- Please mute your microphone
- Please turn on your camera (webcam)
- We will start at 10:02am

IPART Independent Pricing and Regulatory Tribunal | NSW

Review of prices for Sydney Desalination Plant Pty Ltd from 1 July 2023

Public Hearing

21 February 2023

Welcome and Acknowledgement of Country

Carmel Donnelly

IPART Chair

Agenda

10:00 am	Session A: Overview of the price review and presentation by SDP
10:50 am	Session B: Service levels and costs
11:20 am	Short break
11:40 am	Session C: Incentives and risks
12:10 pm	Session D: Pricing arrangements

Public hearing

Session A
Overview of price review

Our goal

Ensuring you pay a fair price for safe, good quality and reliable services

Our role

Setting maximum prices for SDP based on efficient costs

Context for this review

SDP – Construction
2007-2010

IPART – SDP water price review
2011

SDP – 50y lease
2012

2017 Metropolitan Water Plan
2017

IPART – SDP water price review
2017

2022 Greater Sydney Water Strategy
2022

Decision Framework
2022

SDP's new Network Operator's Licence
2022

Terms of Reference
2022

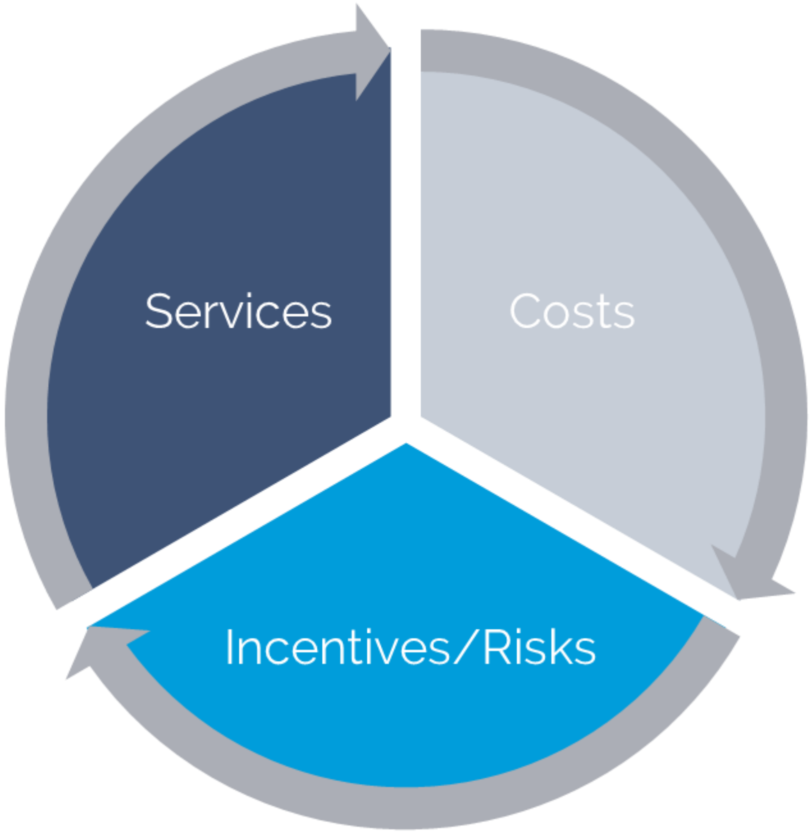
IPART – SDP water price review
2022-23

SDP's new prices
1 July 2023

Key theme of our price review

Achieving balance between service levels, costs and risks

SDP's prices should reflect a fair balance between the levels of service expected from SDP, the efficient costs required to deliver these services and the efficient allocation of risk between SDP and customers who are paying for these services



Our review timeline

Pricing Proposal
16 Sept 2022

Issues Paper
29 Nov 2022

Public Hearing Sydney
21 February 2023

Draft Report
April 2023

Final Report
End June 2023

New prices
1 July 2023

Public hearing

Session A
Presentation by SDP

SYDNEY DESALINATION PLANT

SDP’s 2023-27 Pricing Submission

21 February 2023

Acknowledgement of Country

We acknowledge the Gweagal clan of the Dharawal people as the Traditional Owners of the land that the Plant resides on, and we pay our respects to Elders past and present

