

Review of South Australian Electricity Licensing Framework

LGA Submission

February 2022

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Introduction

The Local Government Association of SA (LGA) welcomes the opportunity to have input into the State Government's 'Review of South Australian Electricity Licensing Framework' (the Review).

The Review examines the costs, benefits and opportunities of the current regulatory regime for Electricity Act licensees. The Consultation Paper for the Review, available through the *YourSAy* website, provides¹:

"Licensing seeks to address different types of risks that have the potential to negatively impact consumers, industry, the community, and the environment. The balance of advantages and disadvantages of the licensing of electricity entities depends on the risks being targeted and how cost-effective the licensing framework is at addressing these risks."

The LGA's submission is focused on one aspect of SA's Electricity Act licensing framework, namely the prohibition on councils charging fair rates on land used for the generation of electricity (the Rates Prohibition Clauses). The Rates Prohibition Clauses are contained in a number of regulatory instruments including:

- Clause 3 of Schedule 1 of the *Electricity Corporations (Restructuring and Disposal) Act 1999* (the 'ECRD Act').
- Proclamations made pursuant to the ECRD Act; and
- The Valuation of Land Regulations 2000, particularly in Regulation 10, which prevents the taking into account the value of electricity generation plant and equipment, in assessing the capital value of a parcel of land.

Clause 3 of Schedule 1 specifically refers to Electricity Act licensees and, as understood by the LGA, this section *only* applies to bodies licensed pursuant to the *Electricity Act (SA) 1996*.

The Consultation Paper seeks stakeholder views, "*preferably backed by evidence*"² on the following:

- observed strengths and weaknesses of the current electricity licensing regime.
- observed costs and benefits of the current electricity licensing regime.
- whether the current electricity licensing regime is achieving its objectives.
- how well the current electricity licensing regime interacts with the NEM.

The LGA's submission will respond to the first three of these dot points, insofar as they relate to the Rates Prohibition Clauses.

¹ Consultation paper, page 16.

² Consultation paper, page 5.

Discussion

The Electricity Corporations (Restructuring and Disposal) Act 1999

The ECRD Act was introduced during a period when the South Australian government was privatising the state's electricity generation and transmission assets.

As the LGA understands the circumstances, a major aim of the Rates Prohibition Clauses was to enhance the value of these assets to prospective buyers; in this case by holding out the offer of future discounted council rates.

The Rates Prohibition Clauses have the following effect:

- When calculating the value of land, they prevent the consideration of electricity generating plant. This reduces the capital value of the land and thereby reduces the council rates that can be levied for that land.
- They also enable the Governor to make proclamations to reduce (and only reduce) council rates on land used for electricity generation. Once one of these proclamations has been made to reduce council rates, it cannot be revoked. The Governor made proclamations to this effect shortly after commencement of the ECRD Act in 2000.

Most land in South Australia is rated on the basis of the capital value of the land. Much electricity plant is situated on land where the unimproved value is low.

As a result of the Rates Prohibition Clauses, councils cannot levy fair rates on land used for electricity generation.

Council must nevertheless provide services (eg roads, other infrastructure) in respect of the land and the people who work on this land. Those costs are borne by other rate payers in the community, who are effectively cross-subsidising electricity generators.

As noted above, the Rates Prohibition Clauses were an attempt to increase the sale value of State Government assets, by reducing future income to the local government sector. As we set out below, this policy aim was likely misconceived. Independent research demonstrates that electricity generation investment decisions are primarily based upon:

- Proximity to sources of energy; and
- Access to the national electricity grid.

Council rates form a negligible component of the costs of electricity generation companies. The Rates Prohibition Clauses were unlikely to have been a compelling factor in any decision to purchase electricity assets.

The Rates Prohibition Clauses do not advance any principle, pursue a policy objective, solve any problem or address any market failure. In the absence of any identifiable reason for their continuance, the Rates Prohibition Clauses should be repealed.

AEC Group Research

The LGA and the Legatus Group³ of councils commissioned research from the respected, independent AEC Group. The AEC Group specialise in economic and other research in the regional development, resources, planning and development sectors.

