

OFFICIAL



SA Water Regulatory Determination 2024: Guidance paper 1

The Regulatory Business Plan

December 2021

OFFICIAL

Enquiries concerning this Guidance Paper should be addressed to:

Essential Services Commission
GPO Box 2605
ADELAIDE SA 5001

Telephone: (08) 8463 4444
Freecall: 1800 633 592 (SA and mobiles only)
E-mail: escosa@escosa.sa.gov.au
Web: www.escosa.sa.gov.au

Any queries on SA Water Regulatory Determination 2024 should be directed to:

Julia Oakley, Director, Consumer Protection and Pricing

Related reading

This Guidance Paper should be read in conjunction with the Framework and Approach paper and any other Guidance Papers released by the Commission for SA Water Regulatory Determination 2024. Those papers and other relevant information are available on the Commission's website:

<https://www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024-framework-and-approach/sawrd2024>

Timing for this review and upcoming consultation opportunities

While the Commission remains responsible for making the final regulatory determination, the review process will involve multiple opportunities for stakeholders to be involved prior to that final determination.

Input from a diverse range of stakeholders is important, as it helps the Commission to make better informed and more inclusive decisions. The Commission will therefore draw on the full range of evidence provided by all stakeholders in making the final determination.

1 Purpose

This Guidance Paper sets out the Commission's high-level expectations for the matters to be addressed in SA Water's Regulatory Business Plan for SA Water Regulatory Determination 2024.

The Commission will make a new regulatory determination to apply to the water and sewerage retail services provided by SA Water Corporation (**SA Water**) from 1 July 2024 to 30 June 2028: SA Water Regulatory Determination 2024 (**SAWRD24**). The regulatory determination sets the maximum revenues that SA Water can earn from its customers over that four-year period, and the service standards it must deliver for its customers.

The SAWRD24 Framework and Approach¹ sets out the key timing, process and governance matters, for the regulatory determination process, which challenges SA Water to:

- ▶ provide water and sewerage services at the lowest sustainable price for the quality and reliability levels valued by customers, and
- ▶ have and deliver against sound long-term asset management, operating and financing strategies, which support the provision of those services for present and future customers.

A key element of the regulatory determination process is the development of a Regulatory Business Plan by SA Water, which details its proposed expenditures and service outcomes for the four-year regulatory period. As a significant (but not sole) input into the Commission's final regulatory determination, the Regulatory Business Plan is an important public document and must contain sufficient evidence for the Commission and stakeholders to understand and engage with SA Water's proposals.

The Commission will not prescribe the manner and form that SA Water's Regulatory Business Plan must take. However, the Commission's preliminary view is that it expects SA Water to address at least the following matters:

- ▶ A clear explanation of how proposed expenditure relates to the core business of SA Water: the provision of drinking water and sewerage services on demand at the lowest sustainable price and meeting required standards of safety, quality and reliability. In simple terms, the Regulatory Business Plan needs to explain what needs to be done during the regulatory period, why that should be done during the period (given SA Water's long-term assets and operating context) and why customers should pay for it.
- ▶ Demonstration of clear and strong integration between proposed expenditure for the four-year regulatory period and SA Water's long-term asset management, operating and financial strategies.
- ▶ Clear explanation of the link between specific expenditure drivers and outcomes for customers.
- ▶ Evidence that expenditure proposals have been thoroughly tested with a broad range of stakeholders, including the Customer Challenge Group, and that customer research and input has informed the development of those proposals.
- ▶ Justification as to how proposed expenditures are prudent and efficient.

This Guidance Paper expands on the Commission's high-level expectations in each of these areas. Feedback from stakeholders on any of these matters is welcome.

