



ACT
Government

**ACT Government Submission to the Independent Competition and
Regulatory Commission's Water and Sewerage Tariff Review**

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Introduction

The following Submission is provided by the ACT Government in relation to the Independent Competition and Regulatory Commission's (Commission's) *Draft Report – Tariff Review 2016: Regulated Water and Sewerage Services* (referred to as the Draft Report or the Tariff Review).

Overarching Government Comments

The Government thanks the Commission for undertaking the Tariff Review and the substantial analysis that has been involved. The Government acknowledges the current tariff structure for water and sewerage prices has served the ACT well, but the environment has changed significantly as a result of the substantial increase in water security that has been achieved in the Territory. Therefore, it is timely to review the ongoing appropriateness of the tariff structure, in advance of the next major pricing investigation for water and sewerage services due to commence in early 2017. The Government appreciates the release of a draft report of this kind provides an important opportunity for consultation about the Commission's draft conclusions at this stage.

The Government considers the proposed tariff reform outcomes identified in the Draft Report do not achieve an appropriate balance between the need for increased economic efficiency, and the potential adverse social and environmental impacts that may result from the proposed reforms.

The Government considers that the response of Canberrans to water saving and efficient water use measures has been positive. When taken with infrastructure investments such as the Cotter Dam, this community response has improved the water security of the ACT. The Government does not support perverse incentives that would see the use of greater amounts of potable water, to the environmental cost of the Territory, and with a significantly greater water tariff impost on around 75 per cent of households.

In particular, the Government notes that even with the transitional approach outlined, the proposed tariff reforms would result in substantial continuous real increases in water bills for most ACT households over that period. Conversely, it would see major commercial water users, who despite being around 2 per cent of users use around 25 per cent of potable water, record significant reductions in their water bills.

In summary, key matters about which the Government holds significant concerns are:

- the significant impact the proposed water tariff structure would have on the costs associated with water use for low volume users (both household and commercial) and vulnerable ACT residents, even after taking into account the assistance the transition period will provide in managing this impact;
- the impact the proposed water tariff structure would have on the ongoing implementation of ACT Government water policies, in particular those that promote ongoing water conservation and efficient use of water in the Territory;
- the need for the Commission to clearly demonstrate that an appropriate balance has been achieved between its competing regulatory objectives within its decision-making process for the Tariff Review;

- ensuring consistency can be achieved between the decision-making framework utilised within the Tariff Review and that which will govern decisions made in the upcoming water and sewerage pricing investigation;
- the overriding focus on developing a water tariff structure that best fulfills the economic efficiency objective, without detailed commentary and analysis being provided about the environmental and social implications for the community from the proposed changes; and
- the stated preference for Icon Water to take responsibility for directly setting prices for water and sewerage services, under a revenue cap administered by the Commission, during the transitional period for implementing water tariff reforms.

The Government acknowledges the proposed changes are designed to improve the economic efficiency of the water tariff structure. The Government is supportive of a measured approach to water tariff reform that balances the pursuit of increased economic efficiency with social and environmental considerations, including the need to manage carefully the ongoing impact of tariff reforms on water consumers.

The Government supports the proposal to maintain the current sewerage tariff structure, given the absence of a viable mechanism that would capture a reliable measurement of volumetric sewerage, which would be critical for implementing a tariff structure for sewerage incorporating a volumetric component.

Regulatory Objectives of the ICRC Act

Under section 7 of the *Independent Competition and Regulatory Commission Act 1997* (the ICRC Act), the Commission has three major objectives in relation to the regulation of industries. The relevant objective to the Tariff Review is contained in section 7(b), being:

“to facilitate an appropriate balance between efficiency and environmental and social considerations”.

In the case of undertaking a process to determine a price direction, the objective of the Commission is established by section 19L of the ICRC Act, which outlines the Commission’s objective when making a price direction is to promote economic efficiency in the long-term interests of consumers, and Section 20(2), which outlines key matters the Commission must have regard to when determining prices in a regulated industry.

