



**COTA SA
Submission**

**Review of
SA Water's Regulatory Business Proposal
for the
Revenue Determination Period 2013/14-2015/16**

November 2012

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COTA SA

COTA SA is the peak organisation for older South Australians with an individual membership of around 20,000 and over 250 organisational members with a combined membership of more than 60,000. In addition, COTA SA has 80 associate members who are aged care providers, local government bodies, health units and other service and educational institutions. COTA SA membership networks and programs are state-wide.

COTA SA has a longstanding record of representing the views and opinions of older South Australians in public policy development processes in the state.

As we have previously highlighted, COTA SA principal concern is that older people's access to affordable and safe supplies of water should not be unduly impacted by the transformation of the water supply and sewerage systems to an economic regulatory model. COTA SA advances the view that everybody should have affordable access to sufficient quantities of essential services for health, wellbeing and social participation. We continue to maintain that even small nominal increases in the price of utilities can have significant proportional and actual impacts on the lifestyle of older people. There is a section of the population that is now only just able to manage their existing financial commitments due to the growing proportion of income spent on essential services. Many people on low and fixed incomes, including many older people, spend a higher percentage of their income on essential services than those on higher incomes.

With these concerns in mind, we are pleased to have the opportunity to participate in the consultation being conducted by the Essential Services Commission of South Australia (the Commission) for the development of the first revenue determination for SA Water for the period 2013/14 to 2015/16.

Key suggestions

In particular, COTA SA submits the following suggestions:

COTA SA does not consider SA Water's proposed revenue model for drinking water services represents an appropriate balancing of demand risk between consumers and SA Water.

COTA SA considers the process proposed to manage cost pass through events to be reasonable subject to the Commission's usual scrutiny processes including opportunity for community comment.

COTA SA calls on the Commission to highlight in its draft determination the community's concerns about the current price of water, the substantial increases that have been borne by the community in recent years and to recommend that the value of the RAB should be set at a level that will ensure a pricing order that protects South Australian customers from further price shocks and maintains current tariff rates at CPI indexation increases only.

Further details regarding these suggestions are set out in the commentary below.

1. General comments – implementation of an economic regulatory model

COTA SA has previously submitted our views to the Commission ESCOSA on the economic regulation of water in South Australia.¹ We reiterate our general observations that the regulatory framework must balance market drivers with sound social policy measures if good community outcomes are to be achieved.

In this context, COTA SA is particularly concerned about staged implementation of the economic regulation model. Despite the passage of the Water Industry Act 2012 earlier this year, the SA Government issued a Pricing Order (in accordance with section 35 of the Act) in May. The Pricing Order effectively constrains the Commission in its statutory role and requires it to ‘only determine the revenue which may be derived from the provision of drinking water and sewerage retail services’.²

We note that there has been some public questioning about the reasoning for this including whether the Commission’s full review might determine that water is currently overpriced.³

During earlier consultation on the development of the *Water Industry Act*, COTA SA raised some apprehension about the operation of clause 35(4) of the *Water Industry Act* which allows the Treasurer to override the independence of the Commission in its price regulation role. While we appreciate the Treasurer’s motivations regarding this intervention relate to managing price following significant infrastructure investment and during a period of transition in the regulatory framework, we are concerned that this action has not clarified the long-term outcomes for consumers of water services.

Water pricing

With the announcement of the last pricing order in May 2012, the SA Premier noted that:

When the Government announced a 26 per cent increase to average water prices last year we said we expected there would be a similar price increase this year. The Government is aware of current pressures on home budgets and to help households, we have introduced a one-off rebate for residential customers.⁴

In responding to the announcement of price increases as a part of the SA Budget 2012-2013, COTA SA observed that

The one-off water rebate is welcome as are the higher levels of concessions. However equitable reform of the concessions system has been left in the too hard basket yet again, while essential services prices rise faster than pensions and country people miss out almost entirely on transport concessions. Water and electricity are becoming unaffordable to pensioners and will become more so next year because the rebate is one-off.⁵

¹ See COTA SA submission to the *Economic Regulation of the SA Water Industry Draft Advice* (January 2012) accessed 17 August 2012 on the ESCOSA website at <http://www.escosa.sa.gov.au/library/120209-EconomicRegulationWaterIndustry-DraftAdviceSubmission-COTASA.pdf>

