



**SACOSS Submission to ESCOSA's Issues Paper on the Review
of SA Water's Regulatory Business Proposal for the
Revenue Determination Period 2013/14 to 2015/16**

November 2012

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for the Revenue Determination Period 2013/14 to 2015/16*
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Executive Summary

SACOSS has openly approached the Commission's Issues Paper fully supportive of commitments by the government to keep water price rises in line with inflation. SACOSS strongly believes that water and sewerage prices should be capped at no more than CPI only increases for at least this coming regulatory period and that this would enable consumers to absorb the price rises of recent years which have been driven by large water security investments.

While this will be the first Revenue Determination for SA Water by the Commission under the Water Industry Act 2012, SACOSS acknowledges that the Treasurer will issue a further Pricing Order in May 2013 that will specify the initial value of the Regulated Asset Base (RAB).

SACOSS is well aware of the critical role that the Treasurer has in specifying the initial value of the RAB and consequently, in effectively determining the final price to be paid by South Australian consumers for water. Accordingly, SACOSS makes the following proposals:

1. That the Commission provides the Treasurer with the values which would result in revenue determination options which cap water prices at no more than CPI only increases for the coming regulatory period.
2. That the Commission take this opportunity to highlight the differential impact of recent price rises on those consumers on the lowest of incomes and encourage the government to consider ways of better protecting these consumers into the future.
3. That the Commission conduct an extensive review and detailed examination of SA Water's proposed Capital and Operating Expenditure programs to determine areas for significant savings for both water and sewerage.
4. That the Commission convey to the Treasurer the option of reducing the RAB to below current levels at the start of the regulatory period.

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Introduction

As the peak body for the community services sector in South Australia, SACOSS has had a long-standing interest in the delivery of essential services and in particular in ensuring that the most vulnerable South Australians are able to access an adequate, affordable and always available supply of potable water for health and hygiene.

SACOSS thanks the Commission for the opportunity to provide comment on the Commission's Issues Paper on the Review of SA Water's Regulatory Business Proposal for the Revenue Determination Period 2013/14 to 2015/16.

SACOSS has been engaged in discussions surrounding the development of the regulatory framework for water in South Australia since 2010 when SACOSS concurrently reviewed the Draft Water Industry Bill 2010 and the Commission's Economic Regulation of the South Australian Water Industry Statement of Issues. In 2011, SACOSS provided comment on the Draft Advice to the Treasurer on the Economic Regulation of the South Australian Water Industry and on the Draft Advice to the Treasurer on the Regulatory Rate of Return for SA Water.

Throughout these processes, SACOSS has consistently drawn attention to the impact of price increases on households with the lowest incomes across our community. These households are already burdened by major cost of living pressures and because they struggle to meet significant price increases, they are at high risk of losing unrestricted access to a basic and essential service.

SACOSS has commissioned st.kitts.associates to provide further advice to SACOSS about the Commission's Issues Paper. The report prepared by st.kitts.associates has been attached to this submission at Appendix 1. SACOSS supports the recommendations made and wishes to draw the Commission's attention to the full report.

Capped at CPI increases only

As has been reported by the Commission, SA Water's prices for water have increased significantly over recent years¹. SACOSS notes that SA Water's prices are now the highest in the nation, as illustrated below:



Figure 1: 2012/13 Annual Residential Water Bill by Jurisdiction (based on 180kL consumption per annum) Source: Essential Services Commission of South Australia (2012)

In South Australia, this is compounded by the fact that not only do South Australians have the highest prices in Australia but they also continue to experience a high rate of increase (as illustrated in Figure 2 below).

