

State  
water

*Taking care of it*

***State Water Submission to the 2014 Review of  
the Water Act 2007 (Commonwealth)***



***State Water Corporation***

All inquiries about this submission should be directed to:  
Joseph Caruana  
Senior Regulatory Economist

Stevan Munic  
Regulatory Analyst

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July 2014

State Water reference: DOC14/16275

State Water Corporation  
PO Box 1018, Dubbo NSW 2830  
[www.statewater.com.au](http://www.statewater.com.au)

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## State Water submission to the 2014 Review of the Water Act 2007

### Introduction

State Water welcomes the opportunity to respond to the Expert Panel's (the Panel) 2014 Review of the *Water Act 2007 Cth* (the Act) (the Review).

State Water recommends a number of changes to the legislative framework and provides commentary on what it considers to be priority issues to ensure alignment of the Act with key strategic objectives.

State Water, New South Wales' rural bulk water delivery business, is a NSW State Owned Corporation. Until 2014 all of State Water's regulated charges were determined by the NSW Independent Pricing and Regulatory Tribunal (IPART). From 1 July 2014 State Water's Murray Darling Basin (MDB) charges are regulated by the Australian Competition and Consumer Commission (ACCC), for which the ACCC released its final determination on 26 June 2014. State Water's non-MDB charges continue to be regulated by IPART.

State Water has analysed the application of the recent MDB water charging arrangements and identified that the arrangements neither achieve Basin-wide consistency nor contribute to the Basin water charging objectives to the degree intended by the Act. To address these identified issues and improve the regulatory process and outcomes, State Water recommends that the Panel consider, in the context of their impacts on stakeholders and consumers, the:

- transparency and accountability in the regulatory decision making process;
- discretion afforded to the regulator in setting or approving prices; and
- potential for legal and regulatory error from administration of the Act and Water Charge (Infrastructure) Rules 2010.

Addressing these priority areas is essential to improving the certainty of the existing regulatory process, particularly in the area of pricing. Minimising regulatory uncertainty ensures that regulation is efficient, which reduces costs and maximises the overall net benefit of regulation to customers.

To achieve this State Water recommends the following amendments to the Act:

- more guided discretion and prescriptive charging arrangements;
- full merits review undertaken by the Australian Competition Tribunal;
- judicial review under the *Administrative Decisions (Judicial Review) Act (Cth)*;

- recommendations to minimise cost burden through streamlining the ACCC and state based pricing process.
- transparent rule change process;
- institutional reform of the funding arrangements for the Murray Darling Basin Authority, which may include some form of price regulation;
- improving Part 5 and Part 7 regulation; and
- recommendations to reduce or simply reporting burden across all water legislation.

These recommendations are informed by best practice approaches to regulation in the energy sector, which has experienced and sufficiently addressed similar risks to those identified by State Water in this submission.

State Water believes its recommendations will improve overall consistency in the water charging arrangements across the MDB and the achievement of the *Basin water charging objectives*, maximising the benefits to customers through lower costs and more transparent arrangements.

Further, State Water recommends that the Panel release an Issues Paper outlining the Panel's preliminary views with calls for submissions. Alternatively, State Water would be happy to provide feedback to the Panel on its preliminary recommendations or proposed amendments to the Act prior to the release of its Final Report in November 2014.

State Water also recommends that the Panel consider the effectiveness of the subordinate instruments under the Act for example the Water Charge (Infrastructure) Rules 2010 (WCIR) and Water Market Rules 2009, as the Act should not be considered in isolation of the detailed arrangements in these Rules.

## Summary of Recommendations

The table below outlines a summary of State Water's recommendations and comments and the submission reference in order of priority.

**Table A – Summary of State Water's Recommendations**

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
<p>1. Increase the level of prescription in the water charging arrangements and move towards a guided discretion model.</p> <p><b>See Section 1.1 of the submission.</b></p>	<p>Greater predictability and a guided discretion model can increase the efficiency of regulation and lower costs to customers by:</p> <ul style="list-style-type: none"> <li>• reducing the regulatory risks faced by Operators;</li> <li>• reducing risks faced by customers and investors;</li> <li>• ensuring investors are more likely to commit capital, facilitating efficient investment and the provision of long term benefits to consumers; and</li> <li>• ensuring that lower level statutory instruments and regulatory determinations are consistent with the underlying intent of the legislation.</li> </ul> <p>Increasing the level of prescription in the charging arrangements is a cost effective way to address the potential for legal and regulatory error.</p>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Effectiveness of the Act in achieving its objects.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>
<p>2. Include a full merits review mechanism for price approvals or determinations.</p> <p><b>See Section 1.2 of the submission.</b></p>	<p>The Act does not have a merits review mechanism for price approvals or determinations under the Act.</p> <p>The creation of a merits review mechanism provides an incentive for administrative bodies to be accountable for the decisions they make. This improves the efficiency of the current regulatory arrangements by reducing the opportunity for uncertain, inconsistent, and sometimes unintended regulatory outcomes.</p>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Effectiveness of the Act in achieving its objects.</p> <p>Reduce or simplify regulatory</p>

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
	<p>Merits review is consistent with best practice regulation as experienced in the energy sector.</p> <p>In addition, the merits review mechanism would be available to customers as well as businesses and so provides protection to both parties.</p> <p>The arrangements in the Act could better address the risks of regulatory creep and or industry/regulatory capture in the regulatory decision making process. This is significant given the ACCC's other regulatory functions and the ability for outside influences to 'creep' into the MDB pricing process. Merits review can effectively address this risk.</p> <p>Further, greater prescription in the charging arrangements (section 1.1 of this submission) will not prevent all regulatory errors from occurring. In these cases, merits review provides additional protection against the risk of regulatory error, which can have serious economic and social consequences.</p>	burden and/or reporting.
<p>3. Include a statutory right of judicial review for price approvals or determinations.</p> <p><b>See Section 1.3 of the submission.</b></p>	<p>The Act does not have an explicit right of appeal on the grounds of judicial review for price approvals or determinations under the Act.</p> <p>Without judicial and merits review, the regulator will be deciding matters of law on a final basis, therefore exercising a judicial function. This is inconsistent with the regulator's role as an administrative body.</p>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
<p>4 Engage with IPART to determine the changes to be made to the Act and the WCIR to encourage IPART to seek accreditation.</p> <p><b>See Section 1.4 of the submission</b></p>	<p>Sections 91 (2) and (3) of the Act limits the application of charging arrangements to Basin water resources. This results in inefficient regulation of pricing, with higher cost to customers because State Water is required to:</p> <ul style="list-style-type: none"> <li>• participate in two separate pricing processes (ACCC for MDB valleys and IPART for Coastal valleys and some Fish River customers) using different sets of rules; and</li> <li>• provide variations of the same data to two separate administrative bodies.</li> </ul> <p>Dealing with two regulators increases regulatory burden on State Water with no apparent benefit to State Water or customers. This anomaly can be removed by IPART seeking accreditation under the Act. IPART should be consulted on the changes to the Act or the WCIR which would encourage it to seek accreditation.</p>	<p>Reduce or simplify regulatory burden and/or reporting.</p>
<p>5. Include a clear and transparent rule change process which removes the regulator's advisory role to the rule maker.</p> <p><b>See Section 1.5 of the submission.</b></p>	<p>The Act empowers the Minister to create, amend or revoke the water charge rules and water trading rules. However, the Act imposes additional hurdles for the Minister if the Minister disagrees with the regulator's advice.</p> <p>It is noted that the Act:</p> <ul style="list-style-type: none"> <li>• discourages disagreement between the Minister and the regulator in creating, amending or revoking the rules;</li> <li>• does not provide clear separation of the rule maker from the regulatory function;</li> <li>• does not empower either customers or regulated entities to request</li> </ul>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Effectiveness of the Act in achieving its objects.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>



State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
	<p>amendments to the WCIR; and</p> <ul style="list-style-type: none"> <li>• does not provide a clear and transparent review date for the WCIR.</li> </ul> <p>The arrangements could better address the risks of regulatory creep and or industry/regulatory capture in the rule making process.</p>	
<p>6. Consider improving Part 5 and Part 7 Operators to encourage more economically efficient outcomes.</p> <p><b>See Section 1.6 of the submission.</b></p>	<p>Part 5 and Part 7 Operators are subject to more light handed regulation, which does not include a pricing process. Pricing outcomes for Part 5 and Part 7 operators differ significantly to the pricing outcomes for Part 6 operators.</p> <p>The Panel should consider ways to improve Part 5 and Part 7 regulation - to give effect to incentive based outcomes observed under Part 6 pricing regulation to ensure that more efficient outcomes for customers are being achieved.</p>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>
<p>7i Reform the funding arrangements for the MDB Authority (MDBA), which may include some form of price regulation.</p> <p>7ii Alternatively, provide a mechanism for Part 6 Operators to pass MDBA costs onto customers without undue financial, commercial or</p>	<p>The MDBA is not subject to price regulation as it neither owns nor operates infrastructure for the purposes of storage or delivery of water.</p> <p>In NSW, MDBA costs are passed through to customers via the State Water price determination, without regard to prudence or efficiency requirements. Without price regulation of the MDBA, charges levied by customers in the Murray and Murrumbidgee valleys cannot be deemed to be efficient.</p> <p>In addition, the NSW Government requires State Water to make a fixed payment for the NSW Government contribution to the MDBA by June of each year. However, this fixed cost is recovered under State Water's variable tariff</p>	<p>Basin wide consistency and achieving the Basin water charging objectives.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
<p>reputational risk to that Operator.</p> <p><b>See Section 1.7 of the submission.</b></p>	<p>structure, which results in additional revenue volatility risks.</p> <p>The Panel should have regard to the need for institutional reform of the funding arrangements for the MDBA, which may include some form of price regulation to incentivise prudent and efficient investment in order to provide more efficient outcomes for customers.</p> <p>Alternatively, the Act should be amended to provide a mechanism for Part 6 Operators to pass MDBA costs onto customers without undue financial, commercial or reputational risk to that Operator.</p>	
<p>8. Consider information sharing arrangements/protocols for all water related legislation.</p> <p><b>See Section 1.8 of the submission.</b></p>	<p>State Water is required to report variations of the same data to the ACCC, National Water Commission and the Australian Bureau of Statistics.</p> <p>This increases reporting burden on State Water, the costs of which are passed on to customers. This burden can be minimised through information sharing arrangements and protocols for all water related legislation.</p>	<p>Reduce or simplify regulatory burden and/or reporting.</p>
<p>9. Promote common language and a common set of rules for Commonwealth-accredited water resource plans.</p>	<p>The Murray Darling Basin Plan (Basin Plan) provides a framework to manage the water resources of the MDB. Chapter 10 of the Basin Plan requires Basin States to prepare Commonwealth-accredited water resource plans.</p> <p>State Water understands that there are no specific form and content requirements for Commonwealth-accredited water resource plans. The Act should promote common language and a common set of rules for accredited-</p>	<p>Ensuring the management objectives and outcomes of the Basin Plan are being met.</p>

