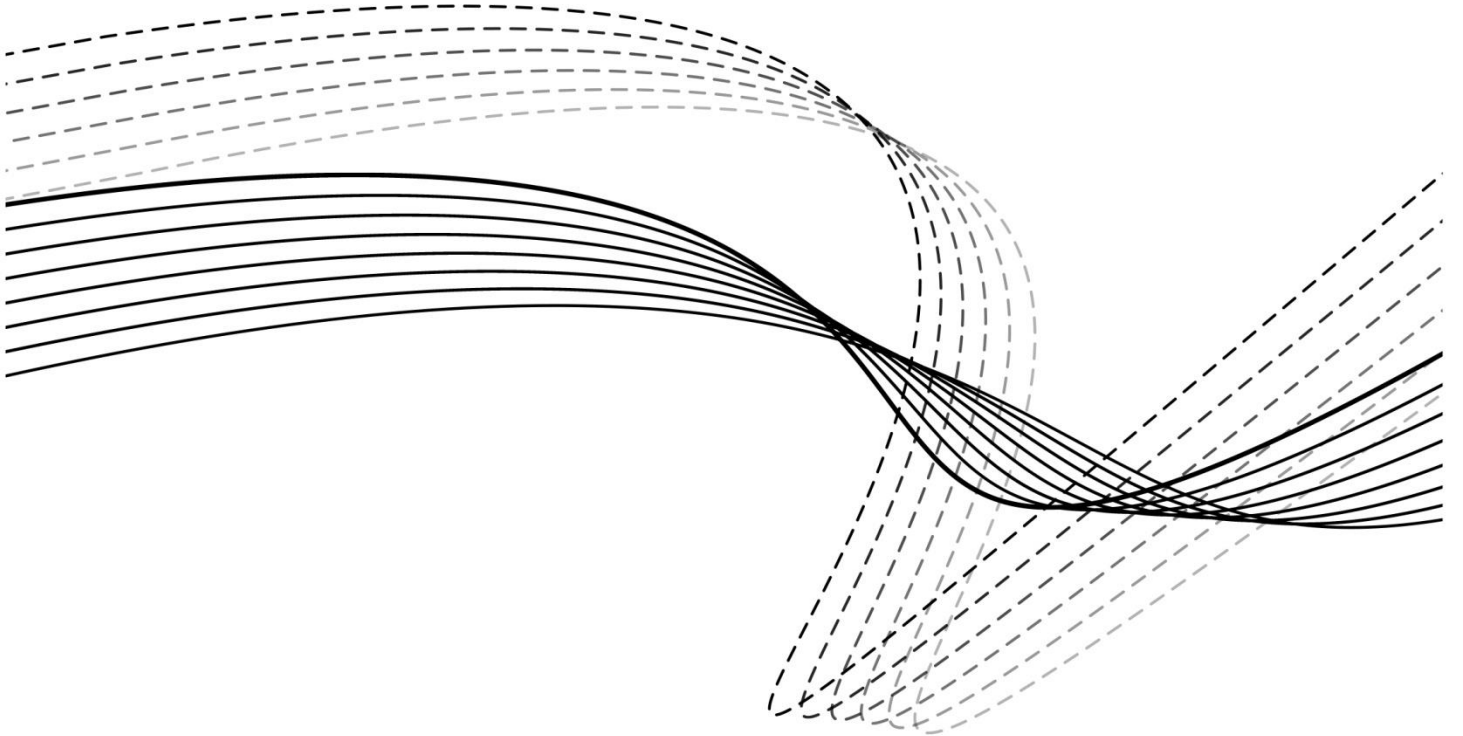


QUEENSLAND TREASURY
DEPARTMENT OF ENERGY AND WATER SUPPLY

Response to the Review of Water Charge Rules Draft Advice

Submission to the Australian Competition and
Consumer Commission

March 2016



1.0 Introduction

1.1 Legislative and Regulatory Context

Queensland Treasury (Treasury) and the Department of Energy and Water Supply (DEWS) welcome the opportunity to provide a submission to the Australian Competition and Consumer Commission (ACCC) on the *Review of Water Charge Rules Draft Advice* (Draft Advice).