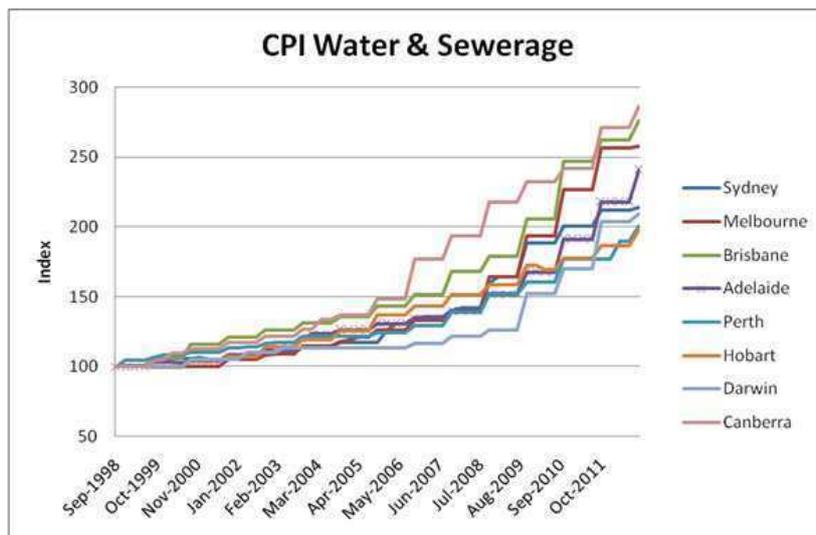


Figure 2: Water and sewerage indexes Source: ABS (2012), 6401.0 - Consumer Price Index, Australia, September Qtr 2012, Australian Bureau of Statistics, Canberra

¹ Essential Services Commission of South Australia (2012) "Economic Regulation of SA Water's Revenues" at <http://www.escosa.sa.gov.au/library/120713-EconomicRegulationOfSAWatersRevenue-StatementOfApproach.pdf> pg.12

For example, the Treasurer's 2012-13 Pricing Decision to apply to SA Water was released on 21 May 2012². Water prices subsequently rose 25% for 2012-13.

According to the 2011-12 Regulatory Statement, the main reasons for the increase in water charges were:

- SA Water's continued investment in securing South Australia's drinking water supply
- Regulatory costs of independent economic regulation
- The recovery from SA Water and its customers of water planning and management costs incurred by the Department for Water³.

Water prices in South Australia have actually increased by 114.4% over the last 10 years, as indicated in Table 1 below:

	% Increase Sept 2002- Sept 2012
Electricity	137.1
Gas	100.3
Water	114.4
Utilities	124.0
CPI – All Groups	33.3

Table 1: Utilities increases over the last 10 years, South Australia Source: ABS (2012), 6401.0 - Consumer Price Index, Australia, September 2012, Australian Bureau of Statistics, Canberra

These index increases have real impacts on weekly budgets and are a significant source of financial stress. In fact, the government recognised the impact of recent price rises with the introduction of a one off water security rebate which had the impact of temporarily reducing the level of increase. SACOSS believes that if nothing else this rebate should be permanently extended for all those eligible to access a utilities concession.

Given the above context, SACOSS fully supports recent commitments by the government to keep water price rises in line with inflation. SACOSS strongly believes that water prices should be capped at no more than CPI only increases for at least this coming regulatory period. This would enable consumers to absorb the prices rises of recent years which have been driven by large water security investments.

Recommendations

SACOSS proposes that the Commission provides the Treasurer with the values which would result in revenue determination options which cap water prices at CPI only increases for the coming regulatory period.

SACOSS further proposes the Commission take this opportunity to highlight the differential impact of recent price rises on those consumers on the lowest of incomes and encourage the government to consider ways of better protecting these consumers into the future.

² <http://www.sawater.com.au/SAWater/YourAccount/UnderstandingYourAccount/Pricing+Information.htm>

³ http://www.treasury.sa.gov.au/dtf/infrastructure_support/water.jsp

Regulated Asset Base (RAB)

While this will be the first Revenue Determination for SA Water by the Commission under the Water Industry Act 2012, SACOSS acknowledges that the Treasurer will issue a further Pricing Order in May 2013 that will specify the initial value of the RAB.

SACOSS is well aware of the critical role that the Treasurer has in specifying the initial value of the RAB and consequently, in effectively determining the final price to be paid by South Australian consumers for water. As the Commission has explained in the Issues Paper (pp.24-25):

Whilst the Pricing Order (clause 4.1.7.1) provides that the initial regulatory value of the RAB that must be adopted by the Commission will be set through a subsequent Pricing Order, the Commission notes that value will need to be considerably lower than the current WDV of SA Water's assets if significant increases in South Australia's already high water bills are to be avoided.

As the Treasurer will set the initial value of the RAB, the Commission's revenue determination will only affect the amount of revenue to be earned by SA Water to the extent that the Commission determines capex and opex savings compared to the forecasts contained in the May Regulatory Statement. The SA Government has committed to ensuring that any such savings will ultimately flow through to prices faced by consumers. All other decisions made by the Commission (for example, on the regulatory rate of return), will not have any impact on revenues during the first determination period, as the RAB will be set to compensate for those decisions.