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
<p><b>See Section 2.1.1 of the submission</b></p>	<p>water resource plans for the Basin to make them more accessible to customers and operators.</p>	
<p>10. Allow the Commonwealth Environmental Water Holder (CEWH) to apply the funds under the Special Account towards other initiatives that further the environmental objectives in the Act.</p> <p><b>See Section 3.1.1 of the submission.</b></p>	<p>The CEWH is tasked with managing water rights acquired by the Commonwealth Government for the purposes of meeting the environmental objectives in the Environmental Watering Plan. This can be achieved through the CEWH trading water. However, the Act restricts the extent to which the CEWH may engage in trade for the purposes of meeting its environmental objectives.</p> <p>For instance, the proceeds from the disposal of water holdings must be paid into a Special Account, which cannot be redirected to a use other than managing or acquiring Commonwealth environmental water.</p> <p>State Water recommends removing this limitation to allow the funds to be utilised in a most efficient and effective manner possible to achieve environmental outcomes.</p>	<p>Ensuring the management objectives and outcomes of the Basin Plan are being met.</p> <p>Water trading is occurring efficiently and effectively.</p>
<p>11. Water trading arrangements should include an appropriate mechanism to allow accurate billing of, and collection of revenue from, interstate customers.</p>	<p>There are various regulatory instruments that have been developed under the Act to facilitate interstate trade such as the Water Market Rules, WCIR and Water Trading Rules.</p> <p>State Water has identified a number of issues with the water trading arrangements in the Act, which promote inequitable outcomes, increase financial risk to State Water and ultimately increase costs to existing customers in NSW. These include:</p>	<p>Water trading is occurring efficiently and effectively.</p> <p>Reduce or simplify regulatory burden and/or reporting.</p>

State Water Recommendations	State Water Comments	Relevant Water Act Review Terms of Reference
<p>See Section 3.1.2 of the submission.</p>	<ul style="list-style-type: none"> <li>no specific agreement or mechanism for recovery of revenue by State Water for the water extracted in other MDB jurisdictions; and</li> <li>the usage charges levied by State Water on allocation trades to other MDB jurisdictions are difficult to impose on customers in other MDB jurisdictions, who are accustomed to fixed charges.</li> </ul>	
<p>12. Consider the extent to which the Act could facilitate the unbundling of water access rights across the MDB</p> <p>See Section 3.1.3 of the submission.</p>	<p>Water access rights across the MDB still encompass separate rights relating to water storage, carry over, and water delivery, which is overly complex and can present a barrier to water access.</p> <p>State Water supports the ACCC's recommendations in relation to the unbundling of water access rights.</p>	<p>Water trading is occurring efficiently and effectively.</p>

## About State Water

State Water is a State-Owned Corporation under the *State Water Corporations Act 2004 (NSW)* and *State Owned Corporations Act 1989 (NSW)*. State Water's core objective is to capture store and release water in an efficient, effective, safe and financially responsible manner.<sup>1</sup>

State Water maintains, manages and operates major infrastructure to deliver bulk water to approximately 6,300 licensed water users on the state's regulated rivers along with associated environmental flows. As NSW's rural bulk water delivery business, State Water's activities extend to MDB valleys, as well as NSW coastal valleys and other unregulated activities across NSW.

State Water is a Part 6 operator under the WCIR (an operator where the total volume of entitlements to which the operator and its customers are entitled within the MDB exceeds 250 GL) and is therefore subject to the approval or determination of regulated charges. Other operators are subject to more light handed regulation.

The pricing determination process means that the costs incurred as a result of regulation are recovered from customers. Increasing the efficiency of regulation and reducing the cost of that regulation to State Water therefore also means reducing costs to customers. As it is the customers who are intended to be the ultimate beneficiary of regulation, it is essential that the regulatory framework promote the most prudent and efficient regulatory outcomes. Therefore State Water believes that any improvements to the regulatory framework established under the Act are not only in State Water's best interests, but also that of customers.

State Water is in a good position to address the effectiveness of the Act against the criteria in the Panel's terms of reference, having recently participated in the 2014-17 ACCC price determination process.

The ACCC Final Decision on regulated charges for MDB valleys in NSW was delivered on 26 June 2014 and came into effect 1 July 2014. The Final Decision and related documents are available on the ACCC's website.<sup>2</sup>

State Water is also subject to an independent pricing process for regulated charges levied in NSW coastal valleys and some Fish River charges under State legislation. The Independent Regulatory and Pricing Tribunal's (IPART) pricing process will begin in July 2014.

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<sup>1</sup> *State Water Corporation Act 2004 (NSW)*, s 5.

<sup>2</sup> <<https://www.accc.gov.au/regulated-infrastructure/water/state-waters-regulated-charges-2014-17-review>>

## 1. Submission on water charging arrangements

State Water believes that the water charging arrangements for Part 6 Operators neither achieve Basin-wide consistency nor contribute to the *Basin water charging* objectives as intended under the Act. State Water recommends that the Panel consider, in the context of their impacts on stakeholders and customers, the:

- discretion afforded to the regulator in setting or approving prices;
- transparency and accountability in the regulatory decision making process; and
- potential for legal and regulatory error from the administration of the Act and WCIR.

State Water submits that amendments to the Act should consider the issues identified above in order to achieve consistent charging arrangements in the MDB and the *Basin water charging objectives*.

The benchmark for addressing these risks can be observed in best practice approaches to regulation in the energy sector, where similar risks have been addressed. State Water's recommendations are informed by developments in the energy sector.

In each recommendation, State Water sets out:

- the current situation;
- State Water's preferred approach and proposed amendment; and
- State Water's comments to the relevant Terms of Reference.

State Water's preferred recommendations are as follows:

1. increase the level of prescription in the water charging arrangements and move towards a guided discretion model;
2. full merits review undertaken by the Australian Competition Tribunal; and
3. minimise cost burden by streamlining the reporting requirements for the pricing process including state based pricing.

### 1.1 Guided discretion and more prescriptive charging arrangements

The MDB water charging arrangements are of considerable economic significance, involve highly complicated topics and a significant amount of judgement by the regulator. This highlights a relatively high risk of regulatory error in the pricing process, which could have significant social and economic consequences. For example, see the Productivity Commission's views on the impact of regulatory error:

*Nonetheless, the Commission accepts that there is a potential asymmetry in effects:*

- *Over-compensation may sometimes result in inefficiencies in the timing of new investment in essential infrastructure (with flow-ons to investment in related markets), and occasionally lead to inefficient investment to by-pass parts of a network. However, it will never preclude socially worthwhile investments from proceeding.*
- *On the other hand, if the truncation of balancing upside profits is expected to be substantial, major investments of considerable benefit to the community could be forgone, again with flow-on effects for investment in related markets.*

*In the Commission's view, the latter is likely to be a worse outcome. Accordingly, it concurs with the argument that access regulators should be circumspect in their attempts to remove monopoly rents perceived to attach to successful infrastructure projects.<sup>3</sup>*

Given the complicated nature of the pricing process, State Water submits that the Act should be amended to increase the level of prescription in the water charging arrangements and move towards a guided discretion model. Implementing State Water's recommendation would:

- encourage greater predictability in the charging arrangements;
- improve transparency and accountability in the pricing process;
- prevent regulator errors which can have serious economic or social consequences; and
- increase consistency in the application of the WCIR by all regulators in the MDB, including accredited agencies.

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<sup>3</sup> Review of the National Access Regime Inquiry Report, Productivity Commission, 2001.

This conclusion is informed by the views of the Australian Energy Market Commission:

*Principles of good regulatory design suggest that greater predictability and consistency in the regulatory regime can reduce the regulatory risks faced by TNSPs [sic Transmission Network Service Providers], as well as the risks faced by users of transmission services and investors in other parts of the energy supply chain. Greater certainty in the Rules governing regulation means investors are more likely to commit capital, facilitating efficient investment and the provision of long term benefits to consumers. Predictability and consistency of decision making can be increased through:*

- *Rules that provide clear objectives and outcomes in relation to regulatory decisions;*
- *Rules that provide a greater degree of guidance about the decisions to be made; and*
- *Rules that set out clear procedural and informational requirements thereby increasing the transparency of decision making.<sup>4</sup>*

State Water's specific recommendations are set out in the following categories:

- providing clear objectives in relation to regulatory decisions (section 1.1.1);
- providing greater degree of guidance for decisions to be made (section 1.1.2);  
and
- providing clear procedural and information requirements (section 1.1.3).

The merits of these recommendations to the relevant Terms of Reference are set out in sections 1.1.4, 1.1.5 and 1.1.6 of this submission.

### *1.1.1 Providing clear objectives in relation to regulatory decisions*

#### *1.1.1.1 Current situation*

The water charging arrangements for Part 6 Operators require the regulator to have regard to the *Basin water charging objectives* when exercising its pricing powers, but do not specify which objectives should be given more weight in the pricing process.

This can be interpreted to provide a wide discretion to the regulator in setting or approving charges, which is reflected in the application of vastly different price control mechanisms and tariff structures for Part 6 Operators across the MDB. As

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<sup>4</sup> Australian Energy Market Commission Review of the Electricity Transmission Revenue and Pricing Rules Issues Paper October 2005.



the *Basin water charging objectives* have not been applied in a consistent manner by all economic regulators across the MDB, State Water concludes that the charging arrangements do not contribute to Basin wide consistency.

For example table 1.1 sets out the customer bill impacts for private diverters supplied through the Murray River in NSW and Victoria as per the new pricing arrangements. Table 1.2 sets out the customer bill impacts as per the previous arrangements before the application of the WCIR: <sup>5</sup>

Table 1.1 hypothetical bills for private diverters—50 ML, 250 ML and 1000 ML of water access entitlement, with 50 per cent or 100 per cent delivered—total bill (\$ amount per ML of water access entitlement held), under new pricing arrangements. <sup>6</sup>

Bulk water supplier	System	Charging category	50 per cent delivery			100 per cent delivery		
			50 ML	250 ML	1000 ML	50 ML	250 ML	1000 ML
GMW <sup>2</sup>	Murray		1 084 (22)	4 662 (19)	18 078 (18)	1 084 (22)	4 662 (19)	18 078 (18)
LMW <sup>3</sup>	Murray		759 (15)	3 055 (12)	11 665 (12)	759 (15)	3 055 (12)	11 665 (12)
State Water <sup>4</sup>	Murray	High Security	157 (3)	783 (3)	3 131 (3)	223 (4)	1 115 (4)	4 462 (4)
		General Security	118 (2)	588 (2)	2 351 (2)	184 (4)	920 (4)	3 682 (4)

1. Estimated bulk water bill. Brackets indicate \$ per ML of water access entitlement held.

2. GMW (Goulburn-Murray Water) total bills were calculated using the 2014-15 pricing calculator on the GMW website accessed on 17 June 2014. The total bill for Murray Regulated High Reliability was divided by the ML of water entitlement to determine the \$ per ML of water access entitlement held.

