



4 February 2011

Essential Services Commission of SA
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via email to: escosa@escosa.sa.gov.au
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Dear Mr Petrus,

Re: Economic Regulation of the South Australian Water Industry – Statement of Issues

We write in response to the Statement of Issues published by the *Essential Services Commission of South Australia* (the Commission) in December 2010.

Introduction to the Australian Industry Group

Ai Group is a leading industry association in Australia and is committed to helping Australian industry meet the challenge of change. Our focus is on building competitive industries through global integration, human capital development, productive workplace relations practices, infrastructure development and innovation.

Ai Group's SA Branch was formed out of a merger between the *Engineering Employers Association, South Australia* ('EEASA') and Ai Group. The SA Branch was created on 1 July 2009 and further builds our strong national representation.

Ai Group members operate small, medium and large businesses, and employ around 750,000 staff in a number of industry sectors. Many members are in resource intensive industries, and the generation of waste and residues as a by-product of industrial processes remains a major issue for management of compliance and costs.

We have significant membership in the electrical and electronic manufacturing and ICT sectors, where product stewardship, e-waste and eco-design are key issues. Other members are directly involved in waste management and disposal, resource recovery or recycling.

Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations, including the Australian Constructors Association. Together, Ai Group and its affiliates represent the interests of approximately 60,000 businesses which employ in excess of 1.2 million staff across Australia and the world.

Ai Group provides an extensive range of advisory services to member companies in the areas of industrial relations, human resource management, OHS&W, workers' compensation, environment, education, training, industry development and economic performance.

It should also be noted that the Ai Group has also become an Alliance Member with the *Community Engagement Board* in support of the achievement of targets in the SASP, including T3.5 - *Climate Change*.

Ai Group's submissions

Please find Ai Group's submissions to the Issues Paper appended. As a courtesy and for the Commission's information, we have also appended a copy of our submissions to the Government on the draft *Water Industry Bill* itself.

In forming our submissions, we have concentrated on our major concern in respect of Adelaide's water supply - the critical need to maintain secure water supplies for industry, for business and for the broader community. Critically allied to this concern is the need to ensure that these secure supplies of water are provided at a reasonable cost to consumers. This being the case, not all aspects of the Issues Paper were directly relevant to our constituency. **Accordingly, please note that we have limited our responses to our main concerns - Issues 22 to 44 inclusive.**

Ai Group believes that it is essential that any economic regulatory regime be developed with this purpose in mind and broadly supports the commitment to reform the institutional arrangements over the water sector, together with a reform package for water legislation.

In respect of the proposal for a new Act in 2011, we have previously urged the *Office of Water Security* to proceed cautiously and to "get the legislation right" on the first occasion. We also support the fact that the structure of the Bill is largely based on the model established under the *Electricity Act 1996 (Electricity Act)* and the *Gas Act 1997 (Gas Act)*.

Ai Group is pleased to observe that the draft Bill envisages the provision of water moving away from the current monopoly situation, with a third party access regime incorporated into the structure of the Bill. However we are of the view that the *implementation* of a third-party access regime could be more definitely articulated.

ESCOSA's Customer Advocacy Committee

Ai Group strongly supports the Commission having its own independent *Customer Advocacy Committee* to provide advice on regulated water supply and wastewater services. We note that this Committee could be that already in place, or some expanded version of it.

It any event, as a leading industry association that constructively deals with most governmental regulators around the country, Ai Group would seek to contribute to any decision regarding the basis and constituency of the Committee. We indicate at the outset that, in due course, Ai Group would like to be considered for a seat on the Committee.

Transitional measures for industry

A vital factor in implementing the Bill will be the measures proposed for transitional arrangements, particularly for industry. It is critical that industry is able to effectively transition into any new regulatory environment. On that basis, it is essential that transitional measures be developed without delay, and in close consultation with industry.

As a leading Australian industry association, Ai Group remains keen to play its part in efforts to achieve a viable and independent water industry for *South Australia*.

On behalf of the Australian Industry Group, we have appreciated the opportunity to provide our views on the Statement of Issues which are, and will remain, of key interest to our South Australian membership. Should you have any question in relation to these submissions, please do not hesitate to contact me on (08) 8300 0136.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S Myatt', with a large, stylized flourish at the end.

Stephen Myatt
Director – SA Branch
Australian Industry Group

Ai GROUP'S RESPONSE TO THE ESCOSA ISSUES PAPER (Note – addresses issues 22 to 44 only)

<i>Issue</i>		
22.	<p>Are there any aspects of the compliance regime that the Commission currently administers that would be problematic if implemented for all water industry entities?</p> <p>If so, how?</p> <p>Should the Commission adopt a different compliance approach to licensees that provide limited retail services to only a small community or region? If so, to what extent?</p>	<p>None perceived</p> <p>N/A</p> <p>Yes, as per the discussion in the Issues Paper, a more 'light-handed' approach that limits the number of regulatory obligations and sign-off requirements.</p>
23.	<p>Are there any good reasons why the Commission shouldn't apply direct price controls to SA Water's drinking water and sewerage services?</p> <p>What is the appropriate form of regulation for SA Water's other services?</p> <p>Are there other providers of retail services for which price regulation of some form is required? If so, what form of price regulation should be applied?</p>	<p>No</p> <p>The natural monopoly position of SA Water in relation to trade waste disposal and recycled water provision is weaker than in relation to water and sewerage, given the availability of on-site trade waste treatment and scope for new entrants in recycled water. As such, a relatively looser form of regulation should suffice, perhaps only in the form of pricing principles. The focus of these should be on full cost recovery and reasonable rates of return. This should allow trade waste producers and recycled water consumers to make appropriate decisions.</p> <p>As the industry, and industry competition develops, it may be</p>

