



19 March 2013

Essential Services Commission of South Australia
GPO Box 2605
Adelaide SA 5001

Via e-mail to: escosa@escosa.sa.gov.au

Dear Dr Kerin,

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Director – SA Branch

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Re: ESCOSA's DRAFT DETERMINATION & STATEMENT OF REASONS for SA WATER - February 2013

We write in relation to the call for submissions in regards to the Commission's Draft Determination as above.

Specifically, we refer to **Section 9.6 - Annual nominal revenue changes** (at pages 114 and 115 of the Commission's Draft Determination).

In this section we note that the Commission provided some detail of the annual adjustment mechanism. This requires SA Water to submit an updated water sales forecast for coming year for review by ESCOSA.

We understand from the Draft Determination that ESCOSA proposes to set an Average Revenue Cap which is directly aligned to volumes of water sales. We note that:

1. the Commission's Final Revenue Determination will specify (in real terms) the Average Revenue Caps to apply in each year of the regulatory period;
2. ESCOSA's Determination sets SA Water's revenue not its water tariffs (prices). Having received its Average Revenue Cap, it then falls to SA Water (in consultation with Treasury) to set the necessary water tariffs;
3. Having set the Average Revenue Cap, the Commission converts it into 'Nominal Revenue Caps' to apply from 1 July each financial year, by the most recent actual annual inflation rate (the year to March CPI);
4. SA Water will be required to provide ESCOSA with a statement to demonstrate that the average revenue that results from the proposed tariffs and forecasts is no greater than the Average Revenue Cap set out in the Commission's *Final Revenue Determination*; and

5. in formulating that statement, SA Water must forecast revenue amounts for drinking water and sewerage services based on the best evidence available at the time, including a forecast of:
 - a. drinking water sales (by pricing tier); and
 - b. drinking water and sewerage customer/ connection numbers.

Ai Group's understanding of the Commission's requirements (as outlined above), together with the form of price control proposed by ESCOSA (i.e. an Average Revenue Cap) will, in our view, result in the need to reset prices each year to reflect for any changes in proposed water sales forecasts.

Noting that SA Water charges its consumer prices based on a fixed element (an effectively fixed supply charge), in addition to a variable element (usage charges), any variation from the original Revenue target will necessitate a proportionally larger variation in usage charges.

Our concern is that by incorporating this type of annual adjustment mechanism, the Commission will create a situation where SA Water's prices (through yearly variance in usage charges) will also need to be adjusted each year to reflect updates in SA Water's sales forecasts. Inherently, this will result in price volatility for consumers – something that would not assist Ai Group's members. We therefore submit that this is not a desirable feature of the price setting mechanism.

Ai Group's believes that our members' interests are best served by stability in water and sewer pricing so far as is practicable, particularly in the current difficult business environment.

Accordingly, Ai Group submits that this aspect of the Draft Determination be reconsidered with a view to mitigating annual volatility in water prices so far as is practicable. We understand that SA Water has proposed a banking scheme to offset the risks associated with volatility in pricing. It could be that such a scheme is worthy of consideration.

Ai Group looks forward to continuing to play a constructive role with the Commission in the pricing and regulation of the State's water industry.

Please feel free to contact me on (08) 8394 0002, should you require further clarification of these issues.

Yours sincerely



Stephen Myatt
Director – SA Branch
Australian Industry Group