3. LMW (Lower Murray Water) total bills were calculated using 2014-15 prices on the LMW website. Total bill was derived by the service and HR Entitlement Storage Fee. Total bill was divided by the ML of water entitlement to determine the \$ per ML of water access entitlement held.

4. State Water bill impacts were calculated under a 40:60 fixed to variable tariff structure using the General Security, High Security and variable charges set out in the ACCC 2014-17 Draft Decision released in March 2014. These charges exclude MDB Authority costs.

<sup>5</sup> Prior to 2012-13 (and 2013-14 for State Water), Part 6 operators levied bulk water charges in accordance with state based pricing determinations, as these were still in effect under the transitional arrangements in the WCIR.

<sup>6</sup> From 2013-14 GMW and LMW levied bulk water charges in accordance with the 2013-18 VESC price determination – the first determination made under the accreditation arrangements in the WCIR. From 2014-15 (after the 2010-14 IPART price determination elapses) State Water will levy the charges set under the 2014-17 ACCC price determination.

Table 1.2 hypothetical bills for private diverters—50 ML, 250 ML and 1000 ML of water access entitlement, with 50 per cent or 100 per cent delivered—total bill (\$ amount per ML of water access entitlement held), under the previous pricing arrangements for 2012–13.

Bulk water supplier	System	Charging category	50 per cent delivery			100 per cent delivery		
			50 ML	250 ML	1000 ML	50 ML	250 ML	1000 ML
GMW	Murray		1 130 (23)	4 930 (20)	19 180 (19)	1 130 (23)	4 930 (20)	19 180 (19)
LMW	Murray		744 (15)	3 320 (13)	12 980 (13)	744 (15)	3 320 (13)	12 980 (13)
State Water	Murray	High Security	272 (5)	1 358 (5)	5 430 (5)	394 (8)	1 970 (8)	7 880 (8)
		General Security	239 (5)	1 193 (5)	4 770 (5)	361 (7)	1 805 (7)	7 220 (7)

1. Estimated bulk water bill. Brackets indicate \$ per ML of water access entitlement held.  
Source ACCC 2012-13 Water Monitoring Report

In comparing table 1.1 and 1.2, it is evident that the pricing outcomes still differ significantly in New South Water and Victoria despite Part 6 Operators being subject to the same regulatory framework. In both tables, Goulburn-Murray Water (GMW) and Lower Murray Water's (LMW) bills remain unchanged as usage increases, whereas State Water bills are higher as usage increases.

Further, the charges under the new pricing arrangements closely resemble the charges determined under the previous pricing arrangements. Consequently, the new pricing arrangements have failed to result in any substantial improvement to water charging as intended under the Act, thereby denying customers the consistency and compatibility in the charging arrangements envisaged under the Act. See table 1.3 for the price control mechanisms under the new and previous pricing arrangements:

Table 1.3 – price control mechanism under new and previous pricing arrangements in NSW and VIC.

New pricing arrangements		Previous pricing arrangements	
NSW (State Water)	VIC (GMW, LMW)	NSW (State Water) <sup>5</sup>	VIC (GMW, LMW) <sup>6</sup>
<ul style="list-style-type: none"> <li>• ACCC determined a 40:60 fixed to variable tariff structure despite State Water's predominately fixed costs base .</li> <li>• ACCC set a price cap despite revenue volatility risk to State Water.<sup>1</sup></li> <li>• ACCC determined charges at below costs recovery for the Peel Valley. This is despite Rule 29 of the WCIR, which requires charges to be set so that they are reasonably likely to meet the prudent and efficient cost of providing the services.<sup>2</sup></li> <li>• ACCC applied NSW Government costs shares.</li> </ul>	<ul style="list-style-type: none"> <li>• VESC determined GMW and LMW tariff structures that closely aligned with their predominately fixed cost base.</li> <li>• VESC set a revenue cap to ensure sufficient revenue streams.<sup>3</sup></li> </ul>	<ul style="list-style-type: none"> <li>• IPART determined a 40:60 fixed to variable tariff structure despite State Water's predominately fixed costs base .</li> <li>• IPART set a price cap despite revenue volatility risk to State Water.</li> <li>• IPART determined charges at below costs for some valleys, such as the Peel Valley.</li> <li>• IPART applied NSW Government costs.</li> </ul>	<ul style="list-style-type: none"> <li>• VESC determined tariff structures that closely aligned with GMW's and LMW's predominately fixed cost base.</li> <li>• VESC set a revenue cap to ensure sufficient revenue streams.<sup>4</sup></li> </ul>

1. Revenue volatility risk occurs when forecast water extractions (which set variable charges) fall below actual usage, resulting in under recovery of revenue from the variable component of the tariff structure set by the regulator. State Water's tariff structure contains a high variable component (60:40 fixed to variable), placing it at additional risk of revenue volatility compared to other MDB Part 6 Operators.

2. The ACCC capped Peel Valley prices by 10 per cent per annum.

3. Victorian Essential Services Commission Price Review 2013: Rural Water businesses. Final Decision. Chapter 8-9.

4. Victorian Essential Services Commission 2008 Water Pricing Review, page 170.

5. The IPART arrangements resulted in State Water's revenue shortfall cumulating to \$72.9 million to 2013. IPART's tariff structure did not sufficiently address State Water's revenue volatility risk, especially in times of low water availability. The arrangements dampened the incentives to invest in bulk water infrastructure and diminished price signals to customers.

6 Unlike NSW customers, Victorian customers are exposed to the true costs of providing bulk water services in the MDB due to the application of predominately fixed charges and a revenue cap to its Part 6 Operators.

The State Water 2014-17 ACCC Price Determination and the VESC Price Review 2013 provide a good example of the application of vastly different price control mechanisms and tariff structures for Part 6 Operators across the MDB.

State Water notes that the *Basin water charging* objectives focus on achieving economic efficiency, ensuring sufficient revenue streams to the operator, and giving effect to the principle of user pays and ensuring the ongoing ability of operators to provide service delivery to customers.

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In the ACCC Final Decision Paper, the ACCC proposed high variable charges, a price cap, and setting Peel Valley charges at below cost recovery.<sup>7</sup> The ACCC justified this approach by having regard to the *Basin water charging objectives* but placed considerable emphasis on the phrase - *avoid perverse or unintended pricing outcomes* – one of the eight *basin water charging objectives*.

Frontier Economics conducted analysis for State Water which concluded that the ACCC placed undue weight on one aspect of the *basin water charging objectives* in setting its price control mechanism for State Water.<sup>8</sup>

State Water is not aware of a situation where the VESC has interpreted and applied the *Basin water charging objectives* in a similar manner for its Part 6 Operators.

#### 1.1.1.2 State Water's preferred approach and proposed amendment

State Water recommends that the charging arrangements provide clear objectives in relation to regulatory decisions. This would avoid a situation where economic regulators within the MDB apply the same set of charging arrangements to similar businesses, yet achieve vastly different pricing outcomes which do not reflect the underlying intent of the Act.

State Water submits that the Act should be amended to specify which *Basin water charging objectives* should be given more weight in the pricing process. This can be achieved by specifying the primary objectives and secondary objectives in the *Basin water charging objectives*. This will establish an order of hierarchy in the *Basin water charging objectives* and ensure they are balanced appropriately by the regulator to reflect the underlying intent of the Act.

The Act should also be amended to exclude consideration of irrelevant matters in the pricing process, such as Government subsidies and Government cost shares. Such matters may influence the outcome of a pricing decision.

For example, if the regulator considers Government subsidies or cost shares, the regulator may undertake less scrutiny of Government allocated costs as opposed to customer allocated costs. The NSW cost share arrangements are a matter for the NSW Government determined under greater policy considerations. These

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<sup>7</sup> The ACCC capped Peel Valley prices by 10 per cent per annum to avoid 'perverse or unintended pricing outcomes'.

<sup>8</sup> For further analysis, see Frontier Economics Analysis of aspects of the ACCC Draft Decision on State Water Application and Frontier Economics Review of Appendix A ACCC Draft Decision on State Water Application attached to State Water's submission to the ACCC Draft Decision Paper <<https://www.accc.gov.au/regulated-infrastructure/water/state-waters-regulated-charges-2014-17-review/draft-decision>>

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arrangements should be applied by the Part 6 Operator under the direction of the NSW Government.

Further, State Water submits that the Act should be amended to explicitly remove unclear and ambiguous objectives such as the need to *avoid perverse or unintended outcomes*. Such objectives may be interpreted broadly, which could promote consideration of irrelevant matters and increase the potential for regulatory and legal error.

Alternatively, the Act should require the phrase - *avoid perverse or unintended outcomes* – to be interpreted in the context of the other *Basin water charging objectives*; that is, interpreted in a way that would best achieve the *Basin water charging objectives* as a whole. This is consistent with the principles of statutory interpretation. See section 15AA of the *Acts Interpretation Act 1901 (Cth)*:

*In interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose or object is expressly stated in the Act) is to be preferred to each other interpretation.*

#### 1.1.2 *Provide greater degree of guidance for decisions to be made*

##### 1.1.2.1 Current situation

The water charging arrangements for bulk water operators:

- do not provide specific guidance to the regulator and the regulated entity as to how the regulator's discretionary powers are to be exercised during the pricing process; and
- do not contain sufficient form and content requirements for pricing decisions.

These factors may reduce transparency and accountability and increase the potential for regulatory and legal error in the regulatory decision making process.

One of the characteristics of good regulatory systems is that they should be applied in a consistent and predictable manner. The regulator is tasked with providing guidance to regulated entities as to how it intends to exercise its regulatory functions. If clear guidance is not provided, regulated entities will incur additional costs in complying with regulatory requirements, which will be passed through to customers. A lack of clear guidance can make it problematic for the Operator to effectively engage in the pricing process.

The Act and supporting delegated legislation requires the ACCC to determine economically efficient bulk water charges that represent the underlying cost of the

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service being provided. Further, the Act requires charges to be set to ensure sufficient revenue streams to the Operator in the forthcoming regulatory period. Examples of the legislated above outcomes are set out below:

- the policy intent of the Act, including the *Best Practice Water Pricing* in the Intergovernmental Agreement on a National Water Initiative and the *basin water charging objectives* in the Act;<sup>9</sup>
- ACCC Discussion Papers on the making of the WCIR<sup>10</sup>;
- the provisions in the WCIR, such as Rule 29, which requires charges to be set so that they are reasonably likely to meet the prudent and efficient cost of providing the services;
- ACCC pricing principles; and
- the interpretation and application of the above documents by an accredited agency endorsed by the ACCC under the WCIR.

Appendix A contains specific information on these outcomes in reference to the National Water Initiative, ACCC Discussion Papers and the ACCC pricing principles.