² ESCOSA, *Public Consultation – Issues Paper: Revenue of SA Water’s regulatory business proposal for the revenue determination period 2013/14-2015/16*, (October 2012) p5

³ Ross Womersley quoted in ABC News Online, “Water price controls questioned”, 16 July 2012 accessible at <http://www.abc.net.au/news/2012-07-13/water-prices-sacoss-womersley/4129354>

⁴ Jay Weatherill, “New Water Prices for 2012-13” Media Release, 21 May 2012

⁵ Ian Yates, “Older people at risk in State Budget, but Disability Reform Welcome” Media Release, 21 May 2012

The SACOSS Budget Snapshot provided the following analysis:

The rebate reduces the price rise on the average water consumption to 14%. The net impact on Concession recipients using a modest 120kL pa is a 12% price increase for both renters and owner occupiers. Concession recipients consuming the average 190kL pa are 10% worse off if renting and 12% if owner occupiers. For those without the concession, the net impact is a 14-15% price increase.⁶

After the one-off rebate is paid from January 2013, the full impact of the 2012-13 price rises will be borne by consumers. We note from the Commission's issues paper (Chart 3) that water prices are the highest in Australia and from the detailed analysis provided to this Review in the submission from SACOSS that water price increases have occurred at a higher rate compared to other jurisdictions.

COTA SA reiterates the concerns previously raised that we see no reason for water consumers to pay higher costs than required in order to treat SA Water as a type of business while continuing to pay a dividend to Government. This is regressive taxation that obfuscates underlying fiscal drivers rather than promoting transparency and regulatory accountability.⁷

2. Comments on the key issues for the review

2.1 Form of Revenue Control

COTA SA notes that SA Water proposes a dual approach to revenue control which treats the supply of drinking water and the supply of sewerage services differently. They argue that fluctuations in demand due to weather and environmental conditions may result in significant price variations in the cost of drinking water which would cause over and under-recovery of costs, potentially, to the detriment of customers. Consequently, in relation to drinking water, they propose a hybrid model with a "banking" mechanism which would allow difference between cost and billing revenue to be set aside to offset decreases in revenue in later years. SA Water considers a total revenue cap appropriate for sewerage services.

COTA SA agrees that a total revenue cap is appropriate for sewerage services as this will provide some certainty to consumers.

We do not support the proposal to bank revenue differences between actual and forecast revenues. This model serves to protect SA Water from competitive risk and offers none of the benefits to consumers that might be anticipated from a competitive market scenario. Indeed, it would seem more likely, that it would be in SA Water's interests to invest resources in maintaining a revenue buffer and identifying discretionary spending that would offset any reduction in prices to the consumer.

COTA SA does not consider SA Water's proposed revenue model for drinking water services represents an appropriate balancing of demand risk between consumers and SA Water.

⁶ SACOSS, *State Budget Snapshot 2013-2014*, (May 2012), p16: accessible at http://www.sacoss.org.au/online_docs/SACOSS%20Budget%20Snapshot%202012-13.pdf

⁷ COTA SA, *Submission to Economic Regulation of the South Australian Water Industry Draft Advice* (January 2012), p12, accessible at <http://www.escosa.sa.gov.au/library/120209-EconomicRegulationWaterIndustry-DraftAdviceSubmission-COTASA.pdf>

2.2 Cost pass through

SA Water has identified the following cost pass through events:

- Changes in taxes
- Service standards
- Regulatory change
- Extraordinary events
- Major projects
- Aspects of the operation of the desalination plant and the management of water licences.

It has agreed that it would make an application to the Commission for determination on grounds of efficiency, the appropriateness of the costs forecast and subsequent revenue allowance for the following year.

COTA SA considers the process proposed to manage cost pass through events to be reasonable subject to the Commission’s usual scrutiny processes including opportunity for community comment.

