

26 March 2021

Mr Adam Wilson
Chief Executive Officer
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Dear Adam

RD24 Framework and Approach

Thank you for the opportunity to provide feedback on the draft Framework and Approach for Regulatory Determination 2024 (RD24). Our response to the Consultation on the Framework and approach is attached.

The Framework and Approach is an important first step in the regulatory process as it sets out the intended outcomes, strategies, overall process, governance arrangements and timetable for RD24. We thank the Commission for the opportunity to be consulted on this process as certainty on key regulatory parameters, methods and other related issues will enable preparation and consultation for the upcoming regulatory business plan.

Due to the timeframes required to provide feedback on the proposed approach, we have not been able to consult all our stakeholders on the suggestions provided below, and therefore would like to consider this our preliminary position while we seek to engage with our stakeholders and the Commission before the final framework and approach is developed.

We remain committed to being a high-performing water utility that understands and responds to the expectations of customers, delivering the services our customers are willing to pay for while meeting regulatory responsibilities. Our aim is to deliver services in the most efficient and innovative way, ensuring savings are passed on to customers and, in doing so, we endeavour to build trust, credibility and strong relationships with stakeholders and customers.

Our team looks forward to working collaboratively with the Commission in the coming weeks and months on the development of the final RD24 Framework and Approach to achieve best regulatory practices that meets the long-term interests of South Australians.

Please do not hesitate to contact Senior Manager Regulation and Pricing Graham Rix to discuss further.

Yours sincerely,



David Ryan
Chief Executive

Executive summary

At SA Water we are proud to provide high-quality water services to more than 1.7 million South Australians. Water is critical to the wellbeing of communities, the economy, and the environment. Our vision is to deliver trusted water services for a sustainable and healthy South Australia, and we consider environmental, social and economic factors in our decision-making and performance reporting to ensure water services are sustainable and available for future generations.

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While water assets are a long-life asset, the environment in which we operate is becoming less clear and predictable. To address these uncertainties and external drivers, we are proactive in ensuring our strategy, business plans and operations respond to these opportunities and challenges in order to be more agile and improve continuous planning.

We are generally supportive of the Commission's proposed approach outlined in the Framework and Approach Consultation Paper and, like the Commission, we continually seek to improve on past gains and act in the long-term interests of customers.

As part of the continual improvement process, and based on stakeholder feedback from RD20, the Commission is proposing to change the delivery timeframes for RD24. Additional time for consultation is important, particularly at the beginning of the determination process. Allowing adequate time to prepare robust investment plans that reflect input from stakeholders and customers as well

as sufficient time to develop prices after the final determination, will be key to a successful outcome.

The best way to achieve the desired level of consultation for long-term planning is to allocate more time to the development of our submission. We are looking to work with the Commission to facilitate more time for customers and the Commission to be actively consulted and engaged during the planning process, which will result in a better outcome for the draft and final determinations. Providing adequate time after the final determination for price setting will enable certainty for customers.

The development of effective customer and stakeholder engagement is one area where continual improvements should be made. Our preliminary view supports the Commission in the need to establish a Customer Challenge body as well as a Customer Experts Panel. Collaboration with the Commission in finalising the membership and remit will ensure challenge body membership that enables successful engagement. Diverse perspectives and expertise within the membership of the body will help in achieving meaningful and productive consultation, informing a better final outcome.

SA Water looks forward to working collaboratively with the Commission to develop the guidance papers in the coming weeks and months and, through the Commission's Working Group, to achieve best regulatory practices that meet the long-term interests of South Australians.

Background and introduction

In supporting the Commission's objectives, outcomes and strategies proposed for the next regulatory determination, we have identified the following issues and factors we wish to consider with the Commission to ensure the realisation of these objectives and outcomes.

We actively monitor both economic and social trends and engage with stakeholders and customers to predict future needs, yet we operate in an uncertain environment where unforeseen events can materially change costs and our ability to deliver on the intended objectives and outcomes. These external influences are driving the need for a more agile, iterative approach to business planning and less reliance on the four-yearly regulatory determination decision-making process.

The economic context for RD20 was one of great uncertainty, with prevailing interest rates at historic lows. This was compounded in the first quarter of 2020 by the advent of the COVID-19 global pandemic, precipitating a major economic downturn, both internationally and in Australia. It is anticipated that these external operating influences will continue to dominate the regulatory decision-making process leading into RD24.

