

SUBMISSION

TO | Inquiry into Water Pricing in South
Australia

By email:

TOPIC | Response to “A Balanced Bargain”

DATE | May 2019

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CARF Funding. The participation in responses to this Inquiry by Uniting Communities is possible due to funding received from the CARF (Consumer Advocacy Research Fund). The views expressed through our engagement cannot be regarded as reflecting those of the SA Government as provider of CARF funding.

Executive Summary

The SA Water industry act sets out objects of the Act, object 'e' is to **“protect the interest of consumers of water and sewerage services.”** We suggest that the Inquiry must be cognisant of this object and to provide recommendations that are in line with this object. This means that once a reasonable range has been established for the value of RAB, then the decision rule should be to accept the lower value of this range. The best interests of consumers, whether poor renter households or larger businesses, are all met by having the lowest efficient costs for the provision of water services. Consequently since the Regulated Asset Base (RAB) is a significant component of water service costs, the lowest efficient RAB is in the best interests of SA water service customers.

In setting a base year for RAB valuation, the Inquiry says that *“the data provided in the 08-09 TS which relate back to the year 2006-07 provide a reasonable basis for its proposed roll-forward approach commencing from 1 July 2006.”* Uniting Communities accepts this finding.

We then believe that the appropriate valuation of the RAB that is in the best interests of SA consumers is \$7150 million. It would be difficult for the SA Government to justify a RAB valuation that is higher than this value to be in the interests of consumers, in our opinion.

On the question of transition to a lower RAB valuation we suggest that a reasonable bargain with consumers would be for the transition to a lower RAB valuation to occur over the four years of the forthcoming regulatory period, to be fully in place by 2024.

About Uniting Communities

Uniting Communities works across South Australia through more than 100 community service programs, including: aged care, disability, youth services, homelessness intervention, foster care and family counselling. Our team of staff and volunteers support and engage with more than 20,000 South Australians each year. We strive to build strong and supportive communities, and help people realise their potential and live the best life they can.

We have a long-standing role as a provider of financial counselling services and have observed over recent years that utilities affordability is the number one presenting issue across our financial counselling services. Consequently we have actively engaged in advocacy and engaged with energy and water businesses and regulators to seek to make these essential services more affordable.

This submission builds on the experience of thousands of financial counselling interviews, provision of a diversity of other support services to lower income and disadvantaged households along with a decade and a half of active engagement in utilities policy and regulation advocacy.

This submission is in response to the review of SA Water's regulated Asset base (RAB) valuation and is made to 4th publication of the review: A Balanced Bargain. Uniting Communities has participated in public forums that have been conducted as part of the review and wrote a submission in response to the previous Inquiry paper; A Cautions

Conclusion. We commence by revising our dialogue with the Inquiry about “reasonableness.”

Reasonableness revisited

In responding to the proposal from the previous Inquiry report, a Cautious Conclusion, the inquiry proposes three elements that constitute a reasonable decision:

- Sensible, credible, sound judgement, logical.
- Fair, just, proper, good-faith
- Moderate, prudent, not extreme, pragmatic.

Uniting Communities responded by proposing a fourth element of reasonableness: “ethical.” We argued that an ethical approach was in line with emerging /contemporary best practice regarding regulation which seeks an approach with all parties committing to “do the right thing.” We also suggested that the right thing as a matter of principle would be in line with, a Rawlsian approach of “justice as fairness” with the resultant decision rule for good regulatory practice (and public policy in general) focusing on outcomes which preferably favour the most disadvantaged people in our community.

In a Balanced Bargain, the Inquiry has responded by recognising that *“the Inquiry is limited to reviewing the reasonableness of the initial RAB value, and is unable to engage in the setting of prices and support for the most needy.”* The Inquiry continues with *“there is a long chain of connection between the RAB, allowable revenue, profits, tax and dividend payments, and the distribution of government receipts to those in need, and the Inquiry has no ability to go beyond the first step in this complicated chain of multiple decisions.”*

Whilst being largely in agreement with the view of the Inquiry, we suggested some nuance is worthwhile. In particular we note that the SA Water industry act sets out objects of the Act, object ‘e’ is to **“protect the interest of consumers of water and sewerage services.”** We suggest that the Inquiry must be cognisant of this object and to provide recommendations that are in line with this object. Consequently we suggest that even though there is a “long chain of connection” between the value of the RAB and the prices that customers ultimately pay through their bills, the Inquiry should not propose a RAB valuation that would result in bills that place additional financial burden on current and future customers.