Given that the RAB is outside of the scope of ESCOSA's determination but that capex and opex savings are in scope, SACOSS believes that SA Water's proposed Capital Expenditure program needs to be reduced or offset by reduced expenditure in other areas, which would in reality require significant reductions in Operating Expenditure. SACOSS is extremely concerned that SA Water's proposed capital expenditure as currently outlined will further increase revenues (and hence prices) across the period.

SACOSS notes an alternative approach considered in the st.kitts.associates report which is "for the RAB to be reduced below current levels at the start of the period and allowed to grow back to its historic levels so that prices at the end of the regulatory period (2015-16) simply return to their current levels (in real terms)" (page 2).

While SACOSS also supports this approach, it is recognised that the latter approach is outside of the Commission's control and the final decision about whether to support this approach remains with the government.

Recommendations

SACOSS proposes that the Commission conduct an extensive review and detailed examination of SA Water's proposed capex and opex programs to determine areas for significant savings for both water and sewerage.

SACOSS further proposes that the Commission convey to the Treasurer the option of reducing the RAB to below current levels at the start of the regulatory period.

Appendix 1

st.kitts.associates report to SACOSS on ESCOSA's Issues Paper for the Review of SA Water's Regulatory Business Proposal (RBP) for the Revenue Determination Period 13/14 to 15/16

ESCOSA

**REVIEW OF SA WATER'S REGULATORY BUSINESS
PROPOSAL (FOR 2013/14 TO 2015/16)**

ISSUES PAPER

SOUTH AUSTRALIAN COUNCIL OF SOCIAL SERVICE

A report on:

- ESCOSA's Issues Paper for the Review of SA Water's Regulatory Business Proposal (RBP) for the Revenue Determination Period 13/14 to 15/16 (October 2012).
- Key issues for SACOSS
- Recommendations

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November 9th, 2012

PREFACE

SACOSS has sought a brief report on ESCOSA's Issues Paper¹ for the Review of SA Water's Regulatory Business Proposal (RBP) for the Revenue Determination Period 13/14 to 15/16. The report is to identify key issues of relevance to the work of SACOSS and its members in advancing the interests of the market's most vulnerable consumers.

CONCLUSIONS AND RECOMMENDATIONS

1. Following on from our discussions, it is clear that the preferred approach for SACOSS is to continue to advocate for regulation of SA Water on the basis that revenues should not rise at a rate that exceeds CPI. Proposals that would see revenue rise beyond CPI would need to be justified on the grounds that expenditure would result in a greater reliability or quality of service.
2. In this regard, the objective for SACOSS for this regulatory period can be stated as to ensure water and sewer prices that are no more than now by the end of 2015/16.
3. It is clear that the most significant element of this regulatory transition for SA Water is the establishment of the Regulatory Asset Base (RAB) by the Treasurer after ESCOSA has made its determination of other parameters. The RAB will, in effect, establish a new baseline of prices in SA. The elements of the ESCOSA Revenue Determination are also important because they determine whether prices are likely to increase or decrease from this new baseline.
4. The RAB is outside of the scope of ESCOSA's determination. The analysis contained herein shows that in order for prices to remain the same in real terms, the proposed Capital Expenditure program would need to be reduced (particularly in the case of sewerage services) or offset by reduced expenditure in other areas. In reality this would require significant reductions in Operating Expenditure.
5. An alternative approach would be for the RAB to be reduced below current levels at the start of the period and allowed to grow back to its historic levels so that prices at the end of the regulatory period (2015-16) simply return to their current levels (in real terms).
6. It is very important to note that setting prices in line with CPI at the start of the period does not allow for any operation of the Adelaide Desalination Plant (ADP) other than its commissioning and proving period: stand-by mode from 1 January 2015 (RBP page 156). There remains a real risk that prices will rise regardless. However, higher prices when water is more scarce is not necessarily an unreasonable outcome.
7. There are some mathematical constraints on levels of capital expenditure that can be sustained without pushing up prices. This also relates to the size of the RAB. Whenever expenditure (as a % of RAB) exceeds the % growth in customer connections plus the average RAB value depreciated each year, the RAB will grow. Unless RAB growth is offset by savings in Operational Expenditure, revenue must increase. Unless consumption increases, revenue growth must equal price growth.