La Perouse Local Aboriginal Land Council

Our role is changing…

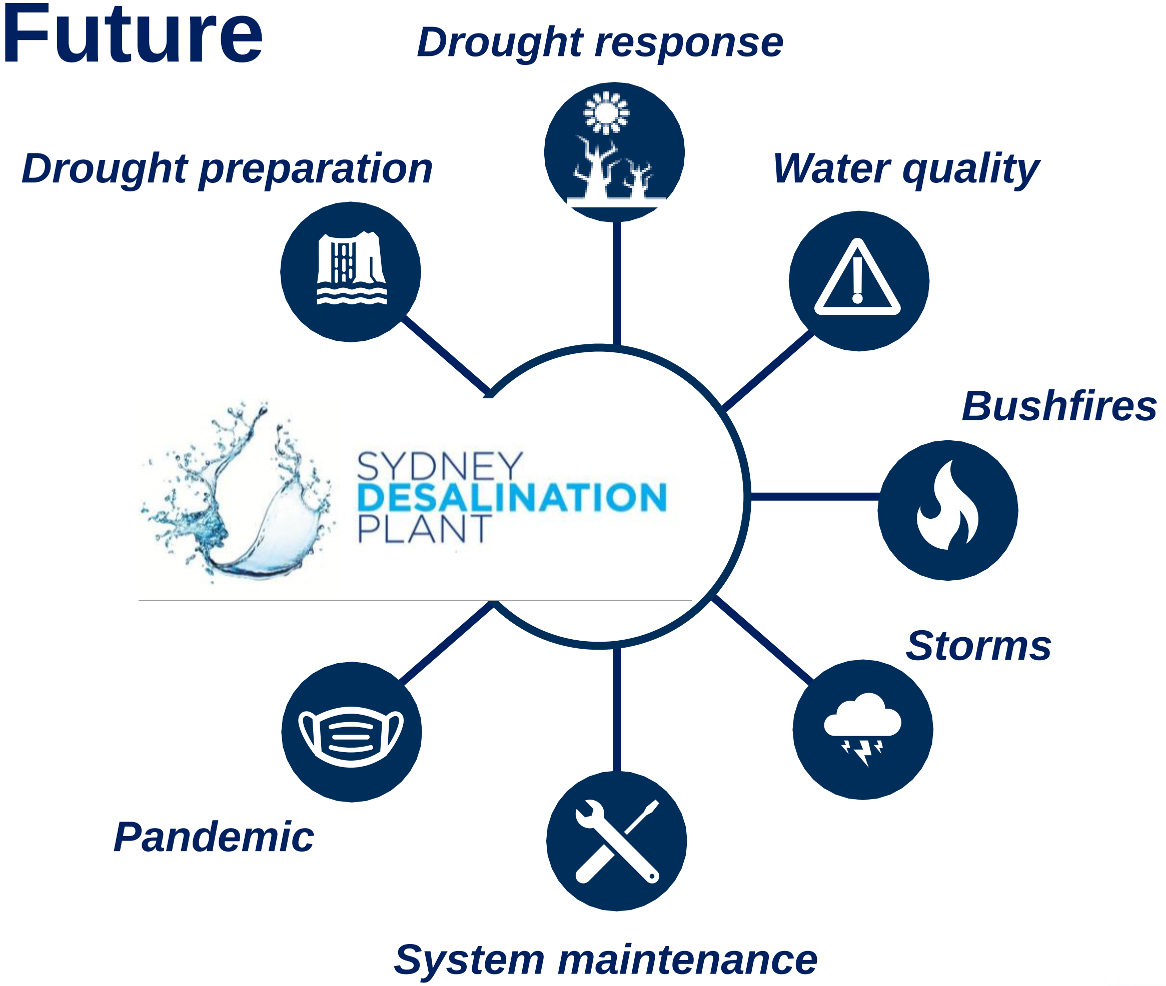
Historical

Drought

Water quality

…to provide greater value to customers

Future



Stakeholder engagement

Sydney WATER

NSW GOVERNMENT

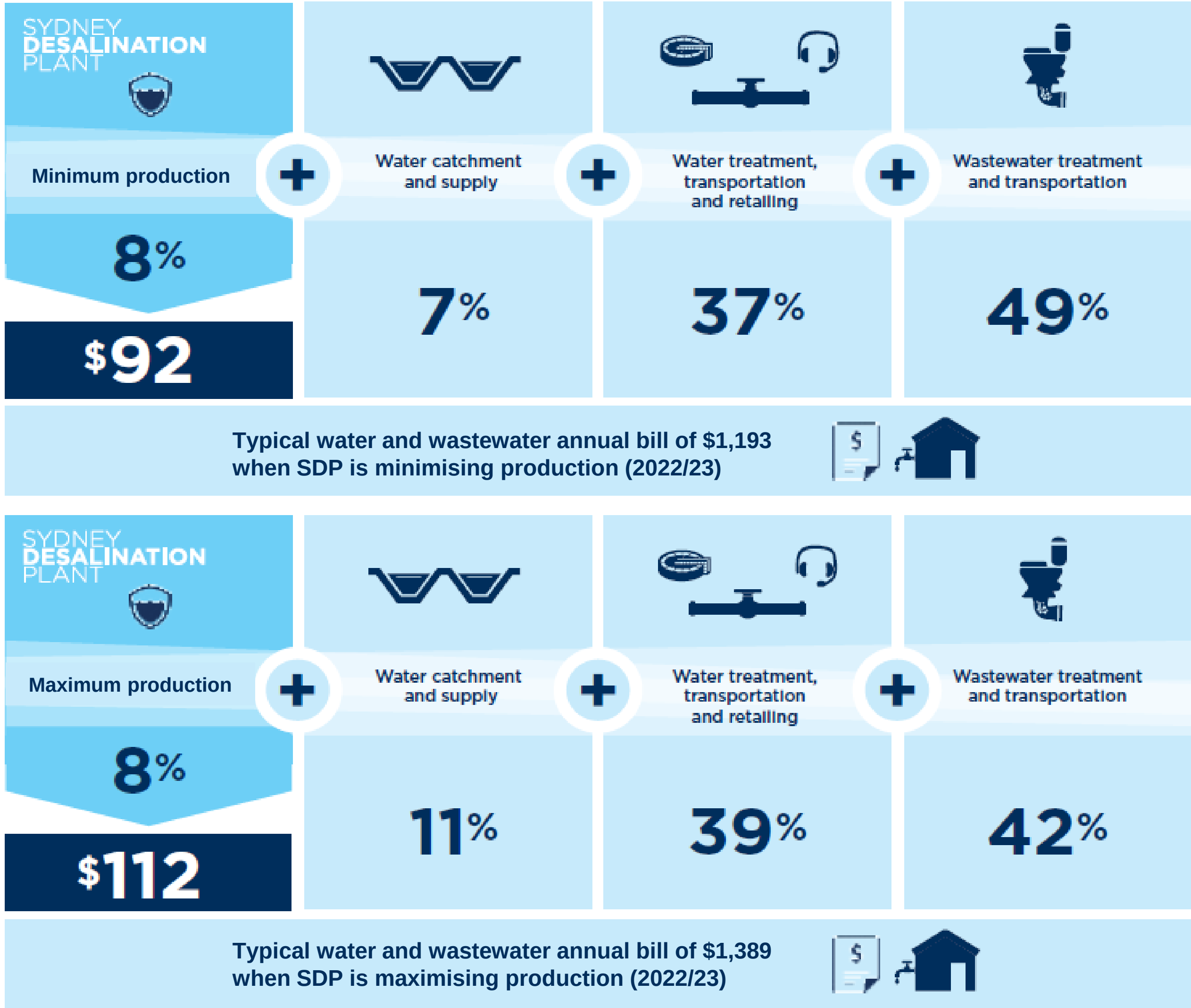
IPART

Customer focus groups

Long-term customer value

SDP’s 2023-27 Pricing Submissio

Projected bill impacts under SDP Submission



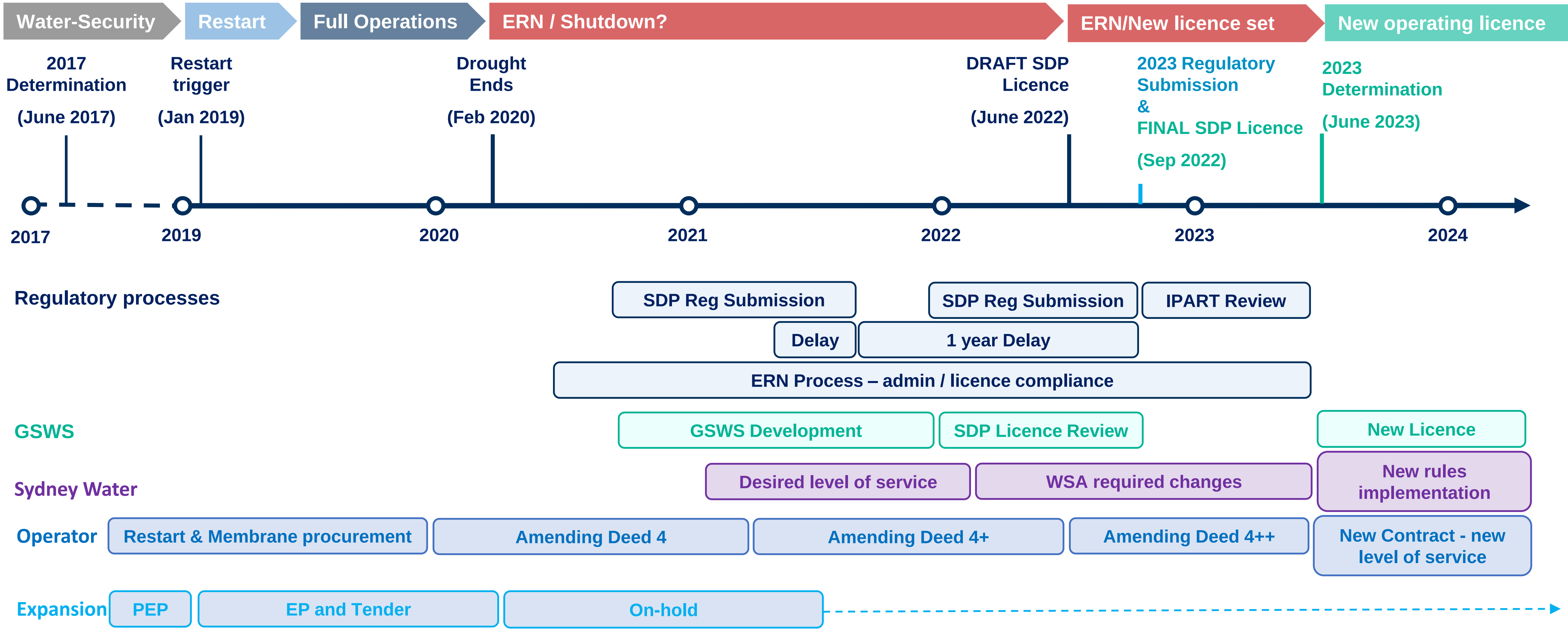
Annual bill impact on 1 July 2023

+ 0%
at minimum/baseline production

SDP proposes to provide more value to customers while keeping prices stable

+ 0.3%
at maximum production

For SDP, 2017-22 did not unfold as expected…
It was challenging, unprecedented and unknown



For SDP, 2017-22 did not unfold as expected…
It was challenging, unprecedented and unknown

Water-Security | Restart | Full Operations | ERN / Shutdown? | ERN/New licence set | New operating licence

