

24 August 2012

**SOUTH AUSTRALIAN
WATER CORPORATION**

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Dr Paul Kerin
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Dear Dr Kerin

SA Water welcomes the opportunity to respond to the Essential Services Commission of South Australia on the documents released on 12 July 2012, most notably the draft Water Retail Code.

There are a number of issues which SA Water would like to resolve with the Commission, the most fundamental of which include:

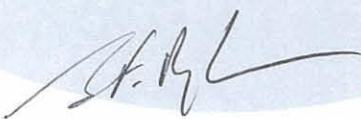
1. The facilitation of a level playing field (refer to section 1.1 of the attached document);
2. Required changes to systems and protocols (refer to sections 1.2 and 1.3 of the attached document); and
3. Increases to SA Water's current service standards (refer to section 1.4 of the attached document).

Points 2 and 3 above will have a significant impact upon SA Water's expenditure proposal for the upcoming regulatory control period if required before or during that period. SA Water has not considered these costs in the upcoming Regulatory Business Proposal, and in many instances does not believe the required expenditure to be in the best interests of its customers.

If any of these proposed requirements come into effect before or during the forthcoming regulatory control period SA Water would need to address the matter of additional required expenditure with the Commission.

SA Water looks forward to working with the Essential Services Commission of South Australia to resolve these issues for the benefit of SA Water's customers.

Yours sincerely



John Ringham
CHIEF EXECUTIVE

ECONOMIC REGULATION OF THE SOUTH AUSTRALIAN WATER INDUSTRY

SA WATER SUBMISSION – AUGUST 2012

On 13 July 2012 the Essential Services Commission of South Australia (Commission) released numerous documents pertaining to the economic regulation of the South Australian water industry, most notably:

1. Draft Water Retail Code;
2. Discussion paper and supporting information on the Price Regulation of Water and Sewerage Service Providers other than SA Water;
3. Statement of Approach on the Economic Regulation of SA Water's Revenues;
4. Guidance Paper on the Review of SA Water's Prices: 2013/14 – 2015/16;
5. A reissue of the Water Industry Guideline 1: Compliance Systems and Reporting;
6. A Draft Water Licence for consultation, application form and water advisory bulletin regarding licensing arrangements;
7. Various fact sheets.

The Commission sought public response on the draft *Water Retail Code* and the *Price Regulation of Water and Sewerage Service Providers other than SA Water* only. SA Water has a number of concerns related to the Statement of Approach but notes this document has been excluded from the public consultation process and will raise these issues separately with the Commission.

1. Draft Water Retail Code

SA Water welcomes the Commission's draft Water Retail Code (Retail Code) as a further step in implementing the Government's goal of a regulated and competitive water industry in South Australia.

SA Water is currently working towards the implementation of any and all necessary regulatory requirements and welcomes the additional detail the Retail Code has afforded it. Overall, SA Water found the draft Retail Code to be a reasonable representation of the required conduct of the South Australian water industry under a regulated environment. However, SA Water seeks further clarity in a number of areas and also wishes to respond in relation to the Commission's approach. These areas can be summarised as follows:

- Level playing field issue in terms of retailer obligations;
- Unsuitable requirements for the water industry;
- System and protocol changes;
- Regulation of SA Water's service standards; and
- Insufficient detail of regulatory requirements.

1.1 Level Playing Field

As previously detailed within its public response to the Commission's Draft Advice¹, SA Water strongly supports a level playing field within the South Australian water industry for all water entities providing substantially the same service as a fundamental underpinning of a competitive market, regardless of the size or scope of the entity.

SA Water understands the Commission has implemented a number of protections for smaller entities and accepts that in some cases this may be appropriate and in the best interests of consumers. However, SA Water is of the view that this type of approach should be conducted very carefully in order:

1. not to disadvantage the customers of entities which the Commission does not consider require protection; and/or
2. discourage efficiency and innovation in the water industry by effectively protecting smaller water industry entities and their business success.