		<p>desirable for price regulation to be considered for the provision of recycled water, including stormwater. The type of price regulation to be applied should be considered closer to that time.</p> <p>It should be noted that there will be a contradiction between SA Water as the monopoly owner of the State's water infrastructure, as well as becoming a powerful competitor for any future provider of treated stormwater. It remains to be seen how the requisite leadership will be provided to progress and coordinate such projects.</p> <p>Further, there may well be cost issues in respect of access to infrastructure (pipelines), depending upon the type of costs arrangements that are eventually adopted.</p>
24.	<p>A key issue for the Commission is whether or not the typical approach used by Australian regulators should be applied to SA Water, in the current context of significant increases in capital expenditure intended to increase the security of water supply in South Australia.</p>	<p>In recent years, water security has been a critical consideration for the entire South Australian community. Given that Adelaide's 'water security' is to be delivered through expensive desalinated water, it may be necessary to deviate from the typical approach used by Australian regulators.</p> <p>It should also be borne in mind that South Australian water consumers have been prepared by the Government for price increases that double the costs of water over the five years from 2009. Since significant price increases have already been experienced, this is also a factor to be taken into account.</p> <p>The form of regulation ultimately chosen should provide adequate incentive for SA Water to pursue demand management and water efficiency options where these have a lower cost to customers than further network investment and supply augmentation.</p>

		<p>While this may seem implicit in the principle of permitting recovery of capital expenditure only where the expenditure is prudent, similar regulation in the electricity sector has been dogged by complaints that efficiency is not properly incentivised.</p> <p>While the SA Water case is distinct in many respects, ESCOSA should ensure that worthwhile water efficiency measures are not made unattractive by the regulatory approach.</p> <p>This is not necessarily a matter of requiring particular efficiency activities, but SA Water should be able to earn returns from activities that reduce the growth of its asset base.</p>
25.	<p>The Commission requests comments on these key drivers and any other drivers that are influencing water demand in South Australia.</p>	<p>The key drivers identified are appropriate, but Ai Group suggests also taking into account projections of economic growth and assessments of future activity in major water-using sectors, including the industrial sector.</p>
26.	<p>In what form should demand forecast information be sought, having regard to the key drivers of demand (e.g. by customer group, by geographic basis)?</p> <p>Is there a need to differentiate between average demand and peak demand, given that peak water demand impacts on the capacity requirements of the network infrastructure?</p>	<p>Demand forecasts should be based as much as possible on existing data and assessments collected by other State and Federal agencies. The need for new surveys of or reporting by customers should be minimised.</p> <p>Given the sums invested by taxpayers to acquire water security, it would be unreasonable for consumers not to be able to reliably and continuously access water at all times. Further, there is a general</p>

		<p>expectation of increasing consumption due to a growing population, as well a broad acceptance of the impacts of climate change. That being the case, it makes sense for the capacity requirements of the network infrastructure to be able to cope with peak demands.</p>
27.	<p>How can the Commission best balance the need to undertake sufficiently robust scrutiny of business costs with the need to avoid undue reporting requirements on SA Water?</p>	<p>In addition to consideration of the factors listed at the top of page 83 of the Issues Paper, Ai Group recommends that ESCOSA have regard to the achievements by peer water service providers in recent years (both in terms of absolute cost levels as well as changes in costs), as well as performance comparisons and benchmarking, to help identify possible future cost pressures.</p>
28.	<p>What other factors should the Commission consider relevant in assessing whether forecast costs are both prudent and efficient?</p> <p>How can SA Water best demonstrate that its expenditure forecasts are efficient?</p>	<p>No relevant factors other than those identified in the Paper are offered to assess whether forecast costs are both prudent and efficient.</p> <p>The best way for SA Water to demonstrate that its expenditure forecasts are efficient may be for it to self-audit against industry benchmarks. It is understood that SA Water already benchmarks itself against other Australian water suppliers, many of whom have had to make similar large desalination investments in recent years.</p> <p>Those experiences should offer a range of historical data against which SA Water's expenditure forecasts could be reviewed. Any significant anomalies identified should be able to be explained by SA Water.</p> <p>In performing this work, it would be prudent to expect a significant component of projection modelling for the future in terms of demand and expenditure forecasts. Ai Group understands that Western</p>