As highlighted in table 1.3 of this submission, the VESC, an accredited agency endorsed by the ACCC, applied the above principles for its Part 6 Operators by applying a revenue cap and predominately fixed tariffs for GMW and LMW. This provided guidance to State Water on how economic regulators were expected to apply the charging arrangements in the Act. It was apparent to State Water that the VESC pricing approach should be applied in NSW given the need to ensure consistent pricing outcomes across the MDB as envisaged under the Act.

State Water proactively engaged with the ACCC to understand the expected regulatory approach to the State Water 2014-17 price determination, well before the due date for State Water's pricing submission under the WCIR.<sup>11</sup> State Water's pricing submission was strongly influenced by these discussions.

However, there was a lack of specific guidance in the Act regarding the way in which the above principles would be applied in State Water's circumstances. Consequently, the ACCC rejected State Water's pricing submission on all points when it was lodged (see Appendix A of this submission). This was an unpredictable outcome for State Water and its customers.

In the energy sector, the Australian Energy Regulator (AER) sets out its 'framework and approach' to a price determination<sup>12</sup> (including the AER's views on tariff structures and the price control mechanism), well before the due date for the

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<sup>9</sup> *Water Act 2007 (Cth)*, Schedule 2. Also see Appendix A of this submission.

<sup>10</sup> See Appendix B of this submission.

<sup>11</sup> The due date is 13 months prior to the start of the regulatory period.

<sup>12</sup> National Electricity Rules, rule 6.8.1 (b).

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network service providers' regulatory proposal. Further, the AER is required to provide specific reasons for departures from the 'framework and approach' and relevant regulatory guidelines. State Water believes there is merit in imposing similar requirements in the MDB water charging arrangements in the Act.

Regarding the form and content of regulatory decisions:

- The ACCC 2014-17 Final Decision Paper lacked some details on the way in which the ACCC's individual decisions (such as the rate of return, tariff structure, price control mechanism and building blocks) worked together to achieve the objectives of incentive based regulation. Consequently, some individual decisions were made in isolation of the other interrelated decisions.
- In the energy sector, the AER is required to explain these individual decisions and how they interrelate. State Water believes there is merit in imposing similar requirements in the water charging arrangements in the Act.

For example:

In the Draft Decision:

- The ACCC proposed a rate of return based on parameters in the energy industry, in isolation of the revenue volatility risk as a result of high variable tariffs as determined by the ACCC.<sup>13</sup>
- The ACCC proposed a 'novel' approach to addressing revenue volatility risk faced by State Water - by coupling an 'overs and under' mechanism and high variable tariffs, with a price cap. Novel approaches should be examined and explained in more detail given the relatively high risk of regulatory error, which can have serious economic and social consequences.

In the Final Decision:

- The ACCC stated that the building blocks would, on its own, achieve cost reflective prices, but did not consider State Water's specific concern around whether the price control mechanism allows for sufficient recovery of the building blocks.<sup>14</sup>

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<sup>13</sup> The rate of return is based on, among other things, the equity beta from the electricity industry. However, the electricity industry does not experience revenue volatility risk arising out of variable tariffs to the degree experienced by State Water as a result of high variable tariffs set by the ACCC.

<sup>14</sup> The ACCC Final Decision on State Water pricing application 2014-15 to 2016-17, page 118.

- o The ACCC was selective in responding to State Water's submission particularly for Peel Valley charges.<sup>15</sup> The ACCC's statement of reasons does not articulate how the determination of charges below cost recovery supports cost reflective prices.<sup>16</sup>

#### 1.1.2.2 State Water's preferred approach and proposed amendment

State Water submits that the water charging arrangements should adopt the high level mechanisms prescribed in the energy sector, which provide a greater degree of guidance for the decisions to be made by the regulator.

For example, the Act could be amended to include mechanisms that:

- require the regulator to make decisions that meet the objects of the Act or the *Basin water charging objectives* to the greatest degree;<sup>17</sup>
- require the regulator to provide specific reasons for departures from the Act, the *Basin water charging objectives*, the WCIR, or the ACCC pricing principles;<sup>18</sup>
- require the regulator to articulate a 'framework and approach' to the price determination well before the due date for a pricing submission;<sup>19</sup>
- require the regulator to comply with specific form and content requirements for pricing decisions, including constituent decisions and how they interrelate;<sup>20</sup>
- provide specific guidance to the regulator on the individual factors it should take into account in interpreting the *Basin water charging objectives* and exercising its functions under the Act (such as the need to consider efficient tariff structures<sup>21</sup> and the long run marginal costs of providing the service<sup>22</sup>);
- introduce specific and narrow powers which outline the circumstances in which the regulator can reject or accept certain parts of the regulated entity's pricing submission<sup>23</sup>; and

<sup>15</sup> State Water made further points on 1) subsidies being a matter of Government policy 2) customers in the Peel not endorsing a lower level of service that would arise from charges being set at below cost recovery and 3) the ACCC needing to articulate who should bear the revenue shortfall and why and how this is more consistent with the *Basin water charging objectives* compared to alternative approaches. See State Water submission <<https://www.accc.gov.au/regulated-infrastructure/water/state-waters-regulated-charges-2014-17-review/draft-decision>>

<sup>16</sup> ACCC Final Decision State Water Pricing Submission 2014-15 – 2016-17, page 11 <<https://www.accc.gov.au/regulated-infrastructure/water/state-waters-regulated-charges-2014-17-review/final-decision>>

<sup>17</sup> National Electricity Law, s 16 (d), National Gas Laws, s 28 (1) (b) (iii).

<sup>18</sup> National Electricity Rules, rule 6.2.8 (c), rule 6.12.13 (b), (c), (d).

<sup>19</sup> National Electricity Rules, rule 6.8.1 (b).

<sup>20</sup> National Gas Law, s 28 (1) (b) (ii), National Electricity Law, s 16 (c), National Electricity Rules, rule 6.11.2 (3), rule 6.12.1, rule 6.12.2.

<sup>21</sup> National Electricity Rules, rule 6.2.5 (c).

<sup>22</sup> National Electricity Rules, rule 6.18.5 (b).

<sup>23</sup> National Electricity Rules, rule 6.12.3 (b) and (c).



- introduce specific guidance on how the regulator is required exercise its general discretion under law.<sup>24</sup>

High level mechanisms may include mandatory obligations or specific form and content requirements for lower level statutory instruments (such as the WCIR, regulations or regulatory guidelines).

The above proposals are consistent with similar requirements in the energy sector. See references in footnotes for equivalent provisions in the energy sector. These provisions have been proven to:

- encourage greater predictability in the charging arrangements;
- improve transparency and accountability in the pricing process; and
- prevent regulator errors which can have serious economic or social consequences.

### *1.1.3 Provide clear procedural and information requirements*

#### *1.1.3.1 State Water's preferred approach and proposed amendments*

Further, State Water submits that the water charging arrangements should adopt the high level mechanisms prescribed in the energy sector, which provide improved procedural and information requirements for the pricing process.

For example, the Act could be amended to include mechanisms that introduce:

- more prescriptive and objective form and content requirements for the issuing of regulatory guidelines and information templates;<sup>25</sup>
- robust and transparent public consultation requirements;<sup>26</sup>
- important timeframes with clear obligations on the regulator as to when it has to make a final decision<sup>27</sup> including a more efficient process for price determination's to avoid time overruns; and
- confidentiality requirements, including clear obligations on the regulator to do everything reasonably necessary to prevent the disclosure of confidential information<sup>28</sup>.

The above proposals are consistent with similar requirements in the energy sector. See references in footnotes for equivalent provisions in the energy sector.

<sup>24</sup> National Gas Rules, rule 10, rule 40, National Electricity Rules, rule 6.12.3.

<sup>25</sup> National Gas Law, ss 48 49, National Electricity Rules, rule 6.4, rule 6.2.8.

<sup>26</sup> National Gas Law, s 28H, National Electricity Rules, rule 6.9.3, rule 6.16, rule 8.9. National Gas Rules, rule 8, rule 9A.

<sup>27</sup> National Gas Rules, rule 13, National Electricity Rules, rule 6.11.2.

<sup>28</sup> *Competition and Consumer Act (Cth)*, s 44AAF. National Gas Rules, rule 138AB.

#### *1.1.4 Ensuring Basin-wide consistency and achievement of Basin water charging objectives*

As stated previously, more guided discretion and prescriptive charging arrangements would:

- encourage greater predictability in the charging arrangements;
- improve transparency and accountability in the pricing process;
- reduce the potential for regulatory and legal errors; and
- increase consistency in the application of the WCIR by all regulators in the MDB, including accredited agencies.

The proposal will reduce the number of potential pricing outcomes under the Act and ensure closer alignment with the *Basin Water charging objectives*, with customers as the ultimate beneficiaries.

#### *1.1.5 Effectiveness of the Act in achieving its objects*

As the WCIR contain the majority of the charging arrangements in the Act, there is a risk that lower statutory instruments (such as the Rules or ACCC guidelines) may be inconsistent with the policy intent of the Act. This could lead to a situation where the regulator delivers a decision that is consistent with regulatory guidelines and the WCIR, but inconsistent with the objects of the Act.

Incorporating some high level charging arrangements is consistent with good regulatory design and would cement a clear hierarchy for statutory instruments. High level charging arrangements would be used to assess compliance of lower statutory instruments against the policy intent of the Act. This is consistent with the arrangements in the energy sector, where Rules and regulatory guidelines are issued and applied by reference objective criteria and specific powers outlined in higher statutory instruments.

The regulator would implement measures to promote consistency with the Act in the first instance. This will address the potential for legal and regulatory error, as well as promote pricing decisions that align with the objects of the Act to the greatest degree. Further, implementing the proposals will remove any doubt as to the policy intent of the Act.

The proposal would also ensure that the *Basin water charging objectives* are used to guide to the decision making process and intended by the Act, not to justify an outcome on a case by case basis. The Administrative Review Council's Decision

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Making Guide states that a decision *must not be made solely so as to accord with the wishes or views of any other person.*<sup>29</sup>

#### 1.1.6 Reduce or simplify regulatory burden and/or reporting

Increasing the level of prescription and introducing a guided discretion model in the water charging arrangements, will encourage more predictable and stable regulatory outcomes. This will result in an overall net benefit for the market and consumers by:

- reducing the regulatory risks faced by Operators;
- reducing the risks faced by customers and investors; and
- ensuring investors are more likely to commit capital, facilitating efficient investment and the provision of long term benefits to consumers.

Further, the cost burden of implementing the proposal (that is, the additional administrative and compliance cost) will be minor, as most of the proposed amendments reflect regulatory best practice and should be applied regardless.<sup>30</sup> These costs will be fully offset by savings in reducing:

- the likelihood of regulatory errors; and
- the compliance burden from unpredictable regulatory outcomes.

These savings to business will be passed onto consumers. Increasing the level of prescription in the charging arrangements is a cost effective way to prevent legal and regulatory error.