2017 Determination (June 2017)

Restart trigger (Jan 2019)

Drought Ends (Feb 2020)

2017

2019

2020

- It was presumed unlikely that the Plant would operate let alone operate in an Emergency Response capacity
- The Plant restarted, operated and prepared for shutdown then has continued to operate under Emergency Response provisions
- Planning was advanced for an expansion – currently on-hold

Regulatory processes

Delay | 1 year Delay

ERN Process – admin / licence compliance

GSWS: GSWS Development | SDP Licence Review | New Licence

Sydney Water: Desired level of service | WSA required changes | New rules implementation

Operator: Restart & Membrane procurement | Amending Deed 4 | Amending Deed 4+ | Amending Deed 4++ | New Contract - new level of service

Expansion: PEP | EP and Tender | On-hold

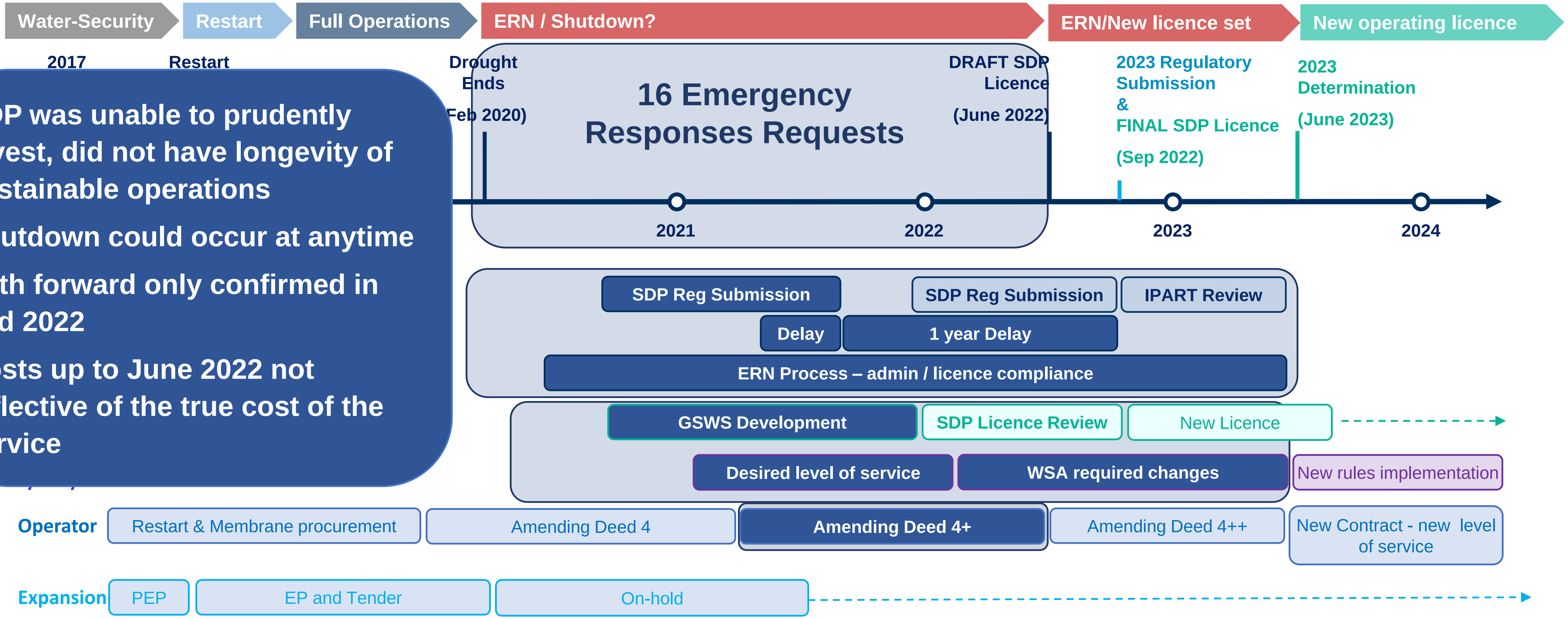
Emergency response/Shutdown?

