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Dear Mr Wilson,

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RE: SA Water Regulatory Determination 2020: Draft Framework and Approach

As the peak body for the health and community services sector in South Australia, the South Australian Council of Social Service (SACOSS) has an established history of interest, engagement and provision of proposed advice on the supply of essential services including water. We thank the Commission for the opportunity to make a submission on the SA Water Regulatory Determination 2020: Draft Framework and Approach.

SACOSS research shows that the cost and supply of basic necessities like water have significant and disproportionately greater impacts on vulnerable people. SACOSS advocacy is informed by our members and direct consultations with consumers and other consumer organisations: organisations and individuals who witness and experience these impacts in our community.

Framework for consumer engagement

SACOSS considers that the draft F&A paper could provide additional clarity on how the regulatory process is expected to proceed, the objectives of the F&A paper within overall regulatory process, and the responsibility of the regulator to consumers within the overall regulatory process.

An important element of the effectiveness of SA Water's interactions with consumers will be the degree to which the interactions occur with clear information on SA Water's willingness to supply services.

This means that:

- There should be a customer-focused objective for this regulatory process and as a first step for the F&A paper. A suggested starting point for an objective would be that, within the regulatory process, the F&A paper should provide the community with a clear mechanism and information to engage with SA Water to determine: (i) the services the community want and the range of community priorities and preferences, and (ii) the cost of delivery of services by SA Water across a range of service points.
- The regulator should have oversight of the process of discovering the community priorities and preferences, and the costs and service points that SA Water are willing to offer services at.

Obviously, a utility may wish to conceal the minimum price that it is willing to supply at.¹ Managing this information asymmetry is a key challenge of the regulatory process.

In a competitive market it is presumed that the process of competition reveals the minimum prices that suppliers are willing to provide services at, although in practice there is typically a process of negotiation to

¹ It is acknowledged customers may be unwilling to reveal the maximum price they are willing to pay for services. However, in this case, where there is a single monopoly provider and many customers, each individual customer has little incentive to hide its willingness to pay.

find a price point where there is a range of overlapping prices acceptable to both parties. Consumers go into each purchasing decision knowing a lot about the prices that suppliers are willing to supply at.

However, in a monopoly market, a regulated entity can conceal the price that it is willing to supply at, confident that in the absence of alternative offers, its minimum price point is not likely to be revealed through a competitive process.

The Commission as the regulator has some powers to reveal SA Water's costs of service as part of the regulatory process. Consumers, unfortunately, are not in a position to be able to use their normal market interactions with SA Water as a supplier to learn SA Water's willingness to supply particular services at particular prices.

Ideally then, what consumers are seeking through the F&A process and through the overall regulatory process is greater information about the prices at which SA Water would be willing to offer various price-service packages. Hopefully at the same time, SA Water can learn more about the prices and services that consumers want and their priorities and preferences, noting that SA Water will have to aggregate individual preferences into sensible price-service packages.

It is difficult to see in the absence of consumers having clear information about the minimum prices at which SA Water is prepared to offer various price-service packages, how the consumer engagement process can be as robust as possible or fully reflect customers' preferences and price-service trade-offs.

The Commission's price revelatory processes occur *after* the consumer engagement process, when the Commission uses the building block approach as a proxy way of determining the minimum prices that SA Water would be willing to accept for certain offerings.

Ideally, it would be valuable for the Commission to investigate and release prior to the consumer engagement process as much information as it could reasonably provide on SA Water's expected willingness to supply.

Consequently, we consider that more thought needs to be given to providing clear and reliable information to consumers as part of the consumer engagement process. Ideally, the Commission would engage in these revelatory processes before the consumer engagement process so that consumers are better informed about SA Water's willingness to offer. This could be achieved in part by the regulator determining a cost of service for SA Water through benchmarking reports or a simplified building block process and publishing this to consumers early in the regulatory process so that consumers are more informed in making choices and participating in consumer engagement processes.

Where consumers do not have information on SA Water's willingness to supply, then consumer engagement is more limited in what it can reveal. Without clear information about SA Water willingness to supply, the consumer engagement process can only reveal *ordinal* information such as whether consumers would prefer to pay more and receive more or pay less and receive less. It may also be able to reveal some information about consumer preferences and willingness to pay.

The second challenge is revealing consumer priorities and preferences.

This task is complicated by the fact that different consumer group has different preferences as to price and service quality. The regulated entity needs to deliver against either the aggregate requirements of consumers or, where it is commercially feasible, deliver a range of different services towards the preferences of different types of consumers. It may be possible to take a geographic approach to determining different prices and willingness to pay in different regions. In effect this may already be

occurring given it is understood that the standard of services varies very significantly across the geographic area served by SA Water.

Variations among consumers in terms of their preferences means that through the process, it is important to pay attention to the views of different sections of the community to consider how a spread of needs can sensibly be met. It may well be that the preferences of low income and vulnerable customers are different to other customer classes.

It is essential that the views of low income and vulnerable customers are properly weighted against other customers during the regulatory process. Adequate, affordable access for all to water and sewerage services is essential in treating all members of the community with dignity and respect. As such it will be important for the consumer engagement processes to build a clear picture of the priorities and preferences of low income and vulnerable customers.