Changing business and operating environment

Our next regulatory business proposal (RBP) will be prepared during a time of significant uncertainty and change. The environment in which we operate could change with short notice (for example, policy and regulatory changes, customer affordability, environmental changes, etc), impacting the next regulatory determination.

Other changes in the external operating environment may also impact the objectives for the next regulatory determination and our ability to accurately predict future expenditure requirements. These include:

- Climate change – highly variable rainfall patterns due to droughts and floods can have significant variances to water levels making forecasting extremely difficult and managing water resources challenging.
- Extreme weather events – bushfires can destroy vital infrastructure assets that must be replaced as quickly as possible.
- COVID-19 – the pandemic is expected to continue to impact the way we manage our business and operating environment.
- Economic recovery – customer connections and industrial projects are unpredictable and subject to government plans and external drivers.
- Government policy and regulatory reform – changes may impact future water entitlements¹.

¹ ;For example Productivity Commission's Review – National Water Reform 2020

- Changing customer behaviours and expectations – for example, tailored service offerings.
- Customer hardship and expectation of service continuity.
- Cyber threats and security breaches and the evolving regulatory environment for businesses that own and operate critical infrastructure.
- Unplanned and unexpected changes in external industry demands – for example, mining, viticulture and agriculture.

The best intelligence available will be used to foresee and plan for such events, however, the regulatory framework must be flexible enough to allow us to continue to meet our regulatory requirements, service standards and the long-term interests of customers with sufficient revenue.

Communication and timing

The Commission undertook an external review of the RD20 process, to inform its assessment of the effectiveness of that process and identify opportunities for further refinements and improvements for the RD24 review process. The review included commissioning an external post-project report prepared by Dr Patrick Walsh². Through the external review, stakeholders expressed a desire for key decisions of the Commission to be made earlier and, ideally, have a more ongoing and iterative approach to understanding our past performance and possible future investment drivers. The report stated that, “A frequent comment from stakeholders about the RD20 process was that it suffered from time pressures”³ and so it is imperative that sufficient time is allowed for each stage of the regulatory planning process to build on the lessons learnt from RD20.

The Commission’s proposed timeframe indicates we will develop the RD24 plan with stakeholders starting in June 2021 with the final RBP to be submitted and publicly released by March 2023. These proposed timeframes are about six months shorter than the RD20 submission. We would like to work with the Commission to extend these timeframes to ensure there is sufficient time for stakeholders to effectively be involved in the development of RD24.

Additional time will ensure the Customer Challenge body and stakeholders will be able to fully appreciate and effectively challenge our business proposal. It will also enhance our ability to engage customers in business case development, which requires customer feedback and engagement in the design and testing phase. An extended timeframe will ensure sufficient resources are applied and result in better customer outcomes.

Additionally, this would result in the final submission being completed 16 months before the start of the next regulatory period on 1 July 2024. This may increase the likelihood that unforeseen changes to the external operating environment may not be incorporated and impact the final determination.

We would like to work with the Commission to consider the following:

- 1) *Development of guidance papers* – the timing and potential overlap between release of guidance papers and the consultation of the RBP. Recognising the earlier timeframe and the fact that planning needs to be ongoing and continually evolving, we propose taking a continuous

² Dr Patrick Walsh ‘Stakeholders Views Regarding the Process Applied to the SA Water Regulatory Determination 2020’ October 2020.

<https://www.escosa.sa.gov.au/ArticleDocuments/21592/20201304-Water-SAWRD20-ExternalPostProjectReview-FinalReport-PatrickWalsh.pdf.aspx?Embed=Y>

³ Ibid page 26

improvement approach with the understanding that as guidance papers develop, methods and processes are adjusted prospectively for future development cycles and that work already done on a best endeavours basis is taken on merit. Agreeing with the Commission to make certain guidance papers a priority will also be beneficial to increase certainty and the quality of preparatory work already underway (particularly around the important role that customers play in developing our proposal).