2.3 Capital Expenditure

COTA SA notes from the Commission’s Issues Paper (p14) that the calculation offered by SA Water for forecast capital expenditure is nearly \$200 million more than that calculated by the SA Government’s Regulatory Statement on Prices. SA Water’s Regulatory Business Proposal explains that:

SA Water’s capital expenditure in recent years has been dominated by significant investment in projects to secure water supplies for the State’s future...The expenditure proposed represents the minimum which SA Water considers necessary to remain within acceptable levels of risk.⁸

The Commission has observed in the Issues Paper that the proposed investments are ‘driven principally by asset renewal requirements, system growth, new external obligations, and drought response measures’ but notes that the calculation of CPI at 1.5% to 1.8% is above the current rate of inflation and could add \$49million to the forecast.

COTA SA cannot comment on the veracity of the calculations used by SA Water (provided by consultants, Evans and Peck) but would highlight the impact of this level of proposed investment may have on the overall cost calculation. COTA SA is of the view that SA consumers of water and sewerage services have experienced considerable increases in tariff over recent years and, to the extent that “catch-up” expenditure on infrastructure will impact on tariff, we would ask SA Water to consider the consequences for many of their customers.

In particular, COTA SA would highlight the situation for older residents of the community who are generally modest residential users of water yet they are subject to the same increases in supply charges and tariff. As Chart 3 of the Commission’s Issues Paper highlights, SA water customers already pay the highest water prices in Australia.

⁸ SA Water, *Regulatory Business Proposal Executive Summary* (October 2012) p7 accessed 5 November 2012 at http://www.sawater.com.au/NR/rdonlyres/3D60DD6A-C598-4E11-B2F1-90305F4146E3/0/SAW_RBP_ES_2013.pdf

2.4 Operating Expenditure

COTA SA notes that SA Water has adopted 2011/12 as the base year for forecasting operating expenditure for the first revenue determination and understands the rationale being that this is the first standard operating period after drought conditions. While we do not intend to comment on the specifics of SA Water's methodology and estimates for operating expenditure, we agree that this seems a reasonable forecast base.

However, we would also note that SA Water has identified a number of ongoing or potential operating costs that will impact on their service costings, including operation of the desalination plant and waste water treatment plants.

COTA SA is particularly concerned about public comments made by SA Water regarding potential costs associated with regulatory requirements. In comments regarding the draft circulated by the Commission as a part of the development of the Water Retail Code, SA Water submitted that they were:

[C]oncerned that the some of the obligations proposed by the Commission will require changes to operating practice and system upgrades, with significant cost implications and price increases to customers. SA Water does not believe that the Commission is fully aware of the implications of the proposed obligations and that further consideration is required to ensure that they are in the best interests of the customer.⁹

In subsequent media reports, SA Water was reported to have commented that:

While it is difficult to currently determine the scope and therefore any cost impacts of these proposals at this early stage, our initial estimates indicate these could run into the tens of millions of dollars. With just over one million customers, SA Water would have to recoup \$10 from each for every \$10 million extra it needs to update computer and billing systems. The bill increases would put the organisation at odds with State Government attempts to freeze bills at close to inflation in coming years, and claims that deregulation would be cost neutral for householders.¹⁰

The Commission subsequently provided further public advice that SA Water's interpretation of the Code was not correct and substantial changes to billing arrangements would not be required.¹¹

COTA SA considers that the regulatory code should reflect best practice and provide robust protections for consumers in an industry that has previously been publicly owned and operated as a virtual monopoly. We do not consider that costs associated with achieving best practice service and ensuring protections to the SA community should be blithely passed through to customers and, following clarification by the Commission, it is clear that SA Water miscalculated the impact on their current billing processes. We consider the statements by SA Water regrettable as the public suggestion that codification of retail services has resulted in higher costs does little to support the process currently underway nor does it promote public confidence in the outcomes.

⁹ SA Water, Submission to ESCOSA on the Draft Water Retail Code (August 2012) accessed 6 November 2012 at <http://www.escosa.sa.gov.au/library/120824-WaterRetailCodeSubmission-SAWater.pdf>

¹⁰ John Ringham, SA Water Chief Executive quoted by Miles Kemp, "Customers to pay more for water deregulation red tape" *Adelaide Now*, 2 September 2012 accessible at <http://www.adelaidenow.com.au/news/south-australia/customers-to-pay-more-for-water-deregulation-red-tape/story-e6frea83-1226463495074>

¹¹ Paul Kerin, CEO, ESCOSA, "Commission clears up misperceptions: economic regulation of SA Water" 16 October 2012, accessible at <http://www.escosa.sa.gov.au/article/newsdetail.aspx?p=16&id=999>

2.5 Demand

Demand for water is influenced by a number of factors including, as the Commission highlights, drought conditions and subsequent water restrictions. Over recent years, many households have installed water tanks and water efficiency devices. In addition, increased charges for water have reinforced efforts undertaken by most residents to monitor and moderate water consumption, in some cases to a bare minimum. For older residents, self-initiated water use reduction measures can mean that the supply charge will be higher than their usage costs. This is particularly the case with steady increases in the fixed supply charge being applied over recent years.