SDP was unable to prudently invest, did not have longevity of sustainable operations

Shutdown could occur at anytime

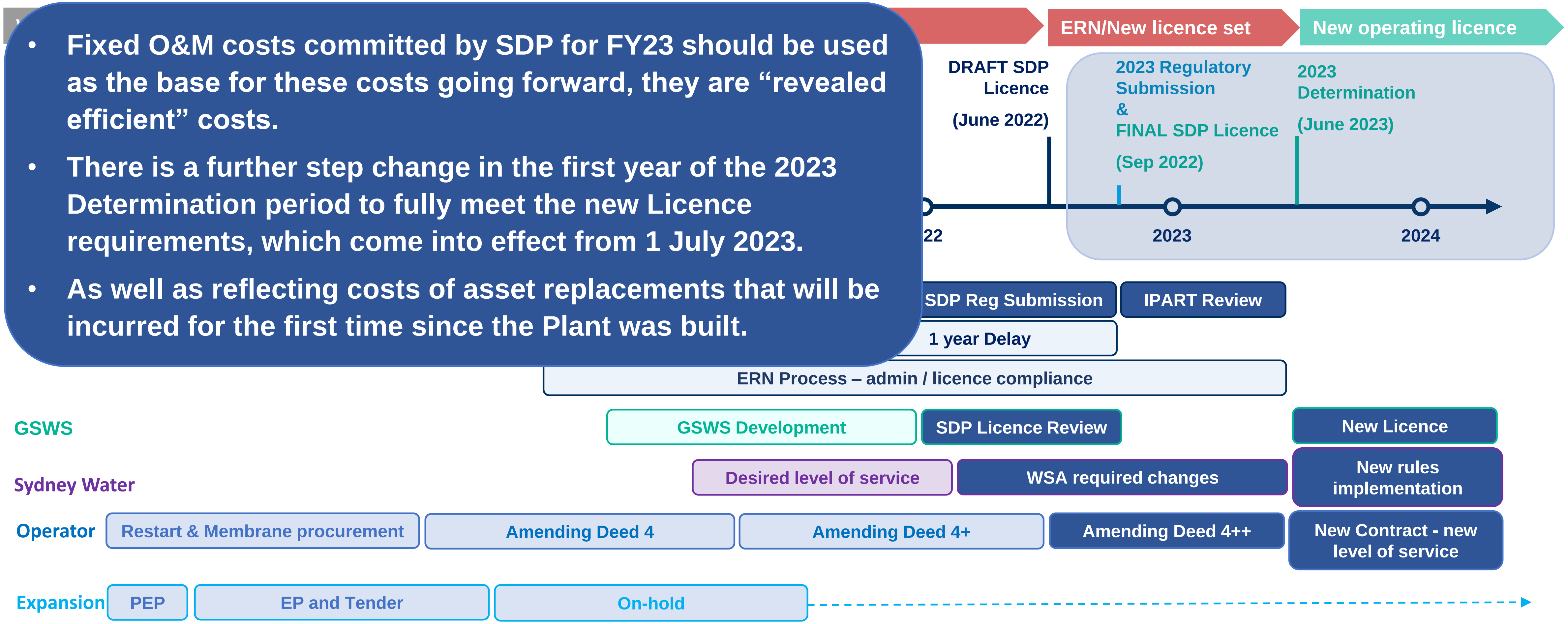
Path forward only confirmed in mid 2022

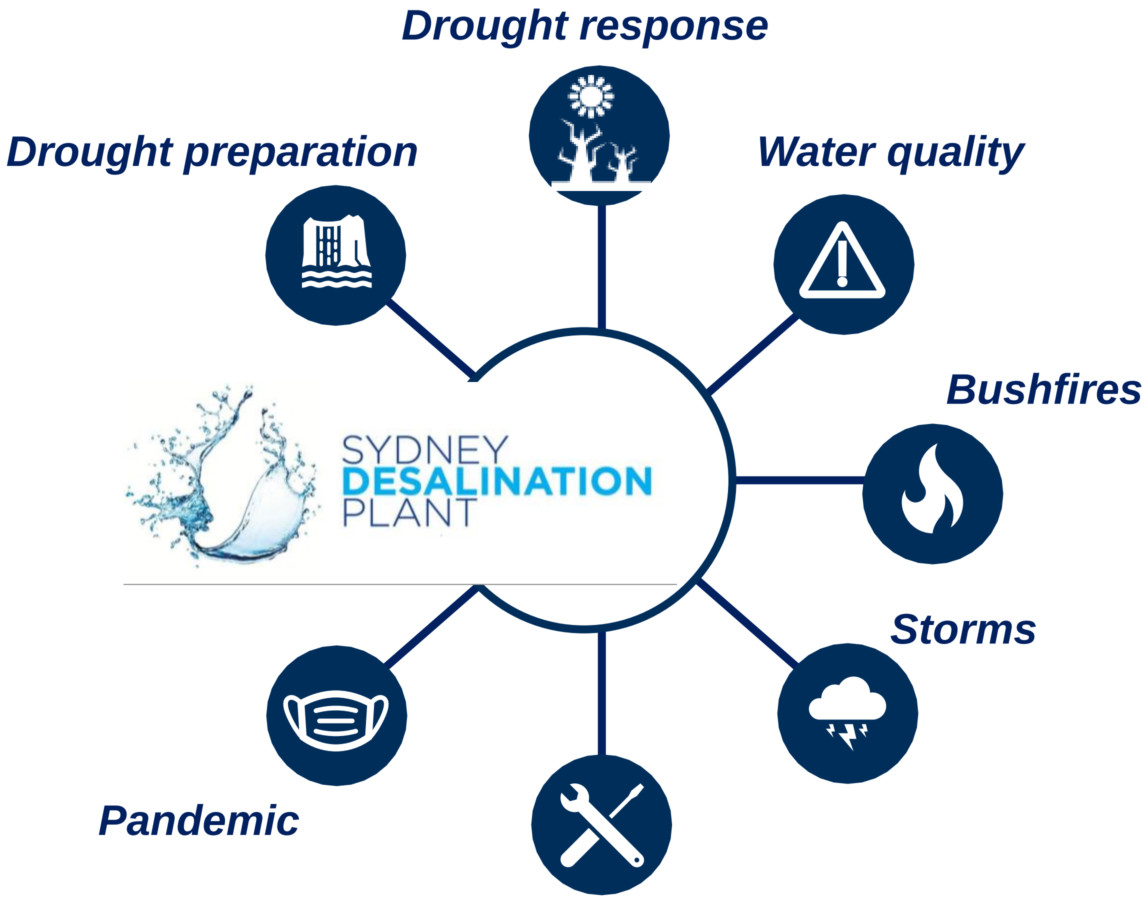
Costs up to June 2022 not reflective of the true cost of the service



