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SA Water Regulatory Determination 2024

DRAFT Decision: Statement of reasons

January 2024

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Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this paper by Wednesday, 6 March 2024.

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The Commission may also exercise its discretion not to publish any submission based on length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to: **SA Water Regulatory Determination 2024 – Draft Determination**

It is preferred that submissions are sent electronically to: reviews@escosa.sa.gov.au

Alternatively, submissions can be sent to:
Essential Services Commission
GPO Box 2605
ADELAIDE SA 5001

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

Contact Officer: Natasha Cheshire, Director – Consumer Protection and Pricing

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Glossary of terms

AER	Australian Energy Regulator
AGS	Australian Government Securities
ANCOLD	Australian National Committee on Large Dams
Atkins	WS Atkins International
CAC	Consumer Advisory Committee
CCG	Customer Challenge Group
CAPM	Capital Asset Pricing Model
Code	Water Retail Code – Major Retailers WRC-MR/03
Commission	Essential Services Commission, established under the <i>Essential Services Commission Act 2002</i>
COTA SA	Council of the Ageing South Australia
COVID-19	COVID-19 pandemic event
CPI	Consumer Price Index
CRM	Customer Relationship Management system
CSO	Community Service Obligation
CWMS	Community Wastewater Management System
DEW	Department for Environment and Water
Draft Determination	SA Water Draft Regulatory Determination 2024
EBA	Enterprise Bargaining Agreement
EPA	Environment Protection Authority
ERA	Economic Regulation Authority Western Australia
ESC Act	<i>Essential Services Commission Act 2002</i>
ESCV	Essential Services Commission of Victoria
EWOSA	Energy and Water Ombudsman SA
FTE	Full time equivalent positions
FTI	FTI Consulting

FWS	Uniting Communities Financial Wellbeing Services
Guidance Paper 1	Guidance Paper 1 – The regulatory business plan
Guidance Paper 2	Guidance Paper 2 – Stakeholder engagement for the regulatory business plan
Guidance Paper 3	Guidance Paper 3 – Assessing the regulatory business plan
Guideline 1	Water Industry Guideline No. 1 – Compliance Systems and Reporting – Major Retailers
Guideline 2	Water Industry Guideline No. 2 – Regulatory Information Requirements – Major Retailers
GSL	Guaranteed Service Level
ICT	Information Communications Technology
ICRC	Independent Competition and Regulatory Commission
IPART	Independent Pricing and Regulatory Tribunal
Issues Paper	SA Water Regulatory Determination 2024 - Water Retail Code and Monitoring and Evaluating Performance Framework
LOTS	Land Ownership and Tenure System
LTO	Lands Titles Office
MECS	Monitoring, Evaluation and Compliance Strategy
MEPF	Monitoring and Evaluating Performance Framework
Minister	Minister for Climate, Environment and Water
NAIS	Northern Adelaide Irrigation Scheme
NWI	National Water Initiative
OFW	Office for Women SA
OTTER	Office of the Tasmanian Economic Regulator
PBEF	Peak Bodies Engagement Forum
PC Act	<i>Public Corporations Act 1993</i>
PPI	Producer Price Index
QCA	Queensland Competition Authority
RAB	Regulated Asset Base
Rate of return	Regulatory rate of return

RBA	Reserve Bank of Australia
RBP	SA Water's Regulatory Business Proposal
RT Act	<i>Residential Tenancies Act 1995</i>
SA Water	South Australian Water Corporation
SACAT	South Australian Administrative Claims Tribunal
SACOSS	South Australian Council of Social Service
SAFRRA	South Australian Federation of Residents and Ratepayers Associations Incorporated
Sapere	Sapere Research Group
SAPN	SA Power Networks
SAWRD13	SA Water Regulatory Determination 2013
SAWRD16	SA Water Regulatory Determination 2016
SAWRD20	SA Water Regulatory Determination 2020
SAWRD24	SA Water Regulatory Determination 2024
SAWRD28	SA Water Regulatory Determination 2028
SOCI	<i>Security of Critical Infrastructure Act 2018 (Cth)</i>
TTG	Tea Tree Gully
Treasurer	Treasurer for the South Australian Government
VTA	Verified trust and accountability
WACC	Weighted average cost of capital
WI Act	<i>Water Industry Act 2012</i>
WI Regulations	<i>Water Industry Regulations 2012</i>
WPI	Wage Price Index
WTP	Willingness to pay
ZFA	Zahra Foundation Australia

1 At a glance

Following a detailed independent review and an opportunity for public submissions, the Essential Services Commission is consulting on a proposed revised regulatory framework, including consumer protections, service standards and revenue caps, to apply to SA Water for the period **1 July 2024 to 30 June 2028**.

The Commission welcomes comment and feedback on those proposals by **Wednesday, 6 March 2024**. A final regulatory determination will be published in **June 2024**.

People, businesses and communities in South Australia use water and sewerage services as an essential part of their everyday lives. The essential nature of these services means it is important for SA Water to deliver value for money, now and into the future.

The Essential Services Commission's (**Commission**) regulation of SA Water's water and sewerage retail services incentivises SA Water to deliver these services at the lowest sustainable price for the quality and reliability levels that customers value.

Key Point	Description
Purpose of regulatory determinations	To reproduce the incentives for efficient outcomes that benefit SA Water customers in the absence of a competitive market.
Key objectives of the new regulatory determination	To protect South Australian consumers long-term interests with respect to the price, quality and reliability of SA Water's services, enhance protections for water users, and confirm the need for SA Water to provide regular, meaningful and transparent public information on its performance.
Key outcomes of the new regulatory determination	<ul style="list-style-type: none"> ▶ Generally maintaining the existing consumer protection framework, but providing enhanced protections for tenants (as consumers), customers experiencing payment difficulties and customers affected by family violence. ▶ An overall cap of \$5,335 million (\$Dec22) on the revenue that SA Water can recover from customers over the period July 2024 to June 2028, comprising: <ul style="list-style-type: none"> – \$3,550 million revenue cap for water retail services, which is 3 percent less than SA Water's proposal. – \$1,785 million revenue cap for sewerage retail services, which is 1 percent less than SA Water's proposal. ▶ A pricing principles, price disclosure, monitoring and dispute resolution determination in relation to the recycled water and end-user specific retail services provided by SA Water.
Key measures of the new regulatory determination	Performance and compliance by SA Water, reported publicly and to the Commission, in relation to consumer protection performance and delivery, revenue allowance compliance, and service, asset and delivery performance and outcomes.

This draft regulatory determination sets out the consumer protection measures, revenue allowances and performance monitoring that are proposed to apply to SA Water over the four years from 1 July 2024. Further submissions, evidence and information will be considered by the Commission in preparing a final regulatory determination, to be released in June 2024. In that context, positions put forward in this report are draft and subject to change.

Under the statutory framework governing the economic regulation of SA Water, the Commission makes four-yearly economic regulatory determinations that set the maximum revenues that SA Water may earn and the service standards that it must provide to its customers.

The Commission will make a new regulatory determination to apply to SA Water for the period 1 July 2024 to 30 June 2028: SA Water Regulatory Determination 2024 (**SAWRD24**).

Consistent with its primary objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services, and with its past approach, SAWRD24 will challenge SA Water to continue 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.

1.1 Protecting consumers

The Water Retail Code – Major Retailers (**Code**) sets out the behavioural standards and minimum requirements that apply to SA Water for the sale and supply of retail services (water and sewerage) to customers and, in some instances, other consumers.

The Commission's draft decision is that the existing consumer protections contained in the Code continue to remain appropriate for SAWRD24, subject to some limited amendments to enhance protections for consumers, customers experiencing payment difficulties and customers affected by family violence.

The Commission has considered and reached draft decisions on two proposals for changes to the Code from SA Water, as explained below. As these are draft decisions, the Commission welcomes comment and feedback, as well as other further relevant information from stakeholders to inform its final decision.

- ▶ The Commission has accepted SA Water's proposal to remove the requirement for it to undertake an out of cycle meter read when a customer's self-read has not been accepted. To minimise the risk that customers will be over or under-charged SA Water will need to provide customers with the option of either resubmitting a compliant self-meter read or organise a time for a meter reader to have access to the meter before using an estimate of water use.
- ▶ The Commission has accepted SA Water's proposal that it have the discretion to charge customers for paper bills. Implementation approval will be subject to SA Water meeting minimum requirements including public consultation, provision of information to customers prior to the scheme taking effect and the establishment of an exemption scheme to remove the charge for certain customers (for example, those experiencing financial hardship or without access to the internet at home).

With regard to the service standards that SA Water must meet in the sale and supply of retail services to its customers, the Commission's draft decision is that the existing 22 service standards will continue to apply during SAWRD24, with one performance target lifted to reflect SA Water's historical performance.

The Commission has not accepted SA Water's proposals to adjust the performance metrics for regional response service standards and sewer overflow clean-up, as it considers doing so may result in service reductions.

1.2 Prudent and efficient revenue outcomes

The Commission's draft decision for revenue caps for water and sewerage retail services are approximately 3 percent and 1 percent lower than that proposed by SA Water in its regulatory business proposal (**RBP**), on a comparative basis.

Under the legislative framework governing SA Water regulatory determinations, the Commission will fix the maximum revenue that SA Water can recover from customers over the four-year period 1 July 2024 to 30 June 2028. While the Commission does not set prices, the legislative requirements mean SA Water must set its prices to recover no more than the revenue permitted, subject to ancillary revenue adjustment mechanisms included in the determination.

Through a six-week consultation on SA Water's RBP, the Commission heard that affordability is a key concern for South Australians. In reviewing SA Water's operations, the Commission has considered whether SA Water is operating prudently, efficiently and delivering value for money. The Commission sought to understand whether SA Water can deliver the projects it planned so that customers do not pay for projects before they commence.

The draft positions are consistent with stakeholders' submissions that some of the expenditure proposed by SA Water was neither justified nor consistent with customers' priority that prices should be kept as low as possible while delivering on the service levels valued by customers.

The draft revenue caps for SAWRD24 have been calculated as the forecast total efficient costs of providing water and sewerage retail services. The total efficient costs of providing water and sewerage retail services have been determined using the building blocks cost model. Efficient costs need not be the costs the regulated business is actually incurring, and it is for the regulated business to demonstrate that its actual costs represent an efficient cost base.

The draft decision is that the revenue caps for the four-year period commencing 1 July 2024, in present value terms, are:

- ▶ \$3,550 million (\$Dec22) for **water** retail services, and
- ▶ \$1,785 million (\$Dec22) for **sewerage** retail services.

The Commission's assessment is that the revenue caps will provide SA Water with sufficient revenue to fund prudent and efficient operations and finance prudent and efficient investments on a long-term basis while meeting SA Water's applicable health, safety, environmental and customer service standards and obligations over SAWRD24. In order to deliver value for money on an ongoing basis, SA Water should ensure it has in place sound long-term asset management, operating and financing strategies. These strategies should support the provision of retail services for current and future customers.

Following the release of the final regulatory determination in June 2024, SA Water has responsibility for setting prices for water and sewerage retail services. SA Water has the flexibility to set prices from year to year as it sees fit, but is only allowed to recover revenues over the SAWRD24 period in accordance with the final four-year maximum revenue caps.

The revenue caps set by the Commission are fixed, subject to any adjustment mechanisms in the following regulatory period. SA Water must ensure its revenues do not exceed the caps, expressed as a present value at 1 July 2024, in dollars of December 2022. In setting the caps, the Commission's assessment of SA Water's prudent and efficient expenditure benchmark has been completed in real, December 2022 dollars. The expenditure forecasts also include allowances for growing demand and customer numbers over the regulated period. SA Water will set prices for water and sewerage retail services from time to time as actual current prices for customers, including the effects of inflation. It is

therefore important to note that the likely percentage change in prices set by SA Water will not necessarily mirror the percentage change in revenue caps between regulatory periods.

While the revenue caps are set by the Commission in inflation-adjusted terms (that is, real, December 2022 prices), SA Water will set prices for water and sewerage retail services in nominal terms (that is, they will be set in current prices for customers). It is therefore worth noting that the percentage change in the revenue caps between regulatory periods (for example, the increase in the caps for SAWRD24 relative to those set out in SA Water Regulatory Determination 2020 (SAWRD20)) may not necessarily translate into the same percentage increase in the nominal prices that are set by SA Water.

1.2.1 Comparison against SA Water's regulatory business proposal

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 1.1.

Table 1.1: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SA Water's proposal terms (\$Dec22)

	SA Water's proposal for SAWRD24 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,386	2,272	-114 ↓	-5% ↓
Capital expenditure	2,831	2,529	-302 ↓	-11% ↓
Total	5,217	4,801	-416 ↓	-8% ↓

Of the \$2,831 million of capital expenditure proposed by SA Water for SAWRD24, approximately \$1,160 million (41 percent) is related to five major projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 3 percent decrease for water retail services compared with SA Water's proposal, and
- ▶ 1 percent decrease for sewerage retail services compared SA Water's proposal.

Table 1.2 compares the draft revenue caps for SAWRD24 with an adjusted version of SA Water's proposal.

Table 1.2: Draft revenue caps for SAWRD24 compared with an adjusted version of SA Water's proposal, in present value terms (\$Dec22)

	SA Water's proposal for SAWRD24 ¹ (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Total Water	3,647	3,550	-97 ↓	-3% ↓
Total Sewerage	1,809	1,785	-23 ↓	-1% ↓

¹ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission's draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. As noted in Chapters 10 and 11, the Commission understands that SA Water's proposal stated expenditure in December 2022 dollars.

The Commission has, for the purposes of making a like-for-like comparison, adjusted SA Water's revenue proposal (including for the latest rate of return and the consumer price index (CPI) inflation roll-forward of the Regulated Asset Base (RAB)), in order to estimate a comparison between the Commission's draft determination and SA Water's proposal. Without making an adjustment, any comparisons of revenue caps may be, for example, significantly impacted by the timing of the assessments and the differing rate of return and other assumptions utilised.²

1.2.2 Comparison against SAWRD20

The SAWRD24 determination is made in a different economic context to the previous regulatory determination, SAWRD20, which occurred in a low interest rate environment. That environment has changed materially, with material uplifts in interest rates which directly flow through into the determination of the regulatory rate of return (**rate of return**).

During the four-year SAWRD20 period, lower financing costs meant SA Water was able to deliver the same level of water and sewerage retail services for less than was the case in previous regulatory periods. The cost savings in SAWRD20 were passed on to customers through lower bills.

Current financing costs have increased operational costs compared to SAWRD20, returning to levels experienced previously. In addition, higher prices for energy and raw materials are adding to overall cost pressures.

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 1.3.

Table 1.3: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SAWRD20 (\$Dec22)

	Final SAWRD20 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,237	2,272	+35 ↑	+2% ↑
Capital expenditure	1,885	2,529	+644 ↑	+34% ↑
Total	4,122	4,801	+679 ↑	+16% ↑

The \$644 million (34 percent) increase in capital expenditure is driven by five major projects with total expenditure of approximately \$1,160 million for the SAWRD24 regulatory period (\$Dec22).

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 22 percent increase for water retail services compared with those determined in SAWRD20, and
- ▶ 28 percent increase for sewerage retail services compared with those determined in SAWRD20.

While increased expenditure benchmarks have contributed to additional revenue requirements, the Commission's assessment is that the increases in the revenue caps, compared to SAWRD20, have been driven largely by the increase in the rate of return (refer Box 1.1).

² SA Water's proposal used a rate of return of 3.23% that it calculated in March 2023, and so this would not be an appropriate comparison with the Commission's updated estimate derived as at November 2023.

Box 1.1 Key driver - Rate of return

Increased financing costs have resulted in a draft decision to set SA Water’s allowed average rate of return at 3.99 percent (real, post-tax), calculated as of 14 November 2023. By way of comparison, the average regulatory rate of return (real, post-tax) adopted in previous determinations was:

- ▶ 4.5 percent in 2013-16
- ▶ 4.17 percent in 2016-20 and
- ▶ a low of 2.68 percent in 2020-24.

In its Regulatory Business Proposal, SA Water calculated revenue requirements using an average regulatory rate of return (real, post-tax) of 3.23%, calculated in March 2023.

To illustrate the impact of the revenue caps from the higher rate of return, holding all things equal, if the rate of return used in SAWRD20 (2.68 percent) was applied for the purposes of the SAWRD24 determination, it would lead to the following revenue outcomes (refer Table 1.4).

Table 1.4: Comparison of revenue caps for SAWRD24 using SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (\$m)	Draft Determination SAWRD24 - 2.68% Rate of Return (\$m)	Variance (\$m)	Variance (%)
Water	3,550	3,108	-441 ↓	-12% ↓
Sewerage	1,785	1,572	-213 ↓	-12% ↓

In this scenario, the revenue caps would be 7 per cent and 13 percent higher than in SAWRD20 (compared to 22 percent and 28 percent respectively). In both instances, this is 15 percentage points below the SAWRD24 draft decision (refer Table 1.5).

Table 1.5: Comparison of percentage change in revenue caps for SAWRD24 compared to SAWRD20, using SAWRD24 and SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (%)	Draft Determination SAWRD24 - 2.68% Rate of Return (%)	Variance (%)
Water	22%	7%	-15% ↓
Sewerage	28%	13%	-15% ↓

The conclusion may be drawn that the rate of return is the major contributing factor to the increase in the revenue caps.

1.3 Transparent performance reporting

In SAWRD20, the Commission established a new monitoring and evaluating performance framework that outlined the public reporting requirements and regulatory expectations that apply to SA Water. The framework requires SA Water to publicly account for the long-term commitments made to customers, including under its RBP, and for delivering the outcomes as required under the consumer protections established by the Code. The Commission's draft decision is to retain and strengthen this framework for SAWRD24.

1.4 Next steps

The Commission is consulting on this SAWRD24 draft regulatory determination, with written submissions due by Wednesday, 6 March 2024. It is requested that submissions are sent to reviews@escosa.sa.gov.au.

The Commission will consult directly with key stakeholders during the consultation period, providing opportunities for all interested parties to ask questions about the draft regulatory determination (and related matters) and provide further evidence and information to inform the final regulatory determination.

All relevant submissions, evidence and information will be considered by the Commission in preparing that final regulatory determination, to be released in June 2024.

Following the release of the final regulatory determination, SA Water will set water and sewerage prices in accordance with the final revenue caps and pricing requirements. Those prices will apply from 1 July 2024.

Timing	Milestone
January 2024	Commission releases draft regulatory determination for consultation
February 2024	Commission invites feedback on draft regulatory determination
June 2024	Commission releases final regulatory determination
June 2024	SA Water and SA Government develop prices
1 July 2024	SAWRD24 regulatory period commences

The Commission thanks those who made submissions following publication of SA Water's proposal, all of which were carefully considered and have provided valuable information and insights for the draft regulatory determination.

1.5 Structure of this statement of reasons

The following section, Chapter 2 – Overview, provides an expanded summary of the Commission's draft positions as part of the draft regulatory determination.

The remaining parts set out, in detail, why regulation of SA Water's retail services is required and the specific approach under which the Commission will regulate SA Water, refer:

- ▶ Part A – Background and context
- ▶ Part B – Consumer protection framework
- ▶ Part C – Form of regulation for water and sewerage retail services
- ▶ Part D – Determining revenue caps for direct control retail services, and
- ▶ Part E – Monitoring and evaluation.

2 Overview

Following a detailed independent review and an opportunity for public submissions, the Essential Services Commission is consulting on a proposed revised regulatory framework, including consumer protections, service standards and revenue caps, to apply to SA Water for the period **1 July 2024 to 30 June 2028**.

The Commission welcomes comment and feedback on those proposals by **Wednesday, 6 March 2024**. A final regulatory determination will be published in **June 2024**.

People, businesses and communities in South Australia use water and sewerage services as an essential part of their everyday lives. The essential nature of these services means it is important for SA Water to deliver value for money, now and into the future.

The Essential Services Commission's (**Commission**) regulation of SA Water's water and sewerage retail services incentivises SA Water to deliver these services at the lowest sustainable price for the quality and reliability levels that customers value.

Under the statutory framework governing the economic regulation of SA Water, the Commission makes four-yearly economic regulatory determinations that set the maximum revenues that SA Water may earn and the service standards that it must provide to its customers.

The Commission will make a new regulatory determination to apply to SA Water for the period 1 July 2024 to 30 June 2028: SA Water Regulatory Determination 2024 (**SAWRD24**).

Consistent with its primary objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services, and with its past approach, SAWRD24 will challenge SA Water to continue 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.

This draft regulatory determination sets out the consumer protection measures, revenue allowances and performance monitoring that are proposed to apply to SA Water over the four years from 1 July 2024. Overall, the draft regulatory determination:

- ▶ continues to deliver the protections and consumer benefits put in place over the last 10 years, since the economic regulation of SA Water commenced
- ▶ enhances protections for water users and provides incentives for SA Water to deliver additional financial and management efficiencies over the coming four years and beyond, and
- ▶ confirms the need for SA Water to provide regular, meaningful, transparent and public information on how it is responding to its customers and to explain its ongoing performance as a monopoly water utility.

The release of this draft determination is a key milestone in the SAWRD24 process, allowing further feedback, commentary and evidence to be gathered to inform the review. In making the regulatory determination, the Commission's primary objective is to protect the long-term interests of consumers with respect to the price, quality and reliability of essential services.

Further submissions, evidence and information will be considered by the Commission in preparing a final regulatory determination, to be released in June 2024. In that context, positions put forward in this report are draft and subject to change.

2.1 Background to SAWRD24

SA Water is a vertically integrated water and sewerage business, wholly owned by the South Australian Government. SA Water provides water and sewerage services to approximately 1.7 million South Australians.

The retail services provided by SA Water are subject to economic regulation by the Commission under the *Essential Services Commission Act 2002 (ESC Act)* and the *Water Industry Act 2012 (WI Act)*. The economic regulatory regime has two main elements:

- ▶ SA Water is licensed by the Commission under the WI Act to provide retail services, subject to conditions. While some matters are addressed through licence conditions alone, the Commission is able to make industry codes and rules that prescribe the rules of conduct and procedures that SA Water must follow in providing retail services. This relates in particular to the setting of service standards and the nature and scope of consumer protections that must be adhered to by SA Water.
- ▶ The Commission also has the discretion to make determinations relating to pricing for SA Water's retail services. Under the legislative settings of the regime, the Commission regulates the revenues that can be earned by SA Water for the provision of retail services (having regard to the service standard, consumer protection and other regulatory requirements), with SA Water being responsible for setting the specific prices that recover the relevant revenues.

The Commission's overall purpose and approach in regulating SA Water aims to encourage economically efficient behaviour that is in consumers' long-term interests.

The Commission undertakes its role as economic regulator within a broader legislative and policy framework. The South Australian Government develops and implements, through legislation, public policy in relation to public health, the environment, water supply and demand planning, technical standards, safety and social welfare, all of which impact on SA Water. The Commission and other regulators perform roles and functions assigned to them by the South Australian Government and Parliament under that policy and legislative framework.

SA Water is regulated by other bodies in relation to matters such as health, quality safety and environmental obligations: the Commission works closely with those bodies but is not responsible for those other regulatory requirements or outcomes.

Under the economic regulatory regime, the Commission brings the making of codes, rules, and price determinations into a single regulatory determination process. The regulatory determination will apply for the period 1 July 2024 to 30 June 2028. This is the fourth SA Water regulatory determination made by the Commission. The determination process includes:

- ▶ reviewing and amending the consumer protections contained in industry codes
- ▶ reviewing the customer service and network reliability service standards with associated performance targets
- ▶ making regulatory determinations covering revenue caps for water and sewerage retail services and other pricing-related controls for recycled water services and other ('excluded') retail services, and
- ▶ reviewing and amending the monitoring, evaluating and performance framework.

The Commission has considered all relevant legislative objectives and factors in making this draft regulatory determination. The statement of reasons sets out the legal and policy framework for SAWRD24 and how the Commission has addressed the legal requirements.

This draft regulatory determination sets out the Commission's considered position as to the most reasonable form and quantum of regulation and revenue control to be applied to SA Water during the 2024-2028 regulatory period. It considers that it best protects South Australian consumers' long-term interests with respect to the price, quality and reliability of the water and sewerage retail services provided by SA Water.

For further information, please refer to **Chapter 3 – Introduction** and **Chapter 4 – SA Water's Regulatory Business**.

2.2 Protecting consumers

The Water Retail Code – Major Retailers (**Code**) sets out the behavioural standards and minimum requirements that apply to SA Water for the sale and supply of retail services (water and sewerage) to customers and, in some instances, other consumers.

The Commission has considered and reached draft decisions on proposals for changes to the Code and Service Standards from SA Water, discussed further below.

The Commission's draft decision is that the existing consumer protections contained in the Code continue to remain appropriate for SAWRD24, subject to some limited amendments to enhance protections for consumers, customers experiencing payment difficulties and customers affected by family violence.

With regard to the service standards that SA Water must meet in the sale and supply of retail services to its customers, the Commission's draft decision is that the existing 22 service standards will continue to apply during SAWRD24, with one performance target lifted to reflect SA Water's historical performance.

As these are draft decisions, the Commission welcomes comment and feedback, as well as other further relevant information from stakeholders to inform its final decision.

2.2.1 Draft decision - Water Retail Code – Major Retailers

The Commission's draft decision is that the existing protections contained in the Code remain appropriate for SAWRD24, subject to the following variations:

- ▶ Certain protections that currently apply only to customers, defined as owners of land to which a retail service is provided, will be extended to apply to all consumers, such as tenants and other occupants.
- ▶ New requirements will be established that require SA Water to publish information about how hardship provisions apply differently to customers, as owners of land, and other types of consumers, and what consumers can do if they dispute a bill.
- ▶ SA Water will be prohibited from restricting water flow in properties that SA Water believes or should reasonably believe, is tenanted.
- ▶ The current prohibition on SA Water charging customers for provision of paper bills will be removed. SA Water will have the discretion to charge for the provision of paper bills provided:
 - it has undertaken public consultation on the proposal and, following consultation, publicly explained its decision whether to proceed with the charge

- an exemption scheme is established; the charge is clearly identified on bills
 - 12 months' notice has been provided before the charge is introduced, and
 - customers have the option to receive a bill free of charge via an alternative method (for example, electronically).
- ▶ The requirement for SA Water to undertake an actual meter read at a customer's property where a self-read has not been accepted will be removed. This requirement will be replaced with an obligation for SA Water to provide customers with the option of either resubmitting a compliant read or organising a time for a meter reader to have access to the meter.
 - ▶ SA Water will be required to offer and apply flexible payment plans to both residential and non-residential customers who are experiencing payment difficulties (currently this protection is only required for residential customers) and protect both residential and non-residential customers from debt recovery and restriction of water services while adhering to the terms of an agreed payment plan.
 - ▶ SA Water will be required to establish policies and processes for early identification of residential customers who may be experiencing payment difficulties and will be required to employ best endeavours to contact these customers to provide information about available assistance.
 - ▶ New conduct and policy requirements will be introduced for SA Water in relation to providing protections for customers experiencing family violence.
 - ▶ New provisions will establish the service standards that will apply when SA Water has been directed to take over the operations of another water industry entity on either a temporary or ongoing basis.

For further information, please refer to **Chapter 5 – Water Retail Code – Major Retailers**.

2.2.2 Draft decision – Best endeavours service standards with performance targets

The Commission's draft decision is that the existing 22 best endeavours service standards will continue to apply to SA Water during SAWRD24. The service standards cover aspects of customer service, responsiveness to service issues, service restoration timeliness and timeliness of connections. There are separate service standards for the Adelaide metropolitan area and regional areas.

The Commission has not accepted SA Water's proposal to adjust the performance metrics for regional response service standards or the sewer overflow clean-up service standards, as it considers doing so may result in service reductions.

To improve transparency where SA Water does not meet a service standard performance target the best endeavours regime requires SA Water to provide public justification and evidence of why and how it considers that it employed best endeavours notwithstanding that the performance target was not met. The Commission will consider SA Water's justification and evidence in assessing whether or not best endeavours were used. This regime provides greater transparency on SA Water performance for its customers, while also aiding the Commission in undertaking a review of the reasonableness of any service standard targets that SA Water is unable to meet over SAWRD24 when setting performance targets for SAWRD28.

For SAWRD24, SA Water has proposed to maintain its service levels, and therefore proposed no increases to the service standard performance targets. However, as SA Water has consistently exceeded the performance target for the service standard relating to complaint escalation to the Ombudsman over SAWRD20, the Commission proposes to increase the target for SAWRD24 to reflect SA Water's current performance.

The Commission has also made a draft decision that customers connected to the Tea Tree Gully (TTG) Community Wastewater Management System (CWMS) will not be included in the assessment of SA Water's overall performance against its service standards. Instead, separate performance reporting requirements have been proposed by the Commission in Chapter 5.

The Commission's draft decision on service standards for SAWRD24 is to:

- ▶ Maintain current regional response time performance measures.
- ▶ Maintain current sewer overflow clean-up performance measures.
- ▶ Require SA Water to provide more detailed annual public reporting on missed service standard performance targets.
- ▶ Increase the performance target for service standard 5: complaint escalation to the Ombudsman from ≤ 15 percent to ≤ 10 percent.
- ▶ Maintain current public reporting requirements for water and sewer network reliability.
- ▶ Maintain current public reporting requirements for sewer overflows to the environment.
- ▶ Maintain current public reporting requirements for water quality improvement.

SA Water must continue to use its best endeavours to meet the 22 service standards and performance targets that will apply in SAWRD24. These are summarised in Table 2.1.

For further information, please refer to **Chapter 6 – Service standard with performance targets**.

Table 2.1: Summary of draft decision on best endeavours service standards for SAWRD24

Service standards			Draft SAWRD24 target
No.	Category	Standard and performance measure	
1	Customer service	Customer satisfaction: Customers who are satisfied with recent service experience.	$\geq 93\%$
2	Customer service	Telephone responsiveness: Fault telephone calls answered within 50 seconds.	$\geq 85\%$
3	Customer service	First contact resolution: Account enquiry telephone calls resolved at first point of contact.	$\geq 85\%$
4	Customer service	Complaint responsiveness: Customer and community complaints responded to in 10 business days.	$\geq 95\%$
5	Connections	Complaint escalation: Percentage of customer and community complaints escalated to the ombudsman following dissatisfaction with SA Water response to a complaint. * Change from the current target	$\leq 10\%^*$

Service standards			Draft SAWRD24 target
No.	Category	Standard and performance measure	
6	Connections	Connection application responsiveness: Network connection applications processed in the target timeframe of 20 business days.	≥95%
7	Connections	Water network connection timeliness: Water network connections constructed in target timeframes.	≥95%
8	Connections	Sewer network connection timeliness: Sewer network connections constructed in target timeframes.	≥94%
9	Response (attendance)	Water quality responsiveness – metropolitan Adelaide: Water quality service requests assessed by field staff that have resolution or plan of action communicated with the customer in target timeframes.	≥97%
10	Response (attendance)	Water quality responsiveness – regional areas: Water quality service requests assessed by field staff that have resolution or plan of action communicated with the customer in target timeframes.	≥99%
11	Response (attendance)	Water event responsiveness – high priority – metropolitan Adelaide: Water network break and leak events with the greatest customer or community impact attended by field crews in target timeframes.	≥99%
12	Response (attendance)	Water event responsiveness – high priority – regional areas: Water network break and leak events with the greatest customer or community impact attended by field crews in target timeframes.	≥99%
13	Response (attendance)	Water event responsiveness – low priority – metropolitan Adelaide: Water break, leak and boundary events with low to medium customer or community impact attended by field crews in target timeframes.	≥83%
14	Response (attendance)	Water event responsiveness – low priority – regional areas: Water break, leak and boundary events with low to medium customer or community impact attended by field crews in target timeframes.	≥97%
15	Response (attendance)	Sewer event responsiveness – metropolitan Adelaide: Sewer events attended by field crews in target timeframes.	≥99%
16	Response (attendance)	Sewer event responsiveness – regional areas: Sewer events attended by field crews in target timeframes.	≥99%
17	Restoration	Water service restoration timeliness – metropolitan Adelaide: Unplanned interruptions to a water service restored in target timeframes.	≥98%
18	Restoration	Water service restoration timeliness – regional areas: Unplanned interruptions to a water service restored in target timeframes.	≥98%

Service standards			Draft SAWRD24 target
No.	Category	Standard and performance measure	
19	Restoration	Sewerage service restoration timeliness – metropolitan Adelaide: Unplanned interruptions to a sewer service restored in target timeframes.	≥95%
20	Restoration	Sewerage service restoration timeliness – regional areas: Unplanned interruptions to a sewer service restored in target timeframes.	≥99%
21	Restoration	Sewer overflow clean-up timeliness – metropolitan Adelaide: Sewer overflow clean-ups completed in target timeframes.	≥98%
22	Restoration	Sewer overflow clean-up timeliness – regional areas: Sewer overflow clean-ups completed in target timeframes.	≥99%

2.3 Revenue caps for direct control retail services

The Commission considered all relevant legislative objectives and factors in making its draft decision regarding revenue caps for direct control water and sewerage retail services. The Commission considers the proposed revenue caps reflect an appropriate sustainable cost for providing those services at the determined service standards and in accordance with the obligations set by all regulators of SA Water.

Regulating revenues to recover the lowest sustainable cost of supplying water and sewerage retail services allows SA Water sufficient revenue to efficiently deliver the services valued by customers, in the long term. The Commission is not seeking to deliver low prices in the short term at the expense of long-term service delivery. That would be inconsistent with the Commission's requirement to protect customers' long-term interests. Nor is the Commission setting revenues above the efficient cost of service delivery, as that would deliver excessive profits to SA Water, which would also be inconsistent with the long-term interests of consumers. The Commission's regulation of SA Water's seeks to incentivise performance that delivers efficient capital investment and operations, over time.

As a matter of general practice, the Commission's expectation is that a prudent and efficient water utility, which manages long-life water and sewerage assets, should be able and willing to provide supporting evidence to justify all elements of its expenditure proposals. For regulated water utilities such as SA Water, this is as set out in its Regulatory Business Proposal (RBP).

However, a RBP cannot be divorced from the long-term operating context of an asset-intensive business. Long-term strategies and plans, relating to asset management, operational delivery and financing, should be in place and given effect. Investment decision-making should be ongoing and frequently reviewed, clearly linked to long-term goals and the strategies that support them.

A RBP is, therefore, simply a point-in-time snapshot of the regulated business' long-term plans, providing more granular short-term detail to explain and justify proposed expenditure, investment, action and service levels for the next regulatory period.

In that overall long-term planning and delivery context, a regulated business, such as SA Water, should have the information and materials underpinning its RBP readily available to be provided to any and all interested stakeholders and the Commission.

In making its assessment, the Commission is not bound to accept a regulated entity's claims regarding expenditure requirements, without testing and assessing those claims (publicly, wherever possible) and, where it considers better information or evidence exists, then it may choose to adopt that better information and evidence.

Furthermore, the regulatory decision-making process can involve issues of discretion, judgement and degree (to the extent permitted under the ESC Act and the WI Act). In such cases, given the range of possible choices, the Commission recognises that different minds, acting reasonably, can be expected to make different choices on the same subject matter.

The methodology applied by the Commission in determining revenue caps for direct control water and sewerage retail services, has been informed by all information, materials and submissions available to it at the time of making the draft decision. This includes information and submissions from industry and consumers, SA Water's consumer engagement, as well as public and private sources of data, and information contained in SA Water's RBP.

The Commission has also sought additional information and materials from SA Water, some of which is confidential and may not be reported in part or in full in the following chapters. In addition, the Commission has undertaken its own enquiries to obtain relevant information to inform and assist it in determining the revenue caps for direct control water and sewerage retail services, including obtaining the advice of consultants.

Reports have been prepared for the Commission by the following consultants, and are publicly available for consideration and review as a part of the draft determination consultation:

- ▶ Sapere Research Group (**Sapere**): demand adjustment mechanism
- ▶ Oxford Economics Australia: cost escalation and forecasts
- ▶ WS Atkins International (**Atkins**): capital expenditure review excluding Information Communications Technology (**ICT**) infrastructure, and
- ▶ FTI Consulting (**FTI**): capital expenditure relating to ICT infrastructure.

For further information, please refer to **Chapter 9 – Approach to determining revenue caps for direct control retail services** and **Part D – Determining revenue caps for direct control services**.

2.3.1 Form of regulation for direct control retail services

The Commission's draft decision on the form of regulation for direct control services is that:

- ▶ SA Water's direct control water and sewerage retail services will be subject to separate four-year maximum revenue caps and be prepared and presented on the basis of a building blocks cost model.
- ▶ The caps will be calculated as the forecast efficient costs of providing water and sewerage retail services and will be set at a fixed dollar amount subject to five ancillary (adjustment) variation mechanisms.
 - A 'cost pass-through' mechanism that will enable the revenue caps to be adjusted in the subsequent regulatory period where an event beyond the control of SA Water has, or will have, a material impact on SA Water's costs of providing water or sewerage retail services.
 - A 'demand variation adjustment' mechanism that will adjust the revenue caps in the subsequent regulatory period to account for any material differences between forecast and actual water and sewerage retail service revenue earned, due to differences between forecast and actual water sales and sewerage connections.

- A ‘shared infrastructure’ mechanism for water retail services that adjusts the revenue caps in the subsequent regulatory period to account for the difference between actual and forecast revenues from the previous period, in relation to 10 percent of the revenue earned by SA Water for the provision of non-regulated services that utilise water retail service infrastructure. For sewerage retail services, the ‘shared infrastructure’ mechanism allows for 10 percent of the revenue amounts earned during the regulatory period, through the use of SA Water’s regulated infrastructure required to provide sewerage retail services but which are not attributable to the provision of sewerage retail services, to be deducted from the revenue caps in the subsequent regulatory period.
- A ‘River Murray license adjustment’ mechanism that will reduce revenue caps in the subsequent regulatory period to reflect income derived by SA Water from the sale of water allocations associated with River Murray water entitlements. The income from the sale of water allocations should be returned to customers, taking into account any prudent and efficient costs incurred as a result of selling those allocations, insofar as customers have paid for those water entitlements.
- A ‘contingent project’ mechanism that may allow for the recovery of efficient costs associated with a pre-determined major capital project that SA Water has committed to, where the costs were not incorporated into the revenue caps because of a defined contingency. The mechanism will allow additional expenditure to be incurred within the SAWRD24 regulatory period but included in the revenue controls for the SA Water Regulatory Determination 2028 (**SAWRD28**) regulatory period (with a time-value of-money allowance).

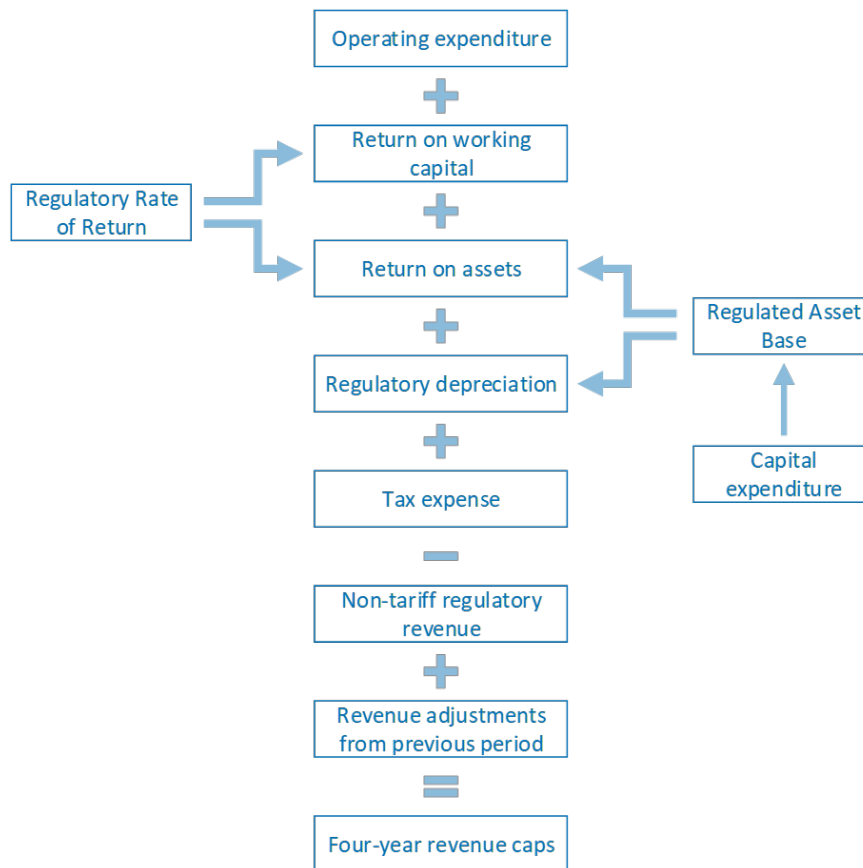
The building blocks cost model is a commonly accepted economic approach to estimating efficient costs: it is effectively a build-up of the forecast efficient costs of the regulated firm. This approach to setting revenues aligns with the National Water Initiative (**NWI**) Pricing Principles and the legal framework within which the Commission operates. As it is based on standard and generally-accepted (within Australia and internationally) regulatory methodologies, the approach followed in this determination promotes consistency in regulation with other jurisdictions.

Efficient costs need not be the costs the regulated business is actually incurring, and it is for the regulated business to demonstrate that its actual costs represent an efficient cost base.

As shown in Figure 2.1, the building blocks cost model will involve adding the forecast efficient operating expenditure, return on working capital, return on assets, regulatory depreciation and tax expense to determine the total efficient costs of providing each service. It will deduct revenue that SA Water receives from other sources that contribute towards those costs, such as Community Service Obligations (**CSO**) payments, to ensure that SA Water does not over-recover those efficient costs.

Adjustments will also be made to reflect outcomes from the current regulatory period that flow through to the next regulatory period, such as those under the demand variation adjustment mechanism, the shared infrastructure revenue adjustment mechanism and the River Murray water licence adjustment mechanism.

Figure 2.1: Building blocks cost model of water and sewerage services revenue



For further information, please refer to **Chapter 7 – Form of regulation – Revenue caps and adjustment mechanisms for direct control retail services** and **Part D – Determining revenue caps for direct control services**.

2.3.2 Revenue caps outcome and comparison

The Commission's draft decision for revenue caps for water and sewerage retail services are approximately 3 percent and 1 percent lower than that proposed by SA Water in its RBP, on a comparative basis.

Under the legislative framework governing SA Water regulatory determinations, the Commission will fix the maximum revenue that SA Water can recover from customers over the four-year period 1 July 2024 to 30 June 2028. While the Commission does not set prices, the legislative requirements mean SA Water must set its prices to recover no more than the revenue permitted, subject to ancillary revenue adjustment mechanisms included in the determination.

Through a six-week consultation on SA Water's RBP, the Commission heard that affordability is a key concern for South Australians. In reviewing SA Water's operations, the Commission has considered whether SA Water is operating prudently, efficiently and delivering value for money. The Commission sought to understand whether SA Water can deliver the projects it planned so that customers do not pay for projects before they commence.

The draft positions are consistent with stakeholders' submissions that some of the expenditure proposed by SA Water was neither justified nor consistent with customers' priority that prices should be kept as low as possible while delivering on the service levels valued by customers.

The draft revenue caps for SAWRD24 have been calculated as the forecast total efficient costs of providing water and sewerage retail services, based on current interest rates and forecasts of inflation³ and available observations of expenditure and revenue.⁴ The total efficient costs of providing water and sewerage retail services have been determined using the building blocks cost model. The cost components have each been outlined in Chapters 10 through to 16. The draft revenue caps are subject to change before the final determination is made, as the Commission will, in line with its Charter of Regulatory Consultation and Regulatory Practice, have regard to submissions from all stakeholders.⁵

The draft decision is that the revenue caps for the four-year period commencing 1 July 2024, in present value terms, are:

- ▶ \$3,550 million (\$Dec22) for **water** retail services, and
- ▶ \$1,785 million (\$Dec22) for **sewerage** retail services.

The Commission's assessment is that the revenue caps will provide SA Water with sufficient revenue to fund prudent and efficient operations and finance prudent and efficient investments on a long-term basis while meeting SA Water's applicable health, safety, environmental and customer service standards and obligations over SAWRD24. In order to deliver value for money on an ongoing basis, SA Water should ensure it has in place sound long-term asset management, operating and financing strategies. These strategies should support the provision of retail services for current and future customers.

Following the release of the final regulatory determination in June 2024, SA Water has responsibility for setting prices for water and sewerage retail services. SA Water has the flexibility to set prices from year to year as it sees fit, but is only allowed to recover revenues over the SAWRD24 period in accordance with the final four-year maximum revenue caps.

The revenue caps set by the Commission are fixed, subject to any adjustment mechanisms in the following regulatory period. SA Water must ensure its revenues do not exceed the caps, expressed as a present value at 1 July 2024, in dollars of December 2022. In setting the caps, the Commission's assessment of SA Water's prudent and efficient expenditure benchmark has been completed in real, December 2022 dollars. The expenditure forecasts also include allowances for growing demand and customer numbers over the regulated period. SA Water will set prices for water and sewerage retail services from time to time as actual current prices for customers, including the effects of inflation. It is therefore important to note that the likely percentage change in prices set by SA Water will not necessarily mirror the percentage change in revenue caps between regulatory periods.

While the revenue caps are set by the Commission in inflation-adjusted terms (that is, real, December 2022 prices), SA Water will set prices for water and sewerage retail services in nominal terms (that is, they will be set in current prices for customers). It is therefore worth noting that the percentage change in the revenue caps between regulatory periods (for example, the increase in the caps for SAWRD24 relative to those set out in SAWRD20) may not necessarily translate into the same percentage increase in the nominal prices that are set by SA Water.

³ The rate of return will be updated for the final regulatory determination using latest available observations.

⁴ SA Water will provide to the Commission updated information regarding revenue earnings and demand (sales and connection numbers) for the SAWRD20 period, to be considered for the final determination.

⁵ The Commission's approach to consultation and engagement is outlined in a Charter of Consultation and Regulatory Practice, which is available on the Commission website: www.escosa.sa.gov.au/approach/charter-of-consultation-and-regulatory-practice.

2.3.2.1 Comparison against SA Water's regulatory business proposal

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 2.2.

Table 2.2: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SA Water's proposal terms (\$Dec22)

	SA Water's proposal for SAWRD24 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,386	2,272	-114 ↓	-5% ↓
Capital expenditure	2,831	2,529	-302 ↓	-11% ↓
Total	5,217	4,801	-416 ↓	-8% ↓

Of the \$2,831 million of capital expenditure proposed by SA Water for SAWRD24, approximately \$1,160 million (41 percent) is related to five major projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 3 percent decrease for water retail services compared with SA Water's proposal, and
- ▶ 1 percent decrease for sewerage retail services compared SA Water's proposal.

Table 2.3 compares the draft revenue caps for SAWRD24 with an adjusted version of SA Water's proposal.

Table 2.3: Draft revenue caps for SAWRD24 compared with an adjusted version of SA Water's proposal, in present value terms (\$Dec22)

	SA Water's proposal for SAWRD24 ⁶ (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Total Water	3,647	3,550	-97 ↓	-3% ↓
Total Sewerage	1,809	1,785	-23 ↓	-1% ↓

The Commission has, for the purposes of making a like-for-like comparison, adjusted SA Water's revenue proposal (including for the latest rate of return and the consumer price index (CPI) inflation roll-forward of the RAB), in order to estimate a comparison between the Commission's draft determination and SA Water's proposal. Without making an adjustment, any comparisons of revenue caps may be, for example, significantly impacted by the timing of the assessments and the differing rate of return and other assumptions utilised.⁷

⁶ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission's draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. As noted in Chapters 10 and 11, the Commission understands that SA Water's proposal stated expenditure in December 2022 dollars.

⁷ SA Water's proposal used a rate of return of 3.23% that it calculated in March 2023, and so this would not be an appropriate comparison with the Commission's updated estimate derived as at November 2023.

2.3.2.2 Comparison against SAWRD20

The SAWRD24 determination is made in a different economic context to the previous regulatory determination, SA Water Regulatory Determination 2020 (**SAWRD20**), which occurred in a low interest rate environment. That environment has changed materially, with material uplifts in interest rates which directly flow through into the determination of the regulatory rate of return (**rate of return**).

During the four-year SAWRD20 period, lower financing costs meant SA Water was able to deliver the same level of water and sewerage retail services for less than was the case in previous regulatory periods. The cost savings in SAWRD20 were passed on to customers through lower bills. Current financing costs have increased operational costs compared to SAWRD20, returning to levels experienced previously. In addition, higher prices for energy and raw materials are adding to overall cost pressures.

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 2.4.

Table 2.4: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SAWRD20 (\$Dec22)

	Final SAWRD20 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,237	2,272	+35 ↑	+2% ↑
Capital expenditure	1,885	2,529	+644 ↑	+34% ↑
Total	4,122	4,801	+679 ↑	+16% ↑

The \$644 million (34 percent) increase in capital expenditure is driven by five major projects (refer Table 2.5).⁸

Table 2.5: SA Water's major projects proposal for SAWRD24 (rounded figures)

Major projects	Total four-year expenditure (\$Dec22, million)
Eyre Peninsula Desalination Augmentation	240
Mount Bold Dam Safety Upgrade	110
Metro Water Quality Improvement	160
Northern Metropolitan Growth*	370
Tea Tree Gully Sustainable Sewers*	280
Total	1,160

* SA Water advised that a Government direction is expected for these projects.

⁸ In relation to the projects for Northern Metropolitan Growth, \$370 million (\$Dec22), and Tea Tree Gully Sustainable Sewers, \$280 million (\$Dec22), SA Water has advised it expects a Government direction to undertake these projects. In that context, and for the purposes of the draft determination, the Commission has included expenditure for these projects in line with SA Water's proposal. In doing so, the Commission has not reviewed, in detail, the prudent and efficient expenditure requirements of these two projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 22 percent increase for water retail services compared with those determined in SAWRD20, and
- ▶ 28 percent increase for sewerage retail services compared with those determined in SAWRD20.

While increased expenditure benchmarks have contributed to additional revenue requirements, the Commission’s assessment is that the increases in the revenue caps, compared to SAWRD20, have been driven largely by the increase in the rate of return (refer Box 2.1).

Box 2.1 Key driver - Rate of return

Increased financing costs have resulted in a draft decision to set SA Water’s allowed average rate of return at 3.99 percent (real, post-tax), calculated as of 14 November 2023. By way of comparison, the average regulatory rate of return (real, post-tax) adopted in previous determinations was:

- ▶ 4.5 percent in 2013-16
- ▶ 4.17 percent in 2016-20, and
- ▶ a low of 2.68 percent in 2020-24.

In its Regulatory Business Proposal, SA Water calculated revenue requirements using an average regulatory rate of return (real, post-tax) of 3.23%, calculated in March 2023.

To illustrate the impact of the revenue caps from the higher rate of return, holding all things equal, if the rate of return used in SAWRD20 (2.68 percent) was applied for the purposes of the SAWRD24 determination, it would lead to the following revenue outcomes (refer Table 2.6).

Table 2.6: Comparison of revenue caps for SAWRD24 using SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (\$m)	Draft Determination SAWRD24 - 2.68% Rate of Return (\$m)	Variance (\$m)	Variance (%)
Water	3,550	3,108	-441 ↓	-12% ↓
Sewerage	1,785	1,572	-213 ↓	-12% ↓

In this scenario, the revenue caps would be 7 per cent and 13 percent higher than in SAWRD20 (compared to 22 percent and 28 percent respectively). In both instances, this is 15 percentage points below the SAWRD24 draft decision (refer Table 2.7).

Table 2.7: Comparison of percentage change in revenue caps for SAWRD24 compared to SAWRD20, using SAWRD24 and SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (%)	Draft Determination SAWRD24 - 2.68% Rate of Return (%)	Variance (%)
Water	22%	7%	-15% ↓
Sewerage	28%	13%	-15% ↓

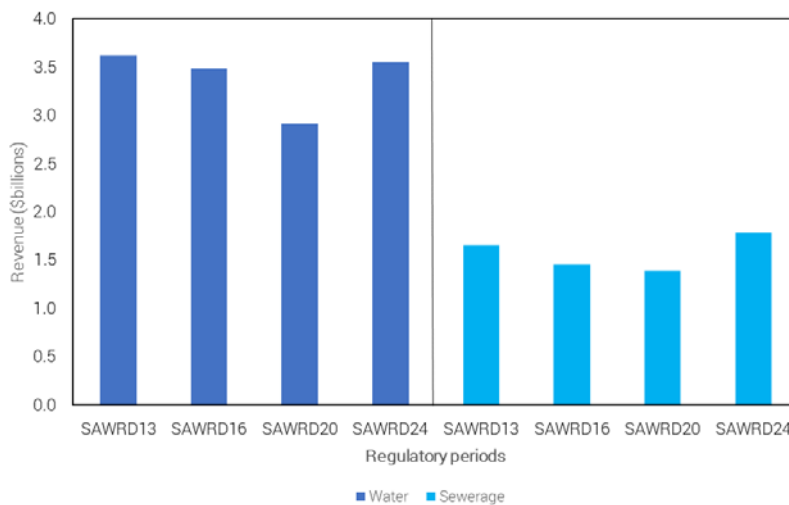
The conclusion may be drawn that the rate of return is the major contributing factor to the increase in the revenue caps.

2.3.2.3 Comparison against previous determinations

To put the SAWRD24 draft determination into context, comparisons can be made against the revenue allowances set out in previous regulatory determinations.

A comparison against the SA Water Regulatory Determination 2013 (**SAWRD13**) highlights that the current SAWRD24 draft determination is not out of the ordinary in terms of the total efficient costs for SA Water for the delivery of water and sewerage retail services (Figure 2.4). The SAWRD24 revenue caps for water and sewerage retail services are approximately 2 percent lower and 8 percent higher than the revenue amounts determined under SAWRD13.

Figure 2.4: Revenue amounts across SAWRD13, SAWRD16, SAWRD20 and SAWRD24, in present value terms (\$Dec22)



For further information, please refer to **Chapter 16 – Determination of total revenue caps** and **Chapter 17 – Revenue caps outcomes and comparison**.

2.4 Excluded retail services and recycled water

Recycled water and excluded services are provided to specific customers who request those services. For instance, this can involve primary producers, businesses and government sourcing recycled water, households and businesses seeking non-standard connections, and businesses disposing of trade waste. The cost of those services can be more easily attributed to the customers who benefit from them compared to water and sewerage services, which are provided to customers at large.

2.4.1 Draft decision – Form of regulation for recycled water and excluded retail services

The Commission has undertaken a review of SA Water’s recycled water and excluded services pricing and has not found any evidence that SA Water is misusing its market power in setting prices. As such, current evidence does not indicate that a more prescriptive regulatory approach is required for SA Water’s recycled water or excluded retail services.

The Commission’s draft decision is to continue to regulate the sale and supply of recycled water and excluded retail services under a pricing principles approach and to do so on an ongoing basis. To improve transparency over SA Water’s excluded services pricing and support the move to an ongoing pricing principles regulatory approach, the Commission will maintain the current requirement for SA Water to provide the Commission with pricing information but will include more detail on the manner and form of the data required.

The Commission will continue to undertake compliance monitoring and enforcement through its general compliance framework.

For further information, please refer to **Chapter 8 – Form of regulation – Recycled water and other excluded services**.

2.5 Transparent performance reporting

The Monitoring and Evaluating Performance Framework (**MEPF**) was introduced in SAWRD20 and outlines public reporting requirements and regulatory expectations that apply to SA Water. It requires SA Water to account for the long-term commitments made to customers, including under its RBP, and for delivering the outcomes as required under the consumer protections established by the Code.

Public reporting requirements were set based on four focus areas that stakeholders deemed most important: service standards and performance targets, expenditure and revenue outcomes, key investment areas, and long-term asset management and planning. Under the MEPF, the Commission verifies and provides assurance on SA Water's data collection and analysis through assurance statements, reviews and audits, as required.

The MEPF is based on the Commission's Verified Trust and Accountability (**VTA**) framework. Under the VTA, there is greater emphasis on licensee accountability and regulatory verification of performance outcomes and long-term trends. A licensee can gain and lose trust based on its own actions, and the Commission can intervene or take regulatory action as required to protect consumers' interests.

2.5.1 Draft decision - Monitoring and Evaluating Performance Framework

The Commission's draft decision is to retain and strengthen the MEPF that applies to SA Water, for SAWRD24.

Proposed changes are to:

- ▶ embed SA Water's public reporting requirements in the Code
- ▶ introduce a new Code requirement for SA Water to report annually to the Commission and the public about how it has applied its best endeavours where it has not met a service standard performance target
- ▶ introduce a new Code requirement for SA Water to submit a Basis of Preparation, annually, for the financial and operational performance reporting metrics it submits to the Commission
- ▶ introduce a new Code requirement for SA Water to publicly communicate and explain any significant data revisions or errors in its published reports, and
- ▶ introduce a new obligation in SA Water's retail licence for it to have and adhere to a compliance system based on the Australian Standard on Compliance Programs, AS 37301:2023 (as amended from time to time).

The Water Regulatory Information Requirements - Major Retailers Water Industry Guideline No. 2 (**Guideline 2**) will be amended to include:

- ▶ the broad information to be covered in SA Water's public reports
- ▶ new hardship reporting indicators, including:
 - average amount of bill debt for residential customers upon entry into the financial hardship program as at the end of the quarter
 - average amount of bill debt for residential customers upon successfully exiting the financial hardship program as at the end of the quarter

- number of residential customers who exited without successfully completing the financial hardship program during the quarter, and
 - average amount of bill debt for residential customers who exited without successfully completing the financial hardship program as at the end of the quarter.
- ▶ expectations in relation to the quality and accuracy of information in public reports
 - ▶ requirements for SA Water’s public reports to be reasonably accessible to the public and include timeseries datasets to enable public comparison and analysis of service standard performance, and
 - ▶ definitions of ‘bill debt’ and ‘successfully exiting the financial hardship program’.

In conjunction with these changes, the Commission intends to strengthen its communication on SA Water’s performance both publicly and directly to SA Water.

For further information, please refer to **Chapter 18 –Monitoring, evaluating and reporting the outcomes achieved in SAWRD24.**

2.6 Next steps

The Commission is consulting on this SAWRD24 draft regulatory determination, with written submissions due by Wednesday, 6 March 2024. It is requested that submissions are sent to reviews@escosa.sa.gov.au.

The Commission will consult directly with key stakeholders during the consultation period, providing opportunities for all interested parties to ask questions about the draft regulatory determination (and related matters) and provide further evidence and information to inform the final regulatory determination.

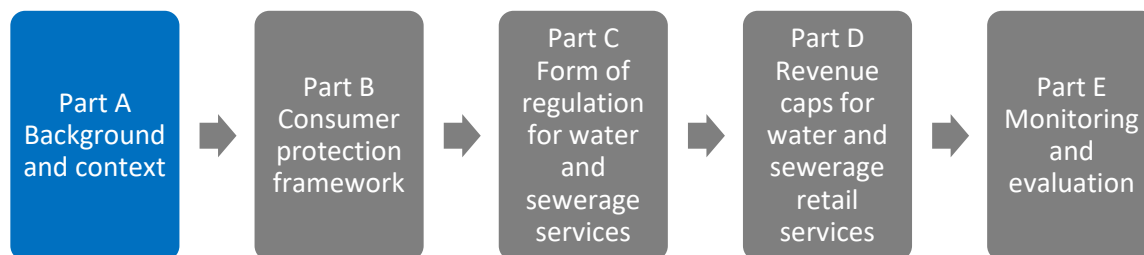
All relevant submissions, evidence and information will be considered by the Commission in preparing that final regulatory determination, to be released in June 2024.

Following the release of the final regulatory determination, SA Water will set water and sewerage prices in accordance with the final revenue caps and pricing requirements. Those prices will apply from 1 July 2024.

Timing	Milestone
January 2024	Commission releases draft regulatory determination for consultation
February 2024	Commission invites feedback on draft regulatory determination
June 2024	Commission releases final regulatory determination
June 2024	SA Water and SA Government develop prices
1 July 2024	SAWRD24 regulatory period commences

The Commission thanks those who made submissions following publication of SA Water’s proposal, all of which were carefully considered and have provided valuable information and insights for the draft regulatory determination.

Part A – Background and context



Part A provides background and contextual information relevant to SAWRD24. It summarises:

- ▶ how SAWRD24 will operate within a broader policy framework
- ▶ why regulation of SA Water’s retail services is required
- ▶ the making of the regulatory determination
- ▶ SA Water’s regulatory business, and
- ▶ key themes raised in submissions to SA Water’s regulatory business proposal.

3 Introduction

To protect the long-term interests of consumers with respect to the price, quality and reliability of SA Water's retail services, the intended outcomes from this regulatory determination are that SA Water:

- ▶ provides water and sewerage services at the lowest sustainable price for the quality and reliability levels valued by customers
- ▶ has in place sound long-term asset management, operating and financing strategies, which support the provision of those services for current and future customers, and
- ▶ transparently demonstrates and provides evidence of its performance to the people, businesses and communities in South Australia that use water and sewerage services as an essential part of their everyday lives.

SA Water is a vertically integrated water and sewerage business, wholly owned by the South Australian Government.⁹ SA Water provides water and sewerage services to approximately 1.7 million South Australians.

The retail services¹⁰ provided by SA Water are subject to economic regulation by the Commission under the *Essential Services Commission Act 2002 (ESC Act)* and the *Water Industry Act 2012 (WI Act)*. The economic regulatory regime has two main elements:

- ▶ SA Water is licensed by the Commission under the WI Act to provide retail services, subject to conditions.¹¹ While some matters are addressed through licence conditions alone, the Commission is able to make industry codes and rules that prescribe the rules of conduct and procedures that SA Water must follow in providing retail services.¹² This relates in particular to the setting of service standards and the nature and scope of consumer protections that must be adhered to by SA Water.
- ▶ The Commission also has the discretion to make determinations relating to pricing for SA Water's retail services.¹³ Under the legislative settings of the regime, the Commission regulates the revenues that can be earned by SA Water for the provision of retail services (having regard to the service standard, consumer protection and other regulatory requirements), with SA Water being responsible for setting the specific prices paid by customers.

The Commission's overall purpose and approach in regulating SA Water aims to encourage economically efficient behaviour that is in consumers' long-term interests.¹⁴ Of note, and as explained further below, SA Water is regulated by other bodies in relation to matters such as health, quality safety

⁹ The South Australian Water Corporation is established under the *South Australian Water Corporation Act 1994*. It is a public corporation subject to the *Public Corporations Act 1993*. Not all of the functions undertaken by SA Water are subject to regulation by the Commission. Further information about SA Water's Regulatory Business is provided in Chapter 4.

¹⁰ Retail services are defined in section 4 of the WI Act. A retail service is: (a) the sale and supply of water to a person for use (and not for resale other than in prescribed circumstances (if any)) where the water is to be conveyed by a reticulated system; or (b) the sale and supply of sewerage services for the removal of sewage (even if the service is not actually used), but does not include any service, or any service of a class, excluded via regulations.

¹¹ Refer section 25(1) of the WI Act. SA Water's licence is available at: www.escosa.sa.gov.au/industry/water/licensing/licence-register

¹² Section 28 of the ESC Act.

¹³ Section 25 of the ESC Act and section 35 of the WI Act.

¹⁴ Section 6 of the ESC Act.

and environmental obligations: the Commission works closely with those bodies but is not responsible for those other regulatory requirements or outcomes.

Under the economic regulatory regime, the Commission brings the making of codes, rules, and price determinations into a single regulatory determination process. The regulatory determination will apply for the period 1 July 2024 to 30 June 2028 (SA Water Regulatory Determination 2024 or **SAWRD24**). This is the fourth SA Water regulatory determination made by the Commission.¹⁵ The determination process includes:

- ▶ reviewing and amending the consumer protections contained in industry codes
- ▶ reviewing the customer service and network reliability service standards with associated performance targets
- ▶ making price determinations covering revenue caps for 'direct control' water and sewerage retail services and other pricing-related controls for recycled water services and other 'excluded' retail services,¹⁶ and
- ▶ reviewing and amending the monitoring, evaluating and performance framework.

The release of this draft regulatory determination is a key milestone in the SAWRD24 process, allowing further feedback, commentary and evidence to be gathered to inform the review. In making the regulatory determination, the Commission's primary objective is to protect the long-term interests of consumers with respect to the price, quality and reliability of essential services.

3.1 SAWRD24 will operate within a broader policy framework

SA Water is a government-owned provider of water and sewerage services. Its primary role is to source, treat, distribute and sell drinking water and non-drinking water, and to remove, treat and dispose of sewage from homes and businesses. Those essential services are highly regulated, including service level and revenue regulation by the Commission (referred to generally as 'economic regulation') as well as health, technical or environmental regulation by other agencies, as outlined below.

The Commission undertakes its role as economic regulator within a broader legislative and policy framework. The South Australian Government develops and implements, through legislation, public policy in relation to public health, the environment, water supply and demand planning, technical standards, safety and social welfare, all of which impact on SA Water. The Commission and other regulators perform roles and functions assigned to them by the South Australian Government and Parliament under that policy and legislative framework. A summary of the key entities involved in the regulation of SA Water is provided in Table 3.1 on the following page.

The Commission's role is limited, by legislation, to assessing the efficient costs of providing essential services; it does not extend to assessing affordability or an individual customer's capacity to pay for essential services. The South Australian Government makes decisions about social policy, including policies supporting customers to meet the costs of accessing essential services.

¹⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, June 2020, pp. 1-305, Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, June 2016, pp. 1-146, and Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, May 2013, pp. 1-192. Previous determinations are available on the Commission's website at <https://www.escosa.sa.gov.au/industry/water/retail-pricing>.

¹⁶ Refer to Chapter 4 – SA Water's Regulatory Business – for further information on the water and sewerage retail services provided by SA Water.

Table 3.1 Entities involved in the regulation of the water industry

Entity	Overview of role within the water industry	Relevant legislation
Minister for Climate, Environment and Water	Administers the <i>Water Industry Act 2012</i> and is responsible for non-regulatory instruments (eg schemes), appointing water industry entities, and issues Ministerial directions.	<i>Water Industry Act 2012</i> <i>Public Corporations Act 1993</i>
Treasurer	Sets licence fees for water industry entities and issues Pricing Orders. ¹⁷	<i>Water Industry Act 2012</i>
Essential Services Commission	Regulates customer service standards for the sale and supply of water and sewerage retail services. Establishes average customer service and reliability service standards for water and sewerage retail services and assesses the prudent and efficient costs for delivery of water and sewerage retail services. Regulator for the third-party access regime.	<i>Essential Services Commission Act 2002</i> <i>Water Industry Act 2012</i>
Environment Protection Authority	Regulates the environmental impact of water businesses.	<i>Environmental Protection Act 1993</i>
Department for Environment and Water	Regulates State water resources, and other natural resource management matters.	<i>Natural Resources Management Act 2003</i>
SA Health	Regulates public health requirements for providing drinking water supplies.	<i>Safe Drinking Water Act 2011</i>
Technical Regulator	Regulates safety and technical matters.	<i>Water Industry Act 2012</i>
Consumer and Business Services	Responsible for administration of the Australian Consumer Law, covering consumer protection and fair trading, in South Australia. Regulates the relationship between landlords and tenants for the payment of rates and charges for water and sewerage services. Regulates the professional conduct of plumbing contractors.	<i>Competition and Consumer Act 2012</i> <i>Residential Tenancies Act 1995</i> <i>Plumbers, Gasfitters and Electricians Act 1995</i>
Department of Human Services	Develops customer hardship and concession policies.	<i>Water Industry Act 2012</i>
Energy and Water Ombudsman SA	Resolves complaints from customers of water retailers that have joined the scheme.	<i>Water Industry Act 2012</i> <i>Corporations Act 2001</i>

¹⁷ All Pricing Orders that have been issued under the WI Act are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

In that context, through its regulatory determinations the Commission determines the efficient expenditure required by SA Water to meet its regulatory obligations for a defined four-year period. It does not decide whether South Australian Government policies that impact on water and sewerage prices are appropriate or correct. Nor does the Commission make decisions about the governance of SA Water: that is a matter for SA Water and its owner, the South Australian Government.

SA Water makes the day-to-day commercial decisions about the operations and investments required to deliver water and sewerage services that meet its regulatory obligations. SA Water and its owner, the South Australian Government, are responsible for setting the prices that apply to customers. The prices set by SA Water must be set to recover revenues at or within maximum caps set under the Commission's revenue determinations and comply with relevant pricing principles.¹⁸

Consumer and industry advocates have an important role to play in the economic regulation of SA Water, through understanding and representing or reflecting the views of their constituents in consultation and engagement processes (both to SA Water and the Commission). They may advocate for changes where their constituents' interests are not being met (for example, in relation to the price/service offerings being provided by SA Water).

The Commission has an established Consumer Advisory Committee (**CAC**), comprising consumer representatives, which advises the Commission on its regulatory functions, including the economic regulation of SA Water. Those consumer advocacy representatives and associated organisations helped the Commission to understand consumer experiences and expectations and provide evidence to inform the Commission's regulatory decision-making process.¹⁹

3.2 Why regulation of SA Water's retail services is required

As part of its regulatory functions under the WI Act and ESC Act, and to protect the long-term interests of SA Water's consumers, the Commission has decided to make a regulatory determination and to amend the consumer protection regime that applies to the retail services provided by SA Water.²⁰ These consumer protections will continue to apply as:

- ▶ SA Water is a monopoly service provider of water and sewerage retail services to the majority of South Australians, and
- ▶ as a result, SA Water's consumers do not have the benefit of competition to drive economically efficient behaviour by SA Water, such as providing service levels that are valued by customers and seeking cost efficiency in the provision of retail services.

Economic regulation can act to substitute for that lack of competition by providing drivers for efficiency, thereby ameliorating potential economic detriment to customers (the costs of which may be materially greater than the costs of regulation) and protecting their long-term interests.

The following sections of this statement of reasons sets out, in detail, why regulation of SA Water's retail services is required and the specific approach under which the Commission will regulate SA Water:

- ▶ Part B – Consumer protection framework
- ▶ Part C – Form of regulation for water and sewerage retail services
- ▶ Part D – Determining revenue caps for direct control retail services, and
- ▶ Part E – Monitoring and evaluation.

¹⁸ Discussion of the maximum revenues and pricing principles is set out in Part D of this report.

¹⁹ As established by section 17 of the ESC Act and section 14 of the WI Act.

²⁰ Further information on the Commission's powers to make codes, rules and price determinations is contained in Appendix 2 of this report.

3.3 Economic context of SAWRD24

The SAWRD24 determination is made in a different economic context to the previous regulatory determination, SA Water Regulatory Determination 2020 (**SAWRD20**), which occurred in a low interest rate environment. During the four-year SAWRD20 period, lower financing costs meant SA Water was able to deliver water and sewerage retail services for less than in previous regulatory periods. The cost savings in SAWRD20 were passed on to customers through lower bills. Current financing costs have increased the cost of doing business, compared to SAWRD20, returning these costs to levels experienced previously. In addition, issues affecting global supply chains have added cost pressures to expenditure requirements.

Higher interest rates have raised financing costs for companies, including those that provide essential services, such as SA Water. In general, a higher cost of equity and debt will result in a higher cost to deliver the same level of services.

The cost of materials and intermediate inputs (for example, energy-related prices such as oil and electricity, and raw commodity prices such as copper and aluminium) have also increased, in some cases, by amounts well above changes observed in Consumer Price Index (**CPI**) inflation.²¹ In terms of SA Water, this cost pressure is a factor in determining the prudent and efficient expenditure associated with operating, renewing and expanding its water and sewerage network, to deliver the same level of retail services to customers.²²

It is also noted that the South Australian economy has performed strongly over recent years,²³ and, like all businesses, SA Water's ability to obtain resources and deliver effectively on its investment and operational plans can be impacted by economic circumstances. The unemployment rate in South Australia is at an historic low, currently at below 4 percent, and labour market conditions indicate that spare capacity may be low.

The South Australian Auditor-General's Department has noted that there is currently a '*heated construction market*', and that the South Australian Government may face challenges delivering its state-wide capital program on time and on budget, given capacity constraints of key building materials and skilled labour and cost pressures.²⁴ Consistent with this, nationally, some surveys indicate skills shortages for engineers,²⁵ and the Reserve Bank of Australia (**RBA**) has stated that firms are reporting risks to the delivery of investment plans and challenges securing labour for construction and engineering projects.²⁶

²¹ Department of Industry, Science and Resources, *Resources and Energy Quarterly*, September 2023, pp. 74-94, 110-122, available at <https://www.industry.gov.au/sites/default/files/2023-10/resources-and-energy-quarterly-september-2023.pdf>, and Reserve Bank of Australia, *Statement of Monetary Policy*, November 2023, p. 52, available at <https://www.rba.gov.au/publications/smp/2023/nov/pdf/statement-on-monetary-policy-2023-11.pdf>.

²² The economic context and cost escalation theme has been discussed by Oxford Economics Australia; see Oxford Economics Australia, *Labour and materials cost escalation forecasts to 2027-28*, Final report prepared for the Essential Services Commission of South Australia, October 2023, pp. 1-49.

²³ Oxford Economics Australia, pp. 10-11.

²⁴ South Australian Auditor-General's Department, *Report 10 of 2023 – State finances and related matters*, Report of the Auditor-General, 14 November 2023, pp. 39-40.

²⁵ For example, see IPWEA, *Overseas engineers and Australia's skills*, 23 October 23, Insite community news by IPWEA, available at [Overseas engineers and Australia's skills shortage | IPWEA](#).

²⁶ The Reserve Bank of Australia states in the context of its business liaison program: 'Firms also report a number of risks to the timely delivery of their investment plans. Securing labour is still a challenge for construction and engineering projects and related delays are common....' See Reserve Bank of Australia, August 2023 Statement of Monetary Policy, p. 35, available at <https://www.rba.gov.au/publications/smp/2023/aug/>.

Looking ahead to economic conditions in the SAWRD24 period, higher interest rates are expected to continue to weigh on domestic demand growth. As a result, labour market tightness is expected to ease in South Australia, with a forecast increase in the unemployment rate and a slowing in employment growth.²⁷

3.4 Making the regulatory determination

This draft regulatory determination represents the independent review and determinations of the Commission, consistent with the underpinning statutory requirements and informed by its consideration and review of SA Water's Regulatory Business Proposal (RBP), public submissions on the RBP and any relevant related matters, independent consultant reports and its own research and analysis. The process for making SAWRD24 is described in more detail in Appendix 1.

In setting regulated revenues that recover the lowest sustainable costs of providing retail services, the Commission assesses whether SA Water's proposed expenditure for the 2024-28 regulatory period is *prudent and efficient*.

Broadly speaking, expenditure on an activity will be considered prudent where there is a clear justification for that activity. Decisions on whether expenditure is prudent will be informed by the Commission's consideration of whether the expenditure is driven by:

- ▶ a legislative or regulatory obligation, which SA Water must comply with
- ▶ an expectation that the activity will deliver benefits to customers that outweigh the costs
- ▶ a clear expectation from customers that an outcome should be achieved, and that they are willing to pay for that outcome.

Expenditure is likely to be considered efficient where it represents the lowest sustainable (or 'long-term') cost of achieving the intended outcome. The Commission will set revenues to recover efficient costs only, as this will help deliver the lowest sustainable prices to SA Water's customers.

The RBP comprises a series of documents and information, much of which is public but some of which is classified by SA Water as commercially sensitive and therefore confidential. Much of the detailed analysis conducted by the Commission relies on that commercially sensitive information. While the Commission's information gathering powers are broad, and do not limit its ability to collect and consider confidential information, it has preserved the confidentiality of commercially sensitive information in outlining its reasons for this draft regulatory determination. It has sought to strike an appropriate balance between providing sufficient information to enable stakeholders to understand the basis of its positions, while ensuring that confidential information that could adversely affect SA Water's commercial or competitive position is not disclosed.

As noted above, this draft regulatory determination sets out the Commission's decisions, for public scrutiny and comment, and the reasons for those decisions, on the following regulatory issues:

- ▶ the consumer protections contained in industry codes
- ▶ the customer service and network reliability service standards with associated performance targets
- ▶ a regulatory determination covering water retail services, sewerage retail services, recycled water services and other ('excluded') retail services, and
- ▶ the monitoring, evaluating and performance framework.

²⁷ Oxford Economics Australia, pp. 10-11, and South Australian Department of Treasury and Finance, 2023-24 State Budget – Budget Paper 3, p. 94, available at https://www.treasury.sa.gov.au/_data/assets/pdf_file/0009/914670/2023-24-Budget-Statement.pdf.

In reaching those decisions and reasons, the Commission has had regard to all relevant legislative factors and objectives framework (including any Pricing Order or statutory directions issued by the South Australian Government), the materials provided to it by SA Water and the submissions, evidence and information provided by stakeholders throughout the review process.

In doing so, it has given consideration to and acknowledges all of the evidence, arguments and submissions relevant to the issues under consideration in this regulatory determination and has given appropriate weight to those matters in the context of the principles and requirements set out in the ESC and WI Acts. While the Commission has not adopted all of the positions or arguments put or raised in that material and has not directly referenced in this draft regulatory determination all of the material before it, the material has assisted it in considering each of the relevant issues under consideration and in understanding the competing viewpoints held.

Where appropriate, the Commission has, either by direct quotation or by reference to themes or arguments, mentioned certain evidence, arguments and submissions to explain the draft decisions that it has reached. The Commission has taken all arguments and submissions into account in its deliberations.

However, while this draft regulatory determination is informed by all representations received, it is not a judgment on those representations. Rather, it is the Commission's considered position on the nature and scope of the economic regulatory regime to be applied to SA Water over the four-year regulatory period 2024-2028 that will protect South Australian consumers' long-term interests with respect of the price, quality and reliability of regulated services provided by SA Water, having regard to the requirements of the legal framework.²⁸

Detailed information about the process for making SAWRD24, can be found in Appendix 1 of this report.

3.5 How does this Regulatory Determination meet the legal requirements?

The Commission has considered all relevant legislative objectives and factors in making this draft regulatory determination. This statement of reasons sets out the legal and policy framework for SAWRD24 and how the Commission has addressed legal requirements.

Regulating revenues to recover the lowest sustainable cost of supplying water and sewerage retail services allows SA Water sufficient revenue to efficiently deliver the services valued by customers, in the long term. The Commission is not seeking to deliver low prices in the short term at the expense of long-term service delivery. That would be inconsistent with the Commission's requirement to protect customers' long-term interests.²⁹ Nor is the Commission seeking to set revenues above the efficient cost of service delivery, as that would deliver excessive profits to SA Water and would be inconsistent with the long-term interests of consumers.

Overall, the draft regulatory determination is consistent with the Commission's primary objective of protecting the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services as it:

- ▶ sets service standards that are based on consumers' preferences, reflecting the service levels that customers are willing to pay for

²⁸ This model is different to the propose-respond methodology required under national energy regulation. Under that approach, a regulated entity is required to provide the Australian Energy Regulator (AER) with a proposal, which it must either accept if it is considered reasonable, or substitute with its own proposal if it is considered unreasonable.

²⁹ See section 6(1) of the ESC Act.

- ▶ fixes maximum water and sewerage revenues for most retail services, which the Commission considers reflect an appropriate sustainable cost for providing those services at the determined standards and in accordance with the obligations set by all regulators of SA Water, and
- ▶ fixes a pricing principles approach for recycled water and other retail services that are provided to specific customers on a 'beneficiary pays' basis.

It is important to set service standards that are in line with consumer preferences to balance price and service levels, noting that preferences will vary between customers. A key element of this draft regulatory determination has been to set service levels and costs, having regard to all available evidence, including the diverse views expressed by consumers and other stakeholders. This has required the Commission to exercise careful judgement.

However, many aspects of SA Water's services are regulated by other regulatory agencies and the Commission's role does not extend to determining the balance between those regulatory requirements and costs. Accordingly, this draft regulatory determination accepts the environmental, health, technical and social obligations that are imposed on SA Water by those agencies and seeks only to determine the efficient cost of meeting those requirements (refer Chapter 3 for further information).

The Commission has fulfilled its statutory role established under the WI Act and the ESC Act, in which it is required to:

- ▶ have regard to all relevant statutory factors and objectives (including the terms of Pricing Orders issued by the Treasurer and directions issued to SA Water by the Minister for Climate, Environment and Water)
- ▶ consider all relevant evidence available to it (including all submissions, data, information and representations provided and available to the Commission) and, thereafter
- ▶ make regulatory determinations which it considers best meets those statutory factors and objectives in light of the evidence.

In considering these matters, the Commission notes that there is no single correct decision which arises from them, and that the decision-making process involves the exercise of discretion and judgement (to the extent permitted under the statutory framework). In such cases, given the range of possible outcomes, the Commission recognises that different minds, acting reasonably, can be expected to make different decisions on the same subject matter.³⁰

Therefore, this draft regulatory determination sets out the Commission's considered position as to the most reasonable (in the context of the nature and scope of the governing statutory regime and all the available evidence) form and quantum of regulation and revenue control to be applied to SA Water during the 2024-2028 regulatory period. It considers that it best protects South Australian consumers' long-term interests with respect to the price, quality and reliability of the water and sewerage retail services provided by SA Water.

Detailed information about the legal requirements for SAWRD24 can be found in Appendix 2 of this report.

³⁰ Refer *Re GasNet Australia (Operations) Pty Ltd* [2003] ACompT 6 (23 December 2003) at paragraph 29.

4 SA Water's regulatory business

SA Water's water and sewerage service operations are subject to economic regulation by the Commission, which includes the making of a regulatory determination every four years. This chapter outlines the services subject to a regulatory determination by the Commission, SA Water's regulatory business proposal and stakeholder views on SA Water's regulatory business.

The *South Australian Water Corporation Act 1994* establishes SA Water as a statutory corporation, wholly owned by the South Australian Government. It is a public corporation subject to the *Public Corporations Act 1993*. SA Water's primary functions are to provide services for the:

- ▶ supply of water by means of reticulated systems
- ▶ storage, treatment and supply of bulk water, and
- ▶ removal and treatment of sewage by means of sewerage systems.

It also has other functions, including:

- ▶ carrying out research and works to improve water quality and sewage disposal and treatment methods
- ▶ commercial development and marketing of its products, processes and intellectual property produced or created in the course of its operations, and
- ▶ to encourage and facilitate private or public sector investment and participation, whether from within or outside the State, in the provision of water and sewerage services and facilities.

In addition, SA Water is also responsible for acting as the agent of the Minister for Climate, Environment and Water (**Minister**):

- ▶ in the Minister's capacity as Constructing Authority under the *Murray-Darling Basin Act 2008*, and
- ▶ for the purpose of purchasing water entitlements under the *River Murray Act 2003*, for and on behalf of and as instructed by the Minister from time to time.

As a statutory corporation, wholly owned by the South Australian Government, SA Water must comply with various South Australian Government requirements. As a result, SA Water:

- ▶ has a Board that is accountable to the Minister and the Treasurer for the sound management and stewardship of SA Water and its assets for and on behalf of its owners
- ▶ must undertake its commercial operations in accordance with prudent commercial principles and use its best endeavours to achieve a level of profit consistent with its functions
- ▶ must undertake its non-commercial operations in an efficient and effective manner, consistent with the requirements of its charter, which are:
 - subject to a community service obligation (CSO) agreement between SA Water and a purchasing Minister
 - subject to a direction under section 6 of the *Public Corporations Act*³¹

³¹ Pursuant to section 6 of the *Public Corporations Act 1993* and sections 6 and 7(2)(f) of the *South Australian Water Corporation Act 1994*.

- related to the operational responsibility of water and wastewater facilities for identified Aboriginal communities, or
 - agreed by the Minister and the Treasurer to be non-commercial
- ▶ must comply with South Australian Government policies and relevant Treasurer’s Instructions on dividend and tax equivalent payments; including paying all rates, duties and taxes that would apply if SA Water were not a government-owned entity.³²

4.1 SA Water’s regulated and non-regulated services

The Commission undertakes economic regulation of SA Water’s retail services through a regulatory determination (discussed further in chapters 7 and 8). The regulatory determination sets the maximum revenue SA Water can recover from its customers in respect of ‘direct control’ retail services, specifies service standards for the delivery of those services and provides a consumer protection framework in respect of SA Water’s relationship with its customers. The regulatory determination also sets out pricing-related provisions in respect of recycled water and other ‘excluded’ retail services (as shown in Table 4.1 below).

Table 4.1 lists the retail services that are provided by SA Water (direct control and excluded) and provides examples of SA Water’s services that are not retail services and are therefore not regulated by the Commission.

Table 4.1: SA Water’s regulated and unregulated services

Regulated services		Non-regulated services
Direct control retail services	Excluded retail services	
<ul style="list-style-type: none"> ▶ Sale and supply of water services ▶ Sale and supply of sewerage services 	<ul style="list-style-type: none"> ▶ Sale and supply of recycled water ▶ Standard and non-standard connection services (including developer services) ▶ Trade waste services ▶ Non-domestic hauled waste services ▶ Easement extinguishment and encumbrance services ▶ Hydrant and fire plug services ▶ Meter services ▶ Network analysis and audit services 	<ul style="list-style-type: none"> ▶ Availability charging (rating on abuttal) ▶ Laboratory services that are not retail services ▶ Project management services and consultancy services that are not retail services ▶ Water transportation services provided to third parties ▶ Operation and maintenance of the River Murray lock system and Salt Interception Schemes ▶ Soil and sand testing services ▶ Emergency functional services ▶ Metropolitan floodwaters drainage administration ▶ Beekeeping licenses ▶ Fishing permits

³² Refer sections 29 and 30 of the *Public Corporations Act 1993*.

4.1.1 Direct control retail services

Direct control retail services are typically provided to all, or a broad class, of SA Water’s customers, and includes the provision of water and sewerage retail services.

Provision of these services requires the construction, maintenance and operation of infrastructure and includes activities such as asset refurbishment, preventative and corrective maintenance, management of water quality and the management of water reserves. It also includes the ongoing costs of serving customers, for example regular meter reading and issuing bills.

Direct control retail services have historically been regulated through a regulatory determination that establishes separate revenue caps for water and sewerage retail services.³³ The revenue caps fix SA Water’s revenues for four years subject to mechanisms that allow for the pass-through of certain unforeseen costs and revenue changes due to variations in demand.³⁴

4.1.2 Recycled water and other excluded retail services

Excluded retail services are retail services that are ‘excluded’ from the direct control revenue caps.

In general, excluded retail services are provided to specific customers and the cost of such services are recovered through specific charges to those customers (or potential customers) rather than being paid by all customers. This includes the supply of recycled water, the provision of new connections and trade waste services.

Excluded retail services, including recycled water services, have historically been regulated under a regulatory determination that establishes principles that SA Water must apply when setting prices for those services. Those include both National Water Initiative (NWI) Pricing Principles and principles established by the Commission.³⁵

4.1.3 Non-regulated services

The Commission’s functions and powers only extend to the regulation of retail services, as defined in the WI Act. Services that are not retail services are not regulated by the Commission and therefore do not form part of this regulatory determination.

This includes availability charging (also known as rating on abuttal) and services such as issuing permits and testing services (refer Table 4.1). SA Water’s pricing schedule details its non-regulated services fees and charges.³⁶

³³ As specified in Pricing Orders issued by the Treasurer pursuant to section 35(4) of the WI Act, available at www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation.

³⁴ As specified in Pricing Orders issued by the Treasurer pursuant to section 35(4) of the WI Act, available at www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation.

³⁵ Available at: www.dcceew.gov.au/water/policy/policy/nwi/pricing-principles.

³⁶ SA Water’s 2023-24 Pricing Schedule – Fees & Charges is available at www.sawater.com.au/_data/assets/pdf_file/0009/732753/2023-24-Price-setting-fees-and-charges.pdf.

4.2 SA Water's regulatory business proposal

In August 2023, SA Water published generally and submitted to the Commission its Regulatory Business Proposal (RBP), titled 'Regulatory Business Plan 2024-28' (available on its website).³⁷

The RBP set out SA Water's proposed customer service standards, revenues and indicative prices for water and sewerage services for the four-year regulatory period. In summary, SA Water proposed:³⁸

- ▶ Investment of \$462 million in water services and \$245 million in wastewater services, on average, through each year of the regulatory period to maintain the current service standards. This is estimated to impact a residential customer's quarterly SA Water bill with typical water use and average property value by \$10.20 (excluding inflation, or \$17.80 where inflation of 2.5 per cent is assumed in 2024-25).
- ▶ Capital investments of \$2.8 billion, largely be driven by work programs to maintain services to current customers (47 per cent), meet external obligations (26 per cent) and meet growth (22 per cent), with the balance spent on improving services.
- ▶ A flat 2 per cent capital efficiency and additional operating efficiencies in the next regulatory period.

The major initiatives proposed by SA Water include (\$ real 2022-23):

- ▶ the Eyre Peninsula desalination project, following extended consultation that saw works deferred from the current regulatory period (\$273.9m)
- ▶ continuing investment in the Tea Tree Gully (TTG) Sustainable Sewers program (\$311.9m)
- ▶ investment in subsystem growth within the metropolitan north supply zone (\$365.2m)
- ▶ continuing Mount Bold Dam safety upgrade works, which are being delivered over multiple regulatory periods (\$110.0m), and
- ▶ starting work to replace SA Water's billing system (\$22.4m), which is scheduled to occur over two regulatory periods to reduce costs to customers.

4.3 Engagement to inform SA Water's regulatory business proposal

SA Water states that the RBP has been informed by an extensive program of stakeholder engagement, set out in Chapter 4 of the RBP. It further states that the foundation for the RBP's engagement program was SA Water's existing, ongoing engagement program comprising regular customer research, online engagement, use of advisory groups, and meetings with community, industry, and regulatory stakeholders.

4.3.1 SA Water's engagement program

SA Water's stated that its RBP engagement program had three phases:

▶ Forming an engagement approach and direction

This stage produced a ranked list of future potential actions, informed by a survey of 1500 customers that identified key customer priorities and areas for investigation, and a further prioritisation survey completed by 1400 residential and business customers. It involved focused engagement on some specific projects and proposed investments.

³⁷ SA Water, *Regulatory Business Plan 2024-28*, August 2023, pp. 1-306, available at: www.sawater.com.au/about-us/how-we-operate/planning-for-2024-28.

³⁸ Extracted from: SA Water, *Regulatory Business Plan 2024-28*, pp. 1-306, and SA Water, *Regulatory Business Plan 2024-28 Summary*, August 2023, pp. 1-12, available at: <https://www.sawater.com.au/about-us/how-we-operate/planning-for-2024-28>.

► **Engaging on customer experience and value**

This stage involved deliberative engagement activities with two stakeholder groups, the Customer Challenge Group (CCG) and the Peak Bodies Engagement Forum (PBEF),³⁹ and a willingness-to-pay (WTP) survey of 1900 customers.^{40,41}

The CCG was comprised of community members and the PBEF was comprised of members from SA Water's existing Customer Advisory Group and the Commission's Consumer Advisory Committee (CAC). Each met regularly throughout 2022 to test specific business proposals and explore the trade-offs between different outcomes and levels of service delivery.⁴²

► **Prioritising investment decisions**

This stage involved presenting draft SAWRD24 proposals to the CCG and PBEF for feedback. In this stage, SA Water explained how it had used engagement alongside other evidence to develop proposals.⁴³ Affordability concerns raised by the CCG and PBEF were explored by prioritising which initiatives to progress during SAWRD24 while managing cost impacts.