- 2) *Final RBP timing* – the draft framework and approach proposes that we publish our final RBP in March 2023 (seven months earlier than for RD20). Allowing additional time for development of our submission will enable more time for customer engagement and will increase the value customers can provide to support the development of a robust RBP. It will also enable additional Commission involvement *throughout* our planning process, rather than after we submit our proposal.
- 3) *Additional timeframe for consultation at end of process* – the proposed timeframe has allowed five months for work/consultation (May-September 2023) following the final submission of our proposal and a further seven months following the draft determination. The Commission notes that it has allowed this additional time to consult with stakeholders between the draft and final determinations. We believe the additional time can be advantageously used earlier in the process for engagement with customers, stakeholders and the Commission as we develop our business plans. Additional time could also be advantageously used to implement the final determination by determining prices, to provide all stakeholders with regulatory certainty.
- 4) *Base year* – 2022-23 is the preferred base year for determining operating expenditure. The proposed timeframes indicate we will be submitting the RBP based on year-to-date 2022-23 un-audited accounts (as at March 2023). We will work with the Commission to provide updated audited financials for the base year calculations before the draft determination.
- 5) *WACC inputs to final determination* – following the release of the final determination, we develop prices which then undergo a subsequent approval and consultation process. Variances between the draft and final determinations, mainly due to the weighted average cost of capital (WACC) and its sensitivity to short-term fluctuations in market inputs, makes customer engagement and price development complex and limits our ability to ensure timely pricing communication to customers. Earlier deliver of the final determination, together with a ‘locked-in’ timing of the WACC inputs to be the same as the draft determination, will enable us to provide earlier visibility of prices for our customers and ensure sufficient consultation in price setting.

The proposed timetable says we will publish various documents that support the final RBP between June 2021 and March 2023. As no specific timeframe has been proposed, we will work with the Commission to ensure these documents are

published when they fit with our planning, and customer and stakeholder engagement activities. While early release of revenue and expenditure expectations can be useful, this needs to be balanced with the risks associated with setting expectations before completing consultation with our customers, the Commission and our owner. We will seek agreement with the Commission on how to best manage this risk.

Recommendations:

- **Additional time is provided to develop our RBP with stakeholders (including the Commission) with the final proposal submitted by September 2023.**
- **WACC inputs are not changed between draft and final determination, to enable consistent and timely consultation with stakeholders about pricing.**
- **The Final Determination is finalised by March 2024 to allow for timely consultation with stakeholders about pricing.**

The nature, scope and timing of our draft regulatory business plan

The Commission is seeking stakeholder views on the approach we should adopt for developing our next RBP. Two options were presented for feedback:

1. the draft plan is developed with stakeholders
2. the draft plan is developed ahead of public consultation.

Option 1 is our preferred approach, as it aligns with our focus on building and maintaining trusted relationships with our customers and delivering outcomes that meet customers' needs. As detailed above, this option requires sufficient time to enable meaningful engagement with customers and timely release of guidance papers.

The Commission proposes we adopt an iterative process to prepare our draft RBP over time together with stakeholders, with projections for future investment beyond the regulatory period. With a strategy that takes a longer-term view with horizons extending up to 2050, we are building maturity in long-term investment planning and prioritisation.

Recommendation:

- **Our RBP is developed progressively with stakeholders.**

Options for involving customers in RD24

Regular and ongoing engagement with our customers is critical. We continue to ensure our engagement activity is effective and the changing needs and expectations of customers are addressed.

The Commission is seeking stakeholder views on how to best involve customers in the RD24 process. As mentioned above, we support the Commission in its preference for Option 1 as it aligns with our strategy and desire to engage with and listen to our customers and drive customer-led decision-making across our business.

Customers, customer advocates and other stakeholders play a vital role in providing, assessing and challenging the evidence put before the Commission for its consideration. When considering investment plans, short-term customer preferences must be balanced with the long-term interests of customers, including future generations.

It is also important to note that different approaches to customer engagement are required across different categories of investment. A clear and common understanding of what is non-discretionary investment and what is discretionary investment will ensure the right method and timing of research and engagement is used with stakeholders and customers.

Additionally, there is a spectrum of what is considered effective customer research and engagement and we use a variety of methods to gather customer and community insights. Working together with the Commission will ensure the guidance papers provide the necessary direction on the level of expected engagement to achieve the desired outcomes, enabling the most effective use of resources.

The Commission is the ultimate decision maker and, as such, customers have limited influence on the Commission's decisions (and by extension, our decisions). We agree with the Commission that this level of influence must be clear to avoid confusion and so the customer challenge role is more appropriate than one of negotiation. There may also be certain technical matters (for example the WACC) that require niche knowledge and experience to inform debate and so may be more appropriate to be challenged by technical experts.

SA Water's preliminary view on the Customer Experts Panel and the Customer Challenge body are detailed below, noting that we will continue to consult with the Commission and our stakeholders on this position over the coming months.