New operating environment

- Fixed O&M costs committed by SDP for FY23 should be used as the base for these costs going forward, they are “revealed efficient” costs.
- There is a further step change in the first year of the 2023 Determination period to fully meet the new Licence requirements, which come into effect from 1 July 2023.
- As well as reflecting costs of asset replacements that will be incurred for the first time since the Plant was built.





SDP’s new licence requirements

- Respond to Annual Production Requests (APRs) issued by Sydney Water consistent with the Decision Framework +/-10%
- Undertake its best endeavours to respond to other production requests issued by Sydney Water consistent with the Decision Framework (including monthly and 7-day production requests).

Proposed movements in key cost items

Overall cost to customers projected to remain stable under SDP's Submission

Cost item	Movement	Explanation
O&M Expenditure	↑	Increases driven by need to maintain the plant in a constantly operational state consistent with **new Operating Licence** requirements, as well as additional **routine asset maintenance** and increases in **chemical costs**.
Capital Expenditure	↑	Slight increase in projected capital expenditure to implement an **ongoing membrane replacement program**, small number of **critical asset upgrades** and some refurbishment of aging assets.
Energy	↔	Energy costs at the end of 2021-22 are close to the GGRP contract prices, adopting the GGRP contract prices keeps energy costs flat in real terms (market based prices would increase SDP's energy cost allowances above its costs).
Financing costs	↓	Reductions in interest rates compared to last regulatory period results in lower financing costs into RP3.
Corporate & Insurance	↑	Increases driven by **greater complexity in SDP's operations** since the last regulatory period as well **higher insurance costs** driven by heightened natural disaster/climate change, cyber and pandemic related risks.

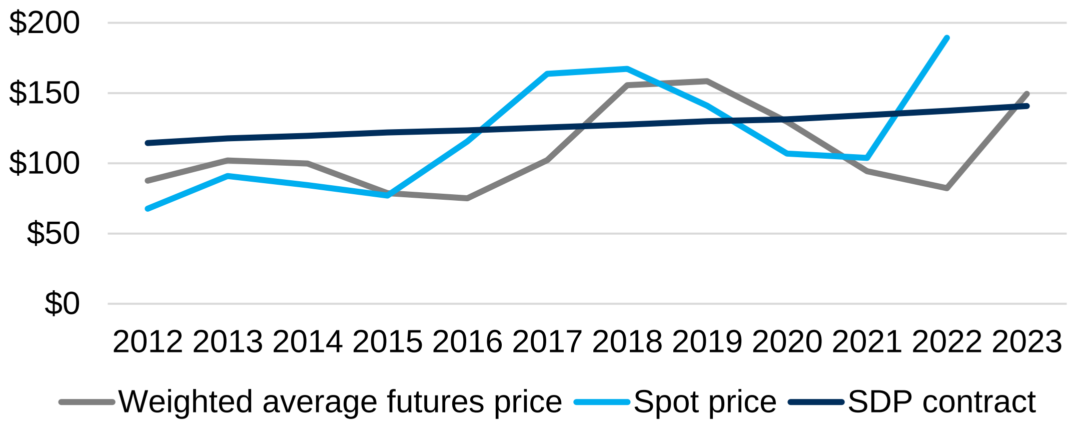
O&M Expenditure

- Additional staff to manage **production transitions, resilience and safety**.
- Ensuring SDP meets its **environmental licence requirements** at different production levels.
- **Asset rotation** across modular equipment including pumps and desalination modules to deliver customer service.
- **Refurbishments** with a frequency of 4-6 years – previously covered through insurance funding for the re-instatement, due again.
- **Replacements** of a large number of electrical, instrumentation and controls assets with a life of 10-15 years (classed as opex due to low individual value).

Energy costs

- SDP is required to be 100% renewable powered, demonstrated through a Greenhouse Gas Reduction Plan (GGRP).
- SDP's Project Approval nominated the long-term contracts with Iberdrola (the GGRP contracts) as the means through which SDP ***must*** procure its energy.
- SDP has a legal obligation to source energy through these contracts
- Government has recognised this through amendments to SDP's Terms of Reference and it is supported by Sydney Water

Combined energy prices (Electricity + LGCs) – GGRP contracts v prevailing market prices ($/MWh, $nominal)*



The prices under the GGRP contracts sometimes higher, sometimes lower, but stable and predictable, removing risk of price shocks for customers.