4.3.2 Commission's expectations for SA Water's engagement

SA Water's program of stakeholder engagement is aligned with expectations set by the Commission in Guidance Paper 2: Stakeholder engagement for the RBP (**Guidance Paper 2**).⁴⁴ Guidance Paper 2 was established after receiving feedback on SA Water's stakeholder engagement in establishing the SAWRD24 Framework and Approach.⁴⁵

In Guidance Paper 2, the Commission set expectations in relation to stakeholder involvement. The Commission advised SA Water to demonstrate that, in preparing its RBP:

- it engaged in a meaningful and substantial way with an appropriately diverse range of stakeholders
- it used an appropriately diverse range of channels and methods to engage with stakeholders, and
- stakeholder views and feedback have been carefully considered and incorporated into project design and prioritisation.

SA Water outlines how it believes its engagement activities have met these expectations in Appendix 4.1 to its RBP. SA Water has also linked engagement with specific expenditure proposals throughout its RBP.

Commission staff have observed SA Water's engagement process since planning and inception, and have reviewed materials and attended CCG and PBEF meetings.

³⁹ SA Water, *Regulatory Business Plan 2024-28*, Appendix 4.3 - What we heard report: RD24 engagement – Phase 2, p. 2, available at https://www.sawater.com.au/_data/assets/pdf_file/0010/747064/Appendix-4.3-What-We-Heard-Report-Nov-2022.pdf.

⁴⁰ SA Water, *Regulatory Business Plan 2024-28*, p. 99.

⁴¹ SA Water *Regulatory Business Plan 2024-28*, Appendix 4.3, p. 25.

⁴² Ibid, p. 25.

⁴³ Ibid, pp. 1-34.

⁴⁴ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2024: Guidance Paper 2*, April 2022, pp. 1-11, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21810/20220407-Water-SAWRD24-GuidancePaper2-Stakeholder-engagement-for-RBP.pdf.aspx?Embed=Y>.

⁴⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2024: Final Framework and approach*, September 2021, pp. 1-27, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21756/20210916-Water-SAWRD24-FrameworkAndApproach-FinalDecision.pdf.aspx?Embed=Y>.

Generally, stakeholders have advised that they have been satisfied with the approaches used by SA Water. This is demonstrated in comments from the CCG and PBEF included in Appendix 4.3 to the RBP, and by the South Australian Council of Social Service (**SACOSS**) submission to the RBP:

*'SACOSS would like to commend SA Water for actively addressing concerns raised by ESCOSA and other stakeholders from the previous regulatory determination. This has been evident in the engagement to date and in the presentation of RBP24. The level of detail presented in RBP24 is a vast improvement from RBP20, with greater transparency around how SA Water has arrived at its investment decisions.'*⁴⁶

The Commission acknowledges the work done by SA Water to improve its engagement approach for its SAWRD24 RBP. The Commission considers that SA Water has demonstrated that its engagement:

- ▶ was early, meaningful, transparent, and collaborative
- ▶ used methods and channels to maximise stakeholder opportunities to contribute
- ▶ facilitated obtaining diverse perspectives as early as possible, and
- ▶ met expectations regarding stakeholder engagement for SAWRD24.

The engagement process undertaken by SA Water for SAWRD24 reflects a significant improvement as compared to the engagement processes undertaken for SA Water's 2013, 2016 and 2020 regulatory business proposals.

As noted in Guidance Paper 2, stakeholder engagement to support preparation of the RBP should be integrated with its ongoing programs of stakeholder engagement. The Commission encourages SA Water to continue and build on the positive stakeholder engagement program it has established for SAWRD24 when planning future projects and programs.

The Commission considers that an area for further focus for SAWRD28 is the use of Willingness to Pay (**WTP**) research to inform investment prioritisation. While the Commission considers that quantitative WTP research can be useful, it can have limitations, and be less important than broad, deep, and nuanced conversations with customers. Particular care is required in the methodology used for this type of research.

The Commission originally discussed its concerns regarding the use of WTP research in Guidance Paper 2,⁴⁷ partly in response comments from stakeholders about the use of WTP research in SAWRD20.⁴⁸ The Commission will carefully consider its position on the role of WTP research in stakeholder engagement ahead of SAWRD28.

⁴⁶ South Australian Council of Social Services, *Submission to Regulatory Business Plan*, October 2023, pp. 1-27, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁴⁷ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2024: Guidance Paper 2*, p. 4.

⁴⁸ South Australian Council of Social Services, *Submission to Framework and approach*, March 2021, pp. 1-9, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21706/20210604-Water-SAWRD24FrameworkApproachSubmission-SACOSS.pdf.aspx?Embed=Y>.

4.4 Pricing Order under the *Water Industry Act 2012*

The Treasurer may issue a Pricing Order under the WI Act, which forms part of the legislative framework that governs the making of this Draft Determination. Issued Pricing Orders are available on the Department of Treasury and Finance website.⁴⁹

The Commission will consider and comply with the requirements emerging from any Pricing Order, with discussion of those matters contained in Part D of this Draft Determination (where applicable). Previous Pricing Orders required the costs of directions under section 6 of the *Public Corporations Act 1993* to be included within the revenue controls under this Draft Determination.

At the time of publishing this Draft Determination, no Pricing Order had been issued in respect of the SAWRD24 regulatory period.

4.5 Directions under section 6 of the *Public Corporations Act 1993*

The Minister may issue directions to SA Water under the *Public Corporations Act 1993* (section 6 of that Act). Such directions may specify on-going and new requirements that SA Water must deliver during a regulatory period, with associated cost-related requirements or specifications.

The Commission will take into account the requirements emerging from any directions, with discussion of those matters contained in this regulatory determination (where applicable).

At the time of publishing this Draft Determination, no Section 6 directions had been issued in respect of the SAWRD24 regulatory period.

4.6 Key themes raised in submissions to SA Water's regulatory business proposal

The Commission sought public submissions on SA Water's RBP. Thirteen submissions were received (refer Appendix 3). Some of the key themes arising from submissions included:

▶ **Support for prioritising affordability**

In later stages of the engagement process, SA Water decided not to progress several proposed initiatives in response to concerns from stakeholders about increasing cost of living pressures. Prioritisation of affordability was supported by submissions from the Council of the Ageing South Australia (COTA SA), SACOSS and Uniting Communities.⁵⁰

▶ **Concern about the integrity of the regulatory process in relation to expenditure resulting from a Ministerial direction pursuant to section 6 of the *Public Corporations Act 1993***

Significant expenditure is included in the RBP for metro north subsystem growth and the Tea Tree Gully Sustainable Sewers program, which SA Water expects to be subject to a Ministerial direction. Some submissions have asked for assurance that expenditure subject to section 6 directions is subject to the same level of scrutiny as the rest of the RBP.

⁴⁹ Available at: www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation.

⁵⁰ COTA SA, *Submission to Regulatory Business Plan*, October 2023, pp. 2-3, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024, South Australian Council of Social Services, *Submission to Regulatory Business Plan*, pp. 1-27, and Uniting Communities, *Submission to Regulatory Business Plan*, October 2023, p. 5, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

COTA SA expressed concern that the increased use of Ministerial directions compromises the regulatory process.⁵¹ SACOSS queried whether the expected section 6 direction has distorted the aim of keeping costs down and resulted in other discretionary initiatives supported in engagement not being progressed.⁵² The City of Playford and the City of Salisbury were of the opinion that investment in water supply in northern Adelaide should be part of SA Water's core infrastructure program and should not be reliant on Ministerial direction.⁵³

► **Provision for urban growth**

The Energy and Water Ombudsman South Australia (EWOSA), City of Playford and City of Salisbury, Property Council of Australia and Villawood Homes all expressed concern about provision for urban growth in their submissions.⁵⁴

EWOSA requested that projections of water demand and customer growth be updated to reflect population projections published in mid to late-2023.⁵⁵ The City of Playford and City of Salisbury outlined their views that SAWRD24 needs to provide for critical infrastructure required to facilitate residential and employment growth in northern Adelaide.⁵⁶ The Property Council of Australia expressed concerns about the capacity for SA Water to service greenfield developments areas that do not currently have water or sewerage infrastructure and sought clarification about how growth will be funded for significant land release projects.⁵⁷

► **Regional water aesthetics**

Submissions from COTA SA, the Flinders Ranges Council and one private individual express concern that the RBP does not include expenditure for improving water aesthetics for the regional town of Quorn.⁵⁸ Submissions note that the poor water aesthetics at Quorn mean few customers use it as drinking water, and that its hardness and salinity impact pipes, appliances and gardens.

Expenditure for regional water aesthetic improvements was initially supported in SA Water's RBP engagement process but was removed in the later stages to prioritise affordability.⁵⁹ Expenditure to improve regional water aesthetics was also considered (and decided against) at RD20.⁶⁰

SA Water's multi-criteria assessment of regional water supplies identifies Quorn as a high-priority supply for improvement.⁶¹

⁵¹ COTA SA, pp. 2-3.

⁵² South Australian Council of Social Services, *Submission to Regulatory Business Plan*, pp. 7-15.

⁵³ City of Playford and City of Salisbury, *Submission to Regulatory Business Plan*, October 2023, pp. 1-2, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁵⁴ City of Playford and City of Salisbury, pp.1-2, Property Council of Australia, *Submission to Regulatory Business Plan*, October 2023, pp. 1-4, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024, Energy and Water Ombudsman South Australia, *Submission to Regulatory Business Plan*, October 2023, pp. 1-4, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024, and Villawood Properties, *Submission to Regulatory Business Plan*, October 2023, p. 1, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁵⁵ Energy and Water Ombudsman South Australia, October 2023, pp. 1-4.

⁵⁶ City of Playford and City of Salisbury, pp.1-2.

⁵⁷ Property Council of Australia, pp. 1-4.

⁵⁸ COTA, pp. 1-3, Bradley J, *Submission to Regulatory Business Plan*, October 2023, p. 1, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024, and Flinders Ranges Council, *Submission to Regulatory Business Plan*, October 2023, pp. 1-4, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁵⁹ SA Water *Regulatory Business Plan 2024-28*, Appendix 4.3, p. 26.

⁶⁰ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 179-182,

⁶¹ SA Water, *Long-term plan for improving drinking water aesthetics*, May 2023, available at <https://watertalks.sawater.com.au/long-term-planning-for-regional-drinking-water-supplies>.

► **Consumer protections for tenants**

Submissions from EWOSA, SACOSS and Uniting Communities all expressed concerns with the protections available to tenants as water consumers, which arise from the lack of a direct financial relationship with SA Water. Issues include access to bill information, hardship assistance and dispute resolution.⁶²

Other matters raised in submissions include: the capacity and long-term security of Bordertown's water supply (Tatiara District Council),⁶³ the RBP's lack of connection to SA Water's Resilient Water Futures project (Uniting Communities),⁶⁴ the response of the RBP to regulatory requirements (Environment Protection Authority, Office of the Technical Regulator),⁶⁵ and views about initiatives that will not be progressed in SAWRD24 (smart meters – EWOSA, and further upgrade of non-drinking supplies – SACOSS).⁶⁶

The Commission's consideration of these themes and other relevant matters raised in submissions are discussed in subsequent chapters.

⁶² South Australian Council of Social Services, *Submission to Regulatory Business Plan*, pp. 1-6, Uniting Communities, pp. 1-5, and Energy and Water Ombudsman South Australia, October 2023, pp. 1-4.

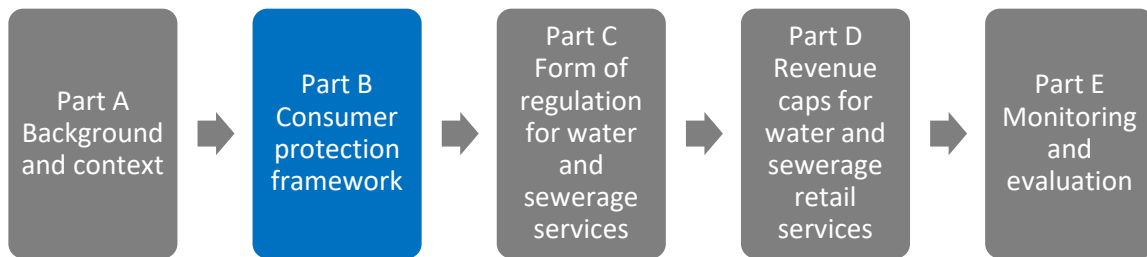
⁶³ Tatiara District Council, *Submission to Regulatory Business Plan*, October 2023, p.1-4, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁶⁴ Uniting Communities, p. 3.

⁶⁵ Environmental Protection Authority, *Submission to Regulatory Business Plan*, October 2023, pp. 1-10, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024, and Office the Technical Regulator, *Submission to Regulatory Business Plan*, October 2023, p. 1, available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.

⁶⁶ Energy and Water Ombudsman South Australia, pp. 1-4, and South Australian Council of Social Services, *Submission to Regulatory Business Plan*, pp. 1-6.

Part B – Consumer protection framework



Part B set out the Commission’s decisions on the consumer protection framework that it applies to SA Water, established by the Water Retail Code – Major Retailers (**Code**).

The Commission reviewed that consumer protection framework having regard to its primary objective, as set out in section 6 of the ESC Act: *‘the protection of the long-term interests of South Australian consumers with respect to price, quality and reliability of essential services’*.⁶⁷

In that context, the Commission considered whether or not the various consumer protections and service standards in the Code remained appropriate and should continue, be varied or revoked, and whether or not SA Water is providing retail services at the quality and reliability levels valued by customers.

As set out and explained in Chapters 5 and 6, the Commission has made a series of draft decisions that it considers will enhance consumers’ long-term interests and which, if given effect in the final Regulatory Determination, will result in amendments to the consumer protection framework and service standards set out in the Code.

⁶⁷ It has a further requirement under section 28(8) of the ESC Act to keep the contents and operation of codes under review to ensure their continued operation and effectiveness.

5 Water Retail Code – Major Retailers

Draft decision – Water Retail Code – Major Retailers

The Commission's draft decision is that the existing protections contained in the Water Retail Code – Major Retailers remain appropriate for SAWRD24, subject to the following variations:

- ▶ Certain protections that currently apply only to customers, defined as owners of land to which a retail service is provided, will be extended to apply to all consumers, such as tenants and other occupants.
- ▶ New requirements will be established that require SA Water to publish information about how hardship provisions apply differently to customers, as owners of land, and other types of consumers, and what consumers can do if they dispute a bill.
- ▶ SA Water will be prohibited from restricting water flow in properties that SA Water believes or should reasonably believe, is tenanted.
- ▶ The current prohibition on SA Water charging customers for provision of paper bills will be removed. SA Water will have the discretion to charge for the provision of paper bills provided:
 - it has undertaken public consultation on the proposal and, following consultation, publicly explained its decision whether to proceed with the charge
 - an exemption scheme is established; the charge is clearly identified on bills
 - 12 months' notice has been provided before the charge is introduced, and
 - customers have the option to receive a bill free of charge via an alternative method (for example, electronically).
- ▶ The requirement for SA Water to undertake an actual meter read at a customer's property where a self-read has not been accepted will be removed. This requirement will be replaced with a obligation for SA Water to provide customers with the option of either resubmitting a compliant read or organising a time for a meter reader to have access to the meter.
- ▶ SA Water will be required to offer and apply flexible payment plans to both residential and non-residential customers who are experiencing payment difficulties (currently this protection is only required for residential customers) and protect both residential and non-residential customers from debt recovery and restriction of water services while adhering to the terms of an agreed payment plan.
- ▶ SA Water will be required to establish policies and processes for early identification of residential customers who may be experiencing payment difficulties and will be required to employ best endeavours to contact these customers to provide information about available assistance.
- ▶ New conduct and policy requirements will be introduced for SA Water in relation to providing protections for customers experiencing family violence.
- ▶ New provisions will establish the service standards that will apply when SA Water has been directed to take over the operations of another water industry entity on either a temporary or ongoing basis.

5.1 Introduction

The Water Retail Code – Major Retailers (**Code**) sets behavioural standards and minimum requirements that apply to SA Water for the sale and supply of retail services (water and sewerage) to customers (defined as owners of land to which a retail service is provided) and, in some instances, to other consumers such as tenants. It includes requirements for SA Water to:

- ▶ have a customer charter that sets out the respective rights and obligations of SA Water and its customers⁶⁸
- ▶ have a standard form customer sale contract, and have any amendments approved by the Commission⁶⁹
- ▶ connect customers to its network in accordance with the terms of its connection and augmentation policies, as approved by the Commission
- ▶ minimise supply interruptions, provide information to customers on interruptions and use its best endeavours to meet customer service and network reliability service standards⁷⁰
- ▶ have enquiry, complaint and dispute resolution procedures that provide for escalation to an independent dispute resolution body⁷¹
- ▶ meet minimum billing requirements to ensure that customers receive accurate billing information in a timely manner, and make provision to resolve billing errors, undercharging and overcharging
- ▶ meet minimum requirements around payment terms, methods and managing payment difficulties experienced by customers,⁷² and
- ▶ limit disconnections and restrictions for non-payment to specific circumstances and fulfil certain obligations prior to restricting a customer.

SA Water is required to demonstrate to the Commission that it has adequate systems and processes in place to comply with the Code's requirements, and to report any material breaches of its obligations as soon as practicable (and non-material breaches within designated timeframes).⁷³

The Commission's compliance framework focuses on ensuring that SA Water provides rectification or restitution to customers as a first priority, then identifies the root cause of any material breach of obligations and puts in place systems and processes to minimise future non-compliances. Enforcement action is taken where there is ongoing, wilful and/or material non-compliance.⁷⁴

⁶⁸ SA Water, *Customer Charter*, September 2021, available at:

www.sawater.com.au/_data/assets/pdf_file/0006/508245/SA-Water-Charter-September-2021.pdf

⁶⁹ SA Water, *Standard Customer Contract*, accessed 9 October 2023, available at: www.sawater.com.au/about-us/how-we-operate/policies/customer-contract

⁷⁰ Service and reliability standards are set out in Schedule 1 of the Code, available at:

www.escosa.sa.gov.au/ArticleDocuments/21489/20200701-Water-RetailCode-MajorRetailers-MR03.pdf.aspx?Embed=Y

⁷¹ The EWOSA is SA Water's approved independent dispute resolution body.

⁷² SA Water, *Hardship Policy for Residential Customers*, August 2018, available at:

www.sawater.com.au/_data/assets/pdf_file/0005/288977/hardshippolicy_0818.pdf

⁷³ Essential Services Commission of SA, *Water Industry Guideline No 1 – Compliance System and Reporting*, July 2022, available at: www.escosa.sa.gov.au/ArticleDocuments/616/20220728-Water-ComplianceSystemsReporting-MajorRetailers-WG1-06.pdf.aspx?Embed=Y

⁷⁴ Commission, *Enforcement Policy*, August 2021, available at:

www.escosa.sa.gov.au/ArticleDocuments/21734/20210811-Corporate-EnforcementPolicy-V2.6.pdf.aspx?Embed=Y

5.2 Review process

The Commission has reviewed the protections contained in the Code as part of the SAWRD24 process.

The review process has involved stakeholder engagement and research by the Commission, including:

- ▶ public consultation on an Issues Paper⁷⁵
- ▶ a workshop with the Consumer Advisory Committee (CAC), which focussed on the Code and the Monitoring and Evaluating Performance Framework (MEPF)
- ▶ meetings with stakeholders and other regulators of SA Water (including the Environment Protection Authority, Department for Environment and Water, Office of the Technical Regulator and SA Health)
- ▶ a series of meetings with SA Water regarding communications, payment difficulty and hardship, and protections for customers experiencing family violence
- ▶ a review of developments in other jurisdictions
- ▶ analysis of complaints data held by the Commission and case data held by the Energy and Water Ombudsman SA (EWOSA), and
- ▶ consideration of the findings and recommendations of various regulatory, compliance and audit reports.

5.3 Changes to protections

5.3.1 Protections for tenants

Most protections in the Code relate to customers which is defined in the *Water Industry Act 2012* (WI Act) as an owner of land to which a retail service is provided. Under regulation 4 of the *Water Industry Regulations 2012* (WI Regulations) and section 25(1) of the WI Act, the definition of a customer includes a consumer (eg tenant) in a number of defined circumstances (these circumstances are discussed further in section 5.3.1.2).

For example, the Water Retail Code sets out the minimum payment options SA Water must offer to its *customers*. Other requirements for SA Water, such as requirements for dispute resolution processes, apply to both customers and consumers.

5.3.1.1 Matters raised in consultation

In consultation on the Issues Paper and SA Water's RBP, the South Australian Council of Social Service (SACOSS), Uniting Communities and EWOSA raised concerns about the different levels of protections that apply to tenants as SA Water consumers. These differences arise from the type of relationship SA Water has with tenants, who are not direct customers of SA Water.

Both SACOSS and EWOSA have encouraged the Commission to investigate possible ways to make changes to the Code that would extend further protections to tenants.

A summary of the specific concerns raised are outlined below.

⁷⁵ Essential Services Commission of South Australia, *SAWRD24 Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, available at: [ESCOSA - Water retail code and monitoring and evaluating performance framework](#)

Legislative framework

Uniting Communities⁷⁶ and SACOSS⁷⁷ consider that tenants need to be recognised as customers under the WI Act so they can benefit from all protections under the Code.

EWOSA⁷⁸ stated that a direct relationship between SA Water and the consumer would enable tenants to access the full range of protections. It noted that there may need to be changes to legislation, such as the WI Act and/or the *Residential Tenancies Act 1995 (RT Act)*, to make this possible.

Definition of customer

SACOSS has suggested a change to the definition of 'residential customer' in the 'flexible payment and hardship' section of the Code to match the definition of 'residential customer' in section 37(5) of the WI Act. Section 37 of the WI Act establishes the requirement for the Minister to develop a customer hardship policy, which water industries must adopt (with or without amendments approved by the Commission).

Extension of certain Code protections to consumers

SACOSS considers that the Code does not extend several protections to tenants even though the WI Act specifies those requirements apply to tenants in certain prescribed circumstances. This includes limitations on the grounds on which the supply of designated services for tenants may be discontinued or restricted, certain processes to be followed prior to the restriction to tenants, specified processes to be followed to resolve disputes between the water industry entity and the tenant, and access to the Ombudsman scheme.

Uniting Communities is concerned about the lack of consensus on whether tenants are customers in 'prescribed circumstances' under the WI Act.

Hardship support

EWOSA and Uniting Communities both raised concerns about tenants being unable to access SA Water's hardship support and payment plans without landlord approval. Uniting Communities states that this is a significant issue as the power imbalance between landlords and tenants discourages tenants from informing landlords about their financial situation. It considers that tenants should be able to access hardship programs directly through SA Water as bill paying consumers.

Dispute resolution

Both EWOSA and Uniting Communities noted concerns about the general lack of access for tenants to the independent dispute resolution services of EWOSA.

Uniting Communities noted that as the responsibility of tenants to pay for water charges is established under a tenancy agreement, the body responsible for resolving disputes relating to such agreements is the South Australian Civil and Administrative Tribunal (**SACAT**). It further noted that tenants often report the SACAT process is time consuming, formal, expensive, and intimidating. In contrast, they considered EWOSA's service as informal, low-cost, and timely.

⁷⁶ Uniting Communities submission on SA Water's RBP, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024

⁷⁷ SACOSS submission on the Issues Paper, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

⁷⁸ EWOSA submission on the Issues Paper available at: <https://www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework>

Bill visibility

Both Uniting Communities and EWOSA advised that many tenants do not have visibility over their water and sewerage costs due to not receiving or viewing bills. EWOSA noted that, without visibility over water consumption, there is the possibility of higher leakages at rented dwellings.

Supply charges

Uniting Communities expressed concern about the requirement for tenants to pay water supply charges. It noted that South Australia is one of the only States where tenants are made to pay the supply charge. In other States, including New South Wales, Queensland, and Victoria, the supply charge can only be passed on to tenants if the property is individually metered and complies with minimum water efficiency requirements.

5.3.1.2 Commission analysis

SA Water support for tenants

SA Water currently provides a range of services for tenants, including:

- ▶ Tenant information can be added in the SA Water Customer Relationship Management system (CRM) and tenants can report faults and sign up for outage notifications.
- ▶ If a tenant has an account number, they can access the account balance and can pay the bill. If a property owner or managing agent provides authorisation, SA Water can discuss all aspects of a bill with the tenant.
- ▶ SA Water does not restrict services for non-payment where a property is known to be tenanted.
- ▶ Tenants can access the SA Water Customer Assist program, with permission from the property owner. The benefits of this program (including access to plumbing services and co-payments from SA Water) will be applied to the property's account and therefore relies on the property owner passing this on to the tenant.
- ▶ SA Water does property letter box drops when outages/maintenance are to occur (tenants get these directly).

SA Water explored the option of providing tenants with copies of bills as an investment project under its RBP and estimated that the project would require capital upgrades to SA Water systems and increased operating expenditure of approximately \$20 million within the regulatory period. SA Water advised that the option was not pursued due to cost impacts on the broader customer base and the prospect of landlords being required to provide tenants with copies of the bill through proposed changes to the RT Act.⁷⁹

Legislative framework

Section 18C of the *South Australian Water Corporation Act 1994* provides that an amount due to SA Water for provision of a water service under the WI Act is a first charge on the land in relation to which the service has been provided. As a result, SA Water bills property owners, rather than occupants, for its water and wastewater services.

SA Water advised that the legislative mechanism that directs where debt for water and sewerage retail services resides is the key controlling factor in the relationship it can have with tenants. It advised that where the contract for services and debt is the responsibility of the property owner, and debt remains

⁷⁹ Consumer and Business Services, available at: www.cbs.sa.gov.au/campaigns/review-of-sas-renting-laws#:~:text=Rent%20bidding%20has%20been%20banned,an%20offer%20for%20higher%20rent.

as a first charge on the land, it is necessary for the landowner to approve any decisions that impact their legal accountability for debt. This includes deferral of debt by a tenant where they are required to pay through their tenancy agreement.

The WI Act and associated WI Regulations define the nature of consumer protections that the Commission may establish, and where it may extend those to consumers. While most requirements of the WI Act relate to customers who are defined as landowners, the definition of customer is extended to consumers in some circumstances. The Commission cannot act beyond the scope of the powers given to it under that legislation.

The Department for Environment and Water (**DEW**) is aware of stakeholder concerns regarding protections for tenants and has committed to reviewing arrangements as part of the current review of the WI Act.

Definitions of customer

In response to SACOSS's submission that the definition of residential customer in the Code is not consistent with the definition in the WI Act, the Commission has reviewed the legislative framework to ensure its approach is consistent.

The definition of residential customer that is established by section 37(5) applies only for the purposes of that section of the WI Act. That is, only for the purposes of the Minister developing and publishing a customer hardship policy and a water industry entity adopting this policy (with or without amendments approved by the Commission). Compliance with the hardship policy is required to be a condition of the water entities' licence.

The definition of residential customer that has been used in the Code is based on the definition established by a gazettal notice of 20 December 2012,⁸⁰ which designates classes of customers for relevant clauses of the WI Act, with which the Commission must comply. The designated customers under that gazettal notice are 'residential customers' and 'non-residential customers'.

The Commission is unable to update the definition of residential customers as suggested by SACOSS as this would be inconsistent with the requirements of the gazettal notice of 20 December 2012.

Extension of certain Code provisions to consumers

The WI Regulations extend the definition of customer to include consumers for the Commission to impose licence condition obligations (and separately for SA Water to provide consumers with a statement of the quantity of water supplied during a financial year) in the following circumstances:

- ▶ for the purposes of licence conditions requiring the water industry entity to comply with Code provisions under section 25(1)(b)(iii) and (iv) of the WI Act relating to limitations on the grounds on which the supply of designated services to customers may be discontinued or disconnected and processes to be followed before designated services are discontinued or disconnected
- ▶ for the purposes of licence conditions determining a process to be followed to resolve disputes between a water industry entity and its customers in accordance with section 25(1)(g) of the WI Act, and
- ▶ for the purposes of an ombudsman scheme determined or approved by the Commission in accordance with licence conditions imposed through section 25(1)(h) of the WI Act.

⁸⁰ Government Gazette, No. 83, Thursday, 20 December 2012, p. 5708, available at: www.governmentgazette.sa.gov.au/2012/December/2012_083.pdf

The Code provisions around these matters apply to ‘customers’. The Code definition of ‘customers’ refers back to the definition in the WI Act, which takes into account the WI Regulations and inclusion of consumers in these circumstances (ie for the purposes of the Commission imposing licence obligations on retailers relating to the above matters).

While these obligations legally apply to consumers, there are some barriers to full application of these provisions to consumers. Barriers include:

- ▶ *Prohibitions on water service flow restriction and processes to be followed before restriction* – Currently the Code requires SA Water to send a restriction warning notice to customers. The Code prohibits restriction of properties known to be tenanted where the tenant has provided evidence of their occupancy and payment of their component of the bill. As the requirement to send the notice applies to the customer rather than the supply address, there is a risk that the consumer may not be made aware of the impending restriction and therefore be unable to satisfy the notice requirements prior to being restricted. Options for addressing this risk include requiring a warning notice to be sent to a supply address as well as a customer or prohibiting restriction on properties known to be tenanted.
- ▶ *Processes to be followed to resolve disputes* – The Code requires that a retailer must have, publish and inform customers on request of its customer enquiry, complaint and dispute resolution procedures. Currently there is no requirement under the Code for these procedures to apply to consumers. There is opportunity for the Code to require SA Water to update its procedures to include clear information about how it can assist consumers.
- ▶ *Ombudsman scheme* – it is a condition of SA Water’s licence that it participate in an Ombudsman scheme. The Code then establishes certain circumstances where SA Water must inform customers of the option to lodge a dispute with the industry Ombudsman, including when sending billing reminder notices, restriction warning notices and on review of a bill. In practice, there are barriers to consumers accessing the services of the Ombudsman scheme, for example, EWOSA advises that it cannot assist consumers with complaints relating to billing and hardship – these are referred to SACAT. EWOSA advises that tenants can only have a complaint resolved by EWOSA if they are provided with an “Authority to Act” by their landlord or to lodge a complaint about a water leak on the SA Water side of their water meter.

Hardship support

Section 37 of the WI Act and its hardship policy obligations apply to ‘residential customers’ which includes tenants as a ‘consumer who is supplied with retail services for use at residential premises.’ Therefore, the hardship policy which the Minister has developed applies to tenants in addition to owners of land.

SA Water’s hardship policy is based on the Minister’s hardship policy (with minor amendments approved by the Commission) and applies to tenants since it applies to ‘residential customers.’

The hardship policy establishes the following protections for residential customers experiencing financial hardship:

- ▶ option to pay using an interest and fee free payment plan, Centrepay or have more time to pay a bill
- ▶ if complying with the requirements of an agreed payment arrangement: waiver of restoration fees, protection from restrictions, debt recovery and legal action; and incentives for meeting payment obligations
- ▶ information on: government concessions, grants, rebates and assistance programs; water efficiency measures; and option to redirect bills to a third party with their consent, and
- ▶ referral to financial and other counselling and support services.

While these protections technically apply to tenants, SA Water has advised there are some practical barriers to applying the protections established by the policy to tenants in their fullest form. For example, protections relating to billing, including access to payment plans, can only be extended to tenants with the landlords' consent due to impacts on the landlords legal accountability for debt.

Research by SA Water and the social sector has identified that a key issue is the relationship tenants have with their landlords and their fear of seeking support from landlords when in hardship through fear of losing their tenancy. This research also indicated that tenants could make payment arrangements directly with managing agents/property owners; however, trust factors also inhibit these arrangements.

There are no known barriers to extending the information and referrals related to protections to consumers.

Dispute resolution

The Code provisions around dispute resolution and the Ombudsman scheme apply to 'customers'. The Code definition of customers refers back to the definition in the WI Act. However, as outlined above, for the purposes of the Commission imposing licence conditions regarding dispute resolution, the term customer includes consumers.

Nevertheless, there are some barriers to the practical application of these protections for consumers.

As stated above, EWOSA cannot assist consumers with complaints relating to billing and hardship – these are referred to SACAT.

Bill visibility

Section 73(3) of the RT Act recognises that a water bill will generally be issued to the landlord by the water supply authority and provides that the tenant is not required to pay if *'the landlord fails to request payment from the tenant within 3 months of the issue of the bill'* or the tenant has requested a copy of the account and *'the landlord has failed to provide the copy to the tenant within 30 days'*.

The Government is proposing to change the RT Act to require landlords to provide tenants with a copy of any water bill that the tenant is required to pay within 30 days of receiving the water bill.⁸¹

Supply charges

Pursuant to section 73 of the RT Act, water supply rates and charges are to be borne as agreed between the landlord and tenant. In the absence of an agreement, if the supply of water to the premises is separately metered, they are to be borne by the tenant and, if it is not metered, by the landlord.

The Government is proposing to change the RT Act to specify that where there is no agreement between the landlord and tenant as to who pays the water supply fee, the water supply fee is paid by the landlord.

Other amendments being considered by the Government include a requirement that:

- ▶ new or replacement fixtures in rental properties are required to meet certain water saving standards, and
- ▶ landlords will pay excess water charges resulting from reported water leaks that remain unrepaired, or latent water leaks that could not reasonably be expected to be detected or reported by a tenant.

⁸¹ Consumer and Business Services, available at: www.cbs.sa.gov.au/campaigns/review-of-sas-renting-laws#:~:text=Rent%20bidding%20has%20been%20banned,an%20offer%20for%20higher%20rent.

5.3.1.3 Draft decision

The Commission acknowledges the ongoing concerns of stakeholders about the lower level of protections that apply to consumers that are not SA Water customers. It notes that these differences in protections apply to around 30 percent of households supplied by SA Water.⁸²

The Commission considers that there are limitations to the extent that these matters can be resolved through the Code and that full resolution of the concerns expressed through submissions can only be achieved through legislative changes that enable consumers to be billed directly by SA Water for relevant services. The Commission notes that it explored the costs and benefits of SA Water billing end users in 2014.⁸³

Noting the above limitations, the Commission has carefully considered which aspects of the protections established by the Code can be legally and practically extended to apply to consumers, within the existing legislative framework.

The Commission's draft decision is to extend the following provisions in the Code, which currently apply only to residential customers, to consumers.

▶ **Enquiries, complaints and dispute resolution - clauses 3.1, 3.2 and 3.3**

These clauses require SA Water to have, review and inform customers about its enquiry, complaints and dispute management procedures. Currently, SA Water is only required to set out procedures in relation to residential customers. The Commission's draft decision is for these requirements to be broadened to cover consumers and where there are limitations to how SA Water can assist consumers, compared with residential customers, these limitations must be clearly explained in its procedures.

▶ **Accessible communications – clause 4.2**

This clause requires SA Water to provide access to its services using languages and means of communication that are common to its customer base. Currently, SA Water is only required to extend accessible communications to its customers. The Commission's draft decision is to require SA Water to extend accessible communications to consumers, where SA Water is required to communicate with consumers under the Code.

▶ **Customer hardship policy – clause 10.1**

This clause requires SA Water to publish its hardship policy on its website, display a copy in its retail offices and advise customers of the policy if they are experiencing financial hardship. The Commission's draft decision is to require SA Water to publish information about how its hardship policy applies in different circumstances, including any differences in how it applies to customers and consumers. SA Water will also be required to advise consumers about its hardship policy and how it applies where a consumer is experiencing financial hardship.

▶ **Information for consumers – clause 20.4**

This is a proposed new clause which requires SA Water to provide information on its website, and on request, free of charge, about what a consumer can do if it disputes a bill.

⁸² Australian Institute of Health and Welfare, home ownership and housing tenure 5 April 2023, available at: www.aihw.gov.au/reports/australias-welfare/home-ownership-and-housing-tenure

⁸³ Essential Services Commission of South Australia, *Final inquiry report: inquiry into reform options for SA Water's drinking and sewerage prices*, 2014, Appendix 3, available at: www.escosa.sa.gov.au/ArticleDocuments/436/20141214-Water-FinalInquiryReport-BillingConsumer3.pdf.aspx?Embed=Y

► **Notice to customers experiencing payment difficulties – clause 25.2**

This clause sets out requirements for SA Water to provide information to residential customers experiencing payment difficulties, including information about its hardship policy, government assistance programs and independent financial and other relevant counselling services. The Commission's draft decision is to extend these notification requirements to consumers.

► **Prohibitions on water service flow restriction – clause 26.2**

This clause sets out the circumstances where SA Water is not permitted to restrict water flow and currently includes a prohibition on restriction where SA Water reasonably believes that the property is tenanted, and that tenant provides evidence that they have met the payment obligations for water under their tenancy agreement. The Commission's draft decision is to prohibit restriction of properties known to be tenanted in *all* circumstances. This is to address the risk that a tenant may not have been provided with adequate notice and/or time to respond with the required information prior to the restriction taking effect. There is a risk that a property that is tenanted could be restricted even when they have met their payment obligations for water due to the landlord not passing on the payment to SA Water.

The Commission acknowledges that there may be some minor costs for SA Water in extending these protections to tenants, including costs associated with developing new information for the website and updating its policies and procedures. The Commission considers that there will be benefits for consumers from improved transparency and potentially reduced administrative costs associated with queries to both SA Water and EWOSA.

The Commission intends to write to the Minister for Climate, Environment and Water (**Minister**) to advise of stakeholder concerns about protections for tenants and the limitations on the Commission's ability to resolve the issue. The Commission will also engage with staff from DEW and Consumer and Business Services to support reviews of the WI Act and RT Act.

The Commission will also engage with EWOSA to ensure that SA Water's obligations to consumers established by the Code are clear, and that consumers have support from EWOSA's dispute resolution services in relation to those obligations.

5.3.2 Individual metering

Clause 18.5.3 of the Code requires that, where more than one customer shares a single meter at the supply address, SA Water must apportion the consumption of the water service across the customers supplied through that meter on a basis approved by the Commission and provide separate bills to each individual customer on request.

5.3.2.1 Matters raised in consultation

At a workshop with the CAC on the Issues Paper, the Commission received feedback about reported inequities in attribution of water costs where a number of properties share a single meter. An example was given of a block of units, managed by a strata corporation, where water use is apportioned evenly between occupants. The CAC advised that, in some instances, occupants that have low water use are subsidising occupants with high water use. A member of the CAC suggested that there should be a strategy in place to increase the number of properties that are directly metered.

5.3.2.2 Commission analysis

Most properties⁸⁴ in South Australia have individual meters that measure the amount of water supplied. A meter reading is typically taken every three months and customers are billed for water used during that period. However, some dwellings on group sites (both residential and commercial) are supplied via a shared water meter and receive a bulk bill.

The Commission approved SA Water's basis for apportioning consumption for shared meters on 13 August 2013.

SA Water offers strata or community title corporation groups one of the following options:

- ▶ pay the total water use charges in one payment, or
- ▶ have SA Water divide water use charges between all owners and provide individual water and sewer accounts. The group will receive a notice every three months showing water use as well as a comparison of use over previous periods. Accounts will be posted to each owner every three months and there is no fee for this service.

In these instances, charges to an individual occupant may not reflect actual water use.

Consideration of strategies to increase the number of properties that are directly metered should carefully weigh the costs and benefits.

The Commission undertook a review of the costs and benefits of individual metering in 2014.⁸⁵ This review found that mandating individual metering was not economically beneficial under any of the scenarios that were tested. It is noted, however, that the economic costs and benefits may have changed since this review.

It has not been possible, within the timeframe to prepare this draft decision, to update the cost benefit analysis of individual metering for SAWRD24. The Commission will work with SA Water during the next regulatory period to update the analysis to inform regulatory settings for SAWRD28.

5.3.2.3 Draft decision

The Commission will review the cost and benefits of direct metering during SAWRD24 and consider this issue further for SAWRD28.

5.3.3 Charging for paper bills

Clause 4.1.4 of the Code requires that, if a customer does not advise SA Water of a preferred form of communication, it must deliver any document, bill or notice in hard copy to the supply address at no cost to the customer.

⁸⁴ When the Commission last reviewed this matter in 2014, more than 80 per cent of properties had individual meters.

⁸⁵ Essential Services Commission of South Australia, *Final Inquiry Report: Inquiry into Reform Options for SA Water's Drinking Water and Sewerage Prices*, December 2014, appendix 5, available at: www.escosa.sa.gov.au/ArticleDocuments/436/20141214-Water-FinalInquiryReport-Metering-CBAOth.pdf.aspx?Embed=Y

5.3.3.1 Matters raised in consultation

In its submission to the Issues Paper,⁸⁶ SA Water asked the Commission to consider varying clause 4.1.4 to enable customers to be charged for paper bills.

SA Water proposed that certain groups of customers would be exempt from this fee, including those:

- ▶ on low income, customers on the customer assist program or receiving concessions
- ▶ with a disability or a serious or chronic illness, and
- ▶ who come from a remote area.

5.3.3.2 Commission analysis

In considering SA Water's request, the Commission has reviewed the approaches to charging for paper bills in other jurisdictions and notes that, for the water industry, regulations in other jurisdictions are silent on whether paper bills need to be provided free of charge or whether a customer may be charged. Charging for paper bills has been prohibited by the NSW Government in certain circumstances.

For the energy industry, the Australian Energy Market Commission has decided that the Australian Energy Regulator (**AER**) is *not allowed* to require retailers to provide paper bills free of charge for market offers.⁸⁷

The Commonwealth Treasury reviewed the establishment of charges for paper bills in 2017. Treasury decided not to ban charges, recognising that customers who elect to receive digital bills would effectively subsidise those who do not.⁸⁸

Charging for paper bills has become common in the banking, energy and telecommunications sectors where companies charge between \$1 and \$3 per paper bill. Many of these companies provide exemptions to customers who qualify for concessions, live in remote communities or require special bill formats.

To better understand the potential costs and benefits of charging for paper bills the Commission sought further information from SA Water about the impact of the proposal. SA Water advised that:

- ▶ Approximately 473,000 customers receive paper bills while 314,000 customers receive their bills electronically.
- ▶ SA Water considers the benefits of e-billing to include:
 - improved customer engagement by capturing and maintaining up-to-date customer contact information
 - accurate contact information allowing better customer communication for faults and other notifications

⁸⁶ SA Water's submission to the Issues Paper, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

⁸⁷ Australian Energy Market Regulator, Rule Determination 18 March 2021, available at: www.aemc.gov.au/sites/default/files/2021-03/RRC0036%20Bill%20contents%20and%20billing%20requirements%20-%20Final%20determination_1.pdf

⁸⁸ Commonwealth Treasury media release 28 November 2018, available at: ministers.treasury.gov.au/ministers/stuart-robert-2018/media-releases/government-calls-business-exempt-vulnerable-consumers

- customers receiving their bill earlier which provides additional time to pay the bill
 - potential for improved cash flow for SA Water as earlier receipt of a bill may lead to customers paying sooner, and
 - reduced environmental impact and cost savings relating to postage and printing. In 2022/23 operating expenditure for issuing of paper bills and related notices (for example, reminders, high water use alerts) was around \$2.5m (postage \$2.1m and printing \$0.4m).
- ▶ SA Water estimated the direct costs associated with issuing a paper bill in 2023 to total \$1.21 per bill, which includes printing, envelopes, inserting, formatting, archiving and postage.

The provision of bills in a digital format, is a simpler, lower-cost and more environmentally friendly option for SA Water and may be a more convenient option for some customers. There may be other benefits for customers in moving to e-billing, such as electronic reminders or notifications, access to previous billing information and online changes to personal details. More timely data may also help customers better understand their usage and costs.

There is a risk that charging fees for paper bills could adversely affect older people, pensioners, people on low incomes, people with disabilities, and other vulnerable members of the community. This includes older Australians who are not familiar with, or confident in using the internet and who may need more assistance, as well as those who simply cannot afford access. The Australian Bureau of Statistics Snapshot of Australia data from 2022 indicates that around 8 percent of households have no access to the internet.

5.3.3.3 Draft decision

The Commission has carefully weighed the potential risks and benefits of SA Water's proposal to remove the Code requirement to provide paper bills free of charge to enable it to charge for paper bills.

The Commission's draft decision is to remove the requirement to provide paper bills at no charge at clause 4.1.4 and establish a new clause 18.4 in the Code, which allows SA Water to decide whether or not to charge customers for paper bills, if the following requirements are met:

- ▶ SA Water has undertaken public consultation on the proposal
- ▶ SA Water has obtained written approval from the Commission
- ▶ the customer has the option to receive bills via an alternative method that is free of charge (for example, an electronic bill)
- ▶ at least 12 months' notice is provided before the charge is introduced for the first time
- ▶ an exemption scheme has been established, that exempts relevant customers from being charged for a paper bill. Relevant customers include customers that: are registered for a government concession, are experiencing financial hardship, do not have access to the internet, or require special bill formats, and
- ▶ for relevant customers, the charge for providing a paper bill is clearly identified and itemised on their bill.

SA Water will not be permitted to charge for other types of written communications, including reminder notices and high water use alerts.

If SA Water chooses to proceed with this initiative, the Commission will monitor any charges introduced by SA Water during SAWRD24, to ensure that it complies with the new provisions of the Code and that the charge reflects the direct, efficient cost of issuing the paper bill.

The Commission expects SA Water to make customers aware of the change prior to any charge being implemented (ie at least 12 months' notice). The Commission also expects SA Water to take particular care to target communication to consumers who are likely to be eligible for exemptions.

The Commission's expectation is that the application process and evidence requirements for the exemption program would not be onerous. Where possible, the Commission expects SA Water to automatically apply exemptions to eligible customers, for example, customers on its Customer Assist Program.

5.3.4 Meter reads taken by customers

In SAWRD20, the Code was amended to allow meter reads taken by customers to be accepted as actual reads.

The Code provides SA Water with the discretion to accept or not accept customer reads as actual meter readings. Where the customer read does not align with a past meter reading, or is not considered reasonably accurate, the read may be rejected and will be shown as an estimate.

In these instances, clause 18.4.2 of the Code places a requirement on SA Water to advise the customer where a read is not accepted and to undertake an actual read at the customer's property. This is to provide certainty for customers on water consumption and the billed amount.

5.3.4.1 Matters raised in consultation

SA Water's submission to the Issues Paper states that the requirement to undertake an actual meter read at a customer's property where a self-read has not been accepted can be inefficient.⁸⁹ For example, it states that where a regional or remote customer seeks to submit a meter read that is not accepted, the cost to SA Water of undertaking an out of sequence meter read for this single customer is considerable.

SA Water considers that an alternate response would be more appropriate. For example, a read that is not accepted as an actual read could be treated as an estimated read if SA Water has undertaken an actual read in the preceding 12-month period.

5.3.4.2 Commission analysis

SA Water has advised that customers can provide reads over the phone, through submitting a webform or by email. Customer reads will be accepted as actual reads where a photo is provided of the meter that:

- ▶ provides a date of capture
- ▶ clearly shows the meter reading
- ▶ clearly shows the meter number that is consistent with the account, and
- ▶ is consistent with prior actual meter reads for the property.

Where these conditions are not met the read will show as an estimate. SA Water states that around 5,000 meter reads are processed by customers each quarter, with just over half having met the criteria to be accepted as actual reads.

⁸⁹ SA Water submission on the Issues Paper, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

The Commission accepts SA Water's assertion that sending a field officer out to inspect a meter, outside of a regular meter reading cycle may be inefficient. This includes where a field officer is required to inspect a meter in a regional or remote location or where the field officer is not able to inspect a meter due to access issues.

There are two existing provisions in the Code that help to avoid long periods of estimated bills:

- ▶ clause 18.6.1 requires SA Water to use its best endeavours to ensure that there is an actual meter read of relevant meters by the retailer at a customer's supply address at least once every 12 months, and
- ▶ clause 18.6.2 requires that where a customer has denied access or fails to undertake an approved meter read, SA Water must give the customer the opportunity to provide alternative access to the meter.

5.3.4.3 Draft decision

The Commission's draft decision is to accept SA Water's proposal to remove the requirement at clause 18.5.2 (e) for it to undertake an actual meter read at a customer's property where a self-read has not been accepted.

To minimise the risk that customers will be over or under-charged as a result of SA Water relying on estimated data, consequential changes are proposed for clause 18.6.2, to require SA Water to provide customers with the option of either resubmitting a compliant read or organising a time for a meter reader to have access to the meter, where a self-read has not been accepted.

A new subclause is also proposed for clause 18.6.3, which allows SA Water to provide an estimated bill where a customer has failed to provide either a compliant read or access to the meter.

5.3.5 Flexible payment plans for all types of customers

The Code establishes a range of protections for customers experiencing payment difficulty, in particular, the opportunity to access flexible payment plans and be protected from debt recovery and restriction when adhering to the terms of that payment plan. Currently these protections only apply to residential customers.

5.3.5.1 Matters raised in consultation

At a workshop on the Code, CAC members suggested that the Commission review the protections that apply to businesses to ensure they are getting access to appropriate levels of hardship support.

5.3.5.2 Commission analysis

The Commission has reviewed the protections that apply to non-residential customers in other jurisdictions. In Western Australia, Tasmania and Victoria payment plans are available to any type of customer, and any type of customer that is adhering to the terms of an agreed payment plan is protected from debt recovery. The Victorian Water Industry Standard also requires water entities to have a customer support policy that covers both residential customers and small business customers that are experiencing financial hardship.

SA Water has advised the Commission that, for business customers facing financial challenges, it can offer support in the following ways:

- ▶ Extend the payment due date out to the date of the next bill due date.
- ▶ Offer a payment arrangement for up to six months, with set dates for incremental payments. This ensures that no further collection activity or fees are applied if the customer is meeting the agreed payments.

Extending the requirement to offer payment plans to all customers is likely to have some minor costs for SA Water associated with additional administrative costs for setting up the payment plans, possible delayed recovery of debt, and fees and charges that are not recoverable. These costs are likely to be outweighed by the benefits including potential for increased debt recovery and reduced costs associated with third party debt recovery practices. There are also likely to be benefits for SA Water in terms of customer satisfaction and benefits for the participating customers in being able to manage payments in a way that suits their individual circumstances.

5.3.5.3 Draft decision

Consistent with SA Water's current practices, the Commission's draft decision is to amend clause 25.1 of the Code to require SA Water to offer and apply flexible payment plans to all types of customers who are experiencing payment difficulties. Consequential amendments are proposed for clauses 24.2 and 26.2.2, to protect non-residential customers from debt recovery and restriction of water services while adhering to the terms of an agreed payment plan.

5.3.6 Early identification of residential customers experiencing payment difficulty

Clause 37 of the WI Act requires that the Minister's hardship policy set out processes to identify residential customers experiencing payment difficulties due to hardship, including identification by a water industry entity and self-identification by a residential customer.⁹⁰ The WI Act requires that SA Water adopt that policy or adopt it with modifications with the approval of the Commission.⁹¹

SA Water's policy states that:

'A residential customer experiencing financial hardship is someone who is identified by themselves, by us, by an accredited financial counsellor, or by a welfare agency as having the intention, but not the financial capacity, to make required payments in accordance with our payment terms.'

SA Water's policy does not outline specific processes for early identification of residential customers experiencing payment difficulty.

5.3.6.1 Matters raised in consultation

No matters have been raised in consultation on this issue.

5.3.6.2 Commission analysis

Since the Commission began collecting data on hardship in quarter one of 2014 -15, the number of customers in the hardship program has decreased in both metro and regional areas. At the same time, the average amount of bill debt for customers on the hardship program has increased (See Figures 5.1 and 5.2).

⁹⁰ Department for Human Services, *Hardship Policy for Residential Customers*, February 2013, available at: [hardship-policy-for-customers-of-water-industry-entities.pdf\(dhs.sa.gov.au\)](http://hardship-policy-for-customers-of-water-industry-entities.pdf(dhs.sa.gov.au))

⁹¹ SA Water, *Hardship Policy for Residential Customers*, August 2018, available at: [hardshippolicy_0818.pdf\(sawater.com.au\)](http://hardshippolicy_0818.pdf(sawater.com.au))

Figure 5.1 – Financial hardship indicators – metropolitan Adelaide

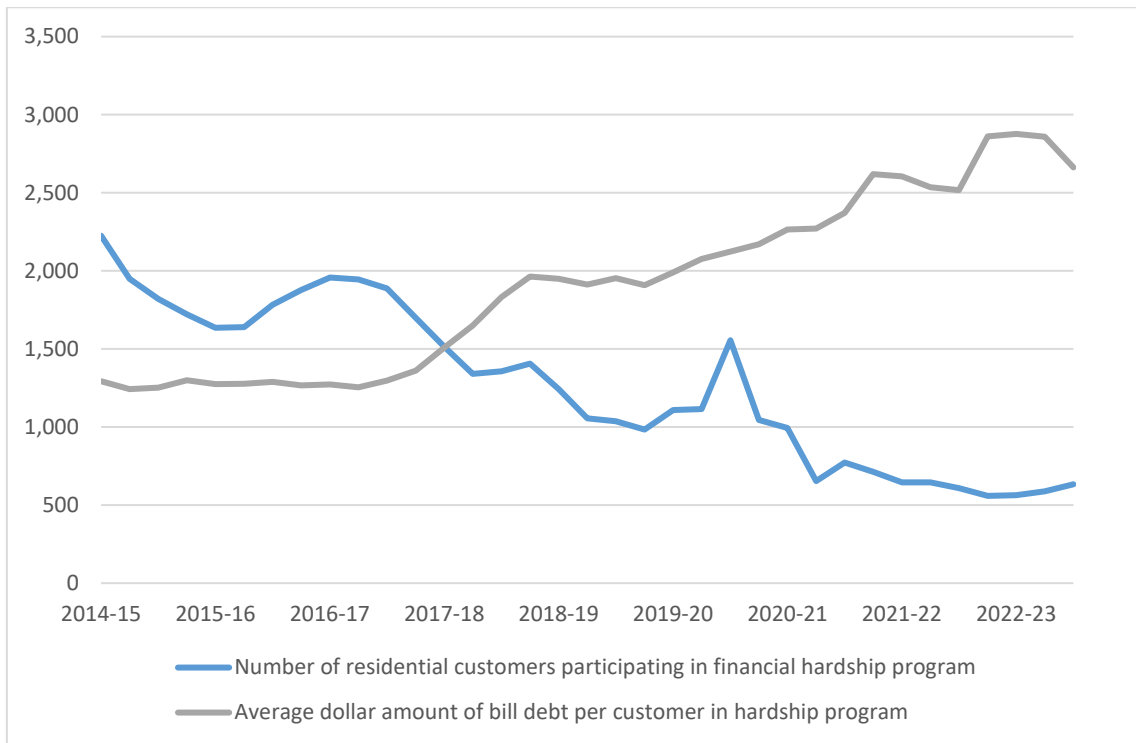
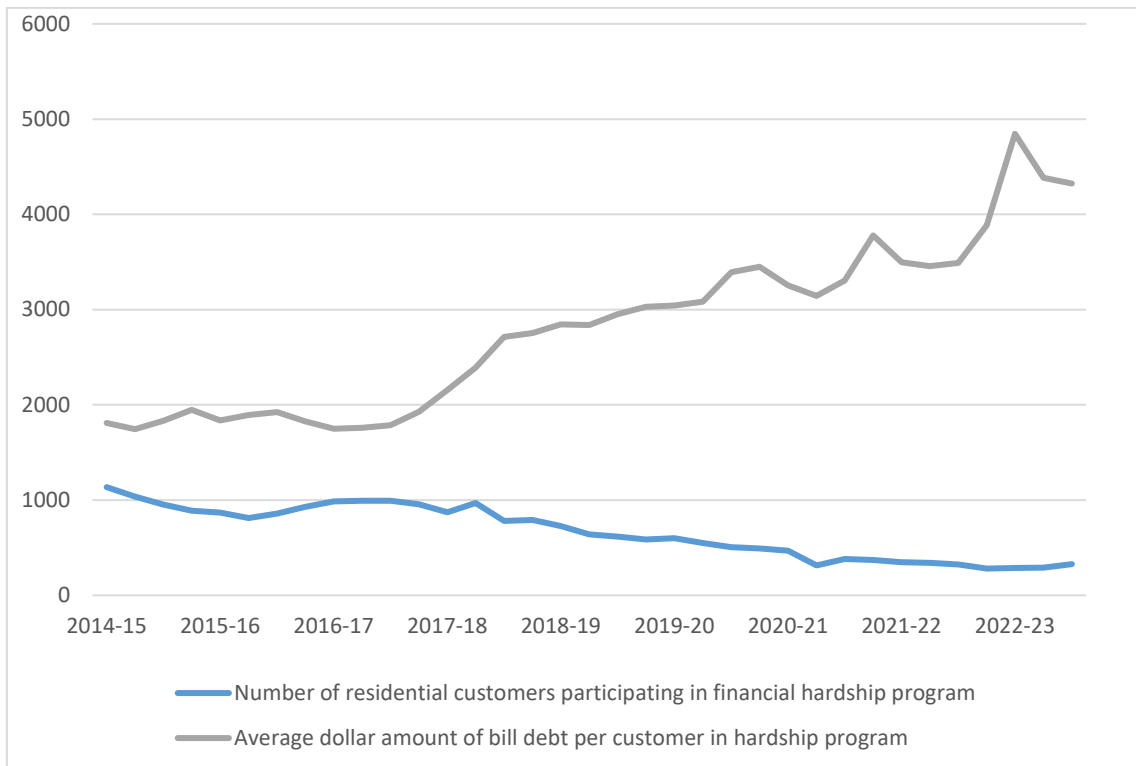


Figure 5.2 – Financial hardship indicators – regional South Australia



The Commission sought further information from SA Water to better understand the causes and drivers of increasing levels of average debt and decreasing participation in the hardship program. SA Water advised:

- ▶ In May 2020, SA Water paused the process of restricting customers' water supply due to non-payment of outstanding debt. This saw a reduction in customers making proactive contact to talk through payment options to enable re-connection. This has tended to result in the customers most in hardship being entered into SA Water's hardship program. It has also been a contributing factor to the reduction in the number of customers participating in the Customer Assist Program.
- ▶ SA Water ran a temporary Covid-19 assistance program in 2020-21, which attracted a number of customers with lower debt levels who might have otherwise entered the Customer Assist Program. These customers have not been included in reporting on average levels of bill debt for customers on the hardship program. Had they been included this would have lowered the average debt in the program.

To better understand SA Water's approach to early identification of customers that might be experiencing payment difficulties, the Commission sought information from SA Water about policies and processes in relation to missed bill payments.

SA Water advised that it follows a recovery cycle for missed bill payments with the aim of engaging with the customer through several channels including mail, email, SMS, phone calls and site visits. If contact is made, it seeks to understand the customer's situation and offer assistance with an appropriate solution specifically tailored to their circumstances.

SA Water also provides information about payment assistance information on all bills and on its website.

SA Water has developed a predictive model tool using billing, payment, and other aggregated demographic data to identify residential customers who may be at increased risk of financial hardship. This allows tailoring the messaging for people depending on the level of financial hardship they may be experiencing.

SA Water advised that it commenced a new campaign in October 2023 to communicate with customers about the support available should they need help paying their bills through updated information on bills and social media advertisements.

The Commission has reviewed the approaches of other jurisdictions in identifying customers who may be experiencing payment difficulties. For the water industry, economic regulators in Victoria, Western Australia and Tasmania require water entities to have policies and processes in place for early identification of customers experiencing payment difficulty or financial hardship.

For the energy industry, the Victorian economic regulator has introduced specific requirements on retailers to contact customers who have arrears of more than \$55 to provide information about the payment and hardship assistance⁹². A review of those requirements was completed in 2022 and it was found that introduction of the requirements has led to more customers receiving appropriate assistance and fewer disconnections for non-payment⁹³. The AER is reviewing implementation of the

⁹² Essential Services Commission of Victoria, Energy Retail Code of Practice, available at:

www.esc.vic.gov.au/electricity-and-gas/codes-guidelines-and-policies/energy-retail-code-practice

⁹³ Essential Services Commission of Victoria, Payment Difficulty Framework Implementation Review 2021, available at: www.esc.vic.gov.au/electricity-and-gas/inquiries-studies-and-reviews/payment-difficulty-framework-implementation-review-2021

requirements that have been introduced in Victoria to decide whether to introduce a payment difficulty framework in the National Energy Customer Framework⁹⁴.

Introducing new requirements around early identification of payment difficulty is likely to create some costs for SA Water in developing and implementing new procedures, including customer service costs associated with contacting customers that may be experiencing payment difficulties. These costs need to be weighed against the benefits, including the potential for improved debt recovery by SA Water. Affected customers are expected to benefit from being more aware of assistance available and improved ability to access payment arrangements that suit their individual circumstances.

5.3.6.3 Draft decision

The Commission is concerned that the current hardship arrangements do not appear to be preventing debt escalation. The Commission's view is that earlier intervention to establish manageable payment arrangements when a customer has a low level of debt is likely to provide better outcomes for both the customer and SA Water.

The Commission's draft decision is to require SA Water to establish policies and processes for early identification of residential customers who may be experiencing payment difficulties and a requirement for it to employ best endeavours to contact these customers to provide information about the available assistance.

5.3.7 Expanded use of SMS messages

SA Water's engagement demonstrated strong demand from customers for SA Water to communicate by SMS.⁹⁵ This is recognised by SA Water, which uses a digital preference management system to allow customers to opt-in to receiving a range of communications by SMS and email.

Where a customer has opted in, SA Water will use SMS to acknowledge requests (such as fault reports), to communicate about supply outages (including notification of outages and restoration both to customers and other consumers including tenants), for billing and payment reminders (including for overdue payments, payment plan instalments, and demand notices), to advise when communications sent by email have failed, and for some functions related to its digital customer interface MySAWater (including multi-factor identification and confirmation of change of details).

Current Code provisions enable use of SMS for direct written communications. Clause 4.1 compels SA Water to use the customer's reasonable preferred form of communication, if one has been nominated, to send a document, bill, or notice, to other forms of direct written communication.

5.3.7.1 Matters raised in consultation

SA Water's engagement demonstrated the strong demand for SA Water to communicate by SMS, particularly for time-critical matters such as supply outages and overdue bills.

SA Water's research found that customers are interested in setting bill reminders, being able to control contact preferences and want to be contacted by SMS for most communications from SA Water.⁹⁶ SA Water's service standard review customer research found that expanding use of SMS communications

⁹⁴ Australian Energy Regulatory, Towards Energy Equity – a strategy for an inclusive energy market, available at: www.aer.gov.au/industry/registers/resources/reviews/towards-energy-equity-strategy-inclusive-energy-market

⁹⁵ SA Water, *Customer research summary – SA Water RD24 Engagement – Phase 1*, 2023, p. 6, available at: [Appendix-4.2-RD24-Engagement-Phase-1-Report_Final.pdf \(sawater.com.au\)](http://Appendix-4.2-RD24-Engagement-Phase-1-Report_Final.pdf(sawater.com.au))

⁹⁶ SA Water, RBP, Appendix 4.2, p. 6

is an area of opportunity for improving the customer experience. It suggested proactive communications to acknowledge requests, select appointment times, and provide regular updates.⁹⁷

SA Water has not proposed changes to the Code to support expanded use of SMS messaging, or specific service standards for SMS messages. It has not put forward any specific operating expenditure for expanding use of SMS communications, although it does include proposed expenditure for migrating the CRM to a new platform.⁹⁸ Functions of the CRM include recording customer contact details and communication preferences and generating customer notifications.

5.3.7.2 Commission analysis

SA Water's research demonstrates that there is potential to expand use of SMS to improve customer satisfaction. There is the potential to use SMS as an alternative channel for receiving notices, and to use it to communicate more often and more effectively. For example, proactive use of SMS messages during a service interruption may negate the need for a customer to call the faults and emergencies phone line and build trust that SA Water is managing the issue. There is the potential to use SMS to improve communications with consumers that are not customers (including tenants).

One barrier to expanding use of SMS is that SA Water only has mobile phone numbers or email addresses for one-third of its residential customers. Mobile phone numbers are not included with the customer (property owner) information SA Water receives from the South Australian Integrated Land Information System. SA Water obtains mobile numbers by asking customers to provide them when they contact the call centre or when they register with MySAWater. There are privacy limitations around the potential to use public information like Sensis databases to obtain mobile numbers.

A further consideration in expanding use of SMS messages is cost. Use of SMS has the potential to reduce operating costs by avoiding the need to print and post hard copy communications and reduce the number of calls made to the contact centre. Use of SMS may also improve customer's understanding about their SA Water services and account, and so avoid the cost of future misunderstandings or disputes.

SA Water has advised that, while SMS can reduce operating costs, this is not always the case. For example, SMS unplanned outage notifications provide direct communication to customers which would not have been proactively communicated to customers previously. In this instance, customers would access this information through the SA Water website or the interactive voice response system in the call centre. Providing SMS notifications involves an additional incremental cost to what SA Water would normally incur in making changes to the website and interactive voice response system.

5.3.7.3 Draft decision

SA Water understands the importance and potential of SMS messaging and is working to expand its use. In recognition of the work currently being undertaken by SA Water to expand use of SMS communications, the Commission's draft decision is not to establish minimum requirements in relation to SMS communication through the Code. The Commission encourages SA Water to continue expanding uptake and usage within its operating expenditure determination.

The Commission has made a draft decision to make a minor change to the Code at clause 16.3.1 to recognise and support use of SMS messages when providing information about interruptions.

⁹⁷ McGregor Tan, SA Water Service Standards Review, January 2022.

⁹⁸ SA Water RBP, pp. 184-5

► **Information about interruptions not limited to 24-hour phone service – clause 16.3.1**

Currently, this clause requires SA Water to provide a 24-hour emergency telephone service for providing information about interruptions and for notification of faults and emergencies. The draft decision is to change this clause to ‘a communications system that includes but is not limited to a 24-hour emergency telephone system’. This recognises that SA Water already uses other methods of communication to provide information about interruptions including updates on its website and SMS notifications.

5.3.8 Protections for people experiencing family violence

Family violence⁹⁹ refers to any behaviour that is violent, threatening, controlling, or intended to make someone or their family feel scared and unsafe.¹⁰⁰ Family violence is prevalent in Australia with national statistics showing that one in six women experience physical or sexual violence by a current or former partner, while for men it is one in 16.¹⁰¹

Perpetrators of family violence may exploit essential services to control victim-survivors, affect their financial security, perpetuate psychological abuse, and potentially cause injury or death. Common examples of the ways perpetrators can use essential services to cause harm include:

- insisting an account is in a victim-survivor’s name and refusing to contribute to the cost, resulting in victim-survivors being forced to bear the financial cost of utilities to ensure ongoing access to services
- putting a service in the name of the victim-survivor without their knowledge or consent
- holding a joint account with the victim-survivor and refusing to contribute to the cost, and
- threatening the victim-survivor’s personal safety by accessing their personal information held by the essential services provider.¹⁰²

For SAWRD20, the Commission’s final decision was not to introduce new protections but instead encourage SA Water to adopt a family violence policy with similar features to those employed by regulated entities in other jurisdictions.

⁹⁹ The *Intervention Orders (Prevention of Abuse) Act 2009* defines abuse (domestic and non-domestic) as taking many forms including physical, sexual, emotional, psychological, or economic abuse. This includes physical injury, emotional or psychological harm, and unreasonable and non-consensual denial of financial, social, or personal autonomy.

¹⁰⁰ Domestic and family violence can occur in a range of relationships, including between current and former partners or spouses, parent/carer-child relationships, and relationships between siblings and extended family members. Services Australia, *What is family and domestic violence?*, available at: www.servicesaustralia.gov.au/what-family-and-domestic-violence?context=60033 and Safe and Equal, *Guidelines for Better Practice Responses to Family Violence for the Essential Services Commission and essential service providers*, 2022, available at: www.esc.vic.gov.au/sites/default/files/documents/Part%20B%20-%20Guidelines%20for%20Better%20Practice%20Responses%20to%20Victim%20Survivors%20of%20Family%20Violence.pdf

¹⁰¹ Mission Australia, *Domestic and Family Violence statistics*, available at: www.missionaustralia.com.au/domestic-and-family-violence-statistics and Australian Institute of Health and Welfare, *Family, domestic and sexual violence in Australia: continuing the national story*, 2019, available at: www.aihw.gov.au/getmedia/b0037b2d-a651-4abf-9f7b-00a85e3de528/aihw-fdv3-fdsv-in-australia-2019.pdf.aspx?inline=true

¹⁰² Victorian Government, *Royal Commission into Family Violence Summary and Recommendations*, 2016, p. 104, available at: www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKewirr5HagbD-AhW17zgGHQHYDcYQFnoECA8QAQ&url=http%3A%2F%2Frcfv.archive.royalcommission.vic.gov.au%2FReport-Recommendations.html&usq=AOvVaw3lipS07Jvt14oEfOx2nRAu

The Commission has reviewed its position on this matter as part of the draft decision for SAWRD24. The Commission published an Issues Paper in June 2023 seeking feedback on whether new protections should be implemented for those experiencing family violence and the potential costs and benefits.¹⁰³

In the paper, the Commission provided examples of protections implemented in other jurisdictions, including requiring essential services providers to:

- ▶ develop, implement, and regularly review a family violence policy for customers and staff
- ▶ provide training to customer service staff to help them detect and assist impacted customers
- ▶ adopt processes that avoid impacted customers from repeat disclosures of family violence or providing evidence
- ▶ securely handle customer information and prioritise the safety of impacted customers
- ▶ specify their approach to debt management and recovery, and
- ▶ provide information on external family violence services that can be accessed for support.

5.3.8.1 Matters raised in consultation

Five written submissions to the Issues Paper were received from EWOSA, SACOSS, SA Water, Zahra Foundation Australia (ZFA) and the South Australian Federation of Residents and Ratepayers Associations Incorporated (SAFRRA). The CAC, Uniting Communities Financial Wellbeing Services (FWS), and the Office for Women SA (OFW) provided verbal feedback.

Consultation indicated strong stakeholder support for introducing new family violence protections, with stakeholders considering that the benefits outweigh the potential costs. In its submission, EWOSA noted that the benefits to affected customers would be substantial and potentially lifesaving.

Staff training

Stakeholders supported ongoing training for SA Water staff. Stakeholders noted that customer outcomes are currently inconsistent. Uniting Communities FWS in consultation recommended that having caseworkers trained and experienced in supporting victim-survivors of family violence would improve consistency, reduce trauma and provide affected customers with better support. It noted that if a retailer presents to a customer in an assertive manner, it could trigger the customer and cause them more anxiety.

The OFW noted the risk of further victimising and causing harm to the customer if staff do not receive specialist domestic and family violence training. Untrained staff may also experience vicarious trauma, which refers to the impact caused by engaging with survivors of traumatic incidents. The OFW encouraged the uptake of already established family violence training, such as the Women's Safety Services SA disclosure training, which helps people navigate conversations where an employee notices family violence, but the customer does not disclose it.¹⁰⁴

¹⁰³ Essential Services Commission of SA, *Water retail code and monitoring and evaluating performance framework Issues Paper*, 2023, available at: www.escosa.sa.gov.au/ArticleDocuments/21957/20230616-Water-SAWRD24-RetailCodeandPerformanceFrameworkReview-IssuesPaper.pdf.aspx?Embed=Y

¹⁰⁴ Training provided by Women's Safety Services SA includes training on conversations on family violence, responding to disclosures in the workplace, risk assessment and safety management, work-related stress and vicarious trauma, understanding coercive control, and strangulation awareness and response training. Available at: womenssafety.com.au/index.php/training-2

Referrals

ZFA supported family violence referrals being provided to impacted customers. It noted that customers are often unaware of the support available to them, and SA Water staff may detect impacted customers before the customer has recognised it themselves. Hence, early identification and the provision of relevant, timely information about referral services can help customers seek support.

The OFW supported SA Water publishing contact numbers of the national and state family violence helplines, men's referral service, and information about the escaping violence payment.

Debt management

Stakeholders supported SA Water identifying options to manage and recover debt and acknowledged that debt management processes should not create a barrier to support for victim-survivors.

ZFA and the OFW noted that some women do not leave violent relationships and households due to the fear of being unable to cope financially. ZFA highlighted the significant benefits its clients have experienced from receiving assistance from essential services providers to manage or waive debt. These benefits include reduced distress and financial hardship and restored financial control and well-being.

The OFW noted that debt management options should give victim-survivors the best opportunity to recover, heal and thrive. Given that victim-survivors face significant financial burdens to re-establish themselves, secure housing, and care for children after escaping a violent home, a utility's debt management response should not further financially disadvantage them.

Confidentiality

Uniting Communities FWS flagged confidentiality as a key issue and noted that its clients fear perpetrators being sent letters and correspondence by mistake, data being leaked, or retailers knowing about their experience.

The OFW noted SA Water should consider that some victim-survivors may not feel comfortable or safe sharing their details over the phone. It noted that SA Water should be prepared to communicate with customers in situations where their phone calls and emails could be monitored. It noted that in cases where the victim-survivor is in the family home and the perpetrator has left, it can be challenging to have the perpetrator's name removed from the account. If the victim-survivor has left the family home, it can be difficult to get their name removed from the account and prohibit the perpetrator's access to their details. The OFW supported processes that allow joint account holders to easily request amending or removing their details.

Other matters

Stakeholders including ZFA, OFW, and Uniting Communities FWS recommended the Code recognise family violence as an explicit eligibility criterion for hardship support. Stakeholders supported SA Water establishing a specific phone number and email for customers experiencing family violence to access support. The OFW noted timeliness of response as a critical consideration, noting that some victim-survivors may call the utility when the perpetrator has left the home for short periods of time, such as running errands or attending work. In this case, they wouldn't be able to wait for extended periods on the phone to speak to the utility. The OFW recommended that SA Water's website should publish information on financial abuse, signs of abuse and where people can access help, dispute resolution options, and concessions.

Regulators in other jurisdictions noted concerns about some electricity retailers falsely advising customers to use their domestic and family violence government grants or payments to pay their debt. SACOSS recommended the Commission introduce appropriate monitoring and reporting requirements to ensure compliance.

5.3.8.2 Commission analysis

Currently, SA Water offers payment arrangements and entry into the Customer Assist Program, if needed, upon disclosing family violence. This provides a referral to Financial Counselling services along with protection from further debt collection activities.

To protect privacy, a customer can apply for name suppression, which suppresses their details from the results of a name search carried out on Land Titles Office (LTO) land information systems and any 'downstream' systems which contain data from the Land Ownership and Tenure System (LOTS).

In consultation with Commission staff, SA Water advised that, once a request is granted, SA Water can see a name suppression flag on the account and will apply a four-point identification requirement. The Commission notes that screening questions to confirm identification should be carefully designed to ensure that persons close to the victim-survivor cannot bypass the screening. For example, a domestic partner may know basic personal information such as date of birth, email address and mother's maiden name.

SA Water advised that if the person is unable to confirm their identity, they can provide their name suppression ID as verification. SA Water may confirm the ID with the LTO before engaging with the person.

SA Water noted that it does not collect or maintain data on the number of customers experiencing family violence and that its hardship customer data are broad. If the account holder consents, it can make general notes on the account to notify customer service staff, which could minimise repeat disclosures.

SA Water also advised that a joint account holder can update their personal details on the account without the other person knowing. However, bills and notices are sent to the advised nominated address and not to two separate addresses.

SA Water noted in its submission that it has a family violence leave policy for staff, and it undertook staff training in 2019 and 2020 to support this. It noted that its role as a founding partner of the Thriving Communities Partnership (a nationwide cross-sector collaboration) provides access to extensive documentation and expert knowledge on family violence.

Feedback received from Uniting Communities FWS and ZFA highlight the need for consistent outcomes for customers experiencing family violence. Uniting Communities FWS in discussions noted that SA Water is usually respectful of its assessments in relation to the customer's experience of family violence.

ZFA provided a case study about a client, who was fleeing family violence and returned to a debt with SA Water. A ZFA financial counsellor emailed SA Water but did not receive a response. The impacted customer continued receiving phone calls from SA Water requesting payment. ZFA noted that, '*she explained her situation to SA Water and whilst they were supportive, '...they did not truly listen' and continued to demand payment.*'¹⁰⁵ The counsellor was eventually able to set up a payment plan to repay the debt.

¹⁰⁵ Zahra Foundation Australia submission to the Issues Paper, August 2023, p. 2, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-ZAHRA.pdf.aspx?Embed=Y

Experiences in other jurisdictions

Economic regulators in other jurisdictions have advised the Commission that family violence provisions are working effectively to assist impacted customers access essential services.

A recent review¹⁰⁶ into the implementation of the Water Industry Standards family violence provisions by the Essential Services Commission of Victoria (ESCV) found that, overall, customers have benefitted from family violence protections. Stakeholders shared a number of examples of good customer experiences, and reflections on positive and supportive responses from water business staff.¹⁰⁷ The review found that family violence provisions remain appropriate and set a consistent minimum standard of protection for all customers and encourage businesses to develop their own flexible responses to meet individual customer needs.

Feedback from retailers on protections proposed in other jurisdictions noted practical issues in relation to protecting customer information and ensuring regional and remote customers could safely access family violence protections. Some utilities noted potential challenges with ensuring customers could access a single point of entry considering employee planned/unplanned leave and about navigating software changes.

Potential costs and considerations

The Commission considers the costs of SA Water implementing family violence provisions may include:

- ▶ ongoing training costs
- ▶ costs of improving systems and processes to improve account security
- ▶ costs of administering hardship support
- ▶ costs associated with sending separate or additional copies of bills to joint account holders, and
- ▶ costs of managing and recovering debt.

SA Water advised of potential challenges in managing debt for joint accounts and legal considerations.

Economic regulators in other jurisdictions have advised that cost was not raised as a concern or barrier to implementation for the entities they regulate. They considered the range of costs for utilities not acting, including potential dispute resolution costs. It was noted that the cost of implementing family violence provisions for retailers is minor compared to the cost of complying with other regulatory obligations.

To support with early implementation, economic regulators promoted low-cost family violence training providers and hosted forums to help businesses engage with service providers to better understand family violence impacts.

¹⁰⁶ The review examined the effectiveness of the family violence provisions five years after they took effect on 1 July 2017. See Essential Services Commission Victoria, *Water Industry Standards Family Violence Provisions Review, 2023*, available at: www.esc.vic.gov.au/sites/default/files/documents/Water%20Industry%20Standards%20Family%20Violence%20Review%20Findings%20Report%2020%20July%202023.pdf

¹⁰⁷ Water Industry Standards, p. 8.

Monitoring, evaluation, and compliance

Economic regulators in other jurisdictions have adopted a flexible approach to enforcing compliance during early implementation. This included providing a lead-in time of six to 12 months, taking stricter compliance action following that period. During the lead time, economic regulators consulted with retailers to resolve any operational or practical difficulties.

Economic regulators did not create mandatory reporting metrics or indicators at the time of implementation. Breaches were highlighted through the economic regulators' enquiries line, reports from the industry Ombudsman, the media and high-level audits of family violence Code requirements. More recently, economic regulators have been developing reporting requirements to strengthen entities' obligations to self-report non-compliance.

Most notably, the AER is seeking feedback on proposed new reporting metrics, such as the total number of customers who identify as affected by family violence, total number of customers identified as being affected by family violence during the reporting period and the total number of customers identified as no longer affected by family violence during the reporting period.¹⁰⁸

5.3.8.3 Draft decision

The Commission considers that essential service providers have a responsibility to assist consumers to access services. Family violence protections are aligned with that responsibility and are backed by community expectations.

The Commission's draft decision is to introduce new clauses in the Code that create conduct and policy requirements for SA Water in relation to:

- ▶ having and implementing a family violence policy for customers, with provisions for periodic review
- ▶ ensuring training is provided to relevant staff to help them detect and assist impacted customers
- ▶ adopting processes that avoid impacted customers from repeat disclosures of family violence or providing evidence
- ▶ ensuring confidential information of the impacted customer is securely handled and account security processes prioritise the safety of impacted customers
- ▶ specifying its approach to debt management and recovery, and
- ▶ providing information on external family violence services that can be accessed for support.

To provide sufficient time for SA Water to establish systems and processes for implementation, the Commission proposes a family violence policy that covers each of the matters outlined above must be in place by 30 June 2025. SA Water should consult widely in the preparation of the policy.

Implementation support

To support SA Water's early implementation of the new Code requirements, the Commission will offer to coordinate an information session for relevant SA Water staff. The session will include presentations from victim-survivor advocates, regulators and utilities from other jurisdictions to share learnings and best practice approaches. The Commission will also identify and share information on resources that SA Water could utilise.

¹⁰⁸ Australian Energy Regulator, *Retail performance reporting procedures and guidelines, 2023*, available at: www.aer.gov.au/retail-markets/guidelines-reviews/retail-performance-reporting-procedures-and-guidelines-2023-update

The Commission will also offer an information session to inform relevant stakeholders (financial counselling organisations, family violence service providers, and EWOSA) about the application of new family violence protections and work with them to stay informed about customers' concerns and issues.

Monitoring, evaluation, and compliance

From 1 July 2025, family violence obligations will be treated as a Type 1 regulatory obligation in the Water Industry Guideline No 1 Compliance Systems and Reporting – Major Retailers (**Guideline 1**). Type 1 obligations are identified as being of such importance that a breach of one gives rise to an immediate requirement to provide to the Commission a Material Breach Compliance Report in accordance with clause 3.2 of Guideline 1.

The Commission intends to undertake a compliance review after the first 12 months of implementation, to assess whether SA Water has established processes and a policy to assist impacted customers. The Commission will also work with stakeholders such as financial counselling organisations and EWOSA to understand any concerns or complaints.

The Commission has decided not to establish reporting indicators in the Code or the Water Industry Guideline No. 2 Regulatory Information Requirements – Major Retailers (**Guideline 2**) at this time. Given the sensitive nature of family violence, the Commission has decided to improve its understanding of the safest and most useful approach to collecting data on family violence before introducing mandatory reporting indicators. The Commission will work closely with stakeholders, SA Water and other regulators during SAWRD24 to understand and determine the best approach to collecting and using family violence data.

5.3.9 Service standards after takeover of operations

In some instances, an essential service provider is no longer willing or able to provide services to its customers. In these cases, SA Water may be directed to take over operations (or a specified part of the water industry entity's operations) of another water retailer.

SA Water may be directed to take over operations by the Minister under clause 6 of the *Public Corporations Act 1993*, or SA Water can be appointed as an operator following a proclamation by the Governor in accordance with clauses 38 and 39 of the WI Act.

For example, in 2020 SA Water was directed to take over provision of sewerage services to properties serviced by the Tea Tree Gully (TTG) Community Wastewater Management System (CWMS) (previously operated by the City of Tea Tree Gully) on an ongoing basis.¹⁰⁹

By way of further example, in 2023, SA Water was directed to use its best endeavours to obtain the agreement of Cape Jaffa Anchorage Essential Services to continue its temporary take over of the operation of non-drinking water and sewerage services at Cape Jaffa, to ensure continued operation to customers until 30 June 2024.¹¹⁰ This direction followed Cape Jaffa Anchorage Essential Services surrendering its water retail licence on 31 October 2022.¹¹¹

¹⁰⁹ Government Gazette, No. 50 - Thursday, 11 June 2020, p. 3381, available at: www.governmentgazette.sa.gov.au/2020/June/2020_050.pdf

¹¹⁰ Government Gazette, No. 69 - Thursday, 7 September 2023, p. 3226, available at: governmentgazette.sa.gov.au/2023/September/2023_069.pdf

¹¹¹ Essential Services Commission of South Australia, 2022, Cape Jaffa Anchorage Essential Services Pty Ltd – surrender of licence/issuing of temporary exemption, available at: ESCOSA - Cape Jaffa Anchorage Essential Services Pty Ltd – surrender of licence / issuing of temporary exemption

Operations which are taken over are typically minor or intermediate retailers. These retailers have standards of service which are different to SA Water. The Water Retail Code – Minor and Intermediate Retailers,¹¹² and individual licence conditions have general obligations about maintaining service. Some operators are required to include specific service metrics in their annual performance reporting. This contrasts with the obligations that apply to SA Water, which include both general obligations about maintaining service and quantitative performance targets for specific areas of service which it is obliged to use its best endeavours to achieve.

Requiring different standards of service for minor and intermediate retailers is appropriate because service levels are affected by the location and scale of operations, the age and condition of infrastructure, and operational practices.

5.3.9.1 Matters raised in consultation

As part of its review of the WI Act, DEW is consulting on the power to take over operations made by provisions in clauses 38 and 39. The Department has asked the Commission to consider if SA Water's service standards should apply to operations which SA Water has been directed to take over.

5.3.9.2 Commission analysis

SA Water's service standards apply either to its whole customer group, to all regional customers, or all metropolitan customers. Under the current framework, operations which SA Water has taken over would not be expected to meet the service standard performance targets in isolation. Instead, the performance of those operations would be incorporated into SA Water's overall performance.

There are two reasons why it may not be necessary to exclude operations which SA Water has taken over in assessing SA Water's performance. Firstly, if the operation which SA Water has taken over has a relatively small group of customers, the service those customers receive is unlikely to affect SA Water's overall performance. Secondly, in the event that the service those customers receive did affect SA Water's overall performance and it missed a performance target, the service standard may still be satisfied so long as SA Water can explain how it applied its best endeavours.

However, there are several reasons why a different approach may be warranted. Firstly, it may be important to understand the service delivered to customers of operations SA Water has taken over. If the previous entity experienced asset management, technical or financial issues prior to takeover, there may be service issues which need to be understood and addressed. Secondly, the costs and benefits for SA Water to improve service levels for a small group of customers require careful consideration. If considered worthwhile, a transition period may be needed while SA Water makes necessary changes.

5.3.9.3 Draft decision

The Commission's draft decision is to establish a new provision in the Code at clause 17.2 which sets out SA Water's service standard obligations where it has been directed to take over the operations of another water industry entity.

► Service standards after temporary takeover of operations – clause 17.2.1

This clause sets out SA Water's service obligations when it temporarily takes over the operations of another water industry entity.

¹¹² Essential Services Commission of South Australia, 2015, Water Retail Code – Minor and Intermediate Retailers, available at: [20150311-Water-WaterRetailCode-MIR-02.pdf.aspx \(escosa.sa.gov.au\)](https://www.escosa.sa.gov.au/20150311-Water-WaterRetailCode-MIR-02.pdf.aspx)

The Commission's draft decision is that when SA Water has been directed to temporarily take over operations of another water industry entity, it must use its best endeavours to maintain historical performance in relation to customer service, connections, response and restoration (the four areas service standards relate to) for those operations. SA Water must report annually on its performance using available metrics but is not required to establish new measurement or reporting practices. SA Water will not be required to include customers of these operations in determining its performance against the service standard targets set out in Schedule 1 of the Code.

► **Service standards after ongoing takeover of operations – clause 17.2.2**

This clause sets out SA Water's service obligations when it takes over the operations of another water industry entity on an ongoing basis. Note that the Commission's decision for customers of the TTG CWMS is set out separately below.

The Commission's draft decision is that when SA Water has been directed to take over operations of another water industry entity on an ongoing basis it must, for the remainder of that regulatory period, use its best endeavours to maintain historical performance in relation to customer service, connections, response and restoration for those operations. It must also start measuring the performance of those operations using the service standard metrics set out in Schedule 1 of the Code, and report annually on that performance.

In the regulatory period that SA Water takes over operations, it will not be required to include customers of these operations in determining its performance against the service standard targets set out in Schedule 1 of the Code.

In subsequent regulatory periods, SA Water must comply with the Commission's decision (included in its regulatory determination) on performance in relation to the service standards in Schedule 1 of the Code. The Commission's decision will address whether customers of those operations must be included in determining its performance against the service standard targets, or whether a transition period or alternative service standard targets will apply.

The Commission will consider service standards for TTG CWMS customers as part of SAWRD24 (as discussed in the following section).

From SAWRD28, the Commission expects SA Water's RBP to include information about any operations it has been directed to take over, the service standards it proposes to apply and the costs and benefits associated with complying with the proposed service standards (and other options explored).

5.3.9.4 Service standards for Tea Tree Gully CWMS customers

In 2020, SA Water was directed to take over sewerage services for properties serviced by the TTG CWMS on an ongoing basis.¹¹³ The transfer of assets occurred on 1 July 2022, with SA Water taking full responsibility for operating the CWMS network from October 2023.

Since 2021, SA Water has been progressively upgrading sewerage services by moving customers from the CWMS to the SA Water sewerage network.

Upgrades involve installation of new sewer infrastructure and decommissioning of existing CWMS infrastructure, with some works occurring on customer's private property. SA Water is prioritising upgrades using criteria including proximity to the existing network, performance of existing infrastructure, other planned development works and community engagement.

¹¹³ Government Gazette, No. 50 - Thursday, 11 June 2020, p. 3381, available at: www.governmentgazette.sa.gov.au/2020/June/2020_050.pdf

By June 2023, SA Water had completed upgrades for 281 customers. The number of CWMS customers had fallen from 4,728 at the end of 2020-21 to 4,447 at the end of 2022-23.^{114,115} SA Water plans to move all CWMS customers to the SA Water sewerage network by the early part of SAWRD28.

Since the transfer of assets was completed in October 2022, SA Water has been responsible for providing sewerage services to TTG CWMS customers. The Commission's expectation has been that SA Water maintain services and use its best endeavours to minimise interruptions and respond when issues arise.

However, the Commission has not required customers connected to the TTG CWMS to be included in assessing SA Water's overall performance against its service standards. Instead, the Commission has required SA Water to report on the TTG CWMS as part of its annual performance reporting, in a manner aligned with that required for other small-scale water providers regulated by the Commission. This reporting includes information on customer numbers, customer complaints, sewer network reliability and sewer overflows.

5.3.9.5 Draft decision

► Vary the Code definition of the *Adelaide metropolitan area* to exclude customers connected to the TTG CWMS

The Commission's draft decision for SAWRD24 is that customers connected to the TTG CWMS will not be included in assessing SA Water's overall performance against its service standards. This is achieved by varying the definition of the Adelaide metropolitan area in the Code to exclude customers connected to the TTG CWMS. However, once transferred to the SA Water sewerage network, former TTG CWMS customers must be included in assessing SA Water's overall performance against service standards.

For the avoidance of doubt all other Code requirements continue to apply to customers connected to the CWMS and therefore, pursuant to clause 16.1 of the Code, it is expected that SA Water will:

- use its best endeavours to minimise interruptions or limitations to supply and to restore supply as soon as practicable following an interruption or limitation to supply.
- have in place and adhere to policies, practices or procedures dealing with minimising the impact of:
 - unplanned interruptions to retail services, including the prompt attendance and actions required to restore the retail services as soon as practicable; and
 - planned interruptions to retail services caused by carrying out maintenance or repair to the network or connecting a supply address to the network.

► Separate reporting requirements for customers connected to the TTG CWMS

The Commission's draft decision is that SA Water is not expected to report on service standard performance metrics for CWMS as specified in the general requirements of Guideline No. 2.¹¹⁶ Instead, SA Water must report on the performance of the TTG CWMS using the specific proforma in Guideline No. 2.