		Australian authorities had modelled various demand scenarios and their impact prior to the most recent drought.
29.	Are the proposed measures appropriate to test the efficiency of the Metropolitan Adelaide Service Delivery Contract?	The proposed measures identified in the paper appear appropriate to test the efficiency of the Metropolitan Adelaide Service Delivery Contract.
30.	How can the Commission be assured that the drinking water supply mix is optimised, given the additional supply resource of the Adelaide Desalination Plant?	<p>In Ai Group's view, two principles should determine whether the desalination plant should run (more-or-less) continuously, to maximise its efficiency, or intermittently to minimise the cost impact on customers.</p> <p>Firstly, the decision is fundamentally an economic one – the cost and difficulty of variable or infrequent operation may or may not be lower than the impact on customers of steady provision of high-cost desalinated water. The environmental dimension should be adequately addressed within the cost-benefit analysis framework with more rational water pricing and a potential carbon price.</p> <p>Secondly, the desalination plant is probably best viewed as an insurance policy against future periods of constrained supply. It follows that it is not possible to maintain an insurance policy without paying an ongoing premium; this premium cost should be kept to a reasonable level given the level of risk.</p> <p>Whilst the recent drought has broken, another one is inevitable. That being the case, the desalination plant should be run at whatever level is necessary to maintain the facility, skills and investment that keep desalination available as a substantial water source for metropolitan Adelaide.</p>

31.	<p>How should uncertainties associated with material unforeseen events be addressed?</p>	<p>In dealing with uncertainty or unforeseen events, (leading to a material change in SA Water's costs relative to those forecast) Ai Group recommends that 'pass-through provisions' be incorporated into its price determinations, subject to the approval of ESCOSA.</p> <p>The types of pass through events that can be accommodated should be predetermined by ESCOSA and in any event must have been caused by factors outside the business' control.</p>
32.	<p>Should consideration be given to assessing and potentially disallowing historic investment as part of this review process?</p> <p>Over what past period should any such assessment cover?</p>	<p>Yes - consideration should be given to assessing and potentially disallowing historic investment as part of this review process. We agree that care should be taken to ensure that past decisions are not assessed based upon current information, however given the significant cost burden incurred by consumers, there should be some such review to reassure customers that they are not paying for inefficient investment decisions made in the recent past.</p> <p>In our view, a period of ten (10) years should be the period of the consideration.</p>
33.	<p>What information can the Commission draw upon to assess the productivity of SA Water relative to its peers?</p>	<p>SA Water would be best placed to advise the Commission as to what information it currently draws upon to benchmark itself against the productivity of its peers. From our involvement on the SA Water Customer Council, Ai group believes that such benchmarking already occurs to a degree. Further comparators could be derived through consultations with SA Water's peers in other state jurisdictions, as well as perhaps leading US or UK authorities.</p>

	<p>Over what period should any identified 'performance gap' be closed?</p>	<p>A definitive period cannot be identified, as it will take varying periods to implement changes such as the deployment of new technologies, the adoption of new operational techniques and the acquisition of 'best practice' etc.</p> <p>That said, any identified 'performance gap' should be closed in the shortest practicable timeframe.</p>
<p>34.</p>	<p>Views are sought on the appropriate tariff structure for SA Water drinking water charges.</p>	<p>Ai Group is aware that the Government's preferred approach to pricing is to effectively maintain the status quo – that is demand management through inclining block tariffs. We also recognise that the Government may wish to retain more than one pricing tier, particularly for residential customers, for policy reasons. It may well require this to be the case through any Pricing Order that is eventually issued by the Treasurer.</p> <p>Whilst SA Water's current water prices consist of a fixed (supply) charge and a volumetric (water usage) price, which rises with consumption under a three-tier inclining block structure, two of the tiers are of little consequence to non-residential customers (other than commercial), our members.</p> <p>Currently, the Tier 1 rate applies only to the first 30KL and therefore affords industrial customers a limited, but beneficial discount. Importantly, as 'other non-residential' users, industrial customers are not charged the highest Tier 3 rate. From the perspective of administrative simplicity then, it makes sense that this category of customer be charged at the single (2nd tier) rate – currently \$2.48/KL - perhaps with some minor discount to accommodate the forfeited Tier 1 amount).</p>

		<p>In respect of commercial customers, Ai Group is also aware that South Australia is the only jurisdiction where the service charge is based upon property value. This means of calculating the supply charge appears to have little rational basis and when considered against state-wide water pricing, could be argued to be inequitable.</p> <p>This means of calculating the supply charge makes little sense to us. Again, based upon detailed modelling, we would be provisionally supportive of a move towards the supply charge element of water bills being designed to provide a better signal to customers of the fixed costs associated with their own capacity requirements. This is best utilised through the supply charge being based upon the size and number of meters (as used in NSW, WA and NT).</p> <p>NB - We note and accord that the Commission does not intend to implement such a change for its first price determination, and that it will examine the merits of such an approach prior to the commencement of the following price path period.</p> <p>Ai Group is aware of the proposed <i>Water for Good</i> action to transition towards a single drinking water volumetric price for SA customers – a price that reflects the Long-Run Marginal Cost (LRMC) of supply.</p> <p>Whilst we can see the logic in the argument that such an approach would provide the most economically efficient water use signal to customers, we could not provide our support for such an approach without first understanding the implications for customers through the provision of detailed modelling and data.</p>
35.	The Commission requests comments on issues surrounding	Ai Group supports the maintenance of uniform water prices apply to

