

31 May 2019

Mr Lewis Owens
Independent Inquirer
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ADELAIDE SA 5000

Dear Lew

Thank you for the opportunity to review the Inquiry's fourth interim report – A Balanced Bargain (the Report). We offer the following further observations for your consideration.

Legal Compliance

At times the Report suggests the Government's opening RAB decision was not legally compliant and/or not within the spirit of the National Water Initiative (NWI) and relevant Acts (e.g. references on pages 64, 65, 86 and 88). These references are not consistent with the Inquiry's independent legal advice which confirmed the Government's opening Regulatory Asset Base (RAB) decision as legally compliant. Further, it is our view that the South Australian approach to move towards cost reflective water prices was compliant with NWI pricing principles and within the spirit of promoting efficient use of a scarce water resource.

Alternative Valuations

Section 8.1 of the Report presents a government perspective of the possible RAB range being between \$7.1 and \$7.4 billion. There is an alternative value not considered in the government perspective range. Specifically, ESCOSA provided advice to the Government that any change in the rate of return at the commencement of economic regulation would require adjustment to the initial RAB (refer page 42 and 43 of the Report). Consistent with this advice, page 68 of the Report suggests the Government could have considered an opening RAB value of around \$8 billion to fully incorporate the changing rate of return. The final opening RAB value of \$7.77 billion is below this and it could be argued that this balances the changing rate of return between the Government and consumers.

Full Cost Recovery

The Report makes various references that the maximum and minimum cost recovery positions in the 2012-13 Regulatory Statement were inflated and a key factor in setting an inflated opening RAB value. Examples include references on pages 44, 45, 50, 64, 68 and 82.

The maximum and minimum cost recovery positions were not used to set the opening RAB value. Whilst these guided the Government on how quickly prices could move towards full cost recovery, it is our understanding the Target Revenue was the key revenue parameter used to set the opening RAB value in 2013. It is important to note:

- The Target Revenue was significantly lower than the full cost recovery position.
- Although the Target Revenue was above the minimum cost recovery position that position was unlikely to be inflated as it was based on significantly lower returns on legacy assets.

Page 28 and 68 of the Report indicates there was no visibility of the method for calculating the 3.1% rate or return on legacy assets. A detailed calculation has since been provided to the Inquiry.

Economic Valuation Calculations

The Report's economic valuation calculations use the minimum cost recovery position as its basis. This is not consistent with a line in the sand methodology which aims to lock in the revenues being earned i.e. the Target Revenue. Using Target Revenue would increase the Report's economic valuations by approximately \$200 million.

Pre-Corporatisation Contributed Assets

The Report proposes and removes a pre-corporatisation contributed asset value of \$210 million from its calculations. Attributing a value to these assets remains highly subjective and in any case the need to remove pre-corporatisation contributed assets is effectively dealt with in the economic valuation calculations by the Government having declared lower returns on legacy assets.

Unadjusted Calculation Differences

We previously raised some calculation differences in our earlier response to the Inquiry dated 14 February 2019. We continue to be of the view these should be corrected for as follows:

- Depreciation based on a weighted average calculation rather than a 2% assumption. A change would increase the Inquiry's RAB calculations by around \$22 million.
- Inclusion of capital expenditure for two recycled water assets which occurred to address water security priorities. A change would increase the Inquiry's RAB calculations by around \$90 million.

The Board and I would welcome the opportunity to discuss these matters further if required.

Yours sincerely,



Roch Cheroux
Chief Executive