¹ <http://www.escosa.sa.gov.au/projects/186/determination-of-sa-water-s-drinking-water-and-sewerage-revenue-2013-14-2015-16.aspx>

8. In summary, SACOSS will need to advocate to both ESCOSA and the Treasurer in order to ensure both water and sewer costs are kept at today's levels until at least 2015/16. In the case of ESCOSA and in relation to SA Water's Regulatory Business Plan, the following key points should be made:
 - a. ESCOSA's determination should proceed on the basis of ensuring per customer revenues are unlikely to exceed CPI increases across the period. Settings that would compromise this must be justified only on the basis of delivering a more reliable or higher quality service.
 - b. Operating Expenditure levels need to be reduced for both water and sewer services from the start of the period.
 - c. Sewerage Capital Expenditure needs to be lowered significantly to avoid growth in the sewerage regulatory asset base or a case needs to be made that consumers will receive a more reliable or higher quality service.
 - d. Consumers have a perverse incentive to argue for an increase in the weighted average cost of capital (WACC) on the basis that this would lower the opening value of the Regulatory Asset Base. This is a dangerous path to take and is best set aside.
 - e. Significant savings from expenditure plans will need to be found now if room is to be allowed for increased operation of the Desalination Plant later in the regulatory period while not materially increasing prices.
9. In relation to the Treasurer, SACOSS will need to advocate for the RAB to be set to deliver a CPI-like outcome for both sewer and drinking water services at the end of the regulatory period (ie 2015/16). This will be particularly important if SA Water's expenditure proposals are approved and revenue are allowed to rise above CPI over the period. This may require the Treasurer to set the RAB to deliver lower real revenues in 2013-14 that are allowed to rise above CPI over the regulatory period.
10. Further, the specific expenditure that puts the prospect of *CPI-like* most at risk is that for Country Sewerage Services. ESCOSA and the Treasurer must be able to explain now how this expenditure will accrue to the country sewer RAB, how the impact on revenues will be recovered from consumers and how state-wide pricing will ensure a community service obligation contribution from government revenue.
11. Finally, it is worth emphasising that the government's statements regarding *CPI-like* price rises for the foreseeable future are quite equivocal. The analysis performed for this report suggests that the service most at risk of not delivering on this objective is sewerage and it is possible for the government to assert that their comments have referred to water only.

BACKGROUND

This is the first Revenue Determination for SA Water by ESCOSA under the Water Industry Act 2012.

The process is also guided by the Initial Pricing Order recently released by the Treasurer (24th September 2012). It is understood that the Treasurer will issue a further Pricing Order in May 2013 that will specify the initial value of the regulated asset base (RAB).

The RAB is a fundamental parameter in the revenue determinations of regulated energy and water businesses. Invariably, the majority of revenue allowances approved by regulators are to cover the return *on* and *of* capital. The return *on* capital is found by multiplying the Weighted Average Cost of Capital (WACC) by the RAB. The return *of* capital is determined by approved regulatory depreciation schedules. This revenue can be considered as representing the principal and interest repayments by consumers for the cost of the infrastructure.

The Government's 2012-13 Regulatory Statement² describes the current RAB (Table 9 p10) and components of regulated revenue. This document shows that Operating Expenditure drove 40% of revenue while the return on and of capital drove the remaining 60%. Since the RAB is therefore responsible for the majority of regulated revenue, analysis of the RBP and ESCOSA's Issues Paper is severely constrained by this missing piece of information.

While expenditure proposals from SA Water will influence revenues and hence prices over the period, ESCOSA has acknowledged that "...other decisions made by the Commission (for example, on the regulatory rate of return), will not have any impact on revenues during the first determination period, as the RAB will be set to compensate for those decisions."

This makes for a rather unique circumstance for this revenue determination. The government has made public statements in relation to keeping water price rises in line with inflation. The following collection of quotes (all from this financial year) are provided as context:

SACOSS Media Release (Friday 13 July 2012)

Are SA's water users really winners?

"... We have heard loose commitments to keeping price increases in line with general CPI from Premier Weatherill and Minister Caica, but in removing the regulators [price setting] role like this, we are now on a slippery slope."