	universal access and how the requirement for cost reflective pricing and transparency can be best applied and reconciled with state-wide pricing.	<p>SA Water's urban and regional customers through application of a state-wide pricing policy.</p> <p>Whilst we note that water and sewerage services are provided to many regional customers at less than total economic cost, we also agree that drinking water, water for production purposes and sewerage are essential services that are vital to the prosperity of rural South Australia. We accord that as such, universal and affordable access is an important policy objective.</p>
36.	The Commission requests views on the issues surrounding protection of low income households during transitional moves to cost reflective pricing.	Ai Group offers no specific comment on this issue, although we understand the importance of this social policy issue for the Government.
37.	The Commission seeks views on the pricing of sewerage services along with the potential to more closely align pricing with usage moving forward.	<p>Ai Group recognises that the costs of metering all sewerage customers would be significant. Further some of our larger members currently have their trade waste metered (as discussed later).</p> <p>We can understand that potential difficulties of using water usage as a proxy for sewerage use, when basing sewerage charges on the amount of water consumed.</p> <p>That said, basing sewerage prices on property values, with no volumetric component at all, can also present equity issues. Ai Group would like to see a reconsideration of the practicable options for South Australian customers, before articulating a preferred position.</p>

38.	Having regard to the fragmented nature of both the drinking water and sewerage services industry, and issues such as Community Service Obligations, the Commission seeks comments on the most appropriate form of price regulation (if any) that should be applied to water retail services in South Australia.	Water retail services prices should not be directly regulated at this stage. A more appropriate strategy would be to agree broadly applicable pricing principles, centred on full cost recovery, and to regularly assess service providers' performance against this criterion. Further action may be warranted should market power or lack of cost recovery produce demonstrably undesirable outcomes. This matter should be reviewed after several years.
39.	The Commission requests comments on the form of economic regulation that should apply to SA Water's trade waste services.	<p>It should be recognised that South Australian commerce can be readily characterised as a predominantly small-business state.</p> <p>On that basis, the economies of scale that allow smaller commercial enterprises to realistically consider alternatives in relation to trade waste discharge, such as on-site treatment, are constrained.</p> <p>Countering this, South Australian industry actively competes in a global marketplace and to be able to do so, it must maximise productivity. One aspect of productivity involves the minimisation of waste, including trade-waste. Further, to be able to supply into some foreign markets, companies are more and more often required to demonstrate their sustainability credentials.</p> <p>Ai Group would be interested to further consider options for forms of price regulation that send appropriate price signals to enable trade waste customers to assess the merits of discharging to the sewerage system, as opposed to investment in alternatives such as on-site facilities to minimise and/or treat trade waste discharge.</p> <p>Such options will become a more significant factor as technological developments allow smaller enterprises to partake in such opportunities.</p>

40.	What is the potential for growth in water recycling in South Australia?	<p>The potential for growth in water recycling in South Australia is increasing, particularly as collection and treatment technologies develop.</p> <p>South Australia status as a leader in water recycling stands it in good stead in this respect.</p> <p>From industry's perspective, the potential for recycled water, as a replacement for potable water in the manufacturing process is significant. Industry is well aware of the costs implications associated with water and trade waste.</p> <p>With proper infrastructure planning and investment in the water market, there should be increased opportunities for industry to readily access recycled water in newly developed 'industrial lands' north and south of Adelaide.</p> <p>Whilst these opportunities will assist companies to better achieve their sustainability goals, recycled water will need to be readily available at a competitive price that is lower than potable water.</p> <p>However industry, which is largely non seasonal, requires certainty of supply. If there is excessive competition for a continuous supply of recycled water, for example with open space or horticulture irrigation, the value of the proposition decreases markedly.</p> <p>Any legislative requirements for water recycling to be mandated should be considered only after a rigorous regulatory impact assessment has ensured that the measures offer net benefits to the community (taking account of economic impacts as well as social</p>

	<p>How does it impact on the Commission's price regulation function?</p>	<p>and environmental ones).</p> <p>Growth in water recycling may act to reduce the natural monopoly status of water provision. If this proves to be the case it would be possible to reduce the intensity of ESCOSA's price regulation. However it is too early to say whether, when or to what extent this will occur.</p>
<p>41.</p>	<p>The Commission requests comments on the extent to which providers of recycled water have market power in the provision of recycled water in South Australia.</p> <p>If providers of recycled water have market power, what is the most appropriate form of economic regulation that should be applied?</p>	<p>Ai Group is not aware of the extent to which providers of recycled water have market power in the provision of recycled water in South Australia.</p> <p>Ai Group recognises that a consequence of market power in the provision of recycled water would be that prices could be higher than would otherwise occur. Whilst the price of recycled water is primarily quality-driven, its price is effectively capped by the price of potable water (industry's current supply source), as well as its availability.</p> <p>As in other jurisdictions, Ai Group would support a light-handed form of economic regulation for recycled water through the development of pricing principles, at least in the initial stages of the development of the industry.</p> <p>Just as the required quality of recycled water for commercial use (horticulture/ open public space irrigation), is heavily driven by its intended purpose, we would observe that the same applies in respect of industrial use – mainly cooling as part of the manufacturing processes.</p> <p>Like the Commission, Ai Group understands that current prices for</p>

