



Submission to the Essential Services Commission of South Australia

**SA WATER'S WATER AND SEWERAGE REVENUES 2013/14 - 2015/16
DRAFT DETERMINATION: STATEMENT OF REASONS**

**Prepared by
COTA SA**

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For older Australians

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About 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.

COTA SA welcomes the opportunity to provide comments on the first draft determination on SA Water's revenue for the period 2013-2016. In this submission, we identify concerns about the constraints that have been placed on the Commission in establishing a working regulatory model and make specific comment on:

- the adjustment mechanism proposed;
- the implications of a cost reflect tariff structures for low use customers; and
- the importance of the regulated asset base determination to be made by the Treasurer in May to the outcome for SA Water customers.

Notwithstanding the efforts of the Commission to protect customers' interests, COTA SA considers that there are broader features of the current implementation process that will leave some customers highly vulnerable and in need of improved government support.

1. Underlying principles and constraints

The National Water Initiative (NWI) Pricing Principles anticipate the provision of urban water services as effectively conducted in monopolistic conditions. In the South Australian context, these market conditions reflect the historical arrangements for the delivery of essential services in the past when a government-owned statutory body provided services to the community. With the enactment of the *Water Industry Act 2012*, the groundwork was laid for monopolistic conditions to be transformed by competition. The transition to a competitive market will likely take many years, however.

In the meantime, the task of the Commission, as the regulator, is framed by these historical conditions. Effectively SA Water is a monopolistic supplier to the majority of South Australia's water consumers who have no real choice. COTA SA appreciates the efforts of the Commission to operate a limited range of relatively clunky levers in an effort to provide buoyant conditions to float the water market. It is early days in this process, but our concerns about the long-term implications for consumers and the extent to which real benefits will be delivered have not diminished. At best, any longer term promise of competitive pricing delivering benefits to users of water is very much a nascent proposition.

In November 2012, we highlighted our concerns about the deregulation process in providing comment on SA Water's regulatory business proposal.¹ Our concerns are compounded by the constraints imposed on the Commission by the SA Treasurer's 2013-2016 Pricing Order. This Order requires that the Commission not only be consistent with the NWI Pricing Principles but also with a

¹ COTA SA (2012) *Review of SA Water's Regulatory Business Proposal for the Revenue Determination Period 2013/14-2015/16* available at <http://www.escosa.sa.gov.au/library/121121-ReviewOfSAWaterRegulationBusinessProposal-IssuesPaperSubmission-COTA.pdf>

number of specified parameters. This includes a requirement that the determination ‘must only determine the revenue which may be derived from the provision of such services’ (s4.1.2) and

must include a mechanism which allows for the adjustment of the allowable revenue to be derived where the Commission determines there to be a relevant and material variation between forecast and actual rates of water consumption or sewerage connections (s4.1.6)².

Within these constraints, we consider the draft determination presents a well-considered regulatory approach. The Commission has prudently reviewed the approaches used in other jurisdictions and carefully set out the foundations of the Commission’s thinking on the best revenue setting method. It has provided sound reasons for selecting an average revenue cap approach to encourage price stability (current prices being above long-run marginal cost) while reducing the risk borne by customers.³

However, it is disappointing that the Commission’s draft determination apportions some risk to customers (in the ratio of 30:70 customer to retailer) – ostensibly because ‘a “pure” average revenue cap would not comply with Clause 4.1.6 of the Initial Pricing Order.’⁴ This requirement on the Commission to comply with the Pricing Order does not seem to meet the Commission’s preferred form of revenue control and consequently convolutes the logic of the draft determination. This reinforces our concerns about the long term outcomes for water consumers. Three key concerns are identified below.

2. Key concerns

2.1 Adjustment mechanism

COTA SA notes that the Commission has adopted a rather awkward and unclear “adjustment mechanism” to meet the requirements of section 4.1.6 of the Pricing Order. The effect of the mechanism would allow the Commission to take into account 30 per cent of any increase or decrease in revenue during this determination period when considering the next revenue determination period (2016-2019). In effect, this means that consumers carry 30 per cent of the demand risk and this may have a positive or negative effect on future revenue limits set and, subsequently, future prices paid.⁵

While the Commission suggests that the ‘technical aspects’ of the adjustment mechanism are yet to be finalised, COTA SA is particularly anxious about the impact of this mechanism over the longer-term. It could result in significant increases (or potentially decreases) in the usage charges for water as this variation is passed through. Furthermore, it is not dissimilar to the “banking” mechanism proposed by SA Water originally and we have already indicated that we do not support measures that protect SA Water from forecast risk and effectively pass this risk on to water consumers who are least well placed to manage this risk.