"SACOSS calls on the Government to immediately issue a statement confirming it will commit to reducing prices as soon as the full cost of the desalination plant has been recovered. Furthermore, given the absence of an independent regulator, SACOSS additionally seeks a written commitment affirming the Government's position that it will keep price rises to within CPI during the 2013-2016 period. Water is an essential service and all South Australians should be protected from paying unreasonable and unfair prices now and into the future."

The South Australian Government's 2012-13 Regulatory Statement (available online August 2012):

"The 2011-12 Regulatory Statement signalled that the 2012-13 pricing decision would be the last significant price increase due to water security. Although ESCOSA's price determinations cannot be pre-empted, CPI-like price increases for SA Water's drinking water services are expected from 2013-14. (page 3)

² South Australian Government 2012-13 Drinking Water and Sewerage Prices Regulatory Statement July 2012 (Department of Treasury and Finance) <http://www.treasury.sa.gov.au/public/download.jsp?id=3454>

The Water Minister was quoted in the media recently, reaffirming the position (ABC online Wed Oct 17, 2012³):

Mr Caica agreed with the need to contain water price rises.

"What the Government's committed to is ensuring on our projections that we won't see increases above CPI for the foreseeable future," he said.

Recent parliamentary debate has also made reference to Water Pricing and CPI. From Hansard October 16th, 2012⁴:

Mr WILLIAMS (MacKillop—Deputy Leader of the Opposition) (14:50): My question is to the Minister for Water and the River Murray. How can the government claim that water prices will be kept to inflation when today, ESCOSA (the Essential Services Commission of South Australia) has stated, and I quote:

The value of SA Water's regulated asset base will need to be set significantly below the current value in order to prevent future price rises above inflation.

The Hon. J.J. SNELLING (Playford—Treasurer, Minister for Workers Rehabilitation, Minister for Defence Industries, Minister for Veterans' Affairs) (14:50): ESCOSA, the government and I are in agreement on the issue of the regulated water base, the SA Water assets, needs to be reduced. I will make a determination of that in March 2013.

In summary, the government statements are equivocal. The use of a term such as 'CPI-like' and the explicit reference to *drinking water* seems to preclude the other regulated service – *sewerage*. Much of SA Water's proposed capital expenditure plan relates to waste-water treatment and may therefore represent an upward pressure on sewerage charges rather than drinking water prices.

³ <http://www.abc.net.au/news/2012-10-17/mothballed-desal-will-make-minimal-savings/4317448>

⁴ http://hansard.parliament.sa.gov.au/pages/loaddoc.aspx?e=1&eD=2012_10_16&c=29

SUMMARY OF APPROACH

12. Given the situation of the Treasurer being yet to declare the RAB, it is worth asking the question: What is in the consumer interest in relation to this process? The approach taken has been to consider what parameter settings will be required to ensure an objective of water and sewer prices that are no more than now (2012/13) by the end of 2015/16.
13. Since this Revenue Determination is part of a linked set of decisions that will impact on the water bills of consumers, it is important to consider this broader scope. The components of the ESCOSA determination must be considered in the context of the setting of the RAB and the objective of water and sewer prices that are the same as now by the end of 2015/16. If it is assumed that consumption and customer numbers either remain steady or grow at trend, prices can only remain constant if total revenue does likewise. This objective can be met by a combination of decisions regarding this revenue determination and the Treasurer's declaration of the initial RAB.
14. Given the enduring nature of the RAB, it is important to consider what represents outcomes in this regard that best aligns with the long term interest of consumers. Consumers are better off with the lowest sustainable initial RAB value. For a given WACC and depreciation schedule (to be agreed in the ESCOSA Revenue Determination but largely based on asset lives), the Treasurer is expected to choose a RAB value that delivers CPI-like increases for this initial regulatory period. ESCOSA have been explicit about this (Issues Paper p24):

