

Mr Michael Cosgrave
Executive General Manager
Infrastructure Regulation
Australian Competition and Consumer Commission

4 March 2016

Dear Mr Cosgrave

WaterNSW response to Review of Water Charge Rules Draft Rule Advice

WaterNSW welcomes the opportunity to respond to the ACCC's Review of the Water Charge Rules Draft Rule Advice.

WaterNSW strongly supports the overarching objective of this review to reduce overlapping regulatory burdens and streamline regulatory reporting obligations, without compromising on customer outcomes. To this end, the WaterNSW's submission is focused on ensuring that the amended Water Charge Rules are flexible and consistent with existing state-based pricing frameworks.

We would welcome an opportunity to discuss our submission with the ACCC. WaterNSW's Chief Financial Officer, Elli Baker, can be contacted on 02 8245 2000.

Yours sincerely

A handwritten signature in blue ink, appearing to be "David Harris". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

David Harris
Chief Executive Officer

1. Executive Summary

Under the terms of reference of the Water Charge Review, the ACCC is required to provide advice to Government on ways to reduce cost to industry and achieve consistency with the Australian Government's deregulation objectives.

The ACCC Water Charge Rules Draft Advice contains a number of recommendations which are expected to be well received by customers, stakeholders and industry. The recommendation to dismantle the current system of 'tiered regulation' and permit state based economic regulation in the Murray Darling Basin, is a common-sense approach to reduce cost burden and maximise the benefits of economic regulation for the customer.

WaterNSW also supports the other recommendations to improve on the existing price setting arrangements in the *Water Charge Infrastructure Rules 2010 (Cth)* (WCIR). These recommendations reflect an appropriate trade-off between regulatory flexibility and regulatory certainty, including the proposed improvements to the cost pass through mechanism, and the ability for the regulator to specify a 'contingency project' to allow operators to better respond to customer needs during a determination period.

However, WaterNSW has concerns around the ACCC recommendation to expand the scope of the non-discrimination requirements to large bulk water infrastructure operators such as WaterNSW. These new requirements will unintentionally offset some of the cost savings identified in this review by creating new overlapping burdens.

This submission is focused on ensuring that the amended Water Charge Rules is flexible and consistent with existing state-based pricing frameworks.

2. Price discrimination

2.1. WaterNSW Recommendation

As state economic regulation overlaps with the proposed non-discrimination requirements, WaterNSW recommends that the new price discrimination requirements not apply to it.

WaterNSW also recommends that draft Rule 10 be amended to include specific and narrow definitions for key terms to improve the clarity of the rules

2.2. ACCC Advice

Currently, the WCIR non-discrimination provisions do not apply to WaterNSW as a Part 6 bulk water operator. The ACCC has proposed new non-discrimination requirements which would apply to all infrastructure operators, including Government-owned bulk water entities, such as WaterNSW.

The new requirements would prohibit an infrastructure operator from specifying infrastructure charges (including rebates) for infrastructure services that are of the same class if the price difference is:

- because of the purpose for which water has been, is or will be, used;
- because a tradable water right has been traded or transformed;
- because the holding, volume or use of a tradable water right or separate location related right;
- because there is an association between a separate location-related right and a water access right; or
- because of the area of land owned, occupied or irrigated;

It is understood that the requirements above:

- do not apply if the price difference does not exceed what is necessary to reflect the difference between the actual cost necessarily incurred in providing the infrastructure service or infrastructure services; and
- does not intend to prevent an infrastructure operator from levying different charges for different classes of infrastructure services.

2.3. Discussions of issues

The expansion of the non-discriminatory provisions to all operators will unnecessarily offset some of the cost savings identified in this review by creating new overlapping regulatory burdens.

For example, under the amended WCIR, WaterNSW would be subject to the Independent Regulatory and Pricing Tribunal (IPART) pricing regime, which includes adequate protections against unfair price discrimination within the same class of infrastructure service. Under section 15 of the *IPART Act 1992* (NSW), IPART must consider (among other things) the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of services.

During an IPART price review, IPART would be expected to review the regulated entity's pricing proposal and assess the allocation of cost between different charge categories. IPART would also be expected to consider any price differentials that may be proposed by the regulated entity across different customer segments and licence categories as the case may be.