Treasury and DEWS present this submission jointly, on the basis of relevant, and in some cases shared, portfolio responsibilities in regard to the pricing and price regulation of water in Queensland. These responsibilities are summarised below:

- The Queensland Treasurer is responsible for issuing referrals to the state's independent economic regulator, the Queensland Competition Authority (QCA) under Section 23 of the *Queensland Competition Authority Act 1997* (the QCA Act);
- Implementation of QCA recommended prices occur via a direction by the Minister for Energy and Water Supply (the Minister) and the Treasurer to SunWater Limited (SunWater) under Section 999 of the *Water Act 2000* (the Water Act (Qld)).

Within the Queensland Government, Treasury and DEWS are responsible for providing policy advice to the Treasurer and Minister respectively on water supply issues in Queensland. The Treasurer and Minister for Energy and Water Supply are also the only shareholders of the Government-owned bulk water supplier SunWater Limited (SunWater) and accordingly DEWS and Treasury support their respective Ministers in their obligations as shareholders under the *Government Owned Corporations Act 1993*.

Treasury and DEWS understand that the Queensland Department of Natural Resources and Mines will also be making a submission. DNRM is responsible for water planning and management and the coordination and management of the Border Rivers Commission. DNRM is the appropriate Queensland agency to comment on these matters. Where matters raised in this submission relate to the portfolio responsibilities of DNRM, reference will be made to DNRM's submission.

1.2 Queensland Water Supply Schemes in the Murray-Darling Basin

The Draft Advice is relevant for the following eight Queensland schemes in the Murray-Darling Basin (MDB) service area (seven bulk water supply schemes and one distribution scheme):

- Chinchilla Weir Bulk Water Supply Scheme;
- Cunnamulla Bulk Water Supply Scheme;
- Macintyre Brook Bulk Water Supply;

- Maranoa River Bulk Water Supply;
- Upper Condamine Bulk Water Supply;
- St. George Bulk Water Supply Scheme Network;
- St. George Distribution Network;
- Border Rivers Water Supply Scheme.

Treasury and DEWS support the review of the Water Charge Rules (Rules) under the *Water Act 2007* (the Water Act (Cwlth)). Treasury and DEWS acknowledge the intent of, and outcomes sought by the ACCC from the Draft Advice. Broadly speaking Treasury and DEWS are supportive of that intent, and specifically the objective to improve the effectiveness of the Rules as part of the regulatory framework for water charges, water trading and water market within the Murray Darling Basin (MDB).

Treasury and DEWS support the proposed amendment to streamline the three sets of rules into one in order to ensure a consistent approach to the regulation of water charges across the MDB. In addition, Treasury and DEWS support the ACCC's recommendation to publish clear and well understood educational and guidance material to assist end users better understand the Rules and their effect.

Furthermore, where practical, Treasury and DEWS are supportive of cooperating with the Australian Government and other Basin States with respect to managing MDB water resources in the national interest including ensuring fit for purpose solutions that are commensurate with market needs. It is noted the proposed amendments aim to better facilitate water trading in the MDB.

Queensland makes up about 25 per cent of the MDB in area, but its volume of MDB water resources represents a much lower proportion of the MDB's volume, and connectivity to the southern MDB is low. The Queensland section of the MDB is characterised by unregulated ephemeral streams with highly variable flows and has a comparatively small amount of publicly-funded water infrastructure. These features make interstate and sometimes intrastate water trade challenging and in certain circumstances uneconomical, with the exception of water trade between the New South Wales and Queensland Border Rivers.

1.3 Treasury and DEWS' consideration of the Draft Advice

Given the physical differences across the Basin which also affect the ability to trade water, any change to the Rules should consider State specific circumstances and policy.

Treasury and DEWS consider the following must be taken into account as part of any change to the Rules;

- Changes to the Rules should be accommodating of pricing, regulatory and industry reforms at the State level, acknowledging the right of States to determine pricing policy and to implement regulatory and industry reforms, consistent with the objectives of the National Water Initiative;
- Changes to the Rules should not leave customers materially worse off compared with similar customers in the rest of the State. The concern in this instance is that such a circumstance would result in either: (i) an

inconsistent approach to pricing and regulation across the State, or (ii) a Government policy response to provide consistency across the State (such as a new Community Service Obligation (CSO)) that would otherwise not be required (which could be considered an inefficient use of Government's administrative capability);

- To the extent possible, implications for customers and infrastructure operators should be considered and clearly understood;
- Changes to the Rules should not increase regulatory burden and compliance costs for stakeholders.