This is to ensure customers of all water services throughout South Australia will receive the same level of protection from the Commission irrespective of their service provider and to give effect to a key objective of the *Water Industry Act 2012*, to "promote efficiency, competition and innovation in the water industry"². The following extract from SA Water's Submission on the Commission's Statement of Issues³ consultation remains relevant:

"As a principle, any regulation of a market should apply to all providers of the same service in order to foster competition. The Water Industry Bill has as one of its aims to promote competition. Having different requirements for licensed providers may impose different costs that will distort the market. It also fosters different service standards for customers depending on their location.

The structure of the water industry in South Australia is very diverse with one large public provider and many small providers, primarily based in regional or remote areas. The provision of these services reflects the population density, supply sources and geography. To maintain viability of the various service providers, different approaches to, for example, the quality and reliability of service may need to apply. Any regulation (by a code or otherwise) should be based on the service being provided rather than one that distinguishes between different service providers. No single provider should incur specific benefits or costs as a result of differing treatment under the code."

SA Water remains concerned with the heavy-handed regulation within the draft Retail Code, and regulatory framework in general, targeted at SA Water on the basis that it is unsubstantiated and creates a discriminatory environment within the water industry. SA Water's performance is nationally benchmarked and has consistently remained in the high achieving quadrant of all national providers despite South Australia being the subject of arguably some of the most difficult operating circumstances in Australia for the delivery of water services. In addition to this SA Water is subject to

¹ ESCOSA, Economic Regulation of the South Australian Water Industry, Draft Advice, 11 November 2011

² *Water Industry Act 2012* (SA), section 3

³ SA Water, Economic Regulation of the South Australian Water Industry, Statement of Issues by Essential Services Commission of South Australia, SA Water Response, January 2011

considerably greater accountability and scrutiny than private providers – evidenced by Ministerial and Government control, Parliamentary scrutiny by various standing committees (Public Works and Estimates Committees) as well as from open debate and Question Time, annual financial examinations by the Auditor-General, complaint investigations by the Ombudsman and the myriad of other health, environmental, occupational and other regulators.

On this basis, SA Water does not feel the level of heavy-handed regulation proposed only for SA Water has been justified and that SA Water customers will be unjustly disadvantaged by footing the unsubstantiated higher costs of regulation than other providers. In addition, SA Water presumes the option available to SA Water customers to counteract this discrimination would be to change service provider in favour of one of the smaller service providers to whom the Commission has afforded light-handed regulation. SA Water notes that this merely “shares the load” amongst the water industry rather than encouraging water industry entities to drive down costs by increasing efficiency and innovation in order to win market share.

The Retail Code is a high-level document governing the conduct of service providers within the water industry of South Australia. It is not appropriate to distinguish one service provider from another. At a code level, all regulatory requirements should apply equally to participants in the water industry. For example in sections 19 and 16.6.2 of the draft Retail Code a distinction has been made between SA Water and other retailers, imposing additional obligations on SA Water not to restrict flow rates for non-payment of bills where other retailers have been afforded the ability to do so as a recovery mechanism. Aside from the practical issues such a distinction creates for SA Water and its recovery processes, which have been discussed with the Commission, SA Water believes it is inappropriate to distinguish between SA Water and other retailers. These sections attribute differing obligations on SA Water than other retailers which creates an unlevel playing field, ultimately disadvantaging the majority of SA Water customers and equally importantly, disadvantaging all South Australians by not promoting a fair and competitive market driving efficiency and innovation amongst service providers. SA Water maintains that all customers should be afforded the same level of service regardless of service provider with greater levels of service being at the discretion of retailers in the interest of promoting competition and maintaining market share.

Whilst within the draft Retail Code, there are limited specific distinctions in the obligations for SA Water versus other water retailers, SA Water notes that the Commission has discretion to determine specific requirements under the Code which can vary between retailers. SA Water encourages the Commission in specifying the requirements for individual retailers to give primacy to the principle of a level playing field.

The Water Retail Code should attribute the same obligations to all retailers regardless of size or scale of operations, ensuring a level playing field and equal treatment of all customers regardless of service provider.