New Service Level Incentive Scheme

- Rewards/penalties for production performance outside the +/-10% tolerance limit in the new Licence.
- A cap of 2.5% of annual fixed charges on rewards/penalties
- The cap will provide a considerable saving to customers through reductions in our business interruption insurance cover

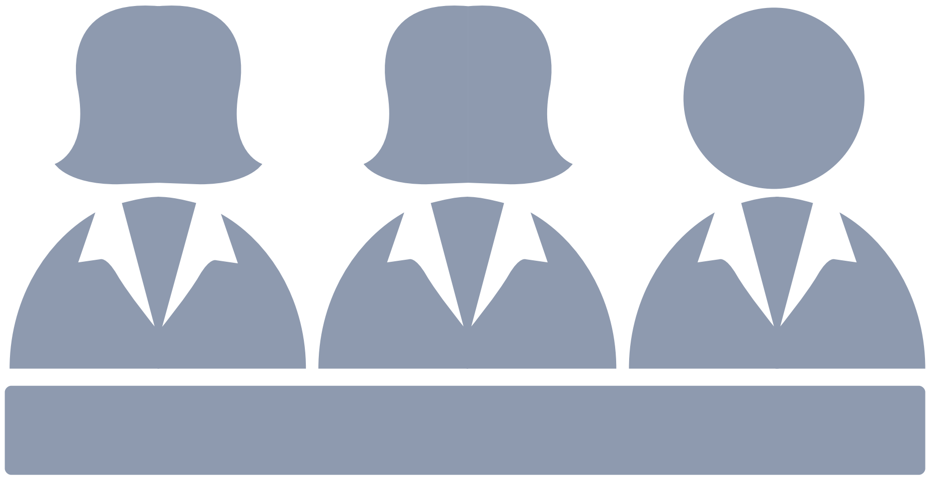
Efficiencies

The right balance of applying efficiencies and providing incentives for SDP to deliver a new service is needed

Past experience cannot be relied on as a measure for delivering services in a new operating environment, the latter will be a steep learning curve for all stakeholders

Thank you

Discussion and Q & A session



Public hearing

Session B

Service levels and costs

SDP's new operating environment

Previously, we set SDP's costs and prices based on its drought response role

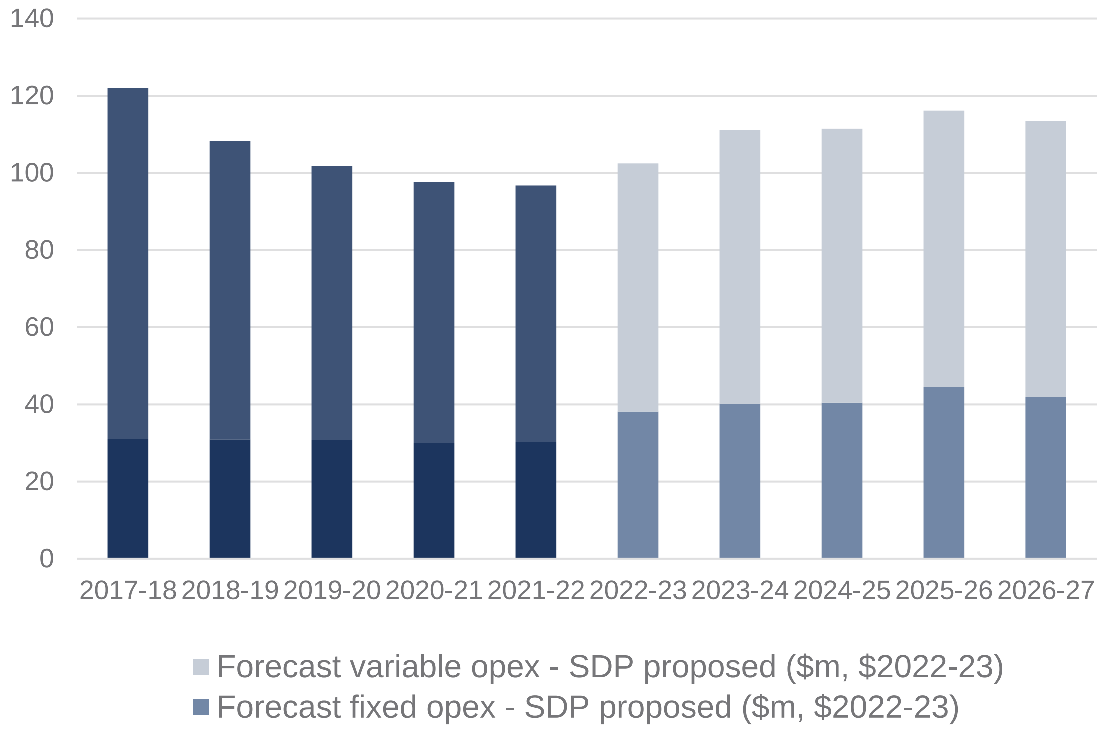
Under the new water strategy, SDP's role has expanded to flexible full time operation

We consulted on whether SDP's proposal reflects a balanced package of services, costs and risks that is in customers' long-run interests

Proposed operating expenditure

SDP proposed to spend around $113 million per year in operating expenditure

- This is 7.5% higher than the average allowance per year set in 2017
- Key drivers are:
  - Higher O&M costs to keep the Plant in a state of ‘readiness’, allowing it to quickly ramp up production when required
  - Higher corporate costs to manage oversight of the Plant, enabling it to respond to production requests in a timely and flexible way



Note: The figure for 2022-23 is an estimate by SDP for the deferral year.

SDP's proposal on energy costs

Previously, we set SDP's energy cost allowance costs based on a benchmark approach using market-based data

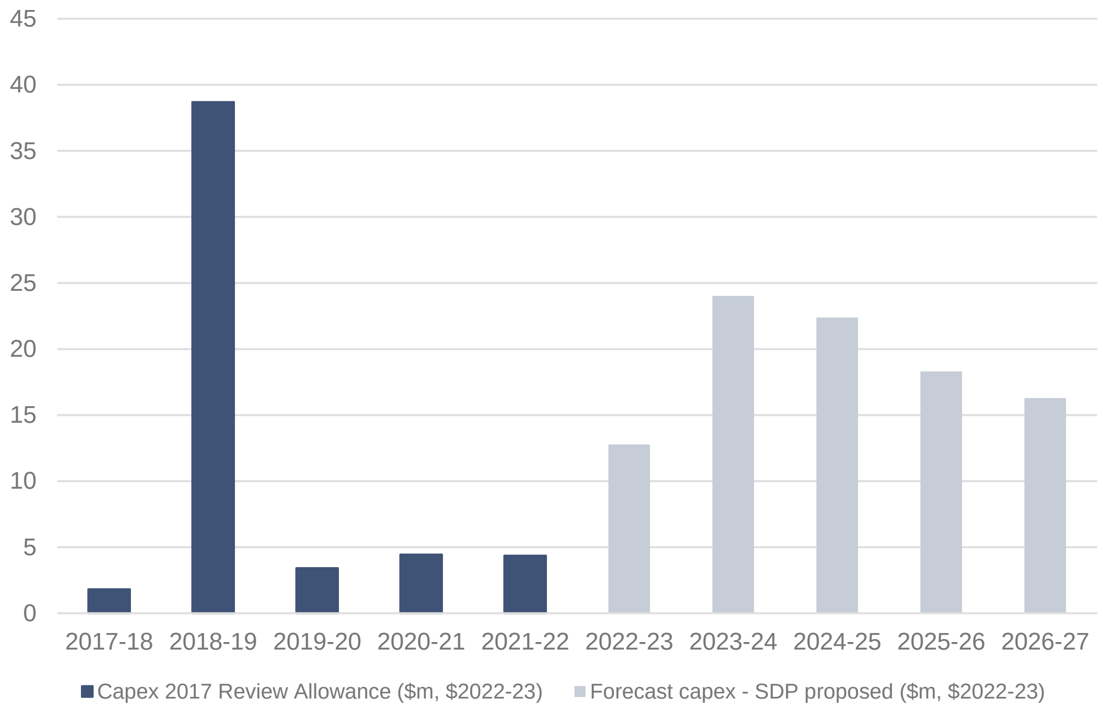
SDP proposed to set future energy costs using its existing energy contracts