Under the recommended changes, WaterNSW would be bound by a pricing determination made by IPART, while also being bound by the non-discrimination civil penalty provisions in the amended WCIR. IPART and the ACCC may form conflicting views on whether the charges approved by IPART and levied by WaterNSW constitute price discrimination under the amended WCIR. Given the overlapping regulatory obligations, WaterNSW seeks guidance from the ACCC on how the non-discrimination provisions would operate in this instance on a practical level.

The application of the proposed non-discrimination requirements may also unduly constrain:

- The ability of IPART to apply different pricing methodologies based on wider policy considerations (for example, scarcity water pricing).
- The ability of IPART or WaterNSW to consider different fixed to variable recovery options under a tariff structure that is not reflective of actual costs (for example

the potential to implement a different fixed to variable split for customers segments within the same class of infrastructure service).

- The ability of WaterNSW to offer new services or incentivise desirable customer behaviours through prices.

Further, while WaterNSW is generally supportive of the overall intent of the proposed recommendations, to promote consistent charging arrangements across the Murray Darling Basin, the ACCC Draft Rule Advice is unclear on whether the expansion of the non-discrimination requirements is in response to a specific problem.

2.4. Drafting issues

The terms in the draft WCIR are unclear and could be open to interpretation in a manner that is inconsistent with the ACCC's draft rule advice and explanatory documents.

Proposed rule 10 is a civil penalty provision that is subject to a right of private action under Rule 57 of the WCIR. Because of the legal implications, WaterNSW recommends that proposed Rule 10 be redrafted to include specific and narrow definitions for all key terms. This will improve on the clarity of the amended WCIR, reduce unnecessary compliance and court costs, and ensure that the amended WCIR are consistent with the ACCC explanatory document.

For example, the term "infrastructure service of the same class" does not appear to be defined in the draft WCIR. Further, Draft Rule 10 (1) could be redrafted to prohibit price discrimination within the same class of infrastructure service only. Draft Rule 10 (5) could omit the phrase 'this rule is not intended to prevent' and instead say 'nothing in this rule prevents an infrastructure operator from specifying different infrastructure charges or discount for different classes of infrastructure services'.

3. Prohibiting levying of infrastructure charges the point of trade

3.1. WaterNSW Recommendation

WaterNSW does not support the recommendation to prohibit the levying of the variable charge at the point of trade for temporary trade.

Should the ACCC decide to proceed with the rule advice, WaterNSW recommends that the amended WCIR permit a bulk water provider to levy regulated charges in connection with trade, while prohibiting regulated charges levied as a condition of trade.

3.2. ACCC Advice

The ACCC has proposed to introduce a requirement that would prohibit an infrastructure operator from imposing an infrastructure charge in the following circumstances:

- upon an application to trade, transfer or terminate a tradable water right;
- as a condition of the infrastructure operator granting its consent or approval to a trade, transfer or termination of a tradable water right;
- when or because a tradable water right has been traded or transformed;

- because a customer has undertaken or intends to undertake, a trade, transfer or termination of a tradable water right

It is understood that the requirements do not extend to limiting an operator from levying an administrative charge that represents the reasonable administrative costs necessarily incurred by the operator in processing the trade.

The effect of the proposed recommendation is that WaterNSW will be prevented from levying, at the point of trade, the regulatory approved variable charge for temporary allocation trades, where the buyer does not have a NSW Works Approval (for example interstate trades).

The ACCC Draft Rule Advice has suggested WaterNSW consider levying the variable charge at the allocation point, instead of the point of trade.

3.3. Current arrangements

WaterNSW currently levies the variable charge on temporary allocation trades (i.e. real, not "paper" water) at the point of trade, but only where the buyer does not have a NSW Water Works Approval (for example, where water is traded outside of NSW).

This is because when water is traded out of NSW, that revenue is lost to WaterNSW. The interstate buyer does not hold a NSW Water Access Licence or Works Approval and WaterNSW is unable to charge the interstate buyer for the prudent and efficient infrastructure costs it incurs in holding and releasing bulk water subject to an interstate trade transaction. This issue is exacerbated due to the higher usage charges in NSW compared to other jurisdictions who have higher fixed charges.