To conclude, the benefits of greater predictability, outweighs the administrative costs of implementing the proposals in the long term. This is consistent with the Government's deregulation agenda.<sup>31</sup>

## 1.2 Merits Review

### 1.2.1 Current situation

The water charging arrangements in the Act require charges to be set so that they are reasonably likely to meet the prudent and efficient cost of providing the

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<sup>29</sup> Administrative Review Council, Decision Making: Lawfulness August 2007.

<sup>30</sup> The ACCC benefitted from the synergies with the AER, by using AER staff for the State Water pricing process. The ACCC is able to use AER staff to comply with any additional administrative cost under this proposal.

<sup>31</sup> The Australian Government Guide to Regulation <  
[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>

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services in that regulatory period. However, this requirement has not been applied in a consistent manner by all economic regulators across the MDB.

For example in the ACCC Final Decision Paper:

- the ACCC set Peel Valley charges at below cost recovery. However, rule 29 of the WCIR requires charges to be set so that they are reasonably likely to meet the prudent and efficient cost of providing the services. As stated previously, Frontier Economics conducted analysis for State Water which concluded that the ACCC's price control mechanism cannot reasonably be assessed as meeting the WCIR requirements; and
- the ACCC proposed a 'novel' approach to addressing revenue volatility risk faced by State Water - by coupling an 'overs and under' mechanism and high variable tariffs, with a price cap which would, in the ACCC's opinion, ensure State Water is able to recover its revenue requirement *over time*. Frontier Economics conducted analysis for State Water which questioned whether the ACCC's approach would ensure State Water recovers its revenue requirement over the three year regulatory period, as required under rule 29 of the WCIR.<sup>32</sup>

In comparison, the VESC applied rule 29 of the WCIR by determining tariff structures that closely aligned with GMW and LMW's predominately fixed cost base. This was complimented with a revenue cap to ensure sufficient revenue streams to these operators. Further, State Water is not aware of a situation where the VESC has applied rule 29 to determine valley charges at below cost recovery.

The Act does not have a merits review mechanism for price approvals or determinations under the Act. Therefore, there is no avenue to appeal the ACCC's application of rule 29 of the WCIR. Such an avenue would have addressed any potential for legal and regulatory error, particularly the application of the 'reasonableness' test envisaged under rule 29 of the WCIR.

In contrast, State Water notes that:

- network pricing determinations in the energy sector can be appealed to the Australian Competition Tribunal (the Tribunal);<sup>33</sup>

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<sup>32</sup> For further analysis, see Frontier Economics Analysis of aspects of the ACCC Draft Decision on State Water Application and Frontier Economics Review of Appendix A ACCC Draft Decision on State Water Application attached to State Water's submission to the ACCC Draft Decision Paper <<https://www.accc.gov.au/regulated-infrastructure/water/state-waters-regulated-charges-2014-17-review/draft-decision>>

<sup>33</sup> Standing Council of Energy and Resources Review of the Limited Merits Review Regime Interim Stage One Report and Consultation Papers 1 & 2.

- there appears to be a generic right of appeal for price determinations made by the VESC in cases where the determination *is based wholly or partly on an error of fact in a material respect*;<sup>34</sup>
- there is a right of review by an industry panel of a Price Direction made by the Independent Competition and Regulatory Commission in the ACT;<sup>35</sup> and
- In the United Kingdom, there appears to be a review process for some decisions made by the Water Services Regulation Authority (OFWAT).<sup>36</sup>

### 1.2.2 State Water's preferred approach proposed amendment

State Water submits that the Act should be amended to include a full merits review mechanism for price approvals or determinations made in accordance with the Act.

The absence of a merits review mechanism may provide less incentive for administrative bodies to be accountable for the decisions they make. This could result in uncertain, inconsistent, and sometimes unintended regulatory outcomes.

Furthermore, greater prescription in the charging arrangements (as proposed in section 1.1 of this submission) will not prevent all regulatory errors from occurring. In these cases, merits review provides additional protection against the potential for regulatory error, which can have serious economic and social consequences.

Further discussion of the merits of this proposal to the relevant Terms of Reference is set out below.

### 1.2.3 Ensuring Basin-wide consistency and achievement of Basin water charging objectives

The existence of merits review would promote a regulatory decision that meets the *Basin water charging objectives* to the greatest degree. The regulator would implement measures to address the potential of its decisions being appealed to a merits review body, improving the quality of pricing decisions and achievement of the *basin water charging objectives*.

Aggrieved parties would be able to lodge an appeal to a single independent review body, regardless of the location within the MDB, or whether the decision was made

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<sup>34</sup> *Essential Services Commission Act 2001 (VIC)*, s 55. It is unclear whether this applies to the VESC's determination under the accreditation arrangements under the WCIR.

<sup>35</sup> *Independent Competition and Regulatory Commission Act 1997, Part 4C*. It is noted that ACTEW Corporation has made a request under this Act.

<sup>36</sup> Bristol Water launched an appeal to OFWAT's determination <<http://www.utilityweek.co.uk/news/Bristol-Water-wins-some-but-loses-more-at-the-Competition-Commission/766612>> accessed 26 June 2014.

by the ACCC or an accredited agency. Over time, a body of precedent would develop, which would apply to all water charging arrangements and regulators across the MDB. This will improve the consistency in the water charging arrangements over time. The existence of a body of precedent will ensure regulators apply similar approaches to similar facts and circumstances across the MDB, providing transparent and cost effective price regulation for customers.

#### 1.2.4 Effectiveness of the Act in achieving its objects

Regulatory bodies can be involved in regulating other industries with different regulatory objectives. For example the VESC regulates energy, transport and statutory insurance and the ACCC is involved in consumer protection initiatives including minimising anti-competitive behaviour and monitoring compliance of industry codes. This poses the following risk to the MDB pricing process and the exercise of regulatory discretion:

- regulatory creep - the regulator could consider its own institutional interest and expand its role; and
- industry/regulatory capture - the regulator may come to identify its own interest with those of the groups it is regulating. This could include stakeholders.

These risks have been acknowledged in the energy sector, where stakeholders have questioned the institutional arrangements of the AER and the ACCC. Further, former ACCC Chairman Graeme Samuel and former ACCC Commissioner Stephen King expressed their views on the need to separate the AER from the ACCC:

*The ACCC has jurisdiction over a variety of regulatory functions, for example in the general access regime in Part IIIA and telecommunications access regime in Part XIC. Is this either desirable or appropriate from the perspective of best practice regulation? The AER is a 'constituent part' of the ACCC. This relationship and its implications for energy regulation has been questioned. The Review should consider whether the AER and the other regulatory functions of the ACCC should be separated into a specialised infrastructure regulator.<sup>37</sup>*

Despite the commentary, State Water acknowledges that there are benefits in having a regulator that can exercise a variety of regulatory functions. For example,

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<sup>37</sup> Agenda for National Competition Policy Inquiry, Monash Business Policy Forum, November 2013 < <http://www.buseco.monash.edu.au/mbpf/agenda.pdf>> despite the commentary, State Water acknowledges that there are benefits in having a regulator that can exercise a variety of regulatory functions. For example, the regulator can benefit from synergies across various business units, develop in house talent, and maintain effective relationships across a range of industries.

the regulator can benefit from synergies across various business units, develop in house talent, and maintain effective relationships across a range of industries.

State Water notes that a review mechanism has been recognised as a way to address the risk of outside influences ‘creeping into’ the regulatory process. See the Standing Council of Energy and Resources Review of the Limited Merits Review Regime Interim Stage One Report:

*First of all, the scrutiny of the appeals system or perhaps just the existence of an appeals system should improve the quality of decision making ... Secondly, the existence of an appeals system and its operation should increase confidence in the system as a whole ... Thirdly, it is a safeguard against regulatory capture, regulatory inertia or regulatory timidity which with the best will in the world may creep into any regulatory system, from time to time.*<sup>38</sup>

State Water submits that a review mechanism could be an effective mechanism to ensure the ACCC benefits from the synergies identified above, while addressing the potential of outside influences ‘creeping into’ the regulatory decision making process.

Further, the existence of merits review would ensure outcomes are free of regulatory error. The regulator would implement measures to address the potential for regulatory errors during the decision making process, thereby improving the quality of pricing decisions under the Act resulting in best practice and cost effective regulation for customers.

#### *1.2.5 Reduce or simplify regulatory burden and/or reporting*

As previously mentioned, network pricing determinations in the energy sector can be appealed to the Tribunal. State Water submits that the Tribunal has the expertise to review pricing decisions made by economic regulators under the Act as is evident from the body of precedent it has produced for the energy sector.

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<sup>38</sup> House of Lords, Select Committee on the Constitution, *The Regulatory State: Ensuring Its Accountability*, 6th Report of Session 2003-04, Volume I, 6 May 2004, at [93] as quoted by the Standing Council of Energy and Resources Review of the Limited Merits Review Regime Interim Stage One Report and Consultation Papers 1 & 2.

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State Water understands that:

- there are eleven members of the Tribunal, some of which are part time member of the Tribunal;<sup>39</sup> and
- the Tribunal is funded through the Federal Court and benefits from cost savings and synergies between the Tribunal and the Federal Court for example operational support, management and determination of proceedings and infrastructure for hearings.<sup>40</sup>

As the Tribunal is already established, State Water considers that the most cost effective way of implementing a merits review mechanism would be to expand the existing scope of the Tribunal. This would avoid the significant costs of creating a new review body for the water industry.

Further, as there are only three Part 6 Operators under the MDB charging arrangements, it is unlikely that the Tribunal would require additional personnel or members. Expanding the scope of the Tribunal's existing functions is likely to be accommodated within the Tribunal's existing resources.

The additional cost of the Tribunal undertaking merits review would be an optional cost for the aggrieved party. The aggrieved party would undertake a cost benefit analysis before considering further action on the grounds of merits review. The cost to the regulator is an avoidable cost as it can implement measures to decrease the likelihood of being scrutinised under a merits review process.

Aggrieved parties would also include customers. Therefore, a merits review mechanism will provide further protection to customers as well as businesses.

The cost burden of implementing the proposal (that is, the additional administrative and ongoing maintenance cost of the merits review body), will be offset by the cost savings in resolving the regulatory errors made under the pricing process). These savings may be passed onto customers. This is consistent with the Government's deregulation agenda.<sup>41</sup>

Further, given the economic significance of the MDB charging arrangements in the Act, there is an overall net benefit in addressing regulatory errors that are not prevented through introducing greater prescription in the charging arrangements (see section 1.1 of this submission).

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<sup>39</sup> < <http://www.competitiontribunal.gov.au/about/members>> accessed 26 July 2014.

<sup>40</sup> Federal Court of Australia Annual Report 2012-13, page



### **1.3 Judicial Review**

#### *1.3.1 Current situation*

The water charging arrangements in the Act do not confer an explicit right of appeal on the grounds of judicial review for price approvals or determinations under the Act. Judicial review includes the right of procedural fairness. Without judicial review, there is no avenue for the Federal Court to consider the transparency and accountability of the regulatory decision making process.

