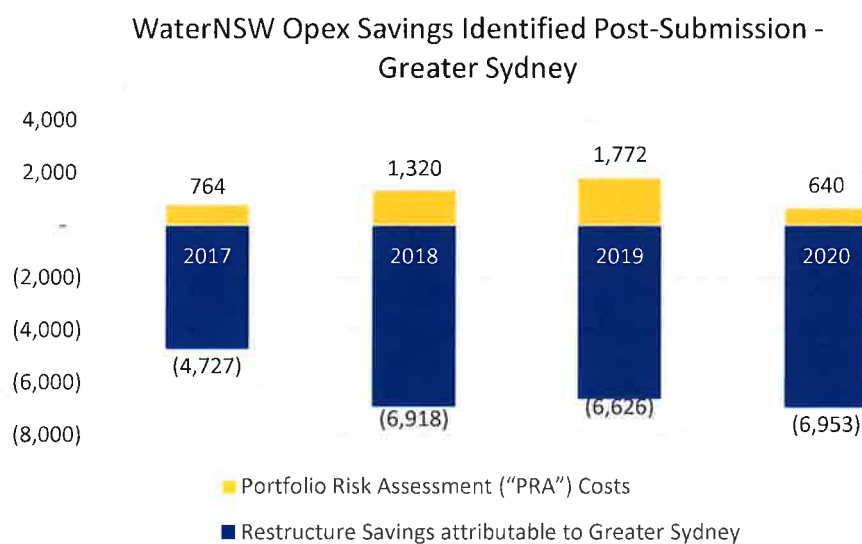
The design of the new organisation structure is the result of 12 months of work by the Executive involving the creation of a new WaterNSW Strategic Action Plan, the development of Team Charters for each of the Business Units in the organisation, a rigorous process analysing and challenging every position in each of the ten Business Units and a benchmarking of these against a peer group. The efficiency savings come from both direct and overhead costs.

These employee cost savings are partially offset by \$4.5 million (\$2015-16) in new costs to undertake a portfolio risk assessment (PRA) of our Greater Sydney Dams, which will enable consistent risk-based analysis of dam safety compliance, providing a robust business planning tool for investment benchmarking across our entire Dam portfolio. Warragamba Dam will be excluded from this study given the significant analysis already being undertaken by both the Warragamba Risk and Reliability Study and the Hawkesbury-Nepean Valley Flood Management Review. These studies will support a future PRA update for Warragamba.

The table below provides a high level summary of the revised operating expenditure to the Greater Sydney 30 June 2015 pricing submission:

(\$'000 2015-16 real)	2016-17	2017-18	2018-19	2019-20
Total Greater Sydney operating expenditure – Submission	102,680	100,956	101,436	100,633
less savings attributable to restructure	(4,727)	(6,918)	(6,626)	(6,953)
add Portfolio Risk Assessment (“PRA”) Costs	764	1,320	1,772	640
Total Greater Sydney operating expenditure – Revised	98,717	95,358	96,581	94,320
Net change to Greater Sydney operating expenditure	(3,963)	(5,598)	(4,854)	(6,313)
<i>change from 2015-16 opex</i>	<i>-4.7%</i>	<i>-7.9%</i>	<i>-6.8%</i>	<i>-8.9%</i>

The chart below shows the restructure savings, slightly offset by the new PRA costs, over the 2017 to 2020 period:



The savings allocated to the Greater Sydney region were calculated based on assumptions shown in the table below:

Cost Category	Allocation to Greater Sydney	Justification
Direct costs	72%	Of the employee related costs that are categorised as direct costs, 72% have been allocated to the Greater Sydney region. This forecast allocation is based on analysis of the new organisation structure, where efficiency gains are greater in the overhead business units and Greater Sydney activities than in Rural activities where resourcing has increased to enable improved State-wide asset planning and infrastructure solutions.
Overhead costs	53%	53% of overhead cost efficiency savings are allocated to the Greater Sydney region. This allocation is based on forecast 10-year average of overhead share based on historical proportions of the combined former Sydney Catchment Authority and the former State Water Corporation.

3. Cost Pass Through for Shoalhaven Transfers and Fish River Water Supply

3.1. IPART Issues Paper question

Question 6: *How should we treat costs of Shoalhaven transfers and bulk water supply from the Fish River Water Supply Scheme?*

3.2. WaterNSW response

IPART has proposed the use of a cost pass through mechanism for the pumping costs for Shoalhaven Transfers and water purchases for the Blue Mountains under the Fish River Water Supply Scheme.

In relation to Shoalhaven Transfers, we agree with IPART that the use of a cost pass through mechanism will provide a clearer signal to customers of increased water scarcity as well as address uncertainty with forecasting the cost of transferring water from the Shoalhaven system.

Currently, it is administratively simple to identify the cost associated with water transfer from the Shoalhaven as WaterNSW receives itemised electricity accounts for the operation of the Shoalhaven system. In practical terms, we would prefer passing through the cost to our customers on a quarterly basis (in arrears), as this would match with Sydney Water's quarterly customer billing cycle, and be administratively simple. Billing of the pass through could be based on actual electricity billed during each official pumping event under the DPI Water Operating Rules for the Shoalhaven System.

During periods where storages are above the pumping threshold of 80%, the pass through amounts would be zero. However, when storages are below the pumping threshold, the cost of water transfer (predominately energy costs) would vary from a few hundred thousand dollars to around \$5 million per quarter.

