

OVERVIEW OF THE COMMISSION'S PRICING INQUIRY

Issues Paper No. 1

Inquiry into the reform of SA Water's drinking water and sewerage prices

August 2013



REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**the Commission**) invites written submissions from all members of the community in relation to the issues raised in this Issues Paper. Written comments should be provided by **5.00 p.m., Friday 8 November 2013**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission's policy to make all submissions publicly available via its website (www.escosa.sa.gov.au), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to exhibit any submission based on their 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:

Overview of the Commission's Pricing Inquiry -
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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit www.escosa.sa.gov.au.

WHAT IS THIS INQUIRY ABOUT?

The Essential Services Commission of South Australia (**Commission**) is inquiring into reforms that could be made to SA Water's drinking water and sewerage prices. The Inquiry has been referred to the Commission by the Treasurer.

The terms of reference state that:

- (a) *The Commission is to inquire into options for pricing reform for drinking water and sewerage retail services provided by SA Water in South Australia.*
- (b) *The Commission is to consider, in particular, the following matters:*
 - i. *approaches to drinking water supply charges for SA Water customers, including charges based on the number and size of meters, and transition arrangements for managing significant impacts on customers;*
 - ii. *alternative approaches to charging for drinking water and sewerage retail services which may improve economic efficiency and/or South Australia's water security, including analysis of the costs and benefits of such approaches for different customer classes, and in particular:*
 - A. *the likely impact of billing a consumer of such services (rather than the owner of land) and the associated elimination of rating on abuttal;*
 - B. *the likely impact of requiring the installation of individual meters for each customer;*
 - C. *the likely impact of requiring the installation of smart meters;*
 - iii. *the impact of statewide pricing requirements on SA Water for drinking water and sewerage retail services in terms of economic efficiency, South Australia's water security, and costs and benefits for different customer classes.*¹

¹ The terms of reference is contained within the Inquiry notice of referral, available at <http://www.escosa.sa.gov.au/library/121207->

The Commission is undertaking the Inquiry pursuant to Part 7 of the *Essential Services Commission Act 2002*. As with all of its functions under that Act, the Commission must be guided by its primary objective, which is the **protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services**.

HOW WILL THE COMMISSION DETERMINE WHICH REFORMS ARE IN THE LONG-TERM INTERESTS OF CONSUMERS?

The Commission will examine options for pricing reforms that promote the long-term interests of consumers. Promoting greater 'economic efficiency' is considered by the Commission to be consistent with the long-term interests of consumers. In particular, economically efficient prices promote the long-term interests of consumers as they:

- ▲ are set to recover only the efficient costs incurred by SA Water in the delivery of its services
- ▲ signal to customers the true cost of their consumption, thereby promoting usage only where the benefits to customers exceed the costs
- ▲ promote efficient investment by businesses that rely on water and sewerage services, as their investment decisions can be based on the true cost of receiving those services.

The terms of reference require the Commission to investigate pricing reforms that may improve economic efficiency and water security.

Water security can deliver economic efficiency, but an acceptable balance between the level of water security and cost must be found. For example, if the level of water security is too low, i.e. there is insufficient capacity in the water and sewerage systems to meet demand at peak times, customers may not be able to receive an essential service. If the level of water security is

too high, i.e. the capacity available in the system far exceeds demand even at peak times, consumers may be paying for infrastructure that will never be required.

The Commission therefore sees promoting economic efficiency as the overarching principle for this Inquiry, consistent with the long-term interests of consumers. Water security is also important, but only to the extent that it promotes economic efficiency.

WHY HAS THE GOVERNMENT REFERRED THIS INQUIRY TO THE COMMISSION?

The Government identified potential areas for reform of SA Water’s drinking water and sewerage prices in its 2009 water security plan, *Water for Good*. In referring this Inquiry to the Commission, the Treasurer highlighted the following three actions from *Water for Good*:

1. *In consultation with customers, and over a period of five years, transition SA Water customers to water supply charges based on the number and size of the customer’s meters while managing any unreasonable impacts for individual customers;*
2. *Request the independent regulator, in the medium term, to examine price structures that may benefit economic efficiency and water security; and*
3. *Require the independent regulator to monitor and report on the effect of statewide pricing.*

The Treasurer’s Notice of Referral of the Inquiry states that the Inquiry will further inform the successful implementation of these actions. It also states that the Inquiry is to be conducted prior to the Treasurer issuing a “Pricing Order” that will guide the determination of SA Water’s drinking water and sewerage prices during the next regulatory period, commencing on 1 July 2016.²

² In May 2013, the Commission determined SA Water’s drinking water and sewerage revenues for the period 2013/14 – 2015/16. Towards the end of that “regulatory period” a new determination of SA Water’s revenues/prices will be made by the Commission to apply from 1 July 2016.