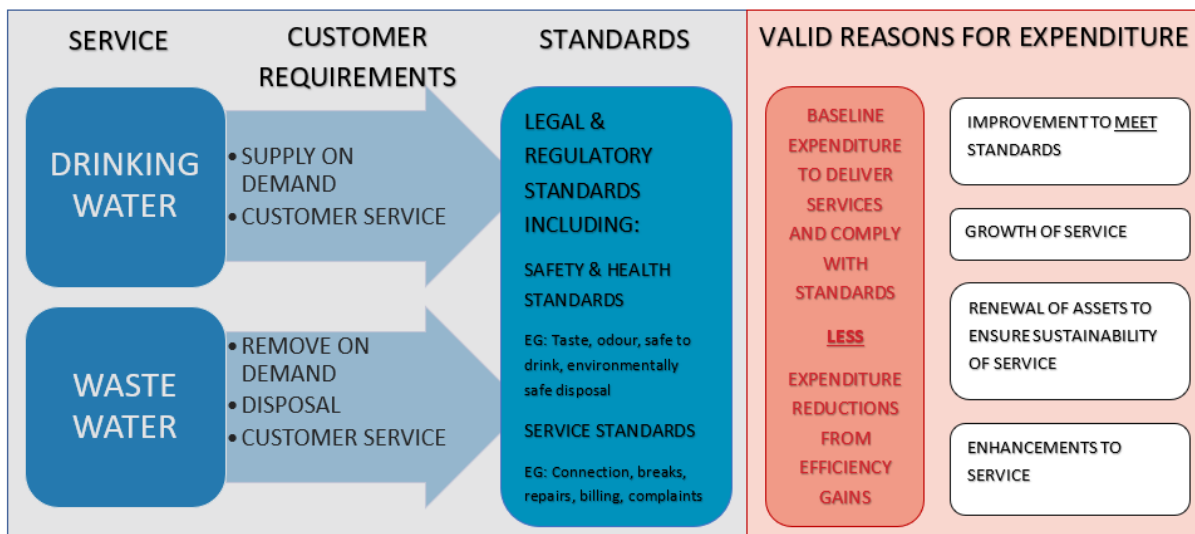
¹ Framework and Approach available: [SAWRD24-FrameworkAndApproach-Final](#)

2 Relationship between proposed expenditure and SA Water’s core business

SA Water should demonstrate how its proposed expenditures relate to either delivery of core services to the required standards, or to improvement, growth, renewal, or enhancement of core services.

For the purposes of the regulatory determination, SA Water’s core business can be described using the simple model below:

Figure 1: SA Water simple business model for regulatory determination



Simply put, SA Water is required to provide drinking water and wastewater services, on demand, along with essential customer services (such as connections, billing, enquiries and complaint resolution) required to facilitate service delivery and revenue collection. In delivering those services, SA Water must meet safety and health standards, such as safety, taste, and odour (for drinking water), and safe and environmentally appropriate disposal (for wastewater). Those standards are established and monitored by regulatory bodies such as SA Health and the Environment Protection Authority. SA Water must also meet service standards established by the Commission to meet customer requirements, such as timing for connection and disconnection, the frequency of breaks and time to repair, customer response times, complaint handling, and billing and payment.

The Commission acknowledges that SA Water is subject to direction and legal and regulatory obligations set by multiple regulators, and that the Regulatory Business Plan should include prudent and efficient proposed expenditures to meet these obligations.

2.1 Baseline expenditure for service delivery

Ongoing service delivery expenditure is a significant portion of the overall proposed expenditure in a Regulatory Business Plan. Delivering services should primarily involve work that is routine and repeatable, with improvements in areas such as technology and strategic contracting arrangements likely to result in ongoing efficiencies. This means that any proposed increases in this expenditure should be able to point to a clear driver.

As such, in the Regulatory Business Plan, SA Water needs to clearly set out:

- ▶ The baseline expenditure required to deliver drinking water and wastewater services in order to continue to meet all required standards at the current level of attainment.

- ▶ The efficiency gains SA Water has already achieved and proposes to achieve over time – which may result from process improvements, technology changes or economies of scale – showing how those gains (past and future) have reduced baseline expenditure.

The overall expenditure required for core service delivery should be reasonably well known. In a long-life asset company such as SA Water, material or significant departures from forecast costs would not be expected absent a clearly identifiable change in the operating environment.

