

29 September 2016

**SOUTH AUSTRALIAN
WATER CORPORATION**

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Dear Adam

ESCOSA Strategic Direction Consultation

Thank you for the opportunity to provide feedback on ESCOSA's Strategic Direction. SA Water is supportive of continued development of the regulatory framework in South Australia, as part of ESCOSA's "Better Regulation" approach, to deliver benefits to South Australian consumers.

To deliver increased benefits for customers, SA Water considers the key areas of focus for better regulation include:

- Increased customer engagement
- Long term price stability
- Efficient regulation to ensure the benefits outweigh the costs
- Integrated regulation
- Incentive based regulation
- Agility to respond to changing customer expectations

Increased customer engagement

Building on the success of the strong customer engagement for ESCOSA's most recent revenue determination process there is opportunity to increase the role customers have in future determinations. The South Australian Government's "better together" program and international examples of customer engagement have shown the benefits from customers and the community having a say in matters that affect them.

SA Water is seeking a greater role for customers within regulatory determinations to allow them to set the balance between the levels of service they wish to receive and the price they pay for them.

Before commencing customer engagement it is also important to consider who is the customer. Traditionally this has been the bill payer. However, more recently, ESCOSA, SA Water and the government have all expressed the importance of considering the views

of consumers who may not be bill payers, such as tenants. Feedback from our customers also shows that they are interested in the impacts on and the benefits for the wider community, through examples such as environmental improvements to coastal waters. SA Water is now taking a wider view of its customers, including tenants and other consumers and the broader community.

Long term price stability

For the 2016 determination of SA Water's revenues ESCOSA moved to a long term approach to considering the cost of debt. The benefit of this approach was that it improved price stability for customers and avoided price shocks between determinations. This long term approach has been widely adopted within regulatory jurisdictions across Australia. SA Water is supportive of this approach and the benefit it provides to customers and is seeking to further increase price stability for customers.

Although debt makes up 60% of the regulatory rate of return, the remaining 40% which is the return on equity, is still based upon short term market rates which can be volatile. There is an opportunity to extend the long term approach to incorporate the equity element of the rate of return thereby further increasing the long term price stability for customers and avoiding the risk of unnecessary price shocks.

Efficient regulation to ensure the benefits outweigh the costs

Any future regulatory framework should ensure the benefits customers receive outweigh the costs they are paying. This could be achieved by moving to a risk based approach with a more light handed form of regulation where it has been proved that the utility is working with its customers and has aligned its regulatory proposals with their expectations. This lesser burden of regulatory obligations can also be used as an incentive for utilities to work closely with their customers. Any savings in the cost of regulation would flow on to customers through lower prices.

One element of economic regulation where there is an opportunity to reduce the cost to customers is the duration of regulatory periods. There is a significant cost to utilities in preparing regulatory proposals, and for both the regulator and utilities in the review of the proposals. The current four year regulatory period is short by Australian and international comparison and by lengthening it, it would reduce the average annual cost for customers. Linked with incentive and risk based regulation, where utilities are listening to and acting in the best interests of customers, there is an opportunity for longer regulatory periods.

Integrated regulation

In addition to economic regulation utilities are also required to comply with the obligations of industry regulators. SA Water's regulatory obligations are listed in the table below:

Regulator	Role for water and sewerage services
Department of Environment, Water and Natural Resources	License the extraction of source water such as Mount Lofty Ranges catchments, groundwater sources and the River Murray
Department for Health and Ageing	Set the requirements for drinking water quality
Environment Protection Authority (EPA)	License activities of environmental significance, such as the operation of wastewater treatment plants (WWTPs)
Office of the Technical Regulator	Regulate technical standards for water and sewerage infrastructure
Safework SA	Regulate work health and safety

To minimise the cost to customers of meeting regulatory obligations it is important to ensure there is no overlap between economic regulation and other regulation, and there is an opportunity for ESCOSA to work with other regulators to ensure that is the case.

Additionally, there is benefit in testing customer support and willingness to pay for regulatory obligations such as environmental improvements, and the impact they have on the utility and ultimately customers before they are implemented. This could be achieved through the participation of industry regulators within utility customer engagement programs and has proven effective in international jurisdictions.

Incentive based regulation

Incentive based regulation is widely used across regulatory jurisdictions both in Australia and internationally to drive efficiencies which will lead to lower prices for customers in the long term.

SA Water would welcome the implementation of incentive based regulation similar to that in place for the water sector in New South Wales, where utilities keep the benefits of efficiency savings for a fixed number of years, irrespective of when they were identified. This provides an incentive for the utility as it allows sufficient time to recover the costs of implementing the efficiency, with the savings flowing on to customers in the form of lower prices for the long term.

Agility to respond to changing customer expectations

Any future regulatory framework needs the agility to allow utilities to respond to changing customer expectations and business needs. Determinations should be based on achieving customer outcomes within the overall revenue allowance and also support the utility in ongoing engagement with its customers and responding to any changes in their expectations. This more light handed approach is preferable to setting allowable expenditure and reviewing this through ex-post review of actual expenditure.

Once again, thank you for the opportunity to provide input into ESCOSA's strategic direction and should you wish to discuss any of these comments, please do not hesitate to contact me or my staff.

Yours sincerely

A handwritten signature in blue ink, consisting of a large, sweeping oval shape with a smaller, more complex signature inside it.

Roch Cheroux
CHIEF EXECUTIVE