Treasury and DEWS do not consider that the Draft Advice sufficiently accounts for the points noted above. As such, Treasury and DEWS do not support a number of the proposed changes to the Rules and seek further engagement with the Australian Government, or further advice from the ACCC, before any change to the Rules is implemented by the Australian Government.

Specifically, Treasury and DEWS consider that the implications for stakeholders in the Queensland schemes are uncertain (or have not been considered) and clarification on a number of aspects of the Draft Advice is required (questions are summarised at the end of this submission). Without this clarification Treasury and DEWS are unable to properly advise their respective Ministers on the potential impacts of the proposed amendments to the Rules for a range of stakeholders including customers, the State, the QCA, and SunWater.

Treasury and DEWS seek to better understand how the proposed amendments aim to achieve the objectives of the Water Act (Cwlth) for the benefit of all member States and the MDB as a whole. If implemented, the overall effect of a number of key proposed amendments appears to be increased administrative and compliance costs for Queensland (noting the amendments may lead to potential benefits for other Basin States). In this case, the costs of complying with these regulatory requirements outweigh the intended benefits associated with the proposed amendments for Queensland. Whilst the proposed amendments may aim to address issues relevant for other Basin States which will benefit the effective use of the MDB (and other member Basin States may be made better off), the implications for Queensland appear to be significantly negative.

This submission seeks to highlight the potential impacts on Queensland of the proposed amendments. Treasury and DEWS require additional clarification of the impacts of the proposed changes in order to assist Government to better understand the resulting implications on the State Budget (ie as a result of additional or increased CSOs) and customers in terms of their capacity to pay.

The basis of the concerns outlined above largely relate to the ACCC's proposals in regard to discriminatory charging, and the application of Part 6 (approval or determination of regulated charges). Further detail is provided in following sections of this submission.

Summary of Issues

The concerns of Treasury and DEWS can be summarised as follows:

- Treasury and DEWS support the intent to improve the regulatory framework for water charges and water trading within the Murray Darling Basin (MDB);

- Treasury and DEWS consider there is a lack of clarity on how the proposed changes to the Rules outlined in the Draft Advice would be applied, and therefore implications for stakeholders are highly uncertain;
- Treasury and DEWS consider that the Rules (if changed) must be flexible enough to accommodate State-specific issues and State policies; and
- Treasury and DEWS seek further engagement with the Australian Government and the ACCC before changes to the Rules are provided as Final Advice to the Australian Government.

2.0 Rule Change Proposed Outcome – Preventing Discriminatory Charging

2.1 Charging arrangements in Queensland’s MDB Water Supply Schemes

The proposed rule change provisions are designed to prevent discriminatory pricing in order to address a number of issues that are apparent in the broader Basin. In particular, the proposed Rule change seeks to address behaviour that results in price discrimination towards non-members of a particular scheme, or different users of water, such as environmental water users. This results in higher prices for these customers and distorts the market by influencing decision making. The outcome is that a scarce resource, and an important contributor to the cost of production, is not being allocated efficiently and allowed to trade to more highly valued uses.

Treasury and DEWS support the ACCC in recommending changes to address the issue of price discrimination. However, Treasury and DEWS understand that the above examples of price discrimination are not prevalent within Queensland’s MDB schemes. To the extent that different users are charged different prices for their water in the Queensland schemes, this is more likely to be the result of Government policy or legacy arrangements. Whilst this will be elaborated on below, these differences should be considered to ensure that any change to the Rules meets its true objectives, and is of benefit to the entire MDB and its member States.

Treasury and DEWS acknowledge that Queensland Government policies result in different approaches to charging arrangements for different customers. However, these policies have generally been developed in consultation with industry and customers and based on advice from the independent QCA, giving consideration to customers’ capacity to pay, and the benefits/costs arising from a subsidy targeting a particular sector or purpose. Furthermore these policies are designed to be compliant with the National Water Initiative pricing principles including consumption-based water pricing, full cost recovery and the removal of cross-subsidies. In addition, the differences are not inappropriate in a public policy sense in that they are the result of transitional price paths and/or have an accompanying CSO or indirect Government subsidy (both of which are publically disclosed at an aggregate level).