2.2 All other expenditure

Other than baseline service delivery, all other expenditure proposals must be clearly linked to one of the valid reasons for expenditure in Figure 1:

- ▶ **Improvement to meet standards:** If there are safety, health, service or other legally-binding or regulatory standards or obligations that SA Water is currently not meeting, or if there are changes to the standards that SA Water is legally required to meet, expenditure to achieve compliance with these standards would be reasonable and appropriate in principle. The Regulatory Business Plan should articulate any such standards and set out a considered proposal to achieve ongoing compliance. SA Water is not expected to exceed required standards unless this can be achieved at no additional cost to customers.
- ▶ **Growth of service:** SA Water needs to expand its network to meet increasing demand, either within its current distribution area or as directed by Government or permitted by legislation. Expenditure proposals to meet such requirements need to clearly set out the prudent and efficient costs to meet that demand over time.
- ▶ **Renewal of assets to ensure sustainability of service:** The Regulatory Business Plan needs to clearly articulate the expenditures proposed in the regulatory period to renew assets in order to ensure the long-term viability of its services, demonstrating clear and logical prioritisation, strong integration with long term asset management plans, and efficient use of resources.
- ▶ **Enhancements to service:** Any proposed expenditures to enhance services that do not fall into the categories listed above must clearly articulate the costs and benefits to customers, as well as providing evidence of engagement with customers in relation to a proposal, and whether there is stakeholder, legislative, policy or other support for it.

3 Integration of the Regulatory Business Plan expenditure with long-term plans and strategies

The Regulatory Business Plan must be a subset of SA Water's long-term strategies and asset management plans. Clear explanation of how proposed expenditures for the regulatory period relate to long-term plans and strategies is required in the Regulatory Business Plan.

SA Water is expected to manage its overall asset stock through its long-term capital investment plan.² The long-term capital investment plan should be a 'live' document and include long-term indicative costs for asset replacement and upgrades, based on the best information available at a particular point in time.

² SA Water, 'Our Plan 2020' (Regulatory Business Plan) is available on SA Water's website at <https://www.sawater.com.au/about-us/our-vision-and-strategy/our-plan-2020-24>. Appendix O: 30 year asset planning provided an overview of SA Water's approach to long-term asset planning, available at https://www.sawater.com.au/_data/assets/pdf_file/0014/420080/2_SAW_Our-Plan-2020-24_Appendix-O_2.1.pdf

The Regulatory Business Plan is a sub-set of that long-term plan. It should provide a more detailed analysis of the specific program of work required in the regulatory period in order to deliver SA Water's long-term plan for customers. As decisions made in one four-year regulatory period will necessarily have flow-on impacts to future plans, it should also clearly articulate how the proposed expenditures for the regulatory period have been prioritised consistently to meet required standards, ensure long-term sustainability, balance any potential trade-offs, and deliver customer benefits.

The regulatory determination process also forms part of SA Water's broader long-term planning processes. The Commission's reviews provide an assessment of SA Water's capital and operating expenditure plans. This includes assessing whether:

- ▶ SA Water's decision-making systems and processes are consistent with the principles set out in its asset management framework
- ▶ on an ex-post basis, capital expenditure in the current regulatory period (2020-2024) was prudent, efficient, and achieved intended outcomes, and
- ▶ on an ex-ante basis, capital and operating expenditure proposals for the next regulatory period (2024-2028) are prudent, clearly identify intended outputs and outcomes and reflect efficient delivery costs.

As regulatory determinations are point-in-time assessments, SA Water's actual expenditure during each four-year regulatory period will often vary from forecasts, due to factors such as changing priorities and external factors (eg, changes in regulatory obligations). SA Water may also need to respond to unexpected events, such as extreme weather conditions, an unforeseeable decline in the performance of a group of assets or changes in key input costs that it cannot directly control. While some variation is expected over time, it is important to understand and articulate the factors driving any material variations. SA Water is also expected to demonstrate how it manages risk and reprioritises expenditure to address material variations.

4 A clear link between specific expenditure drivers and expected customer outcomes

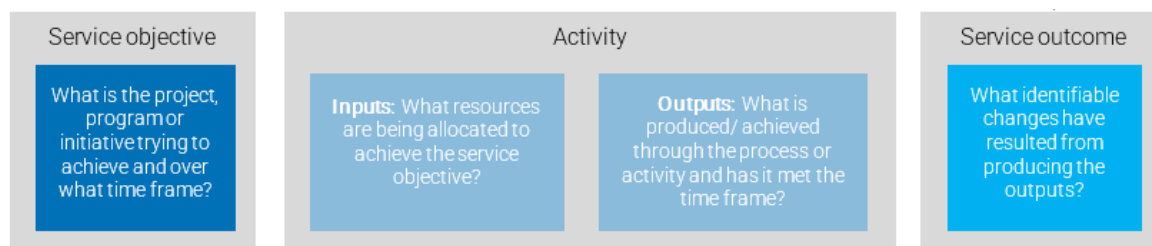
Expenditure proposed must identify clear drivers, or reasons why the expenditure is needed, and the planned outputs as well as the expected outcomes to be achieved for customers.