On the question of acting for the long-term interests of consumers, we agree with the Inquirer’s observation that *“the Inquirer is wary about the different interpretations parties place on the long-term interests of consumers: most long-term benefits are never delivered because there is no one who remembers the commitment and can enforce it, and because it is often an excuse for not living in the short term.”* We observe that the trade-off between long-term and short-term interests of consumers in utility regulation in Australia is inadequately considered and will return briefly to this theme at the end of this submission where we consider the question of transition to a revised RAB.

We recognise that the Inquirer is well aware of the interests and concerns of customers of SA Water and the concerns about rising prices. We affirm that an approach that the Inquiry can take is to determine a reasonable range for the value of the RAB and highlight that the

return on capital (RAB x WACC) has significant impact on the total return to the SA Government through SA Water. A decision rule to propose a RAB value to the bottom end of that range would be appropriate, as being in the interests of consumers, both shorter and longer term.

A final comment on the question of price and the best interests of consumers is to note that in an economic climate of static or declining real incomes for a significant proportion of the South Australian population - through no real increase in benefits for many social security payment recipients and through low minimum wages and an increasingly casualised workforce. Many households face uncertain and declining hours of work, resulting in growing numbers of 'working poor' households. For SA Water customers over the last decade, real costs of water and sewerage have increased substantially, due largely to the impacts of the desalination plant, which has added significant costs to SA Water bills. (Note that we are not assessing the merits of the desalination plant, simply noting the cost impact)

(Uniting Communities is happy to provide further evidence behind the statements should the Inquiry find that useful)

A government perspective in defence of the initial RAB

Chapter 4 of "a Balanced Bargain" seeks to provide a Government perspective in defence of the initial RAB. We found this section to be very helpful and consider that it fairly presents the history of SA Water RAB valuations, along with outlining the work in the previous Inquiry reports. This chapter did beg the question for us of what a low or modest income household perspective of the merits of initial and subsequent RAB valuations might be, as a counterbalance to a government perspective of no change to the valuation of RAB?

The Inquiry has diligently and effectively presented "*a government perspective as to why the initial value of the RAB should not be changed,*" we accept that this is an important consideration and a perspective that the Inquiry must actively consider. However, as noted above, the Water Industry Act includes an objective "**protect the interest of consumers of water and sewerage services.**" We do not consider that the SA Government has adequately applied this objective in past valuations of the RAB, and consequently we suggest that the Inquiry should be making this observation. The question of protecting the interests of consumers is vexed for government, regulators and indeed to consumers and consumer interest groups, but it is an important aspect of a government perspective.

The interest of consumers

We suggest that there is merit in the final report of the Inquiry giving some attention to the interests of consumers, both from a Government point of view and from the point of view of Inquiry stakeholders.

So having said this, there is an onus on us to provide our perspective.

We consider the question of what is the best interest of South Australian consumers, in aggregate, regarding the valuation of the RAB? In our opinion there are three broad approaches that the SA Government could take:

1. Recognising that water services are an essential service, the SA Government helps to reduce water services bills by meeting some capital expenditure / RAB right down costs directly from state budget, The incidence being that consumers as taxpayers subsidise SA Water customers
2. Setting the RAB to reflect the lowest efficient cost of providing services.
3. Setting the RAB at the top end of a range of RAB valuation methodologies so that there is effectively an enhanced dividend to the Government (as owner of SA Water, but not all water/wastewater utilities). This is effectively the water consumer subsidising the taxpayer, with an enhanced SA Water dividend going to general revenue to provide other state run services required by the community.

There is merit in each of these approaches, and we recognise that there is likely to be some attraction to option 3, particularly given the current state budget situation of declining GST revenue and a generally narrow and regressive tax base. However we believe that the fairest approach is the most efficient approach with the least amount of cross subsidies, consequently option 2 is the optimal approach with the focus on water services bills paid by customers being directly related to the water services they receive and at the lowest price for efficient water services provider. This approach must be predicated on ensuring as best as possible, efficient provision of water and wastewater services, which for us means the lowest reasonable RAB valuation. Transparency and efficiency being the guiding principles. Any cross subsidies, in any direction, need to be transparently declared to the wider public.

