

# Excluded Retail Services

## SA Water's 2016-17 Pricing Policy Statement

### Introduction

Section 4.2 of SA Water's Water and Sewerage Retail Services: 2016 to 2020 Price Determination (ESCOSA's Regulatory Determination) requires SA Water to provide ESCOSA with annual pricing policy statements relating to excluded retail services.

This document sets out how SA Water's Excluded Retail Services Framework achieves the requirements of section 4.1 of ESCOSA's Regulatory Determination.

### Description of Excluded Services

Excluded retail services generally represent services that are provided for the benefit of a single customer (or group of customers), rather than uniformly supplied to all customers. The cost of such services are recovered through specific charges to the customer (or potential customer), rather than being paid for by all customers.

Excluded retail services revenue and prices are set by SA Water and remain subject to a 'lighter form' of regulation. That is, ESCOSA monitors prices for excluded services to ensure SA Water applies appropriate pricing principles in determining these prices.

### Excluded Retail Services Offered in 2016-17

SA Water offers over 100 different excluded retail services that have traditionally been classified as miscellaneous fees and charges.

Excluded retail services include but are not limited to:

- connections (water and sewerage);
- annual audit of trade waste;
- miscellaneous minor services;
- recycled water audits;
- easement extinguishment services;
- fire plug flow testing service; and
- network analysis.

### Pricing Policy

SA Water sets excluded retail services fees and charges consistent with section 4.1 of ESCOSA's Regulatory Determination. This includes ESCOSA principles and National Water Initiative (NWI) Pricing Principles.

SA Water aims to set prices that recover the full cost of providing the service and meet the Corporation's strategic priorities. This takes into consideration:

- customer impacts and affordability;
- ongoing viability of SA Water;
- compliance with service standards and regulatory requirements; and
- pricing signals that encourage the most efficient use of resources.

SA Water's guiding principle is that fees and charges also take into account that:

- prices should be simple and transparent;
- in some cases, it may not be possible to remove all cross-subsidies between customers and services offered within a service classification;
- prices may be set below cost in some circumstances or above cost to promote efficient use of resources; and
- overall profitability of fees and charges should be fair and reasonable.

Incentives can be included within the pricing of fees and charges in order to promote specific customer behaviour such as, for example, greater or less usage. A fee or a charge may be considered to include an incentive if it has the following attributes:

- it is set below (or above) the full cost of service; and
- specific behaviour promoted by the fee results in a net benefit to SA Water such as the avoidance of a cost or the compliance with an environmental license condition.

In general, where a service has:

- high volume/low cost with little variation between individual jobs, SA Water sets a standard charge based on the average cost of these job types; and
- low volumes/ high cost with a high degree of variation between jobs, SA Water charge based on an individual estimate of the job.

ESCOSA's Regulatory Determination requires inflation for 2016-17 to be based on the 12 month Consumer Price Index (CPI), all groups index (weighted average of eight capital cities) published by the ABS for the March quarter. This value was 1.3% for March 2016.

For excluded services, where a regulatory rate of return is used it is consistent with the regulatory rate of return used in ESCOSA's Regulatory Determination.

## **Basis of Price Movements 2015-16 to 2016-17**

SA Water periodically undertakes comprehensive reviews of the costs to provide the various services. Where the fee or charge is no longer reflective of the underlying costs, SA Water seeks to move towards recovery of the efficient cost in a structured way that manages the impact on all customers.

For 2016-17 fees and charges, one will not change, 33 will decrease, 79 will increase by less than inflation and 36 will increase by more than inflation. Consistent with the National Water Initiative, SA Water will move towards full cost recovery gradually to help manage customer impacts.

Seven of the fees and charges have been amalgamated and two new fees have been added for third party access.

Average impacts to industry groups have been maintained below inflation and communicated to these groups. SA Water will consult with any industry groups likely to be impacted by more than inflation from changes to fees and charges in future years of the regulatory period.

