



Advice to Treasurer on Water Industry Licence Fees

November 2019

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1 Executive Summary

This report sets out the Essential Service Commission's (**Commission**) advice on new water licence fees (**licence fees**) to be set by the Treasurer under the Water Industry Act 2012 (**Act**) from 1 July 2020 to 30 June 2024. The advice, requested by the Treasurer on 31 August 2019, is summarised as follows:

The costs that are intended to be recovered through licence fees during the 2020-2024 period (**proposed prescribed costs**) of **\$33.4 million** are considered to be within the scope of prescribed costs for the purposes of section 24(8) of the Act. This consists of:

- ▶ A continuation of costs attributable to current activities (**base costs**), currently funded through licence fees, escalated for inflation. These costs total **\$32.2 million** over the 2020-2024 period.
- ▶ New costs attributable to either costs for new activities or costs for existing activities that are not currently funded through licence fees (**additional costs**). These costs total **\$1.2 million** over the 2020-2024 period.

It is the Commission's view that these costs should be fully recovered through licence fees in a way that reflects regulatory effort.

The Treasurer has requested the Commission's advice on licence fees pursuant to section 24(3) of the Act, which provides that:

'The annual licence fee for a licence is the fee fixed, from time to time, by the Treasurer in respect of that licence as an amount that the Treasurer considers to be a reasonable contribution towards prescribed costs after taking into account advice contained in a written report furnished to the Treasurer by the Commission for the purposes of this subsection.'

The 'prescribed costs' referred to in that section are defined in section 24(8) to mean:

- (a) the costs of administration of this Act; and
- (b) any costs of administration of the Essential Services Commission Act 2002 relating to the water industry; and
- (c) any costs associated with the development by the State Government of policies relating to the water industry; and
- (d) other costs prescribed by regulation.

For the purposes of section 24(8)(d) of the Act, there are no other costs prescribed by regulation.

As requested by the Treasurer, the Commission's advice has focused on the following matter:

- ▶ Whether or not the proposed prescribed costs fall within the definition of prescribed costs under section 24(8) of the Act. On this question, the Commission has assessed whether or not the activities that form the basis for the prescribed costs are required under the Act.

Section 2 of this document sets out the Commission's advice on this matter.

The Commission has also provided advice on the setting of licence fees in accordance with what amount can be considered a 'reasonable contribution towards prescribed costs'¹. Section 3 of this document sets out the Commission's advice on this matter.

¹ See section 24(3) of the Water Industry Act 2012.

2 Proposed prescribed costs

On 31 August 2019, the Treasurer wrote to the Commission setting out the proposed prescribed costs for 2020-2024 for the purpose of setting licence fees under the Act and seeking advice from the Commission as part of the fee setting process.

The proposed prescribed costs included costs attributable to the following:

- ▶ Consumer Advocacy and Research Fund (CARF)
- ▶ the Commission's activities under the Act
- ▶ the functions, and other water industry policy activities, undertaken by the Department of Environment and Water (DEW) under the Act
- ▶ the functions undertaken by the Department of Treasury and Finance (DTF) under the Act, and
- ▶ the functions undertaken by the Office of the Technical Regulator (OTR) under the Act.

The prescribed costs proposed in the Treasurer's letter are presented in Table 1. These costs are described in further detail in the following sections, including the Commission's consideration as to whether or not they are consistent with section 24(8) of the Act.

These proposed prescribed costs total between \$8 million and \$8.6 million per year.

Table 1: Proposed Prescribed Costs 2020-21 to 2023-24 - \$'000 ^{a)}

Proposed prescribed costs (\$'000)	2020-21	2021-22	2022-23	2023-24	TOTAL 2020-24
Base costs					
Commission	3,666.6	3,758.3	3,852.3	3,948.6	15,225.9
DTF	383.8	393.4	403.2	413.3	1,593.9
DEW	570.5	584.7	599.4	614.3	2,369.1
CARF	307.7	315.4	323.3	331.4	1,277.9
OTR	2,824.6	2,894.9	2,967.8	3,042.3	11,729.8
Additional costs					
OTR	293.2	300.5	308.0	315.7	1,217.4
Total recommended recovery of prescribed costs	8,046.5	8,247.3	8,454.0	8,665.6	33,414.3

^{a)} Totals may not add due to rounding.

2.1 Base costs

The proposed base costs include the continuation of relevant departmental and agency costs currently recovered from licence fees, escalated for inflation. As stated in the Commission's previous advice on water industry licence fees,² these appear to fall within the scope of prescribed costs for the purposes

² Refer to https://www.treasury.sa.gov.au/_data/assets/pdf_file/0005/36194/20160728-Water-Covering-letter-to-Treasurer.pdf

of section 24(8) of the Act. These base costs total \$32.2 million over the 2020-2024 period and are discussed below.

2.1.1 CARF

Section 87 of the Act establishes the CARF. This fund commenced with an amount of \$250,000 on 1 July 2013 and is adjusted, in accordance with the Act, by reference to the Consumer Price Index (CPI) each year. Over the 2020-2024 period the proposed prescribed costs for CARF are \$1.2 million.

2.1.2 Commission

Section 7 of the Act appoints the Commission as the economic regulator of the water industry and assigns it functions under that Act. These functions include licensing, price regulation and other functions. Over the 2020-2024 period, the proposed prescribed costs for these functions are \$15.2 million.

2.1.3 DEW

The Minister for Environment and Water is the Minister responsible for administering the Act. The Minister has wide ranging functions and powers under the Act including, but not limited to, water planning, the granting of authorisations and exemptions, the development of certain schemes relevant to the water industry, and the issuing of Ministerial Directions. In practice, DEW assists the Minister for Environment and Water to administer the Act. Over the 2020-2024 period, the proposed prescribed costs for these activities are \$2.3 million.

2.1.4 DTF

The Treasurer has certain responsibilities under the Act, including the setting of licence fees. The Treasurer can also issue pricing orders under the Act, which has occurred since the Act commenced. DTF provides advice and support to the Treasurer on these matters. Over the 2020-2024 period, the proposed prescribed costs for these activities are \$1.5 million.

2.1.5 OTR

The Act (section 9) appoints a Technical Regulator for the water industry and assigns it various roles and functions. These functions include:

- ▶ developing, monitoring and regulating technical standards in the water industry, and
- ▶ providing advice in relation to safety or technical standards.

The proposed prescribed costs attributable to the OTR carrying out its functions under section 9 of the Act over the 2020-2024 period are \$11.7 million.

2.2 Additional costs

The proposed additional costs, above the base costs, include costs for new activities and costs for existing activities that are not currently funded through licence fees. These additional costs total \$1.2 million over the 2020-2024 period and are discussed below.

2.2.1 OTR

The remaining additional costs attributable to the OTR (\$1.2 million) include costs for the OTR to administer its functions under the Act for the 2020-2024 period. These proposed additional costs are also attributable to administering the Act and therefore can be considered within the scope of prescribed costs for the purposes of section 24(8) of the Act.

3 Reasonable contributions

Having established that the proposed costs meet the definition of prescribed costs under the Act, the Commission suggests that the following principles should be adopted in the setting of licence fees:

- ▶ Prescribed costs (as defined under section 24 of the Act) should be fully recovered through licence fees. This is consistent with the full cost recovery position adopted for electricity and gas licence fees by relevant Ministers.
- ▶ Licence fees should be established on a banded or class basis, rather than on an individual basis.
- ▶ The amount of each licence fee class should reflect regulatory effort.

The Commission understands that the current licence fee structure has been set according to these broad principles.



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