State Water notes that, in the energy sector, the AER must comply with formal 'consultation' requirements<sup>42</sup> a breach of which may trigger an action on the grounds of judicial review.<sup>43</sup> Further, there appears to be a generic right of appeal for price determinations made by the VESC where the determination has been made on the basis of bias.<sup>44</sup>

#### *1.3.2 State Water's preferred approach and proposed amendments*

State Water submits that the Act should be amended to include a statutory right of judicial review for price approvals or determinations under the Act.

Without judicial and merits review (proposed in section 1.2 of this submission), the regulator will be deciding matters of law on a final basis, therefore exercising a judicial function. This is inconsistent with the regulator's role as an administrative body.

#### *1.3.3 Ensuring Basin-wide consistency and achievement of Basin water charging objectives*

Further to the reasons set out in the merits review section (1.2.3) of this submission, judicial review provides the following grounds of review, which would improve overall transparency and accountability in the pricing process:

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<sup>41</sup> The Australian Government Guide to Regulation <[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>

<sup>42</sup> National Gas Law, s 28H, National Electricity Rules, rule 6.9.3, rule 6.16, rule 8.9. National Gas Rules, rule 8, rule 9A.

<sup>43</sup> *National Electricity (South Australia) Act 1996*, Schedule 1 clause 70.

<sup>44</sup> *Essential Services Commission Act 2001 (VIC)*, s 55. It is unclear whether this applies to the VESC's determination under the accreditation arrangements under the WCIR.

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- (a) *that a breach of the rules of natural justice occurred in connection with the making of the decision;*
- (b) *that procedures that were required by law to be observed in connection with the making of the decision were not observed;*
- (c) *that the person who purported to make the decision did not have jurisdiction to make the decision;*
- (d) *that the decision was not authorized by the enactment in pursuance of which it was purported to be made;*
- (e) *that the making of the decision was an improper exercise of the power conferred by the enactment in pursuance of which it was purported to be made;*
- (f) *that the decision involved an error of law, whether or not the error appears on the record of the decision;*
- (g) *that the decision was induced or affected by fraud;*
- (h) *that there was no evidence or other material to justify the making of the decision;*
- (j) *that the decision was otherwise contrary to law.*<sup>45</sup>

The regulator would implement measures to address the potential for legal error and scrutiny under a judicial review process. This will improve the quality of pricing decisions and promote basin-wide consistency and achievement of the *Basin water charging objectives*.

#### 1.3.4 Effectiveness of the Act in achieving its objects

Further to the reasons set out in the merits review section (1.2.4) of this submission, new legislation generally confers a right of judicial review. For instance:

*The Administrative Decisions (Judicial Review) Act 1977 (the AD(JR) Act) automatically applies in relation to new legislation unless explicitly excluded. The AD(JR) Act enables the Federal Court to review the lawfulness of a decision made under legislation or conduct leading up to or delays in the making of such a decision, and also provides an entitlement for a person to*

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<sup>45</sup> *Administrative Decisions (Judicial Review) Act 1997, s 5 (1).*

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*obtain a statement of reasons for a decision which is made under legislation. Very strong reasons need to be advanced to support proposed exclusion.*<sup>46</sup>

If the right of judicial is available, this right should be explicitly set out in the Act for the avoidance of doubt. It is noted that the right of judicial review is explicitly set out in the pricing arrangements for the energy sector.<sup>47</sup>

#### *1.3.5 Reduce or simplify regulatory burden and/or reporting*

Further to the reasons set out in the merits review section (1.2.5) of this submission, the cost burden of implementing the proposal is negligible as the institutional arrangements for judicial review already exists through the court system. There would be cost savings in correcting legal errors under the judicial review process. These savings may be passed onto customers.

The law should be applied appropriately in the right circumstances. Therefore, there is an overall net benefit in providing some avenue of appeal for the decision of an administrative body.

### **1.4 Streamlining reporting requirements for the ACCC and state based pricing process**

#### *1.4.1 Current situation*

As mentioned previously in section 1.1 of this submission, the charges under the new pricing arrangements closely resemble the charges determined under the previous pricing arrangements. The new charging arrangements have also promoted more diverse pricing outcomes for other parts of the MDB.

For example, Fish River customers are covered by two regulatory frameworks. That is, Delta Electricity and minor customers are regulated by the ACCC, whereas Lithgow and Oberon Councils, and the Sydney Catchment Authority are regulated by IPART.

This means that State Water is required to:

- participate in two separate pricing processes (ACCC for MDB valleys and IPART for Coastal Valleys and some Fish River customers); and

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<sup>46</sup> Legislation Handbook, Department of the Prime Minister and Cabinet Canberra 1999.

<sup>47</sup> *National Electricity (South Australia) Act 1996*, Schedule 1 clause 70.

- provide variations of the same data to two separate administrative bodies even if the ACCC pricing process runs consequently with a state based pricing process.

This is because of section 91 (2) and (3) of the Act, which limits the application of the charging arrangements to Basin water resources. Subsection 3 states that *this Division does not apply to charges in respect of urban water supply activities beyond the point at which the water has been removed from a Basin water resource.*

This anomaly could be addressed by IPART seeking accreditation but to date it has not done so. Dealing with two regulators increases regulatory burden on State Water with no apparent benefit to State Water or customers. In contrast, Part 6 Operators in Victoria (LMW and GMW) participate in one pricing process undertaken by the VESC.

State Water submits that the Panel should engage directly with IPART to determine which changes to the Act or the WCIR are necessary to encourage them to apply for accreditation.

#### *1.4.2 Reduce or simplify regulatory/reporting burden*

Minimising the cost burden by removing duplication of process will result in cost savings to the business which will be passed onto customers. Further, the Government's deregulation agenda requires policy makers to consult with each other to avoid creating cumulative or overlapping regulatory burdens.<sup>48</sup>

### **1.5 Transparent rule change process**

#### *1.5.1 Current situation*

The Act empowers the Minister to create, amend or revoke the water charge rules and water trading rules<sup>49</sup> The Minister must rely on the advice of the regulator before creating, amending or revoking these rules.

In practice, the regulator drafts the rules before they are considered by the Minister. The Act imposes additional hurdles for the Minister if the Minister disagrees with the regulator's advice.<sup>50</sup> For example the Minister must provide

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<sup>48</sup> The Australian Government Guide to Regulation <  
[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>

<sup>49</sup> *Water Act 2007 (Cth)*, Part 4

<sup>50</sup> *Ibid*, s 93 (4), (7). Also see rule change process in *Water Regulations 2010 (Cth)*.

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reasons for departing from the ACCC's advice before laying the rules before Parliament.

It is noted that the Act:

- discourages disagreement between the Minister and the regulator in creating, amending or revoking the rules;
- does not provide clear separation of the advisory role from the regulatory function, blurring the separation of the rule maker from the regulatory function;
- does not empower regulated entities to request amendments to the WCIR; and
- does not provide a clear and transparent review date for the WCIR.

The lack of clear separation between the rule maker and the regulatory function does not sufficiently address the risks of regulatory creep and or industry/regulatory capture. For example the regulator could advise the rule maker to adopt rules that provide greater discretionary powers to the regulator than that intended under the Act. This could lead to a situation where the regulator delivers a decision that is consistent with the WCIR, but inconsistent with the policy intent of the Act.

Deficiencies in the WCIR will be identified over time as it is applied and tested in various circumstances. State Water has identified some deficiencies in the WCIR to date which cannot be considered at the present time without a clear and transparent rule change process.

#### *1.5.2 State Water's preferred approach and proposed amendment*

State Water submits that the Act should be amended to include a clear and transparent rule change process with the following characteristics:

- customers and regulated entities should be permitted to make a rule change application to an independent body (for example the Minister or an expert panel appointed under the Act);
- proposed rule change applications should be assessed by the independent body against objective criteria set out in the Act (such as a 'rule making test'<sup>51</sup>);
- the merits of the rule change application should be considered by the independent body in accordance with public consultation requirements; and
- all stakeholders (including the regulator) should be given equal status in the rule change process, that is, the regulator should not be elevated to an advisory role and should not be involved in drafting the rules.

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<sup>51</sup> For example see National Electricity Law, s 88 and rule 2.4 of the Wholesale Electricity Market Rules in WA.

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State Water's proposal is consistent with the hierarchy of governance arrangements adopted in the energy sector, where:

- Standing Council on Energy and Resources establishes policies for the energy sector;
- Australian Energy Market Commission administers rule change processes in accordance with the established policy; and
- Australian Energy Regulator/Australian Energy Market Operator is responsible for administering specific sections of relevant Acts and Rules.

Such arrangements have been proven to prevent outside influences 'creeping into' the rule change process in the energy sector, while also facilitating continuous improvements to the regulatory regime over time.

#### *1.5.3 Ensuring Basin-wide consistency and achievement of Basin water charging objectives*

As mentioned previously, deficiencies in the WCIR will be identified over time as the WCIR are applied and tested in various circumstances. Some of the deficiencies identified to date by State Water include:

- the WCIR do not appropriately manage time over-runs;
- reopening provisions do not include a specific pass through mechanism for a regulatory change event;
- the WCIR do not set clear criteria with respect to setting the rate of return;
- the information request arrangements are open to interpretation and do not consider the benefits of issuing information request outweighing the costs; and
- the WCIR does not specify the extent to which the guidelines take precedent over the WCIR and vice versa.

A transparent rule change mechanism would enable continuous improvement in the water charging arrangements over time, which would ensure Basin-wide consistency and the achievement of the *Basin water charging objectives*.

#### *1.5.4 Effectiveness of the Act in achieving its objects*

By removing the regulator's advisory role, the proposed rule change process is consistent with the concept of 'separation of powers' between the rulemaking and regulatory function. As mentioned previously, this is also consistent with the hierarchy of governance arrangements adopted in the energy sector and would better address the potential for regulatory creep and/or industry/regulatory capture in the rule change process.

### *1.5.5 Reduce or simplify regulatory/reporting burden*

A transparent rule change process will identify opportunities for better alignment of the WCIR with the *Basin water charging objectives*, as well as reduce and/or simplify the regulatory burden in response to lessons derived from the application and administration of the WCIR over time.

The cost burden of implementing the proposal (that is, the administrative cost in facilitating a rule change process), will be fully offset by cost savings in complying with more efficient regulatory arrangements – as corrected under a transparent rule change process. These savings will be passed onto customers.

Should the Panel reject the rule change process outlined above, State Water submits that the WCIR should be reviewed as soon as possible and every four to five years thereafter by an independent body. The review dates should be legislated. Regulations should be reviewed periodically to test their continued relevance. This is consistent with the Government's deregulation agenda.<sup>52</sup>

## **1.6 Improving Part 5 and Part 7 charging arrangements**

### *1.6.1 Current situation*

As mentioned previously in section 1.1 of this submission, the charges under the new pricing arrangements closely resemble the charges determined under the previous pricing arrangements. The new charging arrangements have also promoted more diverse pricing outcomes for other parts of the MDB. For example bulk water providers in Queensland have been excluded from a pricing process.