The Government recognises the challenges for the Commission in balancing these various objectives, in particular when undertaking a process such as the Tariff Review, which is occurring outside of a broader pricing investigation. The Draft Report clearly outlines the analysis undertaken by the Commission to comprehensively consider the economic efficiency of various tariff structure options.

However, the Government considers the Commission has not demonstrated the same level of consideration and analysis about the environmental and social impacts associated with tariff reform has occurred, as is required to fulfill the broader objective of the Commission. The Government urges the Commission, before finalising any decision in relation to the future water tariff structure, to undertake detailed consideration of the environmental and social implications of the alternative water tariff structure proposals.

As the outcomes of the Tariff Review will be implemented as part of future price directions, the Government considers it would be beneficial for the Commission to demonstrate how the issues the Commission must consider under section 20(2) of the ICRC Act would be impacted by the proposed water tariff structure within its final report of the Tariff Review. Including such discussion will help demonstrate consistency in decision making between the Tariff Review and the upcoming water and sewerage pricing investigation.

As the upcoming pricing investigation for water and sewerage prices will be the first conducted under the new ICRC Act (since the amended Act became effective on 1 July 2016), the Government considers it would be appropriate for the Commission to develop a paper that outlines high level principles about how it intends to prioritise and balance within its decision making process the regulatory objectives of section 7 of the ICRC Act, the price directions objective in section 19L of the ICRC Act and the matters to which the Commission must have regard listed in section 20(2).

The Queensland Competition Authority in 2013 undertook consultation with the community on how to balance a range of regulatory objectives under its relevant Act when undertaking its decision-making process, and subsequently published a [*Statement of Regulatory Pricing Principles*](#)¹ to guide its decision-making process. The Government considers there would be merit in the Commission undertaking a similar process, in consultation with key stakeholders, as part of the initial stages of the review of water and sewerages prices in early 2017. Such an approach was also raised as a possibility within Conclusion 5.9 of the Grant Review of the Water and Sewerage Framework.

Environmental Impacts - Water Policy Context

The Government considers the proposed water tariff structure is inconsistent with the broader water policy objectives in the Territory, in particular those outlined within the ACT Water Strategy. The Government also considers the proposed tariff reforms may impact on the ability of the ACT Government to fulfill its commitments under the National Water Initiative (NWI) and the Murray-Darling Basin Plan.

The ACT Water Strategy

The Draft Report does not refer to the ACT's main water policy framework, the *ACT Water Strategy - Striking the Balance 2014-2044* (the Strategy). The Strategy forms the Government's agreed context for water planning and management, and outlines three key outcomes sought to be achieved, being:

- **Outcome 1:** Healthy catchments and water bodies - Well-managed, functioning aquatic ecosystems that protect ecological values and contribute to the liveability of the ACT community;
- **Outcome 2:** A sustainable water supply used efficiently - An integrated and efficient water supply system that provides for the optimal mix of supply options, encourages efficient use of water and is resilient to climate variability; and

¹ Available at: [http://www.qca.org.au/getattachment/239b5385-ad9f-4717-8fce-ec437111dbc6/Statement-of-Regulatory-Pricing-Principles-\(Aug-20.aspx](http://www.qca.org.au/getattachment/239b5385-ad9f-4717-8fce-ec437111dbc6/Statement-of-Regulatory-Pricing-Principles-(Aug-20.aspx)

- **Outcome 3:** A community that values and enjoys clean, healthy catchments
 - Government working with the community to continue to use water efficiently, and to ensure safe, clean water for recreation and the environment.

The Strategy also incorporates a target of a 25 per cent reduction in per capita water use by 2023, compared with 2003 pre-drought levels. While this target is currently being met, a substantial reduction in volumetric water prices may place the ongoing achievement of this target at risk.