Customer Experts Panel / Customer Advisory Group

Historically, we have regularly managed Customer Advisory Groups and, during a regulatory process, the Commission has managed a Customer Experts Panel (refer Figure 1). There is an important role for a convened Customer Experts Panel or

Customer Advisory Group in conjunction with a separate Customer Challenge body. Our existing Customer Advisory Groups provide guidance on the issues of importance to the stakeholders they represent. They also act as a reference group to provide feedback on customer insights and proposed engagement and research opportunities. There is value in these representative groups continuing in this role and there may be benefits from adding additional representatives to these groups to improve representation. We understand that many of these representatives are time poor, under resourced or are already experiencing engagement fatigue, and so may be unlikely to commit to consistent involvement throughout the planning process. However, their contributions along the way will be extremely valuable and must be considered.

Given many of the members of the Customer Experts Panel and our Customer Advisory Groups are the same, we suggest establishing one combined Customer Experts Panel / Advisory Group to support the RD24 process. This is a more efficient approach to that for RD20 when two groups were run in parallel. To ensure alignment and reduce the risk of duplication, we would prefer to manage the Customer Experts Panel / Advisory Group as well as a Customer Challenge body, with strong involvement from the Commission. For example, Commission representatives will attend all meetings to ensure shared understanding and clear communication.

Customer Challenge body

Our recommendation is to establish a separate Customer Challenge body which includes representatives from key customer segments, both residential and business, ensuring the body reflects the diversity in the community, as well as expertise in the fields of:

- economics
- regulation
- market research
- technology
- finance
- asset management
- social policy
- environment
- Aboriginal affairs
- local government.

There may also be members of the Customer Experts Panel / Advisory Group who should be invited to join this group and have the available capacity to commit the requirements. Additionally, it may be valuable to have an external facilitator lead the Customer Challenge body to ensure all voices are heard.

It will be critical that members of the Customer Challenge body can commit to the time required to be involved throughout the process. This will ensure they build an understanding of our plans, strategic direction and operations so they can effectively challenge our thinking and decision-making at each step of the process to develop our business plan.

Similarly, for continuity of understanding and the basis of decisions made, it is important that representatives from the Commission are also involved as observers in each stage of the Customer Challenge body process.

As our plans will ultimately be tested with customers, they must be represented on the Customer Challenge body.

Figure 2 summarises our proposed structure. We look forward to working with the Commission on agreeing the governance of the two groups and how a facilitator will be selected.

Remuneration is an issue that needs further exploration and consideration as one option to ensure the successful operation and long-term commitment to the customer engagement process. SA Power Networks' Customer Consultative Panel provides remuneration for its members to acknowledge their time and investment.

Figure 1 - RD20 customer engagement structure (simplified)

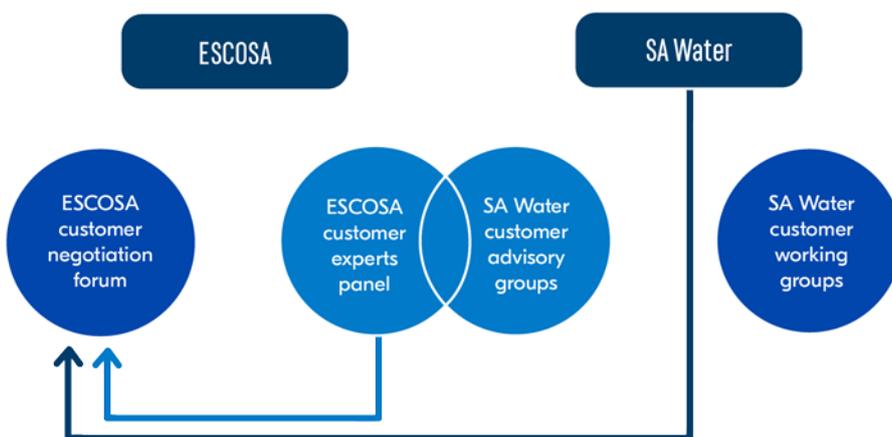
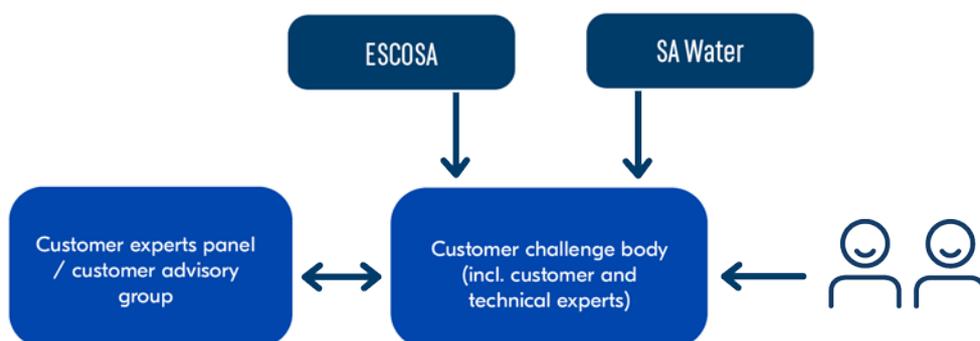