"It is the Commission's understanding that this RAB will be established to achieve the price path forecast in the SA Government's May Regulatory Statement, except that any further capex and opex savings will flow through to consumers; that is, the initial RAB will be set at a value based on delivering the Government's pre-determined price path."
15. In this case, a higher WACC setting for example would need to be offset by a lower RAB if revenues are to remain unaltered. A high value now would be revenue neutral (since the RAB would be lowered to compensate) and, if WACC can be reduced in future determinations this could represent alignment with longer term interests. Given ESCOSA's reports of the nation's highest drinking water prices, it would appear that price reductions may be possible without harming efficiency.
16. SACOSS made a submission⁵ to ESCOSA's Advice on a Regulatory Rate of Return for SA Water. While I believe the comments made in that submission remain valid, there is no incentive for SACOSS to argue further for a lower WACC. In fact, as discussed above, there is a case for arguing for a higher WACC in this current determination. This is a perverse outcome unique to these current circumstances.
17. While the initial RAB will determine prices at the start of the period, capex and opex growth can drive real price increases within the 3-year period. These expenditure programs are in scope for ESCOSA's review. Analysis shows that the proposed expenditure programs are too high to keep sewerage prices at CPI-like increases.
18. In summary, keeping price rises *CPI-like* means keeping real revenue allowances growing no faster than customer numbers. Constraining growth in revenue allowances means limiting growth in capital and operating expenditure. Capital expenditure levels that exceed depreciation amounts lead to growth in the RAB and to higher regulated revenues and prices.

⁵ http://www.sacoss.org.au/online_docs/120105%20Submission%20to%20ESCOSA%20re%20SA%20Water%20Rate%20of%20Return.pdf and <http://www.escosa.sa.gov.au/library/120106-RateOfReturnSAWaterSubmission-SACOSS.pdf>

WATER PRICING

19. The “price of water” is not a simple number. It invariably contains a fixed supply charge and a volumetric charge for water and a property-value linked charge for the sewerage service. The volumetric charge for households has an inclining block structure where the price of a litre of water increases as you consume above a quarterly threshold.
20. The South Australian Government’s *Water for Good* plan provides the policy basis for the *Water Industry Act 2012*. Part 6 of *Water for Good* outlines the Government’s approach to pricing and market instruments. The document makes it clear that the intention is to move towards economically efficient, cost reflective water pricing and that equity considerations are to be addressed through “targeted income support (concessions) measures”. At page 142, the document states:

“The Government will develop a regulatory framework to: ...

- *establish a clear separation between economic objectives, to be pursued by [independent regulator] ESCOSA and non-economic objectives (i.e. health, social and environmental objectives) to which ESCOSA must have regard, but for which the State Government will retain primary responsibility.”*

21. Page 144 discusses ‘Water usage prices’ in more detail. This states a desire to retain the current tariff structure for residential customers in order to:

“... manage the impact on residential customers by smoothing the transition to higher water use prices over a period of time” and to “ensure social equity considerations are adequately provided for until equity instruments can be fully separated from the pricing policy”.

22. It seems reasonable to assume that the current tariff structure will remain for the period of this revenue review. The fixed component of the charge will be constrained at only a CPI increase as will the average (or marginal) volumetric charge.
23. The revenue to be recovered from Residential customers is determined from allocating a proportion of total approved revenue for all customers. Residential customers will therefore have an interest in not only keeping total revenue minimised but also an interest in ensuring they are only allocated their fair share of costs and no more.

THE REGULATORY ASSET BASE

24. It is important to acknowledge and understand the incentives facing utility infrastructure businesses when analysing regulatory proposals such as this one from SA Water.
25. Spark Infrastructure is a publicly listed entity that owns 49% of three electricity distribution *Asset Companies* - SA Power Networks in South Australia and CitiPower and Powercor in Victoria. To illustrate the importance of the RAB: The following is taken from Spark Infrastructure’s HY2012 Securityholder Newsletter⁶.

Managing Director Q&A

⁶ Available from the ASX at <http://clients2.weblink.com.au/clients/spark/article.asp?asx=SK1&view=2694632>

Q What is your main focus over the next 12 months?

A “The next 12 months will be focused on continuing to deliver a solid distribution to our security holders which grows over time and on supporting the substantial growth in capital expenditure in the Asset Companies. ... Our central plan is to continue to grow the Asset Companies’ Regulatory Asset Bases (RAB) while degearing at the asset level towards a level of 75% net debt to RAB.”

26. New capital expenditure and inflation is added to the RAB each year. The RAB is then decreased each year by the depreciation amounts. Most years see new expenditure outpacing depreciation and RAB values have tended to grow in real terms over recent years.
27. Importantly, the RAB has four independent categories: metropolitan and country, water and sewer. Once set, expenditure is allocated to one of these four categories. Revenues, and hence prices are allocated to the respective customer classes. State-wide pricing uses direct payments from government to make up the shortfall in required revenue for Country services as compared to the prices charged and revenue recovered from Country customers.