		<p>recycled water in South Australia have been negotiated on an individual basis and have not always been set at a cost-reflective level.</p> <p>Ai Group supports the principle that water price regulation should take into account the circumstances of the particular industry and minimise compliance costs where possible.</p> <p>We have commented above (see <i>Issue 40</i>) in respect of recommendations that pricing principles should be developed both to provide a basis for ensuring prices do not exceed users' willingness to pay and to allow effective price signals to be delivered.</p>
42.	Is a "pricing principles" approach the most appropriate form of economic regulation that should be applied to recycled water and, if so, what are the principles that should apply?	Yes. The proposed principles in Table 6 are appropriate.
43.	The Commission seeks comments on whether or not SA Water has market power in the provision of miscellaneous water retail services in South Australia and, if so, whether there is potential for that market power to be misused.	<p>As a monopoly provider, SA Water would appear to currently have market power in the provision of miscellaneous water retail services. Ai Group is not aware of any complaints that there has been misuse of that market power, although it would be possible for such power to be misused. That said, SA Water remains entirely owned by the Government and is likely to remain so for the foreseeable future.</p> <p>On that basis, it is unlikely that SA Water would seek to exploit its market power, as it would need to justify this to its owner. Further, as these costs make up a small percentage of total revenue, it may be administratively costly to regulate these charges closely.</p>

	<p>The Commission seeks comments on the potential for competition in the provision of miscellaneous water retail services in South Australia.</p>	<p>Perhaps a 'light-handed' price monitoring role, bearing in mind marked increases and benchmarking across jurisdictions, might be appropriate.</p> <p>There would seem to be no obvious reason that competition should not be contemplated in the provision of miscellaneous water retail services in South Australia, particularly by accredited providers in respect of connections/ disconnections, the installation of water meters to strata units and the installation of metal underground boxes. Many such services have previously been outsourced to United Water as the service provider to SA Water.</p>
44.	<p>Having regard to the differing price regulation approaches that are applied to water retail services in other jurisdictions and, issues of market power and potential for competition in the provision of those services, the Commission requests comments on the most appropriate form of price regulation that should be applied to water retail services in South Australia.</p>	<p>We note the 3 options cited in the Paper and can see merits in each of them. Of particular benefit to all SA customers would be the Victorian approach whereby individual price caps are applied to a group of 'core' miscellaneous services to ensure prices do not vary significantly year-to-year.</p> <p>As noted above however, South Australian customers have already experienced significant price increases, and have been prepared for further significant increases in the foreseeable future - especially with the doubling of the size of the desalination plant and the associated needed to connect Adelaide's northern and southern water reticulation systems.</p>



AUSTRALIAN INDUSTRY

G R O U P

(SA BRANCH)

WATER INDUSTRY ACT

**COMMENTS ON EXPOSURE
DRAFT BILL**

Due: 18 January 2011

INTRODUCTION

The Australian Industry Group

Ai Group is a leading industry association in Australia and is committed to helping Australian industry meet the challenge of change. Our focus is on building competitive industries through global integration, human capital development, productive workplace relations practices, infrastructure development and innovation.

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We have significant membership in the electrical and electronic manufacturing and ICT sectors, where product stewardship, e-waste and eco-design are key issues. Other members are directly involved in waste management and disposal, resource recovery or recycling.

Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations, including the Australian Constructors Association. Together, Ai Group and its affiliates represent the interests of approximately 60,000 businesses which employ in excess of 1.2 million staff across Australia and the world.

Ai Group provides an extensive range of advisory services to member companies in the areas of industrial relations, human resource management, OHS&W, workers' compensation, environment, education, training, industry development and economic performance.

Accordingly, the draft *Water Industry Bill 2010* (**the Bill**) is an issue that is highly relevant to our industry sector at a State and national level, and is therefore of significant interest to our membership.

Overarching comments

Ai Group's major concern in respect of Adelaide's water supply has primarily focused on the critical need to maintain secure water supplies - for industry, for business and for the broader community - and to ensure that these supplies are provided at a reasonable cost to consumers.

Ai Group acknowledges that the main purpose of economic regulation is to protect the long-term interests of South Australian water and wastewater customers in relation to the price, reliability and quality of services.

Ai Group believes that it is essential that any economic regulatory regime be developed with this purpose in mind and broadly supports the commitment to reform the institutional arrangements over the water sector, together with a reform package for water legislation.

In respect of the proposal for a new Act in 2010, we have previously urged the Office of Water Security to proceed cautiously and to "*get the legislation right*" on the first occasion. In this respect, we broadly approve of the layout and content of the Draft Bill and note with approval that the Bill does not appear to duplicate any legislation that already exists to serve the *Water for Good* reforms. We also approve of the fact that the structure of the Bill is largely based on the model established under the *Electricity Act 1996 (Electricity Act)* and the *Gas Act 1997 (Gas Act)*.

Importantly, Ai Group supports the provision of water moving away from the current monopoly situation, with third party suppliers being envisaged in the structure of the Bill. We do however believe that the *implementation* of a third party access regime could be more definitely articulated.