Treasury and DEWS also acknowledge that improving the pricing and regulatory environment in Queensland is an ongoing endeavour. However, it is important that that improvement occurs consistently across Queensland. To that extent Treasury and DEWS welcome the ACCC’s Draft Advice as a contribution to that ongoing endeavour.

Specifically differences in pricing arise in Queensland in regard to irrigation customers and non-irrigation customers as outlined below.

2.1.1 Irrigation Pricing

In 2000 the Queensland Government reviewed irrigation prices and established a price path to lower bound cost recovery for irrigation prices. The initial cost recovery target was set to the very minimum level of cost recovery for a water business to be viable. In essence, these are the ongoing cash costs of supply (lower bound costs). This is in contrast to an 'upper bound' pricing level which would include a rate of return on the existing asset base. As such Queensland irrigation pricing policy is far below any which could be interpreted as seeking monopoly rents.

Since this time, the State Government has subsequently updated this price path through price reviews, where the QCA was asked to provide recommended prices in accordance with the Government's policy objectives (QCA recommended prices have always been accepted by the Queensland Government).

A lower bound target is the current stated Queensland Government policy. A number of schemes in Queensland have reached the lower bound target and those schemes that have not reached the lower bound target are being transitioned toward it. The Queensland Government pays a CSO on the difference between lower bound costs and revenue earned from customers and paid to the Government-owned bulk water suppliers SunWater and the Queensland Bulk Water Supply Authority (Seqwater). In the 2015–16 Queensland State Budget the CSO for irrigation is estimated at \$4.7 million for SunWater and \$2 million for Seqwater. SunWater operates the Queensland schemes in the MDB (noting that SunWater operate the Border Rivers Water Supply Scheme on behalf of DNRM).

Given that lower bound is the target, the Government foregoes any revenue associated with a rate of return associated with the activity of supplying bulk water for irrigation. The Queensland Government has traditionally subsidised water prices to support the growth and development of the agriculture sector. When the Queensland Government makes decisions on pricing matters, it seeks to ensure balanced outcomes for affordable wholesale water prices, and to ensure the regulated water service provider is able to be financially sustainable.

Treasury and DEWS seek greater clarification of the Rule change proposals in so far as they would impact upon the lower bound target currently prescribed by the Queensland Government, and an acknowledgement of the validity of using transitional price paths to achieve stated objectives. Treasury and DEWS are concerned that under the Rule change proposal, an upper bound target could result. This would mean that in order to maintain the lower bound pricing policy for irrigation customers the Queensland Government would be required to pay a CSO on the difference between upper bound and current revenues. This is not considered a sensible outcome given that it would only apply to seven out of 30 SunWater irrigation schemes in Queensland, would be administratively burdensome and inefficient, and potentially confusing for customers. Whilst some additional transparency would be the result (CSO paid to SunWater would increase instead of Government providing a subsidy by foregoing the rate of return), given that it only affects seven out of 30 SunWater irrigation schemes across Queensland, this benefit is clearly outweighed by the costs.

2.1.2 Council customers

SunWater supplies untreated bulk water to some Local Government Authority (council) water businesses. These charges are negotiated between SunWater and the relevant council. Generally these council customers are under different arrangements compared to irrigation customers. However, in a vast majority of cases, Treasury and DEWS understand this difference to be partly driven by the fact that councils have High Priority water allocations and irrigators have Medium Priority allocations. Treasury and DEWS understand that the Draft Advice acknowledges this as a distinction between two difference classes of service, and that it is therefore not price discrimination.

The charges for council customers are not regulated and SunWater negotiates these contracts directly with the councils. This is consistent with SunWater's commercial charter. Treasury and DEWS seek advice from the ACCC on whether pre-existing contracts would be captured under the proposed non-discrimination provisions.

Treasury and DEWS understand that there may be a council or councils that purchase Medium Priority water from SunWater at negotiated prices under legacy contracts. As a commercial operator SunWater seeks to achieve the NWI pricing principle of charging upper bound prices for customers where practicable. Accordingly, it could be the case that because of Government policy, there are irrigation customers paying lower bound and being subsidised by the Queensland Government (as outlined above), and a council customer with a price that is above lower bound. Treasury and DEWS see a distinction between such a case, and the price discrimination that may be occurring in other Basin States, and which appears to be the focus of the Draft Advice. This is because the difference in price for two different types of customers represents a concession below full cost provided by Government, rather than price discrimination resulting from SunWater exercising market power and charging one customer group higher prices. Queensland policy has taken into account considerations such as transition paths for pricing for irrigation customers and benefits of industry to the Queensland economy. The result is that irrigation pricing is to target lower bound costs, while for other sectors, where practicable, a commercial return should be targeted, consistent with the National Water Initiative pricing principles.