The resulting AEC Group Report, *'Rating Equity in SA and the Financial Impacts on Local Government's Ability to Support Growth'*⁴, found:

- SA Council rates account for less than 0.1% of infrastructure lifecycle costs of electricity generators. Council rates are a marginal component of the costs of these businesses.
- Over the past decade, there has been significant investment in new energy generation in Australia. This investment has taken place in States where electricity generators pay full council rates and in South Australia, where they don't.
- Energy investment location decisions are primarily made in consideration of electricity generation efficiencies (access to wind, sun, fossil fuels) and the ease with which connection can be made to the national grid.
- Energy companies sell power into the national grid. Because of the nature of the national energy market, each generator is a price taker. If their costs (such as the cost of council rates) increase, energy generator companies are unable to pass these costs on to consumers.
- The Rates Prohibition Clauses do not enable councils to recoup their expenditure on servicing electricity generators - either during the construction phase or on an ongoing basis. These costs are borne by other ratepayers and have a distorting effect on markets and local economies.
- SA councils are significantly disadvantaged in their ability to rate, compared with their interstate counterparts, particularly in Victoria and Queensland.
- The introduction in SA of similar rating practices to Victoria will not impact the commercial viability of energy sector projects, and therefore will not influence location decisions for investments in such projects. The introduction on this Victorian legislative approach would promote consistency between Australian jurisdictions.
- If councils were able to collect fair rates, they would have a choice:
 - Councils could provide additional services to communities. The AEC Group research found that, if all additional rates revenue was spent by councils, up to 43 FTE jobs could be created, most of them in regional South Australia. This would have a multiplier effect through local economies.
 - Alternatively, councils could use the additional revenue to reduce the rates burden currently imposed on other business and residential ratepayers. This reduction in the rates/tax burden on those ratepayers could also have a small stimulatory effect on local communities.

A copy of the AEC Group Report is attached to this LGA Submission.

³ The Legatus Group is the trading name of the Central Local Government Region which is a regional subsidiary established under the Local Government Act 1999 (SA).

⁴ AEC Group Ltd, February 2020.

The nature of council rates

Council rates are based on equity, they are not a fee for specific services.

Federal, state and local tiers of government in Australia operate on the principle that all citizens make an equitable contribution to the costs of running their government. Not all citizens use all services such as public libraries, playgrounds or jetties and they are unlikely to travel over every local road or bridge. Citizens contribute to the costs of all government services, even if they do not use those services.

By contrast, all ratepayers contribute to the overheads of government that are not attributable to a particular service (eg administration costs, salaries, asset depreciation, etc).

The community elect representatives to make decisions about how funds are raised and how expenditure is prioritised.

The sections of the Local Government Act regulating council rates are primarily premised upon the principle that specific groups of ratepayers should not be singled out by councils for favourable or unfavourable treatment. The range of criteria upon which councils can set differential rates have been limited by Parliament, to prevent this occurring.

The preferential treatment given to electricity generators transgresses the principles of equitable treatment and objective fairness upon which local government's statutory scheme is based.

Local Democracy

Local government is one of the three tiers of Australian governments. This tier of government is established to facilitate local decision making at the local level.

Importantly, it is the democratically elected members of local councils who are entrusted by legislation with the role of determining the service needs of communities and the funds needed to pay for those services. These elected members are accountable to the voters and are likely to not be returned to office if they fail to meet the expectations of their community.

Through the Rates Prohibition Clauses, the State Parliament has implemented legislative provisions that impact councils ability to raise revenue , in relation to the rates payable by Electricity Act licences. As a result, the powers of local communities to determine the financing of their councils, are correspondingly curtailed.

Whilst the State Parliament technically has the power to enact such a law, the LGA submits that it is inappropriate to do so.

The LGA further submits that if the State Government wishes to subsidise or provide industry protection to any organisation or industry sector, it should use State Government funds to do so.

Modernising the Electricity Act

The Consultation Paper notes that the Electricity Act 1996 and ECRD Act 1999 were enacted at times where technology and electricity market arrangements were very different.

In particular, since the passage of these Acts, the electricity generation market in SA has changed substantially.

In the 1990's, most electricity generators were fossil fuel-based and publicly owned. Today, there are a significant number of new entrants to the market. The new licensees overwhelmingly generate electricity from renewable sources and are owned by interstate or overseas-based private companies.