We consulted on whether the proposal provides appropriate signal to efficiently manage costs and deliver value to customers

Proposed capital expenditure

SDP proposed to spend $81 million in total capital expenditure

- This is approx. 90% higher than the average allowance per year set in 2017
- Key drivers are:
  - Membrane replacement, to drive energy efficiency and lower operating costs for the Plant
  - Periodic maintenance, to maintain the Plant's assets in good condition and ensure performance reliability
  - Major projects to improve redundancy and reliability of the Plant, including a new 132kV electrical feeder



Note: The figure for 2022-23 is an estimate by SDP for the deferral year.

SDP's proposal on asset lives

Previously, we set the asset life for the pipeline at 120 years

SDP proposed changing the asset life of the pipeline to 100 years

We consulted on whether the proposal to reduce asset life is appropriate

Proposed total costs

Upward pressures

Operating costs are 7.5% higher per year

Capital costs are 90% higher per year

Downward pressures

The WACC has fallen from 4.7% to 3.6%. Note the final WACC is subject to change.

Under full production and before inflation, the proposed revenue requirement is approx. 7% lower than the level set in 2017

What have stakeholders said so far?

Expanded role

Some stakeholders recognised the change, however others expressed concerns that this change is unnecessary

Minimum production level

Support for setting the minimum level, however there are mixed views on the level and who should set it

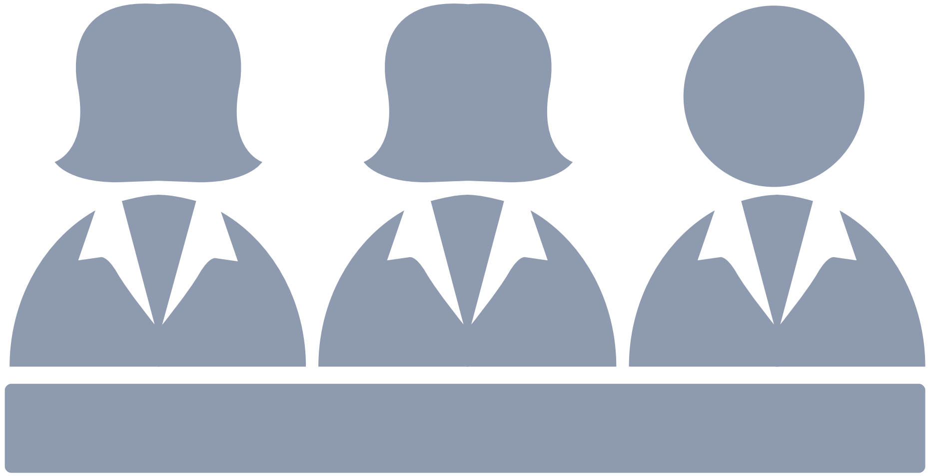
Energy costs

Support for using SDP's existing energy contracts to set the energy cost allowance

