

---

# Icon Water Limited

---

## Response to Issues Paper

12 December 2014

**Submission to the ACT Government review of the ACT's water and  
sewerage pricing framework**



Icon Water Limited (formerly ACTEW Corporation Limited) is an unlisted public company that owns and operates the water and sewerage assets and business in the ACT. The company is owned by the ACT Government and has two voting shareholders: the Chief Minister and Deputy Chief Minister of the ACT.

## Contents

Contents.....	3
1 Introduction .....	4
1.1 Approach to this submission .....	4
1.1.1 Government policy issues .....	4
1.1.2 Improvements to the existing regulatory price control model.....	5
2 Proposed improvements to the framework .....	7
2.1 Strengthening legislative guidance .....	7
2.1.1 Objectives for the determination of water and sewerage pricing.....	7
2.1.2 Regulatory principles .....	7
2.1.3 Expenditure objectives.....	8
2.1.4 Period of price directions.....	8
2.2 Standing guidelines on regulatory methods .....	8
2.3 The price inquiry process .....	9
2.3.1 Timing of the terms of reference .....	9
2.3.2 Approach Paper .....	9
2.3.3 Merit review of decisions.....	9
3 Other issues .....	11
3.1 The role of goodwill .....	11
3.2 Conflict resolution.....	11
3.3 Implications for other industries.....	11
4 Specific questions raised in the Issues Paper.....	12

# 1 Introduction

In April 2014, the Australian Capital Territory (ACT) Auditor-General's office released a performance audit report on the water and sewerage pricing process. As part of its response to this audit report, the ACT Government has committed to introducing improvements to the water and sewerage pricing framework and has commissioned a review to inform its consideration of options for achieving an improved framework. On 24 November 2014, the ACT Government released an Issues Paper (**Paper**) in relation to its review, seeking submissions from interested parties by 12 December 2014.<sup>1</sup> Icon Water Limited (**Icon Water**) provides its response to the Paper in this submission.

## 1.1 Approach to this submission

The Paper raises issues at a number of different levels of the framework from overarching government policy matters, such as consideration of alternatives to independent price control, to specific administrative issues associated with the conduct of a price review process. In this submission, Icon Water proposes improvements to the framework that address each of the levels of the framework illustrated in Figure 1 on page 5. The figure indicates the sections of this submission that address the corresponding level of the framework.

### 1.1.1 Government policy issues

The Paper raises some important overarching policy issues, including:

- whether the independent price setting model should be replaced by an alternative model, such as price monitoring; and
- service delivery matters, such as:
  - whether the current structure of the Independent Competition and Regulatory Commission (**ICRC**) is appropriate; and
  - whether regulatory services might be delivered more efficiently by an external agent (for example, the Independent Pricing and Regulatory Tribunal of New South Wales).

These overarching policy issues are not the main focus of this submission. However, Icon Water is of the view that the policy aspiration should be to transition from the current price setting model to a more light handed approach, such as price monitoring or surveillance. Such a transition would normally be appropriate following consistent application of incentive-based price regulation over a period of 15 to 20 years. Although the current independent price regulation model has been in place for more than 15 years in the ACT, the impacts of the millennium drought and recent changes in regulatory approach may mean that a further period of regulatory price control is required in order to achieve the appropriate level of maturity for a successful transition to price monitoring or surveillance.

Icon Water does not comment further on these issues, but recognises their fundamental importance and submits that they should not be set aside or diluted in considering the more specific comments regarding the current regulatory model.

---

<sup>1</sup> ACT Government 2014. Review of the ACT's Water and Sewerage Pricing Framework, Issues Paper, November.

**Figure 1: Icon Water’s proposed improvements to the pricing framework**



### **1.1.2 Improvements to the existing regulatory price control model**

Section 2 of this submission proposes potential improvements to the existing regulatory price control model. The framework has in the past been heavily reliant on responsible use of regulatory discretion and maintenance of professional working relationships (and goodwill) between the parties. Icon Water submits that the key shortcoming of the framework as it stands is that it does not ensure the provision of sufficient guidance on how regulatory independence, judgement and discretion will be exercised. Icon Water does not dispute that the regulator should have and should exercise discretions over elements of a pricing determination but argues that the exercise of such broad discretions requires robust, transparent guidance to provide confidence to the community and utility that are the subject of the discretion.