¹¹⁴ SA Water Annual Reporting, Tea Tree Gully CWMS Annual Return 2022-23

¹¹⁵ Tea Tree Gully, 2021-22 Annual Compliance Reporting to the Commission, Proforma AR2

¹¹⁶ The Commission's Water Industry Guideline No. 2 - Regulatory Information Requirements for Major Retailers specifies SA Water's reporting requirements and the manner and form of that reporting.

5.3.10 Protections for people living with disability

People living with disability may have specific requirements related to accessing and using SA Water's services.

In SAWRD20, changes were made to the Code to better support the needs of people living with disability. These included requiring SA Water to use each customer's preferred form of communication, where reasonable, for direct written communications (at clause 4.1). They also included requiring bills, notices and other documents to be provided in alternative formats for customers with specific needs, including needs related to disability (at clause 4.2).

At that time, the Commission considered, but did not implement, requirements for SA Water to provide a longer minimum notice period ahead of planned water interruptions and to establish a critical needs register.¹¹⁷

In deciding against such changes, the Commission noted that SA Water planned to expand the functionality of its CRM to register the critical needs of people living with disability during SAWRD20 and saw registering these critical needs as the first step in providing extra support.

5.3.10.1 Matters raised in consultation

The Commission's Issues Paper on the Review of the Water Retail Code and MEPF explained that, as part of the SAWRD24 regulatory determination, the Commission would review SA Water's progress on registering critical needs in its CRM, and progress on its Wider World Initiative more broadly.¹¹⁸ SA Water's Wider World Initiative is its program for improving accessibility of its services for all customers including those with access and interaction barriers; it informed SA Water's Disability and Access Inclusion Plan.¹¹⁹

SA Water has further considered the needs of customers living with disability.¹²⁰ It has engaged with the Wider World Advisory Group, which includes people living with a range of disabilities, and has conducted specific research with customers about accessible services.¹²¹

During the SAWRD24 period, SA Water plans to continue with parts of its Wider World Initiative that can be delivered within current operating expenditure. SA Water has assured the Commission that this will involve continuing to: ensure new contact centre employees have disability awareness training; develop additional Easy Read documents; improve website accessibility; engage through the Wider World advisory group; trial accessible water meters; create accessibility guides for public spaces including reservoirs; and ensure capital delivery contractors are mindful of accessibility needs and communicate with impacted community members.

SA Water has consulted on expanding the Wider World Initiative. It presented a case to the Customer Challenge Group (CCG) in January 2022 which sought feedback on additional expenditure to deliver alternative bill formats, further improve digital channel accessibility, improve work site set up processes and equipment, improve accessibility to SA Water's public spaces, and improve access to SA Water staff.

¹¹⁷ SA Water RD20, pp. 63-64

¹¹⁸ Essential Services Commission of South Australian, *SAWRD24 – Water Retail Code and Monitoring and Evaluating Performance Framework - Issues Paper*, 2023, p. 8, available at: www.escosa.sa.gov.au/ArticleDocuments/21957/20230616-Water-SAWRD24-RetailCodeandPerformanceFrameworkReview-IssuesPaper.pdf.aspx?Embed=Y

¹¹⁹ SA Water, *SA Water Disability Access and Inclusion Plan 2020 - 2022, 2019*, available at: https://www.sawater.com.au/_data/assets/pdf_file/0006/519288/DAIP-2020-22_pages.pdf

¹²⁰ SA Water, RBP, p. 32

¹²¹ SA Water, RBP, pp. 89 and 99

In consulting on expansion of the Wider World Initiative, SA Water also sought feedback on additional expenditure to deliver priority services to identified customers. It shared a list of examples of priority services which included:

- ▶ additional updates and support during supply interruptions and additional notice of planned interruptions
- ▶ verification of SA Water staff attending customer properties and access to approved plumbers
- ▶ affordable smart meters to track water usage and detect leaks, and assistance finding water saving devices and appliances
- ▶ additional bill reminders when a bill is overdue, easy access to flexible payment options, and a bill allowance for those using large amounts of water due to a medical condition
- ▶ addition of secondary account contacts, and
- ▶ provision of information on worksites to help with journey planning.¹²²

The CCG and PBEF supported expansion of the Wider World Initiative but recognised that it would be costly to deliver. The cost of the expansion presented to the CCG and PBEF was \$20 million across SAWRD24.¹²³ The CCG and PBEF suggested that parts of the initiative may be incorporated in business-as-usual operations, and provided for within the existing revenue cap. It was also suggested that SA Water may usefully collaborate with other utilities or the National Disability Insurance Scheme to leverage off existing work on other priority services registers.¹²⁴

Ultimately, the cost impact and competing priorities lead to expansion of the Wider World Initiative being listed as an initiative not to be progressed during SAWRD24.¹²⁵

Other submissions to the Issues Paper and RBP do not address accessibility of services by people living with disability, or specific initiatives for people living with disability.

5.3.10.2 Commission analysis

SA Water understands the importance of considering the needs of people living with disability and has made progress in improving the accessibility of its services. It has provided the Commission with a status report for actions related to the Wider World Initiative.¹²⁶

In SAWRD20, progress on SA Water's Wider World Initiative has included developing seven easy read documents,¹²⁷ providing in-person front counter support (including with language aide boards), and additional telephone support to provide bill information.¹²⁸ Contact centre teams have received training on disability awareness, which is part of induction for new employees.

¹²² SA Water, Presentation to Customer Challenge Group, January 2022. See also SA Water, RBP, p. 240.

¹²³ SA Water, RBP, pp. 240 - 241

¹²⁴ SA Water, RBP, pp. 240 - 241

¹²⁵ SA Water, RBP, p. 240

¹²⁶ SA Water's 2020-22 Disability and Access Inclusion Plan was extended to December 2023. In 2024, SA Water plans to publish a close-out report for the current Disability and Access Inclusion Plan, as well as a revised Disability and Access Inclusion Plan.

¹²⁷ SA Water, *Accessibility statement*, 2023, available at: www.sawater.com.au/about-us/how-we-operate/policies/accessibility-statement

¹²⁸ SA Water, *Submission to Issues Paper*, p. 4, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-SAWater.pdf.aspx?Embed=Y

It has also increased the involvement of people living with disability in customer research and engagement activities, delivered training guides for considering people living with disability when planning works in public spaces, and trialled different types of water meters.

SA Water has engaged widely with customers and has included those living with disability in its engagement and prioritisation of initiatives for SAWRD24.

Expansion of the Wider World Initiative would benefit people living with disability. In particular, and as identified in the Commission's SAWRD20 regulatory determination, people living with disability would benefit from the delivery of some targeted, priority services. Registering the critical needs of people living with disability is a necessary pre-requisite to delivering priority services.

By mid-2024, SA Water will develop:

- ▶ an online form for customers to register for additional assistance
- ▶ a screen in the CRM where that information is visible and can be edited and a banner on relevant customer records to alert employees to check the customer's needs, and
- ▶ the function in the CRM to deliver particular services in response to registered needs (for example, printing bills in an alternative format).

However, SA Water has advised that it will not implement the online form or amendments to the CRM until it can deliver services to meet the needs registered by customers.¹²⁹ SA Water plans to identify, design and pilot opportunities to provide accessible and alternative services to registered customers during SAWRD24 but has not proposed new expenditure for delivering priority services.

5.3.10.3 Draft decision

The Commission notes SA Water's proposal not to increase expenditure on the Wider World Initiative in SAWRD24 is based on engagement with customers about how to prioritise expenditure.

However, the Commission expects SA Water to continue with Wider World Initiative actions within its existing operating expenditure. In particular, the Commission encourages SA Water to identify lower-cost priority services that can be progressed within the revenue cap, such as using a particular mode of communication that is required by a customer, and roll-out of changes to its CRM to allow those services to be delivered to relevant customers.

The Commission encourages SA Water to continue its work to understand and meet the needs of people living with disability, noting that this is likely to improve the experience of all customers. The Commission intends to review what SA Water has done to meet the needs of people living with disability in the lead up to SAWRD28 to inform its regulatory settings for that period.

5.3.11 Other issues

Information on protections

In a workshop on the Water Retail Code with the CAC, members noted that it was difficult to find information about the protections available to customers and consumers on SA Water's website. They considered that people might not be aware of what SA Water is required to do under the Code. It was suggested that SA Water better communicate its protections and rights to customers and explain how customers can exercise those protections and rights.

¹²⁹ SA Water, Submission to Issues Paper, p. 4, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-SAWater.pdf.aspx?Embed=Y and additional information provided by SA Water.

The Commission has reviewed the public information available on protections and notes that there is a range of information published on the Commission's website¹³⁰, including information about customer contracts, pricing, restrictions, disconnections and restriction of supply, rating on abuttal, requirements on SA Water for certain policies and procedures, and customer information obligations.

The Commission notes that SA Water's website also includes a range of information on protections including information on help with paying a bill (hardship provisions), a copy of hardship policy and a copy of its complaints resolution policy.

The Commission encourages SA Water to continue to look at ways to improve its communication on the protections that it offers. The Commission will do the same.

Discounts to water charges for greening

SAFRRA's submission to the Issues Paper¹³¹ made a suggestion that ratepayers be provided with an allowance or discount to their water prices to enable them to water their gardens and green space around their home.

The Commission notes that adopting this proposal would have an impact on the bills of other customers, who would need to cross-subsidise the cost of the scheme. The scheme might also disproportionately benefit customers with larger properties, who on average might have greater ability to pay for water.

The Commission considers that this proposal is better considered by the State or local government in relation to incentives for supporting greening in the community.

The Commission's role in responding to complaints

SA Water's submission to the Issues Paper stated its view that the process and expectations for making complaints to the Commission are not clear.¹³² SA Water requested that the Commission more clearly articulate its process for managing complaints and its requirements as part of its regulatory determination.

The Commission notes that it already provides clear information on its role in relation to responding to complaints on its website.¹³³

The Commission does not resolve general disputes between SA Water and its customers. SA Water is required to have complaint and dispute resolution procedures in place. This must include the ability for a customers' complaint to be escalated within the business and ultimately include referral to the EWOSA for independent dispute resolution.

The ESC Act states one of the Commission's functions is *'to monitor and enforce compliance with and promote improvement in standards and conditions of service and supply under relevant industry regulation Acts.'* In performing that function the Commission will investigate and seek information on complaints that may be systemic or where the complaint raises concern about SA Water's performance against

¹³⁰ Essential Services Commission of South Australia, 2023, available at:

www.escosa.sa.gov.au/consumers/water/consumer-water-information

¹³¹ SAFRRA submission to the Issues Paper, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

¹³² SA Water submission to the Issues Paper, available at: www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

¹³³ Essential Services Commission of South Australia website, 2023, available at: www.escosa.sa.gov.au/engage/feedback-and-dispute-resolution .

regulatory obligations. The Commission is guided by its Enforcement Policy¹³⁴, when investigating potential compliance issues.

Investigation of SA Water's payment plan obligations

SACOSS's submission to the Issues Paper asked the Commission to consider investigating SA Water's compliance with payment plan obligations under the Code and MEPF.

The Commission uses a risk-based approach to determine areas of regulatory concern that require further investigation and potential compliance action.

The Commission has not been made aware of any potential breaches by SA Water in relation to its payment plan obligations, either by stakeholders or customers. The Commission has reviewed complainant case information from EWOSA and has not identified any concerns that have been raised with the Ombudsman.

The Commission will continue to assess any allegations of non-compliance when raised and will take action consistent with its Enforcement Policy.

Record keeping

To ensure SA Water can demonstrate its current and historical compliance with the requirements of the Code, the Code now requires SA Water to create and maintain evidential records for a period of five years. These records, and associated information storage procedures, must be made available to the Commission on request.

This new requirement does not add material regulatory burden, as compliance with the Code is already a requirement of SA Water's licence. The new clauses simply articulates the evidence requirements.

Addressing errors, omissions, and data variations in information submitted to the Commission

The guidance that addresses the process SA Water must follow when reporting errors, omissions, and data variations has been moved from Guideline 2 to the Code. This guidance applies to any information SA Water submits to the Commission under the Code and any Guidelines issued by the Commission.

5.3.12 Minor amendments

The Commission has made several other minor amendments to the Code, which are described in Table 5.2. Unless otherwise noted, no issues were raised in consultation regarding these minor amendments.

Minor amendments include:

- ▶ The definition of consumer has been amended to have the same meaning as it has in the WI Act.
- ▶ A definition of financial hardship has been added, consistent with the Commission's approach to definitions for other industry codes.
- ▶ The requirement for SA Water to report on any rebates paid or credited to customers for failure to meet applicable service standards has been removed as this is not applicable.

¹³⁴ Essential Services Commission of South Australia, Enforcement Policy, 2023, available at: www.escosa.sa.gov.au/approach/enforcement

- ▶ A clause has been added which requires SA Water’s estimation of the usage of retail services to be determined in accordance with an estimation system approved by the Commission. This clause was inadvertently deleted from the Code between SA Water Regulatory Determination 2016 (SAWRD16) and SAWRD20.
- ▶ A new clause has been added which requires SA Water to include the telephone number for billing, payment enquiries and flexible payment options; and information about help that is available if the customer is experiencing difficulties in paying on bill reminder notices. This is already being done by SA Water in practice and has been added to ensure its customers are alerted to financial hardship support in reminder notices.
- ▶ An amendment has been made at the request of SA Water to give it discretion as to whether it charges a customer in advance for checking the meter reading, metering data or for testing the meter.
- ▶ A new clause has been added at the request of SACOSS to prohibit SA Water installing a water flow restriction device where the residential customer continues to adhere to the terms of a flexible payment plan or other agreed payment arrangement. This additional provision is in line with the other protections that have been established under the Code for customers complying with the terms of a flexible payment plan such as restrictions on debt recovery.
- ▶ An amendment has been made to this clause to clarify that the ability for SA Water to restrict water services for non-payment of a bill only relates to the supply address to which the bill relates.

In addition to these amendments, a new part F has been added to the Code to set out public reporting requirements for SA Water. These amendments are discussed further in chapter 18 of this draft determination.

Table 5.2: Summary of other minor amendments to the Code

Clause and description of change	Discussion
1.8.1 The definition of consumer has been amended to have the same meaning as it has in the <i>Water Industry Act 2012</i> .	The purpose of the amendment is to ensure consistency with the <i>Water Industry Act 2012</i> .
1.8.1 A new definition of financial hardship has been added.	Inclusion is consistent with the Commission’s approach to definitions for other industry codes.
17.2.2 (b) The requirement for SA Water to report on any rebates paid or credited to customers for failure to meet applicable service standards has been removed.	There are no Code requirements for SA Water to pay a rebate or payment to customers for failure to meet a service standard.
18.5.1 (c) A new clause has been added which requires SA Water’s estimation of the usage of retail services to be determined in accordance with an estimation system approved by the Commission.	This clause was inadvertently deleted from the Code between SAWRD16 and SAWRD20.
18.11.2 (e) A new clause has been added which requires SA Water to include the telephone number for billing, payment enquiries and flexible payment options; and information about help that is available if the customer is experiencing difficulties in paying on bill reminder notices.	This is already being done by SA Water in practice and has been added to ensure its customers are alerted to financial hardship support in reminder notices.

Clause and description of change	Discussion
<p>20.2.2 An amendment has been made to give SA Water discretion as to whether it charges a customer in advance for checking the meter reading, metering data or for testing the meter.</p>	<p>The clause originally stated that SA Water must charge customers in advance for these services. SA Water has advised that in practice, it charges customers in arrears to avoid needing to refund the payment, should the meter be found to be faulty. The amendment provides SA Water with discretion as to whether to charge in advance or in arrears, without reducing the level of protections provided to customers.</p>
<p>26.2.1 (g) A new clause has been added to prohibit SA Water installing a water flow restriction device where the residential customer continues to adhere to the terms of a flexible payment plan or other agreed payment arrangement.</p>	<p>This additional provision is in line with the other protections that have been established under the Code for customers complying with the terms of a flexible payment plan such as restrictions on debt recovery.</p>
<p>26.3.1 An amendment has been made to this clause to clarify that the ability for SA Water to restrict water services for non-payment of a bill only relates to the supply address to which the bill relates.</p>	<p>This clarification has been made to ensure SA Water is not permitted to restrict water services at other properties the customer may have that do not relate to the property affected by the non-payment of the bill.</p>

6 Service standards with performance targets

Draft decision – Best endeavours service standards with performance targets

The Commission's draft decision is that the existing 22 best endeavours service standards will continue to apply to SA Water during SAWRD24. The service standards cover aspects of customer service, responsiveness to service issues, service restoration timeliness and timeliness of connections. There are separate service standards for the Adelaide metropolitan area and regional areas.

The Commission has not accepted SA Water's proposal to adjust the performance metrics for regional response service standards or the sewer overflow clean-up service standards, as it considers doing so may result in service reductions.

To improve transparency where SA Water does not meet a service standard performance target the best endeavours regime requires SA Water to provide public justification and evidence of why and how it considers that it employed best endeavours notwithstanding that the performance target was not met. The Commission will consider SA Water's justification and evidence in assessing whether or not best endeavours were used. This regime provides greater transparency on SA Water performance for its customers, while also aiding the Commission in undertaking a review of the reasonableness of any service standard targets that SA Water is unable to meet over SAWRD24 when setting performance targets for SAWRD28.

For SAWRD24, SA Water has proposed to maintain its service levels, and therefore proposed no increases to the service standard performance targets. However, as SA Water has consistently exceeded the performance target for the service standard relating to complaint escalation to the Ombudsman over SAWRD20, the Commission proposes to increase the target for SAWRD24 to reflect SA Water's current performance.

The Commission has also made a draft decision that customers connected to the Tea Tree Gully (TTG) Community Wastewater Management System (CWMS) will not be included in the assessment of SA Water's overall performance against its service standards. Instead, separate performance reporting requirements have been proposed by the Commission in Chapter 5.

The Commission's draft decision on service standards for SAWRD24 is to:

- ▶ Maintain current regional response time performance measures.
- ▶ Maintain current sewer overflow clean-up performance measures.
- ▶ Require SA Water to provide more detailed annual public reporting on missed service standard performance targets.
- ▶ Increase the performance target for service standard 5: complaint escalation to the Ombudsman from ≤ 15 percent to ≤ 10 percent.
- ▶ Maintain current public reporting requirements for water and sewer network reliability.
- ▶ Maintain current public reporting requirements for sewer overflows to the environment.
- ▶ Maintain current public reporting requirements for water quality improvement.

SA Water must continue to use its best endeavours to meet the 22 service standards and performance targets that will apply in SAWRD24. These are summarised in Table 6.1.

Table 6.1: Summary of draft decision on best endeavours service standards for SAWRD24

Service standards			SAWRD20 target	SAWRD20 average performance	Draft SAWRD24 target	Change to current framework?
No.	Category	Standard and performance measure				
23	Customer service	Customer satisfaction: Customers who are satisfied with recent service experience.	≥93%	95%	≥93%	No
24	Customer service	Telephone responsiveness: Fault telephone calls answered within 50 seconds.	≥85%	86%	≥85%	No
25	Customer service	First contact resolution: Account enquiry telephone calls resolved at first point of contact.	≥85%	99%	≥85%	No
26	Customer service	Complaint responsiveness: Customer and community complaints responded to in 10 business days.	≥95%	98%	≥95%	No
27	Connections	Complaint escalation: Percentage of customer and community complaints escalated to the ombudsman following dissatisfaction with SA Water response to a complaint.	≤15%	7%	≤10%	Yes
28	Connections	Connection application responsiveness: Network connection applications processed in the target timeframe of 20 business days.	≥95%	97%	≥95%	No
29	Connections	Water network connection timeliness: Water network connections constructed in target timeframes.	≥95%	96%	≥95%	No
30	Connections	Sewer network connection timeliness: Sewer network connections constructed in target timeframes.	≥94%	98%	≥94%	No

Service standards			SAWRD20 target	SAWRD20 average performance	Draft SAWRD24 target	Change to current framework?
No.	Category	Standard and performance measure				
31	Response (attendance)	Water quality responsiveness – metropolitan Adelaide: Water quality service requests assessed by field staff that have resolution or plan of action communicated with the customer in target timeframes.	≥97%	99%	≥97%	No
32	Response (attendance)	Water quality responsiveness – regional areas: Water quality service requests assessed by field staff that have resolution or plan of action communicated with the customer in target timeframes.	≥99%	100%	≥99%	No
33	Response (attendance)	Water event responsiveness – high priority – metropolitan Adelaide: Water network break and leak events with the greatest customer or community impact attended by field crews in target timeframes.	≥99%	99%	≥99%	No
34	Response (attendance)	Water event responsiveness – high priority – regional areas: Water network break and leak events with the greatest customer or community impact attended by field crews in target timeframes.	≥99%	99%	≥99%	No
35	Response (attendance)	Water event responsiveness – low priority – metropolitan Adelaide: Water break, leak and boundary events with low to medium customer or community impact attended by field crews in target timeframes.	≥83%	87%	≥83%	No
36	Response (attendance)	Water event responsiveness – low priority – regional areas: Water break, leak and boundary events with low to medium customer or community impact attended by field crews in target timeframes.	≥97%	99%	≥97%	No
37	Response (attendance)	Sewer event responsiveness – metropolitan Adelaide: Sewer events attended by field crews in target timeframes.	≥99%	99%	≥99%	No

Service standards			SAWRD20 target	SAWRD20 average performance	Draft SAWRD24 target	Change to current framework?
No.	Category	Standard and performance measure				
38	Response (attendance)	Sewer event responsiveness – regional areas: Sewer events attended by field crews in target timeframes.	≥99%	100%	≥99%	No
39	Restoration ¹³⁵	Water service restoration timeliness – metropolitan Adelaide: Unplanned interruptions to a water service restored in target timeframes.	≥98%	99%	≥98%	No
40	Restoration	Water service restoration timeliness – regional areas: Unplanned interruptions to a water service restored in target timeframes.	≥98%	99%	≥98%	No
41	Restoration	Sewerage service restoration timeliness – metropolitan Adelaide: Unplanned interruptions to a sewer service restored in target timeframes.	≥95%	97%	≥95%	No
42	Restoration	Sewerage service restoration timeliness – regional areas: Unplanned interruptions to a sewer service restored in target timeframes.	≥99%	100%	≥99%	No
43	Restoration	Sewer overflow clean-up timeliness – metropolitan Adelaide: Sewer overflow clean-ups completed in target timeframes.	≥98%	96%	≥98%	No
44	Restoration	Sewer overflow clean-up timeliness – regional areas: Sewer overflow clean-ups completed in target timeframes.	≥99%	99%	≥99%	No

¹³⁵ Minor administrative amendments to the wording of performance measures in the 'Restoration' category have been made to improve clarity. These amendments do not change the requirements of the performance measures.

6.1 Introduction

The Water Retail Code – Major Retailers (**Code**) sets out behavioural standards and minimum requirements that SA Water must meet in the sale and supply of retail services to its customers. Its obligations include a requirement to use its best endeavours to meet service standards.¹³⁶ ‘Best endeavours’ has the meaning given to it in clause 1.8 of the Code, ‘*act in good faith and use all reasonable efforts, skill and resources.*’ Code compliance is a condition of SA Water’s retail licence.¹³⁷

Service standards describe what customers can expect from SA Water and are intended to reflect the quality and reliability levels valued by customers, now and in the long term. The standards, and the level they are set at, influence the cost of service delivery, and are an important reference point in defining lowest sustainable prices.

The Commission’s expectation is that service standards should:

- ▶ cover the elements of service that matter to customers¹³⁸
- ▶ draw on genuine and thorough customer engagement¹³⁹
- ▶ not duplicate other regulatory requirements (such as those relating to health, environmental protection, and safety and technical requirements), unless there is evidence that customers value a service level beyond those minimums, and
- ▶ reflect what customers are willing to pay for, as consideration of the inherent trade-offs between prices and service levels (quality and reliability) is a central concern in establishing efficient service standards.

In competitive markets, these trade-offs are resolved through competition between alternative providers. In the case of SA Water, a monopoly provider operating without effective competition in the relevant market, service levels need to be carefully considered and established by the Commission. In doing so, the Commission considers whether customers are willing to pay for improvements to current service levels or would prefer lower service levels in exchange for lower prices.

6.2 Current service standard framework

The SAWRD20 final determination contained 22 service standards, set out in Schedule 1 of the Code.¹⁴⁰ These included three new service standards to address gaps in customer service that were identified as important to customers.¹⁴¹

¹³⁶ Current service and reliability standards are set out in Schedule 1 of the Code, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21489/20200701-Water-RetailCode-MajorRetailers-MR03.pdf.aspx?Embed=Y>

¹³⁷ Clause 6.3 of SA Water’s licence requires it to comply with applicable service standards determined by the Commission. SA Water’s current and past applicable service standards and performance targets are available at www.escosa.sa.gov.au/industry/water/codes-and-guidelines/service-standards.

¹³⁸ SA Water Regulatory Determination 2024: Guidance Paper 2, p. 4. www.escosa.sa.gov.au/ArticleDocuments/1200/20181101-Water-SAWRD20-GuidancePaper3-ServiceStandards.pdf.aspx?Embed=Y.

¹³⁹ SA Water Regulatory Determination 2024: Guidance Paper 2, p. 5. www.escosa.sa.gov.au/ArticleDocuments/1200/20181101-Water-SAWRD20-GuidancePaper3-ServiceStandards.pdf.aspx?Embed=Y.

¹⁴⁰ Available at: www.escosa.sa.gov.au/ArticleDocuments/21489/20200701-Water-ServiceStandardsSchedule-July2020-30June2024.pdf.aspx?Embed=Y

¹⁴¹ The three new service standards introduced for SAWRD20 were: customer satisfaction, first contact resolution (for account enquiry calls), and complaints handled in-house without escalation to EWOSA.

The SAWRD20 service standards address customer service, connections, responsiveness (attendance) and restoration. There are separate responsiveness and restoration service standards for the Adelaide metropolitan area and regional areas. Performance targets for each service standard were set using historical average performance over the longest possible period.¹⁴²

SA Water is required to use its best endeavours to meet the performance target for each service standard.¹⁴³ Performance in individual years may vary from the target. The Code requires that SA Water use its best endeavours to achieve all applicable service standards,¹⁴⁴ where best endeavours means to act in good faith and use all reasonable efforts, skill and resources. Where SA Water misses a performance target but has used its best endeavours to meet the target, and can demonstrate this, it may still satisfy the overall service standard, and avoid an adverse compliance response from the Commission.

In general, SA Water's overall service standard performance over SAWRD20 has been consistent with historical performance.

However, for one service standard, clean-up of sewer overflow events in Adelaide metropolitan area, SA Water failed to meet the performance target for three consecutive years. This has been identified as an area of systemic concern by the Commission (see section 6.3.4.3 below for further analysis).

SA Water also failed to meet the performance target in one year during SAWRD20 for clean-up of sewer overflow events in regional areas and water event responsiveness for low priority events in the Adelaide metropolitan area. Unlike sewer overflow clean-ups in the Adelaide metropolitan area, the Commission does not consider SA Water's performance against these two service standards to be at risk of ongoing concern. The Commission has recommended that SA Water review its ongoing performance in these areas.

6.2.1 Monitoring and reporting on SA Water performance

The Commission analyses detailed SA Water service standard performance data on a quarterly basis, and publishes summary performance reviews and exception reports on its website.¹⁴⁵ In accordance with the Monitoring, Evaluation and Performance Framework (MEPF) established for SAWRD20,¹⁴⁶ SA Water must also publish performance data on its website quarterly, as well as provide an annual self-assessment of its performance.¹⁴⁷

More information on the MEPF, SA Water's SAWRD20 performance reporting obligations and the draft decision on its SAWRD24 public reporting obligations is contained at chapter 18 of this Draft Determination.

¹⁴² When determining performance targets for services standards that aim to maintain current service levels, the Commission uses the longest possible range of performance data to smooth the effect of year-to-year variation. The advantage of smoothing variation is that, sometimes, variation in performance is due to factors in SA Water's operating environment over which it has limited control. Smoothing the data helps to adjust for these performance outliers.

¹⁴³ Water Retail Code – Major Retailers, clause 17.1, available at: www.escosa.sa.gov.au/ArticleDocuments/21489/20200701-Water-RetailCode-MajorRetailers-MR03.pdf.aspx?Embed=Y

¹⁴⁴ Clause 17 of the Water Retail Code – Major Retailers.

¹⁴⁵ The Commission's regulatory reporting on SA Water's performance is available at: www.escosa.sa.gov.au/industry/water/regulatory-performance/sa-water/sa-water-regulatory-performance

¹⁴⁶ The Commission's MEPF for SAWRD20 is available at: www.escosa.sa.gov.au/ArticleDocuments/21627/20210122-Water-SAWRD20-24-MonitoringEvaluationFramework-FinalReport.pdf.aspx?Embed=Y

¹⁴⁷ SA Water's performance data is available at: www.sawater.com.au/about-us/our-publications/our-reports/our-performance-scorecard

6.3 Service standards for SAWRD24

This section details SA Water's proposal and the Commission's draft decision for each group of service standards (customer service, connections, response and restoration).

6.3.1 Customer service standards

SA Water currently has five customer service standards. They relate to telephone responsiveness, complaint responsiveness and three service standards that focus on quality of customer service: customer satisfaction, first contact resolution, and complaints handled by SA Water without escalation to EWOSA.

► Telephone responsiveness

This was an existing standard from SAWRD16 that was modified for SAWRD20. In SAWRD16, the performance measure required SA Water to answer customer account enquiry and fault calls within 30 seconds. Based on customer research, this service standard performance measure was modified in SAWRD20 to limit its application to customer fault calls only and extend the response time to 50 seconds. The cost saving from these changes allowed SA Water to introduce a first contact resolution service standard in SAWRD20.

► Complaint responsiveness

This was an existing standard from SAWRD16 that was modified for SAWRD20. In SAWRD16, the performance measure required SA Water to respond to 95 percent of written complaints (received by mail, fax, email or other means) within 10 business days if complaints do not require investigation, and within 30 business days if investigation is needed. In SAWRD20, the performance target for this standard has required SA Water to respond to all complaints, regardless of whether or not investigation is required, in 10 business days, and applies to all complaints, regardless of whether they are made in writing, by phone, or through another channel. These changes were proposed by SA Water for SAWRD20 and reflected the fact that less than half of all complaints to SA Water are made in writing.¹⁴⁸

► Customer satisfaction

This was a new standard introduced in SAWRD20. The performance measure is 'customers who are satisfied with recent service experience', with a target of 93 percent. Customer satisfaction relates to satisfaction with experience in asking a question, reporting a fault, or applying for a new connection, as reported to SA Water by customers.

► First contact resolution

This was a new standard introduced in SAWRD20. The performance measure is the number of account enquiry telephone calls being resolved at the 'first point of contact' (that is, during the first telephone call), with a target of 85 percent. The service standard was introduced based on findings arising from customer engagement which indicated that customers want to speak with front line staff who are capable of resolving their query without referring them to a different person, and without the customer needing to contact SA Water again.

¹⁴⁸ Reporting to the Commission showed that in 2017-18, 678 written complaints and 1763 total complaints were received.

► **Complaints handled in-house without escalation to EWOSA**

This was a new standard introduced in SAWRD20. It requires that less than 15 percent of customer complaints are escalated to EWOSA (driving a focus on SA Water's first contact and internal dispute resolution processes) and was introduced as proposed by SA Water in SAWRD20.

6.3.1.1 SA Water proposal

SA Water did not propose any changes to the customer service standards or the related performance targets.

6.3.1.2 Matters raised in consultation

SA Water's targeted engagement, undertaken by McGregor Tan,¹⁴⁹ on its service standards indicated that satisfaction with its customer service was higher for those who had a service experience with it than those who had not.¹⁵⁰ In general, a key observation from SA Water's targeted engagement on customer experience was a focus on improved proactive communications from SA Water. This included the use of an SMS system to acknowledge customer requests, communicate expected timeframes, select an appointment time and provide regular updates to customers.¹⁵¹

The Commission notes that most of the customers surveyed by McGregor Tan on behalf of SA Water for its targeted customer research on service standards identified the SAWRD20 performance target for customer service standard 'First contact resolution' of 85 percent as 'very underwhelming'.¹⁵² Customers in this survey indicated that '*general enquiries should be easy to handle and 100 percent of the queries should be resolved when the first contact is made.*'¹⁵³

In its submission to the Issues Paper, and its submission to the RBP, EWOSA proposed that the target for complaint escalation be reduced from <15 percent to <10 percent. EWOSA made this proposal based on SA Water's performance against this target over SAWRD20 (seven percent, six percent, and seven percent), and its view that a tighter target would 'provide greater assurance to customers that their complaints are likely to be dealt with fairly and efficiently by SA Water.'¹⁵⁴

6.3.1.3 Commission analysis

SA Water has performed well across all customer service standards over SAWRD20. In particular, SA Water has exceeded the following two service standard performance targets:

► **'First contact resolution'**

SA Water reported an average performance rate of 99 percent across the first three years of SAWRD20. However, the Commission identified uncertainties regarding SA Water's methodological approach to its performance reporting on this service standard. In reporting its performance, SA Water uses the Customer Care Agent's perspective to determine whether a customer account query has been resolved, rather than a customer perspective. Although SA Water does survey customers to ask if their query has been resolved, it notes that this survey can only be sent to

¹⁴⁹ McGregor Tan, SA Water Service Standards Review, January 2022.

¹⁵⁰ SA Water RBP, Appendix 4.2 *RD24 Engagement Phase 1 Report*, p. 8.

¹⁵¹ McGregor Tan, SA Water Service Standards Review, January 2022, pp.7, 52.

¹⁵² McGregor Tan, SA Water Service Standards Review, January 2022, p. 7, 51.

¹⁵³ McGregor Tan, SA Water Service Standards Review, January 2022, p. 7, 51.

¹⁵⁴ EWOSA submission to the Commission's SA Water Regulatory Determination 2024 – *Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, p. 2, available here: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-EWOSA.pdf.aspx?Embed=Y EWOSA submission on SA Water's RBP October 2023, p.4, available here: www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024

callers who used a mobile phone. For 2022-23, SA Water stated the results of its customer survey on the question of 'Was your query resolved during your call?' were:

- Yes = 88.7 percent
- No = 2.5 percent
- Too soon to tell = 8.8 percent.¹⁵⁵

Although these survey results only reflect a sample of customer experience (that is, do not include customers using a landline, or those who choose not to respond to the survey), they are different from SA Water's reported performance of 100 percent first contact resolution in 2022-23.

While the Commission considered increasing the performance target for SAWRD24 to reflect historical performance, before doing so the Commission will work with SA Water to better understand its reporting methodology and the extent to which it is reflective of actual customer experience. Accordingly, the Commission will retain the existing performance target for SAWRD24 and review it for SAWRD28.

▶ 'Complaint escalation'

SA Water has achieved an average performance rate of 7 percent escalation across the first three years of SAWRD20. This significantly exceeds the SAWRD20 target of ≤ 15 percent.

6.3.1.4 Draft decision

The Commission's draft decision is to:

- ▶ Maintain the current performance target for customer service standard 'First contact resolution' and update Guideline 2 to outline the Commission's expectation that reporting is reflective of actual customer experience.
- ▶ Strengthen the performance target for customer service standard 'Complaint escalation' to ≤ 10 percent of customer complaints escalated to EWOSA. The Commission has decided not to set the target at seven percent, the outturn performance during SAWRD20, in recognition of the limited number of years of data. The Commission will review this target again for SAWRD28 and may adjust the target at that time. The Commission expects SA Water to at least maintain existing levels of performance, which would meet the revised target without any additional costs for customers.

6.3.2 Connection service standards

SA Water currently has three service standards that relate to water and sewer network service connections.

▶ Connection application responsiveness

The performance measure for this service standard is that SA Water will process 95 percent of network connection applications within a target timeframe of 20 business days. This applies to both water and sewer connections. This was an existing standard from RD16 that was not modified for SAWRD20.

¹⁵⁵ Information provided to the Commission, 13 October 2023.

► **Water network connection timeliness**

The current service standard is that SA Water will construct 95 percent of water network connections within target timeframes of 25 business days for standard installations or 35 business days for non-standard installations. This was an existing standard from SAWRD16 that was not modified for SAWRD20.

► **Sewer network connection timeliness**

The current service standard is that SA Water will construct 94 percent of sewer network connections within target timeframes of 30 business days for standard installations or 50 business days for non-standard installations. This was an existing standard from SAWRD16 that was not modified for SAWRD20.

6.3.2.1 SA Water proposal

SA Water did not propose any changes to the connection service standards or the related performance targets.

6.3.2.2 Matters raised in consultation

No matters were raised in consultation on SA Water's connection service standards.

SA Water's targeted engagement on the existing service standards revealed that, while at least one in two customers desired improvement in the connection performance targets, less than one in 10 were willing to pay for any improvement.¹⁵⁶

6.3.2.3 Commission analysis

SA Water's performance against its three connection service standards in the first three years of SAWRD20 has been consistent with its historical performance. The Commission has not been made aware of any issues in relation to SA Water's performance on the timeliness of water and sewer connections.

6.3.2.4 Draft decision

The Commission does not propose any changes to the connection service standards or related performance targets for SAWRD24.

6.3.3 Response service standards

SA Water currently has eight service standards that relate to response (attendance). Two are for response to water quality complaints (metropolitan and regional), two are for attendance at water events (network breaks, leaks and bursts) – high priority (metropolitan and regional), two are for attendance at water events (network breaks, leaks and bursts) – low priority (metropolitan and regional), and two are for attendance at sewerage network overflows (metropolitan and regional).

¹⁵⁶ McGregor Tan, *SA Water Service Standards Review*, January 2022, pp. 59-60.

► **Water quality complaints (metropolitan and regional)**

These were existing standards from SAWRD16 that were modified for SAWRD20.¹⁵⁷ The current service standards are that SA Water will respond to 97 percent of water quality complaints in the Adelaide metropolitan area, and 99 percent of water quality complaints within regional areas, within target timeframes. The definitions of water quality event priorities and associated response timeframes are:

- Priority 1, where the request indicates potential risk to human health – one hour.
- Priority 2, where the request indicates taste and odour issues or contaminated/dirty water – two hours.
- Priority 3, all other water quality reports, for example milky/cloudy water – 48 hours.

► **Water network event responsiveness – high priority (metropolitan and regional)**

These were existing standards from SAWRD16 that were modified slightly for SAWRD20.¹⁵⁸ The performance measures for these service standards in SAWRD20 are that SA Water must respond to 99 percent of water network breaks, leaks and bursts in the Adelaide metropolitan area, and 99 percent of water network breaks, leaks and bursts in regional areas, within required timeframes, as shown in Table 6.2 below.

► **Water network event responsiveness – low priority (metropolitan and regional)**

These were new service standards introduced in SAWRD20. The performance measures for these standards are that SA Water must respond to 83 percent of events in the Adelaide metropolitan area and 99 percent of events in regional areas within the required timeframes. Low priority water network events include leaking or noisy meters, and minor issues that have a limited customer or community impact. ‘Low’ priority events are defined as priority 3 and priority 4 events. See Table 6.2 below for priority definitions and associated response timeframes for water network events.

Table 6.2: Priority definitions for water network event responsiveness

Priority	Definition
Priority 1	Water network break and leak events with the greatest customer or community impact. For example, total loss of supply to a customer, major loss of water, events that cause major or significant damage to property, events that pose an immediate danger to people or the environment. Timeframe: 1 hour
Priority 2	Any other water network break or leak event with potential for high impact to customers or the community. Timeframe: 5 hours

¹⁵⁷ The definition of priority one events was made broader than the SAWRD16 definition to capture all complaints that indicate a potential risk to human health.

¹⁵⁸ Priority 1 events were changed to clarify that such events are those that cause ‘major or significant’ damage, as previously Priority 1 events may have captured those where there is very minor damage.

Priority	Definition
Priority 3	Water network break, leak and boundary events with low to medium customer or community impact, usually at the boundary, for example, a leaking meter. Timeframe: 7 days
Priority 4	Water network break, leak and boundary events with low customer or community impact, usually at the boundary, for example, a meter that cannot be located or read, or a noisy meter. Timeframe: 15 days

- ▶ **Sewerage network overflows (metropolitan and regional):** These were existing service standards from SAWRD16 that were not modified for SAWRD20. The performance measures for the standards are that SA Water will attend 98 percent of sewer network overflows in the Adelaide metropolitan area, and 99 percent of sewer network overflows within regional areas, within the required timeframes. The definitions of sewer network overflow event priorities and associated response timeframes are:
 - Priority 1, where the overflow is inside a customer’s building – one hour.
 - Priority 2, where the overflow is outside a building on customer’s property – two hours.
 - Priority 3, where the overflow is external to a customer’s property – four hours.

6.3.3.1 SA Water proposal

SA Water proposed that the measurement of service standard responsiveness metrics in regional areas be amended to accommodate the travel time required to reach the event by deducting travel time from its overall response time.¹⁵⁹ This would affect service standards 10, 12, 14 and 16.

SA Water stated that, due to the remoteness of some areas of the state, long travel times may be required for field crews to attend incidents, which can make it impossible for SA Water to meet the required response timeframes.¹⁶⁰ For example, where there is a regional response event with a priority 1 timeframe of one hour, travel time can exceed this target response time.

SA Water also noted its concerns that travel time performance measures have the potential to result in unsafe behaviour from its staff in attempting to meet the target timeframes.¹⁶¹ SA Water considered establishing additional workshops to reduce travel times to regional areas but concluded that this would be *‘an unreasonable additional capital and operating expense for the Corporation’s customers.’*¹⁶²

6.3.3.2 Matters raised in consultation

In its engagement with the Customer Challenge Group (CCG), SA Water discussed its proposed change to response times for regional response service standards. SA Water notes that that CCG *‘agreed that maintaining a regional service standard the same as a metropolitan standard in these instances may create an incentive to drive unsafely to attend an event in time to meet the standard. As such, measuring response times to allow for travel time was considered acceptable.’*¹⁶³

¹⁵⁹ SA Water RBP, p. 126.

¹⁶⁰ SA Water RBP, p. 125.

¹⁶¹ SA Water RBP, p. 125.

¹⁶² SA Water RBP, p. 125.

¹⁶³ SA Water RBP, p. 124.

After further clarification was sought from CCG members on the measurement of the service standards, SA Water asked the CCG members for explicit feedback on the following proposal: 'that when measuring attendance service standards in regional areas, the travel time should be deducted from response time.'¹⁶⁴ SA Water stated that '*the CCG indicated strong support for this adjustment.*'¹⁶⁵

SA Water stated that it provided an overview of existing service standards and performance along with the proposal to deduct travel time from regional response times in its deliberative engagement program with the Peak Bodies Engagement Forum (PBEF). SA Water stated that the PBEF '*expressed support to retain the current set of service standards with potential tweaks to recording performance.*'¹⁶⁶

The Commission sought specific feedback on SA Water's proposal in its meeting with the Consumer Advisory Committee (CAC), on 29 June 2023. CAC members raised the following key points on SA Water's proposal to deduct travel time from response times for regional response service standards:

- ▶ If the service standard response timeframes already include provision for travel time, the current approach to setting service standards seems reasonable.
- ▶ It is not clear why SA Water need the response times changed when it is meeting the existing performance targets.

On this basis, CAC members put the view that further information was needed from SA Water on why travel time should be deducted from regional response service standard timeframes.

In its submission to the Issues Paper and its submission on SA Water's RBP, EWOSA suggested a 'remote' category for regional response service standards with a different performance target than existing regional response service standards. EWOSA proposed that this new category would provide:

*'SA Water with a greater ability to meet the targets in a way that was still safe to their workers, the impacted customers and the broader community, without requiring unreasonable additional capital and operating expenses that would raise water and sewerage prices for all customers.'*¹⁶⁷

In its submission on the SA Water RBP, the Environment Protection Authority (EPA) stated that the proposed regional response service standard target timeframes are acceptable but in instances where the response time is not met, due to factors outside SA Water's control, this should be reflected in SA Water's performance reporting.¹⁶⁸

6.3.3.3 Commission analysis

The regional response performance targets are an *average* of SA Water's historical performance. The average performance targets account for the fact that travel time, or some other factor outside SA Water's control, is likely to prevent it achieving 100 percent performance on these service standards.

Over the SAWRD20 period, SA Water has consistently met all regional response performance targets. This demonstrates that SA Water is maintaining its performance against its historical levels.

¹⁶⁴ SA Water RBP, p. 124.

¹⁶⁵ SA Water RBP, p. 124.

¹⁶⁶ SA Water RBP, p. 125.

¹⁶⁷ EWOSA submission to the Commission's SA Water Regulatory Determination 2024 – *Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, p. 2, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-EWOSA.pdf.aspx?Embed=Y EWOSA submission on SA Water's RBP, October 2023, p.4, available here: www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024

¹⁶⁸ Environment Protection Authority, submission to SA Water's RBP, October 2023, p. 5.

SA Water has provided detailed data on the number of regional response events it has attended in relation to service standards 10, 12, 14 and 16, and the number of those events it attended on time.

This data illustrates that during SAWRD20 so far, where a response event (water quality request, water event, or sewer event) occurred in a regional area:

- ▶ SA Water attended 1,451 out of 1,513 priority 1 events within the required one-hour response timeframe (that is, 96 percent achievement against target timeframe)
- ▶ SA Water attended 937 out of 939 priority 2 events within the required two-hour response timeframe (that is, 100 percent achievement against target timeframe)
- ▶ SA Water attended 13,016 out of 13,034 priority 2 and 3 events within the required four or five-hour response timeframe (that is, 100 percent achievement against target timeframes)
- ▶ SA Water attended 26,553 out of 26,837 priority 3 or 4 events within the required timeframe of 48 hours (that is, 99 percent achievement against target timeframe).

SA Water’s detailed performance on regional response service standards is reflected in Table 6.3 below, which demonstrates that SA Water is meeting, or exceeding, its performance targets for regional responsiveness.

Table 6.3: SA Water performance on regional response service standards over SAWRD20

Service standards – Regional response	Performance target	Average RD20	22-23	21-22	20-21
10. Water quality responsiveness	99%	100%	100%	100%	100%
12. Water event responsiveness – high priority	99%	99%	100%	99%	99%
14. Water event responsiveness – low priority	97%	99%	99%	99%	99%
16. Sewer event responsiveness.	99%	100%	99%	100%	100%

Evidence from SA Water on missed priority 1 events from 2020-22,¹⁶⁹ suggests:

- ▶ 25 percent of the missed priority 1 events were within 25km of an SA Water facility, and
- ▶ 70 percent of the missed priority 1 events are located between 25km and 50km from an SA Water facility.

This suggests at least one quarter of missed priority 1 regional response events are more likely to be related to SA Water performance rather than travel time.

The Commission considered the following options in relation to the performance targets, in addition to maintaining the targets at their current level.

▶ **SA Water proposal to deduct travel time from regional response times**

Deducting travel time automatically from the response time target, without increasing the target, may incentivise a reduction in the level of service currently experienced by customers.

¹⁶⁹ Noting that the direct line distance used does not consider traffic congestion, speed limits and road conditions.

The performance targets have been set at a level that account for instances where a one-hour response timeframe is not achievable for SA Water. SA Water is not expected, or obligated, to attend 100 percent of regional response events within target timeframes.

► **Average or median response times**

In Victoria, average response timeframe targets are used for regional response metrics.¹⁷⁰ If an average response time was used for priority 1 regional response events, the target timeframes would need to be reset. The Commission would need to assess SA Water's historical response time data to set an average response time target for regional response performance targets. An average response time would provide greater flexibility to SA Water in achieving the performance target than a hard one-hour response time. However, the Commission considers that the current best endeavours standard also provides flexibility by allowing SA Water to provide evidence of how it has used its best endeavours to meet the performance target but has not, due to factors outside its control (such as long travel times).

► **Remote response times**

In its submission to the Commission's Issues Paper and its submission on SA Water's RBP, EWOSA suggested:

For Service Standard 22: Sewer Overflow Clean-up Timeliness – Regional Areas, that the target be split into regional and remote areas, with different performance targets applying to both.¹⁷¹

The Commission considers this proposal equally applicable to the regional response service standards. The Commission could establish a separate 'remote' category for 'response' service standards that would provide SA Water with additional time to attend events farther than a specified distance from a manned SA Water facility. Although this proposal may result in SA Water missing fewer target response times for regional areas, it would do so at the cost of potentially requiring customers who are moved into a 'remote' class to wait longer for SA Water attendance. Accordingly, the Commission considers that the addition of extra travel time for 'remote' events may result in a lower standard of service for these customers.

6.3.3.4 Draft decision

The Commission's draft decision is to retain the performance measures for regional response service standards for SAWRD24 as they are currently set for SAWRD20.

The Commission notes that this service standard target is based on average historical performance, which allows for the target to be met despite instances where travel constitutes a significant portion of, or exceeds, the response time for particular events. In that context, the Commission does not consider that instances where the travel time exceeds the response time should create a risk of unsafe driving practices for SA Water staff.

The Commission would expect SA Water to be identifying, managing and mitigating any identified work, health and safety risks as part of its obligation to provide safe systems of work under the *Work Health and Safety Act 2012*. This includes communicating to workers that the average service standard performance targets do not require attendance at every event within the target timeframe.

¹⁷⁰ See Clause 18.2 *Water Industry Standard – Urban Customer Service*, Essential Service Commission of Victoria, accessed 17 August 2023, available at: www.esc.vic.gov.au/sites/default/files/documents/Water%20Industry%20Standard%20-%20Urban%20Customer%20Service%20-%20version%20%2020230701.pdf

¹⁷¹ EWOSA submission to the SA Water Regulatory Determination 2024 –Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper, 2023.

SA Water has confirmed to the Commission that it has safe travel procedures in place and a review of SA Water driver incidents does not indicate concerns in this regard. However, if SA Water remains of the view that unsafe driving practices are a risk of occurring within its business, it may wish to review its systems, processes and controls related to regional travel to ensure they are effective.

Where SA Water does not meet a performance target due to factors outside its control, such as long travel times, the Commission expects it to undertake, and publish, a best endeavours assessment that identifies these instances and explains the relevant factors.

6.3.4 Restoration service standards

SA Water currently has six service standards that relate to timeframes for restoration. Two are for water network service restoration (metropolitan and regional), two are for sewerage network service restorations (metropolitan and regional), and two are for sewerage network overflow clean-ups (metropolitan and regional).

► Water network service restoration (metropolitan and regional)

These are existing service standards from SAWRD16 that were modified slightly for SAWRD20 to reflect historic performance.¹⁷² The performance measure for these standards is that SA Water will restore 98 percent of unplanned water service interruption in the Adelaide metropolitan area and 98 percent of unplanned water service interruptions in regional areas within the required timeframes. The category timeframes and definitions are:

- Category 1, where the interruption could be life-threatening or otherwise have serious consequences, such as impacting critical needs customers, hospitals, schools, residential care facilities, childcare centres, prisons, youth detention facilities or other correctional facilities – 5 hours.
- Category 2, where the interruption causes a disruption to a customer's business activities – 8 hours.
- Category 3, all other cases – 12 hours.

► Sewerage network service restorations (metropolitan and regional)

These are existing service standards from SAWRD16 that were not modified for SAWRD20. The current service standards are that SA Water will perform 95 percent of sewerage network service restorations in target timeframes for metropolitan areas and perform 99 percent in target timeframes for regional areas. The category timeframes and definitions are:

- Category 1, where the interruption could be life-threatening or otherwise have serious consequences, such as impacting critical needs customers, hospitals, schools, residential care facilities, childcare centres, prisons, youth detention facilities or other correctional facilities – 5 hours.
- Category 2, where the interruption causes a disruption to a customer's business activities – 5 hours.
- Category 3, all other full loss of service events – 12 hours.

¹⁷² For SAWRD20 the Commission used SA Water's historical performance data to set a target for SAWRD20 that was one percent lower than the SAWRD16 target. Additionally, 'prisons, youth detention facilities or other correctional facilities' were added to the list of examples in the Category 1 definition in the Code's service standard schedule, to align it with the list of examples in the Commission's Water Industry Guideline Number 2, which already includes these facilities.

- Category 4, all partial loss events where a customer has a sewerage service, but it is draining slowly – 18 hours.

► **Sewerage network overflow clean-ups (metropolitan and regional)**

These are existing service standards from SAWRD16 that were not modified for SAWRD20. The current service standards are that SA Water will perform 98 percent of sewer overflow clean-ups in target timeframes for metropolitan areas and perform 99 percent in target timeframes for regional areas. The category timeframes and definitions are:

- Category 1, where a sewer overflows inside a customer's building – 4 hours.
- Category 2, where a sewer overflows outside a building on a customer's property – 6 hours.
- Category 3, where a sewer overflows, external to customer's property – 8 hours.

6.3.4.1 SA Water proposal

SA Water proposed a measurement variation to the metropolitan and regional sewer overflow clean-up service standard performance targets to account for unavoidable or agreed delays.

SA Water identified three drivers of underperformance that it considers outside of its control in relation to performance against sewer overflow clean-up in both metropolitan and regional areas:

► **Customer requested delays**

SA Water stated that customers often request a delay to sewer overflow clean-ups, which leads to the target response times being missed.¹⁷³ SA Water's reasons for these delays include the customer leaving the property, wanting to avoid noise disturbance at night-time, and customers needing time to remove personal property prior to clean-up.¹⁷⁴ SA Water also noted that customer-requested delays make up the majority of the missed events, and that agreeing to an alternative time upon a customer's request improves customer outcomes.

► **Safety risks**

SA Water put the view that, where safety issues arise in the course of cleaning up sewer overflows, completing the work in the required response time could put SA Water workers, or the community, at risk.¹⁷⁵

► **Access issues**

SA Water reported that sewerage overflow events sometimes occur in areas that it is unable to gain access to, such as behind locked gates, which impacts its ability to meet the response timeframes.¹⁷⁶

6.3.4.2 Matters raised in consultation

In SA Water's targeted customer research on service standards, the majority of SA Water customers stated they *'were happy with the standards for responding to sewer overflows inside or outside the customer's property.'*¹⁷⁷ While SA Water's willingness to pay research suggested its customers were willing to pay to reduce the number of sewer overflows onto customer properties and to the

¹⁷³ SA Water RBP, p. 121.

¹⁷⁴ SA Water RBP, p. 123.

¹⁷⁵ SA Water RBP, p. 123.

¹⁷⁶ SA Water RBP, p. 123.

¹⁷⁷ McGregor Tan, SA Water Service Standards Review, 2022, p. 46.

environment, the amount they were willing to pay was less than the cost to deliver the proposed investment.¹⁷⁸

In its engagement with the PBEF, SA Water stated that it provided an overview of existing service standards and performance along with the proposed change to the metropolitan sewer overflow clean-up performance measure. SA Water put the view that the PBEF *'expressed support to retain the current set of service standards with potential tweaks to recording performance.'*¹⁷⁹

The Commission sought specific feedback on SA Water's proposal in its meeting with the CAC on 29 June 2023. CAC members raised the following key points on SA Water's proposal to remove factors outside its control in its calculation of performance against the metropolitan sewer overflow clean-up service standard:

- ▶ It makes sense that service standard performance targets take into account a customer's request for a delay.
- ▶ Some of SA Water's concerns could be addressed through reporting. If SA Water is not meeting a standard, it needs to provide a reason why.
- ▶ Customer experience scores can be tested on service types – for example satisfaction scores for people who have experienced an overflow.

This feedback has been considered in the draft decision below.

In its submission to the Issues Paper, EWOSA proposed that, where a performance target is not achieved and the best endeavours standard is not met or there is otherwise a potential compliance issue, the Commission should undertake an independent assessment of the situation and provide a public statement.¹⁸⁰ EWOSA considers that this would provide stakeholders with an assurance that SA Water's performance is being monitored, and compliance measures are implemented where needed.

The Commission notes that, although it does undertake monitoring and analysis of SA Water's service standard performance¹⁸¹ and has a Significant Performance Event reporting framework,¹⁸² improved reporting on missed performance targets was a theme raised by other stakeholders, including SACOSS and the CAC. The Commission will address this issue with changes to SA Water's public reporting requirements on missed performance targets and improved communication from the Commission on SA Water's performance, explained in the draft decision below, and more generally in chapter 18.

In its submission on the RBP, the EPA stated that the proposed service standards are acceptable, however in instances where the response time is not met due to factors outside SA Water's control, this should be reflected in SA Water's performance reporting.¹⁸³

¹⁷⁸ SA Water RBP, p. 102.

¹⁷⁹ SA Water RBP, p. 125.

¹⁸⁰ EWOSA submission to the Commission's SA Water Regulatory Determination 2024 – *Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, p. 2, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-EWOSA.pdf.aspx?Embed=Y

¹⁸¹ Published on the Commission's website, available at: www.escosa.sa.gov.au/industry/water/regulatory-performance/sa-water/sa-water-regulatory-performance

¹⁸² Published on the Commission's website, available at: www.escosa.sa.gov.au/industry/water/regulatory-reporting/significant-performance-event-reporting-framework

¹⁸³ Environment Protection Authority, submission to SA Water's RBP, October 2023, p. 5.

In its submission on the RBP, the Office of the Technical Regulator noted that additional information is needed from SA Water to support the proposed change to service standard 21, including:

- ▶ An explanation of why there has been a consistent decrease in meeting the clean-up time target over the last four years. The reasons for customer requested delays stated are reasonable, but there is no explanation as to why an increase of requests has occurred.
- ▶ A breakdown of the delays which were beyond SA Water’s control (that is, safety and access issues vs customer requested delays).¹⁸⁴

6.3.4.3 Commission analysis

SA Water stated that removing instances where it does not meet the target clean-up timeframes due to factors outside its control would enable it to meet the performance target for service standard 21 and 22 *‘without the need for best endeavours to be considered.’*¹⁸⁵

Currently, for instances where target timeframes are not met due to these issues, SA Water must provide information and evidence to demonstrate that it has nevertheless used its best endeavours.

SA Water has met the performance target for service standard 22 in two of the three years of SAWRD20. However, it has failed to meet the performance target for service standard 21 in SAWRD20. SA Water has stated that it considers that, where it missed the performance targets, it met the targets on a best endeavours basis.¹⁸⁶

The Commission notes that the performance targets are an average of SA Water’s historical performance, which includes historical instances where target timeframes were not met due to factors outside SA Water’s control. The Commission expects some variability in performance against these targets. However, SA Water’s failure to meet the performance target for service standard 21 in SAWRD20 so far may indicate an underlying performance issue as SA Water is no longer maintaining its historical performance against this service standard.¹⁸⁷

Table 6.4: Sewer overflow clean-up timeliness SAWRD20 performance so far

Service standard	Performance target	SA Water performance		
		22-23	21-22	20-21
21. Sewer overflow clean-up timeliness – metro Sewer overflow clean-ups resolved within the target timeframes.	98%	95%	97%	96%
23. Sewer overflow clean-up timeliness – regional Sewer overflow clean-ups resolved within the target timeframes.	99%	99%	98%	99%

¹⁸⁴ Office of the Technical Regulator, submission to SA Water’s RBP, October 2023, p. 1.

¹⁸⁵ SA Water RBP, p. 125.

¹⁸⁶ SA Water RBP, p. 122.

¹⁸⁷ The Commission has raised this issue with the South Australian Department of Health as to whether extended periods of not meeting the service standard could present an increased risk to human health and the environment though the discharge of pathogens and pollutants. Staff from the Department of Health have confirmed that they are generally comfortable with SA Water’s response to sewer overflows and note that they normally do not see delays in clean-up for major spills.

The Commission notes that National Performance Reporting data for urban water utilities in 2021-22 indicates that SA Water leads the major water utilities on the number of property sewer breaks and chokes per 1,000 properties.¹⁸⁸ For 2021-22, SA Water had 35 property sewer breaks or chokes per 1,000 properties, against a median number of four breaks or chokes per 1,000 properties for other major water utility providers.¹⁸⁹ This is an increase on the previous four years, where SA Water averaged 27 sewer breaks or chokes per 1,000 properties,¹⁹⁰ and is possibly reflected in the significant increase in sewer overflow clean-up events that occurred in 2021-22 as illustrated below in Figure 16.1.

SA Water has reported to the Commission that the increase in sewer overflow clean-up events in 2021-22 is due to multiple factors, including COVID-19 leading to more people working at home *'to report overflows / blockages and an increase in blockages requiring clean-ups caused by items that should not have been disposed of in the sewer network such as wet wipes, fat, and other foreign objects.'*¹⁹¹

SA Water has undertaken a social media campaign to educate its customers about what items can and cannot be flushed into the sewer system to help address this problem.¹⁹²

Figure 6.1 below demonstrates that on a quarterly basis, in particular Q2 2021-2022, SA Water can meet the performance target even where total clean-up events are at record highs.

¹⁸⁸ Australian Government, Bureau of Meteorology, *National Performance Reports: Urban Water Utilities 2021-22*, section 7: Assets. P. 61, available at: www.bom.gov.au/water/npr/

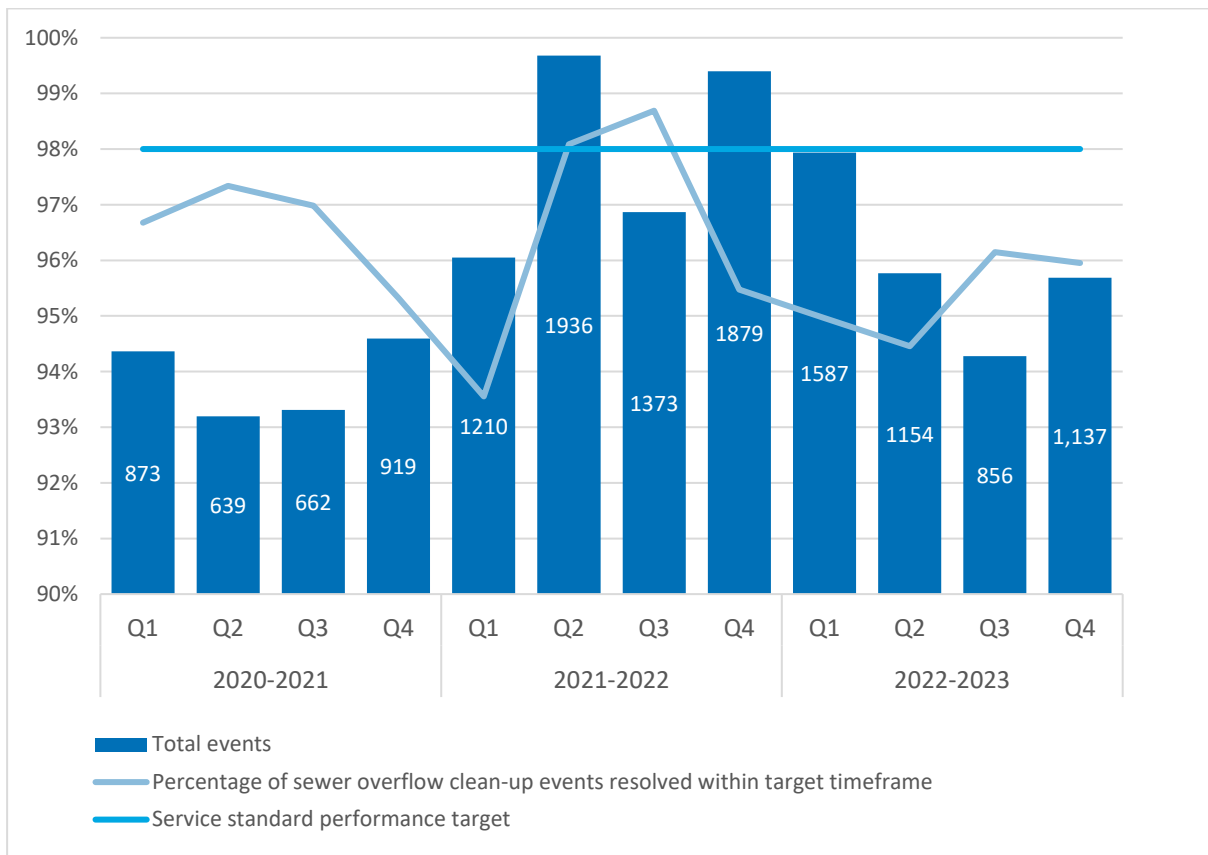
¹⁸⁹ Australian Government, Bureau of Meteorology, *National Performance Reports: Urban Water Utilities 2021-22*, section 7: Assets. P. 61, available at: www.bom.gov.au/water/npr/

¹⁹⁰ Australian Government, Bureau of Meteorology, *National Performance Reports: Urban Water Utilities 2021-22*, section 7: Assets. P. 64, available at: www.bom.gov.au/water/npr/

¹⁹¹ Information provided to the Commission by SA Water in its 2021-22 regulatory performance report, 30 September 2022.

¹⁹² SA Water's *'Healthy Sewer Campaign'*. See SA Water article for example: www.sawater.com.au/news/bad-flushing-habits-getting-rinsed-by-south-australians

Figure 6.1 – SAWRD20 quarterly performance against service standard 21 - sewer overflow clean-up timeliness – Adelaide Metropolitan

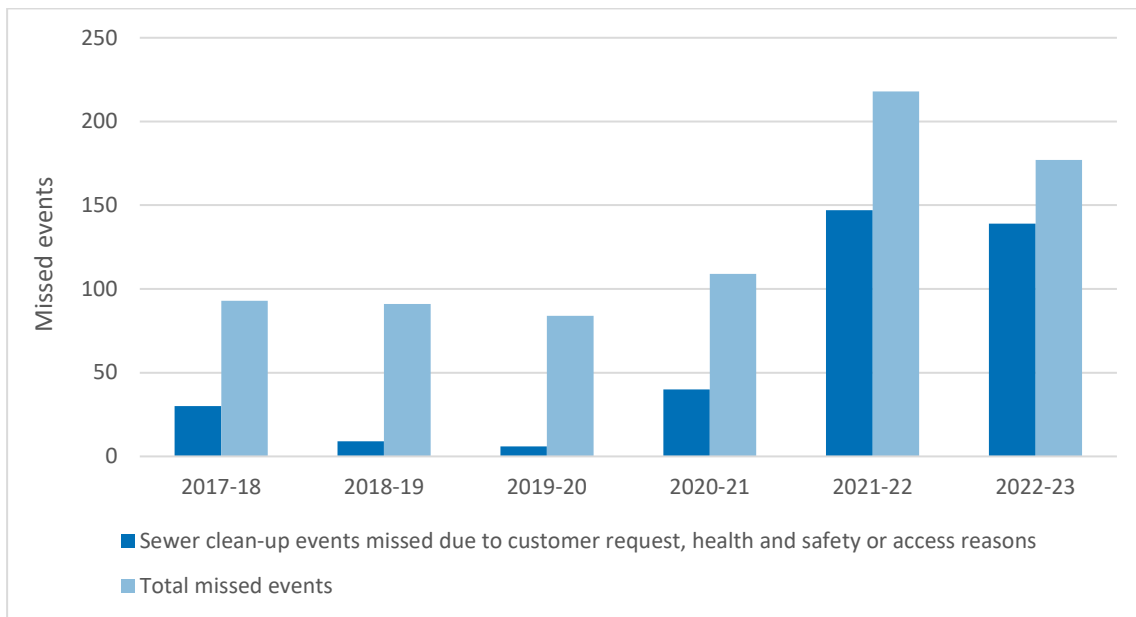


The Commission has been closely monitoring SA Water’s performance against service standard 21 over the four-year SAWRD20 period. Of particular concern to the Commission is SA Water’s continued decline in category 1 response performance – where a sewer overflows inside a customer’s building, which dropped to 80 percent in Q3 and 81 percent in Q4 2022-23.¹⁹³

SA Water has provided six years of data on the number of missed events that it states are due to factors outside its control. As the data in Figure 6.2 below shows, the number of events claimed to be missed due to factors outside its control has substantially increased, as a percentage of total missed events, from an average of 16 percent in the three years prior to SAWRD20 to an average of 61 percent in SAWRD20.

¹⁹³ SA Water achieved an average of 99 percent performance on category 1 events during SAWRD16. However, its performance on category 1 events has continued to decline over SAWRD20: in 2020-21 it was 94 percent, in 2021-22 it was 89 percent and in 2022-23 it was 87 percent.

Figure 6.2 – Total missed events and missed events outside SA Water’s control for service standard 21 - sewer overflow clean-up – Adelaide metropolitan area



The Commission has sought to understand why the claimed number of sewer clean-up events that are impacted by factors outside SA Water’s control has increased substantially and what measures SA Water is taking to maintain its historical performance levels. SA Water has noted that *‘If customer requested delays, safety concerns, and access issues were [taken into consideration], our performance for most quarters would be inline with historical performance’*.

This response fails to acknowledge that its historical performance – the baseline for the targets – includes these factors outside its control.

The Commission notes that SA Water engaged a new service contractor, Lendlease, in the Adelaide metropolitan region on 1 July 2020. In response to a request from the Commission on how it authenticates customer requested delays reported by its contractor, SA Water explained that its process involves the contractor self-reviewing every incidence of a failure to meet the performance target. SA Water stated that it is common for customer delay requests to follow late night sewer restorations or completion of a partial clean-up. In those instances, SA Water’s cleaning subcontractor arranges to return to the customer’s residence in the morning to complete the clean-up. An SA Water technical team then reviews each instance of a failure to meet the performance target to determine whether performance by the contractor and cleaning subcontractor was acceptable. SA Water requests further information from the contractor about missed events as required.¹⁹⁴

The Commission understands that SA Water’s process for monitoring customer satisfaction with sewer overflow clean-ups to be that issues raised by dissatisfied customers are handled one-on-one, and an overall satisfaction level is not recorded or monitored.¹⁹⁵

¹⁹⁴ Information provided to the Commission by SA Water May 3, 2023.

¹⁹⁵ Information provided to the Commission by SA Water September 15, 2023.

The Commission does not consider that adjusting the performance measure for service standard 21 to enable SA Water to remove factors outside its control prior to it assessing its performance is appropriate. The Commission has three primary concerns with this proposal:

► **Best endeavours test**

SA Water's proposal is to adjust the performance metric to enable it to remove factors outside its control prior to calculating its performance. SA Water stated that the purpose of its proposal is to enable it to meet the performance targets for service standard 21 and 22 *'without the need for best endeavours to be considered.'*¹⁹⁶ This means that in instances where SA Water does not meet the performance target due to factors it considers outside of its control, it would not have to provide any evidence that it has accurately determined and categorised the excluded events. A such, adjusting the performance metric as proposed by SA Water would, in effect, enable it to conduct a silent assessment of whether it had employed its best endeavours in meeting the target without any oversight by the Commission or the public.

This contrasts with expectations the Commission has established around performance reporting and transparency through the SAWRD20 final determination, which required SA Water to:

*'...complete performance self-assessments for each service standard during SAWRD20, to demonstrate its understanding of performance outcomes and its response to those outcomes, and to share successes and approach issues openly.'*¹⁹⁷

The Commission acknowledges that if the performance target for service standard 21 is no longer attainable by SA Water on a long-term basis due to factors outside SA Water's control, it may need to be reassessed. If that were case, the Commission would use SA Water's performance data over SAWRD24 to determine the reasonableness of the current performance target for SAWRD28 and, if required, set a new target that reflects the level of service that customers value. The Commission would expect clear evidence from SA Water to substantiate claims of factors outside of its control, for example, evidence of customer-initiated requests for delays (for example, evidence of consent).

► **Increasing number of events beyond SA Water control**

The Commission is concerned by the increasing proportion of missed events that are categorised as caused by factors beyond SA Water's control. In the three years prior to SAWRD20, for service standard 21, an average of 16 percent of all missed events were categorised as due to a factor outside SA Water's control. During SAWRD20, this average has increased to 61 percent. As evidence is still being sought from SA Water on what is driving this increase, the Commission does not consider it appropriate to allow SA Water to exclude these instances from its performance reporting without further review.

► **Historical performance**

SA Water's performance targets for its service standards are based on its historical performance. This historical performance includes missed events due to factors outside SA Water's control. Allowing SA Water to report against the target after these missed events have been removed from its performance will in effect lower the service standard performance target.

¹⁹⁶ SA Water RBP, p. 125.

¹⁹⁷ Essential Services Commission of SA, *SA Water SAWRD20 Final Determination: Statement of Reasons*, 2020, p. 99, available at: www.escosa.sa.gov.au/ArticleDocuments/21489/20200611-Water-SAWRD20-FinalDetermination-StatementOfReasons.pdf.aspx?Embed=Y

6.3.4.4 Draft decision

The Commission's draft decision is to retain the current performance targets for service standards 21 and 22 for SAWRD24 and require SA Water to provide more, and more detailed, annual performance reporting where it misses service standard targets. This will assist consumers by improving transparency on service levels delivered and should drive increased performance accountability from SA Water.

To implement this proposal, the Commission has drafted a clause in the Code that requires SA Water to provide a public, transparent best endeavours assessment of any missed annual service standard performance targets and has provided a proforma in Water Industry Guideline No. 2 Regulatory Information Requirements – Major Retailers (**Guideline 2**) for this purpose. The proforma will require SA Water to report publicly on how it has met the best endeavours standard for any missed service standard targets in a manner that details its performance gross of the factors outside its control, and net of those factors.

This will clearly illustrate for the Commission and the public where SA Water's performance is significantly affected by factors outside its control. It will also provide a public record of such instances and inform future assessment of the reasonableness, or otherwise, of performance targets. This draft decision also acknowledges feedback from stakeholders that more detailed information on SA Water's performance against its service standards, particularly where it misses performance targets, should be included in its performance reporting.¹⁹⁸

6.3.5 Consideration of new service standards

6.3.5.1 SA Water proposal

SA Water has not proposed any new service standards for SAWRD24.

6.3.5.2 Matters raised in consultation

No stakeholders have proposed any new service standards for SA Water over the SAWRD24 period.

6.3.5.3 Commission's analysis

In SAWRD20, the Commission determined that SA Water would have a regulatory obligation to improve water and sewer network reliability and metropolitan drinking water quality. That was based on SA Water's significant program of capital expenditure across SAWRD20 to renew water and sewer network service infrastructure and improve drinking water quality for metropolitan Adelaide customers.¹⁹⁹ However, rather than setting service standards to reflect these proposed improvements, the Commission required SA Water to set and commit to achieving performance measures and targets and to undertake an annual public self-assessment on its performance against those measures.²⁰⁰

¹⁹⁸ SACOSS submission to the Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper, 2023, and CAC meeting 29 June 2023.

¹⁹⁹ Section 6 direction requiring SA Water invest \$155.5 million in renewal of water and wastewater mains to improve service reliability. See the SA Government Gazette, 11 June 2020, available at: www.governmentgazette.sa.gov.au/2020/June/2020_050.pdf and the proposed Metropolitan Adelaide water quality program included \$80.1 million for SAWRD20 in the SAWRD20 Final Determination, 2019, p. 174.

²⁰⁰ SA Water Regulatory Determination 2020: Statement of Reasons, p.260-261, available at: www.escosa.sa.gov.au/ArticleDocuments/21489/20200611-Water-SAWRD20-FinalDetermination-StatementOfReasons.pdf.aspx?Embed=Y

The purpose of this reporting, as outlined in the MEPP,²⁰¹ was to require SA Water to demonstrate a clear 'line of sight' between service objectives, inputs and outputs by publicly reporting on its progress in achieving outcomes it committed to deliver in SAWRD20.

In accordance with this requirement over the SAWRD20 period, SA Water set performance measures in the form of customer service level targets for its network service reliability and water quality and published a self-assessment of its performance against these targets annually.²⁰²

The Commission considers that the self-assessment approach has allowed a more holistic understanding of SA Water's performance and has provided greater transparency on the relationship between SA Water's customer levels of service, the management of various risks in providing that service and the expenditure required to achieve those service outcomes. For instance, in its RBP, SA Water has explained how its asset management objectives incorporate these service levels and how the service levels are informed through customer engagement.²⁰³ Specifically, it notes how 'willingness to pay' feedback, which did not indicate support for increased levels of service reliability, informed SA Water's proposed expenditure initiatives and the resulting level of service for water interruptions in SAWRD24.²⁰⁴

As such, the Commission proposes that SA Water's self-assessment approach on water and sewer network reliability and water quality should continue for SAWRD24 as set out below.

► **Water and sewer network reliability**

In SAWRD20, SA Water set a range of customer service level targets for water and sewer network service reliability that were an improvement on its previous service levels. For SAWRD24, SA Water has proposed to 'maintain' its existing customer service level targets for water and sewer network reliability.

Based on the amount of planned capital expenditure that is still to be invested by SA Water to improve water and sewer network reliability for the remainder of SAWRD20, the Commission anticipates SA Water will either maintain, or continue to improve, its network service reliability. Considering it has already exceeded its SAWRD20 customer service level targets for water reliability, the Commission suggests that SA Water review whether these customer service level targets are reasonable, or if they could be increased to match its current performance trajectory.

The Commission's draft decision is that SA Water should continue to provide public reporting on its current customer service levels and performance measures for water and sewer network reliability. These customer service levels, and SA Water's performance across SAWRD20 in achieving them, are set out in Table 6.5 below.

²⁰¹ The *Monitoring, Evaluation and Performance Framework* established for RD20, available at: www.escosa.sa.gov.au/ArticleDocuments/21627/20210122-Water-SAWRD20-24-MonitoringEvaluationFramework-FinalReport.pdf.aspx?Embed=Y

²⁰² SA Water's self-assessments on its performance improving water and sewer network reliability for its customers are located on its website in its annual 'Key Investments areas' reports, available at: www.sawater.com.au/about-us/our-publications/our-reports/our-performance-scorecard

²⁰³ SA Water RBP, p 131.

²⁰⁴ SA Water RBP, pp. 100, 161.

Table 6.5: Waste and sewer network reliability performance metrics and targets²⁰⁵

Service	Service level	SAWRD20 target	2020-21 result	2021-22 result	2022-23 result	SAWRD24 target
Water	Number of unplanned interruptions per 1000 properties per year	<153	169.4	145.7	188.7	<153
Water	Number of customers with three or more unplanned interruptions	<1,750	2,073	1,482	1,848	<1,750
Sewer	Number of customers that have had an internal overflow in the past 12 months	<191	212	296	235	<191
Sewer	Number of customers experiencing more than one sewer internal overflow in five years	<21	34	34	48	<21
Sewer	Type 1 and 2 environmental overflow events reported to the Environment Protection Authority (five-year annual average)	<135	120	128	131	<135

As set out in chapter 18, the Commission has decided to codify SA Water's public reporting requirements. Accordingly, the Commission has included annual public reporting requirements for these key investment areas in the Code and in Water Industry Guideline No. 2.²⁰⁶

The Commission may consider the establishment of service standards for water and sewer network reliability in SAWRD28, when the relevant significant capital expenditure programs approved for implementation over SAWRD20 are complete, and SA Water has sufficient historical performance data for meaningful targets to be set.

► **Monitoring and reporting on water aesthetics**

For the SAWRD20 period, the Commission decided that SA Water should monitor and self-report on improvements in metropolitan Adelaide water quality delivered through significant increased expenditure planned for the four-year regulatory period. While these improvements in water quality were driven by SA Water's statutory obligation under section 24 of the *Safe Drinking Water Act 2011*, to ensure that the water supplied to customers is safe to drink, water quality improvements were also anticipated. As is the case for the water and sewer network reliability measures described above, the Commission required SA Water to set performance measures and provide annual public reports on its progress.

²⁰⁵ Data obtained from SA Water's annual 'Key Investments areas' reports, available at: www.sawater.com.au/about-us/our-publications/our-reports/our-performance-scorecard.

²⁰⁶ See chapter 18 for more details.

SA Water set a performance measure at the beginning of the SAWRD20 period and provided public self-assessments against this measure in its annual Key Investments Areas reports.²⁰⁷

In its RBP, SA Water has proposed a program of works for SAWRD24 that 'maintain' its existing customer service level for water quality.²⁰⁸ This customer service level, and SA Water's performance across SAWRD20 in achieving it, is set out in Table 6.6 below.²⁰⁹

Table 6.6: Metropolitan water quality improvement performance over SAWRD20 and SAWRD24 target

Performance measure	SAWRD20 target	2020-21 performance	2021-22 performance	2022-23 performance	SAWRD24 target
Customer perception of overall quality of water	80%	84%	78%	79%	80%

Similar to the water and sewer network reliability improvements, SA Water's incurred capital expenditure as part of its program for metropolitan Adelaide water quality improvements has been below its initial plans as part of SAWRD20²¹⁰. SA Water has proposed significant capital expenditure over SAWRD24 to continue to improve metropolitan water quality over SAWRD24.²¹¹ As discussed in Chapter 11, there are expected to be challenges in delivering the profile of capital expenditure for water quality improvements over SAWRD24. Accordingly, on this basis, the Commission anticipates a maintained, or improved, level of customer perception of water quality over SAWRD24.

The Commission's draft decision is that SA Water continue to provide public reporting on the current performance metric for metropolitan water quality improvement.

As the Commission has decided to codify SA Water's public reporting obligations, it has included annual reporting requirements for key investment areas in the Code and Guideline 2.²¹² The Commission may consider the establishment of a service standard for customer perceived water quality in SAWRD28, when the relevant significant capital expenditure programs approved for implementation over SAWRD20 are complete, and SA Water has sufficient historical performance data for a meaningful target to be set.

6.3.5.4 Draft decision

The Commission has made a draft decision not to adopt any new service standards for SAWRD24. Instead, the Commission's draft decision is that SA Water continue to provide public reporting on the current performance metrics for water and sewer network service reliability and metropolitan water quality improvement.

²⁰⁷ SA Water's self-assessments on its performance improving water aesthetics are located on its website in its annual 'Key Investments areas' reports, available at: www.sawater.com.au/about-us/our-publications/our-reports/our-performance-scorecard

²⁰⁸ The customer service measure 'Customer perception of overall quality of water' is monitored through SA Water's quarterly brand health surveys, which sample 300 residents and 100 small to medium-sized businesses online and over the phone. 75 per cent of customers are metropolitan, the balance regional.

²⁰⁹ SA Water RBP, p. 203.

²¹⁰ For example, for SA Water's Metro Water Quality Improvement project, this has reflected, in part, challenges associated with implementing the technology, and there were impacts on customer perceptions of water quality and there were skin rash complaints and impacts on aquatic pets.

²¹¹ SA Water RBP, p. 203.

²¹² See chapter 18 for more details.

6.4 Guaranteed Service Level scheme

A Guaranteed Service Level (GSL) scheme is a system for making defined payments to individual customers who experience certain types of poor service. Typically, GSL scheme payments do not compensate customers for any losses they experience because of poor service; they simply provide a customer service gesture.

In making its final determination for SAWRD20, the Commission considered and decided not to introduce a GSL scheme during SAWRD20.²¹³

Although it does not have a GSL scheme, SA Water makes some service gesture payments to customers on a case-by-case basis. For example, when a billing error has been made, or where property is damaged by water or sewerage and SA Water is responsible. Occasionally, SA Water makes service gesture payments to a large group of customers. SA Water has indicated it will make service gesture payments equivalent to the quarterly supply charge to approximately 5,000 customers affected by the 25-26 October 2023 water interruptions in Adelaide's southern suburbs.²¹⁴

SA Water also sometimes makes payments to assist customers to manage high water use or leakage that occurs on the customer's side of the meter. The Commission considers service gesture, high water use and leakage payments to be a reasonable part of SA Water's customer service program.

The Commission's SAWRD20 final determination included a decision to require reporting, at an aggregate level, on SA Water's service gesture, high water use and leakage payments. This was not implemented in the July 2020 update to Guideline 2 but will be incorporated in the version of Guideline 2 that will apply from 1 July 2024. The Commission will consult with SA Water on categories for reporting.

The purpose of this reporting is not to discourage SA Water from making payments of this nature but to ensure that expenditure on these payments is transparent and informs any future consideration of a more formalised scheme of customer payments.

6.5 Draft Decision

The Commission's draft decision is that the existing 22 service standards will continue to apply to SA Water during SAWRD24. The service standards cover aspects of customer service, responsiveness to service issues, service restoration timeliness and timeliness of connections. There are separate service standards for the Adelaide metropolitan area and regional areas.

The Commission has not accepted SA Water's proposal to adjust the performance metrics for regional response service standards or the sewer overflow clean-up service standards, as it considers doing so may result in service reductions.

To improve transparency where SA Water does not meet a service standard performance target the Commission will require SA Water to provide evidence publicly that it has employed its best endeavours to meet the performance target. This will aid the Commission in undertaking a review of the reasonableness of any service standard targets that SA Water is unable to meet over SAWRD24 when setting performance targets for SAWRD28.

²¹³ Essential Services Commission of South Australia, *SA Water SAWRD20 Final Determination: Statement of Reasons*, 2020, p. 110, available at: www.escosa.sa.gov.au/ArticleDocuments/21489/20200611-Water-SAWRD20-FinalDetermination-StatementOfReasons.pdf.aspx?Embed=Y,

²¹⁴ Australian Broadcasting Corporation, 2023, *SA Water to compensate thousands of residents who were left without water for days*, available at: [SA Water to compensate thousands of residents who were left without water for days - ABC News](https://www.abc.net.au/news/2023-10-26/sa-water-to-compensate-thousands-of-residents-who-were-left-without-water-for-days/10312342)

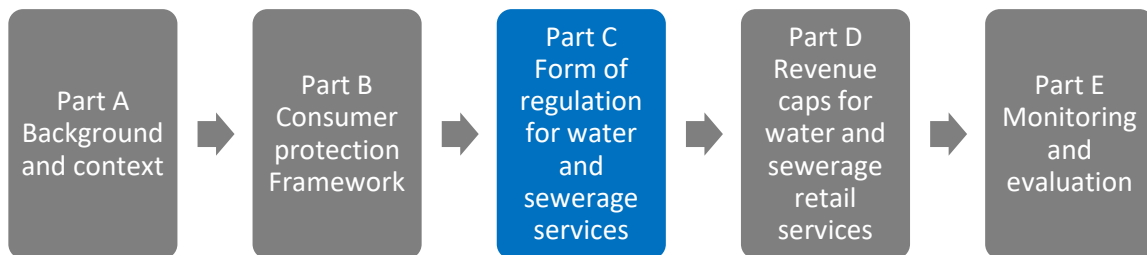
To maintain service at historical performance levels, the performance target for complaint escalation to the Ombudsman will be lifted to better reflect SA Water's performance over SAWRD20.

The Commission's draft decision on service standards for SAWRD24 is to:

- ▶ Maintain the current regional response time performance measures.
- ▶ Maintain the current sewer overflow clean-up performance measures.
- ▶ Require SA Water to provide more detailed annual public reporting on missed service standard performance targets. These new reporting requirements will be included in the Water Retail Code – Major Retailers, and a proforma will be included in Guideline 2.
- ▶ Increase the performance target for service standard 5: complaint escalation to the Ombudsman from ≤ 15 percent to ≤ 10 percent.
- ▶ Maintain the current public reporting requirement for water and sewer network reliability.
- ▶ Maintain the current public reporting requirement for sewer overflows to the environment.
- ▶ Maintain the current public reporting requirement for water quality improvement.

The 22 service standards and performance targets that will apply in SAWRD24 are summarised in Table 6.1.

Part C – Form of regulation for water and sewerage retail services



Part C covers the proposed forms of price regulation to apply to SA Water's water and sewerage retail services, as defined in the *Water Industry Act 2012*.

This includes the form of regulation for 'direct control' water and sewerage retail and related adjustment mechanisms. These are regulated through a price determination that establishes separate revenue caps for each service. The revenue caps fix SA Water's revenues for four years subject to mechanisms that allow for the pass-through of certain unforeseen costs and revenue changes due to variations in demand. This approach is consistent with the requirements of the Pricing Orders that apply to the current regulatory determination.

In addition, this Part C covers the form of regulation for retail services that are not covered by the 'direct control' revenue caps described above. This includes retail services such as the supply of recycled water, the provision of new connections and trade waste services. These are regulated under a separate price determination that establishes pricing principles that SA Water must take into account when setting prices for those services.

7 Revenue caps and adjustment mechanisms for direct control retail services

Draft decision – Form of regulation for direct control retail services

The Commission's draft decision is that:

- ▶ SA Water's direct control water and sewerage retail services will be subject to separate four-year maximum revenue caps and be prepared and presented on the basis of a building blocks cost model.
- ▶ The caps will be calculated as the forecast efficient costs of providing water and sewerage retail services and will be set at a fixed dollar amount subject to the following ancillary (adjustment) variation mechanisms.
- ▶ A 'cost pass-through' mechanism that will enable the revenue caps to be adjusted in the subsequent regulatory period where an event beyond the control of SA Water has, or will have, a material impact on SA Water's costs of providing water or sewerage retail services.
- ▶ A 'demand variation adjustment' mechanism that will adjust the revenue caps in the subsequent regulatory period to account for any material differences between forecast and actual water and sewerage retail service revenue earned, due to differences between forecast and actual water sales and sewerage connections.
- ▶ A 'shared infrastructure' mechanism for water retail services that adjusts the revenue caps in the subsequent regulatory period to account for the difference between actual and forecast revenues from the previous period, in relation to 10 percent of the revenue earned by SA Water for the provision of non-regulated services that utilise water retail service infrastructure. For sewerage retail services, the 'shared infrastructure' mechanism allows for 10 percent of the revenue amounts earned during the regulatory period, through the use of SA Water's regulated infrastructure required to provide sewerage retail services but which are not attributable to the provision of sewerage retail services, to be deducted from the revenue caps in the subsequent regulatory period.
- ▶ A 'River Murray licence adjustment' mechanism that will reduce revenue caps in the subsequent regulatory period to reflect income derived by SA Water from the sale of water allocations associated with River Murray water entitlements.
- ▶ A 'contingent project' mechanism that may allow for the recovery of efficient costs associated with a pre-determined major capital project, where the costs were not incorporated into the revenue caps because of a defined contingency. The mechanism will allow additional expenditure to be incurred within the SAWRD24 regulatory period but included in the revenue controls for the SAWRD28 regulatory period (with a time-value-of-money allowance).

7.1 Introduction

7.1.1 Form of regulation and the Pricing Order

The Commission is authorised under the *Essential Services Commission Act 2002 (ESC Act)* and the *Water Industry Act 2012 (WI Act)* to make price determinations in respect of SA Water's regulated direct control services (water and sewerage retail services). Accordingly, the Commission is responsible for determining the appropriate form of economic regulation to apply to these services for SAWRD24.

In determining the form of regulation to apply for SAWRD24, the Commission must meet any requirements specified in Pricing Orders issued by the Treasurer pursuant to section 35(4) of the WI Act.²¹⁵ At the time of publishing this Draft Determination, no Pricing Order has been issued in respect of the SAWRD24 regulatory period.