1.2 Unsuitable requirements for the water industry

SA Water acknowledges that regulation of the water industry is in its infancy within South Australia and appreciates the consultation conducted with the Commission to date. SA Water recognised that the following items have not previously been contemplated by the Commission in consultation with service providers and offers the following information in terms of proposed regulatory elements the Commission may not appreciate as unsuitable for the water industry:

1. Section 10 Termination of Retail Services (and other references to termination such as section 17.13)

Section 10 of the draft Retail Code fails to recognise the framework on which the water industry has been based and that the systems and processes are currently incapable of accommodating the proposed termination arrangements without considerable cost to the customers of South Australia. The water industry currently operates in an environment where a service provider offers services to a **property** and all rights and liabilities are retained by the landowner (the account holder).

Such a fundamental change to the water industry would cause major changes to systems and processes having a far wider effect than on water retailers alone. For example, SA Water currently has arrangements in place where information required by its systems is automatically obtained from the Lands Titles Office on a daily basis. A change such as section 10 will require far-reaching changes to all of SA Water's key systems and administrative functions. This change is so significant it will have considerable pricing impacts for customers, the magnitude of which has not been contemplated by SA Water's Regulatory Business Proposal and would need to be either recognised in the Commission's pricing determination for the forthcoming regulatory control period or passed through to customers under a regulatory change pass through event within the forthcoming regulatory control period.

2. References to tenants

Further to the above, any references to tenants outside of the minor consumer protections that have been afforded tenants by law, will require significant changes to SA Water's current billing and customer information systems for the reasons detailed above – as the water industry framework does not currently recognise tenants as an account holder major changes would need to be implemented to record and manage the required data to effect any changes regarding tenants.

SA Water is concerned that the Commission may not be fully aware of the current framework under which the water industry operates. SA Water's systems, processes and administrative functions have been developed based on the customer being the property owner. Whilst changes to administrative processes may appear simple and in the best interests of customers, they are in actual fact complex, wound up and restricted by other processes and system capabilities and will involve changes to other government agencies and processes. As a result, the proposed changes in part or in full may not be in the best interests of customers due to the costs associated with making such significant reforms. SA Water invites the Commission to discuss and consider in detail the ramifications of the proposed changes.

SA Water suggests that the outcomes of the inquiry in which the Commission is proposed to be engaged to investigate a number of reforms to the water industry framework (Public Inquiry)⁴ will better inform any changes required to the water industry framework and these changes can be efficiently scoped and implemented once all details and requirements are known.

SA Water believes a number of the proposed obligations within the draft Retail Code are not suitable for the water industry in its current form and suggests any fundamental changes to the water industry be delayed until such time as the relevant formal reforms occur on the basis that part-implementation is an inefficient and irresponsible business decision to the detriment of all customers.

1.3 Changes to systems and protocols

Further to the examples detailed above, a number of additional changes to SA Water's systems, processes and protocols will be required by the Commission's Retail Code if implemented in its current form, including:

1. A change to SA Water's billing system to give effect to section 12.7.1 in order to allocate customer payments to government levies and charges such as the River Murray Levy ahead of SA Water charges.
2. A change to SA Water's meter reading processes and billing system to bring it in line with stringent meter reading processes within the electricity industry where meter reading contracts are set up to allow for strict reading of customer meters on specified dates so that these dates can be detailed on customer bills ahead of the meter read in order to satisfy section 12.8.1(b) equivalent. In SA Water's experience, SA Water customers do not expect definitive meter reading dates and do not currently express dissatisfaction with SA Water's meter reading process. As such, this change, and the associated expense, is not justifiable.
3. Significant changes to SA Water's billing system to give effect to the requirements under sections 12.8.1 and 12.9 to provide further corporate and consumption data on customer bills for all customers;
4. Significant changes and/or implementation of a new Customer Information System to record tenant details to give effect to such sections of the Retail Code as section 12.10.4 and the myriad of other changes expected should the outcome of the Public Inquiry result in recognition of tenants as customers/account holders.

Whilst SA Water recognises the changes the Commission is attempting to make may be required, SA Water is also conscious of the time it takes to implement such major system upgrades carefully to avoid the high levels of disruption to current systems and processes that major system upgrades typically cause. SA Water strongly suggests transitional measures be implemented by the Commission allowing sufficient time for the complete upgrade to be implemented and carefully managed by SA Water to limit disruptive impacts to customers.