Figure 2 - proposed RD24 customer engagement structure



Recommendations:

- **We are responsible for the customer challenge panel and the customer experts group, given they are our customers and we are both experienced in customer engagement and best placed to manage this ongoing relationship.**
- **The Commission is an integral and ongoing partner in our engagement activity.**

Regulators' Working Group

While our everyday business operations are not only overseen by the Commission as economic regulator, they are affected by a broader legal framework and a number of regulatory bodies that ensure we provide our customers with clean and safe water and reliable wastewater services.

Water services regulation is complex and many stakeholders perform a range of roles and functions, which sometimes overlap, creating a challenge for us when prioritising activities and expenditure in order to meet the Commission's objectives and desired outcomes. Often we may have to react quickly to decisions from other regulatory bodies or government departments that will limit the time and ability to engage effectively with customers and affected stakeholders.

In addition to meeting regularly with each regulatory body and providing individual briefings, we support the objective of a combined Regulators' Working Group as an opportunity to strengthen coordination and communication between the various key stakeholders and regulators to avoid conflicting objectives from our various regulators and to promote better long-term planning.

Robust logistics and governance of this group will ensure the objectives and desired outcomes are achieved. It is timely as we head into the next determination that the working group's charter is updated and the following issues are considered for inclusion:

- Who will chair the working group and provide secretariat function?
- Will the minutes and papers of the working group be published and, if so, where?
- Will the Statement of Outcomes be published to ensure transparency?
- How will success be measured?

Recommendations:

- **The Regulators' Working Group continues for RD24.**
- **The expectations and charter for this group are agreed by June 2021.**

Guidance papers

The Commission is proposing increased consultation and focus on long-term planning, which will require guidance papers to be released as early as possible to ensure regulator and stakeholder expectations are adequately factored into our RBP enabling us to achieve the best outcomes for our customers.

Guidance papers provide critical information and are necessary to provide us and our stakeholders with regulatory certainty around governance and process matters. Agreeing with the Commission to make these a priority will be beneficial by increasing certainty and the quality of preparatory work already underway. It is imperative we work collaboratively with the Commission to co-create the guidance papers.

For RD20, the Commission released the following guidance papers⁴:

- Overview of Economic Regulation of SA Water
- Revenue Regulation and Pricing Principles
- Service Standards
- Prudent and Efficient Expenditure
- Cost of Funding and Using Assets
- Treatment of Inflation in the Regulatory Rate of Return
- Averaging Period of the Risk Free Rate
- Treatment of Capital Expenditure Addressing Uncertainty
- Annual Updates of the Rate of Return.

The Commission has suggested the following additional guidance papers may be relevant for future regulatory determinations and we support the development of these additional guidance papers:

- Customer Challenge Process
- Business Case Templates
- Gathering and Using Expert Evidence.

Further to the three new suggested guidance papers, we see value in the following additional papers, or updates to existing papers to incorporate:

- Intra-period Review Mechanisms – including contingent projects, pass-throughs and capex reopeners. Alternatively, if not a new paper, then an update to the existing Treatment of Capital Expenditure Addressing Uncertainty Guidance Paper
- Treatment of Confidential Information

⁴ It is assumed that the RD20 guidance papers will be updated for RD24

- WACC – this is included in the current Cost of Funding and Using Assets Guidance Paper but a review and update is proposed
- Revenue Building Block Model
- Customer Engagement – this would be separate yet linked to the proposed Customer Challenge Process Guidance Paper.

The Commission is proposing to finalise guidance papers by December 2021. Stakeholder and customer engagement will occur at the same time, and so agreeing with the Commission that certain guidance papers need to be released earlier than others will have a significant impact on the robustness and quality of our customer engagement and business proposal.

a. Customer Challenge Process and Customer Research and Engagement Guidance Papers – high priority

The Commission's suggestion for a Customer Challenge Guidance Paper that clearly sets out the role, membership, governance and operational arrangements has our support. We would like to take responsibility establishing and managing the panel and engagement process and early guidance on the Commission's expectations will ensure success in establishing the panel.