While economic theory and regulatory practice in Australia indicate that there are various forms of economic regulation that may be appropriate when regulating a natural monopoly like SA Water,²¹⁶ previous Pricing Orders have outlined the specific forms of economic regulation to be applied.²¹⁷

In general, the form of economic regulation specified in previous Pricing Orders is consistent with the general regulatory practice applied when price regulating monopoly utilities providing essential services. Pricing Order requirements have included:

- ▶ a fixed, four-year maximum revenue cap for water and sewerage services be applied (with separate revenue caps to be applied for each service)
- ▶ a building blocks cost model be applied to prepare and present the maximum revenue caps
- ▶ adjustment mechanism/s be included in the determination that allow for ex-post adjustments to the maximum revenue caps relating to variations in demand and cost pass-through events, and
- ▶ National Water Initiative (NWI) Pricing Principles be adopted or applied (other than the Principles for Recovering the Costs of Water Planning and Management Activities).

The previous Pricing Order from SAWRD20 also precluded the maximum revenue caps from applying on the basis of customer class or location.

7.1.2 Form of regulation in SAWRD20

The Commission met the previous Pricing Order requirements from SAWRD20 for the form of regulation by setting a maximum revenue cap with ancillary (adjustment) mechanisms. This involved establishing separate four-year revenue caps for water and sewerage retail services using a building blocks cost model²¹⁸ and determining that those revenue caps would be subject to:

- ▶ a cost pass-through mechanism (for example, to allow for the pass-through of unforeseen costs)
- ▶ a demand variation adjustment mechanism (for example, to allow for revenue changes due to variations in demand)
- ▶ a shared infrastructure revenue adjustment mechanism (for example, to allow customers to recover a portion of unregulated revenues that have been collected by SA Water from the use of regulated assets)
- ▶ a River Murray water licence adjustment mechanism (for example, to allow customers to recoup income that was derived by SA Water from the sale of water allocations associated with River Murray water entitlements), and

²¹⁵ For a discussion of the legal requirements for SAWRD24, please see Appendix 2.

²¹⁶ For instance, see Decker C, *Modern Economic Regulation; An Introduction to Theory and Practice*, Cambridge University Press, 2015, pp. 103-139.

²¹⁷ Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

²¹⁸ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 37-56.

- ▶ an intra-period project review mechanism that allowed for the recovery of efficient costs associated with a pre-determined major capital project, where the costs were not incorporated into the revenue caps because of a contingency or adverse event.²¹⁹

The following chapter reviews, considers and determines the appropriate form of economic regulation for direct control services²²⁰ for the SAWRD24 period.

7.2 SA Water's proposal

In its Regulatory Business Proposal (RBP), SA Water proposed four-year maximum revenue caps for water and sewerage retail services for SAWRD24, calculated under a building blocks cost model.²²¹

SA Water also proposed the continued use of the following SAWRD20 revenue adjustments:²²²

- ▶ a cost pass-through mechanism
- ▶ a demand variation adjustment mechanism, subject to amendment, and
- ▶ an intra-period project review mechanism, subject to amendment.

SA Water's proposals for amendment of the demand variation adjustment mechanism and intra-period review mechanism are outlined below.

▶ Demand variation adjustment mechanism

SA Water proposed that the current form of the demand variation adjustment mechanism be amended, such that for SAWRD24 the adjustment be calculated based on variations between actual and forecast demand. In practice, this proposal is for the methodology to return to that which was set out in SAWRD16.

SA Water's position was informed by research prepared for the Commission by consulting firm, Sapere Research Group (**Sapere**).²²³ Sapere's research indicated that the SAWRD16 methodology for the demand variation adjustment mechanism complied more closely with the requirements of the previous Pricing Order, as it captured more of the revenue variation due to demand variation. In contrast, the SAWRD20 methodology for the demand variation adjustment mechanism was designed based on variations between actual and forecast prices, and, in Sapere's view, the method complied less closely with the requirements of the previous Pricing Order.²²⁴ As discussed later on below, the Commission supports this proposed position.

▶ Intra-period review mechanism

SA Water proposed that the current form of the intra-period project review mechanism be amended to make it more accessible to it. It proposed to remove the deadline for stage one (which in SAWRD20 was set at six months after the regulatory period commenced) and to consolidate the whole process into one stage (rather than utilising a two-stage process).

²¹⁹ Ibid, pp. 47-56.

²²⁰ Refer to Chapter 4 – SA Water's Regulatory Business, for further information on direct control services.

²²¹ SA Water, Regulatory Business Plan 2024-28, pp. 260-272.

²²² Ibid, pp. 283-287.

²²³ Ibid, p. 284.

²²⁴ Sapere Research Group, *Demand Variation Adjustment Mechanism Review*, Report for the Essential Services Commission of South Australia, July 2022, pp. 1-42.

SA Water considered that the 31 December 2020 deadline for submission of projects under Stage 1 of the mechanism was not practical as not all new non-discretionary initiatives were known by this date, or where driven by a contingent action, that action may not have eventuated.²²⁵

SA Water also stated that due to the timing consideration for SA Water when reacting to unexpected events, implementing a one stage process would make the mechanism more efficient.

SA Water has advised the Commission that it has one known project that it may seek to put forward under the intra-period review mechanism during SAWRD24. It has advised that additional projects may also emerge over the next regulatory period if external factors change.²²⁶

In other submissions provided to the Commission during SAWRD20, SA Water has sought additional guidance in how to utilise the intra-period project review mechanism, including in relation to criteria, appropriate trigger events, and process steps and information requirements.²²⁷ In its submission to Guidance Paper 3: Assessing the regulatory business plan (**Guidance Paper 3**), SA Water suggested further work to be undertaken to improve the process for the intra-period project review mechanism and to consider how the mechanism could allow for unanticipated property development growth.²²⁸

7.3 Matters raised in consultation

Submissions did not comment directly on the form of economic regulation for direct control services to apply to SA Water's water and sewerage retail services.

The Energy and Water Ombudsman South Australia (**EWOSA**) supported the continued use of a demand variation adjustment mechanism (although it noted limitations in SA Water's demand projections for SAWRD24).²²⁹

The Property Council of Australia queried how, and to what extent, regulatory mechanisms currently operate to address growth in SA Water's network to accommodate for water and sewerage retail services for greenfield property developments.²³⁰ In its view, a longer regulatory period (more than four years) would more adequately meet the growth ambitions of the South Australian Government. It further argued that the regulatory framework should be 'more agile' to better respond to changes in housing demand, particularly if they are 'rapid and sudden'.²³¹ The City of Playford and City of Salisbury raised concerns regarding insufficient focus on infrastructure needs for demand growth in northern metropolitan areas and also 'prohibitive SA Water charges'.²³² Also, Villawood Properties queried a perceived lack of information relating to, and funding for, infrastructure in SA Water's RBP to service demand growth at the urban fringe.²³³

²²⁵ SA Water, Regulatory Business Plan 2024-28, pp. 286-287.

²²⁶ Based on correspondence between the Commission and SA Water.

²²⁷ SA Water, *RD24 Framework and Approach*, March 2021, p. 14, 16, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21706/20210604-Water-SAWRD24FrameworkApproachSubmission-SAWater.pdf.aspx?Embed=Y>.

²²⁸ SA Water, *Submission on Guidance Paper 3: Assessing the regulatory business plan*, August 2022, p. 1, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21810/20220810-Water-SAWRD24-GuidancePaper3Submission-SAWater.pdf.aspx?Embed=Y>.

²²⁹ Energy and Water Ombudsman South Australia, pp. 1-2.

²³⁰ Property Council of Australia, pp. 1-4.

²³¹ Property Council of Australia, p. 4.

²³² City of Playford and City of Salisbury, pp.1-2.

²³³ Villawood Properties, p. 1.

7.4 Commission analysis

7.4.1 Four-year revenue caps for direct control services

In carrying forward the SAWRD20 approach for this Draft Determination, the Commission's draft decision is to establish separate four-year maximum revenue caps for water and sewerage retail services to apply for SAWRD24. A revenue cap sets the maximum amount of revenue a regulated firm is allowed to earn over an agreed period, subject to any adjustment mechanisms.

The maximum revenue cap is designed to incentivise efficient behaviour, by encouraging SA Water to incur lower expenditure than that reflected in the maximum revenue caps, while still achieving its statutory obligations. The revenue cap aims to achieve these goals in several ways.

- ▶ The revenue cap is set with regard to the forecast *real* (inflation-adjusted) costs that would be incurred by a prudent and efficient standalone benchmark entity with the obligations and risks of SA Water, not necessarily SA Water's actual or expected costs.²³⁴
- ▶ The revenue cap is not adjusted during the course of the regulatory period, although it is subject to revenue adjustment mechanisms (such as those mentioned earlier). In general, changes to SA Water's actual real costs relative to the efficient costs underpinning the maximum revenues are not passed through to revenues or prices during that period. This means that SA Water incurs the cost of any overspend and it retains the benefit of any underspend relative to the real, efficient expenditure allowance that was made at the commencement of the regulatory period. If SA Water's realised real costs during the period are below forecasts of efficient costs, then those realised lower costs will likely be reflected in the revenue caps in the subsequent regulatory period. Any costs incurred that are above the efficient amounts used to set revenues are only taken into account if the expenditure is prudent and efficient.²³⁵
- ▶ The Commission monitors, reports and enforces compliance against service obligations to ensure that customer service levels are maintained at the required standards. This protects against the incentive to lower service levels in order to reduce realised costs during the regulatory period.

A submission from the Property Council of Australia advocated for a regulatory period of longer than four years.²³⁶ However, the four-year period has been mandated by the South Australian Government through past Pricing Orders, and is expected to be mandated for SAWD24 through the same mechanism.²³⁷ Further, while a longer regulatory period may provide additional certainty, it could raise its own set of risks, including increased forecast risk that could be borne by customers and SA Water.

7.4.2 Building blocks cost model

In carrying forward the SAWRD20 approach for this Draft Determination, the Commission's draft decision is that the revenue caps for SAWRD24 are prepared and presented on the basis of a building blocks cost model. The Commission's revenue determination allows SA Water to recover the efficient cost of providing water and sewerage retail services to customers. The determination will, on an ex-post basis, be subject to various revenue adjustment mechanisms; for example, to allow for the

²³⁴ The revenue determination is set in real, not nominal, terms. SA Water receives inflation compensation through the periodic indexation of the regulated asset base.

²³⁵ Any assessment of the efficient and prudent expenditure in the subsequent regulatory period will consider temporary and one-off movements in real costs, and any trends in actual real expenditure in the previous period, and it will consider all available information about the outlook for expenditure over the period.

²³⁶ Property Council of Australia, p. 4.

²³⁷ Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

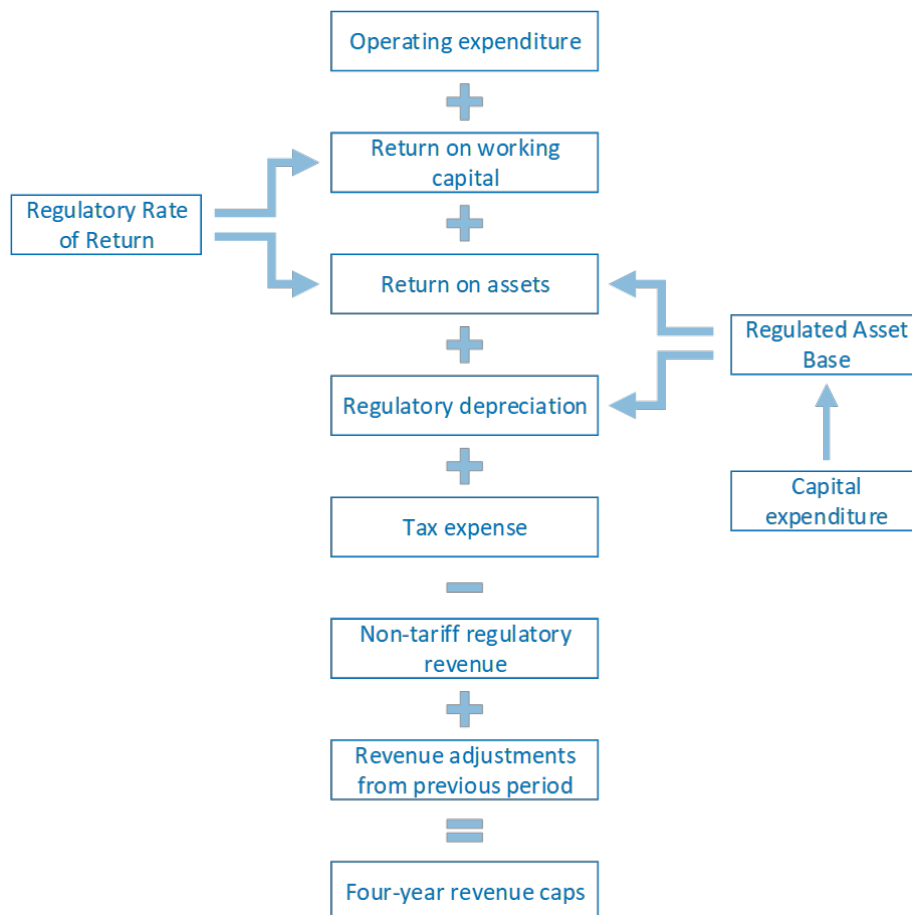
pass-through of certain unforeseen costs and revenue changes due to variations in demand. The revenue caps for water and sewerage services apply on a State-wide basis.

The building blocks cost model is a commonly accepted economic approach to estimating efficient costs: it is effectively a build-up of the forecast efficient costs of the regulated firm. This approach to setting revenues aligns with the NWI Pricing Principles and the legal framework within which the Commission operates. As it is based on standard and generally-accepted (within Australia and internationally) regulatory methodologies,²³⁸ the approach followed in this determination promotes consistency in regulation with other jurisdictions (refer ESC Act, section 6(b)(vii)).

Efficient costs need not be the costs the regulated business is actually incurring, and it is for the regulated business to demonstrate that its actual costs represent an efficient cost base.

As shown in Figure 7.1, the building blocks cost model involves adding the forecast efficient operating expenditure, return on working capital, return on assets, regulatory depreciation and tax expense to determine the total efficient costs of providing each service. It deducts revenue that SA Water receives from other sources that contribute towards those costs, such as Community Service Obligations (CSO) payments, to ensure that SA Water does not over-recover those efficient costs.

Figure 7.1: Building blocks cost model of water and sewerage services revenue



²³⁸ Petersen et al, Access Regulation in Australia, Thomson Reuters (Professional) Australia Ltd, 2016, pp. 69-100; and Decker, Modern Economic Regulation – An introduction to theory and practice, Cambridge University Press, 2015, pp. 103-139.

Adjustments are made to reflect outcomes from the current regulatory period that flow through to the next regulatory period, such as those under the demand variation adjustment mechanism, the shared infrastructure revenue adjustment mechanism and the River Murray water licence adjustment mechanism. The cost building blocks and adjustments for SAWRD24 are discussed in Chapters 10 to 17.

The Commission excludes any costs associated with services that are not direct control retail services. In some cases, infrastructure may be used to provide direct control retail services, excluded retail services and/or non-regulated services, and those infrastructure costs are apportioned between the services based on relevant cost drivers.²³⁹ SA Water's cost allocation methodology as proposed for SAWRD24 is generally consistent with that applied in previous regulatory periods (although there has been an updated realignment in its methodology for SAWRD24).²⁴⁰

7.4.3 Cost pass-through adjustment mechanism

The Commission's draft decision is to include a cost pass-through mechanism in SAWRD24 in the current form, as:

- ▶ it provides a form of flexibility for a revenue-regulated business, without which it may not be able to account for cost impacts of an unexpected, unpreventable and external event that would cause material disruption
- ▶ it carries forward the approach adopted in SAWRD20
- ▶ it is supported by SA Water in its RBP, and
- ▶ stakeholders have not raised any concerns about it in submissions.

It is common practice for economic regulators to use cost pass-throughs in conjunction with either revenue or price controls. The draft determination includes a pass-through mechanism that allows maximum revenues to change if there is a change in legal obligation or an extraordinary event, which is exogenous, unavoidable, and materially impacts SA Water's costs of providing water and sewerage retail services. The determination does not fix a materiality threshold for a pass-through event. Rather, SA Water can propose if an event is material, having regard to the specific circumstances of the event and its financial impact.²⁴¹ Any approved pass-through amount (which could be positive or negative) would be passed through to revenues in the following regulatory period.

Notwithstanding three events highlighted by SA Water, which were COVID-19 related disruptions, bottlenecks in the supply of commodities, freight and goods, and impacts from the 2022-23 River Murray floods, SA Water did not submit any cost pass-through applications in the current period.²⁴²

²³⁹ For a description of SA Water's direct control retail services, its excluded retail services and its non-regulated services, please see Chapter 4. It is noted that availability charging (also known as rating on abuttal) is a non-regulated service.

²⁴⁰ SA Water, Regulatory Business Plan 2024-28, pp. 214-215.

²⁴¹ The current mechanism in the SAWRD20 Price Determination states that a purported pass-through event will be material if it satisfies one or more of the following factors: (a) the total cost/expense of the event meets or exceeds \$10 million, and (b) the total cost/expense of the event does not meet or exceed \$10 million, but the Commission considers that, in the specific circumstances, the passthrough event is of such significance so as to justify the classification of the event as being material having regard to the: (i) impact of the event on SA Water and/or its customers, and/or (ii) practical consequences of the event not being classified as a passthrough event.

²⁴² SA Water, Regulatory Business Plan 2024-28, p. 285.

7.4.4 Demand variation adjustment mechanism

7.4.4.1 Demand risk and the role of mechanism

The adoption of a maximum revenue cap approach, as specified above, can have several important implications for the distribution of demand (volume) risk between SA Water and its consumers.

In theory, and assuming full information and no regulatory lags, under a total fixed revenue cap a regulated firm, such as SA Water, is not exposed to volume risk. This reflects that a firm could adjust prices in response to changes in demand to keep revenue constant and within the fixed revenue cap.²⁴³

In practice, however, this may not necessarily be the case, as water sales volumes can fluctuate significantly on an annual basis from time to time²⁴⁴ and the presence of regulatory lags can impact pricing.²⁴⁵ Furthermore, insofar as the South Australian Government has a preference for price stability within the regulatory period, then this may limit frequent and/or large adjustments in water and sewerage retail prices to keep revenue constant.

In relation to demand risk, the previous Pricing Order from SAWRD20 required that the determination:

'...must include a mechanism which allows for the adjustment of the total revenue which may be derived where the Commission determines there to be a relevant and material variation between forecast and actual rates of water consumption or sewerage connections. The adjustment mechanism must operate on the basis of efficient costs associated with variations in demand, and so as to promote a stable price path for retail services'.²⁴⁶

7.4.4.2 Approach for SAWRD24

The Commission's draft decision is to continue the use of a demand variation adjustment mechanism for water and sewerage retail services, but to:

- ▶ adopt the SAWRD16 methodology
- ▶ set out a 50-50 sharing percentage between customers and SA Water, and
- ▶ exclude the use of a materiality threshold.

The Commission's position has been informed by research by Sapere.²⁴⁷ Sapere was commissioned to review the current form of the demand adjustment mechanism, with the intention to allow the Commission to consider the overall framework and the incentives for the regulated operator.

²⁴³ Decker, p. 123, and Queensland Competition Authority, *Risk and the Form of Regulation*, Discussion paper, November 2012, pp. 13-14, available at https://www.qca.org.au/wp-content/uploads/2019/05/1850_X-QCA-DiscussionPaper-RiskandtheFormofRegulation-1112-2.pdf.

²⁴⁴ See Figure 5-10 in SA Water, *Regulatory Business Plan 2024-28*, p. 115.

²⁴⁵ The presence of regulatory lags can mean that, even if actual volume deviates from forecast, adjustments to prices typically occur with a lag. As such, a regulated firm can experience some deviation from its expected revenues in the interim period (that is, prior to any adjustment). Queensland Competition Authority, pp. 13-14,

²⁴⁶ Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

²⁴⁷ Sapere Research Group, pp. 30-31.

Sapere reported that the SAWRD16 mechanism was designed to be calculated based on variations between actual and forecast demand. Whereas the SAWRD20 methodology was designed based on variations between actual and forecast prices. Consequently, the SAWRD16 methodology complied more closely with the requirements of the previous Pricing Order from SAWRD20, as it captures more of the revenue variation due to demand variation.²⁴⁸ Further, it has the added advantage of being simpler to implement.^{249,250}

A key design issue relates to how much of the revenue variation is passed through to customers. Ultimately, the appropriate sharing percentage is a matter of judgement for the Commission. While there is a case to consider a 100 percent pass-through, in which revenue variation is passed fully through to customers, that approach can reduce SA Water's incentives for seeking out business opportunities, and it can contribute to additional volatility between regulatory periods.²⁵¹ Further, in SAWRD16, the Commission considered that a 100 percent pass-through may be at risk of breaching the Pricing Order in place at that time which required the application of a total revenue cap.²⁵²

On balance, the Commission proposes to maintain a 50-50 sharing percentage between customers and SA Water for SAWRD24 under the demand variation adjustment mechanism. This is consistent with the risk-sharing percentage adopted in the past two regulatory determinations. The benefits of the 50-50 pass-through are, generally speaking, shared between consumers and SA Water: consumers are compensated for any breach in the revenue cap due to demand, while SA Water has incentives to seek out commercial opportunities that can generate more sales.²⁵³

Another design issue, albeit one that is more marginal, relates to whether a materiality threshold should be adopted. The adjustment calculation must be undertaken in any event. Consequently, there is, in the Commission's view, no need for the inclusion of a definition of a minimum materiality threshold in the design of the mechanism (as without a threshold it would allow all revenue variations in line with variations in demand, irrespective of the size of the movements in demand).²⁵⁴ The draft decision is to remove the materiality threshold calculation in the mechanism.

In terms of other design issues, Sapere's research suggested that the demand adjustment mechanism method could be improved by updating it to account for variation in demand by pricing tiers and variation net of (efficient) variable costs.²⁵⁵ However, in the Commission's view these two proposals have practical limitations that make them unsuitable for implementation in SAWRD24.²⁵⁶

²⁴⁸ Ibid, p. 1, 26 and pp. 30-31.

²⁴⁹ Ibid, pp. 30-31.

²⁵⁰ Sapere's research suggested that the usefulness of a demand adjustment mechanism for sewerage connections may be limited, given that sewerage connection growth is relatively predictable (Sapere Research Group, p. i, 4). However, the Commission notes that excluding sewerage from the mechanism would not be in line with the previous Pricing Orders.

²⁵¹ Ibid, p. ii, pp. 15-30.

²⁵² The adoption of a 100 percent pass-through was considered to result in characteristics that were closer to an average revenue cap rather than a total revenue cap.

²⁵³ For example, at one extreme end, the 100 percent may not be in line with the application of a total revenue cap (it may be closer in line with an average revenue cap, which was what was argued in SAWRD16). At the other extreme end, without any adjustment for the sharing of demand a total fixed revenue can reduce SA Water's incentives to engage in business activities that can increase demand. Given those two extreme positions, the 50-50 pass through aims to allocate demand (volume) risks between consumers and SA Water.

²⁵⁴ Sapere Research Group, p. ii, pp. 30-31.

²⁵⁵ Ibid, p. ii, pp. 15-28, 30-31

²⁵⁶ For example, it is the Commission's understanding that SA Water does not forecast demand by pricing tariff band. Further, an ex-post assessment of the variable costs incurred due to demand variation during the regulatory period is made difficult because different sources of water supply (for example, reservoirs, Adelaide Desalination Plant, River Murray) can have significantly different costs.

SA Water has proposed the following demand forecasts.²⁵⁷ The Commission interprets these forecasts as being those submitted for the purposes of the demand variation adjustment mechanism (Table 7.1).

Table 7.1: SA Water's forecasts for SAWRD24

	2024-25	2025-26	2026-27	2027-28
Water (GL)	203.7	204.7	205.6	206.6
Sewerage customer accounts (no.)	647,530	653,842	660,216	666,653

EWOSA's submission noted that the demand projections should be updated to incorporate updated population projections when these are published by the Australian Bureau of Statistics in late 2023. In the Commission's view, however, the current set of forecasts are not unreasonable, and are broadly in line with recent outcomes and historical averages. Nonetheless, the Commission will, in line with EWOSA's submission,²⁵⁸ review and consider the latest population projections and how they will impact SA Water's projected demand for the purposes of the demand variation adjustment mechanism, and the Commission will provide an updated position for the final decision.

In general, the Commission notes that SA Water's modelling approach for water has various limitations, which have previously been outlined to SA Water.²⁵⁹ For future regulatory determinations an improved modelling approach will be an area put to further investigation.

In terms of demand growth, it was noted earlier that the Property Council of Australia queried how, and to what extent, regulatory mechanisms currently operate to address growth in SA Water's network to accommodate for water and sewerage retail services for greenfield property developments.²⁶⁰ The City of Playford and City of Salisbury raised concerns about the cost and lack of infrastructure to support demand growth in northern metropolitan areas.²⁶¹

The demand variation adjustment mechanism allows for water sales and sewerage connections and therefore provides a mechanism to allow for demand risk. The mechanism does not, however, explicitly adjust for capital expenditure requirements relating to unexpected large greenfield developments.

Capital expenditure requirements for planned growth are allowed for under the determination; the Commission does not specify individual demand-related capital projects. As a large infrastructure asset manager, SA Water is allowed a total capital allowance that it manages.

The regulatory framework allows several pathways to accommodate unanticipated growth, including for SA Water to re-prioritise within its capital allowance, or to proceed with the project (using borrowings, if needed) and to seek compensation through an ex-post review of efficient and prudent expenditure, and/or to utilise the contingent project mechanism (insofar as the project and circumstance meets the necessary criteria as discussed in detail below).

²⁵⁷ SA Water, Regulatory Business Plan 2024-28, p. 115, 118.

²⁵⁸ Energy and Water Ombudsman South Australia, pp. 1-2.

²⁵⁹ The limitations relate to model specification (for example, price is excluded from the modelling and periods of strict water restrictions are not necessarily appropriately accounted for); inputs to the modelling are limited (it appears that low population growth projections are used, which was also highlighted in EWOSA's submission); the model's forecast accuracy has not been appropriately evaluated (forecasting practice is known to involve regular and systematic evaluation of forecast errors, and the consideration of (and introduction of, where possible) mechanisms to reduce forecast error); and, finally, the assumption used to account for non-revenue water is not well justified, yet projections for water sales are sensitive to this assumption.

²⁶⁰ Property Council of Australia, pp. 1-4.

²⁶¹ City of Playford and City of Salisbury, pp. 1-2.

There can understandably be unanticipated growth challenges, including relating to shifts in consumer preferences and behaviours, changes in government policy, and macroeconomic drivers, which can impact on long-term growth plans and network extension.²⁶² However, SA Water has processes and augmentation and developer charger policies in place to manage greenfield and infill growth.²⁶³

The Commission expects SA Water – as part of its long-term asset management – to work closely with industry, other utilities, local governments and the South Australian Government on long-term planning and responsiveness to changes in demand. This should mitigate the risk of ‘unanticipated’ growth.

By way of background, Chapter 8 discusses excluded services, which includes developer contributions, and briefly highlights SA Water’s existing developer contribution framework (which includes a framework for various types of developer contributions such as connections, extensions and augmentations).

7.4.5 Shared infrastructure mechanism

The Commission’s draft decision is to continue to include the shared infrastructure mechanism and to utilise the current methodology.

Water and sewerage customers should derive benefit (via, for example, a share of profit) for SA Water’s use of regulated water and sewerage infrastructure assets for the provision of non-regulated services.

The Commission has assessed that 10 percent of relevant non-regulated revenues can be used as proxy for a gross profit margin. The Commission has balanced a trade-off in setting this percentage: a higher percentage may lessen SA Water’s incentive to pursue commercial opportunities, while a lower percentage may not allow customers to sufficiently benefit from the infrastructure that they have paid for.

SA Water’s approach to pricing for direct control water retail services already takes into account a forecast of 10 percent of relevant non-regulated revenues.²⁶⁴ SA Water’s current forecast for the SAWRD24 period for water retail services is approximately \$3.6 million (\$Dec22).

Given SA Water’s pricing for water retail services already accounts for the forecast of 10 percent of relevant non-regulated revenues, the Commission’s shared infrastructure mechanism simply makes an adjustment to account for the difference between actual and forecast revenues at the end of the regulatory period. The calculation of the adjustment for water retail services SAWRD20 is outlined in Chapter 15. The unders/overs methodology was introduced in SAWRD20 with the aim that the revenue adjustment for non-regulated revenues would, over time, reflect actual revenue, not forecast revenue.

For sewerage retail services, the mechanism allows for 10 percent of the revenue amounts earned during SAWRD24, through the use of SA Water’s regulated infrastructure required to provide sewerage retail services but which are not attributable to the provision of sewerage retail services, to be deducted from the revenue cap for sewerage retail services in the subsequent regulatory period. As discussed in Chapter 15, SA Water reported no revenues collected in relation to sewerage retail services under this mechanism during SAWRD20.

²⁶² SA Water, *Regulatory Business Plan 2024-28*, p. 55.

²⁶³ SA Water has highlighted in its RBP that it dedicates time and effort to consulting with developers and to assessing and planning for system augmentation or installation of infrastructure to ensure sufficient capacity of the system. Ultimately, SA Water aims to have infrastructure in place to support growth when needed, and it undertakes dynamic planning, adjusting plans over time to respond to changes in network conditions, customer requirements and standards. See SA Water, *Regulatory Business Plan 2024-28*, October 2023, pp. 54-55.

²⁶⁴ When setting its prices, SA Water removes from the maximum revenue caps 10 percent of relevant non-regulated revenue. The Commission assesses this on an ex-post basis through its assessment of the revenues collected relative the revenue cap, under the demand adjustment mechanism.

7.4.6 River Murray water licence adjustment mechanism

The Commission's draft decision is to continue to include the River Murray water licence adjustment mechanism and to utilise the current methodology. The mechanism allows water retail services customers to recoup income that has been derived by SA Water from the sale of water allocations associated with River Murray water entitlements which have been paid for by customers.²⁶⁵ The income from the sale of water allocations should be returned to customers, taking into account any prudent and efficient costs incurred as a result of selling those allocations, insofar as customers have paid for those water entitlements.

SA Water has reported approximately \$1.8 million (\$Dec22) of revenue from the sale of water allocations (see Chapter 15).²⁶⁶ SA Water will submit an updated estimate, which will be verified and assessed by the Commission and incorporated into the revenue caps for SAWRD24.

7.4.7 Intra-period project review mechanism

7.4.7.1 Role of mechanism

The intra-period review mechanism provides an avenue for dealing with projects that have been fully scoped but have a contingency affecting when, or if, the project might go ahead. It benefits customers by not requiring them to pay for these projects in advance of the contingency being resolved, while also providing a level of certainty of investment for SA Water and the government. Allowing for future revenue caps to reflect the efficient costs of a major capital project or program under this mechanism is also intended to mitigate the risk that SA Water will inappropriately or inefficiently delay investment due to a lack of certainty about how the Commission might treat the expenditure.

Regulators in other jurisdictions have also established mechanisms for dealing with uncertain projects. For example, rules for the treatment of contingent projects are included in the National Electricity Rules,²⁶⁷ the Essential Services Commission of Victoria (ESCV) has an 'Uncertain and Unforeseen Events Mechanism',²⁶⁸ and the New South Wales Independent Pricing and Regulatory Tribunal offers to undertake targeted reviews of projects proposed within a regulatory period and provide letters of comfort or advice about how proposed spending is likely to be perceived.²⁶⁹

7.4.7.2 Implementation of the mechanism in SAWRD20

The intra-period review mechanism was used to a limited extent during the SAWRD20 regulatory period, with SA Water submitting six proposals for stage one pre-approval. Three proposals received stage one pre-approval.²⁷⁰ SA Water has not indicated that it plans to submit any proposals for stage two approval of revenue allowance.

A review of the mechanism identified some design and implementation issues which impacted its efficiency and effectiveness.

²⁶⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, p. 71.

²⁶⁶ SA Water, *Regulatory Business Plan 2024-28*, p. 285.

²⁶⁷ Australian Energy Market Commission, *National Electricity Rules*, available at: www.aemc.gov.au/regulation/energy-rules/national-electricity-rules.

²⁶⁸ Essential Services Commission of Victoria, *Water Pricing Framework and Approach: Implementing PREMO from 2018*, October 2016, pp. 40-43, available at: www.esc.vic.gov.au/sites/default/files/documents/Water-Pricing-Framework-and-Approach-Final-Paper-Oct-2016.pdf.

²⁶⁹ Independent Pricing and Regulatory Tribunal, *Water Regulation Handbook*, April 2023, p. 58, available at: www.ipart.nsw.gov.au/sites/default/files/cm9_documents/Handbook-Water-regulation-April-2023.PDF.

²⁷⁰ The pre-approved proposals are the South Road Torrens to Darlington project extension, Gawler Railway Electrification project and Upper Spencer Gulf supply augmentation project.

- ▶ There were different perspectives between the Commission and SA Water on the scope and application of the mechanism, particularly with regards to the type of projects that would be eligible and the level of information required to support project applications.
- ▶ Confidentiality concerns from SA Water meant that only limited information about Stage 1 proposals and the Commission's assessment were made publicly available – this impacted transparency.
- ▶ There is some level of repetition in the application and assessment requirements for Stage 1 and 2 under the mechanism, which could affect resourcing impost and efficiency.

7.4.7.3 Approach for SAWRD24

SA Water has proposed that the mechanism be retained for SAWRD24 but amended by removing the deadline for using the mechanism and consolidating it into a one-stage process.

It has been suggested that moving to a one-stage process would reduce complexity and resourcing impost for both SA Water and the Commission.

However, allowing SA Water to submit project proposals at any time could act as a dis-incentive to good long-term planning. The intention of the mechanism is for it only to apply to contingent projects that are already known to SA Water. This means that contingent projects expected to commence within the regulatory period should be known at the time SA Water submits its RBP.

If new projects arise during the regulatory period that have not been identified at the outset of the regulatory period, SA Water can use a range of other options for progressing the expenditure, including:

- ▶ deferring or reprioritising other planned expenditure and redirect revenue to the new proposal
- ▶ proceeding with the proposal during the current regulatory period and proposing a cost pass-through, if the project meets the required cost pass-through criteria
- ▶ proceeding with the project in the current regulatory period with the Commission then assessing if the project was prudent and efficient in its ex-post review of capital expenditure at the end of the regulatory period (noting that if the capital expenditure on a project was found not be prudent and efficient then it would not be added to the regulated asset base (RAB))
- ▶ not proceeding with the project during the current regulatory period and propose the project in its regulatory business proposal for the next regulatory period, or
- ▶ proposing to the Commission that the revenue determination is varied (noting this would be subject to any requirements of a Pricing Order issued pursuant to section 36 of the WI Act).

Having considered the costs and benefits of the intra-period project review mechanism, on balance, the Commission considers that there is benefit in retaining the mechanism for SAWRD24, with amendments to clarify its scope and improve its efficiency. The mechanism will provide for regulatory approvals to be given to projects that are known at the time of SA Water's RBP but lack certainty on a key parameter (for example, timing of demand). The Commission's view is that consumers should not have to pay for these types of projects until that uncertainty has been resolved.

The Commission has accepted SA Water's proposal to move to a one-stage assessment process, noting that this will improve the mechanism's efficiency. SA Water will still be required to notify the Commission of proposed contingent projects in the lead up to the commencement of the regulatory period; however, the Commission will not assess the project until the contingency has been resolved.

The Commission does not accept SA Water's proposal that it should be able to submit projects at any time during the regulatory period as it considers that this would act as a disincentive to good long-term planning. The Commission's view is that the mechanism should only be available to projects that have been well scoped and approved by SA Water's Board as part of its RBP.

As a transition period, for SAWRD24, SA Water will be permitted to provide a list of contingent projects and supporting evidence to the Commission by 30 September 2024. For future regulatory periods, SA Water will be required to include information on contingent projects as part of its RBP submission – no submissions will be accepted after that time.

The Commission's draft decision is to rename the mechanism, so it is known as the 'contingent project mechanism' which should assist in providing clarity to SA Water and stakeholders on the purpose and eligibility requirements of the mechanism. The contingent project mechanism will retain the SAWRD20 form of the intra-period review mechanism, but will have the following amendments.

- ▶ Eligibility will be restricted to contingent capital projects only. Projects associated with unforeseen events will no longer be eligible; these can be undertaken by re-prioritising expenditure or proposed under the cost pass-through mechanism.
- ▶ An initial list of potential contingent capital projects is to be provided to the Commission by no later than 30 September 2024 for SAWRD24 and by 30 June in the calendar year prior to the commencement of the regulatory period for SAWRD28 onwards (for example, by 30 June 2027 for SAWRD28).
- ▶ Only contingent projects that have a projected capital value that exceeds \$50 million will be eligible.
- ▶ All proposals from SA Water and decisions by the Commission must be made publicly available (with confidential information omitted or redacted as required).
- ▶ A measurable contingency trigger will need to be defined for each project (for example, a certain level of growth in customer demand, which requires investment in supply augmentation).
- ▶ Additional specificity about the type and level of information required to support an application.
- ▶ The application and assessment processes will be streamlined to reduce resourcing impost, this includes removing the Commission's assessment of the proposed contingent projects at Stage 1 of the mechanism. Instead, a detailed assessment will be undertaken once the contingency associated with the project is removed, or occurs, and SA Water can provide evidence that it is committed and can deliver the project in the regulatory period.

7.5 Draft decision

The Commission's draft decision is that:

- ▶ SA Water's water and sewerage retail services will be subject to separate four-year maximum revenue caps and be prepared and presented on the basis of a building blocks cost model.
- ▶ The caps will be calculated as the forecast efficient costs of providing water and sewerage retail services and will be set at a fixed dollar amount subject to the following ancillary (adjustment) variation mechanisms.
 - A 'cost pass-through' mechanism that will enable the revenue caps to be adjusted in the subsequent regulatory period where an event beyond the control of SA Water has, or will have, a material impact on SA Water's costs of providing water or sewerage retail services

- A 'demand variation adjustment' mechanism that will adjust the revenue caps in the subsequent regulatory period to account for any material differences between forecast and actual water and sewerage revenue earned, due to differences between forecast and actual water sales and sewerage connections
- A 'shared infrastructure' mechanism that will adjust the revenue caps in the subsequent regulatory period to account for the difference between actual and forecast revenues from the previous period, in relation to 10 percent of the revenue earned by SA Water for the provision of non-regulated services that utilise water or sewerage retail service infrastructure.
- A 'River Murray licence adjustment' mechanism that will reduce revenue caps in the subsequent regulatory period to reflect income derived by SA Water from the sale of water allocations associated with River Murray water entitlements.
- A 'contingent project' mechanism that may allow for the recovery of efficient costs associated with a pre-determined major capital project, where the costs were not incorporated into the revenue caps because of a contingency. The contingent project mechanism will retain the SAWRD20 form of the intra-period review mechanism, but with a range of amendments.

8 Recycled water and excluded retail services

Draft decision – Form of regulation for recycled water and excluded retail services

The Commission has undertaken a review of SA Water’s recycled water and excluded services pricing and has not found any evidence that SA Water is misusing its market power in setting prices. As such, current evidence does not indicate that a more prescriptive regulatory approach is required for SA Water’s recycled water or excluded retail services.

The Commission’s draft decision is to continue to regulate the sale and supply of recycled water and excluded retail services under a pricing principles approach and to do so on an ongoing basis. To improve transparency over SA Water’s excluded services pricing and support the move to an ongoing pricing principles regulatory approach, the Commission will maintain the current requirement for SA Water to provide the Commission with pricing information but will include more detail on the manner and form of the data required.

The Commission will continue to undertake compliance monitoring and any enforcement through its general compliance framework.

8.1 Introduction

8.1.1 Form of regulation

SA Water provides certain services for which the costs are not recovered through the revenue caps set under this determination, but are instead charged separately to customers who request those services.

The relevant services are recycled water and excluded services, with the latter defined to be retail services provided to individual customers, or a distinct class of customers, where they are the direct beneficiaries of those services. These services can involve primary producers, businesses and government sourcing recycled water, and households and businesses seeking excluded retail services such as non-standard connections, and the disposal of trade waste. The cost of those services can be more easily attributed to the customers who benefit from them compared to water and sewerage services, which are provided to customers at large.

The Commission is authorised under the *Essential Services Commission Act 2002 (ESC Act)* and the *Water Industry Act 2012 (WI Act)* to make price determinations in respect of SA Water’s recycled water and excluded retail services. The Commission is therefore responsible for determining the appropriate form of economic regulation to apply for these particular services in SAWRD24.

The Commission’s current approach of regulating the price of SA Water’s recycled water and excluded retail services involves setting pricing principles that SA Water must apply when it determines its prices for recycled water and excluded services.²⁷¹ These prices are then subject to compliance monitoring and reporting by the Commission. This approach is known to impose limited administrative costs on SA Water.

The pricing principles approach provides SA Water with the flexibility to set prices for recycled water and excluded services based on the efficient cost of each service, on a beneficiary-pays approach. In setting those prices, it is required to demonstrate that the prices comply with the relevant pricing principles.

²⁷¹ Refer to Chapter 4 – SA Water’s Regulatory Business, for further information on recycled water and excluded retail services.

Revenue from recycled water and excluded services is approximately three percent of SA Water's total retail services revenue (an average of \$43 million per year out of a total average revenue of \$1.3 billion per year).²⁷²

The Commission has applied a pricing principles approach to regulating SA Water's pricing for excluded services and recycled water since it began making price determinations for SA Water in 2013. Since then, the Commission has reviewed its regulatory approach at the beginning of each regulatory period.

The Commission has decided that it will apply the existing pricing principles approach on an ongoing basis and will revisit this approach if material concerns are identified or if there is stakeholder interest.

To ensure SA Water's continued adherence with this approach, the Commission will undertake compliance monitoring of SA Water's application of the pricing principles through its general compliance framework throughout each regulatory period. The Commission will also require SA Water to provide pricing information directly to the Commission on an annual basis.

8.1.2 Form of regulation in SAWRD20

8.1.2.1 Recycled water

SA Water is required to publish a pricing schedule and a 'pricing policy statement', to demonstrate how it has applied the National Water Initiative (NWI) Pricing Principles in determining its prices for recycled water and provide a copy of these documents to customers on request. The Commission monitors the prices set by SA Water and can publish information on price changes and SA Water's compliance with the relevant NWI Pricing Principles.

It is noted that while the price of recycled water is currently regulated under a pricing principles approach, the cost for the relevant infrastructure to provide recycled water schemes is recovered through direct control revenues, where SA Water can demonstrate that the particular scheme:

- ▶ is a prudent and efficient means of addressing environmental (sewerage discharge) obligations and forms part of a least cost mix of diversified water sources needed to achieve required security of supply, or
- ▶ is driven by the need to trial new technologies, with the aim of achieving more efficient ways to deliver a secure supply of water.

SA Water's existing recycled water schemes primarily exist as the least-cost method of sewerage disposal and their costs are therefore recovered through sewerage charges. However, to ensure that SA Water does not over-recover the costs of recycled water schemes, any revenues derived directly from the provision of recycled water must be offset against the costs of providing those schemes and recovered through sewerage revenues.

8.1.2.2 Excluded services

SA Water provides certain retail services to individual customers, or a distinct class of customers, where they are the direct beneficiaries of those services. These are called 'excluded retail services', and consist of:

- ▶ standard and non-standard connection services (including developer services,²⁷³ see Box 8.1 below for more information)
- ▶ trade waste services

²⁷² Five-year average 2017-18 to 2021-22. Chapter 4 of SA Water's Regulatory Business Proposal provides further information on the retail services provided by SA Water that are regulated by the Commission.

²⁷³ Developer services are connection and related services provided by SA Water to property developers.

- ▶ non-domestic hauled waste services
- ▶ easement extinguishment and encumbrance services
- ▶ hydrant and fire plug services
- ▶ meter services, and
- ▶ network analysis and audit services.

The pricing principles that currently apply to excluded services are based on the relevant NWI Pricing Principles, as well as additional principles developed by the Commission (see Box 8.2).

Box 8.1: SA Water's developer contribution framework

As noted earlier in Chapter 7, several submissions raised questions about growth, the regulatory mechanisms in place to address growth, and the price and funding to accommodate growth.²⁷⁴

Developer charges are levied by the utility on the developer. These levies/charges reflect the investment in both the new and existing assets required to serve a new development.

With developer contributions being a form of SA Water's excluded services, it is important to note that SA Water has a developer contribution framework in place. That framework sets out that the prices for developer contributions and augmentation charges should comply with NWI Pricing Principles (as mentioned above).²⁷⁵ Consistent with a beneficiary pays approach, SA Water's application of the principles considers the boundary of the development, the share of capacity to serve the development and any beneficiaries.²⁷⁶

Consistent with NWI Pricing Principles, SA Water's efficient capital expenditure is rolled into the regulated asset base (RAB), net of customer contributions (including developer contributions and augmentation charges). In this respect, the RAB excludes capital recovered via developer or augmentation charges, which avoids over-recovery. This approach is consistent with full cost recovery.

The Commission notes the importance of SA Water effectively implementing its framework to recover appropriate capital contributions. Without appropriate implementation, there is a risk that existing regulated customers pay for more than the efficient costs involved and the benefits derived.

SA Water's RBP includes proposed capital expenditure to accommodate growth in its water and sewerage network, and several submissions pointed to the prospects for growth at the urban fringe. In an environment of network growth and capital expenditure planned to accommodate that growth, the effective implementation of developer contributions is an area of interest for the Commission for the SAWRD24 period. The Commission expects SA Water to operate in a transparent manner and provide information to stakeholders regarding its methodology and how charges have been formulated.

²⁷⁴ Property Council of Australia, p. 4, City of Playford and City of Salisbury, pp.1-2 and Villawood Properties, p. 1.

²⁷⁵ For more details, see SA Water's website at <https://www.sawater.com.au/building.-developing-and-plumbing/developments/developer-contributions>.

²⁷⁶ SA Water's forecasts of capital contributions for SAWRD24 are discussed in Chapter 11.

8.2 SA Water's proposal

SA Water has not proposed any changes to the form of economic regulation applying to recycled water and excluded retail services. Nor has it proposed changes to the specific pricing principles that currently apply.²⁷⁷

8.3 Matters raised in consultation

Submissions did not comment on the form of regulation for recycled water and excluded retail services.

8.4 Commission analysis

SA Water's recycled water and excluded retail services have natural monopoly characteristics. At face value, this can indicate that SA Water may, in some instances, have an incentive and ability to exercise market power. As such, some form of price determination pursuant to the ESC Act and the WI Act may provide protection to customers' seeking these services.

A form of price determination can help to promote efficiency, competition and innovation in the water industry, and promote the economically efficient use and operation of, and investment in, significant infrastructure so as to promote effective competition in relevant upstream and downstream markets.

The current form of regulation has several key advantages.

- ▶ Where markets may not be competitive, a pricing principles approach provides guidance to SA Water to set prices based on efficient costs, while at the same time providing a regulatory threat and allowing for compliance, monitoring and enforcement through the Commission's general compliance framework. The current approach is less intrusive and less costly to administer and comply with.
- ▶ The pricing principles require price transparency on the part of SA Water in relation to recycled water prices and excluded retail services prices. Transparency can help stakeholders to gain a better understanding of how charges are calculated and applied and can assist customers in negotiations with SA Water.
- ▶ Recycled water services are generally a substitute for water retail services. The price of recycled water may be constrained by water retail prices. This can reduce the ability of SA Water to exercise market power.
- ▶ SA Water is required to publish its recycled water prices and excluded services retail prices and demonstrate that those prices comply with the relevant NWI Pricing Principles. It has complied with those requirements since their introduction. The Commission has received no customer complaints about recycled water prices and excluded retail services prices since that time.
- ▶ The use of NWI Pricing Principles for the purposes of regulating SA Water's recycled water and excluded retail services is consistent with their use in regulating SA Water's direct control services. Moreover, NWI Pricing Principles are accepted in regulatory matters at both a state and national level.

Nonetheless, the current form of regulation has some limitations.

- ▶ The effectiveness of a pricing principles approach can depend on the nature, type and level of compliance and monitoring activity.
- ▶ Where published pricing and policy statements do not provide sufficient transparency, this can reduce the effectiveness of the pricing principles approach. It is noted that SA Water's pricing policy statements on excluded services have recently included less information than they previously did.

²⁷⁷ SA Water RBP, pp. 305-306.

- ▶ The Commission's current pricing principles approach does not involve it stating publicly its views regarding whether price movements of recycled water and excluded retail services have been efficient (or not).²⁷⁸

While there are a range of potential regulatory options available that could be introduced, the cost of applying more prescriptive approaches to a group of services which account for a small share of revenue may not be economically efficient.

8.4.1 Recycled water

The Commission is not aware of any issues or concerns regarding the current regulatory approach for recycled water. As such, and in accordance with the Commission's risk-based approach to regulation, a detailed review of SA Water's compliance with its obligations under the *SA Water's water and sewerage retail services: 1 July 2020 – 30 June 2024 Price Determination* in relation to recycled water pricing has not been undertaken.

SA Water's compliance with its recycled water pricing obligations will continue to be monitored in accordance with the Commission's general compliance framework.

8.4.2 Excluded services

The Commission analysed four key areas relating to SA Water's provision of excluded services to make its draft decision. The aim of this analysis was to determine whether SA Water's current approach to setting prices for excluded services complies with the pricing principles as required under the Price Determination. The Commission found:

▶ Pricing for excluded services

Since 2013-14, totalised excluded services prices have, on average, moved in line with the national and Adelaide Consumer Price Index (CPI) and Producer Price Index (PPI).²⁷⁹ A dip in the nominal price of totalised excluded services occurred in 2020-2021, which mirrors the price reductions made for water and sewerage retail services during that period.

SA Water has provided the Commission with estimated costs for excluded services for the period 2020-23.²⁸⁰ On average, these services increased in cost by 9 percent since 2020-21, which is consistent with increases in the national CPI across the period of 11.6 percent and the PPI of 9.7 percent. The Commission notes that this does not necessarily mean that SA Water's prices are efficient. For example, the starting prices may not initially reflect efficient costs and increasing volumes over time could provide opportunity to achieve reduced average costs.

The Commission has not undertaken a detailed assessment of the efficiency of SA Water's costs given that the available evidence indicates that it has been complying with the pricing principles, as explained below.

²⁷⁸ While an approach that involves price monitoring and public statements on the efficiency of SA Water's prices could be adopted instead of only adopting pricing principles, the diverse range of services covered under recycled and excluded services, which can exhibit varying rates of growth in costs, limits the benefits of a public price monitoring approach.

²⁷⁹ The totalised excluded services price data used was a simple average based on 44 excluded services that have retained the same name since 2013-2014.

²⁸⁰ These costs relate to services that are high volume and low cost with little variation and SA Water can apply a standard charge based on the average cost of those services. Where the service is low volume and high cost with a high degree of variation, SA Water develops a non-standard charge based on specific needs.

► **Rate of return applied to excluded services**

SA Water's pricing policy for excluded services for 2023-24 states it has used a cost-plus approach to determine prices.²⁸¹ SA Water states that this approach aims to recover incremental capital expenditure and direct and indirect operating costs while providing for a reasonable rate of return.²⁸² SA Water confirmed to the Commission that during SAWRD20 it has applied a post-tax nominal weighted average cost of capital (**WACC**) of 4.75 percent as a rate of return to its excluded services fees and charges. This return is applied to the sum of the total direct costs and the corporate overhead of the excluded services fee. This rate of return is consistent with the Commission's regulated rate of return for the SAWRD20 period.

► **The proportion of total income from excluded services**

A simple average of the percentage of SA Water's income from excluded services for the last three regulatory determination periods showed this income has risen, on average, less than a percentage point since 2013. Based on the Commission's understanding that SA Water has been moving toward full cost recovery on excluded services since SAWRD16, and that there has been a decrease in total regulated revenue over recent years, this increase is not indicative of monopoly pricing.

► **SA Water's excluded services operating surplus ratio**

An analysis of SA Water's excluded services income and operating costs showed an average annual surplus ratio of approximately 12 percent over the period 2017-18 to 2021-22. This suggests that SA Water is achieving a marginally higher than breakeven position on the provision of excluded services and not a significant operating surplus that would suggest excessive profit seeking.

Based on these findings, the Commission considers that SA Water's approach to pricing excluded services meets the requirements of the applicable pricing principles.

Current evidence does not suggest monopoly pricing, and the proposed regulatory approach provides guidance to SA Water when setting prices. The administrative costs to SA Water of imposing pricing principles are likely to be relatively small. Moreover, there is unlikely to be any impact on SA Water's investment incentives under this regulatory approach, given the broad nature of the pricing principles being imposed.

On this basis, and the absence of consumer complaints and stakeholder concerns with SA Water's excluded retail services pricing, the Commission plans to continue the pricing principles approach in an ongoing manner. Compliance monitoring, and enforcement, of SA Water's application of the pricing principles will continue to be addressed through the Commission's general compliance framework.

To support the Commission's decision to set its regulatory approach to excluded services on an ongoing basis, Water Industry Guideline No. 2 - Regulatory Information Requirements – Major Retailers (**Guideline 2**), will require SA Water to provide information on its pricing approach, including data on, where a service is high volume/low cost with little variation between individual jobs, the standard charge per service based on the average cost of the service.

The Commission will use this information to monitor excluded services pricing changes during regulatory periods.

²⁸¹ Available at: www.sawater.com.au/_data/assets/pdf_file/0010/733843/SA-Water-2023-24-Excluded-Services-Pricing-Policy-Statement.pdf

²⁸² Information provided to the Commission on 8 August 2023.

In regard to improving public transparency over excluded services pricing, the Commission reiterates that the Price Determination requires that SA Water must publish a pricing policy statement that *'demonstrates the manner in which the prices that SA Water will charge customers for the sale and supply of excluded retail services for that regulatory year meet the requirements'* of the pricing principles.²⁸³

The Commission considers SA Water's pricing policy statement from 2016-17²⁸⁴ to be more effective at meeting this requirement than its recent pricing policy statements.²⁸⁵ The Commission expects SA Water to improve its performance in this area and will monitor outcomes over SAWRD24. If SA Water's performance does not improve, the Commission may consider additional regulation for SAWRD28.

8.5 Draft decision

The Commission's draft decision is to regulate the sale and supply of recycled water and excluded retail services under a pricing principles approach on an ongoing basis with compliance monitoring and enforcement to be addressed through the Commission's general compliance framework.

The Commission will require SA Water's future pricing policy statements return to providing a more comprehensive level of detail that demonstrates how its excluded services pricing approach meets the requirements of the pricing principles.

Box 8.2: Pricing Principles for recycled water and excluded retail services

NWI Pricing Principles for SA Water's recycled water and stormwater use

Principle 1: Flexible regulation

Light handed and flexible regulation (including use of pricing principles) is preferable, as it is generally more cost efficient than formal regulation. However, formal regulation (for example, establishing maximum prices and revenue caps to address problems arising from market power) should be employed where it will improve economic efficiency.

Principle 2: Cost allocation

When allocating costs, a beneficiary-pays approach – typically including direct user pay contributions – should be the starting point, with specific costs shared across beneficiaries based on the scheme's drivers (and other characteristics of the recycled water/stormwater reuse scheme).

Principle 3: Water usage charge

Prices to contain a water usage (that is, volumetric) charge.

Principle 4: Substitutes

Regard to the price of substitutes (potable water and raw water) may be necessary when setting the upper bound of a price band.

Principle 5: Differential pricing

Pricing structures should be able to reflect differentiation in the quality or reliability of water supply.

²⁸³ Clause 4.2(a) SAWRD20 Price Determination.

²⁸⁴ Available at: www.sawater.com.au/_data/assets/pdf_file/0009/83907/Excluded-Services-Pricing-Policy-Statement-2016-17.pdf

²⁸⁵ Available at: www.sawater.com.au/_data/assets/pdf_file/0010/733843/SA-Water-2023-24-Excluded-Services-Pricing-Policy-Statement.pdf

Principle 6: Integrated water resource planning

Where appropriate, pricing should reflect the role of recycled water as part of an integrated water resource planning system.

Principle 7: Cost recovery

Prices should recover efficient, full direct costs – with system wide incremental costs (adjusted for avoided costs and externalities) as the lower limit, and the lesser of stand-alone costs and willingness to pay as the upper limit. Any full cost recovery gap should be recovered with reference to all beneficiaries of the avoided costs and externalities. Subsidies and CSO payments should be reviewed periodically and, where appropriate, reduced over time.

Note: Direct costs include any joint/common costs that a scheme imposes, as well as separable capital, operating and administrative costs. This definition of direct costs does not include externalities and avoided costs.

Principle 8: Transparency

Prices should be transparent, understandable to users and published to assist efficient choices.

Principle 9: Gradual approach

Prices should be appropriate for adopting a strategy of 'gradualism' to allow for consumer education and time for the community to adapt.

Pricing principles relevant to SA Water's excluded services**NWI Pricing Principles****Setting developer charges (Principles for Urban Water Tariffs: Principle 8)**

Developer charges should reflect the investment in both new and existing assets required to serve a new development and have regard to the manner in which ongoing water usage and service availability charges are set.

Note: Where there are benefits beyond the boundary of the development, the developer charge should have regard to the share of capacity required to serve the development.

Capping developer charges (Principles for Urban Water Tariffs: Principle 9)

Developer charges should not exceed the costs of serving new developments, which includes investment in both new and existing assets required to serve a new development.

Revenue from developer charges (Principles for Urban Water Tariffs: Principle 10)

To avoid over recovery, revenue from developer charges should be offset against the total revenue requirement, either by excluding or deducting the contributed assets from the RAB, or by offsetting the revenue recovered using other mechanisms.

Cost recovery for new capital expenditure (Principles for Recovery of Capital Expenditure: Principle 1)

For new or replacement assets, charges will be set to achieve full cost recovery of capital expenditures (net of transparent deductions/offsets for contributed assets and developer charges and transparent CSOs) through either:

- a return of capital (depreciation of the RAB) and return on capital (generally calculated as rate of return on the depreciated RAB), or

- renewals annuity and a return on capital (calculated as a rate of return on an undepreciated asset base (Optimised Replacement Cost).

Differential water charges (Principles for Urban Water Tariffs: Principle 7)

Water charges should be differentiated by the cost of servicing different customers (for example, on the basis of location and service standards) where there are benefits in doing so and where it can be shown that these benefits outweigh the costs of identifying differences and the equity advantages of alternatives.

Note: Differential pricing may be achieved by upfront contributions, including developer charges.

Commission's additional Pricing Principles

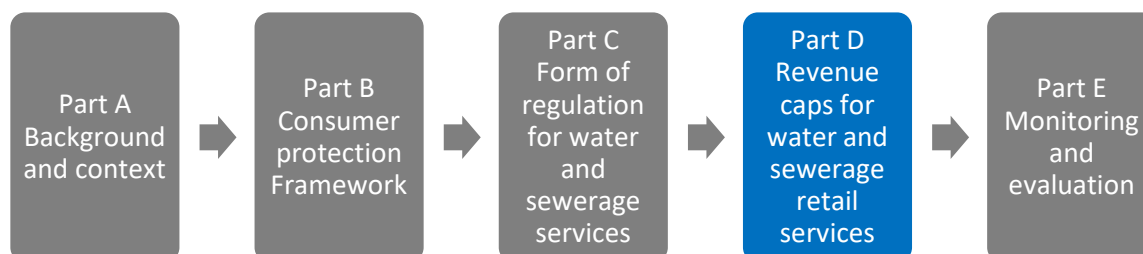
Principle 1: Where a service is provided for the sole benefit of the recipient, the beneficiary should pay the full efficient cost of the service, and other consumers should not be required to contribute to the cost of the service.

Principle 2: Where a service is provided to a distinct group of customers (for example, trade waste audits are provided to trade waste customers only), prices to a customer should reflect the incremental cost of supplying the service to that customer, and a reasonable allocation of the fixed costs of providing the service, where relevant.

Principle 3: Prices should reflect the efficient cost of the particular service provided, although in circumstances where the cost of implementing differentiated prices to different customers is likely to outweigh the benefits, non-differentiated prices can be implemented.

Principle 4: SA Water must be able to provide transparent information to customers on how the costs for these services have been calculated, or are to be applied, and must be able to support its position in the event of a dispute.

Part D – Determining revenue caps for direct control retail services



Part D sets out the context and methodology for assessing the prudent and efficient expenditure and it sets out each of the cost components of the revenue determination that SA Water should incur in providing direct control water and sewerage retail services during the four-year period commencing 1 July 2024.

The cost components that the Commission has determined are:

- ▶ operating expenditure
- ▶ capital expenditure
- ▶ return of capital (depreciation)
- ▶ return on regulated asset base
- ▶ return on working capital
- ▶ tax allowance, and
- ▶ adjustments from previous determination and
- ▶ non-tariff revenue.

9 Approach to determining revenue caps for direct control retail services

This chapter provides a general overview of the Commission's approach to determining revenue caps for direct control water and sewerage retail services.

Detail on each building blocks cost model component can be found in Chapters 10 through to 17.

9.1 Building block approach

As discussed in detail in Chapter 7, the Commission's draft decision on the form of regulation for direct control services is that:

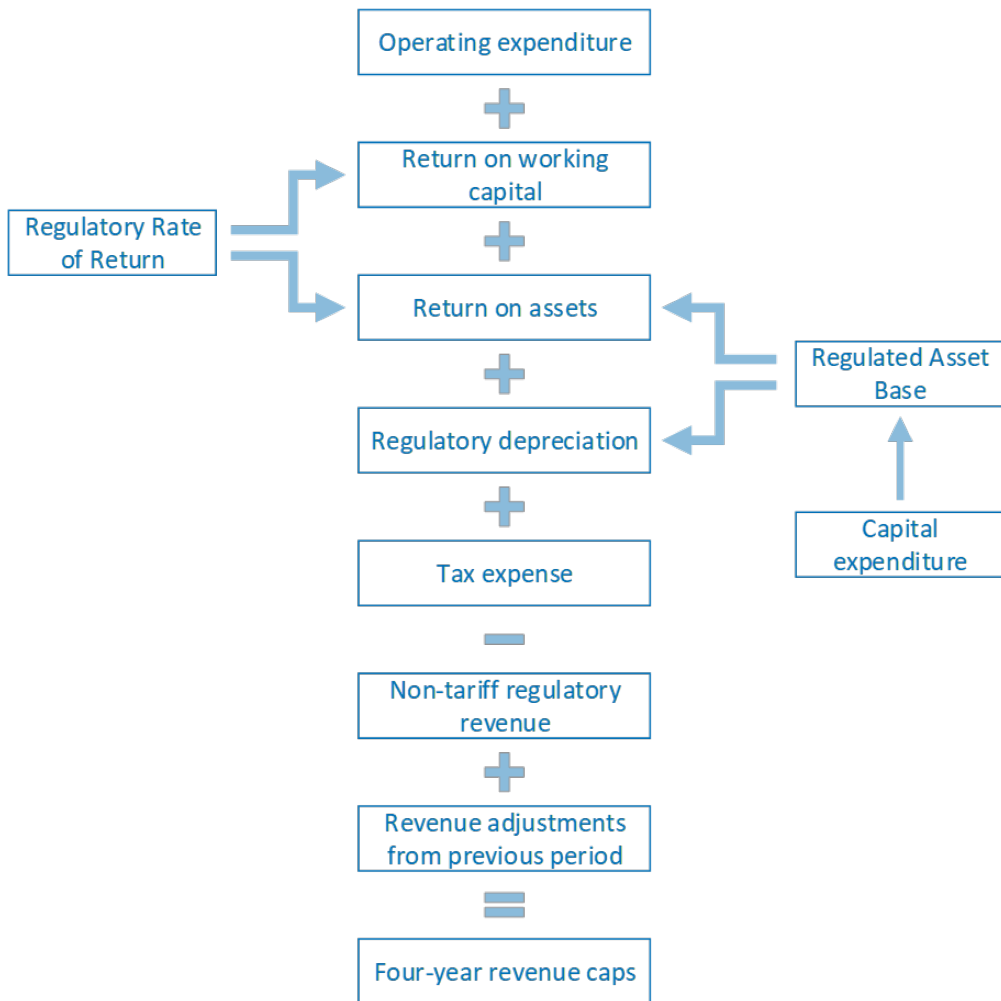
- ▶ SA Water's direct control water and sewerage retail services will be subject to separate four-year maximum revenue caps and be prepared and presented on the basis of a building blocks cost model.
- ▶ The caps will be calculated as the forecast efficient costs of providing water and sewerage retail services and will be set at a fixed dollar amount subject to five ancillary (adjustment) variation mechanisms.
 - A 'cost pass-through' mechanism that will enable the revenue caps to be adjusted in the subsequent regulatory period where an event beyond the control of SA Water has, or will have, a material impact on SA Water's costs of providing water or sewerage retail services.
 - A 'demand variation adjustment' mechanism that will adjust the revenue caps in the subsequent regulatory period to account for any material differences between forecast and actual water and sewerage retail service revenue earned, due to differences between forecast and actual water sales and sewerage connections.
 - A 'shared infrastructure' mechanism for water retail services that adjusts the revenue caps in the subsequent regulatory period to account for the difference between actual and forecast revenues from the previous period, in relation to 10 percent of the revenue earned by SA Water for the provision of non-regulated services that utilise water retail service infrastructure. For sewerage retail services, the 'shared infrastructure' mechanism allows for 10 percent of the revenue amounts earned during the regulatory period, through the use of SA Water's regulated infrastructure required to provide sewerage retail services but which are not attributable to the provision of sewerage retail services, to be deducted from the revenue caps in the subsequent regulatory period.
 - A 'River Murray license adjustment' mechanism that will reduce revenue caps in the subsequent regulatory period to reflect income derived by SA Water from the sale of water allocations associated with River Murray water entitlements.
 - A 'contingent project' mechanism that may allow for the recovery of efficient costs associated with a pre-determined major capital project that SA Water has committed to, where the costs were not incorporated into the revenue caps because of a defined contingency. The mechanism will allow additional expenditure to be incurred within the SAWRD24 regulatory period but included in the revenue controls for the SAWRD28 regulatory period (with a time-value of-money allowance).

The building blocks cost model is a commonly accepted economic approach to estimating efficient costs. In this regard, it is effectively a build-up of the forecast efficient costs of the regulated firm.

As shown in Figure 9.1, the building blocks cost model will involve adding the forecast efficient operating expenditure, return on working capital, return on assets, regulatory depreciation and tax expense to determine the total efficient costs of providing each service. It will deduct revenue that SA Water receives from other sources that contribute towards those costs, such as Community Service Obligations (CSO) payments, to ensure that SA Water does not over-recover those efficient costs.

Adjustments will also be made to reflect outcomes from the current regulatory period that flow through to the next regulatory period, such as those under the demand variation adjustment mechanism, the shared infrastructure revenue adjustment mechanism and the River Murray water licence adjustment mechanism. The cost building blocks and adjustments for SAWRD24 are determined in Chapters 10 to 17.

Figure 9.1: Building blocks cost model of water and sewerage services revenue



9.2 General methodological approach for determining revenue caps

The Commission considered all relevant legislative objectives and factors²⁸⁶ in making its draft decision regarding revenue caps for direct control water and sewerage retail services. The Commission considers the proposed revenue caps reflect an appropriate sustainable cost for providing those services at the determined service standards and in accordance with the obligations set by all regulators of SA Water.

Regulating revenues to recover the lowest sustainable cost of supplying water and sewerage retail services allows SA Water sufficient revenue to efficiently deliver the services valued by customers, in the long term. The Commission is not seeking to deliver low prices in the short term at the expense of long-term service delivery. That would be inconsistent with the Commission's requirement to protect customers' long-term interests.²⁸⁷ Nor is the Commission setting revenues above the efficient cost of service delivery, as that would deliver excessive profits to SA Water, which would also be inconsistent with the long-term interests of consumers.

As a matter of general practice, the Commission's expectation is that a prudent and efficient water utility, which manages long-life water and sewerage assets, should be able and willing to provide supporting evidence to justify all elements of its expenditure proposals. For regulated water utilities such as SA Water, this is as set out in its Regulatory Business Proposal (RBP).

However, a RBP cannot be divorced from the long-term operating context of an asset-intensive business. Long-term strategies and plans, relating to asset management, operational delivery and financing, should be in place and given effect. Investment decision-making should be ongoing and frequently reviewed, clearly linked to long-term goals and the strategies that support them.²⁸⁸

A RBP is, therefore, simply a point-in-time snapshot of the regulated business' long-term plans, providing more granular short-term detail to explain and justify proposed expenditure, investment, action and service levels for the next regulatory period.

In that overall long-term planning and delivery context, a regulated business, such as SA Water, should have the information and materials underpinning its RBP readily available to be provided to any and all interested stakeholders and the Commission.

In making its assessment, the Commission is not bound to accept a regulated entity's claims regarding expenditure requirements, without testing and assessing those claims (publicly, wherever possible) and, where it considers better information or evidence exists, then it may choose to adopt that better information and evidence.

Furthermore, the regulatory decision-making process can involve issues of discretion, judgement and degree (to the extent permitted under the ESC Act and the WI Act). In such cases, given the range of possible choices, the Commission recognises that different minds, acting reasonably, can be expected to make different choices on the same subject matter.²⁸⁹

The methodology applied by the Commission in determining revenue caps for direct control water and sewerage retail services, has been informed by all information, materials and submissions available to

²⁸⁶ Refer to Chapter 3 – Introduction, and Appendix 2 - Legal Requirements, for further information on the legal framework applying to SAWRD24.

²⁸⁷ See section 6(1) of the ESC Act.

²⁸⁸ Wilson A, *Emerging issues in economic regulation of long-term infrastructure*, unpublished speech at Australian Energy Institute event, Adelaide, 7 June 2022.

²⁸⁹ Re GasNet Australia (Operations) Pty Ltd [2003] ACompT 6 (23 December 2003) at paragraph 29, and Application by DBNGP (WA) Transmission Pty Ltd (no 3) [2012] A CompT 14 at paragraph 130.

it at the time of making the draft decision.²⁹⁰ This includes information and submissions from industry and consumers, SA Water’s consumer engagement, as well as public and private sources of data, and information contained in SA Water’s RBP.²⁹¹

The Commission has also sought additional information and materials from SA Water, some of which is confidential and may not be reported in part or in full in the following chapters. In addition, the Commission has undertaken its own enquiries to obtain relevant information to inform and assist it in determining the revenue caps for direct control water and sewerage retail services, including obtaining the advice of consultants.²⁹²

Reports have been prepared for the Commission by the following consultants, and are publicly available for consideration and review as a part of the draft determination consultation:

- ▶ Sapere Research Group (**Sapere**): demand adjustment mechanism
- ▶ Oxford Economics Australia: cost escalation and forecasts
- ▶ WS Atkins International (**Atkins**): capital expenditure review excluding Information Communications Technology (**ICT**) infrastructure, and
- ▶ FTI Consulting (**FTI**): capital expenditure relating to ICT infrastructure.

9.3 Draft decision on revenue caps for direct control water and sewerage retail services for SAWRD24

The Commission’s draft decision on revenue caps for direct control water and sewerage retail services for SAWRD24, is detailed in the following chapters:

- ▶ Chapter 10 – Operating expenditure
- ▶ Chapter 11 – Capital expenditure
- ▶ Chapter 12 – Regulated Asset Base (RAB) and regulatory depreciation
- ▶ Chapter 13 – Regulatory rate of return
- ▶ Chapter 14 – Tax allowance
- ▶ Chapter 15 – Adjustments from SAWRD20
- ▶ Chapter 16 – Determination of total revenue caps, and
- ▶ Chapter 17 – Revenue cap summary.

²⁹⁰ This approach of including all stakeholders has been part of the Commission’s approach to economic regulation for more than two decades. Owens L, *Regulatory Collaboration: SAIR’s Approach to Regulation*, speech presented by Lewis W. Owens at the SA Power Briefing, Adelaide, 27 and 28 April 2000, pp. 1-7.

²⁹¹ Appendix 1 provides a summary of the process followed by the Commission in making the regulatory determination. Appendix 3 provides a list of the submissions from stakeholders.

²⁹² It is commonly accepted that, in light of the known information asymmetry between a regulator and a regulated business, there can be an incentive and ability for a regulated business to pass on inefficient costs to customers, to not reveal full information about the efficient costs of its regulated activities, and/or to overstate the extent of its costs. Economic regulators are known to make adjustments to a monopoly’s proposed costs, for example to disallow inefficient or imprudent expenditure (e.g., where the firm has exaggerated costs or incurred costs that are not necessarily in the long-term interests to consumers), as well as to account for possible future changes in demand and input costs. See Joskow P, ‘Regulation of Natural Monopolies’, In A Polinsky & S Shavell (eds), *Handbook of Law and Economics*. Volume 2, 2007, pp. 1288-1289, and Decker, p. 86, pp. 104-106.

10 Operating expenditure

Draft decision – Operating expenditure

The Commission's draft decision is that the prudent and efficient benchmark operating expenditure amounts to be included in the calculation of the revenue caps are as follows:

- ▶ \$1,550 million (\$Dec22) for **water** retail services, which is approximately 4 percent lower than the benchmark set in SAWRD20 and 5 percent lower than that proposed by SA Water, and
- ▶ \$722 million (\$Dec22) for **sewerage** retail services, which is approximately 16 percent higher than the benchmark set in SAWRD20, but 3 percent lower than that proposed by SA Water.

10.1 Introduction

SA Water's operating expenditure refers to the day-to-day expenditures involved in the delivery of water and sewerage retail services to customers. Through the regulatory determination, the Commission includes **prudent** and **efficient** operating expenditure benchmark amounts for use in the calculation of the revenue caps for SAWRD24 for water and sewerage retail services. Those are at levels that enable SA Water to meet known obligations and service standards when delivering retail services for the four-year period commencing 1 July 2024.

For the purposes of the draft determination, the Commission has determined prudent and efficient operating expenditure benchmark amounts with respect to the forecast *real* (inflation-adjusted) costs that would be incurred by a prudent and efficient standalone benchmark entity with the obligations and risks of SA Water. In doing so, it has had regard to a range of evidence, including SA Water's previously incurred and expected costs (as set out in SA Water's Regulatory Business Proposal (**RBP**)), and SA Water's operating costs relative to other comparable water and sewerage utilities in Australia.

By setting out the operating expenditure benchmark amounts for the four-year regulatory period, the regulatory framework provides SA Water with an incentive to find ways to become more efficient over time. For instance, by incurring lower actual operating costs than the benchmark set under the determination, SA Water can retain the benefits of any cost savings during the four-year regulatory period (at the end of the period, the benchmarks will re-set at lower levels, thereby passing the cost-savings benefits back to customers).

To protect against the risk that SA Water may lower service levels to reduce operating expenditure during the regulatory period, the Commission sets service standards, and then monitors, reports and enforces compliance against those standards (as discussed earlier in Chapter 6).

This chapter sets out the Commission's assessment, decisions and reasoning in relation to the prudent and efficient operating expenditure benchmark amounts to be included in the calculation of the revenue caps in respect of the provision of direct control water and sewerage retail services commencing from 1 July 2024.

The chapter outlines:

- ▶ background information about the methodology for assessing prudent and efficient operating expenditure, including contextual considerations and recent trends in SA Water's operating cost environment (section 10.2)
- ▶ a summary of SA Water's proposal for operating expenditure, as outlined in its RBP (section 10.3)
- ▶ a summary of the matters raised in consultation, including the main themes in stakeholder submissions relating to service levels, sustainability and affordability (section 10.4)

- ▶ the Commission's assessment, reasoning and decisions on the prudent and efficient benchmark level of operating expenditure for SAWRD24 (section 5), including review, analysis and consideration of:
 - a top-down assessment of SA Water's base year operating expenditure relative to other comparable water and sewerage utilities, which by implication can infer an estimate of the prudent and efficient base year operating expenditure for SAWRD24 and/or can infer an estimate of the expected efficiency gain that could be achieved in SAWRD24 (section 5.1)
 - a bottom-up assessment of SA Water's base year operating expenditure, which by implication can infer an estimate of prudent and efficient base year operating expenditure benchmark amounts for SAWRD24 (section 5.2)
 - a sample of operating expenditure projects, programs and initiatives for SAWRD24, including the nature and scope of SA Water's proposed operating expenditure (section 10.5.3)
 - expected efficiencies for SAWRD24, including efficiency factors for application in deciding SA Water's prudent and efficient operating expenditure benchmark amounts and the scope for catch-up and continuing efficiencies given results from the bottom-up and top-down assessments (section 10.5.4)
 - a range of estimates of inferred total prudent and efficient operating expenditure for SAWRD24 (section 10.5.5), and
- ▶ the draft decision of the prudent and efficient operating expenditure benchmark amounts for SAWRD24 (section 10.6).

10.2 Methodology and context

10.2.1 Assessment approach

Consistent with SAWRD20, the relevant classes of operating expenditure under consideration for SAWRD24 are:²⁹³

- ▶ **External responsibilities:** expenditure to meet safety, health, service or other legally binding or regulatory standards or obligations.²⁹⁴
- ▶ **Sustaining services:** expenditure to support the long-term viability of services and sustain delivery of reliable baseline services for existing customers.²⁹⁵
- ▶ **Enabling growth:** expenditure to support an expanded network to meet increasing demand, either within its current distribution area or as directed by the South Australian Government or permitted by legislation.²⁹⁶

²⁹³ In Guidance Paper 3, the Commission outlined that ICT-related expenditure should be categorised in SAWRD24 under one of the valid reasons for expenditure from the model above, rather than treated as a separate category as was the case in SAWRD20. This reflects the Commission's view that ICT-related expenditure is primarily an enabler of service delivery, improvement or growth. Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, p. 9.

²⁹⁴ Expenditure to achieve compliance with these standards would be reasonable and appropriate in principle. SA Water is not expected to exceed required standards unless this can be achieved at no additional cost to customers. Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, pp. 4-9.

²⁹⁵ Ibid, pp. 4-9.

²⁹⁶ Ibid, pp. 4-9.

- ▶ **Improving services:** expenditure to enhance service levels that do not fall into the categories listed above.²⁹⁷

In considering whether expenditure is *prudent* and *efficient*, the Commission applies the following general tests (as outlined in chapters 3 and 9, and in Guidance Paper 3).

1. Expenditure on an activity is considered *prudent* where there is a clear justification for that activity.²⁹⁸ This involves a consideration of whether the expenditure is driven by:
 - ▶ a legislative or regulatory obligation, with which SA Water must comply
 - ▶ an expectation that the activity will deliver benefits to customers that outweigh the costs, and/or
 - ▶ a clear expectation from customers that an outcome should be achieved, and that they value and are willing to pay for that outcome.
2. Expenditure is considered *efficient* where it represents the lowest sustainable (or long-term) cost of achieving the intended outcome.²⁹⁹

The approach to assessing prudent and efficient operating expenditure is undertaken from an economic perspective in order to give effect to the primary objective of protecting the long-term interests of consumers. The assessment involves methodologies that can both mitigate the risks arising from information asymmetry (between the economic regulator and the regulated business) and establish expenditure benchmarks that incentivise efficiency.³⁰⁰

Generally, efficiencies occur through two channels. The first, catch-up efficiency, relates to the comparative performance of a firm relative to its peers. A firm that is on the 'efficiency frontier' has no ability to gain catch-up efficiency given the current technical abilities of firms in the market. The second, a frontier shift, encompasses innovation and technological advances to create further efficiency within the entire market. In simple terms, catch-up efficiency relates to a firm specifically and its relative position to peers, while frontier shifts tend to be industry-wide.

It is important to note that a regulated business, such as SA Water, will have greater knowledge of all facets of its business, including the amount and nature of its operating costs, than an economic regulator, and in light of this information asymmetry, there can be an incentive and ability for a regulated business, such as SA Water, to pass on inefficient costs to customers. Further, there can be an incentive and ability for a regulated business not to reveal full information about the efficient costs of its regulated activities and to overstate the extent of its incurred and allocated costs to the regulated business.³⁰¹

It is accepted regulatory practice for an economic regulator, such as the Commission, to require a regulated business to justify that its proposed costs are efficient.³⁰² Given the issues associated with information asymmetry, when a regulated business declines to supply requested information, or provides insufficient information to justify its proposed costs are efficient, an economic regulator may draw the inference that the information it is querying is not able to be justified as efficient by the

²⁹⁷ Ibid, pp. 4-9.

²⁹⁸ Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, pp. 1-2.

²⁹⁹ Ibid, pp. 1-2.

³⁰⁰ Joskow P, pp. 1227-1348, and Decker C, pp. 86-87.

³⁰¹ Joskow P, pp. 1285-1290, and Decker C, pp. 86-90.

³⁰² The level of justification and information sought by an economic regulator will depend on the nature, specifics and materiality of proposed costs, and the impact that information asymmetry can have on the economic regulator's ability to make decisions that are consistent with its statutory objectives.

regulated business (subject to the reasons for why information was not provided and the nature and circumstance of the information involved).

The Commission has utilised two key methodologies for assessing the prudent and efficient base year operating expenditure for SAWRD24 for water and sewerage retail services.

First, the Commission has utilised a comparative benchmarking approach when assessing prudent and efficient operating expenditure (described in this chapter as a 'top-down assessment'). According to this framework, which has, in effect, been supported by SA Water in the RBP,³⁰³ a regulated firm's prudent and efficient operating expenditure can be inferred not on the basis of past expenditure, or expected future expenditure, but on the basis of the observed expenditure of regional networks whose efficiency can be compared (for example, non-competing water and sewerage utilities operating in different regions or states). Such an approach can be used to infer an estimate of SA Water's prudent and efficient base year operating expenditure for SAWRD24 and/or can infer an estimate of the expected efficiency gain that could be achieved by SA Water in SAWRD24.

This estimate of base year expenditure can be combined with both adjustments to reflect known or likely changes in SA Water's operating circumstances in future years and expectations of efficiency on SA Water's operating expenditure, to infer an estimate of the total prudent and efficient operating expenditure for SAWRD24.

The principal advantage of a benchmarking approach is that it can address information asymmetries when estimating operating costs. Specifically, it can assist the Commission in understanding the cost-reducing efforts of SA Water compared to comparable water and sewerage utilities. In addition, the method is seen as being less susceptible to potential regulatory gaming and can incentivise SA Water to control costs and converge towards the efficient industry level of operating costs. In that context, a top-down efficiency assessment is more consistent with the incentive-based regulatory model (established under the South Australia statutory regime and consistent with the National Water Initiative Pricing Principles), as compared with bottom-up approaches (discussed below and in section 10.5.2).

Benchmarking approaches are suited to settings where the water and sewerage utilities compared are sufficiently similar and face comparable cost and demand conditions.³⁰⁴ A downside of benchmarking is that the information required can be substantial, the data required to perform the relevant analysis effectively is not always available, and there are various technical methodologies that can be used in benchmarking and efficiency analysis.³⁰⁵

Second, the Commission has utilised a bottom-up assessment to infer an estimate of a prudent and efficient base year operating expenditure. This methodology involves estimating a base year of expenditure by taking an actual year of SA Water's operating expenditure and 'normalising' it, by removing any one-off or abnormal costs (or savings) incurred in that year, making it representative of the costs that SA Water is likely to face in future years.³⁰⁶

³⁰³ SA Water, Regulatory Business Plan 2024-28, Appendix 3.2: SA Water Operating cost benchmarking report, June 2022, pp. 1-58.

³⁰⁴ As discussed in section 10.5.1, SA Water has proposed a sample of comparable Australian water and sewerage utilities as part of its benchmarking and efficiency analysis.

³⁰⁵ For example, there are linear programming approaches, such as Data Envelopment Analysis, total and partial productivity index approaches, such as Malmquist or Tornqvist indices, statistical/econometric approaches, such as Stochastic Frontier Analysis, or, as discussed in section 10.5.1, the use of corrected ordinary least squares.

³⁰⁶ The approach uses revealed behaviour in one regulatory period to infer estimates of the prudent and efficient base year of operating expenditure for the next regulatory period.

Once the efficient expenditure base year is set on a bottom-up basis, adjustments can be made to reflect known or likely changes in SA Water's operating circumstances in future years. For example, the imposition of a new legal requirement, as a result of which it would be reasonable to assume there would be increased expenditure requirements, or the removal of an existing obligation, with the opposite effect. The Commission's assessment of adjustments has involved a review of a sample of projects, programs and initiatives proposed by SA Water in the RBP. The Commission's bottom-up approach also includes setting an efficiency expectation on SA Water's operating expenditure for the regulatory period, replicating the pressures that a firm in a competitive market would face.

This methodology balances observations regarding SA Water's incurred operating costs with incentives for efficiency over the regulatory period.³⁰⁷ Such an approach has involved reviewing, considering and analysing business case information and other materials submitted by SA Water. However, the method can be at risk from information asymmetry problems. For instance, SA Water's actual expenditure may be inefficient and include one-off costs, its proposals for additional operational expenditure may not be prudent and/or efficient, and SA Water has an informational advantage, and it has an incentive and ability to overstate prudent and efficient costs and not to reveal one-off and inefficient costs.

Overall, in setting prudent and efficient operating expenditure for SAWRD24, the Commission has had regard to both methodologies (top-down and bottom-up assessments), alongside stakeholder submissions, SA Water's RBP, and all information available at the time of making the draft determination.

10.2.2 Contextual considerations

In considering the context for prudent and efficient operating expenditure for SAWRD24, the Commission has had regard to SA Water's operating expenditure performance in SAWRD20 (to date) and how costs have changed between the commencement of SAWRD20 and the draft determination for SAWRD24.

SA Water's operating expenditure over the period has exceeded the expenditure benchmarks set out for SAWRD20 (Table 10.1). Specifically, for water retail services, actual annual operating expenditure has been approximately 2 percent (\$21 million) higher than benchmark over the period to date, and for sewerage retail services, actual annual operating expenditure has been approximately 5 percent (\$23 million) higher than the benchmark set.

Table 10.1: Operating expenditure for SAWRD20 period to date (\$Dec22)³⁰⁸

	Actual outcomes (\$m)	SAWRD20 Benchmark (\$m)
Water retail services	1,234	1,213
Sewerage retail services	489	466

SA Water has reported cost escalation due to increased materials and labour costs, labour availability challenges and COVID-19 related disruptions.³⁰⁹ In response to those pressures, SA Water reported that, among other activities (including re-prioritising expenditure as well as seeking cost-savings), it

³⁰⁷ For instance, a 'base-step-trend' approach is used by the AER. Australian Energy Regulator, *Better Resets Handbook: Towards Consumer Centric Network Proposals*, December 2021, pp. 25-27, available at <https://www.aer.gov.au/system/files/Better%20Reset%20Handbook%20-%20December%202021.pdf>.

³⁰⁸ Based on available information at the time of making the draft determination (representing the first three years of the SAWRD20 regulatory period).

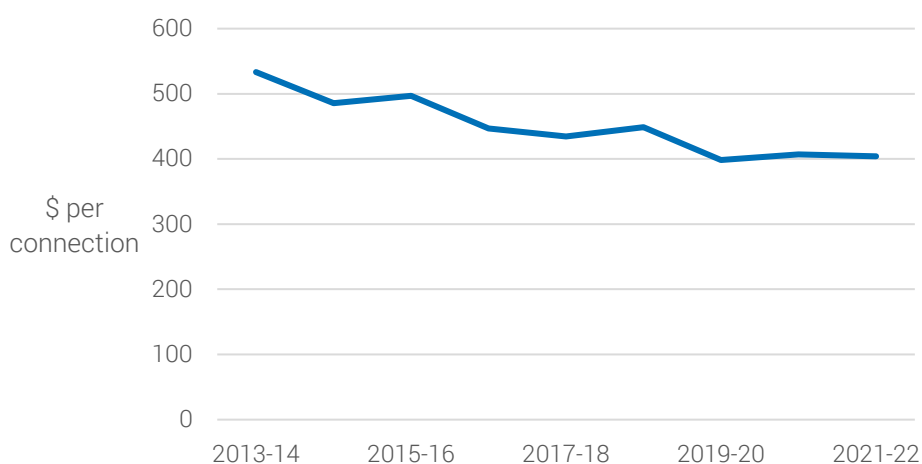
³⁰⁹ SA Water, Regulatory Business Plan 2024-28, p. 41.

reduced its dividend payment to the South Australian Government to support higher operating expenditure.³¹⁰

SA Water's operating expenditure in 2020-21 and 2021-22 may have, at least partially, been impacted by COVID-19 related disruptions.³¹¹ Those impacts are difficult to disentangle from other economy-wide effects and to adjust for when reviewing, considering and assessing historical expenditure data for the purpose of determining prudent and efficient expenditure benchmarks.

The higher operating expenditure in 2020-21 and 2021-22 can also be seen in the recent stabilisation in the measure of total operational expenditure per connection, following a period in which SA Water achieved operational efficiencies since the commencement of economic regulation in 2013 (Figure 10.1).³¹² It is noted that the improved efficiency, as measured in total operating expenditure per total connections, which includes both water and sewerage, does not necessarily indicate SA Water is operating at, or near, the efficiency frontier (that is, the operating cost position of the best-performing firms): firms in competitive markets face pressures to innovate and also find operational efficiencies over time.

Figure 10.1: Total operating expenditure per connection, 2013-14 to 2021-22 (\$Dec22)



Sources: Australian Bureau of Meteorology, Commission

As noted in Chapter 3, the Commission's assessment of prudent and efficient operating expenditure for SAWRD24 is taking place in economic circumstances that are different to those existing when SAWRD20 was made. For example, the cost of materials and intermediate inputs (for example, energy-related prices such as oil and electricity, and raw commodity prices such as copper and aluminium)

³¹⁰ SA Water, *Regulatory Business Plan 2024-28*, p. 41. SA Water's annual dividend payments has averaged approximately \$211 million (in nominal terms) between 2013-14 and 2019-20 but has averaged \$58 million annually across 2020-21 and 2021-22. Australian Bureau of Metrology, *National Performance Report 2021-22: Urban Water Utilities*.

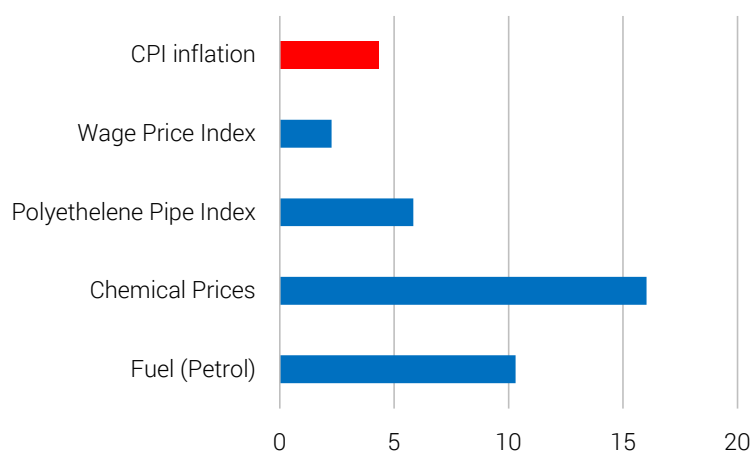
³¹¹ SA Water, *Regulatory Business Plan 2024-28*, p. 74. Disruptions could take various forms. This includes negative productivity impacts. That is, COVID-19 related disruptions could mean that SA Water was required to use more labour and materials than usual to deliver the same level of retail services.

