



Second SA Water Price Determination

Draft Framework and Approach

SA Water response

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1 Executive Summary

SA Water appreciates the early guidance provided by ESCOSA for some elements of the second determination process which will determine prices for water and sewerage from 1 July 2016. Early guidance, where provided, will enable SA Water to plan for the regulatory submission and avoid unnecessary expenditure of money and resources on the submission. However there are other elements of the determination process where guidance has not been provided and SA Water asks that these be resolved as soon as possible.

The ESCOSA draft framework and approach (Draft Framework) provides a broad outline of the process, but there are still a number of areas of uncertainty that may lead to re-work and unnecessary additional expenditure by SA Water on the regulatory process. This additional expenditure by SA Water will either result in increased costs to SA Water customers or in a reduced return to the South Australian community. These areas of uncertainty include:

- **Regulatory building blocks not yet determined or released**

A number of the regulatory building blocks used to determine the price are not set out in the framework. In order to consult meaningfully with our customers on price impacts, SA Water needs full knowledge of all building blocks prior to consulting with our customers.

- **Unknown changes to the pricing framework impacting Customer Consultation**

ESCOSA is completing a pricing inquiry which could have significant impact on how customers are charged. This review will not be complete until late 2014 and will limit SA Water's ability to consult with customers on the price impacts of its regulatory business proposal. Additionally, ESCOSA has asked SA Water to submit its proposal based on ESCOSA's recommendations to Government from the pricing inquiry. These recommendations may not be accepted by Government and the significant amount of work for SA Water to consider these changes in its proposal would be wasted.

- **Uncertainty over the length of the regulatory period**

If the length of the regulatory period is not known prior to SA Water's development of its regulatory business proposal, it may increase the cost of SA Water's submission. A shorter regulatory period will also result in the costs of this process being incurred more often, increasing costs on a yearly basis.

Further detail and discussion on these and other issues is included in this document.

2 Certainty on the regulatory building blocks

To ensure that SA Water is able to engage with customers on the price impact of its regulatory business proposal, SA Water requires greater certainty on the regulatory elements that make up the building blocks that will form the pricing proposal.

SA Water notes that ESCOSA is yet to finalise a number of building blocks to be used to set the price and is proposing reviews of:

- Working capital allowance
- Weighted Average Cost of Capital (WACC)
- Tax allowance

The Draft Framework also indicates that ESCOSA intends to continue the capitalisation of expenditure that by accounting rules would be classified as operating expenditure, but the process for classifying expenditure and attributing asset lives is not clear.

Further areas yet to be determined include:

- The possible introduction of Guaranteed Service Levels
- Ex-post review of capital expenditure
- The level of Community Service Obligations to offset customer prices
- The allowance for pass through events from the first determination
- Risk allocation and estimation for capital works
- The revenue adjustment mechanism for changes in demand
- The allowance for real cost increases

Early clarification is sought on all of these areas to enable SA Water to engage meaningfully with customers on the price impacts of its regulatory business proposal.

Recommendation 1

- That ESCOSA ensures decisions on the abovementioned areas of the pricing determination are made and communicated to SA Water prior to 1 October 2014.

3 Changes to the pricing framework impacting customer consultation

The outcomes of ESCOSA's Pricing Inquiry into the policy and structure of water and sewerage pricing in South Australia will not be known prior to submission of SA Water's regulatory business proposal.

This is likely to add uncertainty to the impact SA Water's proposal will have on customer prices.

To allow SA Water to conduct meaningful customer consultation around expenditure proposals, certainty is required on the policy and structure of pricing to apply during the regulatory period.

The Draft Framework further requests SA Water to develop its pricing proposal based upon ESCOSA's recommendations from the Pricing Inquiry. The recommendations will still be in draft form and subject to consideration by Government at the time SA Water will be consulting with its customers on the price impacts of its regulatory business proposal.

Based upon the scope of the Pricing Inquiry, this may require SA Water to develop prices based upon such approaches as regional based pricing or billing tenants rather than property owners.

If this was the case, it would create a significant level of additional work and cost for SA Water that may be unnecessary if these recommendations are not adopted by Government.

This work will be done as part of the implementation of any recommendations the Government may seek to adopt. Rather than developing alternative pricing proposals that may not be relevant to the industry in the future, SA Water seeks to wait until the recommendations are adopted before incurring any additional costs to evaluate and implement these recommendations.

As ESCOSA is unlikely to be in a position to be able to provide certainty on the pricing policy and structure to apply during the regulatory period at the time SA Water is required to consult with customers on price impacts. It is suggested that the consultation and SA Water's regulatory business proposal be based upon the current pricing policies, in order to gain meaningful feedback from customers and to reduce unnecessary complication and expenditure.

Recommendation 2

- For the purposes of consulting with customers and developing the regulatory business proposal, SA Water should be required to adopt the current pricing policy and structure.

4 Uncertainty over the length of the regulatory period

As part of a commitment to keep costs down for the benefit of its customers, SA Water is seeking the most efficient regulatory processes possible and this includes seeking a four year regulatory period.

In section 2 of the Draft Framework, ESCOSA discusses the duration of the second regulatory period, noting that it should be 3 or 4 years. This uncertainty around the duration of the regulatory period may require SA Water to develop alternative regulatory business proposals depending on the expenditure required in that fourth year which would impact any price path to be proposed. This may result in additional costs being incurred that will be ultimately borne by customers.

In addition, the preparation of each regulatory determination is a significant cost to SA Water and the key stakeholders who participate in the determination process.

SA Water supports ESCOSA's comments that a longer regulatory period would provide a greater incentive and opportunity for SA Water to reduce the costs of regulation to its customers.

SA Water agrees that this would benefit customers in the long term in the form of cost savings. For this reason, SA Water supports adopting a four year regulatory period to reduce the number of determinations.

An additional benefit for customers from a longer regulatory period is the greater certainty a longer price path would provide to them. .

SA Water would also welcome any discussions on other ways to reduce the costs of regulation to our customers.

Recommendation 3

- That future regulatory periods of 4 years be adopted to reduce the cost of regulation to SA Water's customers and provide greater price certainty for customers.
- That SA Water is advised of the regulatory period prior to 1 October 2014 to ensure development costs are kept to a minimum.