For us, it follows that the provision of a staple necessity such as potable (and other high quality) water supplies, should be transparently and independently regulated and that the *Essential Services Commission of South Australia (ESCOSA)* is the appropriate body to assume that role, and provide the price-setting, regulatory and licensing capabilities for the water sector into the future.

It also seems appropriate that participants in this critical market be subject to rigorous licensing and regulatory arrangements.

In previous submissions, we have urged that the Government adopt best regulatory practice in implementing new regulatory instruments. In our view, these have been reasonably summarised by the United Kingdom's *Better Regulation Executive*.¹

Ai Group strongly supports ESCOSA having its own independent *Customer Advocacy Committee* to provide advice on regulated water supply and wastewater services. As a leading industry association that constructively deals with most governmental regulators around the country, Ai Group would seek to contribute to any decision regarding the basis and constituency of the Committee. We indicate at the outset that, in due course, Ai Group would also seek a seat on the Committee.

We have previously noted our concerns in relation to the rating provisions, such as moving to a single volumetric price for residential, commercial and industrial customers, where we can foresee some difficulties. Clearly, Ai Group would be better able to articulate such issues if we were part of ESCOSA's (existing or expanded) *Customer Advocacy Committee*.

A vital factor in implementing the Bill will be the measures proposed for transitional arrangements, particularly for industry. It is critical that industry is able to effectively transition into any new regulatory environment. On that basis, it is essential that transitional measures be developed without delay, and in close consultation with industry.

More broadly, it is important that transitional processes provide continued certainty to all consumers and do not immediately impact upon either supply, or pricing, for residential or non-residential customers. It is important that stability be maintained through the honouring of all existing *Individual Private Arrangements*.²

Ai Group has limited its submissions to the main areas within our sphere of concern, which are as follows:

- Consumer protection and service standards – Industry Codes;
- Water planning provisions, including State Demand and Supply Statements;
- The Essential Services Commission (Administration) and the Customer Advisory Committee;

¹ The Better Regulation Executive (BRE) is part of the Department for Business, Innovation and Skills (BIS) and leads the regulatory reform agenda across government. www.bis.gov.uk/betterregulation

² In respect of third party access for the rural water supply network

- The Water Industry and the licensing of those operating in it;
- Price Regulation; and
- Third party access

The Structure of the Draft Bill

The Bill proposes to:

- appoint ESCOSA as the independent economic regulator for water and wastewater services in South Australia;
- provide for independent technical regulation of plumbing standards and practices;
- allow the development of a state-based third party access regime;
- provide for effective service and fair treatment through independent and transparent customer consultation, complaints processes and the establishment of a Customer Advisory Committee;
- facilitate the regulation of the water industry through the establishment of a licensing regime; and
- provides for the regulation of prices, customer service standards, technical standards for water and sewerage infrastructure and installations.

As signalled above, Ai Group broadly accords with the structure of the Bill, and we acknowledge that the structure of the Bill has largely been based on the model established under the *Electricity Act* and the *Gas Act*.

The empowerment of ESCOSA

Broadly speaking the Bill establishes three distinct areas of power for ESCOSA:

1. the licensing of certain water entities;
2. the establishment of binding service standards (embodying a consumer protection regime as well as performance standards); and
3. the setting of prices (or pricing methodologies) for certain water services, having regard to the binding service standards set.

Ai Group takes no issue with this empowerment. Of these three areas, the latter is of primary concern to Ai Group. We have addressed this issue in detail within our submissions (under Part 4).

Consumer protection and service standards – Industry Codes

Ai Group would agree that the protection of consumers' interests is of paramount importance in the provision of water services, particularly where providers may have competing interests in providing adequate returns to shareholders.

We support ESCOSA ensuring compliance with Industry Codes through the proscription of consumer protection and service standards matters – to cover such matters as the provision of timely and accurate bills to customers and the levels of technical service performance required from the network.

As discussed in ESCOSA's *Statement of Issues* paper, price controls imposed by ESCOSA (including circumstances where ESCOSA uses more light-handed price regulation methods, such as price monitoring) are to be established having regard to the level of service standards set.

We note that the text of any Industry Codes made by ESCOSA must be developed in an open, transparent and consultative manner. Ai Group supports such transparency and would be pleased to be involved in this development, whether it be through the Consumer Advisory Committee, or otherwise.

PART 2 - Water planning provisions, including State Demand and Supply Statements

Ai Group notes and broadly supports the Water Planning provisions outlined in the Bill.

Ai Group supports the requirements in the Bill for the Minister administering the *Water Industry Act* to cause the establishment, maintenance and implementation of a *State Water Demand and Supply Statement* (the Statement).³ We note that this Statement is to outline the current state of water resources and the extent of the

³ We also note in passing, that it is not intended for regional *Demand and Supply Statements* to be legislated. However, we are pleased to see that regional input will be considered through the provision of a regionally specific reference.

water supplies available within South Australia and will include strategies and policies appropriate to secure a reliable and sustainable supply of water within the State.

We support the provisions that would require the Minister to table the Statement in both houses of Parliament within 12 sitting days.