Community engagement principles

The Draft Framework and Approach paper at page 7 sets out principles for judging the effectiveness of consumer engagement.

The paper provides five guiding principles, including: (i) determining the purpose of consultation and how results will be used; (ii) seek representative samples of consumer views; (iii) consulting before finalising the RBP and providing opportunities for customers to validate their views; (iv) engagement proportionate to the size of the investments being made; and (v) clear communication of the results of the process to participants and the wider customer base.

The issue that the Commission needs to deal with is how specific to be in designing the guiding principles. If the principles are too narrow, then the guidance may be more a form of leading SA Water by the hand or micro-managing its consumer engagement process. If the principles are too broad, then it may be that the Commission may not feel confident to rely on the consumer engagement feedback due to methodological holes or other issues in the consumer engagement.

The risk of not providing sufficient guidance is probably greater than the risk of not providing enough guidance. This is because:

- The F&A paper in any case is only providing guidance rather than directing SA Water to conduct consumer engagement in a particular way. SA Water could depart from the guiding principles so long as it justifies its approach;
- If the Commission reviews SA Water's consumer engagement in the process of assessing the RBP and considers that the engagement process was deficient, then there may be little to no time for SA Water to re-engage with consumers

On this basis, it is considered that the guiding principles may be too broad and general to provide adequate guidance to SA Water. It is considered that the Commission could provide more specific guidance while not constraining SA Water too much in terms of its engagement with consumers.

SACOSS considers that the F&A paper could provide more guidance or at least commentary on issues without unduly constraining SA Water.

There are well-known and significant limitations on consumer feedback, especially qualitative feedback. As such, it would be useful to provide some guidance to SA Water on issues including:

- (i) Avoiding common traps in community engagement e.g. status quo bias, or SA Water influencing consumers towards its preferred position (either consciously or unconsciously). It is very easy for providers to tend to unconsciously steer participants towards to particular choice. For example,

where utilities provide three choices along a continuum, participants will often choose the middle choice. Consumers may tend towards selecting existing prices and service standards over other potential choices, and they may tend to assume that future prices will be higher than present prices. This means that

- (ii) Having sufficient regard for market-based evidence. It is easy for consumers to identify particular services that they would like without fully considering the costs. It is important for suppliers to examine consumption preferences as they are currently being expressed by consumers, or using more quantitative approaches where possible, rather than relying on qualitative feedback in the consumer engagement process. For example, the calculation of the value of lost load in the NEM uses a relatively quantitative approach to assessing the value that consumers place on the reliability of electricity services, for example by valuing reliability in terms of the priced choices that consumers would make if power failed for various periods of time;
- (iii) The extent to which particular types of qualitative customer feedback can be relied on given the known shortcomings in it;
- (iv) Using sufficient quantitative methods to judge consumer preferences; and
- (v) Ensuring samples are truly representative. It is easy to place too much weight on those who readily respond to surveys or other offers to provide information. Low income and vulnerable consumers are often harder to reach than some other customer segments.

Reconciling conflicts among consumer views

It would also be valuable for the final F&A paper to provide some guidance on how SA Water might manage the inevitable conflicts between or within customer classes in terms of feedback before it arrives at a landing point for its RBP.

Resolving conflicts is a particular problem for monopoly utilities compared with other markets as it is relatively less feasible for monopoly utilities to segment the market and offer different price-service offerings to different segments of the market. In other words, utilities often have to provide single price-service offerings across broad segments of the market. This means that utilities have to make difficult choices among the wishes of different customer segments in forming overall price-service offerings. It is critically important for SA Water to be clear in its RBP how it has made choices among customer segments and how it has given due weight to the views of different customer segments, including low income and vulnerable customers.

Information provision

The draft F&A paper outlines at pages 7-8 the process that the Commission will use to consult with stakeholders, including consulting on technical papers, gathering a diverse range of evidence, and consulting the Commission's Consumer Advisory Committee.

It would assist stakeholders to understand more about the Commission's timetable for providing information to stakeholders.

In particular, it would be valuable to know:

- What information will be available to stakeholders and when?
- Will benchmarking be used to compare the efficiency of SA Water's services to other water utilities' services?
- How will any information such as benchmarking information be provided to stakeholders? Will it be in a format that allows easy comparison between SA Water and peers, e.g. using the same time period for comparison purposes.

It would also be valuable to stakeholders for the final F&A paper to provide some commentary on how SA Water will be expected to confirm the basis and sources for the information and forecasts that it provides.

It would be valuable for the final F&A paper to briefly address the extent to which any information provided by SA Water to the Commission in the RBP will be kept confidential from stakeholders. SACOSS considers that ideally only information that could directly affect the outcome of a tender should be kept confidential.