³¹² Operating expenditure per connection has decreased by approximately 4 percent per year between 2013-14 and 2021-22. The decrease in operating expenditure per connection has been achieved in the face of annual growth in connections of approximately 1 percent per year. The Commission has previously acknowledged that SA Water has managed its operational expenditure within the expenditure benchmarks set out by the Commission in SAWRD13 and SAWRD16. Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 121-122.

have increased since the time of making SAWRD20, in some cases by amounts well above changes observed in Consumer Price Index (CPI) inflation.³¹³

To provide an indication of the size of movements in the costs of materials, intermediate inputs and labour, the Commission sourced information from Oxford Economics Australia.³¹⁴ Figure 10.2 sets out Oxford Economics Australia's advice on the annual average percentage change for a sample of cost categories from 2020 to 2023, according to estimates and forecasts.³¹⁵ The largest percentage changes are evident for energy, fuel and chemical prices. In contrast, labour cost growth (as measured by the Australian Bureau of Statistics' Wage Price Index) remained contained during 2020-21 and 2021-22 but increased in 2022-23, with Oxford Economics Australia forecasting a further rise in 2023-24.³¹⁶

Figure 10.2: Annual average percentage change, between 2020 and 2023



Sources: Oxford Economics Australia, Commission, Australian Bureau of Statistics

Noting those outcomes and considerations, the Commission's assessment of prudent and efficient benchmark operating expenditure for SAWRD24 is also undertaken in the context of the following factors.

- ▶ A prudent and efficient water utility, such as SA Water, should be able and willing to provide supporting evidence to justify all elements of its operating expenditure proposals, and it should have the information and materials readily available to be provided to stakeholders and the Commission. The Commission is not bound to accept SA Water's claims regarding operating expenditure requirements without testing and assessing those claims (publicly, wherever possible) and, where it considers better information or evidence exists, it may choose to adopt that better information and evidence.
- ▶ In undertaking the review, analysis and consideration of the prudent and efficient operating expenditure for SAWRD24, the Commission has found limitations in SA Water's RBP.
 - Several operating expenditure proposals lacked empirical justification and supporting information did not address why SA Water (if it was currently operating efficiently and prudently) could not mitigate, all or in part, the expenditure increases that it was seeking. For example, SA Water's proposal did not outline why current administrative expenditure could not

³¹³ Department of Industry, Science and Resources, *Resources and Energy Quarterly*, September 2023, pp. 74-94, 110-122, Reserve Bank of Australia, *Statement of Monetary Policy*, p. 52, and Oxford Economics Australia, pp. 1-49.

³¹⁴ Oxford Economics Australia, pp. 2-4.

³¹⁵ *Ibid*, pp. 2-4.

³¹⁶ *Ibid*, pp. 2-4.

be utilised for procurement purposes to meet Treasurer’s Instruction TI-18,³¹⁷ or why research and development expenditure already within SA Water’s base year operating expenditure could not be utilised to fund the operation of its proposed Purified Recycled Water Demonstration Plant.³¹⁸ In these cases, SA Water has not been able to make the case for increased expenditure levels, as those proposed increases have not been supported by sufficiently detailed business cases or other supporting evidence through the Commission’s follow-up enquiries.

- In the absence of a new obligation or significant change in circumstance, simply identifying new activities is not in itself a justification for an increase in total expenditure. For example, while new activities may be required in the future, with associated new costs, other activities which previously took place may no longer be required, offsetting those new costs. SA Water’s proposal for additional operating expenditure associated with the Eyre Peninsula Desalination Plant did not identify, in the Commission’s view, the extent of operating cost-savings resulting from the plant.³¹⁹
- ▶ SA Water’s overall service standard performance over SAWRD20 has been consistent with its historical performance. As outlined in Chapter 6, the draft decision is that the existing service standards will continue to apply to SA Water during SAWRD24. The Commission has had regard to that draft decision when reviewing, analysing and considering the level of prudent and efficient operating expenditure for SAWRD24.
- ▶ The Commission has a range of information, materials and submissions available to it at the time of making the draft decision. This includes information and submissions from industry and consumers, SA Water’s consumer engagement, as well as public and private sources of data, and the information contained in SA Water’s RBP. Matters raised in consultation in relation to operating expenditure are summarised in section 10.4.
- ▶ At the time of publishing this draft determination, no Ministerial directions under section 6 of the *Public Corporations Act 1993 (PC Act)* have been issued in respect of SAWRD24.³²⁰ However, SA Water stated in its RBP that directions will be issued relating to two major projects: Northern Metropolitan Growth and TTG Sustainable Sewers.³²¹ In that context, and for the purposes of the draft determination, the Commission has included expenditure for these projects in line with SA Water’s proposal. In doing so, the Commission has not reviewed, in detail, the prudent and efficient expenditure requirements of these two projects.

10.3 SA Water’s proposal

The following section provides a summary of SA Water’s operating expenditure proposals, which can be viewed in more detail in the RBP.³²² The Commission has reviewed SA Water’s proposal and understands it to state operating expenditure in December 2022 dollars.

³¹⁷ SA Water, *Regulatory Business Plan 2024-28*, p. 251.

³¹⁸ *Ibid.*, pp. 174-175.

³¹⁹ *Ibid.*, p. 168, 174.

³²⁰ The Minister for Climate, Environment and Water may issue directions to SA Water under section 6 of the PC Act. Those directions may specify on-going and new requirements that SA Water must deliver during a regulatory period, with associated cost-related requirements or specifications. This is discussed further in Chapters 3 and 4 and Appendix 2.

³²¹ SA Water, *Regulatory Business Plan 2024-28*, p. 16. For further discussion of those two major projects in the context of the capital expenditure involved, see Chapter 11.

³²² SA Water, *Regulatory Business Plan 2024-28*, pp. 208-259.

In total, SA Water’s four-year combined operating expenditure proposal for water and sewerage retail services is for \$2,385 million (\$Dec22), approximately 7 percent (\$149 million) higher than the operating expenditure benchmark set in SAWRD20.

SA Water’s proposal for operating expenditure for SAWRD24 is made up of three parts:

- ▶ a proposal for an efficient base year expenditure (\$2,385 million)
- ▶ a proposal for a general efficiency applied to that base year (0.9%), and
- ▶ a proposal for additional expenditure to be added in regard to new initiatives, programs and projects (\$162 million).

Table 10.2 presents SA Water’s proposal for total operating expenditure for SAWRD24. In total, SA Water’s four-year combined operating expenditure proposal for water and sewerage retail services is for \$2,385 million (\$Dec22), approximately 7 percent (\$149 million) higher than the operating expenditure benchmarks determined as prudent and efficient in SAWRD20.

Table 10.2: Total operating expenditure proposed for SAWRD24 (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Base year proposal excluding efficiency	560.7	560.7	560.7	560.7	2242.8
Efficiency proposal	5	5	5	5	20
Additional expenditure proposal	24.4	38.0	48.6	51.5	162.4
Total expenditure proposal	580.1	593.7	604.3	607.2	2385.2

10.3.1.1 Base year proposal

For SAWRD24, SA Water selected financial year 2021-22 as the base year for operating expenditure on the basis that it was the most recent full year that audited statements were available at the time of submitting the RBP, and because the financial data was not impacted by the River Murray floods in 2023.³²³

Table 10.3 presents proposed operating expenditure for that base year.³²⁴ It includes expenditure items that SA Water has removed from its incurred expenses in 2021-22 and those which it has added (on the basis of claims that the additions are prudent and/or efficient operating expenditure). Of note, SA Water has framed its operating expenditure performance in SAWRD20 as being impacted by economic circumstances. Those include COVID-19-related disruptions, cost escalation related to bottlenecks in the supply of commodities, freight and goods, impacts from the 2022-23 River Murray floods, and general cost pressures emerging throughout the South Australian economy.³²⁵

³²³ Ibid, p. 212.

³²⁴ Table 10.3 presents SA Water’s base year expenditure proposal against its actual expenditure. Note that SA Water also presents its base year expenditure proposal relative to the Commission’s operating expenditure benchmarks for SAWRD20. For more details on SA Water’s proposal, see SA Water, *Regulatory Business Plan 2024-28*, pp. 208-260.

³²⁵ SA Water, *Regulatory Business Plan 2024-28*, p. 285.

Table 10.3: Total base year operating expenditure excluding efficiencies for SAWRD24 (\$Dec22)

Expenditure Item	Total (\$m)	Water (\$m)	Sewerage (\$m)
Reported operating expenditure in accounts	577.6	413.3	164.3
Adjustments and normalisations			
- RD24 cost allocation methodology realignment ³²⁶	-3.7	-20.3	16.7
- Cloud computing ³²⁷	-8.7	-4.3	-4.3
- Leases ³²⁸	21.3	13.9	7.4
- EBA one-off payment ³²⁹	-1.6	-1.2	-0.5
- Adelaide Metro Alliance contract delivery transition ³³⁰	-2.2	-1.2	-1
- Other once off costs ³³¹	-27.8	-16.3	-11.6
- Water for regional areas ³³²	1.1	1.1	0
- RD20 efficiencies ³³³	-6.5	-3.2	-3.3
- RD20 asset and investment uplift ³³⁴	11.2	5.8	5.4
Base year excluding efficiency for SAWRD24	560.7	387.6	173.1

As noted above, the proposed base year operating expenditure has additions, including the following items:

- ▶ Lease expenses: Under Australian Accounting Standards Board standard number 16, operating leases are required to be recognised on the balance sheet to provide transparency regarding company lease commitments. However, in SAWRD20, leases were treated as operating expenditure and included in the operating expenditure base year. SA Water has proposed to continue this treatment of lease expenses for the purposes of SAWRD24.
- ▶ Asset uplift expenditure: This cost category included a wide variety of asset and technology investment programs that SA Water has reported to have been partially delivered, or are scheduled for delivery, post 2021-22. SA Water proposes that these expenditures be added to the base year.³³⁵

³²⁶ SA Water, Regulatory Business Plan 2024-28, p. 214.

³²⁷ Ibid, p. 215.

³²⁸ Ibid, p. 215.

³²⁹ Ibid, p. 216.

³³⁰ Ibid, p. 216.

³³¹ Ibid, p. 216.

³³² Ibid, p. 216.

³³³ Ibid, p. 217.

³³⁴ Ibid, p. 217.

³³⁵ Adjustments have been made to the base for asset and information technology investment programs that are partially delivered or are scheduled for delivery after the 2021-22 financial year (as per the RD20 determination timing). It has proposed additional operating expenditure to account for several capital projects scheduled to be delivered in the second half of the current regulatory period. It proposes that ongoing operating expenditure

- ▶ Servicing of regional areas: SA Water has reported that actual expenditure for regional initiatives was lower than normal in 2021-22 due to external factors, including COVID-19 related disruptions, contractor availability and community approval processes. SA Water proposes that this expenditure be added to the base year.

The proposed expenditure items that SA Water has removed have included the following:

- ▶ One-off enterprise bargaining agreement (EBA) payment: During 2021-22, SA Water entered into a new EBA that required a one-off payment to employees. This cost is not ongoing and, as such, SA Water has removed it from the proposed base year.
- ▶ Cloud computing costs: While the current accounting standard is to treat these costs as businesses running software as a service (that is, treat them as operating expenditure),³³⁶ SA Water has proposed the capitalisation of these costs, and hence, has proposed that cloud computing costs be excluded from the base year.³³⁷ The capitalisation of cloud-related computing costs is discussed further in Chapter 11.
- ▶ Cost allocation methodology: SA Water has adjusted its cost allocation methodology for the treatment of both direct and indirect costs between water and sewerage retail services.
- ▶ Other one-off costs: There were several initiatives conducted by SA Water during 2021-22 that have costs that are non-recurring in nature. These range from a \$12.9 million reduction due to an adjustment relating to the transition to the Adelaide Metropolitan Alliance contract, to minor adjustments made including replacing odour control units that saw a reduction of just \$0.1 million. A full list of the costs is included in SA Water's RBP.³³⁸

10.3.1.2 Base year including general efficiency for SAWRD24

SA Water proposed an annual general base efficiency of approximately 0.9 percent for SAWRD24 (Table 10.4). Its efficiency proposal is based on continuing efficiencies (industry-wide frontier shift) only; it did not include catch-up efficiencies.

Table 10.4: Total base year operating expenditure proposed for SAWRD24 including efficiency (\$Dec22)

Expenditure Item	Total (\$m)	Water (\$m)	Sewerage (\$m)
Base year excluding efficiency expectation for SAWRD24	560.7	387.6	173.1
General base efficiency for SAWRD24 (annual efficiency for combined water and sewerage of 1%)	-5	-2.2	-2.7
Base year including efficiency for SAWRD24	555.8	385.4	170.4

associated with these programs will be required after the projects are delivered, and therefore it has been added to the normalised base year expenditure.

³³⁶ In April 2021, international accounting standards changed, with the International Financial Reporting Standards Interpretations Committee issuing an agenda decision on the configuration or customisation costs for cloud-based technologies.

³³⁷ SA Water, Regulatory Business Plan 2024-28, p. 215.

³³⁸ SA Water, Regulatory Business Plan 2024-28, pp. 208-233.

A key aspect of SA Water’s proposal is that it claims to be operating efficiently:

‘SA Water operates efficiently in the interest of keeping customer bills as low as possible. It is also an ESCOSA requirement that SA Water demonstrates that its expenditure represents the lowest sustainable cost for achieving the intended outcome. As detailed in Section 3.5, SA Water’s historic costs are shown to be efficient when compared with similar interstate water utilities. For RD24, as part of developing business cases for new expenditure, consideration was given to efficiencies that might be achieved within ongoing operational expenditure.’³³⁹

SA Water provided supporting research from KPMG³⁴⁰ and Stantec.³⁴¹ KPMG’s research stated that SA Water was at, or close to, the efficiency frontier of comparable water utilities.³⁴² Stantec’s research stated SA Water may have reached a point in which opportunities to find efficiencies have been exhausted.³⁴³

10.3.1.3 Proposal for additional expenditure

SA Water proposed additional operating expenditure for a range of services in SAWRD24 (Table 10.5).

Key additional expenditure related to: operating the Eyre Peninsula Desalination Plant, delivering the Tea Tree Gully Sustainable Sewers program and maintaining the existing (albeit declining) Community Wastewater Management Scheme (CWMS) in that area, meeting legislation relating to superannuation and the security of critical Information Communications Technology (ICT) infrastructure, operating a Purified Recycled Water Demonstration Plant, and operating recreational access to reservoirs. Those projects, programs and initiatives are discussed further in section 5.

Table 10.5 Additional expenditure proposed for SAWRD24 (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Operating expenditure associated with capital expenditure projects					
Eyre Peninsula Desalination Augmentation	0	7.6	14.8	13.5	35.9
TTG Sustainable Sewers Program	3.9	4.9	9.4	9.7	27.9
TTG CWMS	3.6	3.2	2.5	1.8	11.1
Cyber Security	0.7	1.6	3.0	4.2	9.5
Purified Recycled Water Demonstration Plant	1.6	1.6	1.6	1.6	6.4

³³⁹ SA Water, Regulatory Business Plan 2024-28, p. 234.

³⁴⁰ SA Water, Regulatory Business Plan 2024-28, Appendix 3.2: SA Water Operating cost benchmarking report, June 2022, pp. 1-58.

³⁴¹ SA Water, Regulatory Business Plan 2024-28, Appendix 3.1: Scope for future efficiencies, March 2023, pp. 1-23.

³⁴² SA Water, Regulatory Business Plan 2024-28, Appendix 3.2: SA Water Operating cost benchmarking report, p. 8.

³⁴³ SA Water, Regulatory Business Plan 2024-28, Appendix 3.1: Scope for future efficiencies, p. 23.

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Additional operating expenditure to the base year					
Recreational Access to Reservoirs	1.7	1.7	1.7	1.7	6.9
Statutory Superannuation Increases	3.0	4.3	4.8	5.3	17.4
Other					
Other ³⁴⁴	9.8	13.1	10.8	13.7	47.3
Total proposed additional spend	24.4	38.0	48.6	51.5	162.4

10.4 Matters raised in consultation

The Commission received several submissions from stakeholders, with the main themes relating to service levels, sustainability and affordability.

Submissions from the Council of the Ageing South Australia (**COTA SA**), the South Australia Council of Social Services (**SACOSS**) and Uniting Communities recognised the trade-off between balancing low prices in the short-term with the risk of long-term sustainability and lower service levels, and supported the prioritisation of affordability for SAWRD24.³⁴⁵ In that context, the submissions noted concerns about the capacity of low-income households to pay higher prices for water and sewerage retail services.³⁴⁶

Submissions from SACOSS, the Energy and Water Ombudsman South Australia (**EWOSA**) and the Environmental Protection Agency (**EPA**) commented on SA Water's proposed level of operating expenditure for SAWRD24.³⁴⁷ The submissions put the view, in general terms, that the Commission should carefully assess the prudence and efficiency of SA Water's proposed operating expenditure (including all potential cost savings).³⁴⁸

For instance, SACOSS suggested that the Commission should only allow expenditure for which SA Water provided evidence to justify the proposed expenditure was prudent and efficient:³⁴⁹

'SACOSS is also calling for ESCOSA to carefully examine whether SA Water has identified all possible operating expenditure savings and trade-offs across expenditure categories to ensure that customers pay no more than is necessary for the safe and reliable delivery of water services. ESCOSA must be satisfied that SA Water has provided sufficient evidence to support the need for the proposed operating expenditure step changes. This is particularly important in the context of current

³⁴⁴ SA Water proposed 79 separate initiatives (captured in the 'Other' category) that would require additional expenditure increases above the normalised base. 62 of those operating expenditure initiatives have total expenditure over the four-year SAWRD24 period of less than \$1 million each. The Commission sampled several of these projects to review the prudent and efficient nature of the proposed spending, and reviewed the justification provided.

³⁴⁵ For instance, South Australian Council of Social Service, p. 12, 26.

³⁴⁶ COTA SA, p. 2, Uniting Communities, p. 1, 5, and South Australian Council of Social Service, pp. 1-2, 26.

³⁴⁷ Energy and Water Ombudsman South Australia, pp. 1-2, South Australian Council of Social Service, p. 12, 26 and the Environmental Protection Agency, pp. 1-9.

³⁴⁸ Energy and Water Ombudsman South Australia, pp. 1-2, South Australian Council of Social Service, p. 12, 26, and the Environmental Protection Agency, pp. 1-9.

³⁴⁹ South Australian Council of Social Service, p. 12, 26.

and future affordability concerns, as the proposed increased operating expenditure will be fully recovered from consumers in the 2024-28 period.'

EWOSA supported a higher base-level of operating expenditure on the basis of maintaining service levels over the long term (and reducing the risk of increases in sewerage overflow) and addressing growth in the network.³⁵⁰

The EPA supported certain additional expenditure proposed by SA Water.^{351,352} This included expenditure for the purposes of major maintenance works and certain capital projects (such as Bolivar and Glenelg Wastewater Treatment Plants),³⁵³ and expenditure associated with SA Water's proposal for a Purified Recycled Water and Demonstration Plant.³⁵⁴ In the EPA's view, higher operating expenditure would assist in minimising failure frequency and the duration of interruptions, and would align to SA Water's commitment to meet external obligations.³⁵⁵ It supported SA Water's proposal for a Purified Recycled Water and Demonstration Plant on the basis that it is demonstrating and exploring climate-independent water sources.³⁵⁶

10.5 Commission Analysis

The Commission's assessment, reasons and considerations on the prudence and efficiency of operating expenditure for SAWRD24 has been informed by top-down and bottom-up methodologies to estimate prudent and efficient base year operating expenditure.

Alongside this, the Commission has reviewed a sample of SA Water's proposed operational projects, programs and initiatives and has considered efficiency targets for the regulatory period ahead.

- ▶ Sections 10.5.1 and 10.5.2 outline the Commission's review, analysis and consideration of both methodologies.
- ▶ Section 10.5.3 outlines the Commission's review of a sample of projects, programs and initiatives.
- ▶ Section 10.5.4 discusses efficiency expectations for the SAWRD24 period.
- ▶ Section 10.5.5 summarises the range of inferred estimates of prudent and efficient operating expenditure for SAWRD24.

10.5.1 Top-down assessment of base year expenditure for SAWRD24

The Commission has utilised a comparative benchmarking approach when assessing prudent and efficient base year operating expenditure. According to this methodology, a regulated firm's prudent and efficient base year operating expenditure can be inferred on the basis of the observed expenditure of non-competing water and sewerage utilities operating in different regions or states.

In its RBP, SA Water stated its view that it is currently operating at an efficient level. To support its position, SA Water provided research and analysis from KPMG³⁵⁷ and Stantec.³⁵⁸ SA Water has used

³⁵⁰ Energy and Water Ombudsman South Australia, pp. 1-2.

³⁵¹ Environmental Protection Agency, pp. 2-3, 5, 7.

³⁵² The support provided by the EPA was specific to projects and expenditure relating to environmental matters. It did not comment on the costs and benefits of projects. Nor did it outline its consideration of any trade-offs between affordability and long-term financial sustainability.

³⁵³ Environmental Protection Agency, pp. 2-3.

³⁵⁴ Ibid, p. 7.

³⁵⁵ Ibid, pp. 1-9.

³⁵⁶ Ibid, p. 7.

³⁵⁷ SA Water, *Regulatory Business Plan 2024-28*, Appendix 3.2: SA Water Operating cost benchmarking report, June 2022, pp. 1-58.

³⁵⁸ SA Water, *Regulatory Business Plan 2024-28*, Appendix 3.1: Scope for future efficiencies, March 2023, pp. 1-23.

the supporting research methodology from KPMG since 2012.³⁵⁹ KPMG's research argued that SA Water was at, or close to, the efficiency frontier of comparable water and sewerage utilities in Australia. The implication of the research was that there was limited scope for catch-up efficiencies.³⁶⁰

The Commission has reviewed, analysed and considered the research put forward by SA Water.

The Commission's analysis has focussed on total operating expenditure – rather than specifying the cost per connection for water and/or sewerage retail services separately³⁶¹ – to avoid issues relating to cost allocation methodologies.³⁶²

A key limitation of the SA Water research is that the methodology used by KPMG to derive its conclusions is based on a sub-optimal measure of operating efficiency. Rather than measuring efficiency on the basis of simply operating expenditure per connection, KPMG's research has utilised other variables, creating a composite statistic termed 'CLD'. This is a combination of length of mains, sales volumes and connections.³⁶³

Graphical representations of the two separate measures are shown below:

- ▶ Figure 10.3 plots SA Water's total operating expenditure against total connections for the sample of water and sewerage utilities utilised in the research submitted by SA Water.
- ▶ Figure 10.4 plots SA Water's total operating expenditure against its proposed CLD measure.

The line of best fit (solid, blue trend line) in Figure 10.3 indicates a measure of average efficiency for total operating expenditure for water and sewerage utilities. Dots above the line can indicate companies with lower-than-average efficiency, while those below the line can indicate above-average efficiency. A key takeaway from the graphical representation is that, while SA Water may be better than the average, it appears to lie behind the best performing water and sewerage utilities – that is, it appears to lie behind those utilities with the lowest operating cost relative to connections.

This can be seen by parallel shifting the average efficiency line such that it passes through a utility with greater efficiency than SA Water (see the dotted black line in Figure 10.3). Parallel shifting is adopted in this circumstance because it does not change the underlying relationship between the average

³⁵⁹ For example, SA Water, *Water Regulatory Business Proposal 2013*, 2012, pp. 121-126, available at https://www.sawater.com.au/_data/assets/pdf_file/0008/9458/REGULATION-Full-Regulatory-Business-Proposal.pdf. SA Water has used this approach in its RBPs for SAWRD16 and SAWRD20. SA Water's analysis requires it to select the time period, sample of comparator utilities and data to use. The sample is made up of SA Water and 12 other Australian water and sewerage utilities. In Victoria, there is Barwon Water, City West Water, South-East Water and Yarra Valley. In New South Wales, there is Hunter Water Corporation and Sydney Water Corporation. In Queensland, there is Gold Coast City Council, Logan City Council, Queensland Urban Utilities and Unity Water. In the Australian Capital Territory there is Icon Water, and in Western Australia there is Water Corporation – Perth. The source of the data is the National Performance Report published by the Australian Bureau of Meteorology.

³⁶⁰ SA Water, *Regulatory Business Plan 2024-28*, Appendix 3.2: SA Water Operating cost benchmarking report, p. 8, and SA Water, *Regulatory Business Plan 2024-28*, Appendix 3.1: Scope for future efficiencies, March 2023, pp. 1-23.

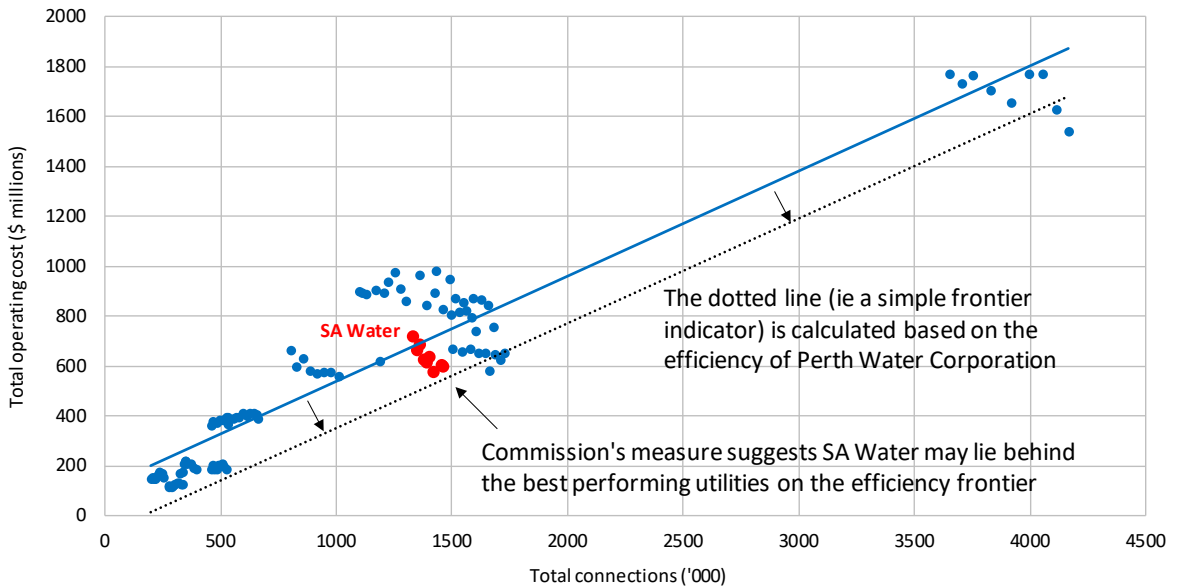
³⁶¹ SA Water's operating cost per connection provides different results across water and sewerage businesses. Considering total operating cost per connection mitigates some of the risk of cost misallocation influencing results.

³⁶² For instance, as noted in section 10.3, SA Water has realigned its cost allocation between water and sewerage retail services as part of the RBP. This recent change in methodology would not be apparent in the Australian Bureau of Meteorology data used in this analysis.

³⁶³ SA Water's CLD analysis uses the following functional form for either of water, sewage, or total operating costs: $TC = c + b(C^{0.5}L^{0.3}D^{0.2})$. This is a straight-line equation, where c represents the intercept and b the gradient of the straight line. TC represents total operating cost, C connections, L length of mains and D demand/volume.

efficiency curve and the efficiency frontier. On the measure of operating expenditure per connection, SA Water may therefore lie behind the efficiency frontier.³⁶⁴

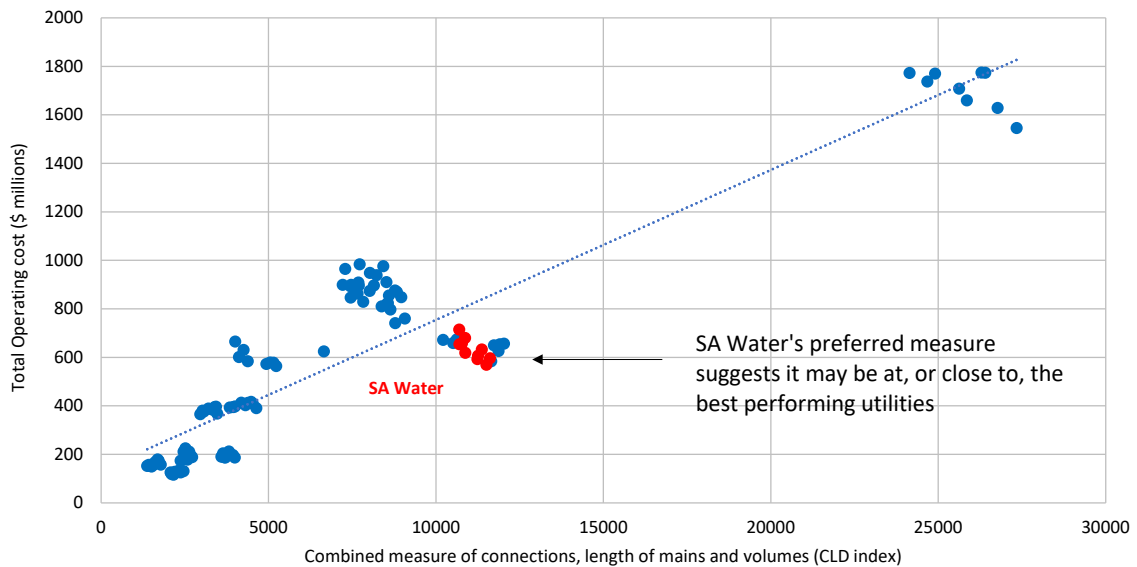
Figure 10.3: Commission’s measure: Total operating expenditure against total connections, 2013-14 to 2021-22



Sources: Commission, Australian Bureau of Meteorology

By contrast, if the same parallel shifting was applied to SA Water’s preferred measure of operating efficiency (CLD index), this measure would suggest that SA Water may be at or close to the efficiency frontier.

Figure 10.4: SA Water’s preferred measure: Total operating expenditure against CLD, 2013-14 to 2021-22



Sources: Commission, Australian Bureau of Meteorology, KPMG

³⁶⁴ Note that a corrected ordinary least squares measure can be used to take the data in the scatter plot and derive an estimate of the water and sewerage utility that would be at the estimated efficiency frontier (that is, it takes the water and sewerage utility furthest to the right of the line of best fit, to estimate the location of the efficiency frontier).

To compare the Commission's measure of operating efficiency and SA Water's preferred measure, the Commission used a simple statistical measure termed R-squared³⁶⁵ to interpret which measure results in a better fit of the available data.³⁶⁶

- ▶ The R-squared value for Figure 10.3 is 0.9 suggesting, at face value, that connections alone account for 90 percent of the variation in total operating expenditure.
- ▶ Comparatively, the R-squared for Figure 10.4 is 0.84. This suggests operating efficiency when measured by SA Water's preferred CLD index provides a weaker fit to the data than if expenditure per connection (in Figure 10.3) was instead used to measure operating efficiency.³⁶⁷

The use of operating expenditure per connection in measuring operating efficiency has advantages. Connections are a driver of operating costs, as they relate to demand across geographical locations and the choices made regarding network, storage, and plant configuration.³⁶⁸ In contrast, the fact that SA Water's network has a large length of mains, but a low level of connections relative to its size, need not mean that SA Water's total operating costs are naturally higher than its peers, nor that this factor exerts a relatively higher influence than other factors across the sample of water and sewerage companies.³⁶⁹ The incremental operating costs associated with this need not be of a magnitude to influence an analysis based on total operating costs across a sample of water and sewerage companies.

As mentioned above, utilising the Commission's measure of operating expenditure per connection suggests that SA Water may lie behind the best performing utilities. For example, at face value, if SA Water was to perform in line with, say, a utility of a similar size that appears closer to the efficiency frontier (for example, Water Corporation – Perth), the relationship between operating expenditure and connections implies SA Water's annual base year operating expenditure could be approximately \$45 million lower than observed in 2021-22 (or equivalent to \$180 million lower over a four-year period).

The Commission acknowledges there can be limitations in empirical assessments of the operating efficiency of utilities.³⁷⁰ Nevertheless, while there are reasons to approach empirical estimates with a

³⁶⁵ R-squared measures the goodness of fit of a line. R-squared values are constrained between 0 and 1, with 1 representing the most superior outcome. The R-squared statistic can be interpreted as representing the percentage of variation.

³⁶⁶ The Commission notes that this outcome could differ when presented with alternate data sets. Variations could include a larger and differing sample and/or greater time period of measurements.

³⁶⁷ The variable $C^{0.5}L^{0.3}D^{0.2}$ is a composite variable that seeks to measure the overall size of a network. This specific form weighs connections 2.5 times greater than demand/volume and 1.7 times more than length of mains in terms of explaining total operating costs. The function is estimated using ordinary least squares. There are many weighting combinations that can be applied, all of which directly impact the influence that each of connections, length of main and volume has upon the functional form estimated, and consequently how well that functional form explains total operating costs, which relates to the R^2 value. The Commission's main observation is that in all cases in all years, solely using connections appears to provide a higher R^2 and therefore a better relationship to total operating cost, across SA Water and its peers. No other form of the CLD relationship provides a better result, including the functional form used in KPMG's analysis submitted by SA Water.

³⁶⁸ This means all direct costs associated with network, storage, and plant configuration, geographical conditions, and indirect costs such as administrative, billing, and overhead costs are included.

³⁶⁹ A key reason SA Water operates its length of main is to transport water to regional communities. The incremental operating costs associated with this relate to the energy associated with pumping costs as well as the maintenance of the long transportation pipes.

³⁷⁰ For example, the analysis does not assess the level of total factor productivity at SA Water (such as that undertaken in 2012, in the lead up to SAWRD13). Moreover, empirical assessments can be sensitive to data quality, methodological specifications and the sample of comparator utilities used. CIE, *Top down efficiency review of SA Water*, September 2012, pp. 1-95, available at <https://www.escosa.sa.gov.au/ArticleDocuments/482/121012-TopDownEfficiencyReviewSAWat.pdf.aspx?Embed=Y>.

degree of caution, the Commission's top-down assessment can provide an inferred estimate of prudent and efficient base year operating expenditure. The data for 2021-22 suggests total annual operating expenditure base year expenditure could be approximately \$542 million.³⁷¹

This base year operating expenditure estimate, once combined with any Commission adjustments to reflect known or likely changes in SA Water's operating circumstances in future years as well as any efficiency expectations for the SAWRD24 period, can by implication infer an estimate of the total prudent and efficient benchmark operating expenditure for SAWRD24. Section 10.5.6 provides a summary of the total inferred estimates.

Even if a top-down estimate of an operating expenditure base year were not adopted, the data shown above on operating cost per connection suggests that SA Water may likely be some distance from the efficient frontier. Therefore, when estimating a base year operating expenditure on a bottom-up basis, the Commission considers that an efficiency target should be set that would include a degree of catch-up efficiencies. As discussed in section 10.5.5, an annual target of 1.5 percent would be higher than previously has been the case, but it does not necessarily seem out of line when viewed in the context of annual targets for other water and sewerage utilities. For example, of the 16 recent (2023-2028) Essential Services Commission of Victoria (ESCV) price determinations for water and sewerage utilities, annual target cost efficiencies ranged from 0.4 percent at Goulburn Valley Water to 3 percent at Greater Western Water. The median annual cost efficiency target was approximately 1.4 percent.

The Commission's assessment of prudent and efficient benchmark operating expenditure for the final decision for SAWRD24 will have regard to submissions from stakeholders including as it relates to SA Water's operating efficiency relative to other comparable water and sewerage utilities.

The Commission notes that SA Water's operating cost efficiency is an area for future research for the Commission for SAWRD28.³⁷² Previous work was last prepared for the Commission in 2012.³⁷³

10.5.2 Bottom-up assessment of base year expenditure for SAWRD24

The Commission's bottom-up approach has examined the level of SA Water's proposed expenditure and has compared that expenditure against various benchmarks. The benchmarks have included previous expenditure amounts set out in SAWRD20, SA Water's current and historical operating expenditure levels, and available indicators provided by consultants such as Oxford Economics Australia³⁷⁴ and FTI Consulting (FTI).³⁷⁵ The assessment has included a focus on understanding the justification for any departures from these expenditure comparison points. The analysis focuses on several key operational line-items that account for a large proportion of expenditure or have had material increases when compared to historical expenditure.

It is important to note that a bottom-up approach has limitations. As explained in section 10.2, the method can be at risk from information asymmetry problems. It is commonly accepted that a regulated business will have greater knowledge of all facets of its business including operating parameters and

³⁷¹ Taking Water Corporation Perth as being a utility that is of a similar size to SA Water and is also closer to the efficiency frontier than SA Water (based on Figure 10.3), and taking operating costs as reported in the National Performance Report as given, this implies an estimated total operating expenditure of \$547 million for 2021-22 (\$Dec22). Assuming a minimum \$5 million of efficiencies over 2022-23 and 2023-24, this can imply an annual base year operating expenditure of \$542 million (\$Dec22) for SAWRD24.

³⁷² It is not uncommon for economic regulators to review proposed methodologies and research issues relating to productivity outside of the regulatory determination. For example, in May 2023, the Independent Competition and Regulatory Commission acknowledged that a review of methodologies and the treatment of productivity would be best handled during the regulatory period as a separate review. Independent Competition and Regulatory Commission, *Regulated Water and Sewerage Services Prices 2023-28*, Final report, May 2023, p. 28.

³⁷³ CIE, pp. 1-95.

³⁷⁴ Oxford Economics Australia, pp. 1-49.

³⁷⁵ FTI Consulting, pp. 1-35.

costs, than the economic regulator. In light of this information asymmetry, there can be an incentive and ability for a regulated business to pass on inefficient costs to customers. Relatedly, there can be an incentive and ability for a regulated operator not to reveal full information about the efficient costs of its regulated activities and to overstate the extent of its incurred and allocated costs to the regulated business.³⁷⁶

Net labour costs

Net labour expenditures for direct control retail services account for approximately 25 percent of SA Water's operating expenditures.

SA Water proposed net real labour costs for the SAWRD24 base year of approximately \$136 million. It has proposed the removal of several non-recurring expenses including once-off EBA related expenses. Further, in line with the Commission's expectation in Guidance Paper 3,³⁷⁷ SA Water did not propose that net labour costs would rise above its base year expenditure proposal for SAWRD24. As outlined previously, the Commission expects SA Water to find labour productivity gains and it considers that labour costs are set in real terms, so SA Water does not require increases above that.

Table 10.6 below provides a summary SA Water's proposed base year operating expenditure for SAWRD24.

Table 10.6 SA Water's base year operating expenditure proposal (\$Dec22)

	SA Water's proposed base year expenditure for SAWRD24 (pre-efficiency) (\$m)
Net Labour	136.2
Contracts	66.4
Electricity	69.6
Metro Alliance Contract	108.8
Other Expenditure ³⁷⁸	174.7
Total operating expenditure	555.7

The Commission has considered SA Water's incurred expenditure over the past half-decade. SA Water's proposed net real labour costs for SAWRD24 are relatively consistent with previous observed years of net labour costs (of approximately \$139 million and \$135 million in 2019-20 and 2020-21, respectively). Further, over the SAWRD20 period, full-time equivalent (FTE) positions have kept relatively stable, and SA Water has not proposed additional FTEs and net labour costs as part of its labour cost proposal in its RBP.

Nevertheless, SA Water has reported to the Commission net real labour costs of approximately \$132 million in 2022-23. This is approximately \$4 million lower than the net real labour costs proposed for the base year expenditure. Inflating the net real labour cost allowance from SAWRD20 by the growth

³⁷⁶ Joskow P, pp. 1285-1290, and Decker C, pp. 86-90.

³⁷⁷ Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, p. 6.

³⁷⁸ The Other Expenditure category includes costs relating to chemicals, materials, plant and vehicles, external fees and charges and several other cost categories.

in a Wage Price Index (WPI) suggests a level of labour cost more consistent with \$132 million.³⁷⁹ Moreover, as shown earlier, when measured by the Wage Price Index, labour cost growth across the economy more generally has remained modest over the period between making SAWRD20 and the base year operating expenditure (2020-21 and 2021-22).

Having regard to SA Water's RBP, stakeholder submissions and all available information at the time of making this draft determination, the Commission's bottom-up assessment can infer an estimate of net real labour cost of \$132 million (\$Dec22), for the prudent and efficient base year of operating expenditure for SAWRD24.

Metro Alliance Contract

SA Water's Metro Alliance Contract, which relates to various field services and production and treatment services, accounts for approximately 20 percent of operating expenditure.

SA Water's proposal for its base year operating expenditure for SAWRD24 was approximately \$109 million, and the proposal removed more than \$15 million of non-recurring expenditure from what was spent in 2021-22. The removed expenditure items related to the termination of the existing contract. For instance, in July 2021, SA Water transitioned from its Allwater Alliance contract to new contract providers, Service Stream (formerly Lendlease) for field services and SUEZ for production and treatment, and SA Water incurred some once-off closure and transition costs.³⁸⁰

In the Commission's assessment the removal of the transition and switching costs is justified. Further, benchmarking the expenditure proposed by SA Water with that allocated within the SAWRD20 efficient base year suggests the expenditure amounts are broadly comparable in real terms.

Having regard to SA Water's RBP, stakeholder submissions and all available information at the time of making this draft determination, the Commission's bottom-up assessment can infer an estimate of \$109 million (\$Dec22) for the Metro Alliance Contract, for the prudent and efficient base year of operating expenditure for SAWRD24.

Contract expenditures

Contact expenditures account for around 12 percent of SA Water's operating expenditure. SA Water proposed \$66 million in contract expenditures for SAWRD24. SA Water's proposal for SAWRD24 is more than 25 percent higher than that observed in earlier years, such as in 2019-20 and 2020-21. For example, contract expenditure was approximately \$46 million and \$56 million in 2019-20 and 2020-21, respectively. Contract expenditure is one of the fastest growing cost category within SA Water's base year expenditure proposal.

The contract expenditures component can incorporate a diverse range of expenditure. For example, contract services include labour and inputs such as fuel and commodities. Between 2020 and 2023, labour costs, as measured by a WPI, increased by approximately 7 percent, while the prices of energy and commodities (fuel, copper and aluminium) increased by more than 30 percent.³⁸¹

After reviewing historical financial information on SA Water's contract expenditures, such as for maintenance and corrective contractors,³⁸² the Commission has found that expenditure on preventative and corrective maintenance for water distribution, sludge and waste disposal for water

³⁷⁹ Oxford Economics Australia, pp. 2-4.

³⁸⁰ SA Water, Regulatory Business Plan 2024-28, p. 216.

³⁸¹ Oxford Economics Australia, pp. 2-4.

³⁸² This included activity level expenditure data for preventative and corrective maintenance for water distribution, sludge and waste disposal for water treatment operations, and support services for contractors.

treatment operations, and support services for contractors increased to be close to \$1 million each in 2021-22, while being small or negligible amounts in 2019-20, 2020-21 and 2022-23.³⁸³

If the average of the previous two years (2019-20 and 2020-21), for expenditure on preventative and corrective maintenance for water distribution, sludge and waste disposal for water treatment operations and support services for contractors was used instead of the expenditure for 2021-22, this would suggest approximately \$3 million worth of non-recurring expenditures should be removed from SA Water's base year proposal.³⁸⁴

In addition, SA Water has proposed additional contract expenditures of approximately \$1 million for water retail services in regional areas. However, SA Water's RBP, business cases and related documentation, do not present sufficient evidence to demonstrate that those regional contract expenditures are not already in the existing base year expenditure in another form. For instance, while SA Water has argued that, because of COVID-19 related disruptions, expenditures on those activities were not included in the 2021-22 financial accounts, SA Water has not outlined what other activities the regional expenditure was re-directed towards during that period (that is, if those activities did not go ahead, SA Water re-directed its expenditure to other areas of the business, but these have not been identified and removed from the base year).³⁸⁵

Having regard to SA Water's RBP, stakeholder submissions and all available information at the time of making this draft determination, the Commission's bottom-up assessment can infer an estimate of \$62 million (\$Dec22) for contract expenditure, for the prudent and efficient base year of operating expenditure for SAWRD24.

Electricity

Electricity expenditure for direct control retail services accounts for around 10 percent of operating expenditure. SA Water proposed electricity costs of \$70 million in its base year for SAWRD24. This total included a net downward adjustment of approximately \$4 million, to account for once-off costs. This proposal is five percent higher than the average cost over SAWRD20, and a 22 percent increase in electricity costs when compared with the incurred expenditure in 2020-21. It is noted that SA Water did not propose any incremental electricity expenditures over the SAWRD24 period.

The Commission examined whether this level of increase was non-recurring in nature and whether the 2021-22 incurred costs provided an indicator for SA Water's base year electricity costs. While electricity costs in 2021-22 increased materially compared with those in 2020-21, the level of expenditure (in terms of volume) is consistent with those observed in 2019-20 and 2022-23, and the per unit increase was not out of line with market price increases over the same period.

The Commission has also reviewed disaggregated data on SA Water's incurred electricity costs, including network and wholesale costs, and mandatory renewables costs. The reduction in electricity costs in 2020-21 was largely driven by a decrease in wholesale electricity prices in that year. The wholesale electricity price in 2021-22 increased to a level more consistent with previous periods.

³⁸³ In particular, preventative maintenance for water distribution rose from approximately \$50,000 in 2020-21 to \$1 million in 2021-22 and fell to approximately \$100,000 in 2022-23; corrective maintenance for water distribution rose from approximately \$30,000 in 2020-21 to \$800,000 in 2021-22 and fell to nothing in 2022-23; sludge and waste disposal for water treatment operations rose from approximately \$500,000 in 2020-21 to \$1.4 million in 2021-22 and fell to approximately \$400,000 in 2022-23; and support services for contractors rose from nothing in 2020-21 to \$1 million in 2021-22 and fell to be almost nil in 2022-23.

³⁸⁴ This is on top of SA Water having already proposed removing approximately \$8 million of expenditures.

³⁸⁵ From the information provided by SA Water, the Commission has not been able to verify the increase of \$1 million with previous years under any specific activity code. On this basis, this proposed cost does not appear to be prudent and efficient.

SA Water did not provide a specific proposal for incremental increases in electricity cost over the SAWRD24 period. However, it proposed additional electricity expenditure indirectly (via its proposal for SAWRD20 uplifts – see below). As explained below, SAWRD20 expenditure uplifts should not be included in the base year operating expenditure. More generally, the Commission notes that SA Water's electricity proposal for SAWRD24 is approximately 11 percent higher than the SAWRD20 allowance (even after adjusting for inflation).

Having regard to SA Water's RBP, stakeholder submissions and all available information at the time of making this draft determination, the Commission's bottom-up assessment can infer an estimate of \$70 million (\$Dec22) for electricity, for the prudent and efficient base year of operating expenditure for SAWRD24.

Other expenditures

The remaining expenditure within SA Water's operating expenditure proposal is made up of many small and mid-sized components. The Commission has reviewed a sample of proposed expenditure components and assessed that these appear consistent with historical trends and/or benchmarks.

- ▶ While lease expenditure is a capitalised expense for accounting purposes,³⁸⁶ in SAWRD20 the Commission accepted SA Water's position to treat lease expenditure as an operating expense for regulatory purposes. For SAWRD24, SA Water has proposed similar treatment, and this accounts for the addition to the base year of lease expenditure (including buildings and leases).

Similar to the treatment of cloud-computing costs (as discussed in Chapter 11), the Commission notes the treatment of these expenditures will be reviewed in SAWRD28, with the intention that the regulatory treatment will move towards alignment with the accounting treatment (unless compelling reasons against this alignment can be provided).

- ▶ In terms of chemical expenditures, there was a sharp increase over recent years. SA Water proposed chemical costs of \$7 million for SAWRD24, up from earlier years, such as \$5 million in 2020-21. SA Water's proposed costs were higher on the back of higher prices for global energy commodities, which flow through on to the manufactured cost of producing chemicals. SA Water forecasts chemical costs to maintain at elevated levels during SAWRD24 relative to SAWRD20.³⁸⁷

The benchmark indicators produced by Oxford Economics Australia suggests that there is a basis for the strong increase in chemical prices.³⁸⁸

Having regard to SA Water's RBP, stakeholder submissions and all available information at the time of making this draft determination, the Commission's bottom-up assessment can infer an estimate of \$175 million (\$Dec22) for other expenditure, for the prudent and efficient base year of benchmark operating expenditure for SAWRD24.

SAWRD20 adjustments for asset investment uplift

SA Water's proposal for SAWRD24 operating expenditure included incremental differences in certain costs and savings – that is, between what was in its revealed expenditure in 2021-22 and in the SAWRD20 operating expenditure allowance. The proposed expenditure adjustments included asset investment operating expenditure increases, including ICT expenditure and electricity expenditure, and the application of the annual 0.5 percent efficient target for the final two years of the SAWRD20 period.

³⁸⁶ For example, the leases standard, Australian Accounting Standards Board (AASB) 16, requires companies to bring the majority of operating leases on-balance sheet.

³⁸⁷ SA Water, Regulatory Business Plan 2024-28, pp. 47

³⁸⁸ Oxford Economics Australia, pp. 2-4.

The Commission's assessment is that the proposal has limitations that make it unlikely to be prudent and efficient expenditure.

First, SA Water's proposals for incremental expenditure should be treated as incremental (additional) expenditure and accordingly should be accompanied by specific justification and evidence to support each proposal. Justification for any cost changes needs to be consistent with other variations proposed for SAWRD24. However, the proposal did not provide sufficient information to support inclusion.

Second, an approach that utilises observed expenditure places weight on the revealed behaviour of SA Water. However, the Commission's determination is for a total operating expenditure allowance for a four-year period. SA Water may choose to manage and allocate its efficiency, cost savings and expenditures from year to year, over the four-year period.³⁸⁹

In undertaking its bottom-up assessment, the Commission has estimated that approximately \$6 million of SAWRD20 efficiencies could be inferred, for the prudent and efficient base year of operating expenditure for SAWRD24. This reflects the SAWRD20 determination efficiency targets for 2022-23 and 2023-24.³⁹⁰

Bottom-up assessment – inferred estimate of efficient base year operating expenditure for SAWRD24

Overall, the Commission's bottom-up assessment can infer an estimate of \$537.6 million for the prudent and efficient base year of operating expenditure for SAWRD24. Table 10.7 below shows that estimate with SA Water's base year expenditure proposal as a point of comparison.

Table 10.7: Commission's bottom-up assessment of normalised operating expenditure base year (\$Dec22)

	Base year (\$m)	Water (\$m)	Sewerage (\$m)
SA Water proposed adjusted base year	555.8	385.4	170.4
Commission bottom-up assessment - normalised base year	537.6	372.9	164.7

10.5.3 Sample review of projects, programs and initiatives for additional operating expenditure for SAWRD24

The Commission has reviewed a sample of proposed projects, programs and initiatives in relation to operating expenditure for SAWRD24. The approach has involved analysing and considering the nature and level of SA Water's proposed additional expenditure. This includes comparing expenditure proposals against previous expenditure benchmarks determined by the Commission, SA Water's current and historical operating expenditure levels, and available indicators provided by consultants Oxford Economics Australia³⁹¹ and FTI.³⁹²

The Commission's assessment has given regard to current performance and expenditure levels (including cost-savings from new programs, projects and initiatives), SA Water's RBP, additional detailed information provided by SA Water to further explain its proposals, submissions received from stakeholders, and an assessment of the evidence provided by consultants including Oxford Economics Australia and FTI. The Commission notes that step changes in operational expenditure above the efficient base year expenditure must be well justified and supported with clear supporting evidence.

³⁸⁹ For example, for certain operational items, four-year cost savings might have already been implemented in 2020-21, and operating expenditure associated with investments may have already been implemented.

³⁹⁰ The Commission's analysis has applied a 0.5 percent per annum efficiency to the adjusted 2021-22 base year. This results in additional efficiency savings of \$5.8 million by 2023-24.

³⁹¹ Oxford Economics Australia, pp. 1-49.

³⁹² FTI Consulting, pp. 1-35.

The Commission has understood the proposals from SA Water as providing operating expenditure in December 2022 dollars.

In total, SA Water proposed 86 separate initiatives that would, in its opinion, require additional operating expenditure increases above the normalised base operating expenditure.³⁹³ SA Water proposed approximately \$162.4 million of additional expenditure over the SAWRD24 period. The proposals accounted for approximately a 7 percent increase in real operating expenditure.

The majority of the section below focuses on large proposals;³⁹⁴ however, the Commission also reviewed a number of smaller proposals.

The sample of operating expenditure projects, programs and initiatives includes the following.

- ▶ Expenditure proposed relating to the superannuation guarantee.
- ▶ Expenditure proposed relating to procurement relating to South Australian Treasurer's Instruction TI-18.
- ▶ Expenditure related to the TTG Sustainable Sewers program.
- ▶ Expenditure related to cyber security.
- ▶ Expenditure related to the Purified Recycled Water Demonstration Plant.
- ▶ Expenditure related to the Eyre Peninsula Desalination Plant.

Superannuation guarantee

As a result of changes made by the Australian Government to the superannuation guarantee under the *Superannuation Guarantee (Administration) Act 1992*, the superannuation guarantee will increase by 0.5 percent per annum from 10 percent in 2021-22, to 12 percent by 1 July 2026.

SA Water proposed that an additional \$17.4 million would be required over the SAWRD24 period in order to meet the increased superannuation guarantee. SA Water has reported that the proposed expenditure is required to meet external obligations.

SA Water calculated the incremental increase in superannuation costs for the following two components:

- ▶ salaries in the 2021-22 base year, and
- ▶ the increase in total superannuation costs resulting from a forecast nominal increase in salaries of 3.5 percent per annum over the SAWRD24 period, including the base level of superannuation costs plus the incremental increases in the superannuation guarantee.

While there are reasons to consider that the increased superannuation guarantee impacts nominal expenditure (and incentives for greater labour productivity), rather than real (inflation-adjusted) operating costs (for example, employee's nominal wage growth expectations may be lower, all things equal, in anticipation of the increase in the superannuation guarantee),³⁹⁵ the Commission notes the

³⁹³ 62 of the initiatives have total expenditure over the four-year SAWRD24 period of less than \$1 million each.

³⁹⁴ Large proposals included initiatives which had expenditure of greater than \$1.5 million per year.

³⁹⁵ Parliament of the Commonwealth of Australia, *Review of the Annual Report of the Reserve Bank of Australia 2019*, House of Representatives Standing Committee on Economics, March 2020, pp. 23-24, available at https://www.aph.gov.au/-/media/02_Parliamentary_Business/24_Committees/243_Reps_Committees/Economics/46p/RBA_-_2019/20200304_Review_of_the_Reserve_Bank_of_Australia_Annual_Report_2019_First_Report_FINAL.pdf?la=en&hash=C9E238AAD8102F75A9E8D4119A106DED686355B2. Coates B, Mackey W and M Cowgill, *No free*

inclusion of the increased superannuation guarantee in regulatory determinations has been applied among various economic regulators in Australia.³⁹⁶

On balance, given the changes to the *Superannuation Guarantee (Administration) Act 1992*, the Commission has assessed that the proposed nature of the expenditure is prudent. The Commission has assessed that compliance with the external obligation presents a prudent requirement for additional cost.

However, having regard to SA Water's RBP, stakeholder submissions, and all available information at the time of making this draft determination, the Commission's assessment is that the proposed level of expenditure has several limitations and is not considered to be efficient.

First, SA Water has proposed a real increase in superannuation costs, calculated on the basis of a commensurate real cost increase in salaries. A real cost increase in superannuation resulting from a real cost increase in salaries would be inefficient and, as such, should not be included in operating expenditure forecasts for SA Water for SAWRD24. In the Commission's assessment, the superannuation guarantee increase should only be applied to the base year level of salary costs.

In relation to the incremental increase in the base year superannuation costs as proposed by SA Water, it is not clear where the base year salary figure of \$150.5 million, used by SA Water to calculate the superannuation guarantee cost increase, has been sourced from. It is also higher than the net real labour costs of \$136.2 million proposed by SA Water for the base year expenditure.

The Commission has therefore re-calculated an estimate of efficient superannuation guarantee increases, using the 2021-22 base year net labour costs estimate as inferred in the bottom-up assessment undertaken by the Commission.³⁹⁷ To estimate the salary only component of the net labour costs, the Commission has netted away 10 percent as superannuation costs. The Commission's methodology aligns with that of other regulators and is shown in Table 10.8.³⁹⁸

Table 10.8: Commission methodology for calculating the superannuation guarantee cost increase (\$Dec22)

	2024-25	2025-26	2026-27	2027-28
Net labour (\$m) (A)	132	132	132	132
Superannuation within the base (%) (B)	10%	10%	10%	10%

lunch: Higher superannuation means lower wages, pp. 1-75, available at <https://grattan.edu.au/wp-content/uploads/2020/02/No-free-lunch-Higher-superannuation-means-lower-wages.pdf>.

³⁹⁶ Australian Energy Regulator, Ausgrid Distribution Final Determination – 2019 to 2024, April 2019, p. 34, available at <https://www.aer.gov.au/system/files/AER%20-%20Final%20decision%20-%20Ausgrid%20distribution%20determination%202019-24%20-%20Overview%20-%20April%202019.pdf>, Australian Energy Regulator, *Issues Paper - Endeavour Energy Electricity Distribution Determination*, March 2023, pp. 42-43, available at https://consultation.acec.gov.au/aer/2024-29-resets-issues-paper-and-public-forum-survey/supporting_documents/AER%20-%20Issues%20Paper%20-%20Endeavour%20Energy%20-%20202429%20Distribution%20revenue%20proposal%20-%20March%202023.pdf, and FTI Consulting, *South East Water: Review of expenditure forecasts*, Report for the Essential Services Commission of Victoria, February 2023, pp. 31-32, available at <https://www.esc.vic.gov.au/sites/default/files/documents/South%20East%20Water%20Review%20of%20Expenditure%20Forecasts%20FINAL%20REPORT%20-%28Amended%2020230302%29.pdf>, and Marsden Jacobs, *Icon Water 2023-2028 expenditure review*, October 2022, p. 56, available at <https://www.marsdenjacob.com.au/wp-content/uploads/2023/01/MJA-public-report-Icon-Water-2023-expenditure-review-Redacted2.pdf>.

³⁹⁷ As noted earlier, the Commission's bottom-up assessment of estimated annual net real labour costs within the base year was \$132 million.

³⁹⁸ For example, in the context of Icon Water, see Marsden Jacobs, p. 30.

	2024-25	2025-26	2026-27	2027-28
Current SA Water Superannuation contribution (\$m) (C) (B * D)	12	12	12	12
Labour less Superannuation (\$m) (D)	120	120	120	120
Increased superannuation Guarantee (%) (E)	11.5%	12%	12%	12%
Revised cost of superannuation (\$m) (F) (D * E)	13.8	14.4	14.4	14.4
Efficient increase cost due to Superannuation (\$m) (F – C)	1.8	2.4	2.4	2.4

Table 10.9 provides the Commission's estimate of the inferred efficient and prudent superannuation guarantee additional cost for SAWRD24. The position only includes an allowance for the real effect of additional superannuation costs for the 2021-22 base year salary costs and represents an estimate of the prudent and efficient cost increase to address SA Water's external responsibility.

Table 10.9: Commission assessment of superannuation guarantee (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
SA Water proposal	3	4.3	4.8	5.3	17.4
Commission's estimate	1.8	2.4	2.4	2.4	9

Procurement relating to TI-18

Under the *Public Finance and Audit Act 1987*³⁹⁹ the Treasurer can direct public corporations, such as SA Water, to comply with various requirements. In February 2023, the Treasurer released the Treasurer's Instructions 18 procurement (TI-18), which SA Water will be required to comply with. The change to procurement frameworks is designed to empower public authorities to engage with industry, clients and communities to innovate and take balanced risks to pursue better outcomes while also increasing the responsibility of public authority Chief Executives.

SA Water proposed that it required \$0.29 million in costs related to this initiative.

While it is a minor proposal, the Commission has sought to review a sample of initiatives including some small items. The Commission reviewed business cases and related documentation, and sought further information from SA Water, to inform its analysis on the prudent and efficient cost.

Having considered SA Water's RBP, stakeholder submissions, and all the available information at the time of making this draft determination, the Commission has assessed that, while it is prudent to comply with the external obligations under TI-18, SA Water's proposal did not provide sufficient evidence to demonstrate why the change in procurement processes and policies could not be accommodated from within SA Water's existing procurement activities and expenditure that are already accounted for in the efficient base year expenditure.⁴⁰⁰ Accordingly, the Commission's assessment is that the expenditure for this proposal is inefficient.

³⁹⁹ TI-18 is available at <https://www.treasury.sa.gov.au/budget/treasurers-instructions/treasurers-instructions-files/TI18-Procurement.pdf>.

⁴⁰⁰ There is nothing precluding existing employees at SA Water learning the new process and applying this – that is, there is no evidence that more funding is necessarily required. Furthermore, SA Water's own business case acknowledges that the proposal for additional expenditure has not yet been agreed between shareholder and SA Water. SA Water, *Business Case 754 – TI18 Reform*, August 2023, p. 2.

A further implication resulting from the Commission's assessment is how many more of SA Water's 62 initiatives (which have total expenditure over the four-year SAWRD24 period of less than \$1 million each) have inefficient expenditure. This suggests caution in taking at face value the efficient and prudent expenditure being put forward.

Tea Tree Gully sewerage retail services

At the time of publishing this draft determination, no Ministerial directions under section 6 of the PC Act have been issued in respect of SAWRD24. As outlined in Chapter 4, SA Water has noted there is likely to be a Section 6 Ministerial direction for the Tea Tree Gully (TTG) Sustainable Sewers program. There are two additional expenditure initiatives proposed by SA Water that relate to the infrastructure in TTG. These are the TTG CWMS⁴⁰¹ initiative and the TTG Sustainable Sewers program.⁴⁰² In total, SA Water has proposed approximately \$40 million of operating expenditure over SAWRD24 for these initiatives (\$11 million for TTG CWMS and \$29 million for TTG Sustainable Sewers program).

The section below documents the proposed expenditure; however, it does not undertake an ex-ante assessment of the prudence and efficiency of the expenditure, given it is likely to be a Section 6 Ministerial Direction.

For context, during SAWRD20, SA Water took full ownership control of sewerage customers in the TTG area which had previously been serviced by the City of Tea Tree Gully. This included the management, operation and maintenance of the sewerage system. SA Water will continue to transition all properties connected to the dated CWMS to a modern sewer system. This process started in 2021-22 and will continue through SAWRD24 and into the first half of SAWRD28 on SA Water's current estimate. In total there were approximately 4,700 properties that required transitioning at the beginning of the project, currently there remain approximately 4,150 that remain unconverted with approximately 3,000 of these scheduled to occur within SAWRD24.

The CWMS operating costs are decreasing through the SAWRD24 period, illustrating the relatively marginal cost of operating the system as customers are transitioned off the system. The costs are shown in Table 10.10 below. Prior to SAWRD28, the Commission will assess these transitional and temporary costs and allow for only permanent ongoing prudent and efficient expenditure on this initiative. The Commission anticipates that the ongoing (permanent) prudent and efficient operating expenditure would be marginal.

Table 10.10: SA Water's proposal for operating costs of TTG CWMS (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Total operating cost – TTG CWMS	3.6	3.2	2.5	1.8	11.1

In addition to the operation of the existing CWMS, SA Water has submitted that there are additional operational costs required above the base year expenditure⁴⁰³ that relate to the new sewerage system being installed. These additional costs have two distinct sub-components. The first is the operation and maintenance of the new sewerage system. The second is the decommissioning of the septic tanks and old CWMS assets. The expenditure is apportioned as per Table 10.11 below.

⁴⁰¹ SA Water, Regulatory Business Plan 2024-28, pp. 253-254.

⁴⁰² SA Water, Regulatory Business Plan 2024-28, pp. 191-192.

⁴⁰³ Currently, within the 2021-22 base year expenditure, there is \$0.18 million apportioned to the TTG Sustainable Sewers program.

Table 10.11: SA Water's proposal for operating cost associated with TTG Sustainable Sewers program (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Operating Expenditure – New Sewerage	0.6	1.0	1.2	1.6	4.5
Septic Tank - Decommissioning	0.9	1.5	1.5	1.5	5.4
CWMS - Decommissioning	2.4	2.4	6.6	6.6	18.0
Total additional expenditure	3.9	4.9	9.4	9.7	27.9
Current costs within base year	0.18	0.18	0.18	0.18	0.7
Total initiative expenditure	4.1	5.1	9.5	9.9	28.6

The Commission notes that the decommissioning of septic tanks and old CWMS assets is a temporary and transitional cost. It would not be in the long-term interests of consumers for temporary and transitional operating expenditure to be directly or indirectly captured in base year operating expenditure for SAWRD28. The Commission notes that it will be important to adjust for this when estimating the efficient operating expenditure base year in SAWRD28.

Purified Recycled Water Demonstration Plant

SA Water proposed approximately \$6 million of operating expenditure over SAWRD24 to conduct a research and development initiative for water security and customer engagement purposes – that is, operating a Purified Recycled Water Demonstration Plant. SA Water has forecast that purified recycled water is an environmentally independent source of water that could provide pivotal water supply to South Australian customers in the future, and that a demonstration plant could help to raise customer awareness of, and confidence in, this type of water source.

However, the major limitation of the proposal is that it does not outline the current level of research and development being undertaken by SA Water that is already within the operating expenditure base year and for which could be re-prioritised toward this particular project. SA Water has various general research activities, and it also undertakes research activities related to certain capital projects (which are often capitalised into the project cost). Research and development expenditures are typically temporary spend and must be monitored and closely assessed prior to each regulatory determination.

The Commission acknowledges stakeholders' support for the project including from the EPA⁴⁰⁴ and the Customer Challenge Group (CCG) and Peak Bodies Engagement Forum (PBEF).⁴⁰⁵ There is nothing precluding SA Water from using existing base year expenditure to support the initiative. The Commission has assessed that SA Water has not outlined how the proposal fits within its overall research and development spend and the current prioritisation of research and development spend. Put simply, it is unclear how SA Water's existing research and development expenditure could not be re-prioritised to fund the operation of the Purified Recycled Water Demonstration Plant.

⁴⁰⁴ Environmental Protection Agency, pp. 5-7.

⁴⁰⁵ SA Water, Regulatory Business Plan 2024-28, pp. 174-175.

Cyber Security

SA Water has proposed an additional \$10 million in operating expenditure over SAWRD24 for cyber security and compliance initiatives. It noted recent cyber-attacks in Australia and highlighted that its infrastructure needs to be upgraded to comply with statutory requirements including those under the *Security of Critical Infrastructure Act 2018 (Cth) (SOCI)*. The proposed operating expenditure is related to SA Water's capital expenditure proposal (T-539a).⁴⁰⁶

The regulation of critical infrastructure under SOCI places obligations on responsible entities for certain infrastructure assets in relevant critical infrastructure sectors. SOCI aims to strengthen the security and resilience of critical infrastructure by capturing sectors and asset classes essential to Australia. As South Australia's primary provider of water and sanitation services, SA Water must seek to address its obligations under SOCI. Additionally, SA Water is governed by the South Australian Cyber Security Framework.

The Commission notes that SA Water provided detail relating to its current and target state of cyber security readiness, and the Commission's assessment was that the planned uplift arising from the proposed expenditure is prudent. While the costs are significant, the intention is to lift SA Water to high cyber maturity that completely satisfies its obligations under SOCI and the South Australian Cyber Security Framework. Further, the proposed expenditure is not inconsistent with trends in cyber security spend across the Australian utilities sector, and globally.^{407,408} Overall, the Commission's inferred estimate is for prudent and efficient operating expenditure for cyber security of approximately \$10 million for SAWRD24.

Eyre Peninsula Desalination Plant

SA Water has proposed operating costs of approximately \$36 million for the Eyre Peninsula Desalination Plant for SAWRD24, with operations commencing in 2025-26. Project development and construction is discussed in Chapter 11.

The Commission has previously (in SAWRD20) reviewed the prudent and efficient nature of an Eyre Peninsula Desalination Plant. There, taking into consideration the information and analysis conducted by the Department of Environment and Water (DEW) and advice from Cardno/Atkins at the time, the proposal was found to be efficient and prudent.⁴⁰⁹ During SAWRD20 there were several modifications to the initiative that have changed the cost, location and design of the proposed operation.⁴¹⁰ This is discussed further in Chapter 11.

In the Commission's assessment, the general nature of the proposal for operating expenditure remains prudent. However, SA Water provided updated cost information in the RBP, and the Commission has found significant deficiencies in its proposal for the required efficient cost of operation. The Commission has, on several occasions, afforded SA Water the opportunity to provide further information on the initiative.

Having had regard to SA Water's RBP, stakeholder submissions and all other information available at the time of making this draft determination, the Commission has assessed that the proposal by SA Water contains certain inefficient costs. These inefficiencies are discussed below.

⁴⁰⁶ FTI Consulting, pp. 20-21.

⁴⁰⁷ Ibid, pp. 20-21.

⁴⁰⁸ Ernst and Young, *How cyber security can keep pace with the energy transition*, available at

https://www.ey.com/en_au/cybersecurity/how-cyber-security-can-keep-pace-with-the-energy-transition.

⁴⁰⁹ The Commission's final decision in SAWRD20 assessed the prudent and efficient operating costs of the original initiative to be \$3.9 million in December 2018 dollars.

⁴¹⁰ Several changes have been made to the initiative including the location of the plant, technology involved, and the size (which increased from 4GL/ per year to the 5.3GL per year).

First, the Commission notes that SA Water's proposal for operating expenditure for the Eyre Peninsula Desalination Plant has not been supported by sufficiently detailed business cases and other supporting evidence, including through the Commission's follow up enquiries. As noted earlier, the level of justification and information sought by an economic regulator will depend on the nature, specifics and materiality of the proposed costs – and the incremental operating expenditure involved in this project are significant. The Commission will seek further information regarding this project from SA Water following the draft determination.

Second, SA Water proposed approximately \$5 million of costs labelled as contract costs with a description of *'two-year proving period paid to the contractor including establishment and transition costs'*. However, it is not clear if these contractor costs relate to the final stages of the construction and development or if they relate to ongoing operational costs. In the Commission's view, these costs are inefficient due to a lack of justification as to why they are ongoing efficient operational costs.

Third, there could be several areas of costs currently covered within base year operating expenditure that would become obsolete, or significantly mitigated, when production from the Eyre Peninsula Desalination Plant begins. Examples of these costs include those associated with extracting water from bores as well as pumping and treating costs associated with water being moved from the River Murray. When the Commission queried this, SA Water acknowledged cost savings of approximately \$1 million over SAWRD24. However, in the Commission's assessment there will likely be additional cost savings. For instance, approximately \$4.3 million of cost-savings were not appropriately factored into SA Water's proposal resulting from the transition to desalination water supply.⁴¹¹

Fourth, SA Water has proposed increased demand within the Eyre Peninsula region of 6 percent annually. This is despite historical information presented by SA Water highlighting that there has been a reduction in water demand on the Eyre Peninsula region over the past eight years. Furthermore, data from the Australian Bureau of Statistics indicates that the population of the Eyre Peninsula has been generally unchanged since 2001. The Commission's assessment is an assumption of water demand on the Eyre Peninsula of approximately 1 percent annual growth is more appropriate.

Taken together, the Commission's assessment is that, while there is a case that no operating expenditure be included for the Eyre Peninsula Desalination Plant on the basis that there has been insufficient justification and supporting evidence presented, an inferred estimate of prudent and efficient total expenditure is approximately \$26 million over SAWRD24. This is \$10 million lower than SA Water's proposal.

As a cross-check to the estimate in operating expenditure, the Commission has considered publicly available estimates for desalination plants around Australia. On average, the costs typically fall between \$1 and \$5 per kilolitre.^{412,413} When producing 5.3 GL per year, as forecast by SA Water for 2026-27 and 2027-28, the Commission's estimate is for an annual operating cost of approximately \$2.50 per kilolitre – which is within a broad range of desalination plant estimates.

⁴¹¹ SA Water's proposal assumed that, despite the operation of the Desalination Plant, the cost of pumping River Murray water would stay the same, at approximately \$5 million over SAWRD24. The Commission's assessment of cost savings includes half of the pumping costs for year 1 (2025-26) and has removed the full amount of pumping costs for 2026-27 and 2027-28.

⁴¹² Australian Water Association Desalination Fact Sheet p. 3, available at:

https://f.hubspotusercontent30.net/hubfs/14568786/Fact%20Sheets/Desalination_Fact_Sheet.pdf.

⁴¹³ Water Services Association of Australia Seawater Desalination information pack two, p. 7, available at:

<https://www.wsaa.asn.au/sites/default/files/publication/download/WSAA%20Seawater%20Desalination%20Fact%20Sheet%20Information%20Pack.pdf>.

Table 10.12: Commission assessment of operating costs for the Eyre Peninsula Desalination Plant (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
SA Water proposal	0	7.6	14.8	13.5	35.9
<i>Commission assessments</i>					
Unclear contract costs	0	-1.3	-2.3	-1.0	-4.7
Cost abatement	0	-0.8	-1.7	-1.7	-4.3
Demand adjustment	0	-0.7	-0.4	-0.4	-1.4
Commission estimate	0	4.7	10.4	10.4	25.5

Summary of Commission's review of sample of projects, programs and initiatives

Table 10.13 summarises the Commission's inferred estimates of prudent and efficient operating expenditure to be added to the efficient base year expenditure, based on its review of a sample of projects, programs and initiatives.

Table 10.13: Commission estimates of additional expenditure for SAWRD24 (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
SA Water proposed additions	24.3	38	48.7	51.5	162.4
Commission estimate	21.3	31.4	39.9	43.6	136.1

10.5.4 Efficiency targets for SAWRD24

As mentioned earlier, the Commission expects opportunities for operational efficiency should exist for SA Water; firms in competitive markets adapt and find efficiencies in the face of competitive pressures.

The Commission has reviewed, analysed and considered efficiency factors for application in deciding SA Water's prudent and efficient operating expenditure. The analysis takes into account continuing efficiencies and given the results from the top-down assessment scope for catch-up efficiencies.

As noted earlier, the Commission's top-down assessment in section 10.5.1 suggests at face value SA Water's operational efficiency (if measured as operating expenditure per connection) is likely to be below the efficiency frontier for comparable water and sewerage utilities in Australia.

The Commission's assessment is that:

- ▶ If the Commission's bottom-up assessment for efficient base year operating expenditure is adopted, an efficiency target of 1.5 percent per year should be adopted for SAWRD24.

The annual cost efficiency target is higher than previously has been the case. This reflects the Commission's assessment that there is likely to be some scope for catch-up efficiencies. The Commission considers that the target being set is not overly ambitious and will not put at risk SA Water's ability to maintain its performance and meet its existing service standards.

For example, of the 16 recent (2023-2028) ESCV price determinations for water and sewerage utilities, annual target cost efficiencies ranged from 0.4 percent at Goulburn Valley Water to 3 percent at Greater Western Water. The median annual cost efficiency target was approximately 1.4 percent.

- ▶ If the Commission's top-down assessment for efficient base year operating expenditure is adopted, an efficiency target focussed only on continuing efficiencies would be appropriate (as it is assumed that SA Water would, following adoption of a top-down estimate of a base year expenditure, be close to the efficiency frontier for a water and sewerage utility of a similar size). An annual target of 0.9 percent is used to infer an estimate of total prudent and efficient operating expenditure, as it is in line with SA Water's proposal for continuing (frontier shift) efficiencies⁴¹⁴ as well as efficiency targets in other jurisdictions (such as in Victoria, as noted above). The magnitude of the annual efficiency target is in line with that in SAWRD16, where the Commission considered a range of between 1 to 1.5 percent efficiency per annum over the period.⁴¹⁵

It is noted that for simplicity the Commission's approach is to apply a flat, rather than compounding, annual efficiency target. The target has been applied to all operating expenditure. The Commission's Guidance Paper 3 noted stakeholder feedback that the approach of efficiency that was applied in SAWRD20 was *'complex, and difficult to understand and measure'*. For the SAWRD20 determination it applied varied rates of efficiency to types of operating expenditure (including labour and capital).⁴¹⁶ Accordingly, for this reason, the Commission has adopted a simpler approach for SAWRD24, consistent with the approach proposed in SA Water's RBP.

10.5.5 Inferred estimates of prudent and efficient operating expenditure for SAWRD24

The Commission has considered SA Water's operating efficiency and a bottom-up assessment of SA Water's proposal for operating expenditure. Both provide a means of reviewing, considering and assessing the prudence and efficiency of operating expenditure for SAWRD24. Taken together, the approaches provide a range of estimates that can inform the Commission's assessment for the total four-year operating expenditure benchmark for SAWRD24.

- ▶ A top-down assessment of base year operating expenditure, including none of SA Water's proposed adjustments for SAWRD24 and no further efficiencies, can infer an estimate of total prudent and efficient operating expenditure benchmark of \$2,168 million for SAWRD24 (\$Dec22).
- ▶ A top-down assessment of base year operating expenditure (based on a water and sewerage entity of a similar size to SA Water), combined with the Commission's assessment of SA Water's proposed adjustments for SAWRD24 and an annual efficiency assumption of 0.9 percent, can infer an estimate of total prudent and efficient operating expenditure benchmark of \$2,284 million for SAWRD24 (\$Dec22).
- ▶ A bottom-up assessment of base year operating expenditure, combined with the Commission's assessment of SA Water's proposed adjustments for SAWRD24 and an annual efficiency assumption of 1.5 percent, can infer an estimate of total prudent and efficient operating expenditure benchmark of \$2,272 million for SAWRD24 (\$Dec22).

⁴¹⁴ As outlined earlier in section 10.3.

⁴¹⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, p. 121, 125.

⁴¹⁶ Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, p. 2.

10.6 Draft decision

The Commission has reviewed, analysed and considered the range of evidence and information regarding SA Water's operating expenditure SAWRD24. The Commission has utilised top-down and bottom-up methodologies, a review of projects, programs and initiatives, and an assessment of efficiency expectations. The draft decision represents the Commission's judgement having regard to the strengths and weaknesses of methodologies, information and evidence available in stakeholder submissions, SA Water's RBP, and all other information available to it at the time of making the draft determination. The Commission's assessment of prudent and efficient operating expenditure for the final decision for SAWRD24 will have regard to submissions from stakeholders.

The Commission's draft decision is that the prudent and efficient benchmark operating expenditure amounts to be included in the calculation of the revenue caps are as follows:

- ▶ \$1,550 million (\$Dec22) for water retail services, which is approximately 4 percent lower than the benchmark set in SAWRD20, and 5 percent lower than that proposed by SA Water, and
- ▶ \$722 million (\$Dec22) for sewerage retail services, which is approximately 16 percent higher than the benchmark set in SAWRD20, and 3 percent lower than that proposed by SA Water.

Higher prudent and efficient benchmark operating expenditure amount for sewerage retail services for SAWRD24 relative to the benchmark set in SAWRD20 reflects, in part, changes in cost allocation methodology and expenditure on TTG.

In total, it is noted that the prudent and efficient benchmark operating expenditure amount for SAWRD24 is \$2,272 (\$Dec22) for direct control water and sewerage retail services, which is approximately 2 percent higher than that set in SAWRD20, but 5 percent lower than that proposed by SA Water.

Table 10.14: Commission draft decision (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Operating expenditure	555.4	565.3	573.9	577.5	2271.9
Operating expenditure – water	377.7	384.9	392.5	395.1	1550.1
Operating expenditure – sewerage	177.6	180.5	181.4	182.3	721.8

11 Capital expenditure

Draft decision – SAWRD24 Capital Expenditure

The Commission's draft decision is that the prudent and efficient benchmark net capital expenditure amounts to be included in the calculation of the revenue caps are as follows:

- ▶ \$1,660 million (\$Dec22) for **water** retail services, which is 31 percent higher than the benchmarks set for SAWRD20, but 11 percent lower than proposed by SA Water, and
- ▶ \$869 million (\$Dec22) for **sewerage** retail services, which is 40 percent higher than the benchmarks for SAWRD20, but 9 percent lower than proposed by SA Water.

Draft decision – SAWRD20 Capital Expenditure

The Commission's draft decision is that the prudent and efficient benchmark net capital expenditure amounts to be included in the roll-forward of the regulated asset base (**RAB**), to decide the opening RAB values for SAWRD24, are as follows:⁴¹⁷

- ▶ \$1,194 million (\$Dec22) for **water** retail services, which is 7 percent lower than that proposed by SA Water, and
- ▶ \$647 million (\$Dec22) for **sewerage** retail services, which is approximately 1 percent lower than that proposed by SA Water.

11.1 Introduction

SA Water's capital expenditure is used to upgrade or replace existing assets or build new assets for the supply of water and sewerage retail services. Through the regulatory determination, the Commission decides the **prudent** and **efficient** benchmark net capital expenditure amounts to be added to the RAB, for the regulatory period ahead (SAWRD24) and the regulatory period ending (SAWRD20). The assessment of the former is decided on an ex-ante basis, while the assessment of the latter is decided on an ex-post basis.

Under the building blocks cost methodology, only the prudent and efficient capital expenditure added to the RAB is recovered over time through a return on assets and regulatory depreciation.

As outlined in Chapters 3 and 10, and in Guidance Paper 3, expenditure on an activity will be considered prudent where there is a clear justification for that activity.⁴¹⁸ Decisions on whether expenditure is prudent have been informed by the Commission's consideration of whether the expenditure is driven by:

- ▶ a legislative or regulatory obligation with which Water must comply
- ▶ an expectation that the activity will deliver benefits to customers that outweigh the costs, and/or
- ▶ a clear expectation from customers that an outcome should be achieved, and that they are willing to pay for that outcome.

⁴¹⁷ Note that SA Water's actual capital expenditure for 2023-24 is not yet known. The Commission has reviewed SA Water's forecasts and has decided a prudent and efficient benchmark net capital expenditure amount for 2023-24 for direct control retail services of \$615 million (\$Dec22).

⁴¹⁸ Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, pp. 1-2.

Expenditure is considered efficient where it is the lowest sustainable (or 'long-term') cost of achieving the intended outcome.⁴¹⁹

Consistent with SAWRD20, and as previously outlined in Chapter 10, the relevant classes of capital expenditure under consideration are as follows:⁴²⁰

- ▶ **External responsibilities:** expenditure to meet safety, health, service or other legally binding or regulatory standards or obligations.⁴²¹
- ▶ **Sustaining services:** expenditure to support the long-term viability of services and sustain delivery of reliable baseline services for existing customers.⁴²²
- ▶ **Enabling growth:** expenditure to support an expanded network to meet increasing demand, either within its current distribution area or as directed by the South Australian Government or allowed by legislation.⁴²³
- ▶ **Improving services:** expenditure to enhance service levels that do not fall into the categories listed above.⁴²⁴

This chapter outlines the Commission's assessment, decisions and reasons in relation to the prudent and efficient benchmark net capital expenditure amounts for the period 1 July 2024 to 30 June 2028 (SAWRD24) and the prudent and efficient benchmark net capital expenditure amounts for the period 1 July 2020 to 30 June 2024 (SAWRD20).

11.2 Approach to the assessment of capital expenditure

The Commission's regulatory approach to capital expenditure is to allow SA Water, as the owner and operator of the water and sewerage assets, the flexibility to manage and prioritise its investment activities for the regulatory period ahead within a total capital expenditure benchmark amount. The Commission does not approve individual capital expenditure projects and/or programs.

The regulatory determination sets out an:

- ▶ **ex-ante** prudent and efficient capital expenditure benchmark amount for SAWRD24, and
- ▶ **ex-post** prudent and efficient capital expenditure benchmark amount for SAWRD20.

Only the prudent and efficient expenditure, as decided by the Commission, is added to the RAB on both an ex-post and ex-ante basis.

The approach to assessing prudent and efficient capital expenditure incorporates the potential for interventions by the economic regulator. For the regulatory period ahead (SAWRD24) and the regulatory period ending (SAWRD20), the Commission determines the prudent and efficient benchmark expenditure amounts added to the RAB. The potential for ex-post regulatory interventions (for example, not including imprudent and/or inefficient capital expenditure in the benchmark capital expenditure

⁴¹⁹ Ibid, pp. 1-2.

⁴²⁰ Ibid, p. 9. In Guidance Paper 3, the Commission outlined that ICT-related expenditure should be categorised in SAWRD24 under one of the valid reasons for expenditure from the model above, rather than treated as a separate category as was the case in SAWRD20. This reflects the Commission's view that ICT-related expenditure is primarily an enabler of service delivery, improvement or growth.

⁴²¹ Expenditure to achieve compliance with these standards would be reasonable and appropriate. SA Water is not expected to exceed required standards unless this can be achieved at no added cost to customers. Essential Services Commission of South Australia, *Guidance Paper 3: Assessing the Regulatory Business Plan*, pp. 4-9.

⁴²² Ibid, pp. 4-9.

⁴²³ Ibid, pp. 4-9.

⁴²⁴ Ibid, pp. 4-9.

amount) can incentivise SA Water to engage in sound long-term asset management and make prudent and efficient capital expenditure decisions.⁴²⁵

As outlined in Chapters 9 and 10, the approach adopted by the Commission in assessing prudent and efficient expenditure is undertaken from an economic perspective, in order to give effect to the primary objective of protecting the long-term interests of consumers. The assessment involves methodologies that can mitigate the risks arising from information asymmetry (between the economic regulator and the regulated business) and set up expenditure benchmarks to incentivise efficiency.⁴²⁶

Given the monopoly retail services being provided and the existence of information asymmetry, a regulated business, such as SA Water, will have greater knowledge of all facets of its business, including the state of its capital assets and the prudent and efficient capital expenditure to sustain services, improve services, enable growth and meet external obligations, than the economic regulator. In light of this information asymmetry, there can be an incentive and ability for a regulated business, such as SA Water, to pass on inefficient costs to customers. Further, there can be an incentive and ability for a regulated business not to reveal full information about the prudent and efficient costs of its regulated activities and to overstate the extent of its capital expenditure.⁴²⁷

As explained in Chapter 10, it is well-accepted regulatory practice for an economic regulator, such as the Commission, to challenge, audit and/or otherwise test the information being provided by a regulated business in relation to its incurred capital expenditure and its proposed capital expenditure.⁴²⁸ Furthermore, given the issues associated with information asymmetry, if a regulated business declines to supply requested information, or provides insufficient information to justify its proposed costs are prudent and efficient, an economic regulator may infer that the information it is querying cannot be justified as prudent and efficient by the regulated business (subject to the reasons for why information was not provided and the nature and circumstance of the information involved).

The Commission's assessment, decisions and reasons on the prudent and efficient benchmark net capital expenditure amounts for SAWRD20 and SAWRD24 has involved:

- ▶ examining a representative sample of ex-ante and ex-post projects and programs alongside various decision-making and related capital expenditure documents
- ▶ analysing trends in capital expenditure, including SA Water's historical expenditure, and indicators of asset health and service standards
- ▶ conducting interviews and meetings with SA Water staff
- ▶ undertaking enquiries and analysis and seeking the opinions of third-party experts

⁴²⁵ The process of an ex-post review is common in regulatory determinations. There are cases where capital expenditure has been determined to be imprudent and/or inefficient on an ex-post basis by an economic regulator. For example, see Independent Pricing and Regulatory Tribunal, *Review of prices for Sydney Water Corporation's water, sewerage, stormwater drainage and other services*, Final report, June 2012, pp. 71-74, available at https://www.ipart.nsw.gov.au/sites/default/files/documents/final_report_-_review_of_prices_for_sydney_water_corporations_water_sewerage_stormwater_drainage_and_other_services_-_june_2012.pdf, and WS Atkins International and Cardno, *Detailed Review of Sydney Water Corporation's Operating and Capital Expenditure*, Final report, November 2011, pp. 121-133, 154-156, available at https://www.ipart.nsw.gov.au/sites/default/files/documents/final_report_-_detailed_review_of_sydney_water_corporations_operating_and_capital_expenditure_-_ws_atkins_international_ltd_-_november_2011_-_website_doc.pdf.

⁴²⁶ Joskow P, pp. 1227-1348, and Decker C, pp. 86-87.

⁴²⁷ Joskow P, pp. 1285-1290, and Decker C, pp. 86-90.

⁴²⁸ Joskow P, pp. 1288-1289, and Decker C, p. 86, pp. 104-106.

- ▶ considering the broader economic context for SAWRD24 as well as SA Water's internal systems and processes and how these could impact on delivering capital expenditure on time and at forecast efficient cost, and
- ▶ considering submissions and customer engagement activities undertaken by SA Water.

In undertaking its assessment, the Commission engaged consultants, WS Atkins International (**Atkins**)⁴²⁹ and FTI Consulting (**FTI**)⁴³⁰, to provide advice and recommendations.

The assessment and decisions on the prudent and efficient benchmark net capital expenditure has been undertaken in the context of the following regulatory expectations:

- ▶ SA Water, as a manager of long-life water and sewerage assets, should have long-term strategies and plans, relating to asset management, delivery and financing, in place and given effect. Further, SA Water's capital expenditure decision-making should be ongoing and frequently reviewed, clearly linked to long-term goals, and a regulated entities' strategies should support them.⁴³¹
- ▶ SA Water's proposed capital expenditure for SAWRD24 should be a point-in-time snapshot of its long-term plans, providing more granular short-term detail to explain and justify its proposed prudent and efficient level of capital expenditure and actions for the next regulatory period. Further, any variations in proposed capital expenditure between regulatory periods (for example, between SAWRD20 and SAWRD24) should be readily identifiable, transparent and justified with clear supporting evidence.
- ▶ Major capital expenditure projects can carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and the timeliness of completion. It is important, and considered best practice, for SA Water to evaluate the expected costs and benefits for capital expenditure projects.⁴³² Where upward cost revisions or project scope changes, it is appropriate for SA Water to re-visit its business cases to assess how expected benefits compare to the revised costs and the impact on the project's viability.⁴³³
- ▶ As noted in Chapter 9, at the time of publishing of this draft determination, no Ministerial directions under section 6 of the *Public Corporations Act 1993 (PC Act)* have been issued in respect of SAWRD24.⁴³⁴ However, SA Water stated in the RBP that directions will be issued relating to two major projects: Northern Metropolitan Growth and Tea Tree Gully (**TTG**) Sustainable Sewers.⁴³⁵ In that context, and for the purposes of the draft determination, the Commission has included expenditure for these projects in line with SA Water's proposal. In doing so, the Commission has not reviewed, in detail, the prudent and efficient expenditure requirements of these two projects.

⁴²⁹ WS Atkins International, *SA Water Capex Review 2024*, January 2024, pp. 1-108. As noted in Chapter 9, the Commission engaged Atkins to review SA Water's actual capital expenditure for SAWRD20 and SA Water's proposed capital expenditure (excluding technology spending) for SAWRD24.

⁴³⁰ FTI Consulting, *Review of ICT capital expenditure for SA Water*, November 2023, pp. 1-30. As noted in Chapter 9, the Commission engaged FTI to undertake a high-level review of SA Water's proposed ICT capital expenditure for SAWRD24.

⁴³¹ Wilson A, *Emerging issues in economic regulation of long-term infrastructure*, unpublished speech at Australian Energy Institute event, Adelaide, 7 June 2022.