SA Water also suggests that a thorough investigation be conducted by the Commission, including consultation with SA Water and SA Water's customers, to ascertain all required changes to any of SA Water's major systems so that any changes to the same system be captured in the one system

⁴ ESCOSA, Economic Regulation of the South Australian Water Industry, Statement of Approach, July 2012, Appendix B, p.1

upgrade to increase efficiency of the project and limit the frequency and risk of disruption to customers. SA Water suggests this investigation could be carried out simultaneously with the Public Inquiry noting that outcomes of both undertakings may have significant impacts on SA Water's systems and substantial benefit can be derived from fully scoping the works ahead of requiring SA Water to undertake them.

SA Water also advises that no costs for such system upgrades have been included in the upcoming Regulatory Business Proposal for the forthcoming regulatory control period. If the transitional measures implemented by the Commission call for upgrades within the forthcoming regulatory control period these costs will need to be either recognised in the Commission's pricing determination for the forthcoming regulatory control period or recovered through a regulatory change pass through event.

SA Water recognises that changes to systems, procedures and protocols may be required of, and expected of, a regulated entity but suggests that the Commission test such changes for feasibility and customer expectation ahead of obligating water entities to undertake the changes.

SA Water also suggests that there is substantial benefit to be derived from the Commission implementing transitional measures until such time as the Commission can provide sufficient information to SA Water to allow for complete scoping of upgrade works, taking into consideration current abilities, future regulatory expectations, customer expectations and the outcome of the Public Inquiry.

1.4 Regulation of SA Water's service standards

Within the Retail Code reference is made to compliance with regulatory service standards. The Commission's Final Advice⁵ lists the service standards to apply to SA Water for the period 1 January 2013 to 30 June 2013. It should be noted that, to date, the Commission has not publicly consulted on SA Water's service standards. SA Water questions the benefit of revisions made to SA Water's current service standards in the absence of any Customer Willingness to Pay Studies, on the basis that:

1. any change is ill-informed until such time as said studies can be undertaken;
2. SA Water consistently performs highly when compared with other major water utilities nationwide in terms of levels of service; and
3. the basis on which the Commission has formulated its proposed service standards is not suitable for the water industry.

It is difficult to make an informed change regarding SA Water's levels of service until an understanding of current customer satisfaction with SA Water service standards can be ascertained coupled with the service levels customers are willing to accept based on how much they are willing to pay for a service (the subject of Customer Willingness to Pay Studies). SA Water has undertaken some preliminary work in estimating the costs associated with meeting the Commission's proposed services standards.

⁵ ESCOSA, Economic Regulation of the South Australian Water Industry, Final Advice, June 2012

The cost impact associated with meeting the Commission's proposed operational services standards would be significant. SA Water has not allowed for these costs in the Regulatory Business Proposal and any costs associated with increasing operational service standards above current levels would need to be either recognised in the Commission's pricing determination for the forthcoming regulatory control period or recovered through a regulatory change pass through event.

SA Water has not allowed for these costs in the upcoming Regulatory Business Proposal as the standards have not been tested with customers and SA Water is not convinced that SA Water customers are willing to pay more to increase the levels of service from that which they already receive.

In addition to the cost impacts of increasing service standards above current levels, SA Water would like to note that it consistently performs in the higher quadrant of comparative utilities in terms of service when compared with interstate utilities and in arguably more difficult operating conditions than most which indicates that its customers are less likely to willingly pay more for levels of service greater than that which they currently receive.

Furthermore, SA Water is concerned with the methodology adopted by the Commission in assessing SA Water's historical performance in order to set future service standards. In particular, SA Water takes issue with the instances in which the Commission established the 5 year average and the highest achieved standard across those 5 years and proceeded to increase service standards above both of those levels without basis. This is particularly concerning for SA Water where 99% targets have been stretched to 100% in instances where the existing target has been set to allow for circumstances where it is unsafe, or in the public interest, not to meet the stringent timing standards. In all instances, SA Water always strives for 100% achievement of its operational targets. However, SA Water recognises that in certain circumstances such as:

1. where an occupational health and safety hazard is present;
2. access to the property is prevented; or
3. it is deemed in the best interests of a majority of customers to delay works (such as certain major roads during peak periods);

It is not reasonable to expect operational staff to always meet the specified timeframes. A target of 99% allows for these exceptional circumstances.