The simple business model (Figure 1) supports the clear articulation of how proposed expenditures benefit customers, with valid reasons for expenditure ranging from baseline service delivery to service growth and renewal. In relation to major proposed expenditures, SA Water is expected to explain:

- ▶ Which valid reason for expenditure (from the model) the expenditure relates to, and how.
- ▶ The customer **outcomes** that will be achieved, namely how customers will benefit from the proposed expenditure. Examples of customer outcomes could be maintenance of water quality, improved sustainability of infrastructure, or reduced risk of service interruptions. Customer outcomes should have quantifiable measures.
- ▶ The **outputs** of the proposed expenditure, namely the specific deliverables that will result, and how these relate to the expected outcomes. Examples of outputs could be a new pumping station, or replacing a section of sewerage network reticulated mains. Expected outputs should be clearly defined.

This approach is already embedded in SA Water’s public reporting obligations. The diagram below shows the relationship:

Figure 2: link between proposed expenditure objectives and outcomes³



The Commission’s reporting framework for SA Water requires it to report publicly on its investments using this approach, which clearly demonstrates the line of sight from the service objectives set out in expenditure proposals through to actual measured service outcomes.

The Regulatory Business Plan also needs to articulate the links between the proposed expenditures for the regulatory period and SA Water’s overall Business Strategy.⁴ The Business Strategy should provide clear explanation of SA Water’s strategic objectives and how it proposes to meet customer requirements.

Integration between the Business Strategy and the long-term asset management plan is essential to ensure shared understanding and prioritisation of expenditures, a subset of which is represented by the Regulatory Business Plan. It should be evident how the priorities established by the Business Strategy and the long-term asset management plan have informed the proposed expenditures in the Regulatory Business Plan.

5 Stakeholder engagement

SA Water needs to provide clear evidence of how its expenditure proposals have been thoroughly tested with stakeholders, including the Customer Challenge Group, and that customer research and input has informed the development of these proposals.

SA Water is expected to engage with a range of relevant stakeholders in the preparation of its Regulatory Business Plan. The Framework and Approach for SAWRD24 requires SA Water to convene a Customer Challenge Group, who will work closely with SA Water throughout the process of developing the Regulatory Business Plan. The Commission will attend all Customer Challenge Group meetings to provide advice and support as needed.

The Customer Challenge Group will discuss and debate the assumptions underlying proposed expenditures, and the options being considered to meet required standards and strategic objectives. This should include discussion of how SA Water assesses and manages customer related risks, and how prioritisation of proposed expenditures works. If required, the Customer Challenge Group will also assist SA Water to design, conduct and review customer research, focusing on research to inform the Regulatory Business Plan.

This process is intended to assist SA Water to articulate the outcomes proposed expenditures will deliver to customers, as well as the associated risks, and to demonstrate where proposals have customer support.

³ Diagram from page 14 of 'Monitoring and evaluating performance – Implementing the final decisions' January 2021, available on the Commission’s website at <https://www.escosa.sa.gov.au/ArticleDocuments/21627/20210122-Water-SAWRD20-24-MonitoringEvaluationFramework-FinalReport.pdf.aspx?Embed=Y>

⁴ SA Water’s current Business Strategy 2020-25: <https://www.sawater.com.au/about-us/our-vision-and-strategy/our-business-strategy>

The Commission will also undertake stakeholder engagement activities as part of the regulatory determination process, and considers that obtaining a diverse range of views is essential.

It is important to note that customer support for a proposed expenditure will be taken into consideration by the Commission in making its determination, but does not guarantee approval. Ultimately, the outputs from SA Water's customer engagement feed into a wider cost-benefit analysis task. Seeking to quantify the value that customers put on a particular service improvement helps to inform the 'benefits' side of the equation; additional financial and economic analysis may be required to understand the costs and benefits of particular expenditure proposals.



The Essential Services Commission
Level 1, 151 Pirie Street Adelaide SA 5000
GPO Box 2605 Adelaide SA 5001
T 08 8463 4444

E escosa@escosa.sa.gov.au | W www.escosa.sa.gov.au