⁴³² Infrastructure SA's Project Assurance documentation, including base case templates including costs and benefits, are available on Infrastructure SA's website at <https://www.infrastructure.sa.gov.au/resources>.

⁴³³ Auditor-General's Department, p. 49.

⁴³⁴ The Minister for Climate, Environment and Water may issue directions to SA Water under section 6 of the PC Act. Those directions may specify on-going and new requirements that SA Water must deliver during a regulatory period, with associated cost-related requirements or specifications. This is discussed further in Chapters 3 and 4 and Appendix 2.

⁴³⁵ SA Water, *Regulatory Business Plan 2024-28*, p. 16.

The remainder of Chapter 11 is separated into the following sections:

- ▶ the assessment, decisions and reasons on **ex-ante** prudent and efficient benchmark net capital expenditure amounts for SAWRD24 (section 11.3) and the draft decision for SAWRD24 capital expenditure (section 11.4), and
- ▶ the assessment, decisions and reasons on **ex-post** prudent and efficient benchmark net capital expenditure amounts for SAWRD20 (section 11.5) and the draft decision for SAWRD20 capital expenditure (section 11.6).

11.3 Ex-ante prudent and efficient capital expenditure for SAWRD24

This section outlines:

- ▶ a summary of SA Water’s proposal for capital expenditure for SAWRD24 (section 11.3.1)
- ▶ a summary of the matters raised in consultation, including the main themes in stakeholder submissions relating to affordability, Ministerial directions under section 6 of the PC Act, regional water supplies, urban growth and individual projects (section 11.3.2), and
- ▶ the Commission’s assessment, reasoning and decisions on the prudent and efficient benchmark net capital expenditure amounts for SAWRD24 (section 11.3.3), including review, consideration and analysis of:
 - SA Water’s proposed capital expenditure and historical trends, indicators of asset health and service standards, a sample of projects and programs, and capital efficiency (sections 11.3.3.1 and 11.3.3.2)
 - capital contributions and cloud computing for the purposes of deciding prudent and efficient benchmark net capital expenditure for SAWRD24 (section 11.3.3.3)
 - inferred estimates of prudent and efficient benchmark net capital expenditure (section 11.3.3.4), and
 - the deliverability of the total capital expenditure program for SAWRD24. This includes scenario analysis, having regard to SA Water’s internal processes and historical performance, economic conditions in South Australia, information available from the Auditor-General’s Department about capital slippage in major infrastructure projects in South Australia, and advice from Atkins and FTI (sections 11.3.3.5).

Together, these activities and analysis can mitigate the risks arising from information asymmetry and set up capital expenditure benchmarks that incentivise capital efficiency for SAWRD24.

11.3.1 SA Water’s proposal

The following section provides a high-level summary of SA Water’s proposal for capital expenditure. The proposal can be viewed in more detail in the RBP.⁴³⁶ The Commission has reviewed SA Water’s proposal and understands it to state capital expenditure in December 2022 dollars.

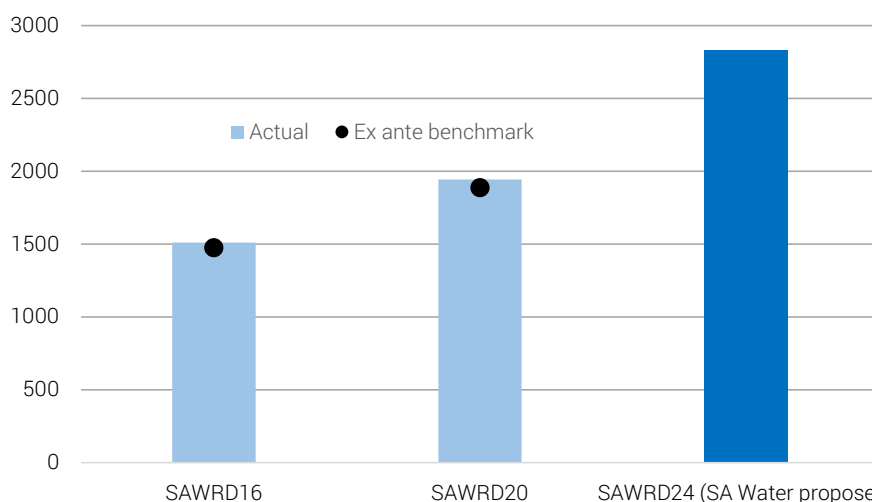
SA Water has stated in the RBP that it has prioritised capital expenditure to address only high and extreme risks, to manage costs and to keep price increases as low as possible, while at the same time maintaining service standards.⁴³⁷

⁴³⁶ Ibid, pp. 154-206.

⁴³⁷ Ibid, p. 206.

SA Water has proposed \$2,831 million (\$Dec22) in capital expenditure inclusive of capital contributions (Figure 11.1).⁴³⁸ The proposal is for capital expenditure that is \$946 million higher (50 percent) than the prudent and efficient benchmark capital expenditure decided by the Commission for SAWRD20. Furthermore, the proposal is \$1,358 million (\$Dec22) (92 percent) more than the prudent and efficient capital expenditure decided by the Commission for SAWRD16. Across retail services, approximately two-thirds of SA Water’s capital expenditure proposal is for water retail services and one-third is for sewerage retail services.

Figure 11.1. SA Water’s four-year capital expenditure proposal for SAWRD24 (\$Dec22, million)⁴³⁹



Of the \$2,831 million of gross capital expenditure proposed by SA Water for SAWRD24, approximately \$1,160 million (41 percent) is related to five major projects.⁴⁴⁰ Those major projects are listed below in Table 11.1 and shown in Figure 11.2 below.

As discussed above, SA Water has stated its understanding that Ministerial directions under section 6 of the PC Act will be issued in respect of the Northern Metropolitan Growth and the TTG Sustainable Sewers major projects.⁴⁴¹

Table 11.1: SA Water’s major projects proposal for SAWRD24 (\$Dec22) (rounded figures)

Major projects	Total four-year expenditure (\$m)
Eyre Peninsula Desalination Augmentation	240
Mount Bold Dam Safety Upgrade	110
Metro Water Quality Improvement	160
Northern Metropolitan Growth	370
Tea Tree Gully Sustainable Sewers	280
Total	1,160

⁴³⁸ Ibid, pp. 154-206.

⁴³⁹ Note that the actual expenditure included in the chart for SAWRD20 is for 1 July 2020 to 30 June 2023. The chart for SAWRD20 includes SA Water’s forecast expenditure for 1 July 2023 to 30 June 2024.

⁴⁴⁰ SA Water, *Regulatory Business Plan 2024-28*, p. 8, 70, 168, 188, 197, 191-192.

⁴⁴¹ Ibid, p. 16.

Figure 11.2: SA Water’s proposed major projects and other capital expenditure (\$Dec22, million)⁴⁴²

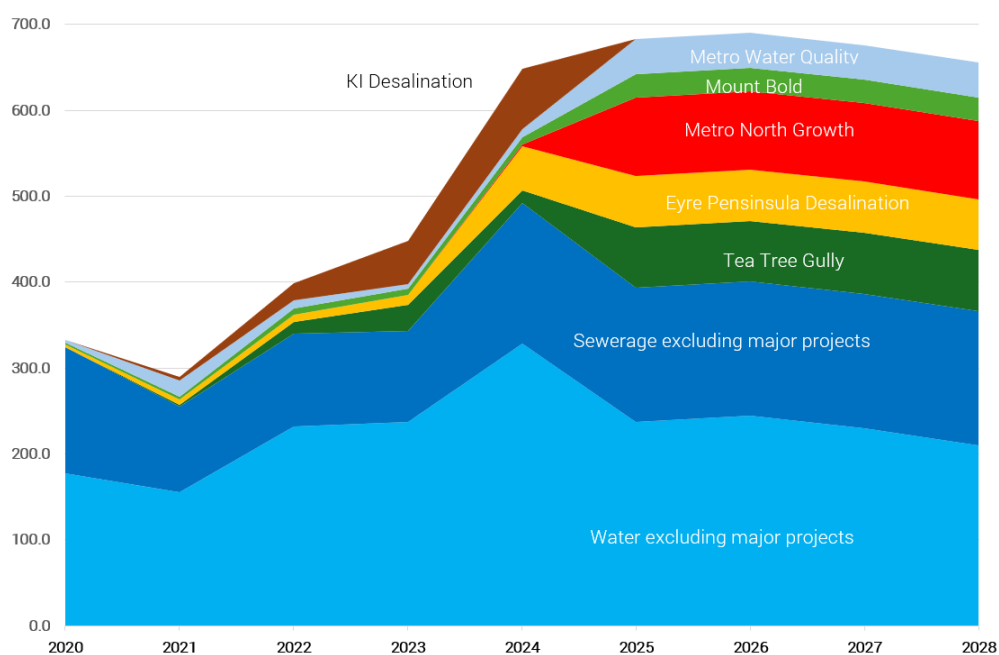


Table 11.2 outlines a summary of capital expenditure according to each of the relevant classes of capital expenditure (explained earlier in section 11.1).⁴⁴³ SA Water’s capital expenditure proposal has a focus on sustaining services, meeting external obligations, and addressing growth in core services.

Table 11.2: SA Water’s gross capital expenditure by category, four-year expenditure in dollars and percentage of total

Category of expenditure	Proposal for SAWRD24 \$m (Percentage of total)	SAWRD20 \$m (Percentage of total)
Sustain services	\$1,338 (47%)	\$935 (51%)
External responsibilities	\$751 (26%)	\$493 (27%)
Enable growth	\$624 (22%)	\$191 (10%)
Improve services	\$162 (5%)	\$196 (12%)

SA Water has proposed to spend \$1,338 million (47 percent) of capital expenditure to sustain services, \$761 million (26 percent) to meet external obligations, \$624 million (22 percent) to enable growth in core services, and \$162 million (5 percent) to improve core services. By way of comparison, the amounts incurred in each category for SAWRD20 are also shown in Table 11.2. The comparison between SAWRD24 and SAWRD20, as shown in Figures 11.3 and 11.4, illustrates the proposed increase in expenditure on sustaining services, enabling growth in core services and meeting external obligations.⁴⁴⁴

⁴⁴² This figure is based on gross capital expenditure and excludes technology expenditure.

⁴⁴³ The various classes of capital expenditure are also outlined in Chapter 10.

⁴⁴⁴ SA Water, *Regulatory Business Plan 2024-28*, p. 205.

Figure 11.3. SA Water’s RD24 and RD20 capital expenditure by driver in percent of total

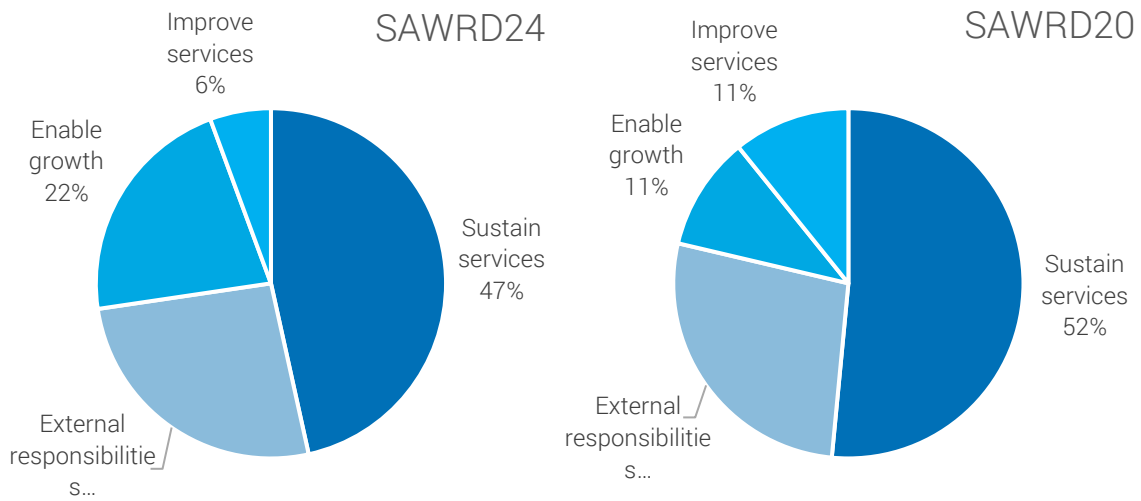
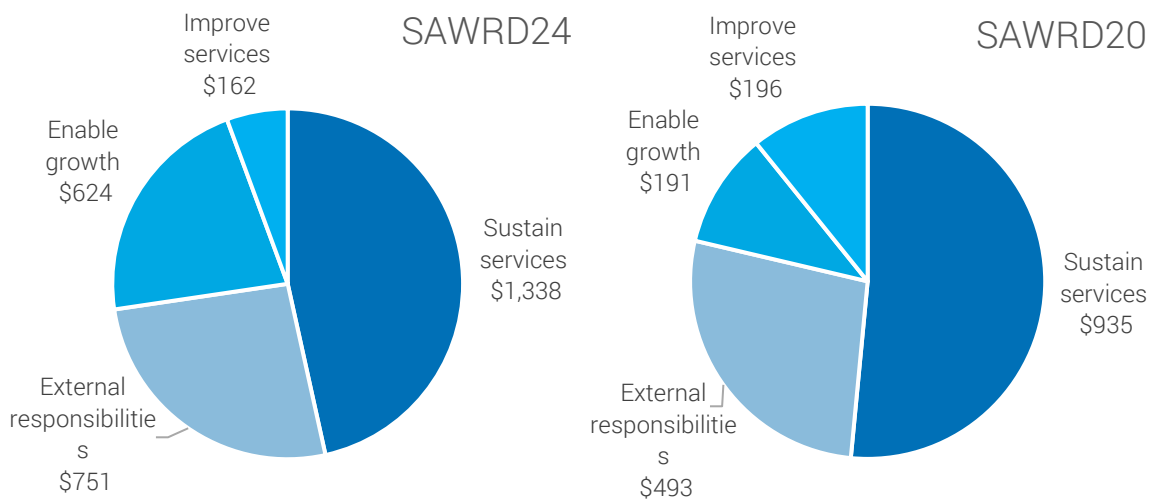


Figure 11.4. SA Water’s RD24 and RD20 capital expenditure by driver in millions (\$Dec'22)



11.3.2 Matters raised in consultation

Stakeholders commented on a range of matters related to SA Water’s capital expenditure proposal. Those matters included managing risk, Ministerial directions under section 6 of the PC Act, affordability, regional water supplies, urban growth and individual projects.

Submissions made by the Energy and Water Ombudsman South Australia (**EWOSA**), the South Australian Council of Social Services (**SACOSS**) and the Environmental Protection Agency (**EPA**) supported SA Water prioritising capital expenditure to manage risk, comply with external obligations and maintain service levels, while having regard to cost of living and affordability issues.⁴⁴⁵

⁴⁴⁵ For example, stakeholders, such as the Office for the Technical Regulator, Energy and Water Ombudsman South Australia, South Australian Council of Social Service and Uniting Communities, noted support to aspects of SA Water’s RBP. See Office for the Technical Regulator, p.1, Energy and Water Ombudsman South Australia, pp. 1-2, South Australian Council of Social Service, p.1, and Uniting Communities, p. 5.

Submissions from the Council of the Ageing South Australia (**COTA SA**), SACOSS and Uniting Communities recognised the trade-off between balancing affordable prices in the short-term with the risk of long-term sustainability and lower service levels and supported the prioritisation of affordability for SAWRD24.⁴⁴⁶ In that context, the submissions noted concerns about the capacity of low-income households to pay higher prices for water and sewerage retail services.⁴⁴⁷

Two submissions raised concern over Ministerial directions under section 6 of the PC Act.⁴⁴⁸ As stated by SACOSS:⁴⁴⁹

'SACOSS is supportive of the position adopted by both SA Water and the State Government to prioritise affordability, however, we question whether the stated aim to keep costs down is distorted by the expected section 6 Ministerial Directions...'

SACOSS further stated:

'...[t]he progression of increasing costs (particularly for large infrastructure projects) to be recovered from South Australia water consumers pursuant to Ministerial Directions is extremely worrying. SACOSS has repeatedly raised concerns around the increased use of Ministerial Directions, coupled with the practice of Treasurer's Pricing Orders requiring ESCOSA to include these expenditures in the revenue determination. We suggest that this practice compromises the integrity and independence of the regulatory process...'

SACOSS added:

'[w]ith respect to the expected Ministerial Directions flagged in RBP24, SACOSS is deeply concerned by the magnitude of the expenditures, and the impact on other discretionary initiatives supported through consumer engagement...'

In terms of capital expenditure and regional water supplies, four submissions raised issues in relation to regional water aesthetics and supplies, as discussed below.⁴⁵⁰

The Flinders Ranges Council noted disappointment in SA Water's exclusion of proposed capital expenditure to improve regional water aesthetics in Quorn. The Council pointed to support for the capital expenditure on the basis of SA Water's stakeholder engagement activities and research, and it pointed to various reasons why, in its view, the Commission should specify capital expenditure for this particular initiative.⁴⁵¹ Similar concerns were also raised in a submission from an individual resident.⁴⁵²

The Council of the Ageing South Australia (**COTA SA**) supported analysis into capital expenditure in regional water quality more generally (noting that it understands the cost impact of investing in regional water quality must be carefully weighed against short- and long-term affordability).⁴⁵³

⁴⁴⁶ For instance, South Australian Council of Social Service, p. 12, 26.

⁴⁴⁷ COTA SA, p. 2, Uniting Communities, p. 1, 5, and South Australian Council of Social Service, pp. 1-2, 26.

⁴⁴⁸ Council of the Ageing South Australia, pp. 2-3, and South Australian Council of Social Service, pp. 7-15.

⁴⁴⁹ South Australian Council of Social Service, p. 7, 9. Also, Council of the Ageing South Australia, p. 2, expressed similar views.

⁴⁵⁰ Council of the Ageing South Australia, pp. 1-3, Bradley J, p. 1, Flinders Ranges Council, pp. 1-4, and Tatiara District Council, pp.1-4.

⁴⁵¹ Flinders Ranges Council, pp. 1-4.

⁴⁵² Bradley J, p. 1.

⁴⁵³ Council of the Ageing South Australia, pp. 1-3.

In terms of capital expenditure and water supplies more generally, Uniting Communities noted that the RBP did not reference SA Water's development of a 50-year plan for water supply requirements (that is, SA Water's Resilient Water Futures project).⁴⁵⁴ EWOSA suggested that SA Water could be more transparent in relation to the nature and type of water sources to be used over the SAWRD24 period.⁴⁵⁵

Three submissions commented about provision for urban growth, particularly for greenfield development in northern Adelaide, and raised questions about who should contribute to the costs of growth.⁴⁵⁶ The Property Council of Australia queried how, and to what extent, regulatory mechanisms currently operate to address growth in SA Water's network to accommodate for water and sewerage retail services for greenfield property developments.⁴⁵⁷ The City of Playford and City of Salisbury raised concerns about the cost and lack of infrastructure to support demand growth.⁴⁵⁸ Villawood Properties queried a perceived lack of information in the RBP relating to infrastructure and its funding sources to service demand growth at the urban fringe.⁴⁵⁹ The Tatiara Council suggested that more capital expenditure is needed to accommodate growth and development in Bordertown.⁴⁶⁰

The EPA provided details on its engagement with and expectations of SA Water. It provided support and comment on various individual projects and programs but noted potential concern on the amount of capital expenditure focussed on sewerage retail services.⁴⁶¹ In particular, the EPA noted SA Water's sewerage assets are reaching the mid to upper-end of their expected useful life, and the use of ceramic pipe can be prone to tree intrusion and blockages. The EPA is supportive of the capital expenditure to sustain the level of SA Water's wastewater services.⁴⁶²

11.3.3 Commission's analysis

The assessment, reasons and considerations on the prudent and efficient benchmark net capital expenditure amounts for SAWRD24 have been informed by analysis of SA Water's historical capital expenditure, asset health and service standards, stakeholder submissions including SA Water's RBP, a representative sample of SA Water's proposed projects and programs and expected capital efficiency. The Commission has also considered the risks and deliverability of capital expenditure for SAWRD24.

Alongside this, the Commission has considered two specific issues that have arisen during the assessment, those being capital contributions and the treatment of cloud-based computing costs.

The Commission's analysis is structured as follows.

- ▶ Section 11.3.3.1 documents the sample of projects and programs reviewed by the Commission and its consultant, Atkins.

⁴⁵⁴ Uniting Communities, p. 3. For more information on SA Water's Resilient Water Futures project, see <https://watertalks.sawater.com.au/resilient-water-futures>.

⁴⁵⁵ Energy and Water Ombudsman South Australia, p. 2.

⁴⁵⁶ Property Council of Australia, pp. 1-4, Villawood Properties, p. 1, and City of Playford and City of Salisbury, pp. 1-2.

⁴⁵⁷ Property Council of Australia, pp. 1-4.

⁴⁵⁸ City of Playford and City of Salisbury, pp. 1-2.

⁴⁵⁹ Villawood Properties, p. 1.

⁴⁶⁰ Tatiara District Council, pp.1-4.

⁴⁶¹ Environmental Protection Agency, pp. 1-9.

⁴⁶² Environmental Protection Agency, p. 4. For example, Environmental Protection Agency (p. 4) states: '[t]he EPA understands that SA Water is proposing to spend \$21.5 million on network management for addressing odour, as well as \$0.5 million in operational costs. The EPA supports the proposed odour management operation and capital program for wastewater networks within RBP 2024 as an approach that begins to address the worst odour cluster locations, as well as wider network odour issues.'

- ▶ Section 11.3.3.2 compares SA Water's proposed capital expenditure against historical trends, considers available indicators of asset health and service standards, reviews a sample of projects and programs, and considers capital efficiency factors for SAWRD24.
- ▶ Section 11.3.3.3 outlines the treatment of capital contributions and cloud-based computing costs for SAWRD24.
- ▶ Section 11.3.3.4 summarises a range of inferred estimates of prudent and efficient benchmark net capital expenditure amounts for SAWRD24.
- ▶ Section 11.3.3.5 considers risks and the deliverability of capital expenditure for SAWRD24.

11.3.3.1 Sample of projects and programs for SAWRD24

The Commission has assessed a sample of SA Water's projects and programs for SAWRD24. As noted above, the Commission does not approve individual capital expenditure projects and/or programs, so a sampling approach is used to inform the Commission of the prudence and efficiency of SA Water's overall approach to asset management.

In selecting the sample, the Commission considered the value of the projects and programs, as well as their service type and category. The sample of projects and programs was selected before starting interviews and information collection.⁴⁶³ The sample for the ex-ante review has accounted for approximately 38 percent of SA Water's SAWRD24 proposed gross (post-efficiency) capital expenditure. The sample has included all technology projects and a sample of all the non-technology related projects and programs.⁴⁶⁴

The approach adopted by the Commission, having regard to advice from its consultants, FTI and Atkins, has been to include services and categories of all types and sizes in the sample to be reviewed.

Nevertheless, while the Commission has taken a random sample of small and mid-sized projects, the Commission has had a focus on major projects for SAWRD24. For the purposes of this draft regulatory determination, the Commission has chosen *not* to review the two projects expected to be issued as Ministerial directions under section 6 of the PC Act (discussed in section 11.3.3.2), as such directions have, in the past, specified expenditure amounts that, under the statutory framework, must be adopted by the Commission within the revenue caps.

Table 11.3 documents the sample of ex-ante projects and/or programs that have been reviewed.

Table 11.3: Sample of projects for ex-ante review for SAWRD24

Project name	Service type	Category	\$m
Water Reticulation Management Reliability	Water	Sustain services	146
Eyre Peninsula Desalination Augmentation	Water	Sustain Services	238
Wastewater Treatment Plant RWTP Reliability	Sewerage	Sustain Services	58
Adelaide Wastewater Trunk Main Renewal	Sewerage	Sustain services	35
Mount Bold Dam Safety Upgrade	Water	External obligations	110

⁴⁶³ The latter occurred through September 2023, October 2023 and November 2023.

⁴⁶⁴ Table 11.3 shows the non-technology sample. However, technology projects were also reviewed. When combined, the total ex-ante sample accounted for approximately 38 percent of SA Water's proposed gross (post-efficiency) capital expenditure.

Project name	Service type	Category	\$m
Milicent EIP	Sewerage	External obligations	49
Summit System Growth	Water	Enable Growth	48
Bolivar Wastewater Network	Sewerage	Enable Growth	68
Metro Water Quality Improvement (SAWRD20 continuation)	Water	Improve services	162

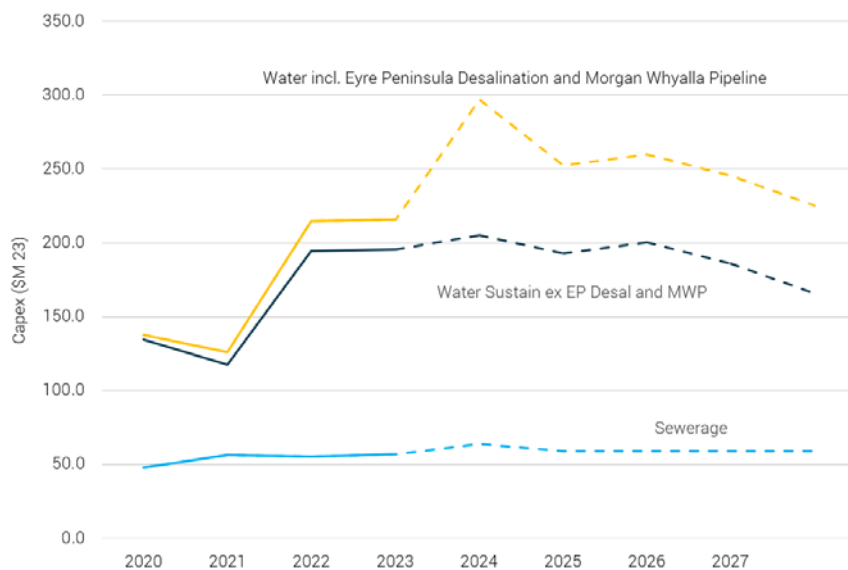
11.3.3.2 Assessment of historic expenditure, project samples and capital efficiency

The Commission has reviewed SA Water’s past expenditure according to classes of capital expenditure (sustaining core services, enabling growth in core services, and external obligations and improving core services) in conjunction with reviewing a sample of projects and programs for SAWRD24. This allows the Commission to consider whether SA Water has been able to make the case for any increases above current expenditure levels.

Sustaining core services expenditure

In the Commission’s assessment, the bulk of SA Water’s proposed sustaining services capital expenditure for water and sewerage retail services is comparable with earlier expenditures on this category over SAWRD16 and SAWRD20 (excluding major projects such as the Eyre Peninsula Desalination Plant and the Morgan to Whyalla Pipeline) (Figure 11.5).

Figure 11.5: Sustaining core services capital expenditure excluding major projects (\$Dec22)⁴⁶⁵



Indicators of asset health performance, including water pipe failures, sewer breaks, and breakdowns and corrective maintenance work orders, do not suggest any significant deterioration (Figure 11.6).⁴⁶⁶ In addition, as discussed earlier in Chapter 6, SA Water is maintaining its average level of service to customers.

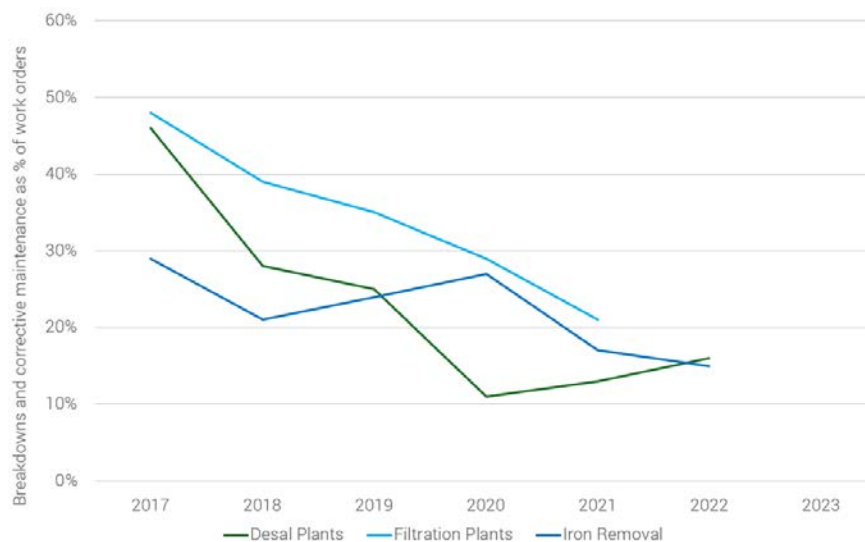
⁴⁶⁵ WS Atkins International, pp. 61-68.

⁴⁶⁶ Ibid, pp. 55-69.

Together, given the indicators of asset health and service performance, and having regard to SA Water’s proposal of sustaining services expenditure, which is in line with previous levels of expenditure (excluding major projects), there is reason for capital expenditure levels to be maintained for SAWRD24 to support sustaining core services. Consistent with this, submissions from the Office of the Technical Regulator, EWOSA and the EPA supported SA Water maintaining capital expenditure levels to manage risk and meet service levels.⁴⁶⁷

As can be seen in Figure 11.5 above, much of the increase in capital expenditure in sustaining services relates to the Eyre Peninsula Desalination Plant. By way of background, the Eyre Peninsula Desalination Plant was a key investment initiative submitted by SA Water in SAWRD20.⁴⁶⁸ The project is to construct and run a desalination plant at Billy Lights Point to address the water supply security issues that exist on the Eyre Peninsula while protecting the natural resources in the area.⁴⁶⁹ As noted in Chapter 10, the Eyre Peninsula Desalination Plant was considered prudent and efficient for SAWRD20,⁴⁷⁰ but there has been large increases in costs since SAWRD20 on the basis of major design changes, processes involved in site selection and investigations, and the cost of developing the project in a regional and marine area. The project expenditure has increased from \$98 million in SAWRD20 to \$316 million for SAWRD24.

Figure 11.6: Asset health performance, breakdowns and corrective maintenance as a percentage of work orders – water facility maintenance⁴⁷¹



Atkins commented on specific projects including the following.

- ▶ In Atkins’ opinion, the capital expenditure on the Eyre Peninsula Desalination Plant is prudent and the amount of capital expenditure is efficient (although Atkins has recommended that the total proposed expenditure is inefficient because the total proposed by SA Water has included an allowance of approximately \$38 million as a form of contingency for unexpected costs). The Commission observes that the project expenditure for Eyre Peninsula Desalination Plant should not include \$38 million as a form of contingency for unexpected costs.⁴⁷² It would not be in

⁴⁶⁷ Office of the Technical Regulator, p.1, Energy and Water Ombudsman South Australia, pp. 1-4, and Environmental Protection Agency, pp. 1-9.

⁴⁶⁸ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 148-150.

⁴⁶⁹ SA Water, *Regulatory Business Plan 2024-28*, p. 70, 168, 174.

⁴⁷⁰ *Ibid*, p. 70, 168, 174.

⁴⁷¹ WS Atkins International, pp. 65-66.

⁴⁷² A project contingency of approximately \$15 million, which was included in the business case documentation, was based on an estimate of median risk. WS Atkins International, pp. 34-36.

consumers' long-term interests for them to bear the cost of mitigating risks for which SA Water, as a manager of long-term assets, should be able to manage.⁴⁷³

- ▶ In Atkins' opinion, the Morgan to Whyalla pipeline, which is discussed further in section 11.5, and was an investment initiative in SAWRD20,⁴⁷⁴ will continue from SAWRD20 through into SAWRD24, but will continue to be delivered only gradually due to the need for the re-appraisal of options to overcome environmental challenges.⁴⁷⁵ Accordingly, Atkins expects that approximately \$36 million from SA Water's current forecasts for SAWRD20 for this project, should be included in the SAWRD24 expenditure profile.⁴⁷⁶
- ▶ In Atkins' opinion, indicators of corrective work orders and breakdowns at desalination plants have seen a slightly increasing trend over the past two years. Acknowledging that membrane replacement is a significant and periodic activity, Atkins supports SA Water's proposed increase in Adelaide Desalination Plant membrane expenditure.⁴⁷⁷

External obligations and improving services⁴⁷⁸

SA Water's proposal for capital expenditure on external obligations and improving core services for SAWRD24 is largely driven by two major projects: the Metro Water Quality Improvement project (\$162 million) and the Mount Bold Dam Safety Upgrade (\$110 million), both of which the Commission has reviewed as part of sampling.

By way of background, the Mount Bold Safety Upgrade was a key investment initiative (of \$87 million) submitted by SA Water in SAWRD20 with a further \$216 million foreshadowed for SAWRD24.⁴⁷⁹ The project was for safety upgrades to the Mount Bold Reservoir to address the risks of failure posed by flood conditions and earthquakes, in line with the requirements of the Australian National Committee on Large Dams (ANCOLD) guidelines.⁴⁸⁰

As discussed in section 11.5, the delivery of the Mount Bold Dam Safety Upgrade in SAWRD20 has been affected by unanticipated complexities due to technical issues. Currently, despite various iterations of modelling and analysis, the project options have been (and continue to be) scoped. Accordingly, the Commission's assessment is that there is still more planning and project optioneering to be progressed before the project is close to the construction phase.⁴⁸¹ Further, given that SA Water still has planning and optioneering to be completed,⁴⁸² and the complexities of the project are high (as evidenced by the delays and the need for re-appraisal during SAWRD20), the Commission has assessed that a prudent and efficient level of capital expenditure would allow for only project development expenditure in SAWRD24. If the project proceeds faster than expected, SA Water may (under the regulatory framework outlined in section 11.2) recoup the prudent and efficient construction costs as part of a future ex-post review.

⁴⁷³ WS Atkins International, pp. 34-36.

⁴⁷⁴ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp 163-164.

⁴⁷⁵ Species of mallee birds were declared as endangered in December 2021.

⁴⁷⁶ WS Atkins International, pp. 50-102.

⁴⁷⁷ *Ibid*, pp. 50-102.

⁴⁷⁸ For the purposes of this analysis, classes of capital expenditure have been grouped together to account for definitional changes in projects over time.

⁴⁷⁹ SA Water, *Regulatory Business Plan 2024-28*, p. 148, 150-152. Also, see WS Atkins International, pp. 87-88.

⁴⁸⁰ *Ibid*, pp. 150-152.

⁴⁸¹ Atkins has recommended re-profiling expenditure on the Mount Bold Safety Upgrade on the basis of past technical complexities of the project and given that SA Water still has planning and optioneering to be completed. WS Atkins International, pp. 87-88, 95-96.

⁴⁸² *Ibid*, pp. 78-85.

The other major project for this class of cost category is for the Metro Water Quality Improvement project. During the SAWRD20 period, SA Water proposed to spend approximately \$122 million on switching Metropolitan Adelaide from chlorine to chloramine to reduce health risks and improve aesthetics, and on the addition of ozone disinfection and biological activated carbon at the Happy Valley water treatment plant.⁴⁸³ In SAWRD20, the Commission assessed that \$81 million was a prudent and efficient capital expenditure benchmark amount.⁴⁸⁴ However, only \$21 million has reportedly been spent on the program during SAWRD20, of which at least \$7 million was SAWRD16 carryover spend.⁴⁸⁵

Since SAWRD20, SA Water has re-considered its approach to the project. It is now proposing to adopt ozone disinfection and biological activated carbon at the Happy Valley and Barossa water treatment plants.

In the Commission's assessment, it would be prudent to allow for the installation of the modern treatment technology (ozone disinfection and biological activated carbon) at one, rather than two, water treatment plants. Given that this is a new technology, and there is potential for unanticipated complexities and challenges, including disruptions from construction on existing assets, the Commission has assessed that prudent and efficient capital expenditure would be to trial the technology on the Barossa water treatment plant.⁴⁸⁶ This would require expenditure to be approximately \$69 million (out of a proposed project budget of approximately \$162 million).⁴⁸⁷

Another major project that is part of the external obligations and improving services classification is the TTG Sustainable Sewers program. At the time of publishing this draft determination, no Ministerial directions under section 6 of the PC Act have been issued in respect of SAWRD24.

For context, and as noted in Chapter 10, during SAWRD20, SA Water began retailing sewerage services to customers in the TTG area, which had previously been serviced by the City of Tea Tree Gully. This included the management, operation and maintenance of the legacy sewerage system while a replacement system is constructed. SA Water will continue to transition all properties connected to the legacy Community Wastewater Management Scheme (**CWMS**) to a modern sewer system. This process started in 2021-22 and will continue through SAWRD24 and into the first half of SAWRD28 on SA Water's current estimate. In total, there were approximately 4,700 properties that required transitioning at the beginning on the project. Currently, there remain approximately 4,150 properties that remain unconverted with approximately 3,000 of these scheduled to occur within SAWRD24. SA Water has stated that it requires \$284 million of capital expenditure for SAWRD24 to continue works that will convert properties to SA Water's sewer standard and to decommission the existing CWMS network, with this activity projected to be completed in the early part of SAWRD28.⁴⁸⁸

Outside of the projects discussed above, the Commission has not observed evidence that indicates inefficient or imprudent expenditure being proposed by SA Water.⁴⁸⁹ When looking at historical expenditures, outside of the Mount Bold Dam Safety Upgrade and the Metro Water Quality project, there is reason for capital expenditure levels to be maintained for SAWRD24 to support external obligations and improving services for SAWRD24. Figure 11.7 shows the expenditure in SAWRD20 on sustaining services, enabling growth and external obligations for sewerage, relative to SA Water's proposed expenditure for SAWRD24.

⁴⁸³ Ibid, pp. 86-87.

⁴⁸⁴ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 172-174.

⁴⁸⁵ WS Atkins International, pp. 86-87.

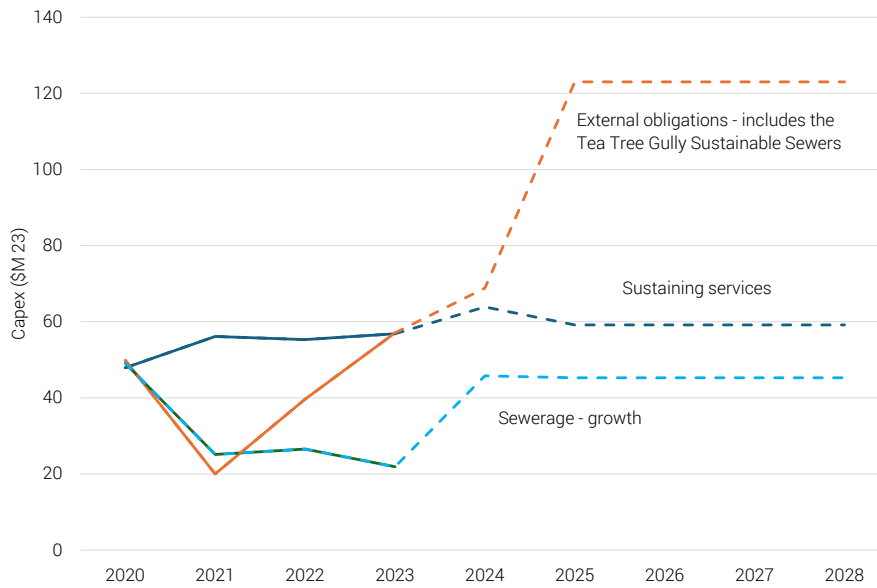
⁴⁸⁶ Ibid, pp. 78-85.

⁴⁸⁷ Ibid, pp. 78-85.

⁴⁸⁸ SA Water, *Regulatory Business Plan 2024-28*, pp. 191-192.

⁴⁸⁹ In Atkins' assessment, SA Water's proposal for increased capital expenditure to implement environmental improvement programs was prudent and efficient for the Millicent project. Ibid, pp. 82-85.

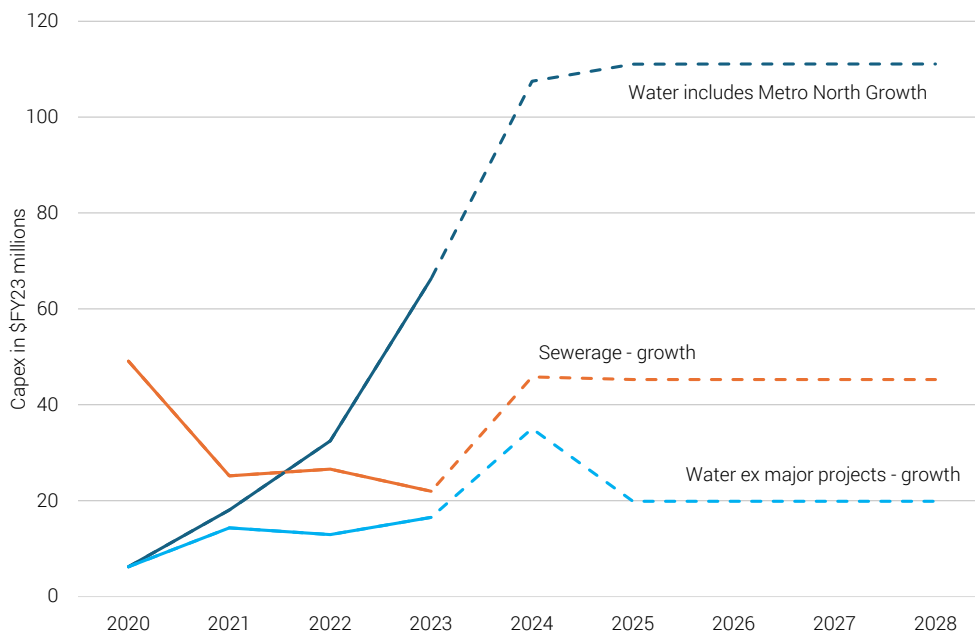
Figure 11.7: Sewerage capital expenditure proposed by SA Water, by category, sustaining, enabling growth and external obligations, against SAWRD20 outcomes⁴⁹⁰



Enabling growth in services

In the Commission’s assessment, SA Water’s proposed capital expenditure for SAWRD24 is in line with historical expenditures in this area (when excluding the amounts proposed for the Northern Metropolitan Growth project, and the two network growth projects proposed for Bolivar and Glenelg) (Figure 11.8).

Figure 11.8: Growth expenditure, according to water and sewerage⁴⁹¹



⁴⁹⁰ Estimates based on Commission’s analysis of project-level information.

⁴⁹¹ Estimates based on Commission’s analysis of project-level information.

Figure 11.8 shows the size of the Northern Metropolitan Growth project compared to the historical expenditure on enabling growth. SA Water has proposed \$365 million for this project.⁴⁹² SA Water has stated that growth within the metropolitan north supply zone has been occurring at a rate greater than forecast. SA Water has proposed this investment to maintain services to existing customers while also meeting new growth in this area. SA Water has noted that this project is expected to be a Ministerial direction under section 6 of the PC Act.⁴⁹³ However, the Commission notes that at the time of publishing this draft determination, no Ministerial directions under section 6 of the PC Act have been issued in respect of SAWRD24.

In terms of sewerage-related capital expenditure projects, based on a review of business cases and related information, and having regard to the advice from Atkins, the Commission has assessed that the two network growth projects for Bolivar and Glenelg are still in the early stages of planning.⁴⁹⁴ Accordingly, the Commission has assessed that the proposed capital expenditure would not be prudent and efficient. Rather, an amount of capital expenditure that would be prudent and efficient would be lower and would involve spending capital expenditure only once solutions have been more fully developed, and demand is better understood.⁴⁹⁵

ICT expenditure for SAWRD24

While ICT-related expenditure is not a separate category, the Commission has considered SA Water's proposed ICT capital expenditure for SAWRD24.⁴⁹⁶ The Commission reviewed business cases and related documentation, interviewed staff from SA Water, and sought advice from FTI.

In FTI's opinion, SA Water's overall proposed ICT capital expenditure for SAWRD24, which was for approximately \$170 million for SAWRD24 and included two sizeable projects, was consistent with a prudent service provider acting efficiently. In its view, the overall proposed expenditure on ICT for SAWRD24 was justified and was capable of being delivered by SA Water during the period.⁴⁹⁷ In terms of sizeable projects, while FTI assessed that the bill modernisation project should proceed, it suggests that SA Water maintain a close watch over the project's delivery, given the project is complex and is only in its planning and preparation stages.⁴⁹⁸

The Commission has given regard to FTI's advice and recommendations when considering SA Water's capital expenditure program as whole.

Capital efficiency for SAWRD24

The Commission sought advice from Atkins about SA Water's overall capital program and any potential efficiencies going forward. The Commission notes the following recommendations from Atkins for catch-up efficiency and continuing efficiency for SA Water for the SAWRD24 period.

In Atkins' opinion, there are potential improvements and significant efficiencies that SA Water can make, to move them toward the efficient frontier for regulated businesses delivering capital programs. This includes more robust early project scoping and planning, optioneering and decision-making, stronger business case development, and greater use of value engineering throughout project and

⁴⁹² The project involves duplication of approximately 37 kilometres of water mains, installation of approximately 12 kilometres of new water mains, replacement of approximately 23 kilometres of water mains, new tanks, two new pump stations, an upgrade of two pump stations, and new hydraulically operated control valves at three tank sites. SA Water, *Regulatory Business Plan 2024-28*, p. 198.

⁴⁹³ SA Water, *Regulatory Business Plan 2024-28*, p. 198.

⁴⁹⁴ WS Atkins International, pp. 80-84.

⁴⁹⁵ *Ibid*, pp. 80-84.

⁴⁹⁶ FTI Consulting, pp. 1-33.

⁴⁹⁷ *Ibid*, p. 33.

⁴⁹⁸ *Ibid*, pp. 18-19.

program development. Atkins has recommended around a \$111 million of efficiency-savings (of which \$86 million is catch up efficiency and \$25 million is ongoing efficiencies).⁴⁹⁹

The Commission has given regard to Atkins' recommendations on capital efficiency when considering SA Water's capital expenditure program as whole.

Inferred estimate of gross prudent and efficient capital expenditure for SAWRD24

Overall, the Commission assessment of capital expenditure in the previous sections, which includes capital efficiency of \$111 million and is set based on general recent expenditure outcomes across most classes of cost categories, can infer an estimate of prudent and efficient benchmark net capital expenditure of \$1,937 million for SAWRD24 (\$Dec22).⁵⁰⁰ Note this inferred estimate does not exclude capital contributions (discussed below). Further, this inferred estimate does not include Ministerial directions under section 6 of the PC Act.

A range of inferred estimates of prudent and efficient benchmark net capital expenditure are discussed in section 11.3.3.4.

11.3.3.3 Capital contributions and the treatment of cloud-computing costs

Cash contributions

Cash contributions are netted off the gross amount of prudent and efficient benchmark capital expenditure for SAWRD24. Contributions come from developers and those seeking extensions and augmentations to SA Water's water or sewerage network.

SA Water proposed \$10 million of cash contributions for SAWRD24,⁵⁰¹ yet in SAWRD20 there were more than \$10 million in contributions annually for water and sewerage retail services as a whole.⁵⁰²

The Commission's assessment of SA Water's cash contribution proposal is that it is inefficient for the purposes of SAWRD24.

The Commission has, for the purpose of the draft determination, estimated capital contributions of approximately \$57 million for SAWRD24. This is broadly in line with SAWRD20. Further, given the growth schemes and programs planned by SA Water for SAWRD24, it is reasonable to consider that cash contributions will be earned over this period and these contributions will likely be in line with recent experience.

SA Water has advised the Commission that it will re-submit estimated capital contributions as part of its submission to the draft determination. It is expected that SA Water will submit its best forecast of the efficient contributions to be recovered by SA Water over the SAWRD24 period, taking into account capital expenditure plans, expected growth and the current excluded retail services.⁵⁰³

Cloud computing

SA Water has proposed an accounting adjustment for the capitalisation of configuration and customisation cloud-based computing expenditure. While the current accounting standard is to treat these costs as businesses running software as a service (that is, treat them as operating

⁴⁹⁹ WS Atkins International, pp. 92-98.

⁵⁰⁰ Ibid, pp. 96-97.

⁵⁰¹ SA Water, *Regulatory Business Plan 2024-28*, p. 205.

⁵⁰² WS Atkins International, p. 95.

⁵⁰³ Excluded retail services, including property developer contributions, are discussed in Chapter 8.

expenditure),⁵⁰⁴ SA Water has proposed the capitalisation of these costs. This was mentioned earlier in Chapter 10.

In principle, the Commission's starting position is that, where control of the cloud-based technology rests with SA Water (for example, it has control over installing and running the cloud-based software) then it would be proper to capitalise cloud-based costs. At the same time, where control of the cloud-based technology rests with the vendor (for example, when the cloud vendor controls the installation and ongoing running costs) then it would be proper that cloud-based costs be treated as operating expenditure.

At present, there does not appear to be a strong consensus position about the regulatory treatment of cloud-based computing costs in Australia.⁵⁰⁵ No submissions have raised concerns with SA Water's proposal.

For the purposes of this draft determination, the Commission has decided that it is prudent and efficient to capitalise cloud-based costs for SAWRD24. However, the Commission expects that for SAWRD28 SA Water's proposal would align its regulatory treatment of cloud-computing costs with accounting standards.

11.3.3.4 Inferred estimates of prudent and efficient net capital expenditure for SAWRD24

The Commission has considered a range of information, including recommendations from FTI and Atkins, SA Water's historical expenditure, indicators of asset health and service standards, stakeholder submissions including SA Water's RBP, a representative sample of SA Water's proposed projects and programs, expected capital contributions, and expected capital efficiency. Taken together, that information infers a range of estimates that can inform the Commission's assessment of the total four-year prudent and efficient benchmark net capital expenditure amounts for SAWRD24.

A range of inferred estimates is presented below.^{506,507}

⁵⁰⁴ In April 2021, international accounting standards changed, with the International Financial Reporting Standards Interpretations Committee issuing an agenda decision on the configuration or customisation costs for cloud-based technologies. The accounting standard is to treat these costs (known as customisation and configuration costs) as businesses running software as a service.

⁵⁰⁵ For example, the Essential Services Commission of Victoria recently made a draft decision for Yarra Valley Water in which \$5.2 million of cloud-based computing costs were treated as an operating expense, while at the same time showing that it would consider treating cloud-based computing transition costs as a capital expense. Essential Services Commission of Victoria, *Yarra Valley Water Draft Decision*, December 2022, p. 22, available at <https://www.esc.vic.gov.au/sites/default/files/documents/C-22-38208%20-%20DDP%20-%20Yarra%20Valley%20Water%20draft%20decision%202023%20water%20price%20review%20December%2022.PDF>. FTI Consulting, *GWMWater: Review of expenditure forecasts*, February 2023, p. 17, available at <https://www.esc.vic.gov.au/sites/default/files/documents/GWM%20Water%20Review%20of%20Expenditure%20Forecasts%20FINAL%20REPORT.pdf>. In a recent draft decision, the AER treated \$12.9 million of ElectraNet's cloud-based computing migration costs as capital expenses. Australian Energy Regulator, *Draft decision – ElectraNet transmission determination 2023–28*, September 2022, available from https://www.aer.gov.au/system/files/AER%20-%20ElectraNet%202023-28%20-%20Draft%20Decision%20-%20Overview%20-%20September%202022%20-%20PUBLIC_0.pdf.

⁵⁰⁶ Atkins has presented more capital expenditure amounts, included as part of its sensitivity analysis (see WS Atkins International, p. 98-102). Scenarios produced by Atkins, once adjusted for the Commission's estimates of capital contributions, are as follows: \$1,801 million (\$Dec22) (low case), \$2,252 million (\$Dec22) (low case), \$2,529 million (\$Dec22) (medium case) and \$2,774 million (\$Dec22) (high case). Atkins' low and medium estimates of capital expenditure are in line with the range of inferred estimates produced by the Commission.

⁵⁰⁷ As a cross-check to these inferred estimates of capital expenditure, the Commission has undertaken a preliminary calculation using depreciation schedules. SA Water has assets that are expected to last for a long time. Based on information about the current asset value and a 30-year depreciation schedule of its assets (that is, its theoretical useful lives over the next 30 year), it is possible to determine an estimate of the periodic

- ▶ An assessment of capital expenditure that includes Commission estimates for capital contributions and capital efficiency factors and is set based on recent outcomes can infer an estimate of prudent and efficient benchmark net capital expenditure of \$1,880 million for SAWRD24 (\$Dec22).⁵⁰⁸
- ▶ An assessment of capital expenditure that includes Commission estimates for capital contributions and capital efficiency factors, is set based on recent outcomes and also, importantly, includes expected Ministerial directions under section of the PC Act, can infer an estimate of prudent and efficient benchmark net capital expenditure of \$2,529 million for SAWRD24 (\$Dec22).⁵⁰⁹
- ▶ An assessment of capital expenditure that utilises SA Water's capital expenditure proposal in the RBP (which includes expected Ministerial directions under section of the PC Act), and applies a project slippage assumption of 80 percent, can be taken to infer an estimate of prudent and efficient benchmark net capital expenditure of \$2,265 million for SAWRD24 (\$Dec22).⁵¹⁰ Note that the project slippage assumption is the same used by credit rating agency, Standard & Poor's, for South Australian Government infrastructure projects.⁵¹¹ Relatedly, an assessment that applies a project slippage assumption of 88 percent, based on a finding from the Auditor-General, where, on average, over the past five years actual capital expenditure has been 12 percent less than what was budgeted, can be taken to infer an estimate of prudent and efficient benchmark net capital expenditure of \$2,491 million for SAWRD24 (\$Dec22).⁵¹²

11.3.3.5 Deliverability of the capital program

The risks surrounding capital program deliverability (that is, the risk of under or overspend on capital) is, in effect, part of the typical forecast risk involved in setting out a four-year prudent and efficient benchmark expenditure amount: the regulator must have regard to the degree of forecast risk involved and who is best able to manage that risk (being consumers or the regulated business).

For SAWRD24, the issue of capital program deliverability is relevant for three main reasons.

First, while SA Water has proposed a large capital program for SAWRD24, it experienced challenges delivering on a much-lower expenditure benchmark amount set out by the Commission for SAWRD20. For example, SA Water's net capital expenditure in SAWRD20 is estimated to be approximately 40 percent (or more than one billion dollars) below its proposal for SAWRD24. As discussed in section 11.5, Atkins' opinion, having reviewed SA Water's business cases and related information, is that SA Water under-scoped some projects and failed to appreciate the risks and complexity of others (for example, locational and technical issues).⁵¹³ This situation raises questions regarding whether or not SA Water's internal processes and systems have improved sufficiently since SAWRD20, for SA Water to

capital expenditure that may be needed to replace the regulatory depreciation of assets in present value terms. This calculation may allow an estimate of the capital maintenance needed to meet broad equivalence with depreciation. While this type of analysis can have limitations, including that it can be impacted by, and be sensitive to, whatever assumptions are utilised, including those relating to demand growth and the discount rate, some preliminary estimates of capital expenditure vary between approximately \$2,400 million and \$2,500 million (using 30-year broad equivalence). Ultimately, the calculation, while preliminary, aims to find the periodic amount of capital expenditure that would replace the present value of a given depreciation profile over a 30-year period.

⁵⁰⁸ Calculated as \$1,937 million minus \$57 million.

⁵⁰⁹ Calculated as \$2,586 million minus \$57 million.

⁵¹⁰ Estimated as simply \$2,831 million multiplied by 80 percent.

⁵¹¹ As stated by the Auditor-General: 'Standard & Poor's notes that market capacity constraints will make it difficult for the State [South Australian Government] to spend the full amount budgeted and assumes in its credit opinion report that the State will only spend 80% of its capital program each year.' Auditor-General, p. 45.

⁵¹² Auditor-General, p. 45. Estimated as simply \$2,831 million multiplied by 88 percent.

⁵¹³ WS Atkins International, pp. 9-10, 17-27.

be capable of delivering, at a prudent and efficient cost, the large gross capital program of \$2,831 million (\$Dec22) it has proposed.

Second, while the Commission has assessed an inferred estimate of a four-year total prudent and efficient benchmark net capital expenditure amount of \$1,880 million for SAWRD24 (\$Dec22), which is comparable to the outcomes delivered in SAWRD20, the potential inclusion of capital expenditure for the Ministerial directions under section 6 of the PC Act can lead to an inferred estimate of a four-year benchmark net capital expenditure amount of \$2,529 million for SAWRD24 (\$Dec22). Such an amount would be a 34 percent increase on the benchmark amount determined in SAWRD20. This amount of expenditure may be challenging to deliver on, not least given economic conditions in South Australia have been relatively strong (as explained in Chapter 3),⁵¹⁴ with labour market indicators and surveys suggesting there is limited available spare capacity.⁵¹⁵ The Auditor-General has highlighted the risks of a 'heated construction' market.⁵¹⁶ As a whole, this suggests risks of construction cost increases and project slippage due to difficulties securing labour and materials.

Third, SA Water's capital expenditure proposal suggests timing and price risk relating to the amount of project capital expenditure in the initial stages of planning and development. SA Water has reported in the RBP a large share (approximately 84 percent) of the total proposed capital expenditure for SAWRD24 has a target cost accuracy of either -20 percent to +30 percent or -30 percent to +50 percent (Table 11.4 and Figure 11.9). The wide band of accuracy is not necessarily unexpected in ex-ante economic regulation: it is inevitable that, at the time of an RBP, projects will be at various stages of development, based on the needs emerging from the regulated business's long-term plans. It follows that it would not be expected that each project or program would be at a cost category of, say, class 3 and 4. Nevertheless, the high share of capital expenditure projects in class 1 and 2 cost categories highlights timing and price risk associated with SA Water's capital expenditure proposals.

Table 11.4: SA Water's cost estimate classification⁵¹⁷

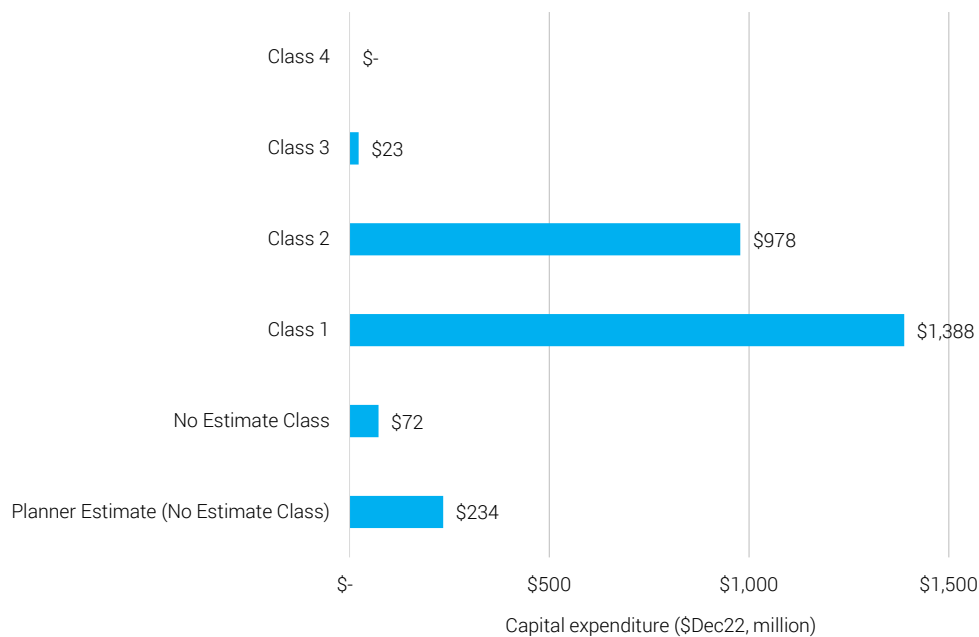
Project stage	Project type	Cost estimate target accuracy
Class 1	Planning / budgeting	-30% to +50%
Class 2	Feasibility or options analysis	-20% to +30%
Class 3	Business case / financial approval	-10% to +15%
Class 4	Procurement stage	-5% to +5%

⁵¹⁴ Oxford Economics Australia, pp. 1-2.

⁵¹⁵ See Chapter 3, section 3.3.

⁵¹⁶ Auditor-General, p. 45.

⁵¹⁷ SA Water, *Regulatory Business Plan 2024-28*, p. 140.

Figure 11.9: SA Water's proposed capital expenditure, according to cost classification categories (\$Dec22)⁵¹⁸

The regulatory framework applying to SA Water provides a means for balancing the risks between consumers and the regulated business. The potential for ex-post regulatory interventions by the Commission (for example, by not incorporating imprudent and/or inefficient capital expenditure in the RAB on an ex-post basis) can reduce the incentive for SA Water to pay above-market rates for labour and materials when delivering capital projects and programs. Furthermore, in the Commission's view, the risk of project slippage (for example, underspend) has been considered in the assessment of the inferred estimate of a four-year total prudent and efficient benchmark net capital expenditure amount of \$1,880 million for SAWRD24 (\$Dec22).

The Commission understands, from interviews with SA Water and reviews of available documentation, that the proposed capital expenditure for the Ministerial directions under section 6 of the PC Act will involve activities that SA Water already typically delivers⁵¹⁹ and/or has already commenced.⁵²⁰ While this situation may suggest less deliverability risk relating to these two major projects, the matter of deliverability should be considered for the capital program as a whole, not necessarily on the basis of any particular individual major projects.

The Commission intends to increase monitoring efforts in relation to SA Water's investment activities during SAWRD24, consistent with the Monitoring and Evaluating Performance Framework (MEPF) (refer Chapter 18). Increased monitoring will be important. There is, as mentioned above, a question as to whether or not SA Water's internal processes and systems have improved since SAWRD20, and SA Water's internal processes and systems will be critical in facilitating and allowing for the prudent and efficient delivery of the capital expenditure program.

⁵¹⁸ WS Atkins International, p. 57. Note the data on cost classifications in Figure 11.9 is assumed to be gross pre-efficiency capital expenditure excluding technology.

⁵¹⁹ The Northern Metropolitan Growth project involves capital expenditure on investment activities typically delivered by SA Water. For example, as mentioned earlier, this project involves duplication of approximately 37 kilometres of water mains, installation of approximately 12 kilometres of new water mains, replacement of approximately 23 kilometres of water mains, new tanks, two new pump stations, an upgrade of two pump stations, and new hydraulically operated control valves at three tank sites. SA Water, *Regulatory Business Plan 2024-28*, p. 198.

⁵²⁰ SA Water has commenced various activities relating to the Tea Tree Gully Sustainable Sewers program.

11.4 Draft Decision – SAWRD24 Capital Expenditure

The Commission has reviewed, analysed and considered the range of evidence and information on the prudent and efficient benchmark net capital expenditure amounts for SAWRD24.

On balance, the Commission has assessed that a four-year total prudent and efficient benchmark net capital expenditure amount is \$1,880 million for SAWRD24 (\$Dec22). The assessment is the Commission's judgement having regard to SA Water's historical capital expenditure, asset health and service standards, stakeholder submissions including SA Water's RBP, a representative sample of SA Water's proposed projects and programs and expected capital efficiency. The assessment is that this total benchmark amount would support prudent and efficient investments on a long-term basis, and as relevant would allow SA Water to meet applicable health, safety, environmental and customer service standards and obligations over SAWRD24.

Nevertheless, in addition to this prudent and efficient expenditure benchmark amount, the draft decision has included the capital expenditure for the expected Ministerial directions under section 6 of the PC Act that are expected to be issued relating to two major projects: Northern Metropolitan Growth and TTG Sustainable Sewers. As mentioned earlier, for the purposes of the draft determination, the Commission has included expenditure for these two major projects in line with SA Water's proposal. In doing so, the Commission has not reviewed, in detail, the prudent and efficient expenditure requirements of these two projects.

The draft decision is therefore that the prudent and efficient benchmark net capital expenditure amounts to be included in the calculation of the revenue caps are as follows:

- ▶ \$1,660 million (\$Dec22) for water retail services, which is approximately \$393 million higher than the benchmarks set for SAWRD20, but \$206 million lower than proposed by SA Water, and
- ▶ \$869 million (\$Dec22) for sewerage retail services, which is approximately \$250 million higher than the benchmarks for SAWRD20, but \$91 million lower than proposed by SA Water.

Table 11.5: Draft decision on ex-ante capital expenditure for 1 July 2024 to 30 June 2028 (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Net capital expenditure – water	366	387	469	438	1,660
Net capital expenditure – sewerage	214	214	218	223	869
Net capital expenditure – total	579	602	687	660	2,529

Further submissions, evidence and information will be considered by the Commission in preparing a final regulatory determination. In that context, the Commission will continue to consider its position on the prudent and efficient capital expenditure benchmark amounts to be included in the calculation of the revenue caps for SAWRD24.

11.5 Ex-post prudent and efficient capital expenditure for SAWRD20

This section outlines:

- ▶ a summary of SA Water’s capital expenditure outcomes for 1 July 2020 to 30 June 2023 and SA Water’s capital expenditure forecast for 1 July 2023 to 30 June 2024 (section 11.5.1)
- ▶ a summary of the matters raised in consultation (section 11.5.2), and
- ▶ the Commission’s assessment, reasoning and decisions on the prudent and efficient benchmark net capital expenditure amounts for SAWRD20 (section 11.5.3), including review, consideration and analysis of:
 - actual capital expenditure over the 1 July 2020 to 30 June 2023 period (section 11.5.4.1), and
 - forecast capital expenditure for the 1 July 2023 to 30 June 2024 period (section 11.5.4.2).

The assessment has involved reviewing a sample of projects and programs, business cases and related information, and conducting interviews with SA Water staff. Together, these activities mitigate the risks arising from information asymmetry. Further, as mentioned in section 11.2, the potential for ex-post regulatory interventions can incentivise SA Water to engage in sound long-term asset management and make prudent and efficient capital expenditure decisions in future.⁵²¹

11.5.1 SA Water’s outcomes in SAWRD20 and its forecast for 2023-24

SA Water has reported actual capital expenditure for the period 1 July 2020 to 30 June 2023 (including an estimate for 2022-23) (of \$1,226 million, \$Dec22) and has proposed a forecast of capital expenditure for 2024-24 of \$717 million (\$Dec22) (Table 11.6).⁵²²

Table 11.6: SA Water RBP proposal actual capital expenditure (\$Dec22)

	2020-21	2021-22	2022-23 (estimate)	2023-24 (forecast)	Total
Net capital expenditure – water	183	281	353	473	1,290
Net capital expenditure – sewerage	116	139	154	244	653

Overall, if including the forecast for 2023-24, SA Water’s proposal for the four-year ex-post capital expenditure outcomes is for an increase of over \$50 million in excess of the expenditure benchmark set by the Commission in SAWRD20 (approximately 3 percent higher).

However, as discussed below, actual capital expenditure in SAWRD20 to date has been approximately 15 percent less than the expenditure benchmark set in SAWRD20. Consequently, the increase in the four-year outcome compared to the SAWRD20 benchmark largely reflects SA Water’s forecast of a sharp increase in capital expenditure for 2023-24.

⁵²¹ For example, if the Commission were to decide on an ex-post basis not to add to the RAB certain actual capital expenditure that the Commission assessed was imprudent and/or inefficient.

⁵²² At the time of making this draft determination, the 2023-24 capital expenditure proposal remains a forecast based on SA Water’s budgeted amounts. The amounts reported (and shown in Table 11.6) are aggregate amounts based on the capital expenditure in SA Water’s revenue model, adjusted for inflation. Amounts from the RBP and the revenue model can differ to project-level information (used by Atkins), in part, due to the timing in which the amounts have become available; project-level information can include updated information from activities undertaken throughout 2023.

Further discussion of expenditure outcomes and project-level information is included in section 11.5.3 below.

11.5.2 Matters raised in consultation

Submissions did not comment on SAWRD20 capital expenditure outcomes to be included in the RAB. However, as mentioned in section 11.3, stakeholders raised general themes relating to affordability, managing risk, Ministerial directions under section 6 of the PC Act, regional water supplies, urban growth and individual projects, all of which primarily relate to the SAWRD24 period (discussed earlier in section 11.3).

11.5.3 Commission's analysis

The assessment, reasons and considerations on the prudent and efficient benchmark net capital expenditure amounts for SAWRD20 has been informed by a representative sample of capital expenditure projects and programs, business case and related information (for example, project development information, costing information and details regarding the project or program's delivery approach), and interviews with SA Water staff.

The Commission's analysis is structured as follows:

- ▶ Section 11.5.3.1 documents the sample of projects and programs reviewed by the Commission and its consultant Atkins.
- ▶ Section 11.5.3.2 outlines discussion and analysis of capital expenditure over SAWRD20 including outcomes related to certain major projects.
- ▶ Section 11.5.3.3 outlines discussion and analysis of SA Water's forecast for capital expenditure for 2023-24.

11.5.3.1 Sample of projects and programs for SAWRD20

The Commission has assessed a sample of SA Water's projects and programs for SAWRD20. In selecting the sample, the Commission considered the value of the projects and programs as well as their service type and category. The sample of projects and programs was selected before starting interviews and information collection.⁵²³ The sample for the ex-post review has accounted for approximately 23 percent of SA Water's capital expenditure for the period.⁵²⁴

The approach adopted by the Commission, having regard to advice from its consultants, has been to include services and categories of all types and sizes; however, the Commission notes that it has focussed, to an extent, on major projects and programs.

Table 11.7 (below) documents the sample of ex-post projects and/or programs that have been reviewed.

⁵²³ The latter occurred through September 2023, October 2023 and November 2023.

⁵²⁴ WS Atkins International, pp. 17-18.

Table 11.7: Sample of projects for ex-post review⁵²⁵

Project name	Service type	Category
Kangaroo Island Desalination Plant	Water	Enable growth
Eyre Peninsula Desalination Augmentation	Water	External obligations
Bolivar Wastewater Treatment Plant Capacity Growth Upgrade	Sewerage	Enable growth
Morgan Whyalla Pipeline No1 Replacement	Water	Sustain services
Asset Program Mains Water Network Water Mains Replacement Metro OP20	Water	Sustain services
Regional Areas Water Quality Improvement Water Treatment Plant	Water	Improve services
Northern Adelaide Irrigation Scheme Infrastructure	Sewerage	External obligations
Asset Program Structures Wastewater Treatment Plant and Bolivar Wastewater Treatment Plant	Sewerage	Sustain services
Major Plant Acquisition	Other	Sustain services

11.5.3.2 Assessment of SA Water's actual expenditure for SAWRD20

Having reviewed the RBP, business cases and other supporting evidence made available by SA Water and the advice provided by Atkins,⁵²⁶ the Commission has assessed that there have been material capital expenditure variations in five major projects,⁵²⁷ as shown in Table 11.8 below. At the overall level, the variance appears to relate to slippage in the timing of projects (for instance, projects have been delivered materially later than planned, delaying capital expenditure) or cost overruns.

Table 11.8: Examples of major projects with variances (\$Dec22)⁵²⁸(rounded figures)

Project name	Planned (\$m)	Estimate for actual for SAWRD20 (\$m)	Estimated variance (\$m)
Mount Bold Dam Safety Upgrade	98	26	-72
Kangaroo Island Desalination Plant	53 ⁵²⁹	144	+91
Bolivar Wastewater Treatment Plant Capacity Growth Upgrade	26	49	+23
Eyre Peninsula Desalination Augmentation	98	79	-19
Morgan Whyalla Pipeline No1 Replacement	70	56	-14

⁵²⁵ Ibid, pp. 18-20, 20-51.

⁵²⁶ Ibid, pp. 18-20, 20-51.

⁵²⁷ Major projects are defined as those of value above \$50 million. The five major projects are based on those reviewed as part of the ex-post and/or ex-ante reviews of a sample of projects and programs.

⁵²⁸ WS Atkins International, pp. 17-18, pp. 31-33, 33-34, 34-36, 38-39, and 87-88.

⁵²⁹ Total includes contributions from South Australian and Commonwealth Governments.

Atkins' opinion, having reviewed the SA Water information, is that SA Water has under-scoped some projects and has failed to appreciate the risks and complexity of others (for example, locational and technical issues).⁵³⁰ It put the view that this may, in part, have been due to the fact that, when SA Water explained those projects in the SAWRD20 process, they were in early stages of preparation and planning.⁵³¹ The Commission notes that a similar deliverability risk exists in relation to SA Water's proposed capital program for SAWRD24 (refer section 11.3.3.5).

The Commission observes that this is not unusual in ex-ante economic regulation: a regulated business has (or should have) a suite of long-term asset management and delivery plans; those plans will be based on the best evidence of matters such as likely future demand and asset condition; the plans should not be based on, or fixed to, a four-year regulatory period. As such, it is inevitable that, at the time of submitting a RBP, the suite of projects will be at various stages of development, based on the needs emerging from the long-term plans. It follows that it would not be expected that each project or program would be at a final stage at the time an RBP is submitted.

Nevertheless, that does not mean that nascent (or early stage) proposals should be expected or paid for by customers. The full timing and price risk of those proposals should not be borne by customers as SA Water is best placed to manage these risks. SA Water has identified different cost classification categories of project readiness (as discussed earlier in section 11.3). Noting the degree of cost risk associated with those different categories, it would not be in consumers' long-term interests for them to bear the full risk of early-stage projects – and the regulatory determination, through the assessment and setting out of prudent and efficient net capital expenditure benchmarks and the potential for ex-post regulatory, is set accordingly.

Atkins also identified other potential contributing factors for the variances, such as observed increases in infrastructure construction costs in South Australia, which have increased over the past three years,⁵³² as well as potential impacts from COVID-19-related disruptions (although disentangling these from other economic effects appears difficult based on current evidence).⁵³³

The under-scoping and under-appreciation of challenges and complexity during SAWRD20 can be seen in several major projects that have been reviewed as part of the ex-post or ex-ante samples.

- ▶ In the case of the Mount Bold Dam Safety Upgrade, the complexity involved has resulted in project slippage during SAWRD20. Notwithstanding various iterations of modelling and analysis, the project options have been (and continue to be) scoped. As noted in section 11.3, there is still more planning and project optioneering to be progressed before the project is close to the construction phase.⁵³⁴
- ▶ Cost overruns have been evident for several projects. These included the Kangaroo Island Desalination Plant and, to a lesser extent, the Bolivar Wastewater Treatment Plant Capacity Growth Upgrade.⁵³⁵ Capital expenditure on the Kangaroo Island Desalination Plant has significantly exceeded plans. The original cost and scoping under-estimated the complexity of delivering a project of this sort.⁵³⁶ The Commission has assessed inefficient capital expenditure relating to the removal and relaying of a new pipeline associated with the Kangaroo Island Desalination Plant, and it has assessed an expected small amount of capital slippage from 2023-24 into 2024-25.⁵³⁷

⁵³⁰ Ibid, pp. 9-10, 17-27.

⁵³¹ Ibid, pp. 8-20, 20-51.

⁵³² Auditor-General's Department, pp. 48-49. Also, see Oxford Economics Australia, pp. 1-2.

⁵³³ WS Atkins International, pp. 27-29. Atkins' opinion is that the underspend by SA Water in 2020-21 and 2021-22 is likely to be only partially, rather than fully, affected by COVID-19 related disruptions.

⁵³⁴ WS Atkins International, pp. 87-88.

⁵³⁵ Ibid, pp. 33-34, 38-39.

⁵³⁶ Ibid, pp. 29-31, 46-47.

⁵³⁷ Ibid, p. 30.

- ▶ In the case of the Eyre Peninsula Desalination Plant, while the variance between planned and incurred expenditure during SAWRD20 has not been as large as for the Kangaroo Island Desalination Plant or the Mount Bold Dam Safety Upgrade, the total capital expenditure proposed for the project in SAWRD24 highlights that significant re-scoping of the project has taken place since 2020. The Eyre Peninsula Desalination Plant is an example of a project in which under-scoping and under-appreciation of challenges have led to major re-scoping and cost changes since it was originally proposed (for example, project costs have increased on the basis of design changes, processes involved in site selection and investigations, and an under-appreciation of the cost of developing the project in a regional and marine area).⁵³⁸
- ▶ In the case of the Morgan to Whyalla pipeline, there has been underspending due to the project slipping from the planned expenditure profile. This has reflected the need for the re-appraisal of options to, among other factors, overcome environmental challenges (such as risks to local fauna and species of mallee birds).⁵³⁹ As noted in section 11.3, this project will continue through into SAWRD24, but is likely to involve only gradual delivery (given these current challenges).⁵⁴⁰

In contrast to the major projects listed above, SA Water maintained capital expenditure on sustaining services during SAWRD20 (with only a minor underspend). This is an indication that it was possible for SA Water to keep a significant part of its capital program on track, despite higher infrastructure construction costs and any potential impacts from COVID-19 related disruptions.⁵⁴¹

Furthermore, the Commission has found that comparator utilities in Australia did not appear to experience the same level of variance as seen in SA Water's performance in 2020-21 and 2021-22. Also, SA Water underspent in 2016-17, which, on one hand may be of limited relevance (if its planning and processes have changed since then), but on the other hand, it could be indicative of a 'year one effect', in which projects do not progress as quickly during the first year of a regulatory period, as assumed in original planning and scoping.⁵⁴²

In the RBP, SA Water stated that it expects capital expenditure 'deferrals' to the value of more than \$400 million in the SAWRD20 period.⁵⁴³ However, the Commission has assessed that during the period SA Water re-prioritised expenditure across various activities and projects – which it considers appropriate and typically a standard practice among utilities.⁵⁴⁴ SA Water should be re-prioritising expenditure, on prudent and efficient basis, within its overall capital benchmark to manage and mitigate risks. Furthermore, despite re-prioritisation of expenditure, SA Water's indicators of asset health performance, including water pipe failures, sewer breaks, and breakdowns and corrective maintenance work orders, do not suggest any significant deterioration in asset health.⁵⁴⁵

Overall, despite the challenges in scoping, project planning and delivery (noted above), the Commission has assessed that SA Water's actual net capital expenditure over 2020-21 to 2022-23 has been prudent and efficient for the purposes of the draft determination. The prudent and efficient benchmark net capital expenditure amounts have been outlined in the draft decision in section 11.6.

⁵³⁸ Ibid, pp. 34-36.

⁵³⁹ Species of mallee birds were declared as endangered in December 2021.

⁵⁴⁰ WS Atkins International, pp. 31-33.

⁵⁴¹ Ibid, pp. 8-15, 24-26.

⁵⁴² Ibid, pp. 27-29.

⁵⁴³ SA Water, *Regulatory Business Plan 2024-28*, p. 41, 52, 67, 147, 206. The calculation and concept of deferrals being referred to by SA Water relates to SA Water's delivery plan. WS Atkins International, pp. 9-10, 28-19.

⁵⁴⁴ WS Atkins International, pp. 26-27.

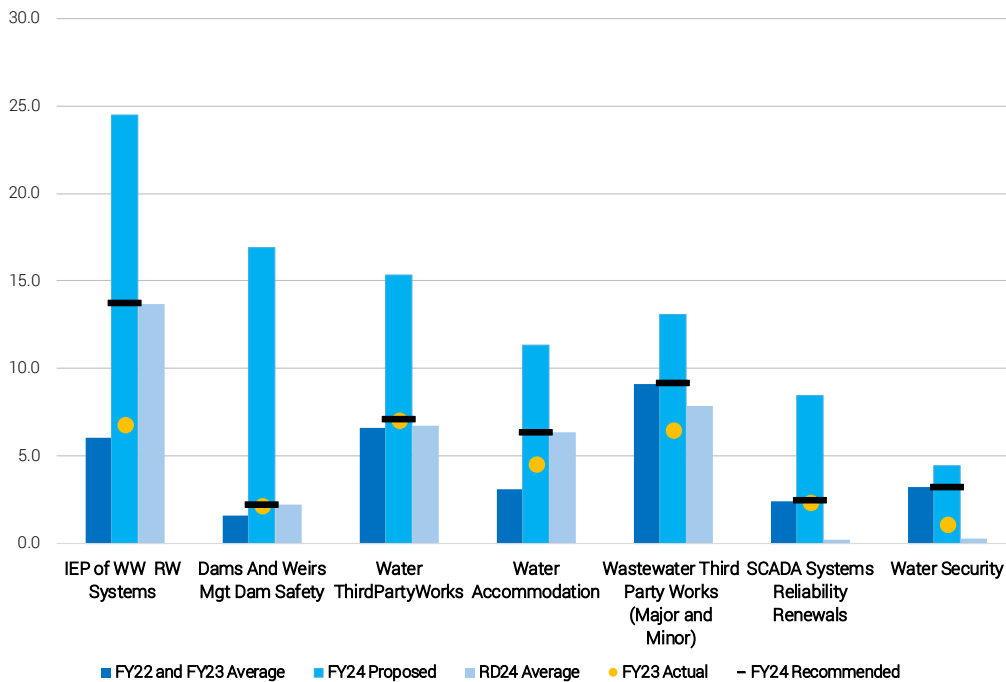
⁵⁴⁵ In terms of non-pipes, breakdowns and corrective maintenance as a proportion of work orders have been improving since 2017. In terms of pipe failures, the annual number of failures during the SAWRD20 period has not been that different to the number observed during SAWRD16. Ibid, pp. 59-60, 66-67.

11.5.3.3 Assessment of SA Water’s forecast for 2023-24

The ex-post review has considered SA Water’s forecast of capital expenditure for 2023-24.

The Commission has decided that seven proposed projects had an inefficient forecast. For example, there were seven projects with large forecasts of expenditure for 2023-24 (Figure 11.10).⁵⁴⁶

Figure 11.10: Seven projects with large increases in expenditure proposed by SA Water for 2023-24 (\$Dec22)⁵⁴⁷



The expenditure forecast for 2023-24 was considered large when scaled against the following three comparisons: actual expenditure over 2021-22 and 2022-23, SA Water’s forecast for SAWRD24, and the amount of actual expenditure seen in 2023-24 to date. Further, within business cases and related documentation, the Commission has assessed that there was limited justification for the size of the planned increase in 2023-24.⁵⁴⁸

Atkins found approximately \$41 million (\$Dec22) of inefficient expenditure relating to seven projects with large, proposed increases in expenditure in 2023-24. Atkins’ stated:⁵⁴⁹

‘Based on the initial analysis, we have identified several projects that show significant step change increase between FY23 and FY24 as well as forecast 1.5x higher expenditure than the rate of expenditure proposed for RD24. This was done by identifying business cases line items with a step-change that is 75% higher than the actual spend in FY23. Additionally, another flag was added to identify projects with FY24 forecast expenditure that is 1.5 times higher than the rate of expenditure proposed for RD24. For each project that satisfied the two identification flags, we undertook a desktop review for linked business cases as well as individual sub-projects for RD20 to understand the context of the step-change. One of the criteria that was looked at for the identification is the driver of investment. For example, we considered the step-change related to growth projects to be reasonable as SA Water is facing growth demands.

⁵⁴⁶ These included: IEP of WW RW Systems, Dams and Weirs Mgt Dam Safety, Water Third Party Works, Water Accommodation, Wastewater Third Party Works (Major and Minor), SCADA Systems Reliability Renewals, and Water Security.

⁵⁴⁷ WS Atkins International, pp. 47-49.

⁵⁴⁸ Ibid, pp. 40-42.

⁵⁴⁹ Ibid, pp. 45-49.

After comprehensively reviewing business cases with significant change, we identified seven with a FY24 step change that we thought was outside of the reasonable expenditure trends. Per the information provided, each RD24 business case is linked to multiple RD20 projects. Therefore, in our review we examined each step-change at both the business case and individual project levels. The step-change for each identified business case ranged from 100% to almost 700% increase in FY24 forecast compared to actual FY23 expenditure...'

In addition, Atkins found approximately \$7 million of inefficient expenditure relating to the Northern Adelaide Irrigation Scheme (NAIS) program in 2023-24 (given limited evidence of increased demand, the extent of proposed expenditure was not considered prudent and efficient in 2023-24). Atkins identified \$14 million of inefficient expenditure related to the Kangaroo Island Desalination Plant (relating to the removal and relay of pipe).⁵⁵⁰

Alongside this, Atkins identified project expenditure that, in its view, will take place in SAWRD24 rather than in financial year 2023-24. Atkins recommended 're-profiling' approximately \$2 million for the NAIS project, approximately \$3 million for the Kangaroo Island Desalination Plant, and \$36 million for the Morgan to Whyalla Pipeline.⁵⁵¹ By way of background, 're-profiling' relates to instances where the proposed expenditure profile put forward by a regulated business (that is, the proposed timing of the capital expenditure) is considered to be imprudent and/or inefficient. For example, if a monopoly overstates its capital expenditure profile, through imprudent and/or inefficient assumptions about timing, this can lead to inefficient costs being borne by customers.

Having reviewed the RBP, business cases and other supporting evidence made available by SA Water and the advice provided by Atkins, the evidence suggests that SA Water's proposal for expenditure in 2023-24 includes imprudent and inefficient expenditure.

Overall, the Commission has assessed the following.

- ▶ There is \$41 million of inefficient levels of capital expenditure in 2023-24 associated with seven individual projects. The Commission determined this by reviewing seven projects with high step-changes, calculating the average incurred expenditure in 2021-22 and 2022-23 and calculating the average expenditure forecast for SAWRD24, and then taking the highest of those two figures. That highest figure was then treated as the forecast for each of the seven projects for 2023-24. This led to approximately \$41 million being determined to be inefficient.
- ▶ There is \$14 million of inefficient spend on removing and relaying pipe for the Kangaroo Island Desalination Plant. There is also a small amount (\$3 million) of re-profiling between 2023-24 and 2024-25.
- ▶ There is \$36 million of re-profiling of expenditure for the Morgan to Whyalla Pipeline between 2023-24 and SAWRD24. Atkins' opinion, having reviewed the SA Water information, including the amount of expenditure in 2023-24 to date, is that delays and environmental challenges (such as risks to local fauna and species of mallee birds) will affect the expenditure profile. The Commission has decided that \$36 million from SA Water's proposal for 2023-24 for the Morgan to Whyalla Pipeline will spread into the SAWRD24 period.
- ▶ There is \$7 million of inefficient levels of expenditure for NAIS for 2023-24. There is also a small re-profiling for NAIS (approximately \$2 million) between 2023-24 and 2024-25. The Commission found that there was information to support approximately \$1.5 million of NAIS capital expenditure in 2023-24 and approximately \$1.5 million in 2024-25, but the rest of the NAIS proposed expenditure (\$7 million) is inefficient based on limited customer demand.

⁵⁵⁰ Ibid, 33-34, 39-41.

⁵⁵¹ Ibid, 31-33, 33-34, 39-41.

Taken together, the Commission has assessed that the prudent and efficient net capital expenditure for 2023-24 is \$615 million (\$Dec22) (Table 11.9).^{552,553}

Table 11.9: 2020-21 to 2023-24 net capital expenditure (\$Dec22)⁵⁵⁴

	2020-21 (\$m)	2021-22 (\$m)	2022-23 (\$m)	2023-24 (\$m)	Total (\$m)
Water					
SA Water actual	183	281	353	-	1,290 ⁵⁵⁵
SA Water forecast	-	-	-	473	-
Commission assessment	183	281	353	377	1,194
Sewerage					
SA Water actual	116	139	154	-	653 ⁵⁵⁶
SA Water forecast	-	-	-	244	-
Commission assessment	116	139	154	238	647

⁵⁵² A simple cross-check to assess SA Water's forecast for 2023-24 is to use information available from SA Water regarding how much spend has taken place in the September quarter of 2023 and how much is still budgeted for the remainder of 2023-24. This can be combined with information available from the Auditor-Generals Department regarding credit rating agency, Standard & Poor's. Standard & Poor's, in its credit opinion, has reportedly assumed that the South Australian Government will only spend 80 percent of its capital program budget each year over the outlook horizon given capacity constraints in the infrastructure construction market. Excluding the Kangaroo Island Desalination Plant and the Morgan to Whyalla pipeline, if Standard & Poor's 80 percent assumption was applied to SA Water's remaining budgeted expenditure profile for the December 2023, March 2024 and June 2024 quarters, and this amount was combined with SA Water's actual capital expenditure for the September quarter of 2023, this would imply an adjustment of more than \$100 million. This could be combined with the earlier recommendations of \$36 million and \$17 million, for the Morgan to Whyalla pipeline and the Kangaroo Island Desalination Plant and would suggest a capital expenditure benchmark amount for 2023-24 which is less than \$600 million.

⁵⁵³ Another approach could be to adopt the existing SAWRD20 benchmark annual capital expenditure for 2023-24 (until the ex-post review takes in place in SAWRD28). Regulators, such as the Essential Services Commission of Victoria, apply this approach. See Essential Services Commission of Victoria, 2023 Water Price Review, 26 October 2021 (August 2022 amendment), p. 38, available at <https://www.esc.vic.gov.au/sites/default/files/documents/2023%20water%20price%20review%20guidance%20paper%20-%20August%202022%20amendment.pdf>. This methodology, if applied for the purposes of SAWRD24, would produce a capital expenditure benchmark amount for 2023-24 of \$467 million (\$Dec22). This would be \$250 million below SA Water's forecast for 2023-24.

⁵⁵⁴ SA Water's reported actual expenditure for 2022-23 includes some estimates of capital expenditure for the period in question. The SA Water numbers presented in this particular table are based on the aggregate figures provided in SA Water's revenue model. However, there can be differences between more up-to-date figures provided during the review process, including those shared with Atkins.

⁵⁵⁵ Total calculated including the forecast for 2023-24.

⁵⁵⁶ Total calculated including the forecast for 2023-24.

11.6 Draft decision – SAWRD20 Capital Expenditure

The Commission has reviewed, analysed and considered the prudent and efficient benchmark net capital expenditure amounts for SAWRD20. It has had regard to SA Water's incurred expenditure over the SAWRD20 period (to date) and SA Water's forecasts for the periods that have not yet occurred. It has also considered stakeholder submissions including SA Water's RBP, a representative sample of SA Water's capital expenditure projects and programs for which business case and related information was gathered and conducted interviews with SA Water staff.

The draft decision is that the prudent and efficient benchmark net capital expenditure amounts to be included in the roll-forward of the RAB, to decide the opening RAB values for SAWRD24, are as follows:

- ▶ \$1,194 million (\$Dec22) for water retail services, which is 7 percent lower than that proposed by SA Water, and
- ▶ \$647 million (\$Dec22) for sewerage retail services, which is approximately 1 percent lower than that proposed by SA Water.

Table 11.10: Draft decision on ex-post capital expenditure for 1 July 2020 to 30 June 2024 (\$Dec22)

	2020-21 (\$m)	2021-22 (\$m)	2022-23 (\$m)	2023-24 (\$m)	Total (\$m)
Net capital expenditure	299	420	507	615	1,841
Net capital expenditure – water	183	281	353	377	1,194
Net capital expenditure – sewerage	116	139	154	238	647

Further submissions, evidence and information will be considered by the Commission in preparing a final regulatory determination. In that context, the Commission will continue to consider its position on the prudent and efficient capital expenditure benchmark amounts to be included in the in the roll-forward of the RAB for SAWRD24.

12 Regulated Asset Base and depreciation

Draft decision – Value of the Opening Regulated Asset Base (RAB)

The Commission's draft decision is to apply a roll-forward methodology to the regulated asset base (RAB), in order to determine the *opening* RAB values for the commencement of the SAWRD24 period.

The Commission's draft decision for the opening values of the RAB are as follows:

- ▶ the value of the RAB at 1 July 2024 (\$Dec22) will be \$9,630 million for **water** retail services, and
- ▶ the value of the RAB at 1 July 2024 (\$Dec22) will be \$4,882 million for **sewerage** retail services.