We think that there is also a valid argument that says that a countervailing position to the defence of the government perspective, should also be developed. This alternative view would be a best interest of consumers perspective that would identify a best outcome for consumers for all RAB valuations that have been undertaken, rolled forward or extrapolated. We note that compliance with the COAG strategic framework and the NWI pricing principles does not necessarily reflect the best interests of consumers.

The Inquiry identifies this reality with its comment on page 44 *“the initial RAB value set by the government achieve the objective of securing the revenue (and price) path it had specified in the 2012-13 RS (less the efficiencies ESCoSA has identified), which ESCoSA had accepted as the basis for setting the average revenue caps while taking into account the cost savings it identified in the regulatory review process. However, it also meant that consumers did not receive much (if any) of the benefit that are falling WACC would normally to deliver to consumers, and the benefit was predominantly captured by the government and locked in for future years.”*

Setting the RAB Range

Uniting Communities recognises the complexities of establishing an historic base from which a roll forward valuation for the RAB could be determined and supports the Inquiry’s changes in view that are listed on page 52 of the Balanced Bargain report. Consequently we accept the Inquiry’s view that *“having examined the data in much more detail in recent months, the Inquiry is of the opinion that the data provided in the 08-09 TS which relate back to the year 2006-07 provide a reasonable basis for its proposed roll-forward approach commencing from 1 July 2006.”*

We consider as reasonable the Inquiry's conclusion that *"the Inquiry will therefore undertake its role forward analysis, and its evaluation of COAG and NWI compliance for determining the "go forward full cost recovery" and target revenue compliance, on the basis of an opening RAB value on 1 July 2006 of \$4200 million, comprising \$2200 million of legacy assets and \$2000 million of non-legacy assets."*

While there are many ways of calculating a RAB value, we are satisfied with the focus that the Inquiry has given to DORC (Depreciated Optimised Replacement Cost) RAB and EV (Economic Value) RAB. The range of RAB values at 30 June 2013 (\$ million, Dec 2012 using three methodologies is applied to both DORC and EV valuations are reasonable and provide a sound basis for establishing a reasonable range for RAB valuation. Consequently we are satisfied with the Inquiry conclusion that "the range of the Inquiry believes is most credible is between \$7150 million (DORC approach) and \$7250 million (EV approach).

As we have argued earlier, we believe that the appropriate valuation of the RAB that is in the best interests of SA consumers is consequently \$7150 million. It would be difficult for the SA government to justify a RAB valuation that is higher than this value, in our opinion.

Transition

Should the decision be made, that we think should be made, to reduce the value of the SA Water RAB, then consideration needs to be given to transition from the current to revised valuations. There is a strong argument that says that consumers have paid more than they need to have for water services, due to the high valuation of RAB, so full reduction should be passed on as soon as possible, which would be the first year of the next regulatory period, 2020-24

However recognising current state budget constraints particularly \$½ billion loss of GST revenue, it would be a difficult time for the SA government to accept a rapid path to reduced revenue from SA Water dividends,

Consequently we suggest that a reasonable bargain with consumers would be for the transition to a lower RAB valuation to occur over the four years of the forthcoming regulatory period, to be fully in place by 2024.

Concluding Comments

In reaching a conclusion about the value of the RAB, as requested by the Treasurer, there is no single technically correct value for the RAB, any final decision will be based on establishing a fair bargain.

The Inquiry has rightly given quite a deal of consideration to the question of reasonableness (fairness) and has suggested that there are three elements that constitute a reasonable decision, these being a decision that is sensible, fair and moderate.

In accepting these principles we suggest that for any current decision and future decisions that flow from it, fairness must include a commitment to transparency. This means that

methodologies for determining all of the components that impact on customer bills, including any future pricing orders, need to be transparent in that they are published in a timely manner and on a website that is readily accessible to any interested party. This Inquiry also has demonstrated the importance of transparency meaning that all relevant calculations are replicable.

We understand that a sensible decision is one that is predicated on the efficient costs of running a water utility. Efficient cost means that consumers do not pay more than is necessary nor a day earlier than is efficient.

In concluding this brief submission we commend the Inquiry on their thoughtfulness, diligence and willingness to bring stakeholders along for the journey on all key debates. We have greatly appreciated the Inquiry members willingness to discuss issues and their openness to the views of all stakeholders. We've also enjoyed the good humour with which the Inquiry has been conducted and of course, the alliteration.

Thank you