WaterNSW introduced this policy as an equitable, transparent and administratively feasible solution to the loss of revenue that would have otherwise occurred from an interstate trade transaction. The policy also provided a means to improve trade outcomes by preventing market distortions that exist when prudent and efficient infrastructure costs are not reflected in a trade transaction.

3.4. Discussion of issues

WaterNSW contends that the current billing arrangement does not represent a significant impediment to trade and requests that the ACCC re-consider the materiality of the perceived impediment to trade. Recent trade data clearly shows that there has been a net trade of water from NSW to Victoria. Water was and is continued to be traded despite WaterNSW applying the variable component of the infrastructure charge on the parties to the trade.

The suggested solution to levy the variable charge at the point of allocation would be difficult to apply as it is impossible to predict whether or not a customer will engage in trade at the point of allocation and before a trade transaction occurs. Further:

- Customers are not obliged to use their water allocation. The suggested solution implies that WaterNSW should charge all its customers for unused water.
- WaterNSW would have to account for any 'carry over' amounts in its billing system to avoid double charging, which will likely require a major reconfiguration

of the water account system and billing systems, and a manual reconciliation of water allocations against 'carry over' amounts.

- There would be a disincentive for customers to carry over their allocations and to allow them to self-manage their water supply and usage over time.

According to the Draft Rule Advice, the 'annualised change in regulatory costs' for the new non-discrimination provisions is around \$16,000 per annum, with 'start up' costs of around \$3,000 for, what appears to be, all of the recommendations in the Draft Rule Advice.

WaterNSW would need more time to consider the true cost implications to customers and whether or not it is feasible to implement the proposed solution given current system limitations. However, the costs to WaterNSW are likely to greatly exceed \$16,000. Should the rule change be accepted by the Minister, WaterNSW would seek to recover any additional cost of compliance in the next pricing period.

WaterNSW is also exploring other solutions to mitigate the revenue risk. It is likely that any solution developed would have an adverse impact on customers who do not engage in trade. Before offering a proposed solution, WaterNSW would need to consult with affected customers before implementation, as well as submit the proposed solution to IPART for approval.

With the removal of the accreditation arrangements, it is understood that IPART would no longer be bound by the requirements in the amended WCIR. If an alternative solution or workaround is not accepted by IPART, WaterNSW questions how the new requirements would operate in this instance. WaterNSW would want to avoid being in a position where it cannot recover its prudent and efficient costs. This would produce an even greater market distortion than the perceived market distortion that this recommendation is proposing to address.

WaterNSW urges the ACCC to consider the cost-benefit trade off in recommending the rule change. Prohibiting prudent and efficient infrastructure charges on trade may inadvertently affect other customers.

3.5. Drafting Issues

If the ACCC decides to include this recommendation in its Final Advice to the Minister, WaterNSW suggests that the draft WCIR be reworded to allow a bulk water operator to levy an infrastructure charge in connection with trade, (to recover prudent and efficient infrastructure costs), while prohibiting an infrastructure charge from being levied as a condition of trade.

This would provide some flexibility for a bulk water operator to consider other potential solutions to the perceived problem, while permitting the operator to recover its prudent and efficient costs.

4. Price notification requirements

4.1. WaterNSW Recommendation

WaterNSW recommends that the proposed price notification timeframes be reduced from 25 business days to 15 business days.

The amended WCIR should be streamlined with the timeframes imposed by state economic regulators. This can be achieved by including either:

- a. an exemption to the amended price notification timeframes, where a bulk water operator is also subject to state-based economic regulation; or
- b. a trigger mechanism, where the timeframes are triggered when the state-based pricing regulator hands down its final decision on regulated charges).

4.2. ACCC advice

Currently, WaterNSW is required to provide 10 business days' notice to customers before new charges come into effect. The ACCC rule advice recommends that this requirement be extended to 25 business days before the new charges come into effect.

4.3. Discussion of issues

WaterNSW is concerned that the 25 business day timeframe may not align with the IPART price review timeframes. Ultimately, IPART price review timeframes will dictate whether or not WaterNSW can comply with price notification requirements in the amended WCIR.