Treasury and DEWS consider that the Queensland Government should not be prohibited from establishing policy to provide concessions for certain customer groups. Such policies may be made from time to time by Governments based on a number of considerations including assessments of customers' capacity to pay, and the potential positive economy-wide flow on effects as a result of a concession targeting a particular sector or purpose. Any change to these policies should also be well considered, involve customer consultation, and allow sufficient time for customers to adjust, lest it result in economic regulation with limited public support and immaterial benefit.

In addition, similar to the point made above regarding irrigators, there are only a minority of council customers (councils) in the MDB compared with the rest of Queensland. Having these customers included in the Rule's provisions regarding non-discrimination would be inconsistent with what happens in the rest of the state. Treasury and DEWS consider that a consistent approach to council pricing arrangements should be applied across SunWater's area of supply.

3.0 Rule Change Proposed Outcome – Application of Part 6 (approval or determination of regulated charges)

3.1 Responsibility for setting prices

The draft advice is unclear on the specific arrangements and their application to Queensland's MDB schemes. The proposed Rules appear to indicate that since SunWater falls under the proposed Part 6 Operator definition, and as such the ACCC would be responsible for determining prices for SunWater's customers in the MDB. Treasury and DEWS seek the advice of the ACCC on whether it intends to take over regulatory responsibilities for Queensland in the MDB.

Presently, shareholding Ministers set SunWater's irrigation prices via a direction under the Queensland *Water Act 2000*. Accordingly SunWater may still require this direction, even in the event of the ACCC issuing a price determination for SunWater's MDB schemes. Pricing will therefore still be subject to the decision of the relevant Queensland Government Ministers. Treasury and DEWS also seek further advice and engagement with the ACCC or the Australian Government on this apparent inconsistency.

Treasury and DEWS consider that the QCA should continue to conduct pricing investigations for Queensland irrigation schemes, including those in the MDB, rather than effectively splitting the state for the purposes of economic regulation. Dealing with two economic regulators in Queensland would be inefficient and confusing for customers. In addition, there could be a significant impact for customers in Queensland's MDB schemes arising from the different regulatory approach. This could arise due to the Government's current policy of targeting lower bound costs for irrigators (canvassed above in the section on price discrimination).

SunWater would also be required to cooperate with two regulatory processes and two regulators for the same customer group (irrigation customers). This could be considered an unnecessary increase in regulatory burden and cost for SunWater, potentially duplicating compliance costs, regulatory submissions and time spent in regulatory reviews. Ultimately the higher cost of this regulation would likely be passed on to customers.

The Draft Advice seems to indicate that along with the ACCC pricing principles, the ACCC in undertaking price approval or price determination investigations, would also take account of:

- The total volume of water access right relevant to the operator's infrastructure services;
- The classes of the infrastructure services provided by the operator;
- The preferences of the operator's customers; and
- The view of Basis State regulators.

Whilst this advice is helpful in providing a high level indication of the approach of the ACCC, Treasury and DEWS consider that significantly more detail on the approach and conduct of any ACCC price investigation is required. This includes in relation to the methodology for determining/reviewing key cost parameters, the timing of review, and the level of stakeholder consultations. Furthermore, Treasury and DEWS consider that the ACCC must have regard to State-specific policies as part of any investigation undertaken by the ACCC. These matters require further

clarification in order for stakeholders to fully assess and consider the impacts on customers, infrastructure operators, and the Queensland Government.

Accordingly Treasury and DEWS would appreciate further advice from the ACCC on the intent of the proposed Rule change in regard to Part 6. As noted above, it is Treasury and DEWS' preference that the QCA maintain responsibility for price regulation of Queensland's MDB schemes through the provision of independent advice to the Queensland Government to ensure consistency in regulation across the State, and to minimise the regulatory burden and costs on stakeholders. To the extent that the ACCC become involved in jurisdictional pricing decisions, precedence must be given to State-specific policies.