This is because Part 6 Operators are subject to the approval or determination of regulated charges under Part 6 of the WCIR. Part 5 and Part 7 Operators are subject to more light handed regulation, which does not include a pricing process. An entity is either a Part 5, 6 or 7 Operator depending on the number of water access entitlements held by all customers served by that operator. These thresholds were recommended by the ACCC.

Pricing outcomes for Part 5 and Part 7 operators differ significantly to the pricing outcomes for Part 6 operators. State Water submits that the lack of pricing regulation for Part 5 and Part 7 Operators, does not contribute to consistent water charging arrangements in the MDB.

For example in Queensland, SunWater and the Queensland Department of Natural Resources and Mines (DNRM) levied the following charges on private diverters:

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<sup>52</sup> The Australian Government Guide to Regulation <  
[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>



Table 1.4 hypothetical bills for private diverters in Queensland —50 ML, 250 ML and 1000 ML of water access entitlement, with 50 per cent or 100 per cent delivered— total bill (\$ amount per ML of water access entitlement held), for 2012–13.

Bulk water supplier	System	Charging category	50 per cent delivery			100 per cent delivery		
			50 ML	250 ML	1000 ML	50 ML	250 ML	1000 ML
DNRM	Border Rivers		739 (15)	3 694 (15)	14 775 (15)	1 020 (20)	5 100 (20)	20 400 (20)
SunWater	Upper Cond 1		2 324 (46)	11 618 (46)	46 470 (46)	2 643 (53)	13 215 (53)	52 860 (53)
	Upper Cond 2		771 (15)	3 853 (15)	15 410 (15)	1 090 (22)	5 450 (22)	21 800 (22)
	Upper Cond 3		1 549 (31)	7 743 (31)	30 970 (31)	1 666 (33)	8 328 (33)	33 310 (33)
	Chinchilla Weir		1 341 (27)	6 706 (27)	26 825 (27)	1 414 (28)	7 070 (28)	28 280 (28)
	St George		951 (19)	4 753 (19)	19 010 (19)	980 (20)	4 898 (20)	19 590 (20)
	Cunnamulla		1 384 (28)	6 919 (28)	27 675 (28)	1 459 (29)	7 295 (29)	29 180 (29)
	Macintyre Brook		1 685 (34)	8 423 (34)	33 690 (34)	1 780 (36)	8 900 (36)	35 600 (36)
	Maranoa Weir		3 604 (72)	18 019 (72)	72 075 (72)	4 971 (99)	24 855 (99)	99 420 (99)

1. Estimated bulk water bill. Brackets indicate \$ per ML of water access entitlement held.

Source ACCC 2012-13 Water Monitoring Report

SunWater, as a part 7 Operator, levies charges that vary significantly across its respective systems – in some cases – significantly above the bill impacts of a customer supplied by a Part 6 operator when comparing table 1.4 with table 1.1. Given this variation, State Water questions the effectiveness of Part 5 and Part 7 pricing regulation in driving prudent and efficient outcomes for customers.

#### 1.6.2 State Water's preferred approach and proposed amendment

State Water submits that the Panel should consider ways to improve Part 5 and Part 7 regulation to give effect to incentive based outcomes observed under Part 6 pricing regulation and to ensure consistent and efficient pricing outcomes are obtained for customers.

Further discussion of the merits of this proposal to the relevant Terms of Reference is set out below.

### *1.6.3 Ensuring Basin-wide consistency and achievement of Basin water charging objectives*

A monopoly services provider is characterised by the existence of substantial market power, which is determined by analysing the level of contestability in the market in which it operates and the level of control in that market.<sup>53</sup>

The ACCC's approach to distinguishing between Part 5, 6 and 7 Operators diverts attention away from the state of actual competition inside a market. A Part 5 or Part 7 Operator still has an opportunity to extort monopoly rents from customers or levy charges beyond prudent and efficient costs.

Improving Part 5 and Part 7 regulation will ensure all operators are guided towards similar outcomes, which is to drive efficiencies for the long term benefit of the market and consumers. This promotes Basin-wide consistency and the achievement of the *Basin water charging objectives*.

### *1.6.4 Reduce or simplify regulatory/reporting burden*

It is noted that regulations should also be reviewed periodically to test their continued relevance. This is consistent with the Government's deregulation agenda.<sup>54</sup>

Any cost burden in improving Part 5 and Part 7 Regulation, may be fully offset by savings to customers. This would depend on the degree to which Part 5 and Part 7 prices are beyond prudent and efficient costs under the current charging arrangements.

## **1.7 Treatment of Murray Darling Basin Authority cost**

### *1.7.1 Current situation*

The Murray Darling Basin Authority (MDBA) is not subject to price regulation as it neither owns nor operates infrastructure for the purposes of storage or delivery of water.<sup>55</sup>

<sup>53</sup> For a discussion on the factors for determining the level of competition in a market see Application by Chime Communications Pty Ltd (No 2) [2009] AComp T2 [48].

<sup>54</sup> The Australian Government Guide to Regulation <[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>

<sup>55</sup> *Water Act 2007 (Cth)*, s 7. It is noted that the infrastructure is owned by the relevant state government.

The extent to which MDBA cost are passed onto customers in other MDB states is unclear. In NSW, MDBA costs are passed through to Murray and Murrumbidgee valley customers via the State Water price determination, without regard to prudence or efficiency requirements. This means that these customers may be paying for inefficient monopoly costs of the MDBA. The NSW Government requires State Water to make a fixed payment to NSW Treasury for the NSW Government contribution to the MDBA. However, this fixed cost is recovered under State Water's tariff structure, which includes a high variable component. State Water incurs additional revenue volatility risk as a result.<sup>56</sup>

The lack of pricing regulation or associated transparency, removes the incentives on the MDBA to undertake prudent and efficient investments, as required by Part 6 Operators, to protect customers from inefficient pricing outcomes.

### 1.7.2 State Water's preferred approach and proposed amendment

State Water submits that the Panel should have regard to the need for institutional reform of the funding arrangements for the MDBA, which may include some form of price regulation.

Alternatively, State Water submits that the Act should be amended to provide a mechanism for Part 6 Operators to pass MDB Authority costs onto customers without undue financial, commercial or reputational risk to that Operator.

Such mechanisms exist in the energy sector for example the recovery of *jurisdictional scheme amounts*.<sup>57</sup> The AER supported the inclusion of separate consideration of jurisdictional scheme amounts, on the basis that it *will eliminate the need for the AER to assess those components of jurisdictional scheme amounts that are uncontrollable and are not directly related to the provision of standard control services*.<sup>58</sup>

Further discussion of the merits of this proposal to the relevant Terms of Reference is set out below.

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<sup>56</sup> The revenue volatility risk is the difference between revenue received under the 40:60 fixed to variable tariff structure and the fixed payment for the NSW Government contribution to the MDBA made by State Water to NSW Treasury by June of each year.

<sup>57</sup> National Electricity Rules, rule 6.18.7A

<sup>58</sup> Australian Energy Regulator response to the Australian Energy Market Commission re Draft Rule Change: Feed-in Schemes Climate Change Fund Payments, 20 May 2010.

### *1.7.3 Ensuring Basin-wide consistency and achievement of Basin water charging objectives*

Imposing some level of price regulation on the MDBA would be consistent with similar requirements imposed on other operators within the MDB. This will promote Basin-wide consistency by ensuring all operators are guided towards a similar outcome, which is to drive efficiencies for the long term benefit of the market and consumers.

### *1.7.4 Reduce or simplify regulatory/reporting burden*

Any cost burden in improving the MDBA funding arrangements and/or administrative arrangements for the pass through of MDBA costs, may be fully offset by cost savings in addressing the revenue volatility risk to State Water, and in driving prudent and efficiency outcomes within the MDBA. These savings will be passed through to customers.

## **1.8 Proposals to reduce or simplify reporting burden**

### *1.8.1 Current situation*

The Act does not encourage streamlining of provision of information requirements to administrative bodies across all water related legislation. For example, State Water is required to report variations of the same data to the ACCC, National Water Commission and the Australian Bureau of Statistics. These arrangements increase regulatory burden on Part 6 Operators across the MDB with no apparent benefit to customers.

### *1.8.2 State Water's preferred approach and proposed amendment*

State Water submits that the Act should include information sharing arrangements/protocols for data provided to administrative bodies under the *Water Act 2007 (Cth)*, *National Water Commission Act 2004 (Cth)* and to the Australian Bureau of Statistics.

### *1.8.3 Reduce or simplify regulatory/reporting burden*

Minimising the cost burden through removing duplication of process will result in cost savings to the business, which will be passed onto customers. Further, the

Government's deregulation agenda requires policy makers to consult with each other to avoid creating cumulative or overlapping regulatory burdens.<sup>59</sup>

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<sup>59</sup> The Australian Government Guide to Regulation <  
[http://www.cuttingredtape.gov.au/sites/default/files/documents/australian\\_government\\_guide\\_regulation.pdf](http://www.cuttingredtape.gov.au/sites/default/files/documents/australian_government_guide_regulation.pdf)>

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## 2. Submission on Basin Plan implementation

### 2.1.1 *Consistent water resource plans*

#### 2.1.1.1 *Issue and proposed amendment*

The Murray Darling Basin Plan (Basin Plan) provides a framework to manage the water resources of the MDB. Chapter 10 of the Basin Plan requires Basin States to prepare Commonwealth-accredited water resource plans.

State Water understands that there are no specific form and content requirements for Commonwealth-accredited water resource plans. This promotes inconsistent language and terms across the water resource plans, making them less accessible to operators and consumers. For example, in Queensland, *the Basin Plan will be implemented through existing statutory instruments such as water resource plans and Healthy Waters Management Plans.*<sup>60</sup>

State Water submits that the Act should promote common language and a common set of rules for accredited-water resource plans for the Basin.

#### 2.1.1.2 *Ensuring the management objectives and outcomes of the Basin Plan are being met*

Consistent form and content requirements for all Commonwealth-accredited water resource plans will ensure plans are easily accessible and can therefore be implemented with less administrative burden to Operators and to customers.

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<sup>60</sup> < <http://www.dnrm.qld.gov.au/water/catchments-planning/qmdb/the-basin-plan>>

### 3. Submission on Water Trading

#### 3.1.1 Restrictions on trade for the Commonwealth Environmental Water Holder

##### 3.1.1.1 *Issue and proposed amendment*

The Commonwealth Environmental Water Holder (CEWH) is tasked with managing water rights acquired by the Commonwealth Government for the purposes of meeting the environmental objectives in the Environmental Watering Plan.<sup>61</sup> This is achieved through:

- water being delivered within the current year to meet current environmental needs;
- water being carried to future years to meet future environmental needs; or
- water is traded (sell or buy) to meet environmental needs.

It is noted that the Act restricts the extent to which the CEWH may engage in trade for the purposes of meeting its environmental objectives.