In 1999, the impact to council revenue of the Rates Prohibition Clauses was small. Today it is substantial.

In 1999, there was a policy basis for the Rates Prohibition Clause (albeit the LGA argues this was misconceived -see above). Today, there is no identifiable policy objective achieved through these clauses.

The LGA supports modernising the regulatory regime for Electricity Act licensees.

Principles of Regulation making

The Council of Australian Governments (COAG) have approved a series of 'Best Practice Regulation Principles'⁵. These COAG principles, in turn, have been adopted by the South Australian Government⁶.

The Rates Prohibition Clauses transgress the COAG/State Government regulation principles, as set out in the table below.

State Government-approved Regulatory Principle	Impact of the Rates Prohibition Clauses.
Establish a case for action before addressing a problem.	The Clauses were introduced for the purpose of facilitating the privatisation of SA's electricity assets. However (for the reasons set out in this submission), the Clauses are unlikely to have facilitated this outcome. It is unclear whether any evaluation was made of the effectiveness of these clauses, after the privatisation period was complete.
Adopting the option that generates the greatest net benefit for the community	The Clauses benefit the shareholders of a small number of Electricity Act licensees, most of whose head offices and shareholders are located in other Australian states or overseas. These licensees have enjoyed a twenty-year discount on their council rates, compared with other ratepayers. The mere existence of such an anomaly is not a justification for its continuance. The Clauses require other South Australian residential and business ratepayers to pay disproportionately increased council rates, to make up this shortfall. The LGA submits that this additional tax burden is unnecessary and represents a net cost to the SA community and economy and further results in a worse outcome than if the Clauses were repealed.
Ensuring that regulation remains relevant and effective over time	The purported object of the Clauses (to facilitate privatisation of electricity assets) is no longer relevant. The AEC Group research demonstrates that the Clauses have a negligible impact on the location of new electricity generation investment. There is no identifiable public policy objective served by the Clauses.

⁵ Principles of best practice regulation | Department of the Prime Minister and Cabinet (pmc.gov.au)

⁶ <https://www.dpc.sa.gov.au/documents/rendition/B18801>

State Government-approved Regulatory Principle	Impact of the Rates Prohibition Clauses.
Government action should be effective and proportional to the issue being addressed	The Clauses are not at all effective in furthering a valid policy objective. The Clauses do not facilitate the privatisation of government electricity assets and they do not (according to the AEC Group research) promote electricity generation investment in SA. By contrast, the costs to councils are considerable. Councils forgo \$4.8 million per annum⁷ in rates from electricity generators (which, if collected could result in a reduction of rates charged to other ratepayers). The costs of the Clauses are disproportionate, compared with the benefits (if there are any).

The LGA accepts that State or Federal Governments should pursue policies in relation to power generation and may have legitimate preferences as to the form of power generation that is preferred and/or subsidised.

In the absence of agreement with the local government sector, the LGA opposes the use of council rates as a policy lever to pursue state or federal government power generation policies.

The ESCOSA Objects

The Consultation Paper sets out the objects of the Essential Services Commission, as prescribed in the section 6 of the *Essential Services Commission Act 2002* (the ESC Act). For the purposes of this LGA submission, it assumed that these ESC Act objects will underpin the Review.

The inclusion of the ESCOSA objects in the Consultation paper further demonstrate that this LGA submission and recommendations are squarely within the scope of this Review.

These 'Objects' are set out below, together with the LGA's commentary on how the Objects are furthered by the Rates Prohibition Clauses.

ESC Act Objects (Section 6, ESC Act)	LGA response on the impact of Rates Prohibition Clauses.
Promote competitive and fair market conduct.	The Clauses provide a cost advantage to Electricity Act licensees at the expense of other SA businesses. Most new electricity generation plant in SA is in the form of wind or solar power. These plants require relatively few employees to operate and maintain. This market intervention by the State Government distorts markets, by favouring low-employment businesses at the expense of other business who could otherwise create additional jobs.

⁷ Compared with the rates payable by electricity generators based in Vicotria, who pay council rates based upon a statutory formula based on Kilowatt hours generated.

