1 April 2016

Mr Adam Wilson
Chief Executive Officer
Essential Services Commission of South Australia
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Business SA
Chamber of Commerce and Industry South Australia

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Working for your business.
Working for South Australia

Dear Mr Wilson

I write in response to your draft decision on SA Water's 2016-20 Regulatory Proposal.

## Executive Summary

- Business SA welcomes a small overall price reduction for water consumers and ESCOSA's focus on ensuring SA Water only recoups efficient costs, particularly labour which had originally been proposed to increase above the rate of inflation.
- Business SA supports ESCOSA's decision to allow SA Water to operate the Adelaide Desalination Plant in minimum production mode provided there is still a strong emphasis on ensuring efficient water use and prioritising the most cost-effective water sources.
- Business SA supports SA Water spending on IT initiatives which improve the efficiency of its operations, such as attending and remediating leaks and bursts, but we are concerned that the total level of proposed IT investment is not appropriately evidenced by future cost savings.
- There is a lack of transparency as to why SA Water's industry licence fees have more than tripled to $9.5 million per annum. We acknowledge this is a State Government decision and involves some transfer of functions from SA Water to Government, but it's ultimately paid for by water users who have a right to know how such costs are justified and on what basis they are levied on water users.
- ESCOSA should review its approach to transitioning SA Water to a trailing average approach for return on debt in light of the recent Australian Competition Tribunal ruling which allowed for the AER to make an adjustment where consumers may be paying "a second time" for the consequences of the GFC.

Should you require any further information or have questions, please contact
Andrew McKenna, Senior Policy Adviser, on (08) 8300 0000 or andrewm@business-sa.com.

Yours sincerely,

Nigel McBride
Chief Executive Officer

**Why this matter is important to South Australian businesses**

*As South Australia's Chamber of Commerce and Industry, Business SA is the peak business membership organisation in the State. Our members are affected by this matter in the following ways:*

- South Australian businesses, like other water consumers, have had to contend with significant water price rises over the past decade.
- Operating the Adelaide Desalination Plant during the next drought is likely to be more expensive than existing water sources which places further pressure on SA Water to realise all possible efficiencies in its next regulatory proposal.
- South Australia's volume and load based trade waste customers have been particularly hard hit by rising SA water charges in recent years with further substantial increases forecast.
- Water, sewerage and trade waste charges are a significant cost for many of South Australia's largest employers, particularly food and beverage manufacturers which the State Government is relying on to drive economic growth.

## Key Policy Points

1. Business SA had previously argued that the analysis used to justify SA Water's above CPI wage increases exaggerated demand drivers in the South Australian economy and we welcome ESCOSA's decision to limit wage increases to CPI. It is important that SA Water only recover efficient costs from water users, particularly considering the increases in water, sewerage and trade waste costs our members have had to absorb over the past decade. While Business SA supports SA Water's decision to impose a 1% efficiency dividend on its business, this approach reflects what businesses more broadly are doing to remain cost competitive, particularly in international markets. Constantly striving to improve productivity is necessary for all businesses, including SA Water, and should not just hinge on incentives linked to enterprise bargaining agreements.

   Although national CPI adjustments may be appropriate for some of SA Water's input costs, ESCOSA itself acknowledges that 'the South Australian mining and exploration industry was placing upward pressure on wages in the utilities sector at the time of RD13 was set, but that impact has slowed substantially'[i]. Accordingly, SA Water's labour costs should be adjusted by the South Australian, not national, CPI rate.

2. Although Business SA's survey of members to inform our submission only garnered a limited number of responses, 40 businesses, the results did not indicate a majority in favour of SA Water spending more money to improve customer interfaces.

   Business SA acknowledges that $33 million of SA Water's IT infrastructure spending in the next regulatory period will deliver $11 million in savings per annum by 2020 and we recognise that SA Water needs to continue updating IT infrastructure to maintain and improve operational performance. We welcome the advised cost savings which should be returned to SA Water's users as they materialise.