Despite discussion in the *Explanatory Paper*, the Bill itself does not address any *Independent Planning Process* to consider significant gaps that occur between demand and supply projections.⁴

In our view this is a missed opportunity. Our submission would be that rather than wait for a “significant gap” to exist between demand and supply, it would be prudent for proactive modelling to take place on an ongoing basis, incorporating lessons learnt from major events – for example, the major flooding event occurring presently across the eastern seaboard.

Whether or not our recommendation above is adopted, it is critical that any *Independent Planning Process* is exactly that – independent. The Minister should ensure that the body utilised has access to all necessary resources and data to enable it to properly fulfil its role.

Furthermore the composition of the body is critical. In our view it will be critical to draw highly credentialed experts in the water field, as well as community stakeholder representatives onto such a body.⁵

PART 3 - Administration

Ai Group supports appointing ESCOSA as the independent economic regulator for monopoly suppliers of water and wastewater services in the State. Ai Group also agrees with the proposed powers of ESCOSA, including pricing, licensing, performance monitoring, enforcing compliance, creating industry codes and rules and implementing consumer consultation processes.

⁴ Although the Bill does contain a generic clause giving the Minister power to establish committees and bodies to assist with administering the *Water Industry Act*, and this could establish an Independent Planning Process in the way envisaged.

⁵ For example, water scientists, water economists and representatives from industry and community, as well as State and Local Government.

As implied above, it is vital that ESCOSA regulates the water industry so that it mirrors a competitive market as closely as possible and produces economically efficient outcomes.

Technical Regulator

Ai Group offers no comment in respect of the provisions concerning the Technical Regulator.

Customer Advisory Committee

Ai Group supports the establishment and/or expansion of a *Customer Advisory Committee* (CAC), on the same basis as currently exists for the Energy Consumer Advisory Committee.⁶ Ai Group also notes that as an important sector to the State's economy, broader 'industry' appears not to be represented on the Energy Consumer Advisory Committee.

In the event that a separate CAC for water is established, Ai Group would seek a seat on that Committee to represent our constituency. This would also be our recommendation in the event that the existing CAC is expanded. We believe that Ai Group can also offer valuable industry views in relation to all aspects of energy and water.

Technical Advisory Group

Other than those outlined above, Ai Group offers no comment in respect of the provisions concerning the Technical Advisory Committee. We do however note that whilst employee associations are expressly included in the legislation, employer associations have not been formally recognised. It may be that the Bill offers an opportunity to redress this situation.

⁶ We note in passing that although ESCOSA's *Water Bulletin No.1* does indicate that ESCOSA may consider expanding its Customer Advisory Council to include representatives of other bodies with consumer interest, it is not mandated to do so. Section 14 (2) makes clear it can be the same Consumer Advisory Committee as already exists.

PART 4 – Water Industry

Ai Group has offered its support for ESCOSA to become the economic regulator of the water industry in South Australia. We note and approve of the powers that ESCOSA will have to regulate water as an essential service, under the provisions of the *ESC Act* and other relevant industry legislation.

Licensing

Ai Group supports the licensing of water related business activities by an independent regulator. We agree that any failure by a provider of essential services could result in dramatic consequences for the community. In our view, balanced against costly over-regulation, a conservative health-safety focus must constantly be borne in mind when considering the *rigour* of the licensing arrangements. We therefore broadly support the licensing provisions at sections 18 to 26, that to us appear adequate.

We agree with licensing being cognisant of, and compliant with, Industry Codes, rules and guidelines made by ESCOSA (where this is necessary to ensure the protection of consumers).

We support the Bill's establishment of a licensing regime for those who provide retail services to South Australian consumers, particularly as the model adopted is based in large measure on the model established under the Electricity Act and the Gas Act.

It is appropriate that any person or entity wishing to provide retail services to South Australian consumers will be required to obtain a licence from ESCOSA. It is proper that obligations under these licences require compliance with the terms of industry codes established by ESCOSA, dealing with consumer protection matters, such as billing, payment, disconnection/flow restriction and other contractual matters.

We note that like similar licences for other utilities, such licences can be removed for proper cause.

We note that within the Bill, SA Water (retaining in the ownership and control of the State) will be entitled to the issue of a licence without application, and that its licence

is unable to be transferred, suspended or cancelled. Given that SA Water will effectively become the supplier of last resort, at least for the foreseeable future, Ai Group supports this approach.

(Water) Price Regulation

Ai Group notes that the establishment of independent price regulation is intended to further promote best practice water pricing in South Australia, in line with the State Government's commitments under the *National Water Initiative*.⁷

We also note the close alignment between the pricing principles set out in the NWI, and ESCOSA's own objectives, as well as a common theme towards promoting economic efficiency.

Ai Group completely accords with ESCOSA that a key element of the Bill will be the independent regulation of the price of water and sewerage services. We have already agreed that ESCOSA should be formally appointed as the price regulator.

We note the view that customers should be provided with the 'right signals' to ensure the efficient use of water and we agree that water prices do play a central role in signalling to customers the cost of providing water, and encouraging better consumption decisions.

From a *residential* perspective, it follows that when prices do not reflect the true cost of providing water services, decisions about how much water to consume are distorted. This may then lead to inefficient allocation of the resource and thereby compromise water security objectives.