EXPENDITURE

28. The opening value of the RAB is of course a critical parameter. However, once it is established, the key dimension stops being its initial value but how it grows over time. As will be shown, the RAB inflates with capex and deflates with depreciation. With historic depreciation rates of around 2% per annum for SA Water’s quite long-lived asset base, holding the RAB constant in real terms would limit annual capex to this same rate plus the growth that comes from adding new customers. If the process of connecting each new customer allocated costs so that the RAB only grew in proportion to the increased revenue that will be generated by these new customers then this sort of growth should also have no impact on prices for the average consumer.
29. Of course, it is possible to trade any increase in capex against an improvement in service. If a case is made that consumers have a willingness to pay for improved service (in terms of reliability, quality, safety etc) or if costs are driven by externally applied standards (such as carbon prices, wastewater treatment quality / discharge quality standards etc) then this could arguably still meet a definition of CPI only indexation.
30. On the basis of projected growth in connections and consumption, a revenue growth of 1.5% (real) pa would be approximately neutral on a per consumer basis. Depreciation can be offset by new expenditure without growing the RAB. At an average linear depreciation of 2% of RAB, capex growth at around 3.5% of RAB should be approximately price neutral.
31. 2012-13 Regulatory Statement Tables 11 to 14 show the values assigned to different parameters for water and sewer and for metro v country. Combining this information with SA Waters Expenditure Proposals allows for the consolidation of key regulatory figures for water and sewerage services. The trends in each are not the same. It is apparent that the key deviation from a CPI-like result is in capital expenditure for country sewerage services.
32. The capital expenditure proposal for water services is for around 2.2 to 2.4% of the RAB value in annual capex pa across the period. It is almost entirely for metro services and accrues to the metro RAB account.

33. However, the capital expenditure proposal for sewerage services is for over 4% of the RAB value in annual capex (from 3.88 to 6.31% pa across the period). It is almost entirely for country services and accrues to the country RAB account.
34. The treatment of this under the statewide pricing regime is unclear. Presumably, some of this expenditure would be funded through Community Service Obligation payments from government.
35. It is important to note that if the Treasurer sets lower RAB values, the observed percentages of capital expenditure will rise. There is some scope for this in terms of the water RAB. This will only make the situation for sewerage worse.

ESCOSA'S QUESTIONS

2.1 Form of Revenue Control

Comments are sought from members of the community on SA Water's proposed forms of revenue control.

Are they consistent with the requirements of the Pricing Order?

Do they represent an appropriate balancing of demand risk between consumers and SA Water?

Would they lead to the recovery of revenue amounts that are cost reflective?

36. The key risk in question is that of demand risk for water services – the under or over recovery of revenue from consumers when water consumption is more or less than forecast. SA Water's Figure 5.9 and Table 5.9 illustrate the variability of demand.

Figure 5-9: Forecast water use with weather sensitivities¹⁰⁰

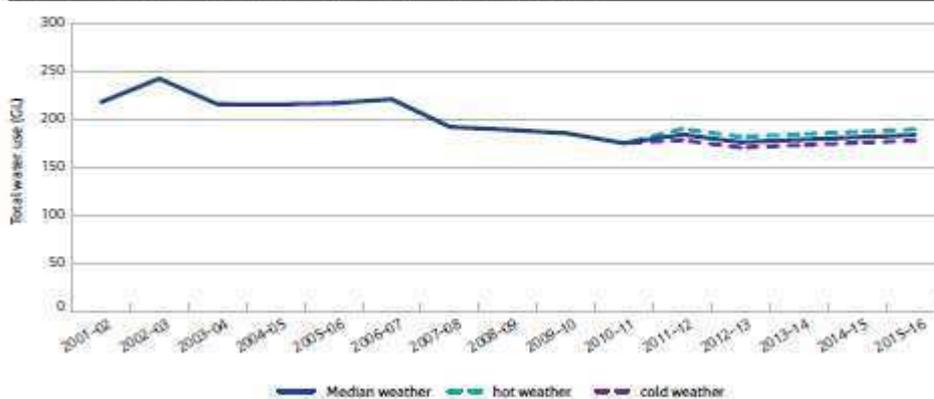


Table 5-9: Forecast water use under various weather assumptions (GL)¹⁰¹

	2012-13	2013-14	2014-15	2015-16
Forecast use: "normal"/median weather	176.2	178.9	181.4	183.8
Forecast use: hot weather	181.9	184.5	187.1	189.6
Forecast use: cold weather	170.7	173.2	175.7	178.0

37. The results indicate a range of 6.35% (ie +/- 3.2% pa) and, given the high service access charges, the revenue at risk is probably in the order of 1-2%. I have no specific opinion on the proposed *banking mechanism* other than to comment that the treatment of demand risk (or *cashflow* risk) should be reflected in the risk premiums used in the derivation of the Weighted Average Cost of Capital. The more that risk is allocated to consumers, the lower the appropriate risk premium for the business should be.

