

Office of the Tasmanian Economic Regulator
GPO Box 770, Hobart 7001

Submission to the 2012 Water and Sewerage Price Determination Investigation – Draft Report

“Use Less Pay More”

With reference to the acceptance of the variable water target tariffs proposed by the regulated entities for 2012-13 (at around \$0.90/kL)

The Southern Water Price and Service Plan core Principle 3, identifies a User Pays principle. This principle is stated as a reflection of the actual cost of service to customers. I agree with this statement but the 90c per kl proposed grossly overstates the actual cost of service. At 90c per kl, the revenue from the variable cost of water will contribute far greater than the Long Run Marginal Cost of water.

The Southern Water Price and Service Plan recognised the Short Run Marginal Cost of water at just 29c but there is no supporting documentation that identifies the Marginal Cost of water. Assuming the 90c represents the Long Run marginal Cost of Water then the Marginal Cost of Water must be 61c.

The report is erred and short of evidence to support the Long Run Marginal Cost including for example - Table 5.10 estimates the fixed costs recovered through variable water charges per customer in nominal dollars for Southern Water as \$175.03 and rising when the estimated usage per residential customer is only 200kl x .90c = \$180. The report also does not look at the effects or even considers the water demand elasticity.

The Economic Regulator considers it appropriate for the regulated entities to set variable charges above costs to attempt to moderate demand and enable Southern Water to defer demand driven capital investment. Totally agree. Yet if the Short Run Marginal Cost of Water is 29c per kl then the proposed Marginal Cost of Water must be .90c less .29c leaving .61c per kl to spend on demand driven capital investment. The projected consumption of water for Southern Water is 31,361,000kl (Table 6.4 Projected Water Consumption, Total Regional Demand) multiplied by .61c per kl would equal \$19,130,210 per annum. This amount should therefore reflect savings in demand driven capital investment. Obviously this figure is far higher than the capex savings

The \$19,361,000 per annum generated from variable water charges over and above the short run marginal cost is over 5 times greater than the total capital growth expenditure identified by Southern Water which identified a total capital expenditure on growth of just \$10.7 million over 3 years. (Table 5.12: Water Capex by Driver)

Setting the variable cost of water so much higher than the true cost will encourage a reduction in usage with the effect of reduced revenue greater than the cost = loss of profit.

This problem has now been recognised by other water authorities where the variable cost does not equal the Long Run Marginal Cost. Reduced water usage has reduced profits which in turn requires even higher charges. A vicious circle of even greater cost and further reductions follows.

I urge the Economic Regulator to seek a true cost of deferred demand driven capital investment to provide a more robust variable charge. This vital information has not yet been provided by Southern Water and it would appear on the information in the Southern Water Price and Service Plan that water charged over and above the Short Run Marginal Cost is grossly excessive.

The bottom line is: If water charges do not reflect the true fixed and variable cost of water then Financial Imbalances will occur. Users will be forced to use less yet pay more in the long run.

Greg Davoren
898 Sandy Bay Rd
Sandy Bay
0408535626
62250315