SACOSS notes and supports the focus of the Commission on understanding SA Water's sustainable costs of delivery not just over SAW RD20 but over the longer term. In this regard, it would assist consumers for SA Water and the Commission to provide as part of this regulatory process indications of SA Water's longer term pricing and reliability trajectories and forecasts, for example over 10 or 20 years.²

Ex-post capex review

The draft F&A paper proposes to conduct an ex-post review of capital expenditure "only if SA Water's total capital expenditure incurred during the current regulatory period ... is greater than the total capital expenditure incorporated into SAW RD16".³

SACOSS broadly agrees with this principle. However, where SA Water has not constructed particular assets proposed for the current regulatory period then this should be considered in determining whether to conduct an ex-post capex review. For example, if SA Water only constructed half the new assets incorporated into SAW RD16 but spent three-quarters of the RD16 capex allowance, then it would be appropriate to conduct an ex post capex review, since actual capex is well in excess of the capex allowed against the new assets constructed during the 2016-2020 period.

Pricing

Originally regulatory processes in Australia tended to separate pricing decisions and assessment from the process of setting regulated revenues for regulated services.

However, there has been a trend to connect revenue decisions with pricing decisions and to increase the transparency of price-setting arrangements.

For example, in electricity and gas markets, there are clear revenue and pricing principles.⁴ Additionally, since 2017 distributors have been required to submit Tariff Structure Statements (TSSs) to the AER for its approval as part of their regulatory reset processes.⁵ The TSSs must comply with pricing principles including setting revenues for each tariff at long-run marginal cost.

SACOSS notes that the Commission reviewed the structure of retail drinking water and sewerage retail prices in January 2015 and decided to move towards cost-reflective pricing.⁶ However, the principle of cost-reflectivity may potentially leave SA Water with very broad scope to set prices between avoidable and stand-alone cost for particular customer classes.

With RD16, SA Water submitted its proposed pricing arrangements with its RBP.

It would be useful for the final F&A paper to seek information from SA Water early in the regulatory process about its approach to price-setting so that there is greater transparency about how SA Water will set prices. This would assist stakeholders to examine and respond to how SA Water has set prices across tariff classes

² It is understood that longer range forecasts are less exact than shorter range forecasts.

³ Draft F&A paper, p. 13.

⁴ NEL, s 7A, NGL, s 24.

⁵ The Distribution Network Pricing Arrangements rule change at AEMC's website at <http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements>

⁶ the Commission website at <http://www.escosa.sa.gov.au/projects-and-publications/projects/water/inquiry-into-drinking-water-and-sewerage-retail-services-pricing-reform>

prior to the development of SA Water's RBP. It would be valuable for consumers to consider pricing issues as part of the consumer engagement process prior to the RBP.

Regulation of SA Water's other retail services

The draft F&A paper at page 14 identifies eight retail services that SA Water offers that the Commission proposes to continue to regulate separately from drinking water and sewerage services.

Some of these services such as sale of recycled water, network analysis and audit services, potentially share the use of staff or assets that deliver the core regulated drinking water and sewerage services. It will be important to ensure careful allocation of costs among core regulated and other services to ensure that core regulated services are not being subsidised by other services.

It would assist stakeholders for the final F&A paper to set out some principles for separation of the costs of core regulated and other services.

Assessing the contestability of other retail services

New meters could be subject to contestability over time, similar to the new arrangements in the electricity industry. Metering installation, reading, and management is a distinct activity that can be separated from the monopoly distribution business and asset base.

It may be possible for other retail services to become contestable. For example, NSW has made electricity distribution connection services contestable through the Accredited Service Provider Scheme.⁷

Network analysis and audit services could potentially be made contestable through an accreditation scheme. Western Power under its Applications and Queuing Policy (which is the policy supporting large new connections) permits some of the connection and load analysis to be performed by third parties rather than its own staff.⁸

It would be useful for the final F&A paper to set out principles for stakeholders on the approach it will take into relation to the contestability of the other retail services listed at page 14 of the draft F&A paper.

Length of SAW RD20 regulatory period

The four year regulatory period proposed by the Commission for SAW RD20 is considered reasonable. Four years seems long enough to reduce the costs of regulatory oversight from year to year while at the same time allowing the regulator to reassess costs frequently enough to evaluate new capital and operating expenditures, and to adjust for any errors or mis-forecasts in previous decisions.

Final comments

The F&A paper notes that SA Water has reduced annual regulated revenues by \$110million compared to 2012-13. This is a significant reduction.

It is important at the same time to note that this may reflect a relative level of inefficiency prior to 2012-13 rather than a high level of efficiency at present, or it may reflect that the current time is a low point in the investment cycle for new capital investment. It will be important as part of RD2020 to assess the overall efficiency of SA Water through benchmarking and other measures rather than changes in regulated revenue since 2012-13.

⁷ <https://www.resourcesandenergy.nsw.gov.au/energy-supply-industry/pipelines-electricity-gas-networks/network-connections/contestable-works>

⁸ See, for example, clause 20.5 of the AQP at <https://westernpower.com.au/media/1428/application-queuing-policy.pdf>

We thank you in advance for consideration of our comments. If you have any questions relating to this submission, please contact Jo De Silva on jo@sacoss.org.au or 08 8305 4211.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'RWomersley', enclosed in a thin black rectangular border.

Ross Womersley
Chief Executive Officer