To comply with a 25 business day timeframe, IPART would have to hand down its final decision on regulated charges by mid-May however IPART has been known to release its final decisions in June. The current indicative timeframe for the IPART Final Decision on MDB Regulated Charges for the next price period is June 2017.

Although WaterNSW would be able to publish the approved charges on its website soon after the IPART Final Decision is handed down, it would take approximately 2 weeks to schedule the mailing house and post the Schedule of Charges to approximately 6,300 rural customers.

WaterNSW recommends that the proposed price notification timeframes be reduced from 25 business days to 15 business days. Further, the amended WCIR should be streamlined with the price review timeframes set by a state economic regulator. This can be achieved by including an exemption to the amended price notification timeframes, where a bulk water operator is also subject to state-based economic regulation.

Alternatively, the amended price notification timeframes could be triggered when the state-based regulator hands down its final decision on regulated charges (~15 days from the date the IPART Final Decision is handed down).

5. Permitting state based pricing regulation

5.1. WaterNSW Recommendation

WaterNSW supports the recommendation to reduce the scope of the WCIR price setting requirements and permit state based economic regulation for bulk water providers in the Murray Darling Basin.

5.2. ACCC advice

WaterNSW is currently subject to price regulation under the rules, instead of state based pricing frameworks. The ACCC recently delegated its price setting functions (through accreditation) to IPART effective 1 June 2016 on the condition that IPART apply the ACCC pricing framework and principals.

The ACCC draft rule advice is to reduce the scope of the price setting requirements in the rules to the following circumstances only:

- As a framework for the regulation of infrastructure operators that would allow Basin States to voluntarily transfer regulatory functions to the Commonwealth at a later date; and
- As a regulatory 'fall back' where state water management law does not provide for the State regulator to directly approve or determine the infrastructure charges of infrastructure operators providing on-river infrastructure service.

The ACCC has anticipated that no bulk water entity will be subject to the new Part 6 price setting requirements (including WaterNSW, who will be subject to the IPART pricing framework).

The ACCC recommendation is to remove the accreditation arrangements in the amended rules. IPART would have the flexibility to apply its own rules when setting prices for the NSW MDB valleys.

5.3. Discussions of issues

WaterNSW supports the recommendation to reduce the scope of the WCIR price setting functions and provide an exemption from those requirements where a bulk water operator is also subject to economic regulation requirements under state legislation.

WaterNSW is confident that the pricing principles set out in the *IPART Act 1992 (NSW)* are broadly similar to the Basin Water Charging Principles and Objectives and will achieve similar pricing outcomes envisaged under the *Water Act 2007 (Cth)* and the WCIR.

An IPART price review will result in lower costs to WaterNSW and to the customer by combining the MDB and Coastal Valley determinations into one rural price review, This will also allow IPART to run the rural price review in conjunction with other NSW water price reviews, bringing the cost of regulation down for the customer.

6. Length of determination period

6.1. WaterNSW Recommendation

WaterNSW supports the proposed amendment to the Water Act (Cth) 2007 to provide discretion to the regulator in determining the length of the regulatory period.

If the proposed amendments to the Water Act (Cth) 2007 are not accepted, WaterNSW does not support the recommendation to reduce the default regulatory period from four to three years.

6.2. ACCC Advice

The default regulatory period for a Part 6 operator is strictly defined in the WCIR. The current default period is 3 years for the first regulatory period and 4 years thereafter.

The ACCC recommends that the default regulatory period be reduced to three years instead of four.

If the *Water Act 2007* (Cth) is amended to provide discretion to the regulator in determining the length of the regulator period, the ACCC recommends that the rules be amended to permit a regulatory period of longer than 3 years up to a maximum of 5 years, as determined by the regulator on a case by case basis.

6.3. Discussions of issues

While WaterNSW supports an amendment to the *Water Act 2007* (Cth), WaterNSW is of the view that the default regulatory period should remain at four years and should not be reduced to three years.

WaterNSW is concerned that any benefit that may arise from reducing the length of the default regulatory period to three years, will be disproportionate to the additional costs and administrative burden on the customer and the regulated entity.

It is also observed that the standard length of the regulatory period set by IPART is 4 years. In the electricity and gas sector, the regulatory period is generally set at 4 to 5 years.