ESC Act Objects (Section 6, ESC Act)	LGA response on the impact of Rates Prohibition Clauses.
Prevent misuse of monopoly or market power.	There are a large number of electricity generators in Australia, supplying their product into a national market. Individual generators are price-takers and are not able to pass on increased costs (eg because of an increase in rates) to consumers. As a consequence, if the Clauses were repealed, the rates costs would be born entirely by shareholders of Electricity Act licensees. Repeal of the Clauses would not reduce market entrants or increase market power of existing Electricity Act licensees.
Facilitate entry into relevant markets.	The AEC Group Report demonstrates that: • electricity generation investment decisions are driven by proximity to power sources and access to the national grid; and • The costs of council rates are a negligible component of the infrastructure lifecycle costs of electricity generators. Repeal of the Clauses would have no impact on access to relevant markets, including access by potential new entrants to these markets.
Promote economic efficiency.	Economic efficiency would be enhanced if all business ratepayers in each council area faced consistent rating arrangements. Discounts for one industry sector increases costs to other industries and distorts efficient market outcomes.
Ensure consumers benefit from competition and efficiency.	The Clauses do not promote competition nor efficiency within the SA electricity generation market.
Facilitate maintenance of the financial viability of regulated entities and the incentive for long-term investment.	The AEC Group Report demonstrates that council rates are a negligible part of operational costs of electricity generators and do not inform decisions about where to invest in new generating plant. The past decade has seen growth in the number of market entrants in this industry, indicating there are sufficient incentives for long-term investment.
Promote consistency in regulation with other jurisdictions.	In other Australian States, councils are able, through a range of differing formula, to collect council rates that are not overly disproportionate to other businesses⁸. Repeal of the Rates Prohibition Clauses would promote consistency between the States.

In summary, the Rates Prohibition Clauses clearly transgress many of the Objects of the ESC Act.

⁸ For example, in Victoria, a regulated formula based upon kilowatt hours produced, results in electricity generators paying council rates approximating the rates paid by other Victorian business ratepayers. See section 94, Electricity Industry Act 2000 (Vic).

Summary

The LGA's concerns about the Rates Prohibition Clauses are clearly within the scope of the issues raised in the Review and the Consultation Paper. The LGA therefore requests that the Department of Energy and Mines engage with the issues raised in this submission and made recommendations for change.

The LGA concludes by addressing three (of the four) dot points set out at the beginning of this paper, by reference to the Rates Prohibition Clauses.

1. Observed strengths and weaknesses of the current electricity licensing regime

The Rates Prohibition Clauses effectively provide a subsidy to Electricity Act licensees. The State Government has used its powers to require another tier of government to reduce the revenue it would otherwise obtain from these licensees.

State Government policy objectives should be pursued with State Government funds. Even if this legislation served a valid policy objective, the LGA would not support such an arrangement that reduced council revenue, unless agreement had been reached with the LGA or the impacted councils.

The Clauses provide a financial benefit to one sector of the economy at the expense of all other industry sectors, who must pay proportionately higher council rates.

2. Observed costs and benefits of the current electricity licensing regime

Electricity Act licensees cannot pass on the benefit of reduced council rates to the consumers of electricity. The Rates Prohibition Clauses only provide a benefit to the shareholders of Electricity Act licensees.

The Clauses compel the local government sector to forgo \$4.8 million in revenue each year. If councils could levy rates fairly on Electricity Act licensees, they could reduce the rates levied upon other ratepayers.

3. Whether the current electricity licensing regime is achieving its objectives

As the LGA understands it, the Rates Prohibition Clauses were enacted on the mistaken premise that the costs of council rates were a relevant factor in electricity generation investment decisions. In any event, the privatisation policy objective is no longer relevant. The clauses no longer further any public policy objective. The AEC Group research also demonstrates that council rates are not a factor in the location of future energy investment decisions.

LGA Recommendations

Based upon the research, information and arguments set out in this submission, the LGA recommends:

1. If the State Government wishes to continue to subsidise energy generation companies (or any other sector of the economy) it should:
 - a. Have a sound and transparent policy basis for doing so; and
 - b. Use its own funds to provide the subsidy.
2. The State Government should repeal or amend the Rates Prohibition Clauses and any other laws or regulatory instrument which have the effect of curtailing the ability of councils to levy rates on Electricity Act licensees.
3. The State Government should consider adopting the Victorian approach for rating licensees.

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