The Government considers the inclusion of analysis about the interaction of the proposed tariff reforms with the outcomes and aims of the Strategy in the final report of the Tariff Review would be useful, in particular in light of the Commission's objective under section 7(b) of the ICRC Act.

The Government considers the proposed tariff structure may lead to outcomes that would conflict with key Government actions committed to within the Strategy. In particular, while it is acknowledged the Territory has achieved water security at the current time, the application of the precautionary principle would suggest that sustainable consumption, in line with long term water security requires continued application of price discipline. The relaxing of price signals associated with responsible consumption would increase risks associated with achieving longer term water security.

The Government is also concerned that the significant decrease in volumetric prices may encourage a substantial increase in potable water use by large users, for purposes such as irrigation, or as a substitute for non-potable water use. Such an increase would be inconsistent with the environmental objectives outlined within the Strategy, which aim to increase the resilience of the water supply through reducing reliance on potable water in circumstances where non-potable water is a viable alternative supply option.

The National Water Initiative (NWI)

The NWI seeks to balance several competing objectives in regards to the use of water. Clause 23 of the NWI seeks to achieve a nationally consistent regulatory and planning based approach to managing surface and groundwater resources for rural and urban use, to optimise economic, social and environmental outcomes. Clause 64 of the NWI seeks to achieve best practice pricing outcomes that promote the efficient use of water, while avoiding perverse or unintended outcomes. A water tariff structure such as that proposed by the Commission could be considered inconsistent with the intent of the NWI and the Territory's obligations under this agreement, as it may produce perverse incentives in relation to consumption of potable water.

Increasing the cost of potable water to low income or fixed income customers who have constraints on their capacity to pay, and providing incentives for increased discretionary consumption by large users could be considered inconsistent with the NWI objectives, and not in line with an approach aimed at achieving ecologically sustainable development and a balanced approach to sustainability.

The Murray-Darling Basin Plan and the Sustainable Diversion Limit (SDL)

Under the Murray-Darling Basin Plan, the ACT will be required to adhere to a net SDL of 42.5 gigalitres per year. Current ACT net consumption is less than 50 per cent of this limit. However, the risk associated with implementing a pricing structure that would

provide significant incentives for increased consumption is that the Territory will see a substantial increase in gross abstractions, which will lead to a significant reduction in the net surplus against the SDL. Given the significant population growth expected over the next several decades in the Territory, if consumption levels were to return to levels such as those recorded in the early 2000s, there would be a long-term impact on the Government's capacity to fulfill its obligations under the Murray-Darling Basin Plan.

In addition, the Government considers there is significant additional value that arises from the Territory not reaching the SDL and having a significant volume of water available in its water storage, for instance by maintaining the opportunity to potentially trade water downstream (including for environmental benefits). The additional benefits from having a plentiful supply of water should be taken into account when balancing the costs and benefits associated with the proposed water tariff structure.

Impact of the Proposed Tariff Structure on the ACT Community

The Government notes the benefits that would accrue from improving the economic efficiency of the potable water tariff structure, and the benefits for Icon Water under the revised tariff structure in regards to increased revenue stability and certainty. The Government is supportive of a measured shift to implement a more economically efficient water tariff structure.

The Government however is concerned about the significant increase in water bills that would occur for most households in the Territory. In particular, the Government is concerned about the impact on low volume households, a group which is likely to incorporate a significant proportion of vulnerable and low income households, who will face substantially increased bills without receiving any apparent benefits from tariff reform. The Government considers a greater focus is required on considering the social impacts associated with tariff reform, so that a balance can be achieved between the benefits of increased economic efficiency and the costs associated with the social impact of the changes.

In addition, the Government notes the requirements created for the Commission, as a public authority, by the *Human Rights Act 2004* (the HR Act). In particular, the HR Act requires the Commission to make decisions that are compatible with human rights. The Government considers it would be beneficial if the Commission, within its final report includes detail that demonstrates an assessment of the consistency of the proposed tariff reforms with the requirements of the HR Act has been undertaken.