For much of *industry* however, water is a key production input. In a truly globalised manufacturing marketplace, all costs need to be closely monitored and any waste, needs to be minimised.

⁷ In 2004, the Council of Australian Governments (COAG) agreed to implement the National Water Initiative (NWI), which is aimed at increasing the efficiency of Australia's water use, leading to greater certainty for investment and productivity, for rural and urban communities, and for the environment.

It is this imperative that makes industry an excellent customer for high quality recycled water as part of the production process, so long as it can be sourced at a competitive price. We see this as one of the roles of ESCOSA in regulating prices of not only potable water, but also alternative sources.

As a leading industry association, Ai Group would be pleased to promote greater innovation in the water supply industry and through more efficient operation of water and sewerage infrastructure, minimising the cost of meeting customers' water needs.

Insofar as the *form* of price regulation that is adopted by ESCOSA, we are of the view that whichever regime is eventually adopted, it needs to provide adequate incentive for SA Water to pursue demand management and water efficiency options, where these have a lower cost to customers than network investment and supply augmentation.

While this may seem implicit in the principle of permitting recovery of capital expenditure only where the expenditure is prudent, similar regulation in the electricity sector has been dogged by complaints that efficiency is not properly incentivised.

While the South Australian water situation is distinct in many respects, Ai Group will be encouraging ESCOSA to ensure that worthwhile water efficiency measures are not made unattractive by the regulatory approach adopted. This is not necessarily a matter of requiring particular efficiency activities, but could involve ensuring that SA Water can earn returns from activities that reduce the growth of its asset base.

Ai Group supports the proposal under the Bill for ESCOSA to be empowered to use its general price determination powers under the ESC Act to make a price determination in respect of retail services.

We note however, that in making a determination (based upon the various factors set out in Part 3 of the ESC Act), ESCOSA is also to be bound by the terms of any Pricing Order issued by the Treasurer.⁸ For the present, we are comfortable with this Pricing Order concept that is consistent with the model which continues to be used in the electricity supply industry.

⁸ We understand that if issued, this Pricing Order will set out various matters which ESCOSA must either adopt or have regard to (as the case may be) in making its determination.

Noting that the Bill will result in the repeal of the *Sewerage Act*, the *Waterworks Act* and the *Water Conservation Act*, it is critical that any carry-over pricing arrangements from those Acts are eased for customers through suitable transitional arrangements, at least until ESCOSA makes its first price determination.

The pricing of non-potable water supplies, such as stormwater harvesting and water recycling will need to be considered carefully, particularly noting the capital investment associated with technological developments that may bring this water up to potable water standards over time.

Prices and charges for services such as meter replacement and meter reading should be subject to regulation by ESCOSA, at least until suitable competition has developed in the market.

Third Party Access

Ai Group strongly supports third party access regime to water and sewerage infrastructure services. In our view, progressing these arrangements will aid in providing greater certainty in expected arrangements and would be a key driver in encouraging market entry of new, innovative suppliers of services.

To Ai Group, the third party access regime outlined in the Bill appears disjointed in achieving the further development of a framework for regulated negotiations between the owner of an essential facility and any third party business seeking access to its services.

The Bill mandates the Minister taking steps to develop a third party access regime. The Bill then goes on to mandate dates for the formulation and tabling of a final report. We also note however, that the Bill does not set any date by which this regime must be operational. But beyond the tabling of the final report within 18 parliamentary sitting days of 1 July 2012, there could be years in which little or no action occurs while the Minister *takes steps towards* the development of the regime.

Ai Group would like to see these provisions tightened, to the effect that s.27(1) would read:

“The Minister must develop a third party access regime to apply to water infrastructure and sewerage infrastructure services, with the final regime to be in operation by no later than DD/MM/YYYY.”

It should be noted that there will be a conflict of interest between SA Water as the monopoly owner of the State’s water infrastructure, as well as becoming a powerful competitor for any future provider of potable water, treated stormwater and possibly sewerage services. We simply note that this issue needs to be addressed in a transparent and accountable manner.

Ideally, the final regime settled upon will enable water suppliers, water retailers and large water consumers to access SA Water’s water distribution network at a fair and reasonable price. Ai Group is cognisant of the types of pricing issues that can arise in relation to access to infrastructure (pipelines) and the need to strike a balance between the demands of access seekers and the interests of the providers of the services.⁹ Ai Group submits that consultation with industry will be critical in the settling the framework under which these access and pricing arrangements will be determined.

Remainder of the Bill (PARTS 5 to 10)

Ai Group makes no submissions in respect of the remainder of the Bill (Parts 5 to 10 inclusive), much of which would be better addressed by the plumbing industry and others.

CONCLUDING COMMENTS

Ai Group looks forward to taking part in the consultation and development of the *Issues Paper* that will inform the final report by July 2012.

⁹ Access prices must ensure that service providers are compensated for the costs of providing access (interconnection costs) and receive some commercial return on their infrastructure investment.

On behalf of the Australian Industry Group, we have appreciated the opportunity to provide our views on an issue that is, and will remain, a key interest to our South Australian membership.

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