A second guidance paper on customer research and engagement is also a priority. There are many different approaches to customer engagement within a regulatory environment and each approach has its advantages and disadvantages. The guidance paper will provide critical information enabling us to finalise our approach to customer research and engagement, including the gathering and use of expert evidence such as customer surveys, willingness to pay data and outcomes from deliberative engagement activities. Given the volume of engagement and research that is required, we have already started research activities and are seeking early direction to avoid any re-work.

These two guidance papers are a high priority and we suggest they are the first to be released in order to increase certainty and the quality of preparatory work already underway.

b. Business Case Templates Guidance Paper – high priority

We support the Commission's suggestion for a business case guidance paper that would include templates setting out the detailed requirements for the publication of information to allow stakeholders to understand and provide feedback on proposed programs and projects.

The guidance paper could clearly state the Commission's expectations of a sufficient business case. Also related to the Customer Engagement Guidance Paper, it would be beneficial to include guidance on how customer insights and engagement need to be reflected in the business case. Consideration should also be given to detail required relative to the size and risk of the project / proposed spend, with the focus on the desired outcomes (as solutions may change and projects may be re-prioritised as new information comes to light or external factors drive changes).

c. Expert Evidence Guidance Paper – high priority

The Commission is proposing to develop a new guidance paper that will set out the expectations on the use and role of parties providing expert evidence, including, but not limited to, the use of customer surveys as a source of evidence.

As this is a high priority, this issue may easily be incorporated into the Customer Research and Engagement Guidance Paper.

Guidance on customer willingness to pay expectations would also be beneficial including user-experience and the type of information presented to study respondents.

d. WACC Guidance Paper – high priority

We believe the WACC should ensure price stability for customers across regulatory periods, maintain our financial viability and provide appropriate incentives for long-term investment.

In response to Patrick Walsh's external review of RD20, we noted in our written submission that the guidance papers were very useful and urged that, for future regulatory determinations, greater efforts be made to resolve the methodology for determining the regulated rate of return earlier in the process.⁵

In addition, WACC variations between draft and final determinations can result in large differences in the costs paid by our customers for services, which can make meaningfully engaging customers challenging.

Therefore, given the importance of the WACC within the regulatory building block model, there is value in ensuring the methodology and inputs to the WACC (particularly inflation) are confirmed with all parties in guidance papers early in the process.

SA Water would like to work with the Commission to consider the long-term view of the WACC to ensure long-term price stability for our customers. For example, using a model like the IPART WACC model which consistently applies short-term and long-term market observations which provides more stable and equitable outcomes.

Due to the highly technical nature of the topic it will be useful to engage external expertise to develop this guidance paper and also to inform the customer challenge body (a sub-group of technical experts for this topic may be required).

e. Revenue Building Block Model Guidance Paper – high priority

Several existing guidance papers could be combined into one Revenue Building Block Model Guidance Paper. The model itself this needs to be finalised as a high

⁵ Patrick Walsh review page 36

priority in order for us to engage with customers and stakeholders on expected revenue and prices.

In addition, due to the sensitivity, we request the model is externally audited to ensure it is accurate and free of errors.

f. Intra-Period Review Mechanisms / Treatment of Capital Expenditure Addressing Uncertainty Guidance Paper – medium priority

The Commission proposes to move to a more continual long-term asset management process and therefore the regulatory framework needs to provide a more flexible mechanism to manage contingent and unforeseeable events.

There is an existing Treatment of Capital Expenditure Addressing Uncertainty Guidance Paper as well as information provided in the 2020 final determination on intra-period projects. However, recent experience has identified that further guidance is still required, particularly in relation to:

- criteria for when a project meets the requirements of a pass-through vs intra-period vs capex reopener and the appropriate trigger events and criteria
- clear steps and information required for each approach (including templates for submissions)
- application of operational expenditure.

g. Treatment of Confidential Information Guidance Paper – low priority

This guidance paper would provide clarity on how the Commission would expect us to make confidentiality claims over information submitted as part of the RBP while balancing the need for stakeholders to have sufficient information for engagement purposes.

Recommendations:

- **Guidance papers are released as early as possible, preferably by June 2021.**
- **Due to the interdependencies, all guidance papers are released at the same time.**
- **The Commission commits to working with SA Water in a review of the WACC methodology, including external technical advice.**