3.2 Proposed industry reform for the St George Channel Distribution Scheme

Substantial industry reforms are currently being progressed in regard to channel irrigation schemes owned and operator by SunWater. The Queensland Government is working to progress Local Management Arrangement (LMA) reforms, which, subject to agreement between irrigators and the Government, involves the transfer of these schemes from SunWater ownership to locally owned and managed entities.

The St George Distribution scheme is one of the schemes being considered for transition to LMA (noting that a final transfer will depend on irrigators and the Government reaching agreement on the terms of the transfer). Treasury and DEWS seek clarification of the proposed rule change as it applies to this particular channel scheme. Clarification is essential for the Government and scheme customers in order to consider the implications, if any, of the proposed change on this important reform.

Summary of issues raised in Sections 2 and 3

Treasury and DEWS:

- In regard to price regulation, do not support a situation where customers in MDB schemes are treated differently to similar customers in the rest of the state.
- Consider that the Queensland Government should not be prohibited from establishing policy to provide concessions for certain customer groups, and that these concessions should be delivered in the most efficient manner (that is, new CSO arrangements should not need to be created to address the proposed Rule change).
- Consider that the QCA should continue to conduct pricing investigations for Queensland irrigation schemes.
- To the extent that the ACCC becomes involved in the consideration of jurisdictional pricing decisions, precedence must be given to the State-specific policies.

In addition, Treasury and DEWS consider that the following should be addressed prior to the finalisation of the Rule change advice. Treasury and DEWS would be prepared to engage further with the ACCC on the matters raised.

The following clarifications were requested throughout the body of the submission:

- Treasury and DEWS seek to better understand how the proposed amendments seek to address the objectives outlined in section 10 of the Water Act (Cwlth) for the benefit of all member States and the MDB as a whole?
- Can the ACCC describe what alternative options have been canvassed in developing the proposed amendments? Has the ACCC quantified the efficiency loss/gain of pursuing its proposed regulation to deliver a net benefit for the MDB?
- Treasury and DEWS require additional clarification of the impacts of the proposed changes in order to assist Government to better understand the resulting implications on the State Budget (with respect to CSOs) and customer's capacity to pay.
- Treasury and DEWS seek advice from the ACCC on whether pre-existing contracts would be captured under the proposed non-discrimination provisions.
- Can the ACCC clarify if the effect of the proposed Rules are such that the ACCC would be responsible for determining prices for SunWater's customers in the MDB.
- Can the ACCC consider and explain how it would propose to address any operational inconsistency between the Rules and the ACCC regulation and the Water Act 2000 (Qld) under which the Queensland Government sets SunWater's irrigation prices?
- Given ongoing and upcoming reviews of the arrangements and pricing principles for the MDB, can the ACCC provide guidance as to how it would determine prices for Queensland and how these prices may differ from those currently charged in Queensland in the MDB?
- Can the ACCC consider and advise on an exemption process and criteria under Part 6? That is, under what grounds can MDB State regulators be exempt from the full price determination process and also from the other proposed Rule change requirements such as the price discrimination and pricing transparency requirements?
- Can the ACCC confirm how the proposed amended Rules would apply to the St George channel scheme both presently and if it transitions to local management?

4.0 Conclusion

Treasury and DEWS broadly support the outcomes sought from the review. However Treasury and DEWS consider greater clarity of the application of the proposed Rules is required. This additional clarity will help inform customers, Basin State Governments, and infrastructure operators. Specifically, and as outlined in the introduction of this submission, Treasury and DEWS:

- Support the intent to improve the regulatory framework for water charges and water trading within the Murray Darling Basin (MDB);

- Consider there is a lack of clarity on how the proposed changes to the Rules outlined in the Draft Advice would be applied, and therefore implications for stakeholders are highly uncertain;
- Seek to highlight to the ACCC the potential impacts on Queensland of the proposed amendments
- Consider that the Rules (if changed) must be flexible enough to accommodate State-specific issues and State policies; and
- Seek further engagement with the Australian Government and the ACCC before changes to the Rules are provided as Final Advice to the Australian Government.

Treasury and DEWS thank the ACCC for their work in reviewing the Rules, and for the opportunity to present a submission on the Draft Rule Change Advice.