12.1 Introduction

As outlined in Chapter 7, the Commission's draft decision is to adopt a building blocks cost model to establish separate four-year maximum revenue caps for water and sewerage retail services to apply for SAWRD24. The adoption of a building blocks cost model involves rolling forward SA Water's regulated asset base (RAB), to determine the *opening* RAB values for the SAWRD24 period. This opening value, in conjunction with the other components of the building blocks cost model, are used in determining the revenue caps for water and sewerage retail services for the SAWRD24 period.

The application of a roll-forward methodology, under a real rate of return approach, involves adjusting the RAB through the SAWRD20 period for:

- ▶ Consumer Price Index (CPI) inflation (to recognise the change in the value of the asset due to changes in the rate of inflation)⁵⁵⁷
- ▶ allowed prudent and efficient regulatory depreciation (allowed depreciation is converted to an end-of-year value based on the value determined and used in the SAWRD20 determination), and
- ▶ prudent and efficient incurred net capital expenditure for the SAWRD20 period.

This chapter documents SA Water's proposal for opening RAB values and outlines the Commission's draft decision for the opening values of the RAB for the commencement of the SAWRD24 period, which will apply as at 1 July 2024 for the purposes of establishing the revenue caps for SAWRD24.

⁵⁵⁷ CPI inflation indexation means that the value of a utility's investments will not be eroded by the effects of inflation. Because inflation indexation increases the value of the nominal asset base, a benchmark efficient entity can increase debt while maintaining the fixed regulatory 60 percent gearing ratio (discussed in Chapter 13). The increase in debt can generate cash flow that is equivalent to a nominal return. This is a known feature of the real rate of return approach used by regulators in Australia and New Zealand to roll forward the asset base. For example, see New Zealand Commerce Commission, Input Methodologies (Electricity Distribution and Gas Pipeline Services) – Reasons paper, 22 December 2010, p. vii, available at https://comcom.govt.nz/_data/assets/pdf_file/0019/62704/EDB-GPB-Input-Methodologies-ReasonsPaper-Dec-2010.pdf.

12.2 SA Water's proposal

SA Water has proposed opening RAB values of approximately \$9,725 million (\$Dec22) and \$4,889 million (\$Dec22) for water and sewerage retail services, respectively.⁵⁵⁸ SA Water calculated the opening RAB values using a roll-forward methodology which used its actual capital expenditure for SAWRD20 (discussed in Chapter 11).

12.3 Submissions

No submissions commented directly on the application of the RAB and depreciation for SAWRD24.

12.4 Commission analysis

The Commission's application of the roll-forward methodology is consistent with Principle 5 of the National Water Initiative (NWI) Pricing Principles.⁵⁵⁹

The assumptions used by the Commission in the roll-forward of the RAB include the following:

- ▶ Depreciation reflects the allowed regulatory depreciation (converted to an end-of-year value) from the SAWRD20 determination.
- ▶ New capital expenditure is recognised in the year it is incurred, rather than on the date that the asset is commissioned.
- ▶ The timing of capital expenditure and asset disposals is assumed to occur evenly throughout the year, which, for modelling purposes, is the same as assuming that all annual capital expenditure is incurred at the midpoint of that year.
- ▶ Customer contributions and gifted assets associated with capital expenditure are not added to the RAB, reflecting the fact that they are directly funded by specific customers and the South Australian Government (as the case may be). This is consistent with the requirements of NWI Pricing Principles.

The Commission and SA Water utilise the same roll-forward methodology; however, different inputs have been adopted. The main differences are the values used by the Commission for prudent and efficient actual capital expenditure for the SAWRD20 period and the annual CPI inflation, as explained below.

As outlined in Chapter 11, the Commission has reviewed, considered and determined, on an ex-post basis, the prudent and efficient benchmark net capital expenditure for SAWRD20, and this has been included in the roll-forward of the RAB. Table 12.1 provides a summary.

⁵⁵⁸ Note that SA Water's opening RAB values for the purposes of this chapter are presented in December 2022 dollars. SA Water's opening RAB values were provided to the Commission in March 2022 dollars. However, to make them comparable for use in this chapter, the Commission has updated CPI inflation in SA Water's proposed revenue model, such that the opening RAB values are on a December 2022 basis.

⁵⁵⁹ NWI Pricing Principles, *Principle 5: Rolling forward asset values after the legacy date, 2004*, clause 19. The application of the roll-forward methodology is consistent with the requirements in the previous Pricing Order from SAWRD20. Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

Table 12.1: 2020-21 to 2023-24 capital expenditure adjustments (\$Dec22)

	2020-21	2021-22	2022-23	2023-24	Total
Water					
RBP	183	281	353	4472	1,290
Adjustments	0	0	0	-95	-95
Adjusted capex	183	281	353	377	1,194
Sewerage					
RBP	116	139	153	244	653
Adjustments	0	0	0	-6	-6
Adjusted capex	116	139	153	238	647

In terms of the annual CPI inflation used to roll-forward the RAB, SA Water's RBP proposed to use March-to-March 2022 CPI inflation as a proxy for December-to-December 2022 inflation. Its reasoning for the nine-month lag was consistency with its previous submissions and alignment with the CPI inflation used to inflate prices for water and sewerage retail services.

Over the longer term, there is likely to be negligible difference between using inflation calculated on a March-to-March basis versus on a December-to-December basis. However, in the short term there can be some differences. The roll-forward of the RAB using annual December-to-December 2022 CPI inflation provides the opening RAB values in December 2022 prices, which aligns with the approach adopted in SAWRD20 (December-to-December 2018 CPI inflation was used to roll-forward the RAB)⁵⁶⁰ and the price basis used to calculate the present value of revenue caps for SAWRD24.

Finally, the application of the roll-forward methodology uses allowed regulatory depreciation from SAWRD20. Regulatory depreciation (the return of assets, which accounts the expected wear and tear over the life of the infrastructure) and the RAB are closely interrelated components of the regulated revenue allowance. Regulatory depreciation is directly affected by the value of the RAB which is, in turn, affected by the way its value is rolled forward over time to reflect remaining asset lives, new capital expenditure and asset disposals.

⁵⁶⁰ This approach was selected to align with the original price basis of the RAB values within the 2013 Pricing Order (which were in December 2012 dollars). For instance, see Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 234, and Essential Services Commission of South Australia, *SA Water's water and sewerage services revenues 2013-14 to 2015-16 – Draft Determination – Statement of reasons*, p. 111, available at <https://www.escosa.sa.gov.au/ArticleDocuments/484/130206-SAWatersWaterSewerageRevenue.pdf.aspx?Embed=Y>.

12.5 Draft decision

The Commission's draft decision is to apply a roll-forward methodology to the RAB, in order to determine the opening RAB values for the commencement of the SAWRD24 period. The draft decision rolls forward the RAB using December 2022 CPI inflation and has included prudent and efficient benchmark net capital expenditure for SAWRD20 (as outlined in Chapter 11).

The Commission's draft decision for the opening values of the RAB are as follows:

- ▶ the value of the RAB at 1 July 2024 (\$Dec22) will be \$9,630 million for water retail services, and
- ▶ the value of the RAB at 1 July 2024 (\$Dec22) will be \$4,882 million for sewerage retail services.

Table 12.2: Opening RAB values as at 1 July 2024 (\$Dec22)

	Draft decision (\$m)
Water retail services	9,630
Sewerage retail services	4,882

13 Regulatory rate of return

Draft decision – Regulatory Rate of Return

The Commission has determined that the regulatory rate of return, calculated based on market data as of 14 November 2023, to apply for the purposes of calculating the maximum revenue for water and sewerage retail services for SAWRD24, is:

- ▶ 3.77 percent (real, post-tax) for 2024-25
- ▶ 3.89 percent (real, post-tax) for 2025-26
- ▶ 4.06 percent (real, post-tax) for 2026-27, and
- ▶ 4.23 percent (real, post-tax) for 2027-28.

These are the Commission’s draft estimates of the real, post-tax costs of capital required that a benchmark, efficient entity would require to provide water and sewerage retail services. These rate of return estimates will be updated for the final decision. The Commission’s methodology adopted for the draft decision is similar to the methodology adopted in SAWRD20.

13.1 Introduction

The regulatory rate of return (**rate of return**) is a measure of the opportunity cost of investment in regulated assets. The Commission determines an estimate of this, with reference to the efficient cost of financing the new and existing regulated assets that would be incurred by a benchmark efficient water and sewerage utility with a similar degree of risk to SA Water.

The rate of return is a key input in calculating the revenue requirement for SA Water. Movements in the rate of return result from changes in economic and market conditions that SA Water cannot mitigate. Those movements can have a significant impact on SA Water’s allowed revenues, given the capital-intensive nature of SA Water’s regulated business and the fact that the return on regulated assets accounts for a material share of the calculated total efficient costs.

In determining the rate of return, the Commission must estimate the cost of capital carefully. If it is too high, customers would pay too much, and SA Water could be encouraged to over-invest. If too low, SA Water’s incentive and ability to invest may be weakened.

The rate of return will be updated for its application to the Final Determination. It will utilise financial market data available to 30 March 2024.

13.2 SA Water’s proposal

As outlined in its Regulatory Business Proposal (**RBP**), SA Water’s proposed methodology for the rate of return is consistent with the Commission’s methodology applied in SAWRD20.⁵⁶¹

SA Water’s proposal is consistent with the Commission’s Guidance Paper 3,⁵⁶² as outlined in Table 13.1 below.

⁵⁶¹ SA Water, Regulatory Business Plan 2024-28, pp. 263-265.

⁵⁶² Essential Services Commission of South Australia, *SA Water Regulatory Determination 2024: Guidance paper 3*, p. 13.

13.3 Matters raised in consultation

Stakeholder submissions did not provide comments on the Commission's rate of return methodology.

13.4 Commission analysis

13.4.1 Summary and comparison against SA Water's proposal

Table 13.1 provides a summary of SA Water's proposed methodology and compares it with the Commission's draft decision for the methodology to be applied for SAWRD24 (differences are marked in **bold** text).

Table 13.1: SA Water's proposed methodology compared with the Commission's draft decision

Parameter	SA Water's proposal	Draft Determination
Risk-free rate	Estimated using the annualised yield on 10-year Australian Government Securities. A 60-day averaging period to be applied.	Estimated using the annualised yield on 10-year Australian Government Securities. A 60-day averaging period to be applied.
Beta	An equity beta of 0.67 to be applied.	An equity beta of 0.67 to be applied.
Market risk premium	A market risk premium of 6.0% to be applied.	A market risk premium of 6.3% to be applied.
Cost of debt	Estimated using a 10-year trailing average of a 10-year BBB rated bond.	Estimated using a 10-year trailing average of a 10-year BBB rated bond.
Debt-raising costs	Debt-raising costs of 0.125% to be applied.	Debt-raising costs of 0.125% to be applied.
Gearing	A gearing ratio of 60% to be applied.	A gearing ratio of 60% to be applied.
Long term inflation expectations	A 10-year term of Consumer Price Index inflation is adopted, and is calculated as the geometric mean of: <ul style="list-style-type: none"> ▶ Reserve Bank of Australia trimmed mean inflation forecasts for the first two years of the regulatory period ▶ A glide path from the end of year two to 2.5% at year seven, and ▶ 2.5% for the remaining three years. 	A 10-year term of Consumer Price Index inflation is adopted, and is calculated as the geometric mean of: <ul style="list-style-type: none"> ▶ Reserve Bank of Australia Consumer Price Index inflation forecasts for the first two years of the regulatory period ▶ A glide path from the end of year two to 2.5% at year four, and ▶ 2.5% for the remaining six years.

The methodologies are quite similar. Taken at face value, if both methodologies were applied to market data as of 14 November 2023, the Commission's methodology would lead to an annual average rate of return for SAWRD24 of 3.99 percent compared with 3.89 percent resulting from SA Water's proposed methodology. The difference is minor and reflects two parameters: the market risk premium and long-term inflation expectations.⁵⁶³ For both of these parameters, the Commission has proposed minor

⁵⁶³ The draft decision for the market risk premium recognises that the Commission sees benefit in reviewing multiple sources of information for a parameter that is not uniformly calculated among economic regulators, and that historical data quality may, in some respects, be better measured from 1958 onwards. The draft

changes to the approaches that were previously adopted in SAWRD20. More information on the draft decisions for both of these parameters, along with all other parameters, is provided later in this chapter.

13.4.2 Methodology

Consistent with previous regulatory determinations, the Commission has determined that for the purposes of the draft decision it will use a real, post-tax rate of return framework for developing the revenue determination for SAWRD24.

This is applied on the basis of a benchmark efficient water and sewerage utility with a similar degree of risk to SA Water.

A weighted average cost of capital (**WACC**) is calculated using the following formula:

$$WACC_{real}^{post-tax} = \frac{1 + \left(k_e \frac{E}{V} + k_d \frac{D}{V}\right)}{1 + i_{exp}} - 1$$

where:

k_e	=	nominal cost of equity
k_d	=	nominal cost of debt
i_{exp}	=	adjustment for expected long-term inflation
E	=	market value of equity
D	=	market value of debt
V	=	market value of the firm (V=E+D)

The Commission's use of a real rate of return framework allows SA Water to receive a real return on capital in its allowed cash flows and to receive inflation compensation via indexation of the regulated asset base (**RAB**). The use of a post-tax framework has been carried forward from SAWRD20.⁵⁶⁴

The Commission sets the real, post-tax vanilla WACC for the rate of return for each year of the four-year regulatory period. The use of a weighted average of debt and equity allows for the relative risks involved in the overall return. The vanilla formulation reflects expected returns to debt holders pre-tax and expected returns to equity holders post company tax. This approach has been applied consistently over recent regulatory determinations and submissions have not suggested a methodology change.

The Commission's methodology is guided by both National Water Initiative (**NWI**) Pricing Principles, which state that the rate of return should be developed using the WACC with the cost of equity derived using the capital asset pricing model (**CAPM**),⁵⁶⁵ and the Commission's own rate of return principles, utilised in both SAWRD16 and SAWRD20 (see Box 13.1 below).⁵⁶⁶

decision for estimating long-term inflation expectations proposes a shortened glide path in recognition of macroeconomic conditions.

⁵⁶⁴ Previous Pricing Orders specified that a post-tax rate of return framework should be applied. Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

⁵⁶⁵ NWI Pricing Principles, Principle 1: Cost recovery for new capital expenditure, 2004, clause 15.

⁵⁶⁶ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, March 2015, pp. 21-23, available at <https://www.escosa.sa.gov.au/ArticleDocuments/424/20150331-SAWaterRegulatoryRateReturn2016-2020-Rep.pdf.aspx?Embed=Y>.

The Commission's rate of return principles are consistent with, and give effect to, the requirements of the *Essential Services Commission Act 2002 (ESC Act)* and the *Water Industry Act 2012 (WI Act)* in the determination of the lowest sustainable cost of delivering water and sewerage services and protecting consumers' long-term interests.⁵⁶⁷ Stakeholders have not suggested that the principles are no longer applicable or appropriate for the purposes of a regulatory determination to apply to SA Water. The Commission considers that its rate of return methodology is appropriate for SAWRD24.

The remainder of this chapter deals with each of the individual parameters and assumptions within the WACC calculation. The chapter outlines the Commission's draft decision in relation to all inputs into the calculation of the rate of return to apply for SAWRD24.

Box 13.1: Rate of Return Principles

In making the draft decision for SAWRD24, the Commission's methodology has been guided by the following principles for determining the rate of return for a benchmark efficient firm.

The principles are consistent with, and give effect to, the requirements of the ESC Act and WI Act. Explanations of how the principles give effect to the relevant Acts is outlined below each principle.

General principle: The rate of return should reflect the prudent and efficient financing strategy of an incumbent large water and sewerage utility, which minimises expected costs in the long term, on a risk-adjusted basis.

As discussed in the Commission's 2015 review on the rate of return, the rate of return should be based on the expected behaviour of a benchmark efficient entity, not those of SA Water. This is consistent with the promotion of economic efficiency.⁵⁶⁸

Minimising long-term costs is also consistent with the efficiency objective. Importantly, those costs should be considered on a risk-adjusted basis. A low-cost approach that may introduce significant financial risks to the regulated entity may create high costs for consumers in the long run (for example, the risk of financial distress or failure). The probability and consequence of those risks should be taken into account in determining what the prudent and efficient financing strategy is in the long term.⁵⁶⁹

Supporting principle 1: The rate of return should reflect a long-term obligation on the utility to provide reliable and secure water and sewerage services to consumers. It should not solely reflect the new entrant cost of capital.

As discussed in the Commission's 2015 review on the rate of return, the Commission has sought to be as explicit as possible, given the overall context of SAWRD24, in stating that the rate of return should not solely reflect a new entrant's cost, which would be driven largely by prevailing costs of capital. An incumbent regulated business may have legacy costs and it is appropriate for those costs to be recognised, particularly where the business cannot hedge against movements in those costs.⁵⁷⁰

Supporting principle 2: The rate of return should provide an incentive for SA Water to incur prudent and efficient investment in regulated assets and financing costs.

As discussed in the Commission's 2015 review on the rate of return, the Commission is committed to a regulatory approach that delivers incentives for regulated businesses to incur prudent and

⁵⁶⁷ For explanations of how the rate of return principles relate to the statutory framework, see Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, March 2015, p. 23.

⁵⁶⁸ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 23.

⁵⁶⁹ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 23.

⁵⁷⁰ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 23.

efficient expenditure, including capital expenditure. Its approach supports levels of capital expenditure at the lowest sustainable cost without compromising service levels.⁵⁷¹

Supporting principle 3: The approach to setting the rate of return should be based on consistent principles over time and should be predictable. It should change only to reflect material changes in evidence or regulatory practice.

As discussed in the Commission's 2015 review on the rate of return, to provide for regulatory certainty and predictability, the Commission committed to not changing the principles and approach to calculating the rate of return in future, unless there is compelling evidence that such a change is required. The Commission acknowledges that there may be occasions where best practice financing or regulatory practice changes in such a way that it is appropriate to reflect that in the methodology for calculating the regulatory rate of return. However, those changes should not occur frequently, and stability of approach should be preferred, to provide certainty to SA Water and consumers. Reducing regulatory risks can lead to lower costs to in the long run, and hence lower prices to consumers.⁵⁷²

Supporting principle 4: The assumed prudent financing strategy should not depend on the ownership of the regulated business (that is, the approach is indifferent to whether the entity is in Government or private ownership).

As discussed in the Commission's 2015 review on the rate of return, this principle explicitly states that ownership is irrelevant to the methodology for calculating SA Water's rate of return. The risks of providing water and sewerage services are different to the risks faced by the South Australian Government as a whole. Regulated revenues should be set with reference to the risks faced by SA Water, which supports prices remaining cost reflective.⁵⁷³

13.4.3 Gearing

The Commission has determined that for the purposes of the draft decision it will adopt a gearing ratio of 60 percent to apply.

The financing of a benchmark efficient water and sewerage utility is made up of debt and equity capital. The gearing ratio is a benchmark measure of the proportion of the RAB that is financed by debt. It is calculated as follows:

$$\text{Gearing} = \frac{D}{V} = 1 - \frac{E}{V}$$

where:

- E = market value of equity
- D = market value of debt
- V = market value of the firm ($V=E+D$)

⁵⁷¹ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 23.

⁵⁷² Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 24.

⁵⁷³ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, p. 24.

The level of gearing is inter-related with the credit rating of the benchmark efficient entity due to the effect of leverage risk on these parameters. For example, a firm that is more highly leveraged may have a lower credit rating due to its perceived higher risk.⁵⁷⁴

A gearing assumption of 60 percent has been applied consistently over time to regulatory determinations applying to SA Water.⁵⁷⁵ It has also been applied by other economic regulators to large, regulated water and sewerage utilities in Australia.^{576 577}

A gearing ratio of 60 percent corresponds to a credit rating in the BBB investment grade band (for example, BBB+, BBB or BBB-).⁵⁷⁸ This has previously been adopted by the Commission and other economic regulators as being representative of a benchmark efficient entity.⁵⁷⁹

The Commission's draft decision is that a 60 percent gearing assumption will provide an incentive for a benchmark efficient entity with a similar degree of risk to SA Water to adopt efficient gearing structures and prevent exposing consumers to excessive leverage risk.

13.4.4 Cost of equity

The nominal cost of equity is calculated using the CAPM. This is a model for determining investment returns and is commonly used by economic regulators.⁵⁸⁰ According to this model, only systematic risk affects the expected return required by the marginal equity investor (who determines the price of equity).⁵⁸¹ This is because the marginal equity investor would hold a well-diversified portfolio of equities, and a diversification strategy can remove firm-specific risk.

⁵⁷⁴ Standard & Poor's, *Guide to Credit Rating Essentials: What are credit ratings and how do they work*, pp. 1-15, available at https://www.spglobal.com/ratings/_division-assets/pdfs/guide_to_credit_rating_essentials_digital.pdf.

⁵⁷⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 208, Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, p. 121, 125, and Essential Services Commission of South Australia, *SA Water Regulatory Determination 2013*, p. 136.

⁵⁷⁶ For example, see Independent Pricing and Regulatory Tribunal, *Review of Prices for Sydney Water*, Final report, June 2020, p. 258, available at https://www.ipart.nsw.gov.au/sites/default/files/documents/final-report-review-of-prices-for-sydney-water-june-2020_0.pdf, and Independent Competition and Regulatory Commission, *Regulated Water and Sewerage Services Prices 2023-28*, Final report, May 2023, pp. 77-78, available at https://www.icrc.act.gov.au/_data/assets/pdf_file/0006/2215455/Regulated-water-and-sewerage-services-2023-28-final-report.pdf.

⁵⁷⁷ The results for, and analysis of, electric utilities support the use of a gearing assumption of 60 percent. See Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, February 2023, p. 84, available at https://www.aer.gov.au/system/files/AER%20-%20Rate%20of%20Return%20Instrument%20-%20Explanatory%20Statement%20-%202024%20February%202023_1.pdf. However, it is noted that a gearing assumption in relation to electric utilities need not mean that the same benchmark is equally applicable to a water and sewerage utility. For example, insofar as water and sewerage utilities may have longer asset lives than electricity networks, this could suggest a lower benchmark gearing assumption.

⁵⁷⁸ Ratings agencies can use slightly different labelling and classification systems for credit ratings. The Commission and other Australian economic regulators have adopted the Standard and Poor's classification of the BBB category to reflect the minimum investment grade.

⁵⁷⁹ It is typical for Australian economic regulators to pair a 60 percent gearing ratio with a credit rating in the BBB investment grade band. For example, Queensland Competition Authority, *Rate of return review*, July 2023, pp. 26-27, 36, available at https://www.qca.org.au/wp-content/uploads/2020/11/qca_rate-of-return-review_updated-report_2023.pdf.

⁵⁸⁰ For example, Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, February 2023, p. 41.

⁵⁸¹ Systematic risk generally relates to events that cause economic uncertainty that cannot be mitigated, or diversified, through management actions.

In this respect, the CAPM provides a model for estimating the cost of equity and providing compensation relating to risks outside of the control of the regulated entity, not those within its control. The use of CAPM is also a requirement under NWI Pricing Principles.⁵⁸²

The CAPM defines the cost of equity as the sum of the returns on a risk-free asset (the expected rate of return on an asset with practically no risk of default) and a risk premium that reflects the risks associated with equity.

The CAPM formula for the cost of equity is as follows:

$$k_e = R_f + \beta_E(E(R_m) - R_f)$$

where:

k_e	=	nominal cost of equity
R_f	=	nominal risk-free rate
β_E	=	equity beta
$E(R_m)$	=	expected return of the market
$E(R_m) - R_f$	=	market risk premium

The following sections outline each of the cost of equity parameters.

13.4.4.1 Risk-free rate

The Commission has determined that for the purposes of the draft decision it will adopt a risk-free rate of 4.47 percent.

The risk-free rate of return is the expected rate of return on an investment that has minimal risk. The Commission's draft decision is to calculate the risk-free rate using a 60-day average of the annualised yield of nominal 10-year Australian Government Securities (AGS).

There are three key considerations when estimating the risk-free rate. These are the type of security, the term to maturity, and the period over which time the risk-free rate of interest is estimated.

► Australian Government Securities

Government default risk is low in Australia, and it is common practice to refer to AGS as risk-free rate assets.⁵⁸³ Given this, the Commission deems AGS to be an appropriate proxy for the risk-free rate. This approach is consistent with that adopted by other economic regulators.⁵⁸⁴

⁵⁸² NWI Pricing Principles, Principle 1: Cost recovery for new capital expenditure, 2004, clause 15.

⁵⁸³ For instance, Australia's credit rating was confirmed as AAA grade by credit rating agencies Standard and Poor's on 30 January 2023; see Chalmers J, *Australia's AAA credit rating confirmed by S&P*, media release, 30 January 2023, available at <https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/australias-aaa-credit-rating-confirmed-sp>. The Reserve Bank of Australia will refer to AGS as risk-free assets. For example, see Kent C, *The Stance of Monetary Policy in a World of Numerous Tools*, Address to the IFR Australia DCM Roundtable Webinar, 20 October 2020, available at <https://www.rba.gov.au/speeches/2020/sp-ag-2020-10-20.html>. Further, according to an investor survey, 89 percent of respondents in 2022 calculated risk-free rates using AGS; see Chartered Accountants Australia and New Zealand, *Business Valuation Survey*, August 2022, p.12, available at <https://www.charteredaccountantsanz.com/news-and-analysis/insights/research-and-insights/2022-valuation-practice-survey-insights>.

⁵⁸⁴ For example, see Independent Competition and Regulatory Commission, p. 78.

► **Term to maturity**

While there can be reasons to adopt a term to maturity for AGS of less than ten years (for example, by applying a 4-year term to maturity to match the length of the regulatory period),⁵⁸⁵ the Commission's draft decision adopts a 10-year term to maturity on AGS on the basis that it is the longest available term to maturity that is also recognised as having sufficient liquidity. In that regard, the 10-year term to maturity approximates the long-lived nature of water and sewerage assets and also recognises the limited liquidity of AGS beyond a 10-year term.⁵⁸⁶ The majority of Australian economic regulators adopt a 10-year term to maturity on AGS.⁵⁸⁷

► **Averaging period**

Historically, research has suggested that few, if any, forecast approaches for financial variables, including bond yields, have been able to consistently improve upon a 'random walk' model. The random walk model assumes that increases and decreases are equally likely over the forecast horizon and therefore a no-change assumption for certain financial variables should be followed.⁵⁸⁸

Consistent with this, most Australian economic regulators apply the no-change assumption to forecast the risk-free rate over the regulatory horizon (referred to as the 'on the day rate'), though they allow a short-term average of recent observations (typically calculated over a twenty to sixty business day period) to lower the risk that pricing anomalies on any particular day might affect the calculation used in the regulatory determination.⁵⁸⁹

Previous Commission research from 2019 suggested that there is limited difference in accuracy between selecting an averaging period of between 20 and 60 days (which is the typical range of averaging periods selected by economic regulators).⁵⁹⁰ The Commission proposes to maintain an averaging period of 60 days.

13.4.4.2 Market-risk premium

The Commission has determined that for the purposes of the draft decision it will adopt a market risk premium of 6.3 percent.

The market risk premium reflects the return an investor would expect to earn over and above the risk-free rate (as measured by AGS) by holding a well-diversified portfolio of assets. It is a measure of investors' expectations about how much risk there is in the market and the price that investors place on that risk. The market risk premium parameter is not directly observed because, conceptually, the parameter incorporates expectations of future share market returns.⁵⁹¹

⁵⁸⁵ For example, securities of less than 10-year term to maturity tend to have higher levels of liquidity. Also, investors may value a regulated business as a series of four-year revenue streams (analogous to a four-year government bond that matches the four-year regulatory period).

⁵⁸⁶ Australian Office of Financial Management, *Ultra-long end of the Treasury Bond Market*, Investor Insight Issue 6, January 2021, pp. 1-9, available at https://www.aofm.gov.au/sites/default/files/2021-01-28/AOFM%20Investor%20Insight%20issue%206_V2.pdf.

⁵⁸⁷ For example, Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, p. 105.

⁵⁸⁸ Duffee G, *Forecasting interest rates*, Chapter 7 in 'Handbook of Economic Forecasting', volume 2A, edited Elliott and Timmermann, 2013, Amsterdam, Elsevier.

⁵⁸⁹ For example, Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, pp. 105-130.

⁵⁹⁰ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020: Guidance Paper 7 (technical paper)*, June 2019, pp. 1-17, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21676/20190606-SAWRD20-GuidancePaper7-AveragingPeriodRiskFreeCostBorrowing.pdf.aspx?Embed=Y>.

⁵⁹¹ For example, Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, pp. 130-132.

To estimate the market risk premium for the purposes of SAWRD24, the Commission sees benefit in consulting multiple sources, given the wide range of potential academic approaches to estimating it and a lack of a uniform methodology used by Australian economic regulators.⁵⁹²

The Commission's draft decision is in line with the market risk premiums adopted by other Australian economic regulators (see table 13.2 below). It is also consistent with investor surveys and is close to the historic excess returns observed in Australia. Market-implied estimates have been considered but not used given their limitations (which are noted in detail later).

Regulatory decisions

The table below shows recent market risk premium decisions made by economic regulators in other jurisdictions. As can be seen, values have ranged from between 6.0 and 6.5 percent (see Table 13.2). The Commission's draft decision lies near the midpoint of this range.

Table 13.2: Market risk premium decisions across jurisdictions⁵⁹³

Regulator	Year	Market risk premium (%)
AER ⁵⁹⁴	2023	6.2
ERA ⁵⁹⁵	2022	6.1
ICRC ⁵⁹⁶	2023	6.3
OTTER ⁵⁹⁷	2022	6.0
QCA ⁵⁹⁸	2022	6.5

⁵⁹² For example, researchers from the Federal Reserve Bank of New York have previously (in 2015) estimated twenty prominent models of the market risk premium used by practitioners and featured in academic literature. While those models were estimated in the context of markets in the United States, the research highlights that there can be a wide range of possible methods to estimating this particular type of parameter. See Duarte F and C Rosa, *The Equity Risk Premium: A Review of Models*, Staff Report No 714, February 2015, available at https://www.newyorkfed.org/research/epr/2015/2015_epr_equity-risk-premium. Consistent with the wide range of possible approaches, in Australia a 2022 survey from Chartered Accountants Australia and New Zealand indicated that 41 percent of respondents used their own in-house models to estimate the market risk premium, 29 percent calculated it from historic observed returns, 58 percent used academic and/or university sources, and 28 percent did not specify. Chartered Accountants Australia and New Zealand, p. 13.

⁵⁹³ Note that the Independent Pricing and Regulatory Tribunal calculates the market risk premium as the midpoint of the current market risk premium (based on market-implied estimates from dividend discount models) and historical excess returns.

Independent Pricing and Regulatory Tribunal, p. 258. For the review of Sydney water prices in 2020, this equated to the midpoint of 9.7 percent and 6.0 percent, resulting in a higher market risk premium than other economic regulators. The current market risk premium is influenced by the output from dividend discount models.

⁵⁹⁴ Australian Energy Regulator, Rate of Return Instrument: Explanatory Statement, pp. 130-131.

⁵⁹⁵ Economic Regulation Authority, *Explanatory statement for the 2022 final gas rate of return instrument*, December 2022, p. 129, available at <https://www.erawa.com.au/cproot/23028/2/2022-Final-Gas-Rate-of-Return-Instrument-Explanatory-Statement--To-publish.pdf>.

⁵⁹⁶ Independent Competition and Regulatory Commission, p. 81.

⁵⁹⁷ Office of the Tasmanian Economic Regulator, *Investigation into TasWater's prices and services for the period 1 July 2022 to 30 June 2026*, Final report, May 2022, p. 76, available at <https://www.economicregulator.tas.gov.au/water/pricing/price-determination-investigations/2022-water-and-sewerage-price-determination-investigation>.

⁵⁹⁸ Queensland Competition Authority, *Seqwater bulk water price review 2022-26*, March 2022, p. 64, available at <http://www.qca.org.au/wp-content/uploads/2022/04/seqwater-review-qca-final-report.pdf>.

Investor surveys

In making its decision in relation to the market risk premium, the Commission has considered values taken from investor surveys since 2018, with the most median values estimated for the market risk premium being between 6.0 and 6.3 percent.⁵⁹⁹ The most recent available survey, undertaken in June 2022 by Chartered Accountants Australia and New Zealand, indicated that ‘most Australian respondents adopted a market risk premium of 6.0 to 6.9%’.⁶⁰⁰

There are, however, limitations in utilising investor surveys. For example, the raw results are rarely published, and the robustness of the survey design is not always transparent.⁶⁰¹ As such, the Commission considers investor surveys as a form of cross-check to other sources and methods. The results of recent investor surveys support the Commission’s draft decision for the market risk premium to be set at 6.3 percent.

Historical excess returns

The historical excess returns method assumes that it is difficult to improve upon a long-run average of past returns when making long-term forecasts of the additional return investors expect to receive from equities relative to that returned from AGS. It is a transparent and objective method.

Between 1958 and 2022, the arithmetic average of excess equity returns relative to AGS in Australia was 6.6 percent.⁶⁰² Despite this value exceeding those indicated by surveys and economic regulatory decisions, it remains close to the Commission’s draft decision of 6.3 percent.

For previous determinations, the Commission used data dating back to 1883 to inform the market risk premium estimate. This represented the longest time period of historical equity returns available. An advantage of using that dataset is that, due to its length, the arithmetic average will be less influenced by any one market cycle or single economic shock, relative to other shorter time periods. However, the measurement of data prior to 1958 has limitations and is not necessarily comparable to data from 1958 onwards. In particular, historical series developed prior to 1958 have typically excluded non-dividend paying shares, thus requiring a subjective adjustment to be made (consequently adding to uncertainty in the market risk premium estimate).^{603,604} Research undertaken by the Reserve Bank of Australia (RBA) in 2019 reiterated this potential shortcoming.⁶⁰⁵ Many Australian economic regulators do not use data from prior to 1958 in their review of historical excess returns.⁶⁰⁶

⁵⁹⁹ Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, p. 162.

⁶⁰⁰ Chartered Accountants Australia and New Zealand, p. 13.

⁶⁰¹ Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, p. 154.

⁶⁰² Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement*, p. 159. The underlying data source is a series that has been developed by T Brailsford, J Handley and K Maheswaran.

⁶⁰³ Brailsford T, Handley J and K Maheswaran, *Re-examination of the historical equity risk premium in Australia*, 2008, *Accounting and Finance* 48 (2008), pp. 73–97.

⁶⁰⁴ For SAWRD20, the Commission provided consideration to the dataset developed by Brailsford, Handley and Maheswaran as well as an alternative dataset developed by NERA Economic Consulting. NERA Economic Consulting had built upon the Brailsford, Handley and Maheswaran data series by making adjustments to some of the older data observations. However, post-1958, both datasets converge, so there is limited benefit in using the NERA Economic Consulting dataset going forward. Economic Regulation Authority, *Explanatory statement for the 2022 final gas rate of return instrument*, p. 134.

⁶⁰⁵ Mathews T, *A History of Australian Equities*, RBA Research Discussion Paper, RDP 2019-04, 2019, p. 8, available at <https://www.rba.gov.au/publications/rdp/2019/pdf/rdp2019-04.pdf>.

⁶⁰⁶ For example, the Economic Regulation Authority discontinued using data from prior to 1958. One reason given for doing so was due to the methodological issues associated with the dividend component of total returns. Economic Regulation Authority, p. 133.

For SAWRD24, the Commission considered data from 1958 onwards (noting that 1958 marked the beginning of the daily calculation of the Sydney All Ordinaries index). Samples from 1958 onwards are regarded by several economic regulators to be the longest period available of high-quality data⁶⁰⁷ and the Commission considers that this sample provides a balance between a large number of historical observations and data quality.

It is important to note that there are limitations of the historical excess returns method that prevent it from being the sole source used to estimate the market risk premium. Limitations include that its estimates may be biased upwards due to structural factors (for example, due to technology change and the liberalisation of financial markets)⁶⁰⁸ and may be volatile (limiting credibility⁶⁰⁹ and their use in forecasting). Also, it is a backward-looking method, yet, as mentioned at the outset, the market risk premium is a forward-looking (expectations) concept.

Below is a summary of the sources used to inform the determination of the market risk premium for the draft decision.

Table 13.3: Sources used to inform the market risk premium

Sources	Market risk premium
Other economic regulatory decisions	6.0 – 6.5
Key results from investor surveys	6.0 – 6.3
Historical excess returns (since 1958)	6.6
Historical excess returns (since 1988)	6.2
Historical excess returns (since 1883)	6.3
Historical excess returns (since 1937)	6.1
Draft decision	6.3

Market-implied estimates

The Commission has reviewed market-implied estimates, as published by the AER in February 2022. Market-implied estimates (such as dividend growth models) have the advantage of being forward-looking, in comparison to the backward-looking historical excess return approach. Estimates indicate that two stage and three stage dividend discount models varied between 6 and 10 percent between 2019 and 2021.⁶¹⁰ Recent estimates indicate a range between 5 percent and 5.8 percent.⁶¹¹

⁶⁰⁷ For example, Queensland Competition Authority, *Rate of return review*, pp. 60-61, and Economic Regulation Authority, pp. 133-134. It is noted that the RBA's dataset of historical equity risk premium data was published in 2019; however, to date, this set of data has not been utilised specifically for economic regulatory purposes.

⁶⁰⁸ This may be due to survivorship bias and structural changes in financial markets, see Damodaran A, *Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2012 Edition*, Stern School of Business, March 2012, p. 24, available at <https://pages.stern.nyu.edu/~adamodar/pdfiles/papers/ERP2012.pdf>.

⁶⁰⁹ This is based on the finding that the realised market risk premium has historically been estimated to be large and volatile, in the context of standard economic models that describe investor behaviour; see Mehra and Prescott, 'The Equity Premium: A puzzle', *Journal of Monetary Economics*, 15, 1985, pp. 145–161, available at <https://www.academicwebpages.com/preview/mehra/pdf/The%20Equity%20Premium%20A%20Puzzle.pdf>.

⁶¹⁰ Australian Energy Regulator, Rate of Return Instrument: Explanatory Statement, p. 160.

⁶¹¹ Ibid, p. 160.

A key limitation of market-implied estimates is that its output is highly sensitive to (contestable) assumptions made, particularly the long-term growth rate. Dividend growth models add complexity to estimating the market risk premium too.⁶¹²

For these reasons, together with a lack of compelling new evidence since SAWRD20 to support their use, while the Commission has had regard to recent market-implied estimates, along with other market data (including indicators of economic uncertainty, dividends and credit spreads), this particular methodology will not be adopted to estimate the market risk premium for SAWRD24.

13.4.4.3 Equity beta

The Commission has determined that for the purposes of the draft decision it will apply an equity beta of 0.67.

The equity beta parameter measures the riskiness of a firm's returns compared with that of the market. The higher the equity beta, the more exposure to undiversifiable risk inherent to the market, reflecting the impact of economic, geopolitical and financial factors. Utility companies typically have an equity beta less than one, indicating that their returns are less volatile than the overall market. Similarly, regulated entities also will typically have an equity beta less than one, as they are protected from some risks that non-regulated entities are exposed to.⁶¹³

Equity beta for private or government-owned companies, like SA Water, cannot be directly estimated from financial markets. Instead, in deriving this parameter for regulatory purposes, regulators will often select a comparator set of publicly listed companies (from domestic or international markets and/or similar or different industries) that have a similar risk profile to the private or government-owned utility in question and regulators will use those comparator companies to derive an estimate of equity beta.

For water and sewerage companies in Australia, regulators have sometimes used international comparators (for example, from the United Kingdom) and/or domestic comparators from different industries (for example, referencing equity betas set for energy utility companies).⁶¹⁴

The Commission's current equity beta of 0.67 is proposed to remain unchanged, given its consistency with decisions made by economic regulators elsewhere in Australia (presented in Table 13.4). It should also be noted that stakeholders have not proposed change to this parameter. The values outlined in Table 13.4 are similar to those at the time of the last determination for most economic regulators.

Table 13.4: Equity beta decisions across jurisdictions.

Regulator	Year	Industry	Equity β
AER ⁶¹⁵	2023	Energy	0.60
ERA ⁶¹⁶	2022	Gas	0.70

⁶¹² Ibid, p. 146.

⁶¹³ For example, as noted in Chapter 7, in theory, and assuming full information and no regulatory lags, under a total fixed revenue cap a regulated firm, such as SA Water, is not exposed to volume risk. This reflects that a firm could adjust prices in response to changes in demand to keep revenue constant and within the fixed revenue cap.

⁶¹⁴ For example, Queensland Competition Authority, *Rate of return review*, p. 72, Independent Pricing and Regulatory Tribunal, *Review of Prices for Sydney Water*, p. 258, Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 221-223, and Independent Pricing and Regulatory Tribunal, *Estimating equity beta*, Fact Sheet, 1 April 2019, pp. 1-9, available at <https://www.ipart.nsw.gov.au/sites/default/files/documents/fact-sheet-estimate-equity-beta-1-april-2019.pdf>.

⁶¹⁵ Australian Energy Regulator, Rate of Return Instrument: Explanatory Statement, p. 171.

⁶¹⁶ Economic Regulation Authority, p. 167.

Regulator	Year	Industry	Equity β
ICRC ⁶¹⁷	2023	Water	0.70
IPART ⁶¹⁸	2020	Water	0.70
OTTER ⁶¹⁹	2022	Water	0.65
QCA ⁶²⁰	2022	Water	0.77

13.4.5 Cost of debt

The cost of debt is comprised of the cost of debt itself and debt raising costs. The cost of debt is calculated from the yield on a 10-year BBB corporate bond.

$$k_d = \text{Cost of debt} + \text{debt raising costs}$$

where:

$$k_d = \text{nominal cost of debt}$$

13.4.5.1 Cost of debt

The Commission has determined that for the purposes of the draft decision it will use a 10-year trailing average approach. This results in cost of debt values for each of the next four years (excluding debt raising costs) as follows:

- ▶ 4.97 percent for 2024-25
- ▶ 5.18 percent for 2025-26
- ▶ 5.46 percent for 2026-27, and
- ▶ 5.75 percent for 2027-28.

The Commission sets the cost of debt for each year of the four-year regulatory period and does not update the cost of debt annually during the regulatory period. This has been consistent with previous Pricing Orders.⁶²¹

The trailing average approach recognises that a business may not finance all of its debt around the same time, so holding a portfolio of debt with staggered maturity dates and the possibility to use products to hedge interest rate exposure represents a potential efficient debt financing strategy. The trailing average approach aims to be reflective of the debt management approaches of an efficient private benchmark entity.⁶²² The long tenor of the bonds (a 10-year term to maturity) approximates the long lives of regulated water and sewerage assets.

⁶¹⁷ Independent Competition and Regulatory Commission, p. 83.

⁶¹⁸ Independent Pricing and Regulatory Tribunal, p. 257.

⁶¹⁹ Office of the Economic Regulator, p. 95.

⁶²⁰ Queensland Competition Authority, *Seqwater bulk water price review 2022-26*, p. 65.

⁶²¹ Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

⁶²² The Australian Energy Regulator has continued its use of the trailing average method, noting that it was unclear whether a benchmark business would find it efficient to increase debt raising significantly beyond 10 percent in a year. AER, *Rate of Return Instrument: Explanatory Statement*, p. 235.

In practice, the 10-year trailing average approach to the cost of debt assumes that approximately one-tenth of the benchmark efficient entity's total debt is refinanced each year, and that the assumed cost of debt for a single year is the average of long-term financing costs over that year and each of the preceding nine years. This is a common approach among most Australian economic regulators.⁶²³

A credit rating of BBB is adopted as the benchmark cost of debt. Selecting BBB reflects that the gearing assumption (of 60 percent) points to a credit rating in this band,⁶²⁴ and that data are publicly available for this particular investment band (estimates of the cost of debt for BBB corporate securities are published by the RBA⁶²⁵).⁶²⁶

The Commission calculates the cost of debt by holding constant the latest available observation over the regulatory period and calculating the trailing average. The table below shows an example of this calculation. As can be seen in Table 13.5, the cost of debt is increasing. This is due to the most recent observation, which is held constant for the regulatory period being higher than the average corporate BBB yield over the preceding nine years. This is the case for all years of the regulatory period.

Table 13.5: Calculation of 10-year trailing average of corporate BBB rated bond yields

BBB corporate securities yield (%)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
July	5.01	4.27	4.35	4.58	3.22	2.78	2.52	5.97	6.56	7.29	7.29	7.29	7.29
August	5.07	4.10	4.36	4.38	2.86	2.77	2.75	6.84	6.51	7.29	7.29	7.29	7.29
September	5.32	4.20	4.46	4.53	2.89	2.61	3.17	7.14	6.85	7.29	7.29	7.29	7.29
October	5.28	4.47	4.18	4.52	3.01	2.54	3.81	7.24	7.29	7.29	7.29	7.29	7.29
November	5.41	4.94	4.16	4.69	2.88	2.30	3.74	6.83	7.29	7.29	7.29	7.29	7.29
December	5.45	4.93	4.28	4.63	3.10	2.29	3.81	7.00	7.29	7.29	7.29	7.29	7.29
January	5.57	4.79	4.31	4.53	2.58	2.32	4.06	6.38	7.29	7.29	7.29	7.29	7.29
February	5.57	4.63	4.29	4.32	2.50	3.11	4.70	6.56	7.29	7.29	7.29	7.29	7.29

⁶²³ For example, AER, *Rate of Return Instrument: Explanatory Statement*, p. 235. An exception is Economic Regulation Authority, pp. 56-95.

⁶²⁴ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 215.

⁶²⁵ As published by the RBA in statistical table F3, available at <https://www.rba.gov.au/statistics/tables/#interest-rates>.

⁶²⁶ Note, as mentioned earlier, that some economic regulators, such as the Australian Energy Regulator and Economic Regulation Authority, will use data on the yields of BBB+ corporate bonds when estimating the benchmark cost of debt, which will typically require interpolation. See Australian Energy Regulator *Rate of Return Instrument: Explanatory Statement* p. 194, and Economic Regulation Authority, p. 79.

BBB corporate securities yield (%)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
March	5.23	4.61	4.37	3.94	3.80	3.15	5.42	6.31	7.29	7.29	7.29	7.29	7.29
April	4.97	4.47	4.46	3.93	3.97	3.02	5.96	6.16	7.29	7.29	7.29	7.29	7.29
May	4.79	4.25	4.49	3.68	3.58	3.21	6.21	6.38	7.29	7.29	7.29	7.29	7.29
June	4.65	4.41	4.49	3.42	3.32	3.03	6.89	6.65	7.29	7.29	7.29	7.29	7.29
Annual average	5.19	4.51	4.35	4.26	3.14	2.76	4.42	6.62	7.13	7.29	7.29	7.29	7.29
10-year trailing average – 2024-25 (2015-16 to 2024-25)										4.97			
10-year trailing average – 2025-26 (2016-17 to 2025-26)											5.18		
10-year trailing average – 2026-27 (2017-18 to 2026-27)												5.46	
10-year trailing average – 2027-28 (2018-19 to 2027-28)													5.75

13.4.5.2 Debt raising costs

The Commission has determined that for the purposes of the draft decision it will apply 12.5 basis points for debt-raising costs.

The debt-raising cost allowance reflects the efficient transaction costs associated with raising debt financing in the corporate bond market (for example, the direct costs of underwriting fees, legal and registry fees and company credit rating fees).⁶²⁷ These direct financing costs could be reasonably expected for any prudent and efficient utility that issues corporate securities as part of its portfolio of debt. The Commission proposes to maintain its current estimate for debt-raising costs of 12.5 basis points. This decision falls within the range of recent regulatory decisions made in other jurisdictions, which have been between 0.08 percent and 0.165 percent (as shown in Table 13.6).

⁶²⁷ For a detailed explanation of debt-raising costs, see Economic Regulation Authority, pp. 193-210.

Table 13.6: Debt raising cost decisions across jurisdictions

Regulator	Year	Debt-raising costs (%)
AER	N/A	N/A ⁶²⁸
ERA	2022	0.165 ⁶²⁹
ESCV	2021	0.15 ⁶³⁰
ICRC	2023	0.108 ⁶³¹
IPART	2018	0.125 ⁶³²
OTTER	2022	0.08 ⁶³³
QCA	2023	0.10 ⁶³⁴

13.4.6 Long-term inflation expectations

The Commission has determined that for the purposes of the draft decision it will apply an estimate for long-term inflation expectations of 2.66 percent.

The Commission's WACC methodology requires an estimate of long-term inflation expectations to deflate the nominal rate of return in order to derive a real rate of return.

Economic regulators tend to have varying approaches to estimating long-term inflation expectations, but broadly adopt a similar structure.

A common structure used by economic regulators in Australia (including the Commission) when calculating the estimate, involves the following three key components:

- ▶ the term of inflation expectations
- ▶ the use of any short-term forecasts (used to infer what might be a reasonable indication of short-term inflation expectations), and
- ▶ the length of the time expected for Consumer Price Index (CPI) inflation to return to an anchor point (typically the mid-point of the RBA's target inflation band of between 2 and 3 percent).⁶³⁵

The parameter is ultimately calculated as a geometric average of the estimates of inflation expectations for each year of the term.

⁶²⁸ The Australian Energy Regulator provides for a separate debt-raising cost allowance as part of the operating expenditure allowance. Australian Energy Regulator, *Rate of Return Instrument: Explanatory Statement* p. 47.

⁶²⁹ Economic Regulation Authority, p. 207.

⁶³⁰ Essential Services Commission of Victoria, *2023 water price review – guidance paper*, October 2021, p. 40, available at <https://www.esc.vic.gov.au/sites/default/files/documents/2023-water-price-review-guidance-paper-20211026.pdf>.

⁶³¹ Independent Competition and Regulatory Commission, p. 86.

⁶³² Independent Pricing and Regulatory Tribunal, *Review of our WACC method*, February 2018, p. 24, available at https://www.ipart.nsw.gov.au/sites/default/files/documents/final-report-review-of-our-wacc-method-february-2018_0.pdf.

⁶³³ Office of the Economic Regulator, p. 76.

⁶³⁴ Queensland Competition Authority, *Rate of return review*, p. 50.

⁶³⁵ Australian Energy Regulator, *Regulatory treatment of inflation*, Final position, pp. 1-110, December 2020, available at <https://www.aer.gov.au/system/files/AER%20-%20Final%20position%20paper%20-%20Regulatory%20treatment%20of%20inflation%20-%20December%202020.pdf>.

Term of inflation expectations

The term of inflation expectations refers to the number years for which inflation expectations are being estimated. The Commission proposes to continue to use a 10-year term.

Many Australian economic regulators⁶³⁶ have recently adopted a ‘term-matching’ approach, which is where the term of inflation expectations is equal to the length of the regulatory period (that is, typically four or five years). Common reasoning given for doing so is that it may allow the estimate of long-term inflation expectations to closely match the amount of actual inflation over the period. Although there has been a move by economic regulators towards using a term-matching approach to inflation expectations, it is not clear in the Commission’s view that doing so necessarily improves the estimation of the parameter. This can depend on the size and type of macroeconomic shock and the size of the deviation away from the RBA’s 2 to 3 percent target band. The Commission’s previous decisions have selected a term of 10 years because it closely aligns with the inflation expectations embedded within the risk-free rate (noting that the risk-free rate is estimated using a 10-year AGS).

Both potential approaches have advantages and disadvantages, and the Australian Energy Regulator (AER) noted in 2020 that either term could be valid and reasonable.⁶³⁷

Short-term forecast

The Commission uses the latest available RBA forecasts for CPI inflation (which tend to be for the first two years of the regulatory period, 2024-25 and 2025-26).⁶³⁸ The Commission proposes to maintain this approach for SAWRD24, noting it is common practice among other Australian economic regulators.⁶³⁹ The Commission considers the RBA to be a credible institution (and its forecasts to be robust), while noting that the RBA does not provide CPI inflation forecasts further out than two years into the future.

Glide path

The glide path approach recognises there can be a degree of uncertainty over the timing of the recovery path for inflation, which can affect household, firm and investor expectations about inflation in the short to medium term. At the same time, the glide path approach recognises that most available evidence suggests that the flexible inflation targeting framework pursued by the RBA has anchored long-term inflation expectations within the RBA’s two to three percent target band.⁶⁴⁰

⁶³⁶ Queensland Competition Authority, *Inflation forecasting*, October 2021, p. 9, available at <https://www.qca.org.au/wp-content/uploads/2021/10/inflation-forecasting-final-position-paper-october-2021.pdf>.

⁶³⁷ Australian Energy Regulator, *Regulatory treatment of inflation*, Final position, p. 38.

⁶³⁸ Note that the Commission used the RBA’s trimmed mean inflation in SAWRD20. Trimmed mean inflation is a trend measure that removes noise and can be a more appropriate measure of inflation when inflation is not stable between quarters. The Commission adopted this approach in SAWRD20 due to the COVID-19 outbreak at the time, and the temporary introduction of free childcare in June quarter 2020 that was expected to place downward pressure on year-end inflation. As these economic conditions have since subsided, the Commission proposes to revert to using CPI inflation for SAWRD24.

⁶³⁹ The Australian Energy Regulator, Essential Services Commission of Victoria, Independent Competition and Regulatory Commission and Queensland Competition Authority all use two years of RBA forecasts in their calculation method. The Independent Pricing and Regulatory Tribunal uses one year of RBA forecasts. See Australian Energy Regulator, *Regulatory treatment of inflation*, December 2020, pp. 54-55, Independent Competition and Regulatory Commission, pp. 86-87, Queensland Competition Authority, *Inflation forecasting*, pp. 17, and Independent Pricing and Regulatory Tribunal, *Review of our WACC method*, pp. 61-76, and Essential Services Commission of Victoria, *South East Water final decision*, June 2023, pp. 31-32, available at <https://www.esc.vic.gov.au/water/water-prices-tariffs-and-special-drainage/water-price-reviews/water-price-review-2023/south-east-water-price-review-2023>. (Note that the Essential Services Commission of Victoria also gives weight to the bond-breakeven approach in order to estimate long-term inflation expectations.)

⁶⁴⁰ Reserve Bank of Australia, *Statement on Monetary Policy*, November 2023, Graph 4.17, p. 53, available at <https://www.rba.gov.au/publications/smp/2023/nov/pdf/statement-on-monetary-policy-2023-11.pdf>.

For SAWRD20, the Commission adopted a glide path where inflation was not estimated to return to 2.5 percent for seven years, reflecting the large demand and uncertainty shock evident at the onset of the COVID-19 pandemic.⁶⁴¹

For SAWRD24, the Commission's draft decision is to adopt a shorter glide path, where CPI inflation is expected to take four years to return to the mid-point of the RBA's inflation target band. CPI inflation data supports this approach, in which inflation has infrequently been above or below 2.5 percent for greater than four years at a time.⁶⁴² The adoption of a four-year timeframe is consistent with other recent economic regulatory decisions⁶⁴³, with most economic regulators estimating inflation to return to the mid-point of the RBA target band within four to five years⁶⁴⁴.

The calculation of long-term inflation expectations can be seen in Table 13.7.

Table 13.7: Path for long-term inflation expectations

Financial year	Draft Decision for SAWRD24 (%)
2024-25	3.30 ⁶⁴⁵ (RBA forecast headline inflation)
2025-26	3.03 (RBA forecast headline inflation) ⁶⁴⁶
2026-27	2.77 (linear glide path)
2027-28	2.50 (midpoint of the RBA's target band)
2028-29	2.50
2029-30	2.50
2030-31	2.50
2031-32	2.50
2032-33	2.50
2033-34	2.50
Geometric average (%)	2.66

⁶⁴¹ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 223-229.

⁶⁴² On only one occasion over the last 30 years has inflation been above, or below, 2.5 percent for greater than approximately four years at a time.

⁶⁴³ For example, the Australian Energy Regulator, Essential Services Commission of Victoria, Independent Competition and Regulatory Commission and Queensland Competition Authority.

⁶⁴⁴ This is in line with the International Monetary Fund's inflation forecast for Australia for the upcoming the five-year horizon, in which it expects inflation to be 2.42 percent by the end of 2028. International Monetary Fund, *World Economic Outlook Database*, October 2023, available at: <https://www.imf.org/en/Publications/WEO/weo-database/2023/October>.

⁶⁴⁵ Reserve Bank of Australia, *Statement on Monetary Policy*, Forecast Table - November 2023, available at <https://www.rba.gov.au/publications/smp/2023/nov/forecasts.html>.

⁶⁴⁶ The RBA is expected to release their forecast for year-ended CPI inflation to June 2026 in February 2024. For the purposes of the Commission's draft determination, and noting that the RBA's forecast to June 2026 is not yet available, the linear glide path begins one year earlier.

Alternative methods to estimate long-term inflation expectations

In making its draft decision the Commission considered alternative approaches that could be utilised.

These include market-based approaches (such as the 10-year bond breakeven rate and the 10-year inflation swaps rate), surveys of professional forecasters' long-term inflation expectations, and econometric modelling. However, most economic regulators have acknowledged, and have previously provided evidence for, why these types of approaches have limitations that tend to make them non-preferred options for adoption in regulatory determinations.⁶⁴⁷

► Surveys

Surveys of professional forecasters' expectations of long-term inflation can be used to set, or inform, estimates of long-term inflation expectation. The use of surveys of market economists' expectations of average annual inflation are considered in central bank research as a useful way to gauge long-term inflation expectations, as they should be less influenced by temporary economic factors or financial market developments, and because professional forecasters are well informed.⁶⁴⁸ A practical issue is that the information in the survey is proprietary, which may restrict replicability and transparency. In SAWRD20, the Commission used surveys of professional forecasters as a guide and cross-check to inform its estimates.⁶⁴⁹ Currently, surveys of economists indicate that long-term inflation expectations remain anchored within the RBA's target band.⁶⁵⁰

► Bond-breakeven rate

The bond-breakeven rate is calculated as the difference in yields between nominal and inflation-indexed bonds. While the approach is a plausible methodology in certain circumstances and is sometimes supported on the basis that investors have large financial resources at stake and strong incentives to form accurate expectations of inflation, there are known time-varying premiums and biases (that is, inflation risk premiums and liquidity premiums).⁶⁵¹ These premiums and biases impede its use in Australia use as a pure measure of inflation expectations.^{652, 653}

⁶⁴⁷ For example, Queensland Competition Authority and the Australian Energy Regulator. Queensland Competition Authority, *Inflation forecasting*, pp. 56-61; Australian Energy Regulator, *Regulatory treatment of inflation*, p. 52.

A minority of regulators will use market-implied estimates to inform their long-term inflation expectations decision. For example, Economic Regulation Authority. Economic Regulation Authority, *Explanatory statement for the 2022 final gas rate of return instrument*, p. 214.

⁶⁴⁸ Ellis, *Re: Regulatory treatment of inflation – inflation expectations*, 5 July 2017, pp. 1-2, available at <https://www.aer.gov.au/system/files/Letter%20from%20the%20RBA%20to%20AER%20-%2025%20July%202017.pdf>.

⁶⁴⁹ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 223-231.

⁶⁵⁰ Reserve Bank of Australia, *Statement on Monetary Policy*, November 2023, pp. 53-64.

⁶⁵¹ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 283-289.

⁶⁵² Finlay R and S Wende, *Estimating Inflation with a Limited Number of Inflation-indexed Bonds*, 2011, RBA Research Discussion Paper, RDP 2011-01, pp. 1-39, available at <https://www.rba.gov.au/publications/rdp/2011/pdf/rdp2011-01.pdf>.

⁶⁵³ Moore A, *Measures of Inflation Expectations in Australia*, 2016, RBA Bulletin, pp 27-28, available at <https://www.rba.gov.au/publications/bulletin/2016/dec/pdf/rba-bulletin-2016-12-measures-of-inflation-expectations-in-australia.pdf>.

For example, the yield on nominal AGS includes an inflation risk premium which is compensation for bearing inflation risk (that is, higher or lower than long-term expected inflation).⁶⁵⁴ This risk premium can account for much of the variation in the bond breakeven rate⁶⁵⁵, making it difficult to distinguish between movements due to pure changes in long-term inflation expectations and those associated with the risk premium.

Regarding liquidity premiums, in 2022-23, annual turnover of nominal AGS was roughly thirty times as large as turnover for inflation-indexed AGS.⁶⁵⁶ Investors may therefore demand a liquidity premium (a higher yield on inflation-indexed AGS) to compensate for the risk of market prices moving against them in a substantial way if they try to sell their position. This can downwardly bias the bond breakeven inflation rate.⁶⁵⁷

► Inflation swap rate

In an inflation swap, one party receives a payment indexed to inflation in exchange for a payment determined by a fixed rate, which is agreed at initiation of the contract but paid at the end. Users of inflation swaps include pension funds (who use them to hedge long-dated inflation-linked obligations) and infrastructure project providers (who use them to hedge their inflation-linked assets or revenues).⁶⁵⁸

As with the bond-breakeven approach, the key advantage of inflation swaps is that their pricing is determined by markets (where investors should have strong incentives to form accurate expectations for inflation). Nonetheless, there are disadvantages in the use of long-term inflation swaps. The market for swaps can lack transparency (with prices and quantities not publicly available)⁶⁵⁹ and, like the bond breakeven rate, it can include inflation risk premia that can bias the measure.⁶⁶⁰ Also, the users of swaps (for example, financial institutions) are subject to various financial regulations and the RBA has previously (in 2016) reported that this can act as a practical liquidity constraint.⁶⁶¹

► Econometric modelling

There are econometric models that decompose a nominal bond yield into its various underlying components, including the latent long-term inflation expectation component. Econometric modelling can be complex, brings its own set of model and estimation risks and can lower transparency and replicability. Due to these limitations, the Commission does not develop its own econometric models to estimate long-term inflation expectations.⁶⁶²

⁶⁵⁴ Finlay R and S Wende, pp. 1-39.

⁶⁵⁵ Finlay R and S Wende, pp. 15-16. The authors note that their estimates of risk premiums may include liquidity premiums.

⁶⁵⁶ Turnover is calculated in value terms and includes all tenors. Data is available from the Australian Office of Financial Management, available at <https://www.aofm.gov.au/data-hub>.

⁶⁵⁷ Moore A, pp. 27-28.

⁶⁵⁸ Moore A, pp. 24-25.

⁶⁵⁹ Moore A, pp. 28-30.

⁶⁶⁰ Finlay R and D Olivan, Extracting information from financial markets, RBA Bulletin, March quarter 2012, pp. 50-52, available at <https://www.rba.gov.au/publications/bulletin/2012/mar/pdf/bu-0312-6.pdf>.

⁶⁶¹ Moore A, pp. 28-30.

⁶⁶² The RBA's forecasts of CPI inflation are used in the Commission's calculation of long-term inflation expectations. The RBA's forecasts are guided by a range of information including econometric modelling. It employs, among other things, a suite of single-equation inflation econometric models, it utilises a full-system economic model, and it maintains a dynamic stochastic general equilibrium model. In this respect, while the Commission does not develop its own econometric models to estimate long-term inflation expectations, inflation modelling outputs are considered, at least implicitly, through the Commission's use of the RBA's forecasts. Cassidy N, Rankin E, Read M and C Siebold, *Explaining low inflation using models*, RBA Bulletin, June

Given the limitations noted in each of the alternative methods discussed, most economic regulators⁶⁶³ adopt practical approaches to estimating long-term inflation expectations (as described earlier).

13.5 Draft Decision

The Commission has determined the rate of return to apply for the purposes of calculating the draft decision. The post-tax real WACC is materially higher than it was for SAWRD20 (the four-year average for the draft decision is 3.99 percent, versus the SAWRD20 four-year average of 2.68 percent). This is largely a result of higher interest rates (which have increased the risk-free rate and cost of debt parameters).

Table 13.8: Summary of regulated rate of return parameters

	2024-25	2025-26	2026-27	2027-28	4-year average	SAWRD20 4-year average
Nominal risk-free rate (%)	4.47	4.47	4.47	4.47	4.47	0.91
Market risk premium (%)	6.30	6.30	6.30	6.30	6.30	6.0
Equity beta	0.67	0.67	0.67	0.67	0.67	0.67
Post-tax, nominal cost of equity (%)	8.69	8.69	8.69	8.69	8.69	4.93
Nominal cost of debt (excluding debt raising costs) (%)	4.97	5.18	5.46	5.75	5.34	4.60
Debt raising costs (%)	0.125	0.125	0.125	0.125	0.125	0.125
Post-tax, nominal cost of debt (%)	5.09	5.30	5.58	5.75	5.46	4.73
Gearing (%)	60	60	60	60	60	60
Post-tax, nominal WACC (%)	6.53	6.66	6.82	7.00	6.75	4.81
Long-term inflation expectations (%)	2.66	2.66	2.66	2.66	2.66	2.07
Post-tax, real WACC (%)	3.77	3.89	4.06	4.23	3.99	2.68

2019, pp. 143-166, available at <https://www.rba.gov.au/publications/bulletin/2019/jun/pdf/explaining-low-inflation-using-models.pdf>.

⁶⁶³ For example, Australian Energy Regulator, *Regulatory treatment of inflation*, Final position, pp. 1-110.

14 Tax allowance

Draft decision – Tax allowance

The Commission's draft decision is that the prudent and efficient benchmark tax allowances for the four-year period commencing 1 July 2024 are:

- ▶ \$81 million (\$Dec22) for **water** retail services and
- ▶ \$23 million (\$Dec22) for **sewerage** retail services.

14.1 Introduction

As outlined in Chapter 7, the building blocks cost model adopted by the Commission for SAWRD24 utilises a post-tax framework.⁶⁶⁴ Accordingly, the draft determination of the maximum revenue caps that apply to SA Water's direct control retail services for the four-year period commencing 1 July 2024 will incorporate prudent and efficient benchmark tax allowances.

This chapter outlines the Commission's assessment, decisions and reasons on the prudent and efficient benchmark tax allowance for water and sewerage retail services for SAWRD24.

14.2 SA Water's proposal

SA Water's proposed benchmark tax allowance for SAWRD24, across the four-year regulatory period, is approximately \$17 million for water retail services and \$1 million for sewerage retail services.⁶⁶⁵

In the Regulatory Business Proposal (RBP), SA Water has proposed that the following three inputs be adopted for the purpose of calculating the benchmark tax allowance.

- ▶ **Gifted assets:** SA Water has proposed a change in the treatment of gifted assets for SAWRD24. It has proposed that gifted assets should no longer form part of taxable income on the basis of a recent Federal Court of Australia ruling.⁶⁶⁶
- ▶ **Gamma:** SA Water has proposed a 'gamma' value of 0.5.⁶⁶⁷ The value prescribed to imputation credit adjustment is referred to as 'gamma' by economic regulators. It is the parameter used to calculate the effective tax rate.
- ▶ **Forecast inflation:** SA Water has proposed a Consumer Price Index (CPI) inflation forecast for the purposes of calculating a benchmark tax allowance for SAWRD24 based on its proposal for long-term inflation expectations included in its proposal for the real, post-tax rate of return (discussed in Chapter 13).

⁶⁶⁴ A post-tax framework was set out as a requirement in the previous Pricing Order for SAWRD20. Clause 6.2.7 of the previous Pricing Order from SAWRD20 states that the determination must identify and assign values to any allowance for tax paid (which should be identified separately from the rate of return on the RAB where the weighted average cost of capital is calculated on a post-tax basis). Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

⁶⁶⁵ SA Water, *Regulatory Business Plan*, p. 269.

⁶⁶⁶ *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2020] FCAFC 169 (21 October 2020), available at <https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2020/169.html>.

⁶⁶⁷ SA Water, *Regulatory Business Plan*, p. 264.

14.3 Submissions

No submissions commented directly on the benchmark tax allowance for SAWRD24.

14.4 Commission analysis

14.4.1 Methodology and inputs

The draft decision is to calculate the benchmark tax allowance for SAWRD24 based on the Australian corporate taxation regime methodology, adjusted to reflect the estimated value to equity holders of associated imputation credits (or franking credits). It is calculated as follows:

$$\text{Tax allowance} = \underbrace{(\text{assessable income} - \text{deductible costs})}_{\text{Taxable income}} \times \underbrace{\text{effective tax rate}}_{\text{Tax rate} \times (1 - \text{gamma})}$$

The adjustment for imputation credits allows investors to receive credits for tax that has already been paid at the company-level. These credits can be used to offset tax liabilities. The effective tax rate includes this adjustment.

The methodology for calculating the prudent and efficient benchmark tax allowance for SAWRD24 is the same as that adopted in SAWRD20.⁶⁷⁰ It allows for tax losses within a retail service segment (that is, within the water retail or sewerage retail businesses) provided that direct control retail services as a whole do not make a tax loss.

As discussed below, the Commission has assessed and considered SA Water's proposals relating to the following three inputs.

14.4.1.1 Assessable income - Gifted assets

The draft decision is to calculate the prudent and efficient benchmark tax allowance excluding gifted assets as a form of taxable income.⁶⁷¹ The decision has been made on the basis that gifted assets account for a negligible amount (approximately 2 percent) of total assessable income used for the tax calculation, therefore the proposed impact of the methodological change is very minor. It is also consistent with the Federal Court of Australia's 2020 judgment in a similar regulatory matter.⁶⁷²

14.4.1.2 Effective tax rate - Gamma

The draft decision is to adopt a gamma value of 0.50, consistent with SAWRD20 and SA Water's proposal. A gamma value of 0.50 is in line with the values used for gamma by most other economic regulators in Australia.⁶⁷³

⁶⁶⁸ Deductible costs consist of operating expenditure, tax depreciation, and interest deductible. The latter is estimated using the cost of debt for a benchmark efficient entity, as calculated as an input into the real, post-tax rate of return methodology, see Chapter 13).

⁶⁶⁹ Gamma is the value prescribed to imputation credits, which is used to offset tax liabilities. Its value lies between zero and one. A higher value for gamma leads to a lower tax allowance.

⁶⁷⁰ Essential Services Commission of South Australia, *SA Water Regulatory Rate of Return 2016-2020*, pp. 248-249.

⁶⁷¹ Taxable income is calculated as assessable income minus deductible costs. As shown above, the tax allowance is then calculated by multiplying the resulting taxable income by the effective tax rate.

⁶⁷² *Victoria Power Networks Pty Ltd v Commissioner of Taxation* [2020] FCAFC 169.

⁶⁷³ The Economic Regulation Authority (WA), Essential Services Commission Victoria, and the Independent Competition and Regulatory Commission apply a gamma value of 0.50, while the Australian Energy Regulator, Queensland Competition Authority and the Office of the Tasmanian Economic Regulator apply a gamma value

14.4.1.3 Tax allowance – CPI inflation forecast

The benchmark tax allowance for SAWRD24 is calculated in nominal terms in order to reflect the underlying tax regime. However, it is converted into real (inflation-adjusted) terms for the purposes of calculating a prudent and efficient benchmark tax allowance to be included as a building blocks cost model component. CPI inflation forecasts for the SAWRD24 period are utilised in the benchmark tax allowance calculation, in order to convert between nominal and real (inflation-adjusted) dollars.

The draft decision is that the CPI inflation forecasts for the purposes of calculating the prudent and efficient benchmark tax allowance are to be based on the Commission's forecasts and glide path used in calculating long-term inflation expectations for the purposes of the post-tax, real rate of return (as discussed and set out in Chapter 13). This approach provides internal consistency across building block cost components. The Commission notes that the forecasts and glide path adopted have a range of supporting evidence, which, in its view, make its application in this circumstance appropriate.⁶⁷⁴

14.4.2 Benchmark tax allowance

The prudent and efficient benchmark tax allowance for SAWRD24 is higher than that allowed in SAWRD20 (for example, approximately \$105 million over four-years compared with \$20 million over a similar period).⁶⁷⁵

The Commission's prudent and efficient benchmark tax allowance for SAWRD24 is significantly higher than the proposal from SA Water. A key reason for the difference is the rate of return that has been calculated using the standard regulatory approach. The rate of return parameter, as explained further below, flows directly through into calculations of assessable income and deductible costs. SA Water's tax proposal was calculated based on a lower rate of return parameter, which was calculated based on market information from March 2023, whereas the Commission has calculated the rate of return (as explained in Chapter 13) using the latest market information from November 2023.

For SAWRD24, assessable income for water and sewerage retail services combined is \$7,014 million, the combined deductible costs are \$6,349 million, the corporate tax rate is assumed to be 30 percent, and gamma is 0.50. The nominal tax allowance can be calculated as follows:

$$(7,014 - 6,349) \times (0.3 / (1 - (0.3(1 - 0.5))) \times (1 - 0.50) = \$117 \text{ million}$$

In real terms, the tax allowance is equal to \$105 million (\$Dec22).

Table 14.1 shows the benchmark tax allowance from previous regulatory determinations and the cost of equity and the cost of debt values.

within 10 basis points of 0.50. See Economic Regulation Authority (WA), p. 219, Essential Services Commission of Victoria, *2023 water price review – guidance paper*, p. 47, Independent Competition and Regulatory Commission, p. 89, Australian Energy Regulator, *Rate of Return Instrument*, pp. 23-24, Queensland Competition Authority, *Seqwater bulk water price review 2022-26*, p. 65, and Office of the Tasmanian Economic Regulator, *2018 Water and Sewerage Price Determination Investigation*, Final report, May 2018, p. 171, available at <https://www.economicregulator.tas.gov.au/Documents/2018%20Water%20and%20Sewerage%20Price%20Determination%20Investigation%20Final%20Report.pdf>.

⁶⁷⁴ As outlined in Chapter 13, the Commission uses CPI inflation forecasts published by the Reserve Bank of Australia, and the glide path approach used by the Commission to estimate long-term inflation expectations recognises that most available evidence suggests that the flexible inflation targeting framework pursued by the Reserve Bank of Australia has anchored long-term inflation expectations within the RBA's two to three percent target band.

⁶⁷⁵ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 249.

Table 14.1: Benchmark tax allowance for water and sewerage retail services from previous determinations (\$Dec22) and the applicable rate of return

	Average real, post-tax WACC (%)	Average difference between cost of equity and cost of debt (%)	Benchmark tax allowance (water and sewerage) (\$m)
SAWRD13 ⁶⁷⁶	4.50	2.0	131 ⁶⁷⁷
SAWRD16 ⁶⁷⁸	4.17	0.0	34
SAWRD20 ⁶⁷⁹	2.68	0.2	20
SAWRD24 draft decision	3.99	3.2	105

While the prudent and efficient benchmark tax allowance for SAWRD24 is higher than in both SAWRD20 and SAWRD16, it is lower than in SAWRD13.⁶⁸⁰ A factor leading to the strong increase in SAWRD24 is the higher rate of return. A higher rate of return increases the return on the regulated asset base (RAB), leading to an increase in assessable income, and consequently, taxable income. Furthermore, a high cost of equity, relative to the cost of debt, may also be a contributing factor.⁶⁸¹

⁶⁷⁶ Essential Services Commission of South Australia, *SA Water's water and sewerage revenues 2013/14 – 2015/16*, p. 145, 166.

⁶⁷⁷ SAWRD13 involved a three-year regulatory period. For comparison purposes, the prudent and efficient benchmark tax allowance for SAWRD13 has been adjusted to represent a four-year period (in other words, the three-year prudent and efficient benchmark tax allowance has been multiplied by 4/3).

⁶⁷⁸ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, p. 126, 137.

⁶⁷⁹ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, p. 231, 249.

⁶⁸⁰ The benchmark tax allowance for water retail services represents roughly 78 percent of the overall benchmark tax allowance (with the tax allowance for sewerage retail services making up the remainder). This represents a larger share than for SAWRD20, where the water retail services benchmark tax allowance was only 64 percent of the overall benchmark tax allowance. Nevertheless, the higher benchmark tax allowance share proposed for water remains lower than in SAWRD13 (where it was 85 percent). The variation in the share of the tax allowance between water and sewerage retail services is influenced by the components of assessable income and deductible costs. For example, a contributing factor leading to the tax allowance in SAWRD20 for sewerage retail services representing a greater share of the overall tax allowance than in SAWRD24 was due to higher cash and non-cash contributions for sewerage retail services (which contribute to assessable income) than for SAWRD24.

⁶⁸¹ As noted above, a high cost of equity can lead to a higher total assessable income. A high cost of debt, however, while still contributing to a high rate of return and consequent assessable income, has the offsetting effect of leading to higher interest deductible expenses, which are subtracted from assessable income to calculate taxable income. The consequence is that the benchmark tax allowance may increase when the difference between the cost of equity and the cost of debt increases. Conversely, the benchmark tax allowance may decrease when the difference between the cost of equity and the cost of debt narrows, or when the cost of debt exceeds the cost of equity. In a period of rising interest rates (as has been the case over the last 24 months), the cost of equity may tend to rise more quickly than the cost of debt. This is because the risk-free rate (which forms part of the cost of equity) is calculated based on current market conditions, while the cost of debt is calculated using a 10-year trailing average approach. (For more information, see Chapter 13 for a detailed discussion regarding the risk-free rate and the cost of debt for SAWRD24.)

14.5 Draft decision

The Commission's draft decision on the benchmark tax allowance is set out in Table 14.2.

Table 14.2: Draft decision on benchmark tax allowances (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)
Water	22	22	18	19	81
Sewerage	9	7	4	4	23
Total	31	29	22	23	105

15 Adjustments from SAWRD20

Draft decision – Revenue Adjustments from SAWRD20

The Commission's draft decision is that the revenue cap for *water* retail services for SAWRD24 will be reduced by the amount of \$26.0 million (\$Dec22) as a result of adjustment factors arising in SAWRD20. There are no revenue adjustments arising in relation to the SAWRD20 revenue cap for *sewerage* retail services.

The relevant factors for water retail services arise from the SAWRD20 demand variation adjustment mechanism, shared infrastructure adjustment mechanism and River Murray water licence adjustment mechanism.

In compliance with the current revenue caps and the current adjustment mechanisms, in early 2024 SA Water will provide to the Commission updated information regarding revenue earnings and demand (sales and connection numbers, and income derived from the sale of water allocations) for the SAWRD20 period.

The Commission will, subject to any stakeholder submissions and information submitted by SA Water, including in relation to the application of the Commission's methodology, determine updated revenue adjustment amounts to be applied to the revenue caps for the final decision.

15.1 Introduction

For SA Water Regulatory Determination 2020 (**SAWRD20**),⁶⁸² the Commission established four-year maximum revenue caps for SA Water's direct control water and sewerage retail services, which were subject to the following adjustment mechanisms enabling the revenue caps to be adjusted in SAWRD24 to reflect SAWRD20 outcomes.

- ▶ A cost pass-through adjustment mechanism: where an event beyond the control of SA Water has had a material impact on its costs of providing water or sewerage retail services during the SAWRD20 period.
- ▶ A shared infrastructure adjustment mechanism: to account for revenue earned by SA Water for the provision of non-regulated services that utilise regulated assets which was either different or not forecast at the time of making SAWRD20, limited to 10 percent of that revenue.
- ▶ A demand variation adjustment mechanism: to account for any material differences between forecast and actual water and sewerage retail service revenue earned during SAWRD20, due to differences between forecast and actual water sales and sewerage connections.
- ▶ A River Murray licence adjustment mechanism: to reflect income derived by SA Water in the SAWRD20 period from the sale of water allocations associated with River Murray water entitlements.
- ▶ An intra-period project review mechanism: to allow for the recovery of efficient costs in the SAWRD24 period associated with a pre-determined major capital project, where the project's costs were not incorporated into the revenue caps for SAWRD20 because of a contingency or adverse event.

⁶⁸² Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 37-56.

The intent of the SAWRD20 adjustment mechanisms was discussed earlier in Chapter 7. The form of those mechanisms, as well as a more detailed discussion of their intent, can be found in the SAWRD20 determination.⁶⁸³

The Commission established the adjustment mechanisms for SAWRD20 to meet Pricing Order requirements,⁶⁸⁴ provide flexibility to a revenue-regulated business⁶⁸⁵ and deliver consumer protections.⁶⁸⁶

This chapter documents SA Water's proposal for revenue adjustments and outlines the Commission's draft decision in relation to the revenue adjustments from SAWRD20 to be included in the revenue caps for SAWRD24.

15.2 SA Water's proposal

In its Regulatory Business Proposal (RBP), SA Water submitted proposed revenue adjustments for water retail services from the application of the following:

- ▶ the shared infrastructure revenue adjustment mechanism: adjustment of \$0.1 million⁶⁸⁷
- ▶ the demand variation adjustment mechanism: adjustment of \$38.7 million,⁶⁸⁸ and
- ▶ the River Murray water licence adjustment mechanism: adjustment of \$1.8 million.⁶⁸⁹

SA Water did not submit any cost pass-through applications in the current period.⁶⁹⁰ Nor did it submit any proposals for the intra-period mechanism for stage two approval of a revenue allowance.⁶⁹¹

15.3 Matters raised in consultation

Submissions did not provide comments on SA Water's proposed revenue adjustments.

15.4 Commission analysis

The Commission's draft determination of the revenue adjustments relates only to the shared infrastructure adjustment mechanism, demand variation adjustment mechanism and River Murray water licence adjustment mechanism, as discussed below.

⁶⁸³ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 37-56, and Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, Price Determination, 1 July 2020, pp. 8-19.

⁶⁸⁴ As noted in Chapters 3 and 7, the Commission's determination must meet requirements specified in Pricing Orders issued by the Treasurer pursuant to section 35(4) of the Water Industry Act 2012 (WI Act). Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

⁶⁸⁵ For example, the cost pass-through adjustment mechanism provides a form of flexibility for a revenue-regulated business, without which it may not be able to account for cost impacts of an unexpected, unpreventable and external event that would cause material disruption. This type of mechanism is discussed further in Chapter 7.

⁶⁸⁶ For example, the River Murray water licence adjustment mechanism allows customers to recoup income derived by SA Water from the sale of water allocations associated with River Murray water entitlements. This mechanism is discussed in Chapter 7.

⁶⁸⁷ SA Water, *Regulatory Business Plan 2024-28*, pp. 285-286. Based on calculations provided, the adjustment mechanisms appeared to be presented in March 2022 dollars. The Commission has placed these adjustments into December 2022 dollars.

⁶⁸⁸ *Ibid*, pp. 283-284.

⁶⁸⁹ *Ibid*, p. 285.

⁶⁹⁰ *Ibid*, pp. 284-285.

⁶⁹¹ *Ibid*, pp. 286-287.

Note that the revenue adjustments below are the Commission's calculations for the purposes of the draft determination, and are based on available information at the time of making that draft determination. SA Water will provide updated information regarding revenue earnings and demand (sales and connection numbers) for the SAWRD20 period to the Commission in early 2024.⁶⁹² The revenue adjustments may therefore change between the draft and final decisions. The Commission will, subject to any stakeholder submissions and information submitted by SA Water, including in relation to the application of the Commission's methodology, determine updated revenue adjustment amounts to be applied to the revenue caps for the final decision. The Commission will publish in the public domain the updated revenue earnings and demand outcomes reported by SA Water for SAWRD20.

15.4.1 Shared infrastructure adjustment from SAWRD20

The shared infrastructure mechanism is set out in clause 2.12 of the Price Determination for SA Water's water and sewerage retail services: 1 July 2020 – 30 June 2024.⁶⁹³

As mentioned above, a shared infrastructure adjustment mechanism: to account for revenue earned by SA Water for the provision of non-regulated services that utilise regulated assets which was either different or not forecast at the time of making SAWRD20, limited to 10 percent of that revenue. The Commission has previously determined that 10 percent of relevant non-regulated revenues can be used as proxy for a gross profit margin earned on the use of water or sewerage retail service infrastructure.

By way of background, for water retail services, when setting its prices at the commencement of the regulatory period, SA Water removes its forecast of 10 percent of relevant non-regulated revenue. Because this share of non-regulated revenues is removed from the prices set by SA Water that water retail customers pay, the Commission's shared infrastructure mechanism relates solely to the calculation of forecast errors and the adjustment to the revenue caps in the subsequent period.⁶⁹⁴

For water retail services, the shared infrastructure mechanism makes an adjustment to account for the difference between actuals (that is, 10 percent of actual non-regulated revenues during SAWRD20) and forecasts (that is, 10 percent of SA Water's forecast, at the time of commencing SAWRD20, of non-regulated revenues for the SAWRD20 period). This unders/overs methodology was introduced in SAWRD20 with the aim that the revenue adjustment for non-regulated revenues would, over time, reflect actual revenue, not forecast revenue.⁶⁹⁵

For SAWRD20, SA Water submitted a forecast of approximately \$4 million. This represented SA Water's forecast of 10 percent of non-regulated revenue for water retail services.⁶⁹⁶ However, in its RBP, SA Water reported that its actual revenues over SAWRD20 have exceeded this, albeit marginally.⁶⁹⁷ The Commission's analysis has established a draft shared infrastructure adjustment for SAWRD24 of \$0.2 million, being the difference between the forecast and actual amounts of non-regulated revenues.

⁶⁹² Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, pp. 8-19, and SA Water, *Regulatory Business Plan 2024-28*, pp. 283-286.

⁶⁹³ Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, Price Determination, 1 July 2020, p. 14, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21489/20200611-Water-SAWRD20-FinalPriceDetermination.pdf.aspx?Embed=Y>.

⁶⁹⁴ SA Water's forecast of 10 percent of non-regulated revenues for water retail services is considered by the Commission when calculating the demand variation adjustment mechanism for the period. Further discussion on the demand variation adjustment mechanism can be found in the next section, and in Chapter 7.

⁶⁹⁵ Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, p. 14.

⁶⁹⁶ Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, p. 14.

⁶⁹⁷ SA Water, *Regulatory Business Plan 2024-28*, pp. 285-286.

Unlike water retail services, for sewerage retail services there was no forecast of revenue made for SAWRD20. Instead, the mechanism allows for 10 percent of the revenue amounts earned during SAWRD20, through the use of SA Water's regulated infrastructure required to provide sewerage retail services but which are not attributable to the provision of sewerage retail services, to be deducted from the revenue cap for sewerage retail services for SAWRD24. SA Water has reported to the Commission that it has earned no revenues collected on this basis during SAWRD20. Accordingly, no shared infrastructure adjustment for sewerage retail services for SAWRD24 has been included for the purposes of the draft decision.

15.4.2 Demand variation adjustment from SAWRD20

The demand variation adjustment mechanism is specified in clauses 2.4 and 2.8 of the Price Determination for SA Water's water and sewerage retail services: 1 July 2020 – 30 June 2024.⁶⁹⁸

The Commission's final decision in SAWRD20 was to continue the operation of the current demand variation adjustment mechanism, consistent with the requirements of the Pricing Order.⁶⁹⁹ In the final decision, the Commission noted:

*'SA Water's proposal for the mechanism to apply to drinking water sales (usage) revenue, rather than fixed revenue, is acceptable as it is consistent with the requirements of the Pricing Order, which requires the mechanism to address any 'material variation between forecast and actual rates of consumption' (emphasis added).'*⁷⁰⁰

The Pricing Order applying to SAWRD20 required that the determination:

*'...must include a mechanism which allows for the adjustment of the total revenue which may be derived where the Commission determines there to be a relevant and material variation between forecast and actual rates of water consumption or sewerage connections. The adjustment mechanism must operate on the basis of efficient costs associated with variations in demand, and so as to promote a stable price path for retail services.'*⁷⁰¹

The methodology was implemented based on variations between actual and forecast prices. The application of the mechanism is shown in Table 15.1 below (for water retail services). It suggests a revenue adjustment amount of approximately \$17.7 million due to higher-than-expected demand during the SAWRD20 period.⁷⁰²

For sewerage retail services, and applying the same mechanism methodology, there is no adjustment to be made. This is because the difference between actual revenue and notional revenue does not reach the materiality threshold of one percent.

⁶⁹⁸ Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, pp. 9-10 and pp. 11-12.

⁶⁹⁹ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020*, pp. 37-56.

⁷⁰⁰ *Ibid.*, p. 50.

⁷⁰¹ Pricing Orders are available at <https://www.treasury.sa.gov.au/economy-taxes-and-rebates/economic-regulation>.

⁷⁰² At previous determinations, the Commission has estimated an adjustment for variation in costs to be made to the overall calculation (for example, adjustment costs were estimated at approximately \$2 million over a four-year period in SAWRD16). However, the ex-post assessment of the variable costs incurred due to demand variation is made difficult because different sources of water supply (for example, from reservoirs, the Adelaide Desalination Plant and the River Murray) can have significantly different costs, and the mix of supply sources in any given period cannot be determined by SA Water based solely on what is most efficient or least cost. Therefore, given the complexity and effort required to estimate the variable costs incurred due to demand variation, and its small influence on the overall adjustment, the Commission has decided for the purposes of the draft determination not to make any adjustment relating to the variable costs incurred due to demand variation.

Table 15.1: Calculation of the demand variation adjustment for water retail services under the SAWRD20 methodology⁷⁰³

Item	Total (present value, \$m)
Actual sales revenue (\$Dec18)	1,730.6
Notional water sales (\$Dec18) [Notional sales revenue calculated as actual usage during SAWRD20 multiplied by forecast average prices]	1,699.7
Variance in sales attributable to demand (\$Dec18) [Actual sales revenue <i>minus</i> notional sales revenue]	30.9
Revenue adjustment for four-year period (\$Dec18) [50% of the variance attributable to demand] ⁷⁰⁴ (Adjustment only applies if: Actual sales revenue/notional water sales – 1 >1%)	15.4
Revenue adjustment for four-year period (\$Dec22) [Conversion of revenue adjustment from \$Dec18 to \$Dec22 dollars]	17.7

On reviewing the design and form of the demand variation adjustment mechanism, the Commission acknowledges that there are limitations with the methodology set out in SAWRD20. The Commission's position has been informed by research undertaken by Sapere Research Group (**Sapere**).

In 2022, Sapere was commissioned by the Commission to review the current form of the demand adjustment mechanism, with the intention to allow the Commission to consider the overall framework and the incentives for the regulated business.⁷⁰⁵ In undertaking its review, Sapere met with both SA Water and the Commission to collect feedback, and both parties were provided copies of Sapere's draft report for comment. In finalising its research, Sapere has had regard to feedback provided.⁷⁰⁶

Sapere's research found that the mechanism applied in SA Water Regulatory Determination 2016 (**SAWRD16**) was designed to be calculated based on variations between actual and forecast demand. Whereas the SAWRD20 methodology was designed based on variations between actual and forecast prices, and so the methodology's application captures demand variation only to the extent that it affects average prices.⁷⁰⁷

⁷⁰³ For the purposes of the ex-post compliance calculation of the demand adjustment mechanism, nominal dollars have been deflated into December 2018 dollars using March-to-March CPI inflation. It is a requirement of the Price Determination (clause 2.3) that March-to-March CPI inflation be used as a proxy for the December-to-December change in CPI for each respective year. Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, Price Determination, 1 July 2020, p. 9.

⁷⁰⁴ The passing through of 50 percent of the revenue variation is consistent with the risk-sharing percentage adopted in the past two regulatory determinations. Chapter 7 includes further discussion on this topic.

⁷⁰⁵ Sapere Research Group, p. 1, 26, 30-31.

⁷⁰⁶ SA Water, *Regulatory Business Plan 2024-28*, p. 284.