For a full list of SA Water’s miscellaneous fees and charges, please refer to SA Water’s website.

## Achievement of Principles as set out in ESCOSA’s Regulatory Determination

SA Water is required to demonstrate that 2016-17 excluded retail service fees and charges are compliant with section 4.1 of ESCOSA’s Regulatory Determination. These principles include five NWI Pricing Principles and four additional pricing principles determined by ESCOSA. The principles are set out in the following table:

Pricing Principle	Applicable 2016-17 Pricing Policy Statement
<b>NWI – Principle 8: Setting Developer Charges (Urban Water Tariffs)</b>	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> </ul>
<b>NWI – Principle 9: Capping Developer Charges (Urban Water Tariffs)</b>	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> </ul>
<b>NWI – Principle 10: Revenue from Developer Charges (Urban Water Tariffs)</b>	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> </ul>
<b>NWI – Principle 1: Capital Expenditure Recovery</b>	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>
<b>NWI – Principle 7: Differential water charges (Urban Water Tariffs)</b>	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>
<b>ESCOSA – Principle 1:</b> Where a service is provided for the sole benefit of the recipient, the beneficiary should pay the full efficient cost of the service, and other consumers should not be required to contribute to the cost of the service	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>
<b>ESCOSA – Principle 2:</b> Where a service is provided to a distinct group of customers (e.g. trade waste audits are provided to trade waste customers only), prices to a customer should reflect the cost of supplying the service to the customer and a reasonable allocation of the fixed costs of providing the service, where relevant	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>
<b>ESCOSA – Principle 3:</b> Prices should reflect the efficient cost of the particular service provided, although in circumstances where the cost of implementing differentiated prices to different customers is likely to outweigh the benefits, non-differentiated prices can be implemented	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>
<b>ESCOSA – Principle 4:</b> SA Water must, at the request of a customer, provide credible, evidence-based and transparent information as to how the costs and prices for excluded retail services have been calculated, derived and applied.	<ul style="list-style-type: none"> <li>• <i>Developer Contribution Framework</i></li> <li>• <i>Excluded Retail Services</i></li> </ul>

The following provides an explanation of how charges relating to **Excluded Retail Services** comply with the relevant pricing principles outlined above.

Other pricing policy statements are available from SA Water’s corporate website ([sawater.com.au](http://sawater.com.au)).

### NWI Principle 1: Capital Expenditure Recovery

For new or replacement assets, charges will be set to achieve full cost recovery of capital expenditures (net of transparent deductions/offsets for contributed assets and developer charges and transparent community service obligations) through either:

- a) Return of capital (depreciation of the RAB) and return on capital (generally calculated as rate of return on the depreciated RAB); or
- b) Renewals annuity and a return on capital (calculated as a rate of return on an undepreciated asset base (ORC)).

In contrast to regulated retail services which normally require significant levels of capital expenditure to deliver services, excluded retail services are generally activities where SA Water employs a smaller number of assets to deliver the service to fewer customers.

While it is the approach of SA Water to recover the direct and indirect costs (including an allowance for overheads) of providing an excluded service, for simplicity, charges for depreciation and rate of return may be replaced with a 'profit margin' or 'cost-plus' approach which seeks to earn a fair and reasonable profit margin, having regard to the particular market circumstances faced by SA Water in providing the service. This approach is applied as follows:

#### COST-PLUS APPROACH

**Cost of Service (fee) = Direct cost + Indirect cost + Profit Margin**

**Where:**

**Direct cost** = costs that can be directly associated with providing a services e.g. labour (including on costs), transport, materials and contractor costs

**Indirect cost** = corporate overhead + local overhead

**Profit Margin** = consistent with regulatory rate of return used in the ESCOSA Regulatory Determination

The main principles behind the cost-plus approach for non-regulated or excluded services are:

- Where the excluded retail service will benefit individual customers, is likely to be infrequent and/or is administrative in nature, SA Water will raise the charge at the time the service is delivered (based on the cost of the service as incurred at the time of delivery). An example is a water connection where it is only a single customer who benefits from the one-off service. The customer should fund the capital investment through charges at the time of connection.
- Significant work associated with the direct cost of an excluded retail service (i.e. meter installation) in a metropolitan area will be outsourced to a third party contractor and is subject to a competitive tendering process.
- Some fees and charges provide broad benefit to SA Water and full cost recovery is not a priority. For example, charges to remove meters are below cost of provision to encourage customers to remove unused meters.