Icon Water proposes amendments to the governing legislation which would establish a clearer framework within which prices would be regulated. The key goal of these amendments is to improve the likelihood that future price reviews will be procedurally fair, cost effective, reliable and consistent and will provide a sufficiently certain basis on which Icon Water can make the operation, investment and

financing decisions that are required to run an efficient water and sewerage business in the long term interests of consumers. These amendments include:

- strengthening legislative guidance through (see section 2.1):
  - clarification of regulatory objectives;
  - establishing principles for regulation;
  - establishing objectives for utility expenditure;
- introducing standing guidelines to be issued by the regulator which would (see section 2.2):
  - relate to key constituent decisions;
  - be subject to periodic review in consultation with the community and the utility;
- improving price inquiry processes by (see section 2.3):
  - introducing additional requirements in relation to the timing of key stages in a price review process; and
  - introducing an Approach Paper to be issued early in the price review process to establish fundamental constituent decisions and expectations in relation to the provision of information and the nature of the review process.

Section 3 of this submission comments on some additional issues and section 4 responds to the specific questions raised in the Paper.

## 2 Proposed improvements to the framework

### 2.1 Strengthening legislative guidance

#### 2.1.1 Objectives for the determination of water and sewerage pricing

Icon Water submits that there is scope to improve the guidance given in relation to the relative importance of the various objectives listed in s20 of the *Independent Competition and Regulatory Commission Act 1997 (the ICRC Act)*. The objectives should be clarified in legislation to give primacy to key objectives such as economic efficiency, a sustainable return for the utility service and the promotion of the long term interest of consumers. Icon Water suggests that the review consider introducing a single overarching objective or statement of regulatory purpose similar to the National Electricity Objective set out in the National Electricity Law:

*promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to -*

*(a) price, quality, safety, reliability and security of supply of electricity; and*

*(b) the reliability, safety and security of the national electricity system.*

The review should also consider the benefits of consistency between the objectives set out for the regulator and those set out for Icon Water in the *Territory-owned Corporations Act 1990*.

#### 2.1.2 Regulatory principles

To assist in achieving these objectives, Icon Water submits that legislation be amended to incorporate principles relevant to the exercise of regulatory powers. These principles should provide direction to ensure that:

- the process incorporates the principles of procedural fairness and natural justice;
- the regulatory process is transparent;
- the regulator is accessible to stakeholders;
- the process is cost effective; and
- there is no retrospective application of decisions nor expropriation that might undermine incentives for efficient investment in long lived assets.

Legislation should also include pricing principles similar to those included in National Electricity Law, potentially including:

- The utility should be provided with a reasonable opportunity to recover at least the efficient costs of providing water and sewerage services and complying with regulatory obligations.
- The utility should be provided with effective incentives in order to promote economic efficiency.
- Regard should be had to the regulatory asset base adopted in previous regulatory determinations.
- Prices should allow for a return commensurate with the regulatory and commercial risks involved in providing the service.
- Regard should be had to the economic costs and risks of the potential for under and over investment by the utility.

- Regard should be had to the economic costs and risks of the potential for under and over utilisation of water and sewerage assets.

### 2.1.3 Expenditure objectives

Icon Water submits that legislation should be amended to clarify the objectives for expenditure included in regulatory proposals. These objectives are a feature of the National Electricity Rules for regulation of electricity distribution networks and would promote efficient investment by providing greater certainty with respect to regulatory treatment of expenditure. These objectives could include:

- meeting or managing expected demand for services;
- complying with all applicable regulatory (including technical) obligations;
- where no applicable obligations exist, maintaining the quality, reliability and security of supply;
- maintaining the safety of the water and sewerage system;
- complying with applicable ACT Government policies; and
- having regard to any transition required when there are material changes in obligations or expenditure levels.

### 2.1.4 Period of price directions

Icon Water is not of the view that the period of a determination should be predetermined in legislation, because there are reasons why the period of a determination might be varied reasonably from the customary five years. However, to provide greater certainty and improve cost effectiveness, legislation should recognise five years as the default period for a price determination subject to change only where the regulator sets an alternative period. If this occurred, reasoning should be provided to explain the rationale behind departing from the default period, including consideration of matters of cost efficiency and avoidance of unnecessary regulatory burden.

## 2.2 Standing guidelines on regulatory methods

Icon Water recommends that legislation be amended to require the regulator to make and publish standing guidelines in relation to the methodology for key constituent decisions in the price review process. The regulator would need to provide reasons for departing from its guidelines when making price determinations.