2.2 Cost Pass Throughs

Comments are sought from members of the community on SA Water's proposed set of pass through events.

Are SA Water's proposed pass through events consistent with the objective of providing SA Water with a reasonable chance to recover the efficient cost of providing water retail services?

Should SA Water bear the risks that most businesses do?

38. The notable entry is in Class 2: Specific Pass Through Events, No.1 **Operation of the Adelaide Desalination Plant (ADP)**. SACOSS should support the treatment of ADP costs as a pass-through event. Given the inexperience with plant operation and costs, the mechanism will provide for a detailed and transparent examination of costs to consumers.
39. It is also important to acknowledge that this approach also leaves open the possibility that price rises would go above CPI if the ADP was utilised beyond that forecast for the period (ie into standby mode once commissioned and out of its warranty/proving period). This provides further reason for scrutinising expenditure proposals.
40. In relation to risk exposure, it is important to reiterate that SA Water is only entitled to efficient risk-weighted returns. The more SA Water seeks to defray risks, the lower the risk premiums afforded in the WACC determination.

2.3 Capital Expenditure

Comments are sought from members of the community on SA Water's proposed capital program.

Comments are also sought on SA Water's forecast of real increases in the cost of labour, materials and contracted services.

41. As noted earlier, the proposed sewerage capital expenditure program cannot be sustained while keeping price rises to below CPI. The timing and scale of the projects may need to be reconsidered, or offsetting savings found elsewhere in order to contain price impacts.

2.4 Operating Expenditure

Comments are sought from members of the community on SA Water's proposed:

- a) level of operating expenditure;*
- b) methodology for selecting the base year of 2011/12; and*
- c) key drivers influencing the proposed operating expenditure.*

42. Issues Paper Table 3, Comparison of Opex Proposals, shows that Opex growth is below CPI across the period. However, both water and sewer Opex levels jump by more than CPI at the start of the period. There does not seem to be a strong case for why Opex needs to increase at the start of the period. Particularly in the case of sewerage, further opex savings can help offset the increased capex program.

2.5 Demand

Comments are sought from members of the community on SA Water's demand forecasting methodology and the resultant demand forecasts.

43. No comment other than to note that SA Water will be incentivised to understate the level of demand.

2.6 Supply Mix

Comments are sought from members of the community on SA Water's proposed supply mix.

44. No comment other than to note the higher costs of desalinated water and that the placing of the ADP in standby mode is likely to provide lower costs to consumers than if it was operated more extensively. The treatment of any change to operating needs as a pass-through event allows for enhanced transparency but leaves the door open for higher prices.

2.7 Return on Assets

Comments are sought from members of the community on how the regulatory rate of return for SA Water should be determined.

45. SACOSS made a submission⁷ to ESCOSA's Advice on a Regulatory Rate of Return for SA Water. While I believe the comments made in that submission remain valid, there is no incentive for SACOSS to argue further for a lower WACC – only a rather perverse incentive to argue for a higher WACC value.

46. Building on previous comments, it seems incongruous that SA Water can seek to defray risks (through a revenue banking mechanism and a solid list of pass throughs) yet also claim the standard Market Risk Premium of 6%.

2.8 Regulatory Asset Base

Comments are sought from members of the community on SA Water's proposed approach for rolling forward the value of the initial RAB.

47. No specific comments on the SA Water roll-forward proposal other than to note the importance of this to maintaining revenue (and hence price growth) as CPI-like.

⁷ http://www.sacoss.org.au/online_docs/120105%20Submission%20to%20ESCOSA%20re%20SA%20Water%20Rate%20of%20Return.pdf and <http://www.escosa.sa.gov.au/library/120106-RateOfReturnSAWaterSubmission-SACOSS.pdf>