As a consequence of these various factors, and despite an increase in SA Water's customer base:

[S]ales have declined from 222GL in 2006–07, to 184GL in 2011–12 (a 17% reduction). Declining water sales have affected revenue generation, and added to the overall pressure on prices for customers.¹²

SA Water, using modelling prepared by ACIL Tasman, anticipates only moderate growth in revenue over the coming years.

COTA SA agrees that the combination of factors, particularly high retail prices, will place downward pressure on use and stabilise demand.

2.6 Supply Mix

SA Water has indicated that it will use a mix that will allow lowest cost supply to the community. In principle, this strategy should benefit consumers of water in curbing costs. We note that the new desalination plant will be operated for two years to allow adequate post construction testing. As a consequence, significant reduction in overall cost of supply cannot be anticipated during this first regulatory period. The Commission has indicated that savings may be in the order of \$5million per annum in the second half of the regulatory period.¹³ Therefore, COTA SA does not expect that SA Water's strategy will significantly vary the price of water over this time.

2.7 Return on Assets

COTA SA understands that the Commission will set the regulated rate of return to apply to SA Water's regulated assets prior to the 1 July 2013 commencement date using relevant recent data. We do not have any specific comments to make regarding the methodology used to derive that rate or to the time period over which the risk-free rate of return is to be calculated.

2.8 Regulatory Asset Base

The Commission, in proposing an initial Regulatory Asset Base (RAB) calculation in its draft determination scheduled for release in February 2013, will take into account legislative, regulatory and community expectations. The Commission's advice will inform the Treasurer's determination of the RAB calculation which will form a critical component of the next Pricing Order (due in May 2013) and which will in turn set the Treasurer's determination on the price path for the period.

¹² SA Water, *Regulatory Business Proposal Executive Summary* (October 2012) pp2-3 accessed 5 November 2012 at http://www.sawater.com.au/NR/rdonlyres/3D60DD6A-C598-4E11-B2F1-90305F4146E3/0/SAW_RBP_ES_2013.pdf

¹³ Paul Kerin, CEO, ESCOSA, "Commission clears up misperceptions: economic regulation of SA Water" 16 October 2012, accessible at <http://www.escosa.sa.gov.au/article/newsdetail.aspx?p=16&id=999>

COTA SA has two concerns relating to the RAB. First, in setting a RAB, there should be some balance between the future accounting needs of SA Water as a business entity to maintain and depreciate infrastructure and the historical fact that the RAB is essentially comprised of assets which the residents of South Australia have contributed to over many years and which SA Water owns on behalf of the State. Secondly, the 2012 Pricing Order incorporated significant infrastructure costs associated with the construction of the desalination plant. To offset the increase, the Government provided a one-off rebate which will be paid to customers early in 2013. Households will have to meet the additional cost of the 2012 price rise subsequently. A further increase in the 2013 Pricing Order would compound this burden.

COTA SA understands that the Commission's role in this scenario is limited as the final determination on the RAB is a matter for the Treasurer's Pricing Order. Nonetheless, the Commission's view will be influential in this process.

COTA SA calls on the Commission to highlight in its draft determination the community's concerns about the current price of water, the substantial increases that have been borne by the community in recent years and to recommend that the value of the RAB should be set at a level that will ensure a pricing order that protects South Australian customers from further price shocks and maintains current tariff rates at CPI indexation increases only.

2.9 Revenues

COTA SA views positively the Commission's intention is to rigorously examine SA Water's Regulatory Business Proposal and to ensure that only prudent and efficient costs incurred in the delivery of water and sewerage services are incorporated and factored into their Revenue Determination for the period 2013/14 - 2015/16.