   However, we are still concerned at the total level of IT spending over the next regulatory period, $115 million, which is an increase of $8 million per annum, the majority of which is not justified on the basis of delivering cost savings.

ESCOSA's external consultant reviewed a number of SA Water's proposed IT investments and noted 'the potential for efficiency gains resulting from the IT investment has not been fully explored and may be understated in some programs. No specific project or program adjustments have been made to the proposed IT expenditure, however, the Commission is proposing to apply a general efficiency target to the IT expenditure program'.

While we welcome ESCOSA's draft decision to reduce SA Water's IT investment by $6.2 million through a general efficiency target, it is still unclear from the information in the statement of reasons as to how each individual program has been independently justified and associated costs verified. Stakeholders such as Business SA rely on ESCOSA's independent analysis of key aspects of SA Water's capital expenditure proposal and we are concerned that, based on the information presented, there is insufficient evidence to justify each aspect of SA Water's IT investment program.

3. Business SA supports the optimal use of the Adelaide Desalination Plant to ensure it is able to service SA Water users as required, particularly during periods of drought. If running the Desalination Plant in minimum production mode is not deemed to impose a material cost impact relative to closing it altogether, it is important that the Desalination Plant is able to be drawn upon to ensure water security for SA Water users and provide support for South Australia's irrigation sector.

   Business SA recently welcomed a State Government decision to undertake a cost-benefit analysis for operating the Desalination Plant to avoid River Murray irrigators losing their water allocations. The outcomes of this study could lead to further demand for the Desalination Plant and now would not be a prudent time to consider shutting it down entirely. Notwithstanding, and considering the evidence provided to ESCOSA by Osmoflo, ESCOSA may need to revisit the need to run the Desalination Plant in minimum production mode if there is no substantiated demand to run it at a higher rate over the coming regulatory period.

   If the State Government does go ahead and decide to run the Desalination Plant to avoid Murray irrigators losing water allocations, there may be increased economies of scale for SA Water users and those savings should be passed back through ESCOSA's processes. While it is unclear as to how the mechanisms for running the Desalination Plant for irrigators would work, it is important for ESCOSA to consider any complications for their final decision on SA Water's 2016-20 Regulatory Proposal.

4. SA Water's industry licence fees are forecast to more than triple in the next regulatory period to $9.5 million per annum. Business SA acknowledges these charges are outside SA Water's control but it is unclear from either SA Water's regulatory proposal or ESCOSA's draft decision what the cost of these functions previously was under SA Water and to what extent unrecovered costs from prior regulatory periods are being recovered by the State Government over the next regulatory period.

   There is already a lack of transparency related to how SA Water's asset values are determined, which drives the majority of its revenues, and Business SA requests ESCOSA clearly articulate if and to what extent additional costs through industry licence fees are being recovered via SA Water.

5. In a February 2016 decision on an application made by the Public Interest Advocacy Centre appealing AER decisions on New South Wales electricity distribution networks, the Australian Competition Tribunal stated:

   'even if the correct starting point is each Networks NSW DNSP's current actual financing costs (that is, if they are efficient), s 16(1)(d) of the NEL may entitle the AER to make some adjustment if – as PIAC says – consumers may thereby be paying "a second time" for the consequences of the spike in rates following the GFC.'

While Business SA accepts that, in the long run, there is unlikely to be a difference between a 'trailing average' and 'on the day' approach to determining SA Water's cost of debt, we are yet to be convinced that ESCOSA's proposed immediate transition does not unnecessarily expose consumers to paying for GFC interest rate increases over the upcoming regulatory period.

**Additional information:** Please see the following link to Business SA's initial submission on SA Water's Regulatory Proposal.

http://business-sa.com/assets/submissions/150731_FINAL_submission%20to%20Issues%20papers%20(1-4)docx.pdf

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[i] ESCOSA, Draft Determination on SA Water Regulatory Proposal, P75