COTA
For older Australians

COTA SA
16 Hutt Street,
Adelaide SA 5000

GPO Box 1583
Adelaide SA 5001
ABN 28 426 218 581

P:(08) 8232 0422
F:(08) 8232 0433
www.cotasa.org.au

6 January 2012

Mr Nathan Petrus
Director, Pricing and Analysis
Essential Services Commission of SA
GPO Box 2605
Adelaide SA 5001

Via email to: escosa@escosa.sa.gov.au

Dear Mr Petrus

Draft Advice on a Regulatory Rate of Return for SA Water

COTA SA welcomes the opportunity to provide comment on ESCOSA's Draft Advice to the Treasurer on the Regulatory Rate of Return for SA Water ('Draft Advice').

As the peak organisation for seniors in South Australia, COTA's main concern regarding water supply is its affordability for older people, particularly those on low incomes or who are otherwise disadvantaged, such as those living in rural areas. As ESCOSA is aware, recent price rises have seen both fixed and consumption costs for water rise significantly – in relative terms particularly for low-use consumers and concession card holders.

This brief submission provides COTA's comments on the Draft Advice, as well as some broad points regarding water regulation in SA generally. The points made in this submission can be read as recommendations for advice to the Treasurer from ESCOSA, which COTA will communicate independently to the Treasurer.

COTA will also incorporate some of the comments provided below along with additional analysis and recommendations into its submission on the Draft Advice on Economic Regulation of the South Australian Water Industry.

General Concerns Regarding Water Regulation in SA

In principle COTA does not dispute the premise of economically efficient pricing for utilities to ensure their long term viability, and agrees that it does help to meet the long term interests of consumers in this regard. However COTA also believes that the cost implications for older people and those on low incomes cannot be ignored and has long argued that as an essential service, all South Australians have the right to a basic amount of water at an affordable price.

COTA notes that price is considered one of the primary long terms interests of consumers in 6(a) of the *Essential Services Commission Act 2002* (ESC Act). In this regard COTA sees a natural and necessary link between the economic regulation of water and the social policy framework underpinning affordability.

Therefore in order to reach the aim of ensuring water is affordable and accessible for older people COTA will continue to participate in discussions on both economic regulation (including tariff setting) and the income support framework, specifically concessions.

In regard to the role of the Treasurer, COTA is concerned that the functions of ESCOSA will be limited to an unacceptable extent in the Pricing Order. As explained in more detail below, COTA does not believe that the Pricing Order should lock in the weighted average cost of capital (WACC) figure, which would remove the ability of ESCOSA to utilise more up-to-date data to inform its price path from 2013. Moreover, COTA believes that the Pricing Order should be primarily used to set side constraints on price increases across pricing tiers and inclusive of the supply charge.

General Comments on the Draft Advice

Recognising the obligations placed on ESCOSA by the Treasurer in his letter of request (cited at p. ii of the Draft Advice) COTA cannot support the use of the 6.88 figure as a basis for the initial price path and will write to the Treasurer regarding this issue. COTA is deeply concerned that the Treasurer has specifically requested that ESCOSA provide its advice on the regulatory rate of return epitomised in a single WACC figure, and to what use the Treasurer will put that figure.

This concern is largely based on the significant jump from the current 6.05% to 6.88% (pre tax real) and the potential for this latter figure to form the basis for both the Pricing Order and price path from 2013.

In terms of the specific figure, COTA is seriously concerned that the limitations and uncertainties iterated in the Draft Advice be adequately considered by the Treasurer. COTA believes that providing advice to the Treasurer on the WACC should be in the form of advice on an acceptable range of WACC calculations to avoid using artificial and non-reflective data.

Aside from the merits of 6.88 as a point-in-time figure, there is a concern that it may be used in the Pricing Order and therefore in setting the price path in 2013. COTA notes that at p. 2 of the Draft Advice ESCOSA states that

> *The advice that the Commission is now providing will be out-dated and hence unreliable for a price determination which will occur at a future date.*

COTA fully supports the view that figures in the Draft Advice should be considered as indicative only and not form the basis of any price determination. As the difference between basis points on the WACC can equate to tens of millions of dollars in revenue, COTA encourages ESCOSA to reinforce this important point.

COTA also considers that the 'bottom-up' regulatory approach utilised by ESCOSA in its Draft Advice should be accompanied by a 'top-down' view of SA Water's business. The former is admittedly the norm for utilities regulation, used by regulators across Australia and involving great levels of detailed economic analysis. Including the latter would actually allow ESCOSA to view the way SA Water operates – including government ownership – and to incorporate this knowledge into its regulatory practices.

Debt Risk Premium (DRP)

As noted above, COTA does not believe that it is in the interests of consumers that an ongoing WACC be set now and this is partly due to uncertainty around the debt risk premium or DRP (specifically in regard to bond yields). However COTA considers the cost of debt to be a significant issue in itself.

In brief, COTA believes that SA Water should be regulated as an 'efficient government-owned water utility' rather than an 'efficient water utility'. While (along with most other major water utilities across Australia) SA Water does need to finance its debt based on its credit rating, this credit rating and hence the cost of its debt should be reflective of its position in the debt market. This would mean an assessment of the South Australian Government's credit rating rather than benchmarking against a non-existent bond market product for a hypothetical privately-owned utility.

COTA recognises that changes to the credit rating (e.g. from BBB to AA+) may affect the gearing ratio – set at 60% in the Draft Advice – and that this may drive the DRP up or down. However in order to ensure the long term interests of consumers are met through this process a thorough assessment should be undertaken which is reflective of SA Water's operating environment. This will ensure that non-existent costs of debt are not being paid by South Australian consumers.

COTA notes that the issue of government versus private debt costs in energy networks is the subject of a Rule Change Request from the Energy Users Rule Change Committee (EURC) which is currently being considered by the Australian Energy Market Commission (AEMC). COTA Australia has supported in principle the EURC request and COTA SA considers that the principles involved are transferrable to water utilities, regardless of current regulatory conventions.

COTA therefore recommends that ESCOSA provide advice to the Treasurer to the effect that government ownership be considered in setting the DRP.

Summary

In summary, COTA's recommends that the following be included in ESCOSA's advice to the Treasurer:

- That social policy in regard to concessions should be linked to economic regulatory outcomes to mitigate price increases caused by those regulatory outcomes;
- That the Pricing Order be primarily used to set constraints on tariffs and price changes;
- That any single weighted average cost of capital (WACC) figure provided by ESCOSA not form the basis for a Pricing Order which does not allow for the revision of elements closer to the price path determination;

- That ESCOSA reinforces the limitations on the analysis of economic elements of the WACC and the inexact nature of the final figure; and
- That SA Water's cost of debt as a government-owned utility be considered when setting the debt risk premium (DRP).

Should you have any questions regarding this brief submission, please contact Tom Stead, Senior Policy Adviser, on 8224 5515 or email tstead@cotasa.org.au.

Yours sincerely

Jane Fisher
Policy Manager