WaterNSW submits that there is no compelling reason to reduce the default regulatory period to three years given that:

- the WICR include an annual price review process, which includes a public consultation and price stability assessment by the regulator;
- the amended WCIR will include new and improved cost pass through provisions;
- there are a range of ex post and ex ante measures that the regulator can implement during a price review;
- there appears to be a lack of evidence presented in the draft ACCC advice to suggest that the measures above are 'not working'.

WaterNSW submits that the measures described above should provide enough flexibility for the regulator to initiate and provide timely responses to changes in regulatory conditions should the need arise.

7. Annual review of regulated charges

7.1. WaterNSW Recommendation

WaterNSW recommends that the ACCC consider other, lower-cost, alternatives to the annual price review.

7.2. Current arrangements

WaterNSW is currently subject to an annual price review for its regulated water charges. Before WaterNSW can levy a charge it must first submit its charges for approval by the ACCC. This includes a period of consultation with customers.

7.3. Discussion of issues

WaterNSW recommends that the ACCC consider other low cost alternatives to the annual price review, such as a mechanical approach to updating regulated charges similar to the yearly price updates in the energy sector.

The regulator could be given the flexibility to approve an alternative to the current annual price reset process. For example, one approach is to allow updates to demand forecasts and consideration of price stability issues in a formula set by the regulator as part of the price review. The regulated entity could update the charges annually in line with the price adjustment formula set by the regulator.

8. Appeal mechanisms

8.1. WaterNSW Recommendation

WaterNSW supports the introduction of a merits review mechanism for price determinations in the MDB.

8.2. Current arrangements

According to the ACCC, the rules include an appeals mechanism whereby an aggrieved party can appeal the decision on the economic regulator on the grounds set out in the *Administrative Decisions (Judicial Review) Act 1977 (Cth)* (generally limited to questions of law and process). There are currently no grounds to appeal the merits of a decision made by the economic regulator.

8.3. ACCC advice

According to the draft rule advice, the ACCC is of the view that it is not clear that the benefits of merits review would outweigh the costs. The ACCC has concluded that administrative review is an appropriate appeals mechanism for pricing decisions made under the rules.

8.4. Summary of discussion

Although WaterNSW agrees that administrative review mechanism is an appropriate appeals mechanism to retain in the WCIR, the appeal rights in an administrative review is limited to 'base line' rights that are expected in any interaction with a statutory authority (for example, the right to due process, natural justice and ensuring that the decision of a statutory authority is made in accordance with law).

WaterNSW acknowledges the view of the ACCC that *it is not clear that the benefits of merits review would outweigh the costs* however this conclusion is based on a high level qualitative assessment by the ACCC without detailed costings on the various forms of merits review that could be applied in the MDB charging arrangements and their associated benefits.

WaterNSW continues to support the introduction of a merits review mechanism for price determinations in the MDB. WaterNSW has outlined the benefits of introducing a merits review mechanism in previous submissions, including to the Water Charge Rules Issues Paper and the Water Act Review.

9. Regulation of MDBA and BRC costs

9.1. WaterNSW Recommendation

The MDBA and BRC should be subject to price regulation in order to drive efficiencies and bring costs down for the benefit of customers

9.2. Current arrangements

According to the ACCC, the Water Act and WCIR only extends to the regulation of bulk water charges that are 'levied' by a bulk water entity. As the MDBA and BRC do not levy an infrastructure charge on customers, the MDBA and BRC are not subject to price regulation under Water Act and WCIR.

9.3. Discussion of issues

WaterNSW notes that the ACCC is unable scrutinise the costs of the MDBA and BRC due to legal issues. WaterNSW stands by its view that the MDBA and BRC should be subject to price regulation in order to drive efficiencies and bring costs down for the benefit of customers.

10. Transitional requirements

10.1. WaterNSW Recommendation

WaterNSW supports the transitional arrangements in Proposed Rule 8

WaterNSW supports the ACCC recommendation to permit IPART to apply its own framework to set MDB regulated charges to be levied by WaterNSW after the end of the current period (30 June 2017).

WaterNSW would like to work closely with the ACCC and IPART to ensure that the WaterNSW 30 June 2016 IPART pricing submission is consistent with any additional requirements imposed on WaterNSW in the amended WCIR, while also being consistent with IPART pricing requirements.