The Government is committed to ensuring affordable access to the essential service that is potable water, in particular to non-discretionary levels of consumption. Under the tariff structure options proposed in the Draft Report, the 75 per cent of ACT households that use less than 300 Kilolitres per annum would face higher water bills following the transition to the new structure.² As demonstrated in Table 1 below, the impact on the average household would be significant, both in the case of standalone residential properties and units/flats.

² Based on 2013-14 data.

While an extended transitional period would help to manage the impacts of a shift to a revised tariff structure, as demonstrated in Table 1 below, the annualised real increase for most households is still likely to be significant. This increase is before taking into account any additional growth in prices that will occur due to the impact of inflation, or changes in the overall revenue requirement for Icon Water, which may place additional upwards pressure on prices across the transitional period.

Table 1: Current vs. Alternative Tariff Structure^{3,4}

Annual Water Consumption (Kilolitres)	Type of User	Tariff Structure	Annual Water Bill in year 1	Annual Water Bill in year 10	Change in Water Bill (From current to year 10 - in real terms)
134	Estimated average residential unit	Current	\$451		
		Option A	\$475	\$843	87% (Annualised 6.5%)
		Option B	\$469	\$740	64% (Annualised 5.1%)
218	Estimated average standalone house	Current	\$718		
		Option A	\$738	\$989	38% (Annualised 3.3%)
		Option B	\$733	\$959	34% (Annualised 3.0%)
300	Approximate usage level where bills are unchanged	Current	\$1,147		
		Option A	\$1,149	\$1,132	-1% (Annualised -0.1%)
		Option B	\$1,149	\$1,173	2% (Annualised 0.2%)
400	Large Residential User or Medium Size Commercial User	Current	\$1,671		
		Option A	\$1,651	\$1,306	-22% (Annualised -2.5%)
		Option B	\$1,656	\$1,434	-14% (Annualised -1.5%)
1,000	Large Commercial User	Current	\$4,815		
		Option A	\$4,633	\$2,350	-51% (Annualised -6.9%)
		Option B	\$4,698	\$3,000	-38% (Annualised -4.7%)

The Government is also concerned by the potential impact that the proposed changes to the tariff structure would have on low volume commercial users in the Territory. This group is likely to include many small businesses in the Territory. These commercial users would face increased costs of doing business as a result of water tariff reforms.

³ Figures in the table are rounded.

⁴ Calculations of the annual Bill assume the first 200 kilolitres of usage is charged at tier 1 prices.

Specific Comments on the Proposed Water Tariff Structure

Volumetric Pricing Structure

At this time, the Government considers the current water tariff structure, incorporating a two tier volumetric charge with a relatively low fixed charge remains the best approach to achieving the required balance between the competing objectives associated with water pricing. The Government would prefer a continuation of this tariff structure in the next regulatory period.

The Government however supports a transitional period to implement a measured reduction in the volumetric tariffs and a gradual increase in the fixed charge. Such an approach would allow for a moderated shift towards a more economically efficient structure, while reflecting the fact that a certain level of water is essential to human life, and therefore should be priced to ensure all households have reasonable access to it. It would also allow the pricing structure to continue to support broader Government policy objectives, in particular ongoing efforts to promote efficient potable water use.

Under a tariff structure with a single volumetric price, the pricing structure would not provide pricing signals to water users in relation to discretionary and non-discretionary water use. Should the Commission choose to implement a single volumetric tier structure, the Government considers that an alternative approach, such as a drought pricing scheme (with triggers tied to available water levels in the ACT's storage facilities) would be required to ensure potable water pricing can support other water demand management measures such as water restrictions, in times of lower water availability.