Insurance costs

Mixed support for the coverage level of the BI insurance

Discussion and Q & A session



Public hearing

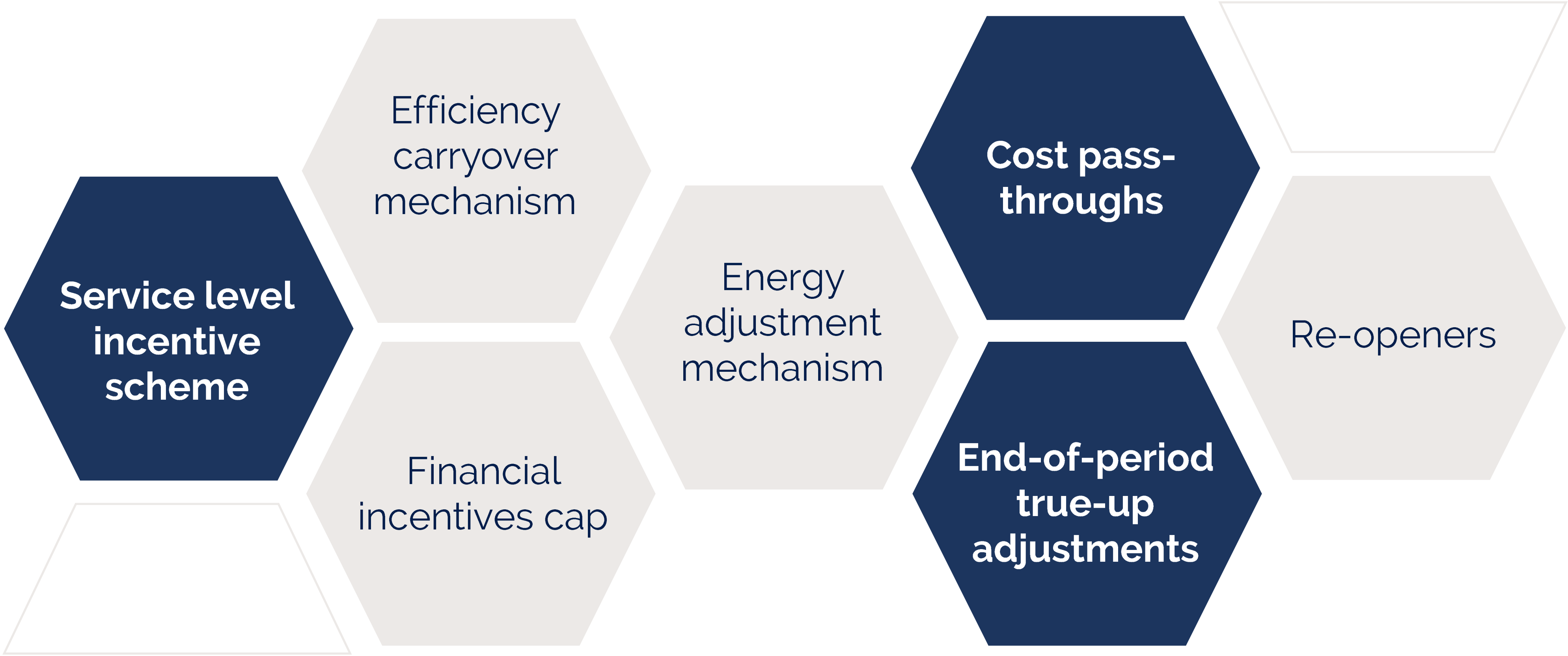
Short break

11.20 am – 11.40 am

Public hearing

Session C
Incentives and risks

Proposed incentives and risk mechanisms



Proposed Service Level Incentive Scheme (SLIS)

Currently, we have an abatement mechanism to encourage SDP to operate at full production during drought

SDP has proposed a new incentive mechanism that encourages it to meet or outperform annual production requests

We sought views on whether the proposed incentive mechanism was appropriate and likely to benefit customers

Cost pass-throughs and true-up mechanisms

SDP identified several cost items that it considers are uncontrollable

SDP proposed to have a combination of cost pass-throughs and end-of-period true-ups for items that it considers are uncontrollable

We sought views on the proposed share of risk between SDP, Sydney Water and end-use customers

What have stakeholders said so far?

Support for change

Agree that the existing abatement mechanism is no longer suitable

Proposed SLIS

Sydney Water raised concerns on the effectiveness of the scheme to deliver good outcomes to customers

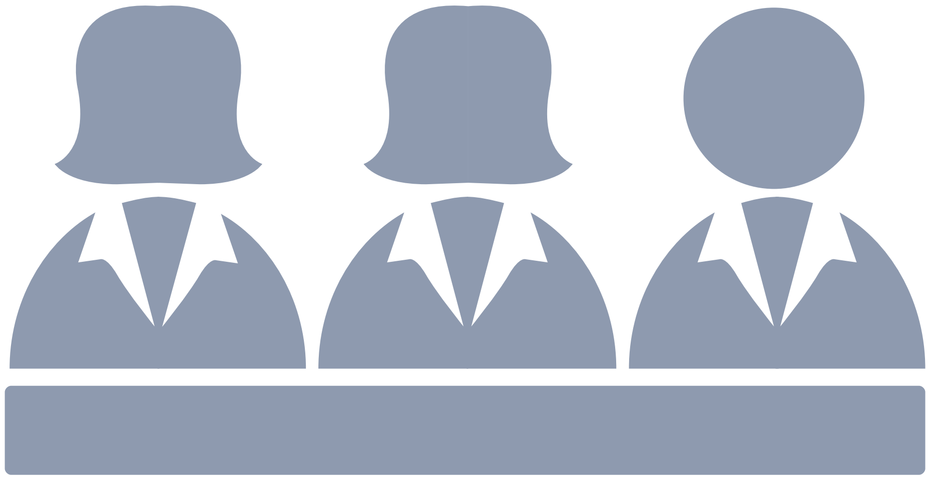
Proposed sharing of risks

Some stakeholders raised concerns that too much risk is transferred to customers

WACC rate

Mixed support for adjusting the WACC to reflect changes in the risk allocation between SDP and customers

Discussion and Q & A session



Public hearing

Session D

Pricing arrangements

Proposed pricing arrangements

When operating within the defined level of service

2017

Prices were mode-dependent, with one usage charge and 6 service charges

2023

Proposed prices are for operational mode only, with one usage charge and 2 service charges

When operating outside the defined level of service

SDP proposed to negotiate prices directly with Sydney Water

What have stakeholders said so far?

Affordability

Some stakeholders raised concerns about price increases and affordability

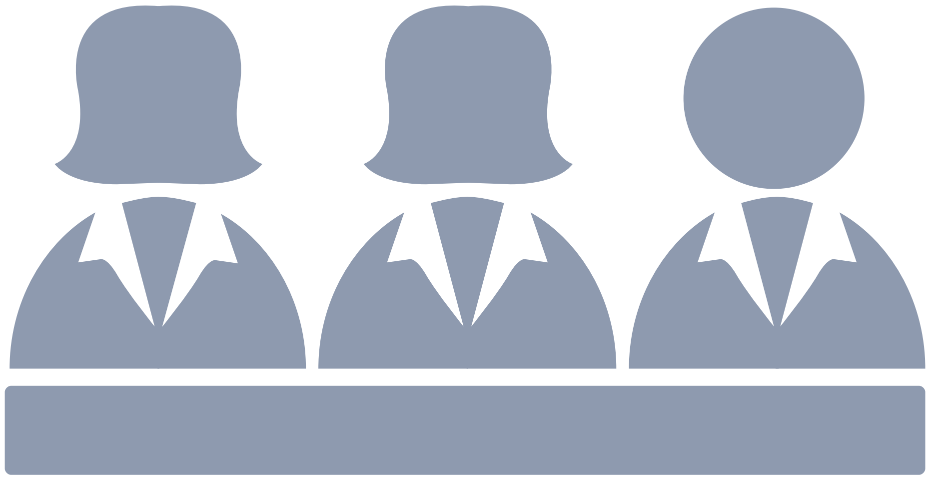
Tariff structure

Support for simplifying SDP's tariff structure and ensuring cost reflectivity

Negotiated agreements

Sydney Water does not support unregulated agreements for the 2023 determination period

Discussion and Q & A session



Public hearing

Closing remarks

Next steps

- **Pricing Proposal** 16 Sept 2022
- **Issues Paper** 29 Nov 2022
- **Public Hearing Sydney** February 2023
- **Draft Report** April 2023
- **Final Report** End June 2023
- **New prices** 1 July 2023

Contact us

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Visit our website

Prices for Sydney Desalination Plant from 1 July 2023