The presence of such guidelines, which are a feature of the National Electricity Rules in relation to regulation of distribution networks, would promote greater confidence in the consistency, reliability and procedural fairness of the price setting process. These guidelines would need to be set in accordance with the objectives and principles in the legislation and reviewed by the regulator in consultation with stakeholders on a regular basis but not during a price review process. During reviews of the standing guidelines, issues about the application of regulatory objectives and principles should be evaluated and reformed or refined in a public process that ensures all parties have opportunities to access and contribute to the process and challenge the outcome. These reviews would enhance the understanding of regulated entities and the community of the process and provide greater certainty with respect to the regulatory treatment of business decisions.

Icon Water submits that the guidelines could cover:

- Information templates and requirements of regulatory proposals;
- The roll forward and revenue building block models;
- Rate of return;

- Expenditure forecast assessment;
- Incentive schemes; and
- Consumer engagement.

Guidance with respect to methods for the various constituent decisions listed above would provide a much more certain basis upon which Icon Water could make the operating, investment, and financing decisions that are necessary to run an efficient water and sewerage business.

## 2.3 The price inquiry process

Icon Water recommends clarification of the schedule and timetable of events in a price review process.

### 2.3.1 Timing of the terms of reference

To ensure that a price review can be concluded in a timely manner, Icon Water would recommend amendment to legislation to require a terms of reference for a price inquiry to be issued by the Minister a specified number of months prior to the expiry of a current price direction.

### 2.3.2 Approach Paper

Icon Water submits that price inquiry processes would be improved if the legislation required an Approach Paper (specific to the price inquiry) early in the process in addition to the existing requirement for a Draft Report. There would be merit in the publication of a draft Approach Paper which would be the subject of a public forum and submissions from stakeholders prior to finalisation well in advance of the regulatory proposal from the utility. The Approach Paper could usefully:

- decide on the control mechanism to be applied (for example, a price cap or a revenue cap mechanism);
- decide on the information that must be provided by the utility in its regulatory proposal;
- propose the formulae to give effect to the control mechanism;
- propose the length of the regulatory period;
- propose the incentive schemes to be applied;
- publish a timetable for the review and clarify the role of:
  - the regulatory proposal from the utility;
  - the draft report, which should include all constituent decisions, including a price direction;
  - a public forum to discuss the draft report;
  - submissions in response to the draft report; and
  - the final report;
- publish a budget for the review.

This Approach Paper, which could be similar to the ‘framework and approach paper’ required under the National Electricity Rules for regulation of distribution networks, would enhance procedural fairness in relation to fundamental constituent decisions and provide all stakeholders with a better understanding of the responsibilities of the respective parties at the outset of the process.

### 2.3.3 Merits review of decisions

A merits review mechanism plays a critical role in ensuring accountability for regulatory decisions. Icon Water supports the retention of the existing appeals mechanism. However, amendments could be made to clarify the way in which a review would be conducted. A particular goal would be to prevent unnecessary and costly reopening of the full review, potentially by limiting the scope of review to the constituent decision(s) raised in the application for review.

The alternative of seeking a remedy through recourse to the Supreme Court would be less efficient as a first step in testing decisions and would add complexity in terms of the time required for issues to be heard, the cost of legal proceedings and the uncertainty for all parties about the outcome of court proceedings.

Appeal for relief or redress should be available where a party is of the opinion that an alternative decision would be materially preferable in terms of satisfying the objectives and requirements of the price determination process. Relief may also be sought where a determination may damage the legitimate interest and expectations of the regulated entity.

In the opinion of Icon Water, availability of the appeals mechanism should not be restricted to instances where financial viability or service obligations are at significant risk (as suggested by ICRC in its 2013-14 annual report), unless these are the sole objectives of the regulatory process. Further, the review provision should not vary depending on whether utility ownership is public or private (as suggested by ICRC in its 2013-14 annual report).