Transition Period

The Government supports the Commission's proposal for a ten year transition period for the implementation of any major reforms to the water tariff structure. The Government considers it important that across the transition period, detailed work is undertaken by the Commission to monitor and analyse the distributional impact of the changes to the tariff structure, as well as the impact on water consumption levels in the Territory.

Split between fixed and volumetric charges

The Government acknowledges the proposed tariff structure involves a reconsideration of the split of revenue recovered by Icon Water from fixed and volumetric charges. The Government notes that as a proportion of total revenues, the revenue received by Icon Water from fixed charges is relatively low in comparison to other jurisdictions. The Government therefore considers that a case can be established for change, but not to the extent proposed in the Draft Report.

Given the relatively small customer base upon which Icon Water can recover its costs, the Government considers caution should be taken when rebalancing revenues received from volumetric and fixed charges. The Government does not consider that all costs associated with historical investment should be recovered only through fixed charges, as proposed under a tariff structure in line with Option A of the Draft Report.

The Government considers that it remains reasonable for the volumetric charges to continue to be a vehicle for recovering part of the costs associated with historical investment. While acknowledging such an approach incorporates a loss of economic efficiency, its continuation would help ensure high volume users, who benefit the most

from the significant investment made to increase water security, will contribute a proportionally greater share of the costs associated with that investment.

Potential for a separate commercial tariff structure

The revised tariff structure proposed within the Draft Report would continue the status quo of there being only one tariff structure that applies to both residential and commercial users in the Territory. The Government acknowledges that, when considered through a lens focused on achieving economic efficiency, there is limited rationale for the implementation of different tariff structures for residential and commercial users.

However, the Government considers that, while the marginal costs of providing water to customers may be constant across different users, the benefits that accrue from particular actions, such as the significant investment made into the water security projects, are not necessarily constant across users. While all users in the Territory benefit from the additional water security achieved through the major water security projects investment, higher volume users will ultimately benefit the most, especially in future drought periods when increased water security will significantly reduce the likelihood for the need to implement stage 3 and stage 4 water restrictions.

Available data indicates that around 50 per cent of commercial water customers use over 400 kilolitres per year, which is a level of usage greater than more than 85 per cent of households. Despite representing less than 2 per cent of total customers, these largest commercial users account for almost a quarter of potable water usage in the ACT.⁵ Under the proposed tariff structure, these largest users will be the greatest beneficiaries from the reduction of the volumetric consumption charges.

Given the significant proportion of total water use in the Territory by these large commercial users, and the benefits that accrue to them through increased water security, the Government considers there would be merit in the Commission considering in depth the merits of implementing a different charging structure for large commercial users, potentially incorporating a higher fixed charge. Such an approach would help ensure these users contribute a proportionally greater share of the costs associated with the investment made to deliver increased water security.

Regulatory Price Setting

The Government recognises the potential benefits that may be realised from a shift to a lighter handed approach to regulation. The Government notes the preference stated by the Commission in the Draft Report for Icon Water to take responsibility for the setting of tariff structures and price levels moving forward. The Government considers that a move towards lighter handed regulation, at an appropriate future time, could deliver improved regulatory outcomes and reduce regulatory burden and costs.

The Government however does not support the implementation of this approach at this time. The Government considers a continuation of the current approach, in which the Commission sets both Icon Water's allowed revenue and the prices it can charge to customers, represents the best approach to managing the significant transition that will be required to implement a revised water tariff structure. This approach would provide greater flexibility for the Commission to implement changes during the transition period,

⁵ These estimates are based on 2013-14 usage data.

should unexpected events occur (such as a greater than modelled change in water demand), which necessitate revisions to the transition path.

The Government however remains supportive of a gradual move over the longer term towards lighter handed regulation, as outlined in the Government's Response to the Grant Review of the Water and Sewerage Pricing Framework. However, any move towards lighter handed regulation should only be implemented in the future if detailed analysis of the costs and benefits associated with such a change clearly demonstrate that it would result in a net benefit for the ACT community.