⁷⁰⁷ Sapere Research Group, p. 1, 26 and pp. 30-31.

As reported by Sapere:

*'The current (SAWRD20) mechanisms largely have the effect of adjusting for material variation in average prices, rather than – as specified in the Pricing Order – for material variation in 'water consumption or sewerage connections'. They [SAWRD20 mechanisms] capture demand variation to the extent that it affects average prices. In this regard, the SAWRD16 mechanisms are more closely aligned with the Pricing Order. Another issue (of lesser significance) is that neither the current nor the 2016 mechanisms account for variations in efficient costs associated with variations in demand.'*⁷⁰⁸

Sapere's research also discussed options for the form of the demand variation adjustment mechanism in future regulatory periods including SAWRD24. These were discussed earlier in Chapter 7.

When submitting its RBP, SA Water acknowledged that it had provided input to the Commission's external review of the demand variation adjustment mechanism. SA Water recognised the limitations of the SAWRD20 methodology, and it utilised the SAWRD16 methodology in its RBP.⁷⁰⁹

Recognising the limitations of the SAWRD20 methodology, the findings of Sapere and the input from SA Water, the Commission has also calculated the demand variation adjustment mechanism via the previous (SAWRD16) methodology. Application of that methodology, if applied to SAWRD20 outcomes, is shown in Table 15.2 for water retail services.⁷¹⁰ It suggests a revenue adjustment amount of approximately \$24.0 million. The higher amount (that is, \$24.0 million compared with \$17.7 million) reflects that the methodology captures more of the demand variation.⁷¹¹

Together, this results in a higher revenue adjustment under the SAWRD16 methodology. A higher revenue adjustment benefits consumers as it is deducted from the revenue cap for water retail services for SAWRD24. This allows a share of the revenue variation attributable to demand to be passed back to customers.

As per the SAWRD20 method, there is no adjustment for sewerage retail services. This is because the materiality threshold of one percent has not been met and forecast revenue exceeds notional revenue.

The Commission's draft decision is that it will apply the SAWRD20 methodology (as it forms part of the current regulatory determination and therefore a change to that determination would be required for it *not* to be used) but will then apply a further revenue adjustment (see Table 15.3), such that demand variation will be calculated as if the SAWRD16 methodology had been administered.

In making this draft decision, the Commission had regard to the requirements of the Pricing Order applying to SAWRD20, the current (SAWRD20) and previous (SAWRD16) methodologies for administering the demand variation adjustment mechanisms, advice from the Commission's consultant, Sapere, feedback from SA Water, and all other information available at the time of making the draft decision.

⁷⁰⁸ Ibid, p. 1.

⁷⁰⁹ SA Water, *Regulatory Business Plan 2024-28*, pp. 283-284.

⁷¹⁰ Application of the SAWRD16 methodology includes adjustments relating to SA Water's forecast of 10 percent of relevant non-regulated revenue and an estimate for rating on abuttal customers.

⁷¹¹ The adjustment (of \$24 million) is lower than that proposed by SA Water (for approximately \$39 million). This is driven, in part, by the Commission updating forecast inflation for the 2023-24 period with actual (March-to-March inflation) inflation. The calculation difference also reflects the Commission's calculation of the additional adjustment mechanism that arises if actual revenue would have exceeded the maximum revenue cap if not for the demand (volume) variation.

Table 15.2: Calculation of the demand variation adjustment for water retail services under the SAWRD16 methodology

Item	Total (present value terms)
Actual total revenue (adjusted for rating on abuttal) (\$Dec18) (\$m) ⁷¹²	2,571.8
Forecast total revenue (adjusted for non-regulated revenue) (\$Dec18) ⁷¹³	2,537.8
Notional revenue (\$Dec18) [Notional revenue calculated as forecast usage during SAWRD20 multiplied by actual average prices, plus other actual revenues]	2,529.9
Variance in sales attributable to demand (\$Dec18) (\$m) [Actual revenue <i>minus</i> notional revenue]	41.9
50% of variance in sales attributable to demand (\$Dec18) (\$m) (Adjustment only applies if: Actual total revenue/notional revenue – 1 >1%)	21.0
Other adjustment ⁷¹⁴ (\$Dec18) (\$m)	0.0
Revenue adjustment for four-year period (\$Dec18) (\$m)	21.0
Revenue adjustment for four-year period (\$Dec22) (\$m)	24.0

⁷¹² The Commission's understanding is that revenues collected from charges on land (that is, charges collected in the situation where there is no infrastructure in place that connects a retailer's water or sewerage main to a connection point on a customer's land or property, commonly known as rating on abuttal) are included in the total reported actual regulated revenues. However, as these services are not a regulated retail service, the Commission has removed an estimate of these revenues. The estimate has been calculated on the basis of customer numbers published in the Commission's 2015 review into drinking water and sewerage prices and an assumption of one percent annual connection growth from that point onward. Essential Services Commission of South Australia, *Inquiry into reform options for SA Water's drinking water and sewerage prices*, Final report, December 2014, p. 67, available at <https://www.escosa.sa.gov.au/ArticleDocuments/436/20150128-Water-InquiryReformOptionsSAWatersDrinki.pdf.aspx?Embed=Y>.

⁷¹³ When setting its prices, SA Water removes from the revenue caps its forecast of 10 percent of relevant non-regulated revenue. The Commission has removed from the maximum revenue cap SA Water's forecast of 10 percent of non-regulated revenues. This allows a comparison of demand and price outcomes over the period against the revenue amount for which consumers' prices were set.

⁷¹⁴ The SAWRD16 methodology includes an additional adjustment mechanism that arises if actual revenue would have exceeded the maximum revenue cap if not for the demand (volume) variation. In other words, if notional revenue exceeds forecast revenue. This adjustment mechanism involves 100 percent of any positive variation in revenue not captured by the demand variation adjustment formula. This would include any additional revenue from an increase in the average price due to a variation in demand. Sapere Research Group, pp. 9-10. However, notional revenue was calculated to be below forecast total revenue, so there was no additional adjustment required for the purposes of the calculation in Table 15.2

Table 15.3: Demand adjustments for application in SAWRD24 (\$Dec22)

	Adjustment (\$m)
SAWRD20 methodology	17.7
Commission's further adjustment	6.3
Total	24.0

15.4.3 River Murray water licence adjustment from SAWRD20

The River Murray water licence adjustment mechanism is specified in clause 2.11 of the Price Determination for SA Water's water and sewerage retail services: 1 July 2020 – 30 June 2024.⁷¹⁵

The River Murray water licence adjustment mechanism allows water retail services customers to recoup income that has been derived by SA Water from the sale of water allocations associated with River Murray water entitlements which have been paid for by customers.⁷¹⁶ The income from the sale of water allocations should be returned to customers, taking into account any prudent and efficient costs incurred as a result of selling those allocations, insofar as customers have in previous periods paid for those water entitlements.

The Commission's analysis has established a draft River Murray water licence adjustment for SAWRD24 of \$1.8 million, being income from the sale of water allocations.⁷¹⁷ SA Water will submit an updated estimate to the Commission in early 2024, which will be verified and assessed by the Commission and incorporated into the revenue cap for water retail services for SAWRD24.

15.5 Draft decision

The Commission's draft decision is that revenue caps for water retail services for SAWRD24 will be reduced by the amount of \$26.0 million (\$Dec22) as a result of adjustment factors arising in SAWRD20. There are no revenue adjustments arising in relation to the SAWRD20 revenue cap for sewerage retail services.

Table 15.4 provides a summary of the various adjustment mechanisms. There were no cost-pass through events or approved intra-period projects during the SAWRD20 period.

In compliance with the revenue caps and the current adjustment mechanisms in early 2024, SA Water will provide to the Commission updated information regarding revenue earnings and demand (sales and connection numbers, and income derived from the sale of water allocations) for the SAWRD20 period.

The Commission will, subject to any stakeholder submissions and information submitted by SA Water in relation to the application of the Commission's methodology, determine updated revenue adjustment amounts to be applied to the revenue caps for the final decision.

⁷¹⁵ Essential Services Commission of South Australia, *SA Water's water and sewerage retail services – 1 July 2020 to 30 June 2024*, pp. 13-14.

⁷¹⁶ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2016*, p. 71.

⁷¹⁷ SA Water, *Regulatory Business Plan 2024-28*, p. 285.

Table 15.4: Revenue adjustments for application in SAWRD24 (\$Dec22)

	Adjustment (\$m)
Shared infrastructure adjustment	0.2
Demand variation adjustment mechanism	24.0
River Murray adjustment mechanism	1.8
Total	26.0

16 Determination of total revenue caps

Draft decision – Total revenues

The Commission's draft decision is that the total revenue caps for the four-year period commencing 1 July 2024, in present value terms, are as follows:

- ▶ \$3,550 million (\$Dec22) for **water** retail services, which is 22 percent higher than the revenue cap determined in SAWRD20, and
- ▶ \$1,785 million (\$Dec22) for **sewerage** retail services, which is 28 percent higher than the revenue cap determined in SAWRD20.

These revenue cap benchmarks will be updated for the final decision.

16.1 Introduction

As outlined in Chapter 7, the draft decision is that the revenue caps for SAWRD24 are prepared and presented on the basis of a building blocks cost model. The Commission's regulatory determination allows SA Water to recover the total efficient cost of providing water and sewerage retail services to customers. The building blocks cost model is the commonly accepted economic approach to estimating efficient costs: it is effectively a build-up of the forecast efficient costs of the regulated firm.

The building blocks cost model sums together each building block (for instance, operating expenditure, return on assets, regulatory depreciation, tax allowance, return on working capital, and any revenue adjustments from previous periods) and it adjusts for non-tariff regulatory revenues (such as payments for community service obligations (CSO)). The building blocks cost model is used in this determination to set separate fixed, four-year maximum revenue caps for water and sewerage retail services for the four-year period commencing 1 July 2024.

Revenue amounts are discounted to present value terms as at the commencement of SAWRD24 and expressed in December 2022 dollars.

This chapter summarises the Commission's draft decision for each of the building block components and the total revenue caps for water and sewerage retail services for SAWRD24.

16.2 Building block cost model components

16.2.1 Total revenue caps

The draft decision is that the present value of the revenue caps for SAWRD24 are:

- ▶ \$3,550 million (\$Dec22) for water retail services, and
- ▶ \$1,785 million (\$Dec22) for sewerage retail services.

A summary of the revenue caps for SAWRD24 can be found in Table 16.1.

The revenue caps for SAWRD24 represent a 22 percent increase for water retail services from SAWRD20, and a 28 percent increase for sewerage retail services from SAWRD20. The outcome and comparison of revenue caps for water and sewerage retail services for SAWRD24 are further discussed in Chapter 17.

The Commission's assessment is that the revenue caps will provide SA Water with sufficient revenue to fund prudent and efficient operations, finance prudent and efficient investments on a long-term basis, and meet SA Water's applicable health, safety, environmental and customer service standards and obligations over SAWRD24.

Table 16.1: Revenue benchmark draft decision (\$Dec22)⁷¹⁸

	2024-25	2025-26	2026-27	2027-28	Revenue cap
Pre-tax real WACC (%)	4.37	4.49	4.66	4.83	
Discount factor	0.97884	0.93732	0.89631	0.85571	
Water					
Revenue amounts (\$m)	911	969	979	1,018	3,878
Present value of annual revenue amounts (\$m)	892	909	878	871	3,550
Sewerage					
Revenue amounts (\$m)	480	483	484	502	1,948
Present value of annual revenue amounts (\$m)	469	452	434	430	1,785

16.2.2 Operating expenditure

The discussion in relation to the prudent and efficient operating expenditure benchmark amounts is set out in Chapter 10. Below is a summary of the draft decision (Table 16.2).

Table 16.2: Operating expenditure (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)	Present value of total (\$m)
Water	378	385	392	395	1,550	1,420
Sewerage	178	180	181	182	722	662

16.2.3 Return on assets

The annual return on the regulated asset base (**RAB**) is calculated as:

- ▶ the product of the real regulatory rate of return (**rate of return**) and the average value of the RAB for that year, to derive a year end equivalent return on assets, which is then
- ▶ discounted by six months, to recognise that revenue is generated consistently throughout each year, rather than at year end.

The discussion in relation to the prudent and efficient net capital expenditure benchmark amounts is set out in Chapter 11 and the discussion of the rate of return is set out in Chapter 13. Below is a summary of the draft decision for the prudent and efficient return on assets (Table 16.3).

⁷¹⁸ The discount factors are calculated based on cumulative pre-tax WACC rates, assuming mid-year discounting. The pre-tax WACC is used for discounting because allowed revenues include an allowance for taxation.

Table 16.3: Return on assets (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)	Present value of total (\$m)
Post-tax real WACC (%)	3.77	3.90	4.06	4.23		
Water						
Opening RAB	9,630	9,750	9,887	10,124		
Capital expenditure	366	387	469	438		
Disposals	4	4	3	3		
Depreciation	242	247	229	238		
Closing RAB	9,750	9,887	10,124	10,320		
Average RAB	9,811	9,942	10,120	10,341		
Year-end return on RAB	370	388	411	437		
Return on RAB	363	380	403	428	1,575	1,440
Sewerage						
Opening RAB	4,882	4,938	5,001	5,078		
Capital expenditure	214	214	218	223		
Disposals	2	2	1	1		
Depreciation	157	150	141	146		
Closing RAB	4,938	5,001	5,078	5,153		
Average RAB	4,989	5,044	5,110	5,188		
Year-end return on RAB	188	197	207	219		
Return on RAB	185	193	203	215	796	728

16.2.4 Regulatory depreciation

As mentioned in Chapter 12, water and sewerage assets are depreciated using a straight-line method, noting that different types of assets have different useful lives. Below is a summary of the draft decision on the prudent and efficient regulatory depreciation amounts (Table 16.4).

Table 16.4: Regulatory depreciation (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)	Present value of total (\$m)
Water	237	242	225	234	937	860
Sewerage	154	147	138	143	582	534

16.2.5 Tax allowance

The discussion in relation to the prudent and efficient benchmark tax allowance is set out in Chapter 14. Below is a summary of the draft decision (Table 16.5).

Table 16.5: Tax allowance (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)	Present value of total (\$m)
Water	22	22	18	19	81	75
Sewerage	9	7	4	4	23	22

16.2.6 Return on working capital

The working capital allowance addresses the funding cost associated with the mismatch in the timing of SA Water's revenue and expenditure cash flows.

The draft decision is that the return on working capital is to be derived as a product of the rate of return (discussed in Chapter 13) and the assumed investment in working capital, where working capital is calculated according to the following formula:

$$Working\ Capital = \left(\frac{Lag\ (Days) - Lead\ (Days)}{365} \right) \times Operating\ Expenditure$$

Where:

- ▶ 'lag' is the delay by which revenue is received relative to when it is generated (assumed to be evenly throughout the year). SA Water has previously estimated the revenue lag to be 70 days, which incorporates half of the three-month billing cycle, plus the estimated average period between meter reading and customer payment.⁷¹⁹
- ▶ 'lead' is the delay by which operating expenditures are paid relative to when they are incurred (which is assumed to be evenly throughout the year),⁷²⁰ and
- ▶ 'operating expenditure' refers to the prudent and efficient operating expenditure benchmark in the determination.

The draft decision is that the methodology for determining working capital is the same as in SAWRD20. The draft decision on the prudent and efficient return on working capital for SAWRD24 is in Table 16.6.

⁷¹⁹ The 'lag' has not been proposed to be changed by SA Water in the RBP.

⁷²⁰ In the RBP SA Water has estimated the operating expenditure 'lead' to be 30 days, in line with SAWRD20.

Table 16.6: Return on working capital (\$Dec22)

	2024-25 (\$m)	2025-26 (\$m)	2026-27 (\$m)	2027-28 (\$m)	Total (\$m)	Present value of total (\$m)
Water	2	2	2	2	7	6
Sewerage	1	1	1	1	3	3

16.2.7 Non-tariff regulatory revenue

An important step in the building block process is to subtract the regulated revenue streams that SA Water generates outside of its retail tariffs, as these revenue streams exist to offset operating costs or carry out non-commercial functions. These revenue streams, referred to as non-tariff regulatory revenue, include reimbursements for CSOs⁷²¹ made by the South Australian Government (in relation to both water and sewerage retail services) and revenues from the sale of recycled water (sewerage retail services only).

The majority of the CSO revenue is set in advance (in nominal terms) and is expected to be published in the South Australian Government Gazette. The remaining CSO revenue represents reimbursements that are made in relation to the provision of water and sewerage retail services to bodies that have been exempted by the South Australian Government from being required to pay for those services.

Recycled water is only a small component of non-tariff regulatory revenue (less than 10 percent of total non-tariff revenue). It reflects the sales proceeds associated with water recycling facilities owned and operated by SA Water.

The Commission's draft decision for non-tariff revenue is \$251 million for water retail services (inclusive of revenue adjustments), and \$163 million for sewerage retail services (both are calculated as the present value over the regulatory period). **No Pricing Order has been issued in respect of the SAWRD24 regulatory period. The Commission has utilised the CSO amounts submitted by SA Water in its RBP.**

16.2.8 Revenue adjustments

As discussed in Chapter 15, SAWRD20 allows for adjustments to be made to the revenue caps in SAWRD24. The draft decision is for an adjustment of \$26 million to be deducted from the SAWRD24 revenue cap for water retail services.

16.3 Draft decision

The Commission's draft decision is that the present value of revenue caps for SAWRD24 are:

- ▶ \$3,550 million for water retail services, and
- ▶ \$1,785 million for sewerage retail services.

The outcome and comparison of revenue caps for water and sewerage retail services for SAWRD24 are further discussed in Chapter 17, including changes in the revenue caps over time and the key drivers of the increase in SAWRD24.

⁷²¹ CSOs refer to an obligation placed on SA Water by the South Australian Government to carry out certain activities that they would not otherwise carry out (as it would be commercially unfavourable).

17 Revenue caps outcome and comparison

This chapter discusses the outcome of the Commission's draft determination of the maximum revenue caps to apply to SA Water's direct control water and sewerage retail services for the period 1 July 2024 to 30 June 2028.

The Commission's draft decision for revenue caps for water and sewerage retail services are approximately 3 percent and 1 percent lower than that proposed by SA Water in its regulatory business proposal (RBP), on a comparative basis.

The Commission's assessment is that increases in the revenue caps, compared to SAWRD20, have been driven largely by the increase in the regulatory rate of return (**rate of return**), which has increased from 2.68 percent to 3.99 percent since 2020.

Following the release of the final regulatory determination in June 2024, SA Water will set water and sewerage prices in accordance with the final revenue caps and pricing requirements. Those prices will apply from 1 July 2024.

Under the legislative framework governing SA Water regulatory determinations, the Commission will fix the maximum revenue that SA Water can recover from customers over the four-year period 1 July 2024 to 30 June 2028. While the Commission does not set prices, the legislative requirements mean SA Water must set its prices to recover no more than the revenue permitted, subject to ancillary revenue adjustment mechanisms included in the determination.

The draft revenue caps for SAWRD24 have been calculated as the forecast total efficient costs of providing water and sewerage retail services, based on current interest rates and forecasts of inflation⁷²² and available observations of expenditure and revenue.⁷²³ The total efficient costs of providing water and sewerage retail services have been determined using the building blocks cost model. The cost components have each been outlined in Chapters 10 through to 16. The draft revenue caps are subject to change before the final determination is made, as the Commission will, in line with its Charter of Regulatory Consultation and Regulatory Practice, have regard to submissions from all stakeholders.⁷²⁴

The draft decision is that the revenue caps for the four-year period commencing 1 July 2024, in present value terms, are:

- ▶ \$3,550 million (\$Dec22) for **water** retail services, and
- ▶ \$1,785 million (\$Dec22) for **sewerage** retail services.

The Commission's assessment is that the revenue caps will provide SA Water with sufficient revenue to fund prudent and efficient operations and finance prudent and efficient investments on a long-term basis while meeting SA Water's applicable health, safety, environmental and customer service standards and obligations over SAWRD24. In order to deliver value for money on an ongoing basis, SA Water should ensure it has in place sound long-term asset management, operating and financing

⁷²² The rate of return will be updated for the final regulatory determination using latest available observations.

⁷²³ SA Water will provide to the Commission updated information regarding revenue earnings and demand (sales and connection numbers) for the SAWRD20 period, to be considered for the final determination.

⁷²⁴ The Commission's approach to consultation and engagement is outlined in a Charter of Consultation and Regulatory Practice, which is available on the Commission website: www.escosa.sa.gov.au/approach/charter-of-consultation-and-regulatory-practice.

strategies. These strategies should support the provision of retail services for current and future customers.

Following the release of the final regulatory determination in June 2024, SA Water has responsibility for setting prices for water and sewerage retail services. SA Water has the flexibility to set prices from year to year as it sees fit, but is only allowed to recover revenues over the SAWRD24 period in accordance with the final four-year maximum revenue caps.

The revenue caps set by the Commission are fixed, subject to any adjustment mechanisms in the following regulatory period. SA Water must ensure its revenues do not exceed the caps, expressed as a present value at 1 July 2024, in dollars of December 2022. In setting the caps, the Commission's assessment of SA Water's prudent and efficient expenditure benchmark has been completed in real, December 2022 dollars. The expenditure forecasts also include allowances for growing demand and customer numbers over the regulated period. SA Water will set prices for water and sewerage retail services from time to time as actual current prices for customers, including the effects of inflation. It is therefore important to note that the likely percentage change in prices set by SA Water will not necessarily mirror the percentage change in revenue caps between regulatory periods.

While the revenue caps are set by the Commission in inflation-adjusted terms (that is, real, December 2022 prices), SA Water will set prices for water and sewerage retail services in nominal terms (that is, they will be set in current prices for customers). It is therefore worth noting that the percentage change in the revenue caps between regulatory periods (for example, the increase in the caps for SAWRD24 relative to those set out in SAWRD20) may not necessarily translate into the same percentage increase in the nominal prices that are set by SA Water.

The following sections discuss the key revenue cap drivers for SAWRD24 and provide a comparison to:

- ▶ SA Water's regulatory business proposal (RBP), and
- ▶ previous regulatory determinations.

17.1 Comparison against SA Water's regulatory business proposal

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 17.1.

Table 17.1: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SA Water's proposal terms (\$Dec22)

	SA Water's proposal for SAWRD24 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,386	2,272	-114 ↓	-5% ↓
Capital expenditure	2,831	2,529	-302 ↓	-11% ↓
Total	5,217	4,801	-416 ↓	-8% ↓

Of the \$2,831 million of capital expenditure proposed by SA Water for SAWRD24, approximately \$1,160 million (41 percent) is related to five major projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 3 percent decrease for water retail services compared with SA Water’s proposal, and
- ▶ 1 percent decrease for sewerage retail services compared SA Water’s proposal.

Tables 17.2 and 17.3 compares the draft revenue caps for SAWRD24 with an adjusted version of SA Water’s proposal.

Table 17.2: Draft revenue caps for SAWRD24 compared with an adjusted version of SA Water’s proposal, in present value terms (\$Dec22)

	SA Water’s proposal for SAWRD24 ⁷²⁵ (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Total Water	3,647	3,550	-97 ↓	-3% ↓
Total Sewerage	1,809	1,785	-23 ↓	-1% ↓

Table 17.3: Draft revenue caps for SAWRD24 compared with an adjusted version of SA Water’s proposal, in present value terms (\$Dec22)

	Draft Determination SAWRD24 (\$m)	SA Water’s proposal for SAWRD24 ⁷²⁶ (\$m)
Total Water	3,550	3,647
Operating expenditure	1,420	1,500
Return on assets	1,440	1,474
Regulatory depreciation	860	870
Tax allowance	75	67
Return on working capital	6	6
Non-tariff regulatory revenue ⁷²⁷	-251	-271

⁷²⁵ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission’s draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. As noted in Chapters 10 and 11, the Commission understands that SA Water’s proposal stated expenditure in December 2022 dollars.

⁷²⁶ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission’s draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. As noted in Chapters 10 and 11, the Commission understands that SA Water’s proposal stated expenditure in December 2022 dollars.

⁷²⁷ Includes revenue for community service obligations, sales of recycled water and adjustments from SAWRD20.

	Draft Determination SAWRD24 (\$m)	SA Water's proposal for SAWRD24 ⁷²⁸ (\$m)
Total Sewerage	1,785	1,809
Operating expenditure	662	686
Return on assets	728	735
Regulatory depreciation	534	537
Tax allowance	22	15
Return on working capital	3	3
Non-tariff regulatory revenue	-163	-168

The Commission has, for the purposes of making a like-for-like comparison, adjusted SA Water's revenue proposal (including for the latest rate of return and the consumer price index (CPI) inflation roll-forward of the RAB), in order to estimate a comparison between the Commission's draft determination and SA Water's proposal. Without making an adjustment, any comparisons of revenue caps may be, for example, significantly impacted by the timing of the assessments and the differing rate of return and other assumptions utilised.⁷²⁹

17.2 Comparison against SAWRD20

The SAWRD24 determination is made in a different economic context to the previous regulatory determination, SA Water Regulatory Determination 2020 (SAWRD20), which occurred in a low interest rate environment. That environment has changed materially, with material uplifts in interest rates which directly flow through into the determination of the regulatory rate of return (rate of return).

During the four-year SAWRD20 period, lower financing costs meant SA Water was able to deliver the same level of water and sewerage retail services for less than was the case in previous regulatory periods. The cost savings in SAWRD20 were passed on to customers through lower bills.

Current financing costs have increased operational costs compared to SAWRD20, returning to levels experienced previously. In addition, higher prices for energy and raw materials are adding to overall cost pressures.

The Commission's draft decision is that the prudent and efficient **expenditure benchmark** amounts to be included in the calculation of the revenue caps are shown in Table 17.4.

⁷²⁸ For the purposes of comparison with the draft decision, this column has been adjusted to reflect the Commission's draft rate of return (calculated as of 14 November 2023) and uses December to December inflation to roll-forward assets in determining the opening RAB value. As noted in Chapters 10 and 11, the Commission understands that SA Water's proposal stated expenditure in December 2022 dollars.

⁷²⁹ SA Water's proposal used a rate of return of 3.23% that it calculated in March 2023, and so this would not be an appropriate comparison with the Commission's updated estimate derived as at November 2023.

Table 17.4: Prudent and efficient expenditure benchmarks for SAWRD24 compared with SAWRD20 (\$Dec22)

	Final SAWRD20 (\$m)	Draft Determination SAWRD24 (\$m)	Variance (\$m)	Variance (%)
Operating expenditure	2,237	2,272	+35 ↑	+2% ↑
Capital expenditure	1,885	2,529	+644 ↑	+34% ↑
Total	4,122	4,801	+679 ↑	+16% ↑

The \$644 million (34 percent) increase in capital expenditure is driven by five major projects (refer Table 17.5).⁷³⁰

Table 17.5: SA Water's major projects proposal for SAWRD24 (rounded figures)

Major projects	Total four-year expenditure (\$Dec22, million)
Eyre Peninsula Desalination Augmentation	240
Mount Bold Dam Safety Upgrade	110
Metro Water Quality Improvement	160
Northern Metropolitan Growth*	370
Tea Tree Gully Sustainable Sewers*	280
Total	1,160

* SA Water advised that a Government direction is expected for these projects.

Under this draft determination, the **revenue caps** for SAWRD24 represent a:

- ▶ 22 percent increase for water retail services compared with those determined in SAWRD20, and
- ▶ 28 percent increase for sewerage retail services compared with those determined in SAWRD20.

While increased expenditure benchmarks have contributed to additional revenue requirements, the Commission's assessment is that the increases in the revenue caps, compared to SAWRD20, have been driven largely by the increase in the rate of return (refer Box 17.1).

⁷³⁰ In relation to the projects for Northern Metropolitan Growth, \$370 million (\$Dec22), and Tea Tree Gully Sustainable Sewers, \$280 million (\$Dec22), SA Water has advised it expects a Government direction to undertake these projects. In that context, and for the purposes of the draft determination, the Commission has included expenditure for these projects in line with SA Water's proposal. In doing so, the Commission has not reviewed, in detail, the prudent and efficient expenditure requirements of these two projects.

To illustrate the impact of the revenue caps from the higher rate of return, holding all things equal, if the rate of return used in SAWRD20 (2.68 percent) was applied for the purposes of the SAWRD24 determination, it would lead to the following revenue outcomes (refer Table 17.6).

Table 17.6: Comparison of revenue caps for SAWRD24 using SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (\$m)	Draft Determination SAWRD24 - 2.68% Rate of Return (\$m)	Variance (\$m)	Variance (%)
Water	3,550	3,108	-441 ↓	-12% ↓
Sewerage	1,785	1,572	-213 ↓	-12% ↓

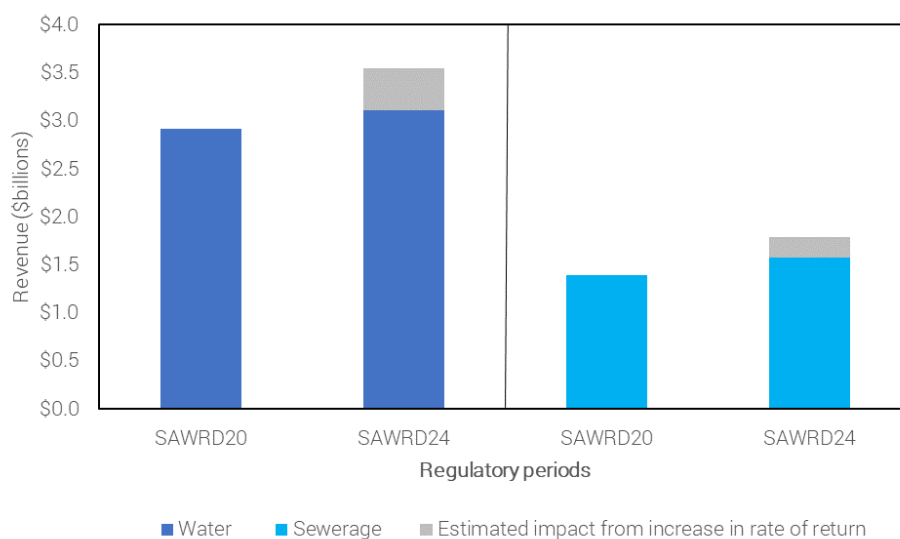
In this scenario, the revenue caps would be 7 per cent and 13 percent higher than in SAWRD20 (compared to 22 percent and 28 percent respectively). In both instances, this is 15 percentage points below the SAWRD24 draft decision (refer Table 17.7).

Table 17.7: Comparison of percentage change in revenue caps for SAWRD24 compared to SAWRD20, using SAWRD24 and SAWRD20 rate of return (\$Dec22)

	Draft Determination SAWRD24 – 3.99% Rate of Return (%)	Draft Determination SAWRD24 - 2.68% Rate of Return (%)	Variance (%)
Water	22%	7%	-15% ↓
Sewerage	28%	13%	-15% ↓

The conclusion may be drawn that the rate of return is the major contributing factor to the increase in the revenue caps, as displayed in Figure 17.3.

Figure 17.3: Revenue amounts across SAWRD20 and SAWRD24 (\$Dec22)



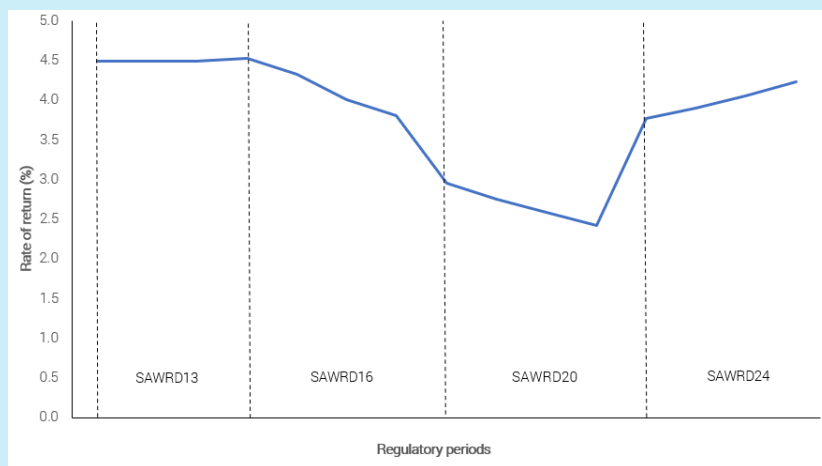
Box 17.1 Key driver - Rate of return

Increased financing costs have resulted in a draft decision to set SA Water’s allowed average rate of return at 3.99 percent (real, post-tax), calculated as of 14 November 2023. By way of comparison, the average regulatory rate of return (real, post-tax) adopted in previous determinations was:

- ▶ 4.5 percent in 2013-16
- ▶ 4.17 percent in 2016-20 and
- ▶ a low of 2.68 percent in 2020-24.

Figure 17.1 displays the rate of return across previous regulatory determinations. It highlights the fall in financing costs over SAWRD16 and SAWRD20 and the recent increase in the draft decision for SAWRD24.

Figure 17.1: Rate of return across SAWRD13, SAWRD16, SAWRD20 and SAWRD24



In its Regulatory Business Proposal (RBP), SA Water calculated revenue requirements using an average regulatory rate of return (real, post-tax) of 3.23%, calculated in March 2023.

The impact of the rate of return can also be seen in changes in the benchmark tax allowance across regulatory periods, refer Figure 17.2.

Figure 17.2: Benchmark tax allowance across SAWRD13, SAWRD16, SAWRD20 and SAWRD24 (\$Dec22)

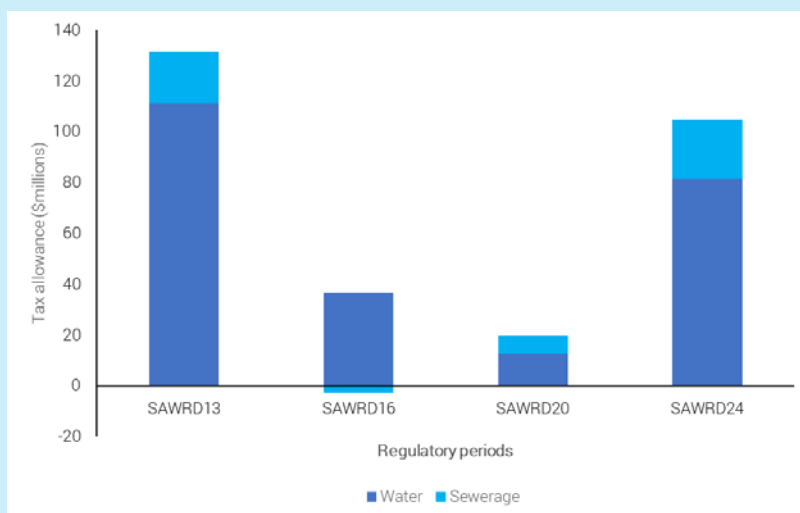


Table 17.8 provides a summary of the key building block cost components, including the amounts incorporated into the revenue caps and the size of the contributors to the percentage increase.

Table 17.8: Revenue caps in SAWRD24 compared with those determined in SAWRD20, in present value terms (\$Dec22)

	Draft SAWRD24 (\$m)	Final SAWRD20 (\$m)	Contributions to change from SAWRD20 (%)
Total Water	3,550	2,913	+22
Operating expenditure	1,420	1,519	-3
Return on assets	1,440	961	+16
Regulatory depreciation	860	780	+3
Tax allowance	75	12	+2
Return on working capital	6	4	+0
Non-tariff regulatory revenue ⁷³¹	-251	-363	+4
Total Sewerage	1,785	1,393	+28
Operating expenditure	662	586	+5
Return on assets	728	485	+17
Regulatory depreciation	534	513	+2
Tax allowance	22	7	+1
Return on working capital	3	2	+0
Non-tariff regulatory revenue	-163	-199	+3

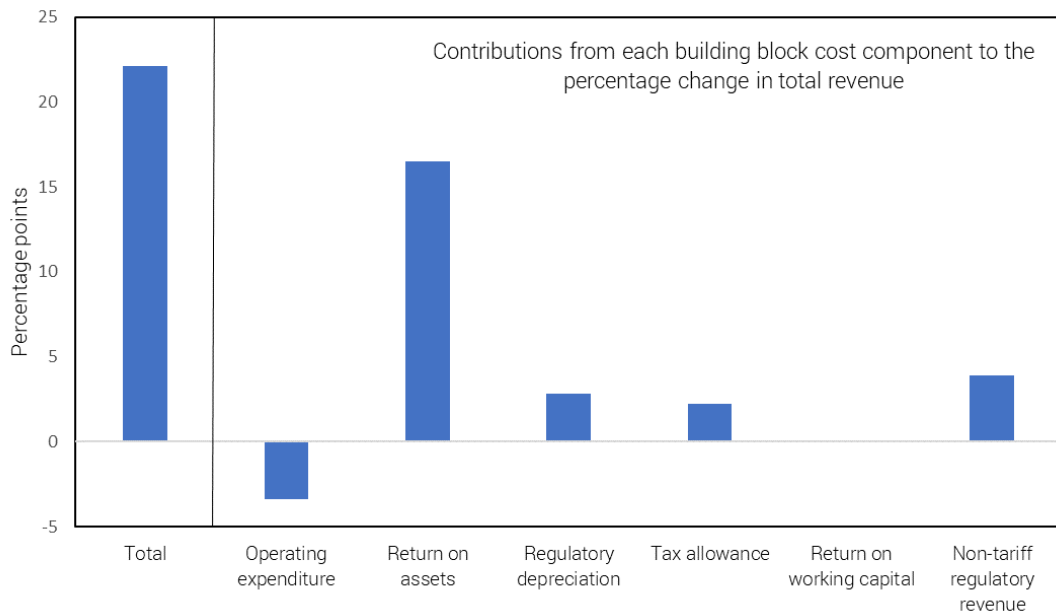
Figure 17.4 illustrates the contributions of each building block cost component to the change in the revenue caps between SAWRD20 and SAWRD24. For example, of the 22 percent increase in the total revenue cap for water retail services since SAWRD20, the return on assets⁷³² has contributed 16 percentage points.

This indicates that three-quarters of the increase in the revenue cap since SAWRD20 has been driven by the return on assets, demonstrating the higher return on assets has been driven largely by the increase in the rate of return.

⁷³¹ Includes revenue for community service obligations, sales of recycled water and adjustments from SAWRD20.

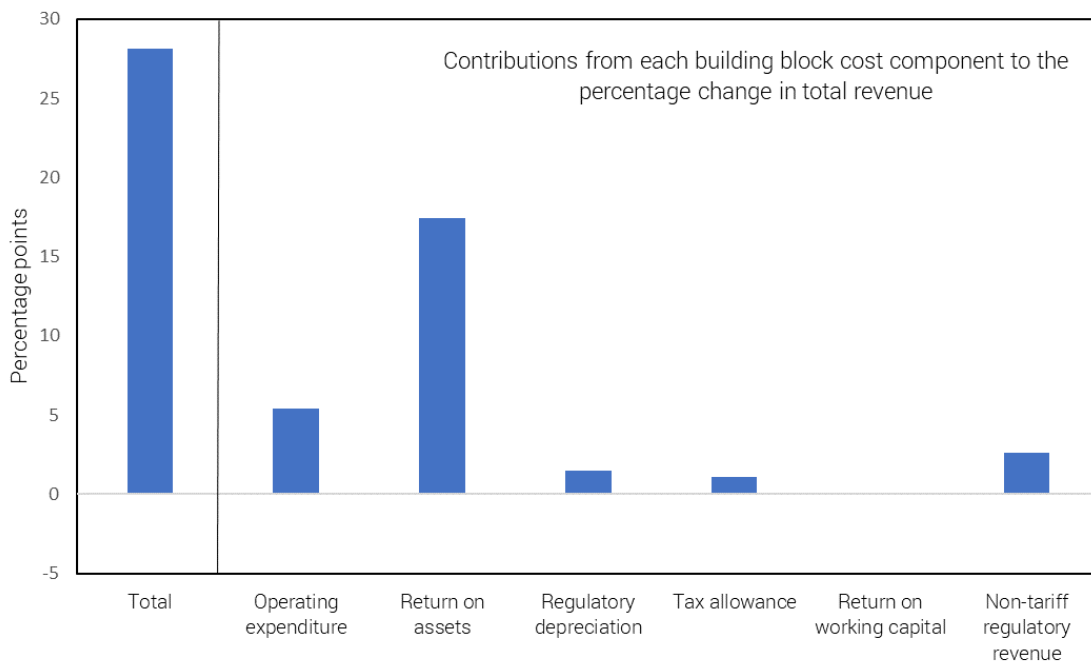
⁷³² Return on assets is the annual return SA Water receives on its regulated asset base (RAB). The opening RAB was set by the Treasurer in Pricing Orders issued pursuant to section 35(4) of the WI Act and then subsequently rolled-forward consistent with Principle 5 of the National Water Initiative (NWI) Pricing Principles.

Figure 17.4: Drivers of changes in water revenue caps between SAWRD24 and SAWRD20



For sewerage retail services, the increase in the revenue caps reflects the higher rate of return and benchmark prudent and efficient operating expenditure (Figure 17.5). The higher operating costs reflect, in part, that SA Water has modified its cost allocation methodology (re-allocating expenditure to sewerage retail services, away from water retail services) and a large increase in prudent and efficient operating expenditure associated with the Tea Tree Gully (TTG) Sustainable Sewers program.

Figure 17.5: Drivers of changes in sewerage revenue caps between SAWRD24 and SAWRD20

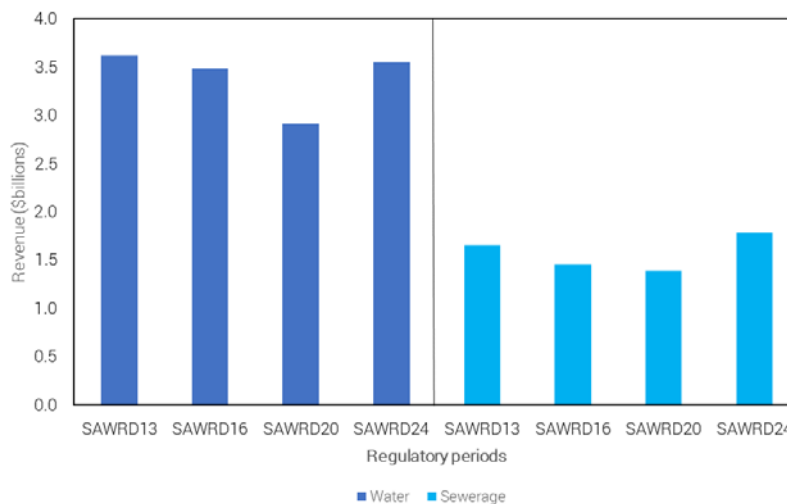


17.3 Comparison against previous determinations

To put the SAWRD24 draft determination into context, comparisons can be made against the revenue allowances set out in previous regulatory determinations.

A comparison against SAWRD13 highlights that the current SAWRD24 draft determination is not out of the ordinary in terms of the total efficient costs for SA Water for the delivery of water and sewerage retail services (Figure 17.6). The SAWRD24 revenue caps for water and sewerage retail services are approximately 2 percent lower and 8 percent higher than the revenue amounts determined under SAWRD13.

Figure 17.6: Revenue amounts across SAWRD13, SAWRD16, SAWRD20 and SAWRD24, in present value terms (\$Dec22)



17.4 Section 6 directions under the *Public Corporations Act 1993*

As mentioned in earlier chapters, the Minister for Climate, Environment and Water (**Minister**) may issue directions to SA Water under section 6 of the *Public Corporations Act 1993* (**PC Act**). Those directions may specify on-going and new requirements that SA Water must deliver during a regulatory period, with associated cost-related requirements or specifications. SA Water stated in its RBP that directions will be issued relating to two major projects: Northern Metropolitan Growth and TTG Sustainable Sewers.

Through submissions, stakeholders have expressed interest in the impact these projects may have on SA Water's revenue requirements. In terms of prudent and efficient net capital expenditure, the Commission has undertaken an illustrative sensitivity analysis.

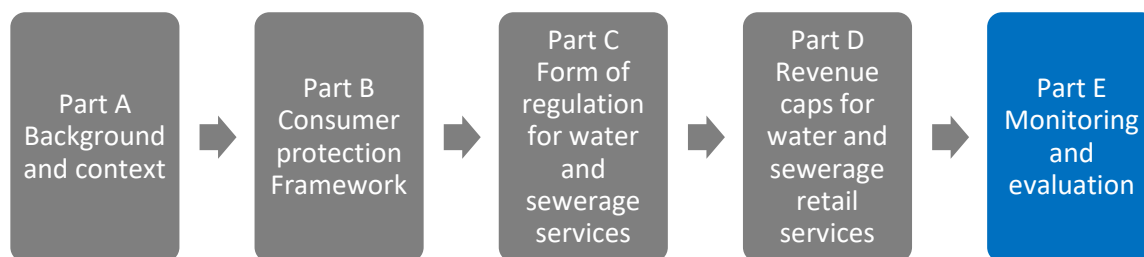
If the Commission adopted a net capital expenditure benchmark for SAWRD24 that *excluded* the potential Ministerial directions under section 6 of the PC Act, but held all else equal, it is estimated that it would lower revenue caps by only approximately 1 percent for both water and sewerage retail services. (Note that in this scenario operating expenditure associated with the expected section 6 directions under the PC Act has not been excluded.)

Overall, the relatively small reduction in revenue caps in this scenario is due to two reasons:

- ▶ the proposed capital expenditure in water and sewerage assets will be recouped over the whole life of the assets (which can be long, in excess of 50 years), and

the return of capital is discounted more heavily than in the previous regulatory period due to the recent increase in the rate of return applicable to SA Water.

Part E – Monitoring and evaluation



Part E sets out the Commission’s review of, and draft decision on, the monitoring and evaluating performance framework (**MEPF**) that applies to SA Water.

Under the MEPF, SA Water is expected to publicly explain its service, expenditure, and investment performance outcomes. To deliver this outcome, SA Water self-publishes performance information and analysis alongside its reporting to the Commission.

The inaugural objectives of the MEPF were to:

- ▶ provide all stakeholders with timely information about SA Water’s levels of customer service and network reliability
- ▶ enable the Commission and other regulators of SA Water to understand the extent to which SA Water is meeting its regulatory obligations and take action where it is not
- ▶ provide stakeholders with annual updates on SA Water’s progress in delivering the activities, projects, programs and outcomes proposed by SA Water in its 2020-2024 Regulatory Business Proposal (**RBP**) and accepted in SAWRD20, and
- ▶ provide a comprehensive and longer-term view of SA Water’s financial and operational performance that can be used as the foundation for SAWRD24 and subsequent regulatory determinations.

18 Monitoring, evaluating and reporting the outcomes achieved in SAWRD24

Draft decision - Monitoring and Evaluating Performance Framework

The Commission's draft decision is to retain and strengthen the Monitoring and Evaluating Performance Framework (MEPF) that applies to SA Water, for SAWRD24.

Proposed changes are to:

- ▶ embed SA Water's public reporting requirements in the Water Retail Code – Major Retailers
- ▶ introduce a new Code requirement for SA Water to report annually to the Commission and the public about how it has applied its best endeavours where it has not met a service standard performance target
- ▶ introduce a new Code requirement for SA Water to submit a Basis of Preparation, annually, for the financial and operational performance reporting metrics it submits to the Commission
- ▶ introduce a new Code requirement for SA Water to publicly communicate and explain any significant data revisions or errors in its published reports, and
- ▶ introduce a new obligation in SA Water's retail licence for it to have and adhere to a compliance system based on the Australian Standard on Compliance Programs, AS 37301:2023 (as amended from time to time).

The Water Regulatory Information Requirements - Major Retailers Water Industry Guideline No. 2 (**Guideline 2**) will be amended to include:

- ▶ the broad information to be covered in SA Water's public reports
- ▶ new hardship reporting indicators, including:
 - average amount of bill debt for residential customers upon entry into the financial hardship program as at the end of the quarter
 - average amount of bill debt for residential customers upon successfully exiting the financial hardship program as at the end of the quarter
 - number of residential customers who exited without successfully completing the financial hardship program during the quarter, and
 - average amount of bill debt for residential customers who exited without successfully completing the financial hardship program as at the end of the quarter.
- ▶ expectations in relation to the quality and accuracy of information in public reports
- ▶ requirements for SA Water's public reports to be reasonably accessible to the public and include timeseries datasets to enable public comparison and analysis of service standard performance, and
- ▶ definitions of 'bill debt' and 'successfully exiting the financial hardship program'.

In conjunction with these changes, the Commission intends to strengthen its communication on SA Water's performance both publicly and directly to SA Water.

18.1 Introduction

The MEPP was introduced in SAWRD20 and outlines public reporting requirements and regulatory expectations that apply to SA Water.⁷³³ It requires SA Water to account for the long-term commitments made to customers, including under its Regulatory Business Proposal (**RBP**), and for delivering the outcomes as required under the consumer protections established by the Water Retail Code – Major Retailers (**Code**).

Public reporting requirements were set based on four focus areas that stakeholders deemed most important: service standards and performance targets, expenditure and revenue outcomes, key investment areas, and long-term asset management and planning. Under the MEPP, the Commission verifies and provides assurance on SA Water's data collection and analysis through assurance statements, reviews and audits, as required.

The MEPP is based on the Commission's Verified Trust and Accountability (**VTA**) framework. Under the VTA, there is greater emphasis on licensee accountability and regulatory verification of performance outcomes and long-term trends. A licensee can gain and lose trust based on its own actions, and the Commission can intervene or take regulatory action as required to protect consumers' interests.

18.1.1 SAWRD20 final decision

In SAWRD20, stakeholders sought increased public transparency and accountability on SA Water in relation to its expenditure and the extent to which that expenditure delivers the outcomes promised. The Commission's final decision in SAWRD20 required SA Water to provide public reports on:

- ▶ its performance against the service standards in the Code, on a quarterly basis
- ▶ its performance in delivering on network reliability and water aesthetics improvements
- ▶ its performance during major service interruptions or significant performance events, shortly after those events, and
- ▶ its progress in achieving the outcomes it committed to deliver in its 2020 regulatory business plan, on an annual basis.

Additionally, SA Water was required to publish:

- ▶ an annual public assurance summary statement containing sufficient information to provide assurance to customers and other stakeholders that SA Water complied, and would continue to comply, with the regulatory revenue controls, and
- ▶ a public regulatory assurance statement for the entire SAWRD20 regulatory period that demonstrated whether the revenues derived from the actual drinking water and sewerage prices, volumes and customer numbers during the period were at or within the revenue caps.

18.2 Matters raised in consultation

The Commission sought feedback on the MEPP through consultation on the SA Water Regulatory Determination 2024 – Water Retail Code and MEPP Issues Paper (**Issues Paper**), released in June

⁷³³ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2020 monitoring and evaluating performance*, 2021, available at: www.escosa.sa.gov.au/news/water-news/jan21-news-2021-w-sawrd20-mep-final

2023.⁷³⁴ The Commission received submissions from the Energy and Water Ombudsman SA (EWOSA), South Australian Council of Social Service (SACOSS), South Australian Federation of Residents and Ratepayers (SAFRRA), and SA Water. The Commission also received feedback from members of the Commission's Consumer Advisory Committee (CAC) members in a workshop held on 29 June 2023.

Submissions indicated that stakeholders are generally satisfied with the established focus areas of reporting. Stakeholders consider that SA Water's reports are easy to understand and include relevant information to help them assess aspects of SA Water's performance and key investments.

SA Water stated that it *'supports the objective to provide customers and stakeholders useful information, in the interest of transparency, accountability and to obtain feedback. However, SA Water also believes that there is an important balance in determining the level of detail and frequency of the information reported, and ensuring information is useful for the intended audience.'*

In particular, SA Water recommended the Commission reconsider the frequency (annual) and the duration (30-year horizon) of reporting on long-term asset management and investment planning. It proposed a 15-year time horizon and less-frequent reporting for SAWRD24, citing the lack of strong stakeholder support for the latter.

Stakeholders such as SACOSS, EWOSA, and the CAC sought improved transparency from SA Water in instances when it did not achieve a service standard target. EWOSA supported requiring SA Water to publish a summary of service standard performance that highlights the proportion of service standards achieved and not achieved, and reasons for not achieving targets.⁷³⁵

Stakeholders would like the Commission to provide its independent analysis of SA Water's performance, particularly where it does not meet a service standard or where a compliance issue has been identified. Further, in its submission, EWOSA recommended that the Commission publish an independent assessment where *'a service standard has not been achieved and best endeavours have not been applied, or there is a compliance issue'*.⁷³⁶ In its submission, SACOSS suggested the Commission should publish an analysis of SA Water's performance reports, with a focus on implications for consumers.⁷³⁷ It noted that *'stakeholders would have a high level of trust in [the Commission's] analysis, and would feel more confident in drawing conclusions'* about SA Water's performance.⁷³⁸

SA Water noted in its submission that it *'has not received any communications from the Commission on RD20 service standard performance relating to the current regulatory period from 2020-21.'* SA Water indicated that it would *'support the Commission formally communicating its views on the Corporation's performance.'*⁷³⁹

⁷³⁴ Essential Services Commission of South Australia, *SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, available at: www.escosa.sa.gov.au/news/water-news/jun23-news-2023-w-sawrd23-wrcmepf-initiate

⁷³⁵ EWOSA submission [to the SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper](#), 2023, p. 4, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-EWOSA.pdf.aspx?Embed=Y

⁷³⁶ EWOSA submission [to the SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper](#), 2023, p. 6.

⁷³⁷ SACOSS submission to the *SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, available at: www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-SACOSS.pdf.aspx?Embed=Y

⁷³⁸ SACOSS submission to the *SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, p. 7.

⁷³⁹ SA Water submission to the *SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper*, 2023, p. 9, available at:

Stakeholders including EWOSA, SACOSS, and the CAC would like more detailed reporting from SA Water including disaggregated data, reporting on additional hardship indicators, and timeseries data in SA Water's public reports to be able to better evaluate performance trends over time. For example, EWOSA and SACOSS have sought reporting on average debt levels while entering and exiting a financial hardship program. SACOSS has also recommended including definitions for certain terms in Guideline 2. Some CAC members sought improved access to SA Water's public reports on its website.⁷⁴⁰

18.3 Commission analysis

18.3.1 Implementation of the MEPF and compliance

The Commission considers that the introduction of the MEPF has improved SA Water's transparency and accountability. SA Water's public reports provide stakeholders with a reasonable level of insight into its service standard performance and ongoing investment planning and evaluation processes.

SA Water met most of the public reporting requirements set out in the MEPF. It publishes quarterly reports on service standard performance, an annual report on performance measures, an annual report on key investment areas, and a rolling 30-year asset plan on its website.⁷⁴¹ SA Water did not satisfy the requirement to publish an annual public assurance summary statement.

Currently, the Commission has limited enforcement powers in this area, as public reporting requirements are not embedded in the Code. Including the public reporting requirements under the MEPF within the Code and Guideline 2 would create a regulatory obligation for SA Water to report on its performance and call up the Commission's statutory enforcement powers, if required. Accordingly, if SA Water does not meet its obligations, the Commission could consider taking appropriate action consistent with the statutory regime and its Enforcement Policy.⁷⁴²

The Commission has considered the annual public assurance summary statement and an end-of-period public regulatory assurance statement. It notes that the regulatory determination provides information on SA Water's revenue performance for the four-year period in the subsequent period (for example, see Chapters 15 and 16). The Commission considers that the requirement for SA Water to develop additional assurance statements does not provide sufficient additional value for stakeholders compared to the regulatory effort by SA Water to develop these statements. It is the Commission's understanding that stakeholders have not sought this information over the period. The Commission considers that there would be greater value for stakeholders in receiving information from SA Water throughout the period on how it has applied its best endeavours where a service standard performance target has been missed. This view is consistent with what the Commission heard from CAC members.

www.escosa.sa.gov.au/ArticleDocuments/21971/20230807-Water-SAWRD24-RetailCodeMEPF-IssuesPaperSubmisison-SAWater.pdf.aspx?Embed=Y

⁷⁴⁰ The Guideline provides for the collection, allocation and recording of SA Water's business data and covers a range of information requirements specified by the Commission in respect of SA Water's operational and financial performance.

See Essential Service Commission of South Australia, Water Regulatory Information Requirements - Major Retailers, Water Industry Guideline No. 2, 2020, available at: [20201002-Water-RegulatoryInformationRequirementsGuidelineNo2-Major-Retailers.pdf.aspx\(escosa.sa.gov.au\)](http://20201002-Water-RegulatoryInformationRequirementsGuidelineNo2-Major-Retailers.pdf.aspx(escosa.sa.gov.au)).

⁷⁴¹ See public reports on SA Water's website, available at: www.sawater.com.au/about-us/our-publications/our-reports/our-performance-scorecard.

⁷⁴² Essential Service Commission of South Australia, *Enforcement policy, 2021*, available at: www.escosa.sa.gov.au/ArticleDocuments/21734/20210811-Corporate-EnforcementPolicy-V2.6.pdf.aspx?Embed=Y

18.3.2 Reporting on long-term asset management and planning

The Commission has considered SA Water's feedback on reviewing the frequency and duration of reporting on its long-term asset management and planning.

With regards to the duration of reporting, the Commission considers that the current requirement incentivises SA Water to take a long-term view of asset sustainability, which informs its planning and investment.

There are other examples of other industries undertaking long-term asset planning. For example, Flinders Ports, another entity regulated by the Commission, publishes a 50-year masterplan that outlines its long-term infrastructure plan, and challenges and opportunities for driving further efficiencies.⁷⁴³

The Commission notes past stakeholder appetite for better visibility of SA Water's asset management processes and long-term asset needs. In its submission on the Issues Paper, EWOSA noted the importance of the Key Investment Areas and 30 Year Asset Plan reports for stakeholders when they consider SA Water's RBP.

With regards to the frequency of reporting, the Commission's expectation is that the long-term asset plan informs SA Water's planning and investment both within a regulatory period and in the lead up to a new regulatory period. At a minimum, this should include an update to SA Water's long-term asset management plan following the Commission's regulatory determination and be in line with the development of SA Water's RBP.

While the Commission acknowledges that there are some costs involved in making this information available to the public, the Commission does not consider these costs to be significant. The Commission notes that SA Water has already made this information available to the public during SAWRD20, in accordance with the requirements of the MEPF. The Commission considers that reducing the frequency of reporting would reduce the regulatory burden on SA Water compared with requirements for SAWRD20.

18.3.3 Best endeavours obligations

Under the Code, SA Water must employ best endeavours in complying with various Code obligations, including meeting service standards.⁷⁴⁴ SA Water should be able to satisfy itself, the Commission, and the community that it has the appropriate culture, systems, processes and controls to demonstrate compliance with that obligation.

SA Water's service standard performance reports include targets and performance data for all service standards both publicly and to the Commission. The reports provide some commentary where service standard performance targets were not met.

Stakeholders have indicated that they would like to see an increased level of explanation and accountability from SA Water in relation to its service standard performance, particularly where performance targets are not met.

SA Water has previously expressed concerns about the Commission's approach to requiring entities to demonstrate best endeavours where a service standard has not been met. In a letter to the Commission, SA Water noted that since the implementation of the MEPF, it *'is now unable to verify for its customers, Board or owner that it is achieving its service standard obligations in instances where it is not*

⁷⁴³ Flinders Port Holdings, *50 year Masterplan*, 29 June 2023, available at: issuu.com/daviha/docs/masterplan_-_summary_doc_final

⁷⁴⁴ 'Best endeavours' means to act in good faith and use all reasonable efforts, skill and resources.

hitting targets for reasons outside of its control.' During this regulatory period, Commission staff have, on a number of occasions, explained the obligations to SA Water in order to clarify the intent of best endeavours obligations. The Commission has also published a 'best endeavours' information page on its website.⁷⁴⁵

There is scope for SA Water to better demonstrate and articulate its best endeavours obligations in SAWRD24 to provide more transparent information about its service standard performance to the public, particularly where performance targets are missed. Providing additional public information is unlikely to create significant additional costs for SA Water and would benefit customers by providing greater insight into and assurance over SA Water's performance.

18.3.4 Data governance

The Commission has identified errors in the reporting and information SA Water submits to the Commission and publishes on its website.

For example, in February 2022, the Commission requested that SA Water provide information about the underlying causes driving the increase in the number of unplanned water service interruptions in 2021-22. Following an investigation, SA Water noted that '*...further analysis also identified a longstanding coding error where water service interruptions have been under-reported since 2012-13.*'

In June 2023, SACOSS raised a concern about whether SA Water was accurately reporting hardship program and payment plan customers in the past few quarters.⁷⁴⁶ In response to a request for information, SA Water advised the Commission that it had been incorrectly reporting hardship and payment plan customer numbers since it started reporting on these indicators. This reporting error impacted both the reporting it submitted to the Commission and published in its quarterly service standard performance reports. SA Water has indicated it is taking steps to correct the error.

The Commission is continuing to investigate this matter, including to determine whether SA Water has met its obligations under the Code and if further regulatory or compliance action may be warranted in the circumstances.

Data governance issues have also been identified in SA Water's internal audit reports in 2018 and 2021. Sound data governance and reporting is an integral part of SA Water gaining trust and providing assurance over its performance to the Commission and customers.

A Basis of Preparation, which explains the systems, processes and controls SA Water uses for reporting, would help the Commission better understand and assess the assumptions and methodology SA Water uses in its performance reporting. A Basis of Preparation usually includes information and descriptions of how data is measured and collected, the methodology applied and assumptions made, and explanations of data revisions. The Commission notes that a Basis of Preparation is considered standard practice in the energy sector for entities regulated by the Australian Energy Regulator (AER).

Developing a Basis of Preparation may create some costs for SA Water. However, SA Water should already have this information and it would have flexibility to determine the manner and form of the Basis of Preparation. Over time, this approach would help to improve efficiency and reduce regulatory effort by SA Water in responding to the Commission's enquiries. It would also provide the Commission and other stakeholders with the assurance that the data reported by SA Water is robust and fit to be used to assess SA Water's performance.

⁷⁴⁵ See the 'Best endeavours' information page on the Commission's website, available at: www.escosa.sa.gov.au/approach/best-endeavours

⁷⁴⁶ SACOSS submission to the SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper, 2023, pp. 8-9.

18.3.5 Compliance systems

Currently, Guideline 1 – Compliance Systems and Reporting (**Guideline 1**), expects licensees to have, and rigorously adhere to, a sound and robust compliance system based on the Australian Standard on Compliance Programs, AS 37301:2023 (as amended from time to time), or on another credible compliance standard (as approved by the Commission in writing on application by the licensee).

SA Water has indicated to the Commission that it has a compliance system. If SA Water already has a compliance system that is based on the Australian Standards, this new licence obligation will impose no additional regulatory burden.

However, inadequate systems and processes can lead to failures in meeting legal and regulatory obligations, including reporting obligations. It is critical that SA Water has in place an effective compliance management system to mitigate its legal and compliance risks.

18.3.6 The Commission's communication on performance

Discussions with stakeholders highlighted scope to improve the Commission's public communication on SA Water's performance.

Currently, the Commission publishes annual performance summaries, including information on the performance targets met and missed.⁷⁴⁷ The Commission sends letters when there are major concerns about SA Water's performance and letters typically do not include broader feedback on performance. The Commission considers that it is important to provide regular feedback to SA Water about its performance in SAWRD24. The Commission also sees value in providing information and improving clarity on how the VTA framework applies to SA Water.

18.3.7 Hardship indicators

Stakeholders including SACOSS, EWOSA, and the CAC supported requiring SA Water to report on additional hardship indicators to help stakeholders understand trends in hardship over time. They noted that the current hardship indicators do not provide information on the extent of hardship experienced and average debt levels at different stages of participating in a financial hardship program. SACOSS noted that the current hardship indicators *'will not provide stakeholders with an understanding of any changing trends in the levels of customer debt over time, which is an important part of the wider context.'*⁷⁴⁸

SACOSS recommended amending Guideline 2 to include new hardship indicators such as average debt levels upon entry into the hardship program. SACOSS also recommended including definitions for 'water bill debt' and 'successfully exiting the financial hardship program.'

As noted in chapter five, the number of people participating in the hardship program has decreased, even though the average amount of bill debt for customers on the hardship program has increased. The Commission considers that, with the benefit of observations over time, the current indicators do not provide sufficient information about how early people are receiving assistance or hardship trends. Collecting additional information will help the Commission understand the extent to which customers are experiencing hardship, receiving assistance when they need it, and whether they successfully complete the hardship program and repay their debt.

⁷⁴⁷ Essential Services Commission of South Australia, *SA Water's regulatory performance*, available at: www.escosa.sa.gov.au/industry/water/regulatory-performance/sa-water/sa-water-regulatory-performance

⁷⁴⁸ SACOSS submission to the SA Water Regulatory Determination 2024 – Water Retail Code and Monitoring and Evaluating Performance Framework Issues Paper, 2023, p. 8.

18.4 Draft decision

To strengthen SA Water's public accountability in relation to its performance reporting, the Commission's draft decision is to add public reporting requirements to the Code and Guideline 2.

The Code will set a requirement for SA Water to publish reports in relation to its service standard performance, performance during significant performance events, financial performance, key investment areas, and long-term asset management and investment planning. In relation to performance during major service interruptions and significant performance events, the Code will require SA Water to provide a report to the Commission within three days of the event occurring. The requirement to publish a long-term asset management plan will change from an annual requirement to a biennial requirement.

The Commission will not retain the requirement to publish an annual public assurance summary statement and an end-of-period public regulatory assurance statement for SAWRD24. The Commission's determination (Chapters 15 and 16) includes a summary of SA Water's revenue earned over the period subject to demand. On balance, the costs of producing the statement appear to exceed the benefits.

To strengthen SA Water's culture and practices around its best endeavours obligations, a new Code requirement will be created for SA Water to publish an annual 'best endeavours statement' where it has not met an annual service standard target.⁷⁴⁹ This statement will outline the reasons for not meeting the annual service standard target, an assessment of how SA Water considers best endeavours have been applied (to meet the annual service standard), and any actions it is taking to improve performance (if required).

Depending on SA Water's regulatory performance and delivery, the Commission may consider requiring SA Water to publish a written Monitoring, Evaluation and Compliance Strategy (**MECS**). A MECS would set out, ahead of time, how SA Water will apply its best endeavours in pursuing performance targets for every service standard. The Commission is using this approach successfully for SA Power Networks (**SAPN**) through the Electricity Distribution Code.⁷⁵⁰

To incentivise SA Water to improve its data governance in SAWRD24, a new Code requirement will require SA Water to submit an annual Basis of Preparation on the financial and operational performance reporting metrics required under Guideline 2.

A new Code requirement will outline expectations in relation to the quality of data and information in SA Water's public reports. SA Water will be required to communicate and explain errors identified and publish revised information within seven business days.

To incentivise SA Water to ensure its compliance system meets and complies with the required standard based on the Australian Standard on Compliance Programs, AS 37301:2023, the Commission will elevate the compliance system guidance set out in Guideline 1 to become a condition of SA Water's retail licence.

⁷⁴⁹ A new proforma has been included in Guideline 2 for SA Water to report on best endeavours.

⁷⁵⁰ Essential Services Commission of South Australia, Electricity Distribution Code, available at: <https://www.escosa.sa.gov.au/ArticleDocuments/21963/20230626-Electricity-DistributionCode-EDC14.pdf.aspx?Embed=Y>.

To improve its public communication on SA Water's performance, the Commission will build on its annual performance summaries in SAWRD24 to include any outcomes of enquiries it makes into SA Water's performance.⁷⁵¹ The Commission will develop additional information on how it monitors and evaluates SA Water's performance under the VTA framework.

In response to stakeholder feedback, Guideline 2 will be amended to require SA Water to publish timeseries data to allow for comparison of performance over time and to ensure reasonable access to its public reports. Four new hardship indicators will be created in Guideline 2 to provide more information on the extent of hardship experienced and average debt levels at different stages of participating in a financial hardship program. These indicators are:

- ▶ average amount of bill debt for residential customers upon entry into the financial hardship program as at the end of the quarter
- ▶ average amount of bill debt for residential customers upon successfully exiting the financial hardship program as at the end of the quarter
- ▶ number of residential customers who exited without successfully completing the financial hardship program during the quarter, and
- ▶ average amount of bill debt for residential customers upon unsuccessfully exiting the financial hardship program as at the end of the quarter.

⁷⁵¹ Essential Services Commission of South Australia, *SA Water's regulatory performance*, available at: www.escosa.sa.gov.au/industry/water/regulatory-performance/sa-water/sa-water-regulatory-performance

Appendices

- ▶ Appendix 1 – Process for making SAWRD24
- ▶ Appendix 2 – Legal requirements
- ▶ Appendix 3 – Submissions from stakeholders

Appendix 1 Process for making SAWRD24

A1.1 Framework and Approach

Following a public consultation process, the Commission published a Framework and Approach for the SA Water Regulatory Determination 2024 (**SAWRD24**) in September 2021.⁷⁵²

The Framework and Approach is a governance paper, setting out broad expectations and process considerations. Its intent is to assist SA Water to prepare and submit a Regulatory Business Proposal (**RBP**) which, under the highest and widest levels of public scrutiny, clearly demonstrates how its proposed investments and revenue requirements will protect consumers' long-term interests and meet regulatory requirements and expectations.

The Framework and Approach outlined the following expectations:

- ▶ a continued focus on early and transparent stakeholder and consumer engagement by all parties throughout the process
- ▶ SA Water should provide continuous and early visibility of its long-term asset planning, delivery and management, to provide stakeholders with better information on its long-term investment plans (and hence revenue requirements)
- ▶ SA Water should clearly and transparently explain how its proposed investments over the four-year regulatory period are prudent and efficient, and how they relate to and impact on its long-term investment plans, and
- ▶ SA Water's RBP is to be submitted by July 2023, to allow the Commission to release a Draft Determination by November 2023 and, following a period of public consultation, a Final Determination by May 2024.⁷⁵³

The Framework and Approach was informed by stakeholder feedback, including members of the Commission's Consumer Advisory Committee,⁷⁵⁴ members of the previous Consumer Negotiation Committee,⁷⁵⁵ members of SA Water's Consumer Advisory Groups, and SA Water staff and management.

Consultation began in August 2020, with an independent, external ex-post review of the process used in the current regulatory determination, conducted by Dr Pat Walsh.⁷⁵⁶ The Commission is grateful for the engagement and contributions from all parties to inform the SAWRD24 process.

The Framework and Approach noted that guidance papers on matters of regulatory policy, methodology and practice will be developed and issued, as necessary, throughout the process. Wherever possible, this will include inviting the views of wider stakeholders on draft positions.

⁷⁵² The Framework and Approach is available on the Commission's website at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024-framework-and-approach/sawrd2024

⁷⁵³ Note: SA Water's submitted its RBP in August 2023, a delay of six-weeks due to realigning its operational focus to the 2022–23 River Murray flood event in Q2 and Q3 of 2022-23.

⁷⁵⁴ Further information on the Consumer Advisory Committee is available on the Commission's website at www.escosa.sa.gov.au/approach/consumer-advisory-committee

⁷⁵⁵ Further information on the Negotiation Committee is available on the Commission's website at www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2020/negotiation-forum

⁷⁵⁶ Dr Patrick Walsh, *Stakeholder views regarding the process applied to the SA Water Regulatory Determination 2020*, October 2020, available at: www.escosa.sa.gov.au/news/water-news/water-news-archived/dec20-news-w-sawrd20-furtherinfo2

A1.2 Guidance Papers

The Commission released three guidance papers, to make clear the Commission's initial positions, principles, requirements, methodology or guidance on matters relevant to the determination. The Commission required SA Water to consider the matters set out in the guidance papers when preparing its RBP. The guidance papers are summarised below.⁷⁵⁷

A1.2.1 Guidance Paper 1 – The regulatory business plan

Guidance Paper 1 set out the Commission's high-level expectations of the matters to be addressed in SA Water's RBP.

The Commission did not prescribe the manner and form that SA Water's RBP must take. However, the Commission's 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, a 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 (CCG), and that customer research and input has informed the development of those proposals.
- ▶ Justification as to how proposed expenditures are prudent and efficient.

A1.2.2 Guidance Paper 2 – Stakeholder engagement for the RBP

Guidance Paper 2 set out the Commission's expectations for how SA Water engages with stakeholders to develop its RBP, including that:

- ▶ it has engaged in a meaningful and substantial way with an appropriately diverse range of stakeholders
- ▶ it has used an appropriately diverse range of channels and methods to engage with stakeholders, and
- ▶ stakeholder views and feedback have been carefully considered and incorporated into project design and prioritisation.

A1.2.3 Guidance Paper 3 – Assessing the regulatory business plan

Guidance Paper 3 set out, at a high level, how the Commission will approach the assessment of SA Water's RBP.

⁷⁵⁷ The Guidance Papers are available on the Commission's website at www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2024/guidance-Papers

In setting regulated revenues that recover the lowest sustainable costs of providing retail services, the Commission assesses whether SA Water's proposed expenditure for the 2024-28 regulatory period is prudent and efficient.

Broadly speaking, expenditure on an activity will be considered prudent where there is a clear justification for that activity. Decisions on whether expenditure is prudent will be informed by the Commission's consideration of whether the expenditure is driven by:

- ▶ a legislative or regulatory obligation, which SA Water must comply with
- ▶ an expectation that the activity will deliver benefits to customers that outweigh the costs
- ▶ a clear expectation from customers that an outcome should be achieved, and that they are willing to pay for that outcome.

Expenditure is likely to be considered efficient where it represents the lowest sustainable (or 'long-term') cost of achieving the intended outcome. The Commission will set revenues to recover efficient costs only, as this will help deliver the lowest sustainable prices to SA Water's customers.

A1.2.4 Submissions

The Commission received two submissions from SA Water to Guidance Paper 2 and Guidance Paper 3 and has taken those submissions into account in making this Draft Determination.⁷⁵⁸ Submissions are further discussed in Appendix 3 and relevant chapters.

A1.3 Issues paper - Water Retail Code and Monitoring and Evaluating Performance Framework

In June 2023, the Commission released an Issues Paper to seek feedback on the effectiveness of the current Water Retail Code – Major Retailers WRC-MR/03 (**Code**) and the SA Water Monitoring and Evaluating Performance Framework (**MEPF**).⁷⁵⁹

The Code sets out consumer protections (standards and requirements) that apply to the sale and supply of water and sewerage services by SA Water, the only major water retailer in South Australia. It includes obligations relating to customer information, customer service, connections, and retailer supply.

The MEPF establishes the reporting requirements and regulatory expectations that apply to SA Water. Its requirements relate to service standards and performance targets, expenditure and revenue outcomes, key investment areas, and long-term asset management and planning.

⁷⁵⁸ SA Water's submissions to the Guidance Papers are available on the Commission's website at <https://www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2020/guidance-papers>

⁷⁵⁹ The Issues Paper is available on the Commission's website at www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

In reviewing the Code, the objective is to establish:

- ▶ minimum service standards that reflect the level of service quality and reliability that is valued by customers, and
- ▶ other consumer protections that respond to the need of consumers to access SA Water’s retail services on fair and reasonable terms.

In reviewing the MEPF, the objective is to determine:

- ▶ how effectively the monitoring and evaluation framework has been implemented
- ▶ whether implementation of the monitoring and evaluation Framework has been successful in achieving its original aims of improving transparency of investment planning, and
- ▶ whether any amendments need to be made to the monitoring and evaluation Framework for SAWRD24.

A1.3.1 Submissions

The Commission received five submissions to the Issues Paper and has taken those submissions into account in making this Draft Determination.⁷⁶⁰ Submissions are further discussed in Appendix 3 and relevant chapters.

A1.4 SA Water’s regulatory business proposal

In August 2023, SA Water published and submitted its RBP, titled ‘Regulatory Business Plan 2024-28’ (available on its website).⁷⁶¹

The RBP sets out SA Water’s proposed customer service standards, revenues and indicative prices for water and sewerage services for the four-year regulatory period.

A1.4.1 Submissions

The Commission received twelve submissions to SA Water’s RBP and has taken those submissions into account in making this Draft Determination.⁷⁶² Submissions are further discussed in Appendix 3 and relevant chapters.

A1.5 Stages in the SAWRD24 review process

The SAWRD24 process has had a strong focus on providing simple and frequent opportunities for stakeholders to raise issues and comment on proposals, well in advance of the Commission making this Draft Determination. The stages of the process are summarised in Table A1.1 below. Further information regarding the process for SAWRD24 is available on the Commission’s website.⁷⁶³

⁷⁶⁰ Submissions to the Issues Paper are available on the Commission’s website at www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

⁷⁶¹ Available at: <http://www.sawater.com.au/about-us/how-we-operate/planning-for-2024-28>

⁷⁶² Submissions to SA Water’s RBP are available on the Commission’s website at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024

⁷⁶³ Available at: www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2024

Table A1.1: Stages in the SAWRD24 review process

Date	SAWRD24 Milestone
Aug 2020	External review of SAWRD20 process with stakeholders to inform SAWRD24 Framework and Approach
Feb 2021	Release of draft Framework and Approach
Feb – Mar 2021	Consultation on draft Framework and Approach
Sept 2021	Release of final Framework and Approach
Dec 2021	Release of Guidance Paper 1 – The regulatory business plan
April 2022	Release of Guidance Paper 2 – Stakeholder engagement for the regulatory business plan
July 2022	Release of Guidance Paper 3 – Assessing the regulatory business plan
June 2023	Release of Issues Paper on Water Retail Code – Major Retailers, Service Standards and Framework for monitoring and evaluating performance
June – Jul 2023	Consultation on Issues Paper (including YourSAy engagement)
Aug 2023	SA Water submits RBP (revised timing incorporating six-week submission delay)
Aug – Oct 2023	Consultation on SA Water’s RBP
Jan 2024	Release of Draft Regulatory Determination
Jan – Feb 2024	Consultation on Draft Regulatory Determination
June 2024	Release of Final Regulatory Determination
June 2024	SA Water and SA Government develop prices
1 July 2024	SAWRD24 regulatory period commences
Aug 2024	External review of SAWRD24 process with stakeholders to inform SAWRD28 Framework and Approach

Appendix 2 Legal requirements

The Essential Services Commission has made a draft regulatory determination in accordance with its primary objective, which is to protect the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.

It has also complied with the specific requirements under the *Essential Services Commission Act 2002* and *Water Industry Act 2012* that relate to the making of a price determination and the Codes and Rules that will also apply to SA Water.

This appendix explains the statutory framework that applies to the making of this regulatory determination and includes a general description of the elements of the statutory regime governing SA Water's operations that are relevant in the regulatory determination context.

A2.1 Functions and powers of the Commission

The regulatory functions of the Commission are set out in section 5 of the *Essential Services Commission Act 2002* (**ESC Act**). Functions relevant to the economic regulation of SA Water include:

5 – Functions

The Commission has the following functions:

- (a) *to regulate prices and perform licensing and other functions under relevant industry regulation Acts;*
- (b) *to monitor and enforce compliance with and promote improvement in standards and conditions of service and supply under relevant industry regulation Acts;*
- (c) *to make, monitor the operation of, and review from time to time, codes and rules relating to the conduct or operations of a regulated industry or regulated entities.*

In performing these functions, the following objectives (including the Commission's primary objective when undertaking any function) inform and guide the Commission. They are set out in section 6 of the ESC Act.

6 – Objectives

In performing the Commission's functions, the Commission must –

- (a) *have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
- (b) *at the same time, have regard to the need to –*
 - (i) *promote competitive and fair market conduct; and*
 - (ii) *prevent misuse of monopoly or market power; and*
 - (iii) *facilitate entry into relevant markets; and*
 - (iv) *promote economic efficiency; and*
 - (v) *ensure consumers benefit from competition and efficiency; and*
 - (vi) *facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and*
 - (vii) *promote consistency in regulation with other jurisdictions.*

With regard to the Commission's principal statutory objective, three elements of service delivery are captured – price, quality and reliability – and these are to be interpreted in a context of economic efficiency. That is particularly so in light of the fact that sections 6(b)(iv) and (v) of the ESC Act expressly refer to efficiency considerations.

A2.2 The Commission's price determination powers

A2.2.1 Under the ESC Act

Part 3 of the ESC Act sets out a legislative scheme governing the exercise of the Commission's price determination powers and functions.

Sections 25(1) and 25(2) have the combined effect of empowering the Commission to make price determinations where authorised to do so by a relevant industry regulation Act, which, in this case, is the WI Act.

Section 25(3) provides that a price determination may regulate prices, conditions relating to prices, or price fixing factors in any manner the Commission considers appropriate. Examples include:

- (a) fixing a price or the rate of increase, or decrease, in a price
- (b) fixing a maximum price, or maximum rate of increase, or minimum rate of decrease, in a maximum price
- (c) fixing an average price for specified goods or services, or an average rate of increase or decrease in an average price
- (d) specifying pricing policies or principles
- (e) specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed, or any other specified factor
- (f) specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services
- (g) fixing a maximum average revenue, or maximum rate of increase, or minimum rate of decrease in maximum average revenue, in relation to specified goods or services, or
- (h) monitoring the price levels of specified goods and services.

These examples are not exhaustive and the Commission may make a price determination to operate in a manner it considers appropriate, subject to any specific requirements of an industry regulation Act. In the case of the WI Act, certain requirements do exist, as discussed further below.

As well as the general factors set out in section 6 of the ESC Act, section 25(4) specifies additional factors to which the Commission must have regard when exercising its price determination function. They include:

- (a) the particular circumstances of the regulated industry and the goods and services for which the determination is being made
- (b) the costs of making, producing or supplying the goods or services
- (c) the costs of complying with the laws or regulatory requirements
- (d) the return on assets in the regulated industry

- (e) any relevant interstate and international benchmarks for prices, costs and return on assets on comparable industries
- (f) the financial implications of the determination
- (g) any factors specified by a relevant industry regulation Act, or by regulation under the Act, and
- (h) any other factors that the Commission considers relevant.

Two further statutory imperatives arise under section 25(5) of the ESC Act in relation to price determinations. They are:

- (i) wherever possible, the costs of regulation do not exceed the benefits, and
- (j) the decision takes into account and clearly articulates any trade-off between costs and service standards.

Finally, section 25(6) provides that subsections 25(3), 25(4) and 25(5) have effect in relation to a regulated industry, subject to the provisions of the relevant industry regulation Act for that industry (in this case, the WI Act).

A2.2.2 Under the WI Act

Section 17 of the *Water Industry Act 2012 (WI Act)* declares that the water industry is a regulated industry for the purposes of the ESC Act. Accordingly, the Commission has a general power to regulate prices in the water and sewerage industries.

Specifically, in terms of the price regulation function, the WI Act provides that:

7 – Functions and powers of Commission

- (1) *The Commission has (in addition to the Commission's functions and powers under the Essential Services Commission Act 2002) –*
 - (a) *the licensing, price regulation and other functions and powers conferred by this Act...*

The provisions of the WI Act that confer pricing powers on the Commission are set out in section 35. Consistent with the general discretionary powers under Part 3 of the ESC Act, the price determination power set out in section 35 of the WI Act is discretionary:

35 – Price regulation

- (1) *Subject to this section, the Commission may make a determination under the Essential Services Commission Act 2002 regulating prices, conditions relating to prices, and price fixing factors for retail services.*

A 'retail service' is defined in section 4 of the WI Act to include a service constituted by:

- (a) *the sale and supply of water to a person for use (and not for resale other than in prescribed circumstances (if any)) where the water is to be conveyed by a reticulated system; or*
- (b) *the sale and supply of sewerage services for the removal of sewage,*
(even if the service is not actually used) but does not include any service, or any service of a class, excluded from the ambit of this definition by the regulations.

Accordingly, any operations or services falling outside the scope of the above definition are not subject to price regulation by the Commission.⁷⁶⁴ For example, SA Water's water testing service provided through the Australian Water Quality Centre, is not a retail service and is not subject to price regulation under the WI Act. As is discussed in Chapter 10 and Chapter 11 of this draft regulatory determination, SA Water's merchant electricity generation service, provided under the ZCEF initiative, is also not a retail service. In addition, section 5(2) of the WI Act states that services provided, or infrastructure held, by irrigation trusts (as defined in the *Irrigation Act 2009*), the Renmark Irrigation Trust or persons providing irrigation services designated by the Minister, are not subject to the provisions of the WI Act.

A2.2.3 Pricing Orders

The price regulation provisions of the WI Act also include a framework for the Treasurer to issue Pricing Orders. Section 35(4) provides that the Treasurer may issue a Pricing Order that:

- (a) sets out any policies or other matters that the Commission must have regard to when making a determination
- (b) specifies various parameters, principles or factors that the Commission must adopt or apply in making a determination, and
- (c) relates to any other matter that the Treasurer considers to be appropriate in the circumstances.

Pursuant to section 35(3) of the WI Act, the Commission must comply with the requirements of any Pricing Order when making a determination.

At the time of publishing this draft determination, no Pricing Order had been issued in respect of the SAWRD24 regulatory period.

A2.3 Industry licences, codes and rules

The Commission has additional powers to issue licences to entities providing water and sewerage retail services and make industry codes or rules that apply to the conduct or operations of such entities, once licensed.

A2.3.1 Under the ESC Act

Part 4 of the ESC Act provides the Commission with broad powers to make, vary and amend industry codes or rules. Industry codes prescribe the rules of conduct and procedures that must be followed by regulated entities providing essential services. The use of industry codes allows for a high degree of regulatory flexibility while maintaining appropriate scrutiny, accountability and transparency in the process of their development. Industry codes can cover any number of areas within a regulated industry, from consumer protection to technical matters.

Section 28(3) requires the Commission to consult with the relevant industry Minister, representative bodies and participants in the regulated industry prior to making, varying or revoking a code or rule. Further, section 28(8) requires that any codes or rules be periodically reviewed by the Commission to ensure they continue to be effective.

⁷⁶⁴ This includes where SA Water imposes a charge on land not connected to its infrastructure pursuant to Regulation 38 of the Water Industry Regulations 2012 as this is not a retail service.

A2.3.2 Under the WI Act

The WI Act requires the Commission to issue SA Water with a non-transferable perpetual licence, which it did on 1 January 2013.⁷⁶⁵ Section 25(1) requires it to make a licence subject to various conditions. While some conditions must be imposed as stand-alone licence conditions, others must be prescribed in industry codes and rules made by the Commission under the ESC Act.⁷⁶⁶

In issuing licences under section 25(1) of the WI Act, section 25(2) requires the Commission to have regard to the scale and nature of the operations of the water industry entity – determining the scale and nature after consultation with the entity or a person or body nominated by the entity.

In addition, and of relevance to the current review of the Water Retail Code – Major Retailers WRC-MR/03 (**Code**) as discussed in Chapter 5 and Chapter 6, section 25(5) of the WI Act requires the Commission, in making an industry code, to include provisions to assist customers who may be suffering specified types of hardship relevant to the supply of any services (such provisions to comply with any direction of the Minister). This provision operates in conjunction with section 37(1) of the WI Act, which requires the Minister to develop and publish a customer hardship policy in respect of residential customers of water industry entities. In summary, the Minister's hardship policy must set out:

- ▶ the processes that water industry entities must have in place to identify residential customers experiencing payment difficulties due to hardship, and
- ▶ the range of processes or programs that a water industry entity should use to assist hardship customers.

The Minister published the applicable hardship policy in February 2013.

The Code also sets out the service standards that SA Water must use its best endeavours to achieve over the course of each financial year. Services standards are generally set in respect of customer service, responsiveness to service issues, service restoration timeliness and the timeliness of connections.

SA Water must report on:

- (a) its performance against service standards
- (b) the amount of any rebates paid or credited to customers as a result of its failure to meet any service standards
- (c) the reason(s) for any non-compliance with any service standards, and
- (d) how it plans to improve its performance to meet service standards, if required.

A2.4 Directions under section 6 of the *Public Corporations Act 1993*

The Minister for Climate, Environment and Water may issue directions to SA Water under the *Public Corporations Act 1993* (section 6 of that Act). Such directions may specify on-going and new requirements that SA Water must deliver during a regulatory period, with associated cost-related requirements or specifications.

The Commission must take into account the requirements of any directions, with discussion of those matters contained in the regulatory determination (where applicable).

At the time of publishing this Draft Determination, no directions had been issued in respect of the SAWRD24 regulatory period.

⁷⁶⁵ SA Water's retail licence is available at: www.escosa.sa.gov.au/industry/water/licensing/licence-register

⁷⁶⁶ The Code has been made by the Commission pursuant to the requirements of section 25(1) of the WI Act.

Appendix 3 Submissions from stakeholders

A3.1 Submissions to the Commission’s Framework and Approach Consultation Paper

The Commission published its Framework and Approach Consultation paper in February 2021. It requested written submissions by 26 March 2021, with four public submissions received, from the following parties:⁷⁶⁷

- ▶ Energy and Water Ombudsman of South Australia (EWOSA)
- ▶ SA Water
- ▶ South Australian Council of Social Service (SACOSS), and
- ▶ Uniting Communities.

A3.2 Submissions to Guidance Papers

The Commission released three Guidance Papers that covered matters relevant to SAW RD24. Written submissions were received from SA Water to Guidance Paper 2 (Stakeholder engagement for the RBP) and Guidance Paper 3 (Assessing the RBP). No other written submissions were received.⁷⁶⁸

A3.3 Submissions to the Commission’s Issues Paper

The Commission consulted directly with stakeholders following the release of its Issues Paper on the Water Retail Code and Monitoring and Evaluating Performance Framework. It requested written submissions by 28 July 2023, with five public submissions received, from the following parties:⁷⁶⁹

- ▶ EWOSA
- ▶ SA Water
- ▶ SACOSS
- ▶ South Australian Federation of Residents and Ratepayers Associations Incorporated (SAFRRA), and
- ▶ Zahra Foundation Australia.

⁷⁶⁷ Submissions to the Framework and Approach are available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024-framework-and-approach/sawrd2024

⁷⁶⁸ Submissions to the Guidance Papers are available at www.escosa.sa.gov.au/industry/water/retail-pricing/sa-water-regulatory-determination-2024/guidance-papers

⁷⁶⁹ Submissions to the Issues Paper are available at www.escosa.sa.gov.au/projects-and-publications/projects/water/retail-code-and-monitoring-evaluating-performance-framework

A3.4 Submissions to SA Water's Regulatory Business Proposal

The Commission requested submissions from stakeholders on SA Water's Regulatory Business Proposal. Twelve submissions were received, from the following parties:⁷⁷⁰

- ▶ City of Playford and City of Salisbury
- ▶ COTA South Australia
- ▶ EWOSA
- ▶ Environmental Protection Authority
- ▶ Flinders Ranges Council
- ▶ Jennifer Bradley – Quorn resident
- ▶ Office of the Technical Regulator – Infrastructure Branch
- ▶ Property Council of Australia
- ▶ SACOSS
- ▶ Tatiara District Council
- ▶ Uniting Communities, and
- ▶ Villawood Properties.

The Commission thanks all parties for their submissions to the Framework and Approach, Guidance Papers, Issues Paper and Regulatory Business Proposal. All submissions were carefully considered in making this Draft Determination.

⁷⁷⁰ Submissions to SA Water's RBP are available at www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2024.



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