

Industry Panel Review of the Independent Competition and Regulatory Commission's 2013 Price Direction: Overview of final report and decision

Why was a review required?

An Industry Panel was appointed by the ACT Treasurer to review the price direction for water and sewerage services set by the Independent Competition and Regulatory Commission (ICRC) in 2013.

The review was triggered by Icon Water (under the name of ACTEW Corporation) under the appeal process provided for in the *Independent Competition and Regulatory Commission Act 1997*.

The Panel submitted its final report setting out its pricing decision to the ACT Treasurer on 29 April 2015. This report took into account matters raised in responses to the Panel's draft report, which was released in December 2014.

Background to the review

The ICRC is responsible for regulating the prices Icon Water charges for water and sewerage services in the ACT. Its price direction released in 2013 determined that Icon Water's maximum prices for water services should increase by 4.9% in 2013–14, while maximum prices for sewerage services should fall by 18.1%. To deal with uncertainties about costs and demand over the five-year regulatory period, the ICRC made provision for prices in later years to be established through two 'biennial recalibrations', to be conducted in 2015–16 and 2017–18.

Icon Water applied for a review of the price direction in September 2013 under the *Independent Competition and Regulatory Commission Act 1997* on a range of grounds.

In response, the ACT Treasurer appointed an independent Industry Panel to conduct the review. Under the Act, the Panel must:

- either substitute a new price direction for the original price direction, or confirm the original price direction, and
- make its decision on the merits of the case, having regard to the legislation that governs the price direction.

What did the Industry Panel decide?

The Panel decided to substitute a new price direction for water and sewerage services that spans the entire remaining regulatory period until 30 June 2018. This determination therefore removes the uncertainty about future pricing changes that could otherwise have arisen from each of the ICRC's proposed biennial recalibrations due in 2015–16 and 2017–18.

The Panel's new price direction is based on a framework that reflects well-tested and accepted regulatory techniques and principles.

The decision provides:

- improved price certainty and stability for Icon Water, the ACT Government and the ACT community over the three years to mid-2018

- a robust foundation for future price determinations for regulated water and sewerage services in the ACT
- a regulatory environment that is conducive to efficient investment in the water and sewerage sector
- incentives for Icon Water to reduce its costs over time.

The effect of the Panel's final decision is that:

- water charges will fall in real terms (by 3.4% less than inflation) in 2015–16, and then rise in line with inflation (CPI) in 2016–17 and 2017–18
- sewerage charges will increase slightly in real terms (by 1.4% more than inflation) in 2015–16, and then increase in line with inflation over the next two years.

What are the impacts of the Panel's final determination?

For households and non-residential customers

Typical households will see a modest increase of \$14 in their combined annual water and sewerage bill (a rise of around 1%) in 2015–16, compared to the current 2014–15 year. This increase is less than the rate of inflation (assuming an inflation rate of 2.5%). Over the remainder of the period, total bills will rise in line with rate of inflation.

Depending on a non-residential customer's annual water consumption and number of billable fixtures, the 2015–16 bill is expected to change in the range of from a 7% decrease to an 11% increase.

These price rises are consistent with water utility charges in other parts of Australia.

The modest price changes proposed are unlikely to have a significant impact on the bills of vulnerable customers. However, the Panel acknowledges that *any* increase will affect low income and vulnerable households, and recognises the importance of programs which assist those facing difficulties in paying water and sewerage bills.

All indicative bills assume the inflation rate (CPI) is 2.5% per annum and that the cost pass-through mechanism is not triggered by unforeseen events or government decisions (such as changes to the Water Abstraction Charge or Utilities Network Facilities Tax).

For Icon Water and future regulatory decisions

Although the Panel has set a price path that is lower than that proposed by Icon Water, the decision incorporates safeguards to protect Icon Water's financial viability.

The form of regulation determined in the Panel's final decision reflects best practice principles for risk allocation. This means that risk is shared between customers and Icon Water. Also, Icon Water has an incentive to pursue efficiencies.

What changes were made following the Panel's draft report?

The Panel's final decision is broadly in line with its draft decision.

The Panel listened carefully to feedback on its draft decision, including matters raised at a public hearing held on 6 February 2015, and took account of additional information provided by Icon Water.

While many components of the draft decision were not challenged in any submission and have been confirmed, several issues were reconsidered by the Panel in light of submissions contending for changes to some aspects of the draft decision. After reconsidering these matters, the Panel revised two key variables: forecasts of capital expenditure and water sales.

The most significant change to prices arise from the Panel adopting lower water demand forecasts:

- While the size of the decrease is modest (with water sales now projected to be around 2% lower than forecast at the draft decision stage), this has a direct impact on the volumetric charges for water.
- Because the Panel's demand forecasts remain higher than those proposed by Icon Water, resulting price rises are lower than that contended by Icon Water.

Other changes include:

- A \$20 million reduction in forecast capital expenditure because of new information concerning delivery of Icon Water's capital program.
- Updated asset lives for around 60 projects, which affect the allowances for depreciation.
- Minor reductions in forecast operating expenditure (reflecting a lower Water Abstraction Charge because of lower water sales forecasts and the correction of an error in conversion from real to nominal values).
- A decision not to include a 'true up' adjustment because of changes to the Panel's views about Icon Water significantly over-recovering revenue during the first two years of the regulatory period (when the ICRC's prices apply).
- Reduced the size of the deadband to 6% (from 7% in the draft decision). This was a direct result of the revised forecast for water sales.

The Panel did not accept Icon Water's contention for a higher rate of return (another major driver of price rises for water and sewerage services).

How did the Panel reach its decision?

In keeping with the Act and the terms of reference for the ICRC's original price direction, the Panel's decision takes account of a broad range of matters. These include objectives related to consumer protection, economic efficiency and Icon Water's financial viability.

The Panel's approach to setting prices was based on tried and tested regulatory practices. This entailed analysis and modelling, and expert advice on the costs of providing water and sewerage services, and the forecast demand for these services over the regulatory period.

In reaching its final decision, the Panel examined the ICRC's original price direction and investigated those matters raised by Icon Water in its Statement of Facts and Contentions, its submission to the Panel's draft report, and in its subsequent responses to Panel questions.

Written submissions from members of the public and matters raised during the Panel's public hearings were also carefully considered.