## 3 Other issues

### 3.1 The role of goodwill

The role of goodwill and the relationship between the regulator and regulated entities in conducting reliable and cost effective price enquiries has not been explicitly identified as an issue in the Paper – perhaps because it cannot be guaranteed in legislation. However, the Auditor-General has identified that these issues have been embedded in questions now being raised about the effectiveness and efficiency of the current regulatory model.<sup>2</sup>

Achieving a successful outcome in the absence of a willingness to conduct proceedings on the basis of being accessible and professional working relationships is extremely difficult where the process is highly complex and subject to judgement at many points. The parties must be accessible and have opportunities to discuss issues in formal and informal settings and to build goodwill and trust in the other party's good faith. The relationship between the regulator and regulated entities, notwithstanding the need to maintain a prudent distance between the parties, is fundamental to the reasonableness and fairness of the process.

### 3.2 Conflict resolution

Icon Water does not believe that mediation by external party is workable, particularly where the ultimate decision on matters in dispute necessarily remains with the regulator and the legislation prevents interference with the regulator once a reference is issued. Similarly mediation by the Minister is fraught with political and sovereign risk given the Minister's role as owner and policy maker.

Negotiation between the regulator and the regulated party on the basis of goodwill is the only reasonable option available, subject to recognition that the process rests on the quality of the relationship between the parties. From the perspective of recent experience there are challenges associated with making this option work effectively, but in Icon Water's view it is still the best approach and achievable, particularly where supported by principles such as goodwill, reasonableness and participation in good faith.

### 3.3 Implications for other industries

The Paper is directed at the determination of water and sewerage prices, because the review is a response to the Auditor-General's review of the 2013 water and sewerage price determination. However, changes to the ICRC Act may also affect other utility services, particularly at this stage of continuing imposition of electricity retail price regulation. It does not appear appropriate for the legislation to be restructured to separate water and other utility services. Instead, any proposed changes to legislation ought to take into account the impact on, and needs of, other current and potential services under the legislation.

---

<sup>2</sup> ACT Auditor-General's Office 2014, Performance Audit Report - The Water and Sewerage Pricing Process, April, p135.

## 4 Specific questions raised in the Issues Paper

Questions raised in the Issues Paper	Icon Water comments
What steps should be taken to improve the cost effectiveness of the current regulatory model?	Icon Water’s proposal would improve cost effectiveness, including by: <ul style="list-style-type: none"> <li>• Setting five years as the default length of regulatory periods (section 2.1.4);</li> <li>• Requiring the regulator to publish a budget at the outset of a review process (section 2.3.2);</li> <li>• Providing more guidance on the exercise of discretion (see section 2.2) and requiring earlier decisions on fundamental constituent decisions (see section 2.3.2).</li> </ul>
Are there alternatives models for providing independent pricing services for regulated water and sewerage services that may be able to provide the required services in a more cost effective manner?	See section 1.1.1.
Does it remain appropriate, on a cost effectiveness basis, for the ACT Government to maintain its own independent pricing authority?	See section 1.1.1.
Are the current governance and administrative arrangements for the determination of regulated water and sewerage process appropriate?	As the Auditor General has observed, the governance and administrative arrangements would benefit from consideration and improvement. For Icon Water’s proposed amendments, see section 2.
What parts of the current administrative and governance arrangements work well, and what areas are in need of improvement?	For Icon Water’s proposed amendments, see section 2.
What steps could be taken to improve the administrative and governance arrangements for independent pricing regulation in the ACT?	For Icon Water’s proposed amendments, see section 2.
Are the roles of the different entities involved within the regulated water and sewerage pricing sphere appropriately defined? If not, what changes should be considered?	Icon Water has proposed that additional guidance be provided on the regulator’s role (see section 2.1). Icon Water has proposed that requirements of its regulatory proposals be specified in an Approach Paper at the outset of a review process (see section 2.3.2)
Do the current objectives for the determination of water and sewerage pricing, as outlined within the ICRC Act, remain appropriate?	Icon Water proposes that the objectives be clarified (see section 2.1).