2.2 Cost reflective tariffs

We note from the Commission’s draft determination that the Treasurer has requested (in September 2012) that the Commission undertake a review of the pricing structure for water and

² South Australian Treasurer (2012) *Pricing Order for the Regulatory Period 1 July 2013 – 30 June 2016* available at http://www.treasury.sa.gov.au/_data/assets/pdf_file/0020/1685/water-industry-act-pricing-order.pdf

³ ESCOSA (2013) *SA Water’s Water and Sewerage Revenues 2013/14 - 2015/16: Draft Determination: Statement of Reasons*, p28

⁴ ESCOSA (2013) *Statement of Reasons*, p29

⁵ ESCOSA (2013) *Statement of Reasons*, p30

sewerage services.⁶ This work will not be completed until end of 2014. However, the Commission offers hints in the direction of NWI urban water pricing principle 3 - cost reflective tariffs – when it agrees that cost reflective tariffs are ‘critical for managing demand risk [because] if tariffs are structured such that revenues and costs are aligned as water demand fluctuates, the risk of actual and forecast demand varying is largely avoided.’⁷ The Commission goes on to urge SA Water to ‘implement any real average water revenue reductions that the Commission may make in its Final Revenue Determination by focusing on moving usage charges towards costs’.⁸

COTA SA is concerned about the implications of this reasoning for low use customers including older people. While the proposition seems to be that usage charges could better reflect actual costs, it is not clear what cost reflective pricing would mean for the supply charge component of the tariff structure. While greater transparency in price signals clearly motivates the Commission’s thinking, COTA SA apprehends a disproportionate impact on many older and low-income households potentially. In these households, the fixed charge component of residential water bills is proportionally greater than for higher use households. Any decrease in the usage tariff would not necessarily offset any increase in the supply charge for low use households but rather may compound cost of living pressures on these already most vulnerable sectors of the community.

2.3 Value of the Regulated Asset Base

The Commission has noted concerns expressed by COTA SA and by SACOSS about the Regulated Asset Base (RAB) value and confirmed the importance of the Treasurer’s determination on this matter in setting prices. Ultimately, it will be the determination of the RAB that will inform water prices over the first regulatory period.

We trust that our concern about the cost of living burden brought about by substantial increases over recent years in water prices and supply charges will be conveyed to the Treasurer by the Commission. We note that the Commission has previously identified South Australia has having the highest water prices when compared to other Australian jurisdictions.⁹

COTA SA is pleased that the Commission will undertake a review of capital expenditures in the lead up to the second regulatory period to ensure that practices that the community has experience in a regulated electricity market (such as the so called “gold plating” of infrastructure) do not occur in the water industry context and have the effect of pushing tariffs up.

3. Concluding comments

The Commission’s first draft determination provides a comprehensive discussion of the regulatory options available and the reasons underpinning the working model proposed. COTA SA also considers that it highlights some substantial administrative constraints on the regulator.

COTA SA has previously expressed concerns about treating SA Water as a type of business while continuing to pay a dividend to government. This is regressive taxation that has the potential to obfuscate underlying fiscal drivers rather than promoting transparency and regulatory

⁶ ESCOSA (2013) *Statement of Reasons*, p30

⁷ ESCOSA (2013) *Statement of Reasons*, p28

⁸ ESCOSA (2013) *Statement of Reasons*, p30

⁹ ESCOSA (2012) *Economic Regulation of SA Water’s Revenues: Statement of Approach*, p12 available at

<http://www.escosa.sa.gov.au/library/120713-EconomicRegulationOfSAWatersRevenue-StatementOfApproach.pdf>

accountability.¹⁰ We consider that the Commission has worked within the parameters set to provide the most effective model possible.

Nonetheless, COTA SA continues to be concerned that in seeking to treat water and sewerage services as a commodity first and an essential service secondly; there are significant groups within the community who will not or cannot assume the market role of savvy consumer. Like the energy market privatisation ten years ago, there are some who simply rely on services being provided and will invariably wear the cost.

For this reason we have repeatedly observed that the regulatory framework must be balanced by sound social policy measures if good community outcomes are to be achieved and easy access to safe drinking water and reliable sewerage services to all residents is to be ensured. The Commission's draft determination reinforces our strong view that the SA Government must move to protect consumers, particularly those on low or fixed incomes, from pricing pressures included cost reflective tariffs. The latter has the potential to severely disadvantage low use consumers, including older people, who may find increased supply charges are not offset by reduced usage charges. On this matter, COTA SA observes that there may be little recourse for these customers other than relief that may be afforded by direct government support in the form of increased and better targeted concessions.

¹⁰ 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>