In relation to water purchases from the Fish River Water Supply Scheme (FRWS), we do not support the use of a cost pass through mechanism as purchases are tied to the operation of the Blue Mountains water supply system. Water is purchased, in most quarters, from the FRWS principally to avoid the higher pumping costs from Orchard Hills Treatment Plant (incurred by Sydney Water) to the upper Blue Mountains. These water purchases are relatively small in quantity. Passing through such small amounts, calculated as an approximate estimation, to the customer would incur relatively high transaction costs compared with the amounts being reimbursed. We therefore do not support the introduction of a cost pass through mechanism for water purchased from the FRWS and request the amount be included in the operating expenditure allowance.

4. Output Indicators

4.1. IPART Issues Paper question

Question 7: *What output measures should we establish for WaterNSW for the 2016 determination period?*

4.2. WaterNSW response

We propose the capital projects shown in the table below be monitored as output measures. These capital projects and their budget and delivery deadlines are representative of the delivery program of our Greater Sydney capital program and include a range of projects in terms of total spend (\$4M to \$610M), business drivers (mandatory, discretionary and government directed), timing (within price path and long run projects, and project type (civil, electrical, mechanical and dam safety).

We will work with IPART and its expenditure review consultants in determining the most appropriate projects for output measures monitoring, including appropriate timeframes.

Project Name	Driver	Total Cost \$000 (2015-16)	2017-2020 Cost \$000 (2015-16)	Expected Completion
Blue Mountains Electrical Monitoring and Control	Discretionary Stds	3,585	3,585	2019
Warragamba Embankment Upgrade	Mandatory Stds-Renewals	10,050	7,200	2022
Burrawang Pumping Station Elect System Stage 3	Mandatory Stds-Other	12,302	3,232	2018
Warragamba Pipelines valves and controls upgrade	Discretionary Stds - Other	11,533	10,137	2021
Upper Canal Interim Works Phase 2	Discretionary Stds - Other	68,845	65,770	2020
Next tranche of water (notionally Shoalhaven)	Growth	610,736	131,116	2024

5. Asset Disposals

5.1. IPART Issues Paper question

Question 11: *How should we treat WaterNSW's sales or disposal of assets in setting prices?*

5.2. WaterNSW response

IPART proposed a new methodology for adjusting the Regulatory Asset Base when utilities dispose of assets. We support IPART's proposed methodology, considering it a fair and appropriate mechanism which will provide the right incentives for utilities, including WaterNSW, to identify and dispose of non-essential assets.

6. Efficiency Benefit Sharing Scheme

6.1. IPART Issues Paper question

Question 14: *Will the inclusion of an Efficiency Benefit Saving Scheme (EBSS) in WaterNSW's pricing determination generate benefits?*

6.2. WaterNSW response

We support the inclusion of an EBSS in the 2016-20 pricing period for the reasons stated in our pricing submission. An EBSS will provide regulated entities with the right incentives to minimise controllable costs and to pass these savings onto customers.

We note IPART's concerns regarding the ability to 'game' the EBSS, namely, the shifting of expenditure between regulatory years or to a single base year to achieve a higher forecast allowance in the next regulatory period and/or a higher efficiency benefit. However we consider this risk relatively low, and consider the incentive benefits of an EBSS, particularly for customers, to outweigh the risks. WaterNSW's cost-base is largely 'fixed' and its ability to 'shift expenditure' and 'game' an EBSS is very limited. We note that IPART has the ability to review and amend any EBSS framework at each regulatory pricing review should any evidence of 'gaming' emerge.

We support an EBSS that strikes the right balance between simplicity, transparency and the achievement of regulatory objectives. We will work closely with IPART and stakeholders with the objective of developing an EBSS that results in incentives and rewards for achieving continuous operational efficiency improvements, puts downward pressure on customer bills and does not create any perverse incentives or 'gaming'. It is worth noting that EBSS schemes operate successfully both in Australia and in international regulatory environments to good effect. We are confident a similar scheme in the NSW regulated water industry will drive better customer outcomes and a stronger and more mature regulatory regime.

7. Raw Water Quality Incentive Payment Scheme

7.1. IPART Issues Paper question

Question 15: *Will the inclusion of a Raw Water Quality Incentive Payment in WaterNSW's prices to Sydney Water result in net cost savings?*

7.2. WaterNSW response

The Raw Water Quality Incentive Payment Scheme (RWQIS) is a service performance incentive mechanism. Service performance incentive mechanisms generally provide a reward (and sometimes apply a penalty) based on achievement of or improvement to specified performance standards. In this case, if WaterNSW can deliver better quality water to Sydney Water than the performance benchmark set in the RWQIS, then Sydney Water will pay WaterNSW up to \$1M each year for this higher quality bulk water.

The RWQIS is designed as a "win-win", as Sydney Water benefits from lower water treatment costs incurred as a result of WaterNSW supplying higher quality water, which funds the incentive payment. WaterNSW is incentivised to go to more effort to provide higher quality to Sydney Water, with the incentive payment funding any additional costs in attempting to provide higher quality water.

We will work closely with IPART to further quantify the benefits of the RWQIS.

8. Price structure to Sydney Water

8.1. IPART Issues Paper question

Question 18: *Should the current 80:20 fixed to volumetric ratio of bulk water prices to Sydney Water be retained?*

8.2. WaterNSW response

We reiterate our proposal to maintain the 80:20 fixed to volumetric ratio of bulk water prices to Sydney Water. As discussed in the June 2015 price submission, this ratio reflects the fixed cost nature of WaterNSW's business and provides cost certainty to the customer.