In addition to the above, SA Water acknowledges the Commission's suggested "best endeavours" approach as a mitigative strategy to the inflated service standards however, SA Water believes this approach will be confusing to customers and artificially inflate their expectations of service without enhancing SA Water's means to achieve them in parallel.

SA Water considers that industry best practice and good customer service is hinged on communicating an accurate expectation of service to customers. The approach proposed by the Commission will cause unavoidable confusion to SA Water's customers resulting in artificially inflated expectations and inevitably a disappointment in service levels that customers are not paying to receive. This will unjustly reflect poorly on SA Water and its dedication to servicing its customers and create customer dissatisfaction. In addition, customer dissatisfaction is a customer service cost

on the business in terms of management and an operational expense in terms of rectification. SA Water believes an efficient approach would avoid creating situations of customer dissatisfaction.

SA Water questions the merit in increasing SA Water's service standards prior to the conduct of Customer Willingness to Pay studies on the basis that this would lead to unjustified expenditure and resultant cost implications for customers. SA Water is also particularly concerned with the proposal to stretch some service targets to 100% which in practice cannot be met. This would unjustly reflect poorly on the Corporation and create customer dissatisfaction leading to additional expenditure.

SA Water suggests the Commission delay any changes to SA Water's service standards until such time as Customer Willingness to Pay studies can be undertaken by the Commission to inform any such changes.

1.5 Insufficient detail

SA Water acknowledges the level of detail the Commission has afforded it and other retailers since the public consultation on the Draft Advice. However, SA Water is still limited by the level of detail available at this late stage particularly in relation to the concerns raised above, compliance and reporting obligations.

SA Water respectfully notes the timeframes for the implementation of a number of key functions of regulation (such as compliance systems specific to regulatory requirements) by 1 January 2013 are becoming increasingly difficult without the required level of detail.

SA Water is concerned that the Commission may not have considered the required time to implement such changes and trusts that the Commission will work with SA Water and other retailers to effect the necessary changes, within suitable timeframes, by providing full detail of all outstanding regulatory requirements as soon as possible.

2. Conclusion

In summary, SA Water supports the majority of material outlined in the draft Retail Code but maintains regulation should not prohibit a level playing field for the benefit of all customers, regardless of service provider. A key objective of the *Water Industry Act 2012*, the legislation introduced into Parliament as a result of the South Australian Government initiative, *Water for Good*, is to "promote efficiency, competition and innovation in the water industry"⁶. SA Water believes that the distinctions the Commission is making between SA Water and other service providers will not serve to increase efficiency or innovation by neglecting to drive other service providers to operate under the same conditions and levels of service that SA Water will be required to operate under. The result is a playing field with an increased number of players but different rules preventing anyone from scoring effectively. SA Water believes that regulation should be uniform across the water industry driving all water industry entities towards efficient, responsive and cost-reflective service within the expectations of customers, competing to drive costs down. If the Commission does not set a level playing field to begin with this competition to drive efficiency and innovation within the water industry will falter and struggle to achieve the desired outcomes.

⁶ *Water Industry Act 2012 (SA)*, section 3

In creating a non-level playing field to the advantage of smaller water industry entities the Commission is encouraging smaller entities to enter the water industry and maintain a level of operation supported by the protections it is being afforded by the Commission to make a desirable level of profit, without providing any incentive to compete effectively, drive down costs and increase efficiency and innovation. This simply shares the load within the industry, it does not encourage effective competition, efficiency or innovation or the associated benefits to customers. SA Water supports a competitive water industry for the benefit of all South Australians but believes it should be implemented without bias.

SA Water is concerned that the some of the obligations proposed by the Commission will require changes to operating practice and system upgrades, with significant cost implications and price increases to customers. SA Water does not believe that the Commission is fully aware of the implications of the proposed obligations and that further consideration is required to ensure that they are in the best interests of the customer.

SA Water will continue to work closely with the Commission to make any and all necessary regulatory changes.

