

Dear Mr. Petrus

Thank you for an enlightening presentation on the Draft Inquiry Report.

I would like to forward the following personal observations, prompted by the Report, but recognise some are perhaps somewhat tangential to the Commission's strict term of reference:

- I believe that the relationship between the consumption component for water supply was too far removed from the marginal cost of supply; accordingly, revenues have had the potential to vary significantly in wet versus dry years. In recent years SA Water was 'accused' of reaping large windfall profits (subsequently passed on the Government) as a direct result of this phenomenon, but a cooler- and/or wetter summer could have occasioned a significant loss, with dire consequences for Treasury. Accordingly the move to lower consumption charges and reduced revenue volatility can be seen as a good thing, particularly if future National tax reform results in additional pressures on the South Australian budget.
- Reduction of the consumption charge(s) may be held up by some as inappropriate in that it 'sends a signal' to consumers to conserve water as a scarce resource. However, in that context, it needs to be recognised that:
 - While high volumetric charges do have a material impact on dependant industry and households with low disposable income, it appears likely that a major contribution to overall conservation has been through watering restrictions, both directly and through modifying the behaviour of consumers.
 - There is even the argument that in a pricing led conservation process higher prices would result in lower consumption, in (SA) practice, lower consumption appears to have resulted in higher prices in order to maintain revenues – which goes, in part, to my original observation on disparity between actual marginal cost of consumption and recent SA Water volumetric charges.
- If there might be pause to think, it is with regard to the suggested LRMC of 62c/kL. While I am quite prepared to accept this is the currently indicative outcome (from the analysis carried out for ESCoSA) there is the question as to how robust that figure might be in the future, given the following potential drivers/issues:
 - In the absence of watering restrictions and the increase in the 'fixed' charge to customers (I have to pay for the service potential – so I may as well use it) total household use could well rise significantly.
 - The lower-cost sources of the water might well diminish, due to:
 - Expected lower total rainfall in the Adelaide catchments;
 - Possible reduced access to water from the River Murray, due to either the longer-term trend in climate change impacts or reduced State allowances from the Operating Authority etc (being mindful that part of the discussion around partial funding of the second 50GL module of the Adelaide Desalination Plant touched on reduced reliance on the River Murray.

- Depending on the level of uncertainty in how long 62c/kL will last and mindful of the benefits of ‘certainty’ for commercial decision-making, there is arguably a case for using the marginal cost per kilolitre out of the desalination plant – (say \$1.20 for the sake of illustration) with a corresponding downward adjustment in the service charge and a consequential slight ‘softening’ of the impact of the service charge increases on low volume water users.
- As identified in the Draft, managing the impacts of the significant increase in the service charge stemming from the combined impact of both moving to the low volumetric cost regime and (in the case of low capital value properties) using a fixed charge based on the service/connection (sewerage) size will be a significant challenge. That said, it is believed that SA Water already has capabilities for concessions and the like that, with suitable adjustment, could mitigate the more extreme impacts on the disadvantaged.
- Particularly given – to my reading – a lack of clarity as to exactly how the replacement of existing country water supply infrastructure would be managed under the line-in-the-sand approach, I believe there is a question as to whether there is a risk of line-in-the-sand being a barrier to lower overall costs from competition and/or greater efficiency (e.g. existing major pipelines versus the evolution of increasingly efficient and cost-effective desalination and/or recycling).
- The final point looks to a possible future, in that it relates to the “Reduced fixed costs scenario” for the general equilibrium modelling. This investigates the impact of reducing fixed costs by \$310 million. Past comparisons suggest that SA Water Operating & Maintenance (O&M) Costs are not dissimilar to its peers. Consequently, future O&M saving are unlikely to make a substantial contribution to a \$310M saving, a reduction approaching that level (in what is acknowledged as only an illustration) is only likely to be achieved by including a significant reduction in the Regulatory Asset Base. Such a move would almost certainly reduce dividend flows to the owners (Government) by a significant amount and one wonders what the impacts (economic and other) would result from Government’s actions in either adsorbing the consequent loss to General Revenue and/or raising the funds by other means. That said; the question at this time reduces to why was this particular scenario presented, while it would appear a considerably lower reduction would be likely to produce an outcome of similar magnitude to the other scenarios given in Table 3.4 “Welfare Gains”?

Regards

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