### **NWI Principle 7: Differential water charges (Urban Water Tariffs)**

Water charges should be differentiated by the cost of servicing different customers (for example, on the basis of location and service standards) where there are benefits in doing so and where it can be shown that these benefits outweigh the costs of identifying differences and the equity advantages of alternatives.

Note: Differential pricing may be achieved by upfront contributions, including developer charges.

### **ESCOSA Additional Principle # 1**

Where a service is provided for the sole benefit of the recipient, the beneficiary should pay the full efficient cost of the service, and other consumers should not be required to contribute to the cost of the service.

Consistent with both principles SA Water is sensitive to the economic basis of applying differential charges to customers where there are benefits to the customer and SA Water from doing so. For excluded retail services SA Water seeks to ensure that the full and efficient costs of service provision are met only from the beneficiaries of the service.

SA Water periodically undertakes comprehensive reviews of the costs to provide the various services. Where the fee or charge is no longer reflective of the underlying costs, SA Water seeks to move towards recovery of the efficient cost in a structured way that manages the impact on all customers.

When determining the cost of some excluded services, for simplicity it may be necessary to utilise average costs. This approach recognises that where the activity is high volume/low cost with low variation between individual jobs a standard charge best applies. In contrast, where volumes are low/cost is high and variation between jobs are also high, charges based on an individual estimate of the job best applies.

By way of example, SA Water's Connections Policy differentiates between standard and non-standard connections (for both water and sewerage connections). A connection will be deemed non-standard and the customer will be required to pay all of the additional construction costs if difficult construction conditions exist, such as existing services in the construction path, underground water, trees, rock or requirements for traffic management etc.

### **ESCOSA Additional Principle # 2**

Where a service is provided to a distinct group of customers (e.g. trade waste audits are provided to trade waste customers only), prices to a customer should reflect the incremental cost of supplying the service to the customer, and a reasonable allocation of the fixed costs of providing the service, where relevant.

As discussed under ESCOSA Additional Principle # 1, excluded retail service charges are recovered employing a cost-plus approach which ensures the incremental costs (direct cost) and fixed costs (e.g. overhead type costs) are charged to customers.

### **ESCOSA Additional Principle # 3**

Prices should reflect the efficient cost of the particular service provided, although in circumstances where the cost of implementing differentiated prices to different customers is likely to outweigh the benefits, non-differentiated prices can be implemented.

We note that the issues raised in this principle are materially the same as:

- NWI Principle 7: Differential water charges (Urban Water Tariffs) with regard to the need for charges to be differentiated; and
- ESCOSA Additional Principle # 1 with regard to the need for prices to reflect efficient costs.

To demonstrate how charges for excluded retail services meet this principle, we refer you to the above discussions under these respective principles.

### **ESCOSA Additional Principle # 4**

SA Water must be able to provide transparent information to customers on how the costs for these services have been calculated, or are to be applied, and must be able to support its position in the event of a dispute.

SA Water sets out prices clearly for customers using a variety of mediums which include information/fact sheets, publishing prices on the Corporation's web-site and in the Government Gazette. Customers are also provided with relevant price information on request.

Fact sheets provide information on SA Water's overarching policies and more specific information on individual charges as appropriate.

Where SA Water charges are based on the estimated cost of the work the customer will be provided with information outlining the basis of the estimation.

As stated above, SA Water has a clear and reproducible methodology for ascertaining costs and charges. SA Water is able to produce the workings to demonstrate how these have been derived.