To ensure that the outcomes of the Inquiry can be considered for the next regulatory period, the Treasurer has required the Commission to submit a draft report by 31 May 2014 and a final report by 31 December 2014. The Commission will provide these reports to both the Treasurer and the Minister for Water and the River Murray and will publicly release them.

WHICH ISSUES WILL THE INQUIRY LOOK AT?

The Commission intends to investigate all possible pricing reform options that could lead to greater economic efficiency. It has identified the following six areas for potential reform:

What changes should be made to the structure of drinking water tariffs?

Different categories of SA Water customers pay different tariffs. For example, residential customers pay a fixed supply charge, plus charges based on three levels of usage, while commercial customers pay a supply charge based on property values and a single usage charge.

The Inquiry will examine how changes to the tariff structure might enhance economic efficiency. In particular, it will look at whether:

- ▲ prices can be made more cost-reflective;
- ▲ the current ‘statewide’ pricing approach (where prices are set uniformly across the state) should continue
- ▲ the price should vary at different times, depending on the availability of natural water supply
- ▲ any other changes should be made to the way in which supply charges and usage charges are set.

The Commission will look at whether or not such pricing reforms would enhance water security and consider implications for non-price alternatives to promoting water security (e.g. water restrictions).

Further discussion of the key issues associated with drinking water tariffs is available [here](#).

Should the basis upon which sewerage prices are set be changed?

SA Water’s sewerage charges are linked to the value of a customer’s property. The Commission will investigate whether alternative approaches to setting these charges would be more efficient.

Further information about key issues associated with sewerage pricing is available [here](#).

How should water planning and management costs be factored into SA Water's prices?

Externalities are costs or benefits involved in the supply of a service that are not borne by the supplier or user of that service. If these externalities are reflected in prices, suppliers and consumers receive clearer signals about the actual cost of the service. If this is feasible and cost effective, it can promote economic efficiency by ensuring that demand occurs only where the benefits to consumers exceed the cost of supply.

The Commission intends to address the issue of environmental externalities, in particular "water planning and management costs" that have been identified by the State Government and reflected in current prices. The Commission seek to ensure that only efficient water planning and management costs are reflected in SA Water's prices.

An issues paper addressing this issue in more detail is available [here](#).

Should changes be made to metering?

Currently, not all water users in South Australia have a meter (e.g. individual tenancies within strata titles may not be separately metered). This means these users may not be paying for the cost of their actual consumption.

The Commission will review the costs and benefits of installing additional meters to address this issue. It will also review the merits of installing 'smart' meters that can not only be read remotely, but can also measure water consumption at different times of the day.

A separate issues paper on metering is available [here](#).

Who should pay water and sewerage charges?

Currently, SA Water charges landowners for drinking water and sewerage services. This approach is different from that used for other utility services (e.g. gas and electricity) in South Australia. Generally, an end user is charged and the end user may not be the landowner (e.g. it may be a tenant). The Commission will consider whether or not a move to end user charging for water services would lead to greater economic efficiency.

Further discussion of this question can be found [here](#).

How can the impacts of price reform be best managed?

The Commission recognises that price reforms may, by themselves, make some members of the community better off and some worse off.

The Commission will therefore estimate the impacts of reform options and consider how those impacts can be addressed. In this way, the efficiency benefits of price reforms can be realised while managing the impacts on those in need.

The State Government uses various mechanisms to assist members of the community, including exemptions and concessions.

Some customers (e.g. charities) receive a discounted price from SA Water to reflect their special status. Others, including pensioners, receive a subsidy through the State Government's concession scheme. The granting of exemptions and concessions is an important policy tool for assisting those most in need. In examining areas of pricing reform, the Commission will be mindful of the impacts on those customers, and consider ways in which those impacts can be managed.

Those issues are discussed in a separate issues paper available [here](#).

As several of the above areas are interdependent, the Commission will consider them as part of an overall reform package, rather than solely on an individual basis.

To facilitate public consultation, the Commission has prepared more detailed issues papers on each of the six areas. Each paper puts forward specific questions for all members of the community to respond to. However, these issues and questions should not limit the areas for response. All members of the community are invited to comment on any other related issues they believe should be taken into account.

HOW CAN I HAVE MY SAY?

Members of the community are welcome to respond, by letter, or on line, to this collection of issues papers. The cut-off date for submissions is 5.00 p.m. Friday 8 November 2013. This is to

ensure the Commission has time to fully consider them.

The Commission also intends to meet directly with members of the community during the consultation period, to understand their views.

FURTHER INFORMATION

Any queries relating to this consultation should be directed to:

▲ Nathan Petrus, Director, Pricing & Analysis

If you would like to keep up to date with the release of papers for consultation and any other activities of the Commission, subscribe at <http://www.escosa.sa.gov.au/subscribe.aspx>.



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