Questions raised in the Issues Paper	Icon Water comments
Does the current legislation provide an adequate framework for ensuring that an appropriate balance can be achieved between consumer protection, the needs of the community, and the needs of the regulated provider of water and sewerage services?	The balance is a subjective outcome depending on the considered, informed judgement of the regulator having access to all relevant information. Icon Water proposes further guidance be provided on how regulatory discretion will be exercised in arriving at this balance. For Icon Water’s proposed amendments, see section 2.
Are the current provisions of the ICRC Act establishing the requirements for the form and content of a draft report for a pricing determination appropriate and sufficiently clear?	The requirements of the draft report in terms of form and content are currently at the discretion of the regulator except to those matters to which the Commission must have regard that are set out in the reference and in the legislation, e.g. S20 of the ICRC Act. Icon Water considers that the draft report should be clearly and directly related to the structure and content of the final report, taking into account the substance of the issues raised in submissions and covering all constituent decisions, including a price direction. Final reports should not need to vary substantially in form or content to the draft report, given there is no opportunity to comment on the final report.
Are the current provisions around the process for undertaking a review of an ICRC pricing determination appropriate and efficient?	Icon Water has proposed that legislation be amended to improve the process for undertaking a review (see section 2.3).
What other parts of the ICRC Act should be reconsidered, and possibly revised, in order to improve the overall arrangements for setting prices?	Icon Water has proposed that legislation be amended to improve the overall arrangements for setting prices (see section 2).
Are there any other parts of the current legislative framework related to the water and sewerage pricing process that should be reviewed within this process?	Icon Water has proposed that legislation be amended to improve the pricing process (see section 2).
Is there a need for administrative principles in relation to the water and sewerage pricing process? If so, what should the focus of these principles be?	Yes. Icon Water has proposed principles for the conduct of regulatory review in section 2.1.2. Icon Water has also made proposals in relation to other matters raised in this section of the Paper, including consultation documentation prepared by the ICRC (section 2.3.2) and the prioritisation of objectives (section 2.1.1).
What should be the appropriate form of any administrative principles – should they be incorporated into legislation, or be policy based? If policy based, by whom should they be determined?	Principles should be included in legislation as high level statements, with guidance on how and when they might be applied.
What protocols for the provision of information would be appropriate in relation to the water and sewerage pricing process?	Icon Water has proposed that requirements for the provision of information be established early in a review process (section 2.3.2). Only information that is relevant to the investigation should be sought.

Questions raised in the Issues Paper	Icon Water comments
What (if any) additional protocols or principles are required in relation to disputes that may occur during the undertaking of a water and sewerage pricing process?	See section 3.2.
What would be the advantages and disadvantages of introducing administrative principles?	See relevant comments in sections 2.1.1, 2.1.2, 2.3.2, and 3.2.
Would there be a benefit to the ACT from introducing pricing principles? Is there a need for greater guidance and predictability in relation to the methods, processes and priorities used for independent price regulation in the ACT?	Yes. Icon Water has proposed that objectives be clarified (section 2.1.1), pricing principles be established (see section 2.1.2) and standing guidelines be established in relation to methodology (section 2.2).
What form should the principles take? For example, how broad or detailed should they be, by whom should they be determined, and how could they be changed if necessary?	The principles at a high level of generality should be included in legislation. Detailed guidance should be provided in standing guidelines and subject to review on a regular basis.
If pricing principles were to be introduced, what key issues should they address?	See Icon Water's comments in section 2.1.1, section 2.1.2 and section 2.2.
If introduced, what guidance should principles provide in relation to the objectives of water and sewerage pricing investigations?	See Icon Water's comments in section 2.1.
Should any principles be codified in legislation, or alternatively be issued in the context of a particular pricing investigation?	The objectives and principles discussed in section 2.1.1 and section 2.1.2 should be codified in legislation. The requirement for standing guidelines and the mechanism for their review and amendment should also be codified in legislation (section 2.2).
What would be the advantages and disadvantages of introducing pricing principles? Would there be any implications for the independence of the ICRC?	See Icon Water's comments in section 2.1.1, section 2.1.2 and section 2.2. The introduction of principles should neither reduce nor undermine the independence of the regulator. They would however enhance reliability, certainty and predictability and increase confidence in regulatory outcomes.
What are the advantages and disadvantages of the current regulated pricing approach to the provision of pricing for water and sewerage services in the ACT?	See section 1.1.1.
Could the protection of consumer interests (a key objective of regulated pricing), be achieved under a price monitoring regime?	See section 1.1.1.
What would be the advantages and disadvantages of a price monitoring regime?	See section 1.1.1.
What other potential options are there for setting water and sewerage prices for potable water and sewerage services provided by ACTEW? What are the advantages and disadvantages of such approaches to pricing?	See section 1.1.1.

<b>Questions raised in the Issues Paper</b>	<b>Icon Water comments</b>
Are there other matters directly related to water and sewerage pricing framework, but not explicitly discussed within the terms of reference, that should be considered by the review?	Icon Water notes the crucial importance of the quality of the relationship between the regulator and regulated parties (see section 3.1).