



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

Marjorie Black House
47 King William Rd
Unley SA 5061

P. 08 8305 4222
F. 08 8272 9500
E. sacoss@sacoss.org.au
www.sacoss.org.au

ABN 93 197 662 296

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

Dear Mr Petrus,

Re: Draft Advice on a Regulatory Rate of Return for SA Water

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 the cost of basic necessities like water because they impact greatly and disproportionately on vulnerable and disadvantaged people.

We thank ESCOSA for the opportunity to provide comment on the Draft Advice to the Treasurer on the Regulatory Rate of Return for SA Water.

While SACOSS believes that there is much scope to improve consumer pricing and the well-being of low income earners by changing both water tariff charges and structures, the Regulatory Rate of Return is important as it provides the overall quantum of money that can be charged and therefore sets the outside parameters for any change in consumer water prices. The lower that rate of return is set (within the bounds of ensuring effective water investment and supply), the more chance there is for limiting water price rises and the more scope for relief for low income earners.

Accordingly, ***SACOSS's starting position is that the Regulatory Rate of Return should always be as low as economically viable, and that it should only ever be increased on the basis of a clear, transparent and robust rationale.***

Moreover access to good quality water is essential for all community members and as such ensuring consumers have adequate access should remain the paramount consideration for the independent regulator in developing any advice with implications for water prices.

This advice specifically involves independently recommending a benchmark to the Treasurer on a reasonable return on capital figure. ***It is our conclusion that there is in fact no adequate rationale on which to base increases in the proposed return on capital contained in the draft decision.***

SACOSS engaged St Kitts Associates to advise on the technical details of the issues raised in the Draft Advice and we have attached herein the consultant's report. This report raises a number of issues of concern to SACOSS and we endorse the comments and recommendations in that report.

Having considered the report and as already noted above, it is not apparent to us that there is a clear and sufficiently robust rationale for making any proposal that results in increasing the Regulatory Rate of Return.

Furthermore, given the many variables acknowledged to be in play, there are serious concerns about both the ability to make, as well as the advisedness of making a determination of quantum at such distance from the decision point. At least some of the assumptions in the Draft Advice are unknowable at this point in time or are otherwise questionable. We particularly draw your attention to the St Kitts sensitivity testing with slightly different assumptions and figures for Debt Risk Premium, Equity Beta and Gamma. The result is much closer to the current figure of 6% than the proposed 6.88% rate.

The St Kitts report suggests various areas where more information is required, but on the basis of the information available, we do not believe that a sufficient case has been made for any increase the rate proposed by the Treasurer.

More's the point, we draw ESCOSA's urgent attention to the fact that historically, SA Water has always operated on a consistent rate of return on capital of 6% (putting aside of course the additional need for capital required to develop the desalination capacity which has already resulted in several years of price increases in the region of 20-25%). This 6% figure has seemingly over time, enabled SA Water to undertake all required capital development and improvements as needed while at the very same time also enabled a consistent and healthy return to Treasury coffers across time.

This may at least in part result from its preferential borrowing position - as an instrument of government SA Water presumably has had a capacity to borrow at a discounted financing cost relative to most commercial operations. This would enable significant cost savings and this advantage seems unlikely to change even though SA Water will now be subject to independent regulation.

From a consumer's perspective, South Australian households are already facing at least 4 years of annual 20-25% increases in the price of water to pay for desalination infrastructure. The current proposal to increase the real rate of return from 6 - 6.88% thus boosting the return to SA Water above its current return by approximately \$100 million per annum may well be welcomed by both SA Water and the Government but will ultimately demand a further 5-10% increase in water prices in addition to these other increases and on top of any future CPI increases.

Price increases of such a nature are unprecedented and will be an enormous impost on all household budgets.

Of greatest concern to SACOSS though is the impost this will inevitably create for households with the lowest incomes across our community – all of whom are already burdened by major cost of living pressures - who in such circumstances will almost certainly struggle to meet these increases and thus will lose access to a basic and essential service.

Therefore simply put, for ESCOSA to conclude an increase in the reasonable rate of return is required in these circumstances, seems utterly illogical and ill advised.

Accordingly, we strongly recommend either maintaining the existing rate in the interim or at least advising the Treasurer of a range of viable rates of return and reserving a final recommendation to be made when/if more data becomes available closer to the time.

We would be very pleased to discuss these issues in person and thank you for your consideration of these comments.

Yours,


Ross Womersley
Executive Director

6 January 2012