For instance, the CEWH can dispose of its water holdings in a water accounting period if:

- the water is not required to its environmental objectives; and
- the water cannot be carried over to the next accounting period for the purpose of meeting those objectives in the next accounting period.

However, the proceeds from the disposal of water holdings must be paid into a Special Account, which cannot be redirected to a use other than managing or acquiring Commonwealth environmental water.<sup>62</sup> It is noted that funding of CEWH staff is through the Government, not the Special Account.

State Water argues that the funds paid into the Special Account can be utilised in a more effective manner without these restrictions to achieve the environmental outcomes in the Act for example through operational and capital expenditure undertaken by the CEWH or other initiatives that are related to the CEWH's functions. State Water submits that the Act should be amended to allow the CEWH to apply the funds under the Special Account towards other initiatives that further the environmental objectives set out in the Act.

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<sup>61</sup> *Water Act 2007 (Cth)*, s 105.

<sup>62</sup> *Water Act 2007 (Cth)*, ss 106 (1) (2).

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*3.1.1.2 Ensuring the management objectives and outcomes of the Basin Plan are being met*

The proposal will ensure the CEWH can appropriately respond to environmental needs in a number of ways depending on the circumstances and conditions. For example, the CEWH may use the Special Account to fund initiatives dealing with delivery constraints and/or opportunities. Such initiatives could further the achievement of environmental objectives rather than through the CEWH continuously acquiring/disposing of water holdings in the long term. This could reduce the socioeconomic cost of the return of water to the environment in the long term to the benefit of the rural community.

*3.1.1.3 Water trading is occurring efficiently and effectively*

The proposal will encourage effective trading of water holdings as envisaged under the Act. For instance, the CEWH could reduce its reliance on acquiring water holdings, which could free up water holdings available for purchase by irrigators and customers, encouraging higher value uses.

*3.1.2 Recovery of usage charge revenue from water extracted in other States*

*3.1.2.1 Issue and proposed amendment*

Schedule 3 of the Act aims to:

- facilitate the operation of efficient water markets and create opportunities for trading within and between Basin States
- minimise transaction costs through good information flows and compatible entitlement, regulatory and other arrangements across the Basin States
- enable the appropriate mix of water products to develop
- recognise and protect the needs of the environment
- provide appropriate protection of third parties.<sup>63</sup>

There are various regulatory instruments that have been developed to facilitate interstate trade such as the Water Market Rules, WCIR and Water Trading Rules.

As previously mentioned, State Water's charges consists of 40 per cent fixed 60 per cent variable. In contrast, equivalent operators in other MDB jurisdictions levy predominately fixed charges.



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State Water has identified the following issues with the water trading arrangements in the Act, which promote inequitable outcomes and result in further financial risk to State Water:

- there is no specific agreement or mechanism for recovery of revenue by State Water for the water extracted in other MDB jurisdictions. This is further complicated by section 93 of the *Commonwealth of Australia Constitution Act (Cth)*, which restricts commodities being taxed across state boundaries;
- the usage charges levied by State Water on allocation trades to other MDB jurisdictions are difficult to impose on customers in other MDB jurisdictions, who are accustomed to fixed charges;
- Because of this, State Water has billed at the point of trade for traded water allocations in the Southern MDB valleys; and
- State Water may lose some of its billing capacity on interstate users on their usage as a result.

In relation to tagged water entitlements across MDB jurisdictions, State Water notes that it is difficult for State Water to access meter assets and/or readings to accurately measure the amount of water taken at that respective location<sup>64</sup>;

State Water submits that the water trading arrangements should include appropriate mechanism to allow State Water to accurately bill, and collect revenue from, its interstate customers under the tariff structure approved by the regulator. This may include some form of agreement or Memorandum of Understanding between Operators and/or Governments within the MDB. Without these mechanisms, it is customers in NSW who ultimately pay higher charges.

The pricing regulator should be required to consider a greater portion of fixed charges for State Water to improve trading outcomes and ensure more equitable trading arrangements for MDB jurisdictions. State Water should not be penalised with further financial risk because of circumstances beyond its control.

### 3.1.2.2 *Water trading is occurring efficiently and effectively*

The proposal will promote more equitable trading arrangements, improve price signals for interstate trade, and reduce financial risks currently imposed on State Water. This will contribute to efficient and effective water trading across the MDB.

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<sup>63</sup> Schedule 3 includes the Basin water market and trading objectives and principles which underpin the water trading arrangements in the Act.

<sup>64</sup> State Water currently "assesses" usage of water on the opposite border and debits it from NSW water accounts.

### *3.1.2.3 Reduce or simplify regulatory/reporting burden*

Any cost burden in improving the trading arrangements will be fully offset by the cost savings in addressing the undue financial risk to State Water. These savings will improve price signals to customers and ensure efficient and effective water trading arrangements in the MDB.

### *3.1.3 Clarifying property rights for rural water storage and delivery*

#### *3.1.3.1 Issue and proposed amendment*

Water access rights across the MDB still encompass separate rights relating to water storage, carry over, and water delivery, which is overly complex and can present a barrier to water access.

State Water supports the ACCC's recommendations in relation to the unbundling of water access rights.<sup>65</sup> State Water submits that the Panel should consider the extent to which the Act could facilitate the unbundling of water access rights across the MDB.

#### *3.1.3.2 Water trading is occurring efficiently and effectively*

Clearly defined tradable water rights can encourage higher value uses and promote efficient and effective water trading across the MDB.

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<sup>65</sup> ACCC, Reinvigorating Australia's Competition Policy, Australian Competition and Consumer Commission Submission to the Competition Policy Review, 25 June 2014, page 56. < <http://competitionpolicyreview.gov.au/files/2014/06/ACCC.pdf> >

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#### 4. Appendix A – Policy intent of the water charging arrangements in the Act

State Water's submitted its 2014-17 pricing submission to the ACCC requesting:

- efficient tariff structures consisting of 80 per cent fixed and 20 per cent variable tariffs progressively introduced over 3 years. This would reflect State Water's predominately fixed cost base and improve price signals to customers; and
- a revenue cap. This would better manage revenue volatility risk and ensure sufficient revenue streams to the Operator; and
- cost recovery for all MDB valleys including the Peel Valley.

State Water's pricing submission was guided by the objects and policy intent of the Act, and the ACCC discussion papers and pricing principles.

The objects of the Act include:

*(g) to achieve efficient and cost effective water management and administrative practices in relation to Basin water resources.<sup>66</sup>*

To achieve the object above, the Act sets out the *Basin water charging objectives and principles* – the criteria underpinning the water charging arrangements in the Act.

The *Basin water charging objectives*, as referred to in the Panel's terms of reference, include the following:

- *promote economically efficient and sustainable use of:*
  - *water resources;*
  - *water infrastructure assets; and*
  - *government resources devoted to the management of water.*
- *ensure sufficient revenue streams to allow efficient delivery of the required services;*
- *facilitate the efficient functioning of water markets, including inter-jurisdictional water markets, and in both rural and urban settings;*

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<sup>66</sup> *Water Act 2007 (Cth)*, s 4.

- *give effect to the principle of user-pays and achieve pricing transparency in respect of water storage and delivery in irrigation systems and cost recovery for water planning and management; and*
- *avoid perverse or unintended pricing outcomes.*

The *Basin water charging objectives and principles* are based on the agreed outcomes on *Best Practice Water Pricing* in the Intergovernmental Agreement on a National Water Initiative (NWI).<sup>67</sup>

It is noted that the NWI is endorsed by the Council of Australian Governments and represents one of the key underlying policies of the Act.<sup>68</sup> The preamble of the NWI refers to a *continuing national imperative to increase the productivity and efficiency of Australia's water use* and to *provide greater certainty for investment*, among other things. It is noted that the Act intended to *accelerate the implementation of the NWI*.<sup>69</sup>

The ACCC's interpretation of the policy intent of the Act is set out in the following ACCC documents:

The ACCC Issues Paper on Bulk Water Charge Rules:

*Where grants, subsidies or other contributions are made by government with the intention of benefiting customers, then charges should not include these contributions as the associated expenditure is not financed by the bulk water service provider.*<sup>70</sup>

...

*The value assigned to an additional ML of water consumed by a bulk water customer within the basin reflects the market price of water (assuming that customer can trade their water) plus the cost of the storage and delivery services at the margin. Hence, the variable component of the bulk water charge should be set with reference to the marginal cost of storage and delivery.*

...

*As a result, the structure of delivery charges should reflect the underlying cost of providing the service, that is, volumetric charges*

<sup>67</sup> The achievement of the Basin water charging objectives is intended by the Act. This is supported by s 253 of the *Water Act 2007 (Cth)*, which requires a review of the achievement of the Basin water charging arrangements by 2014.

<sup>68</sup> National Water Initiative is based on a similar agreement by Australian Governments in 1994.

<sup>69</sup> See *National Plan for Water Security 2007*, the Government's policy document foreshadowing the introduction of the Water Bill.

<sup>70</sup> Issues Paper Bulk Water Charge Rules July 2008 page 16.

*should recover variable costs and fixed charges should recover fixed costs...*

...

*A pricing structure where the volumetric charge exceeds the actual variable cost of supply will generally result in under utilisation of the service, since the price for delivery of an additional unit (ML) of water exceeds the marginal cost of delivery. The scarcity value of water is established through water markets and water resource efficiency is promoted by the efficient functioning of water markets.<sup>71</sup>*

The ACCC Final Advice paper on Water Infrastructure Charge Rules:

*To promote the efficient and sustainable use of water resources, charges should:*

- *reflect the prudent cost of providing the water supply and delivery service, including costs associated with future supplies and periods of peak demands and/or restricted supply*
- *include the costs of complying with relevant laws or regulations*
- *be based on a principle of user pays so that users face the true cost of the service (subsidies and community service obligations should be eliminated or reduced over time; where they remain, they should be publicly reported)*
- *be made publicly available to increase transparency and allow users and potential users to compare charges across regions and use this information to make decisions as to where to locate their business, thus promoting dynamic efficiency.*

...

*To promote the efficient and sustainable use of water infrastructure assets, charges should:*

- *reflect the prudent costs of maintaining, replacing and upgrading infrastructure, where necessary, to accommodate efficient infrastructure investment, including the upgrade and/or rationalisation of assets over time*
- *be based on a principle of user pays so that the costs of infrastructure investment in each service area are reflected in the charges for that area, thus promoting economically efficient*

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<sup>71</sup> ACCC Issues Paper. Bulk Water Charge Rules (July 2008), page 45.

*investment (subsidies and community service obligations should be eliminated or reduced over time; where they remain they should be publicly reported).*

...

*In addition, to promote allocative efficiency and ensure expenditure is prudent, businesses should agree to service standards and develop forward asset management plans in consultation with customers. Service standards should be reported and linked to the proposed asset investment and any resulting adjustments to charges. This will allow customers to understand how service standards relate to infrastructure investment and ultimately to the level of charges. This should foster efficient and sustainable investment in water infrastructure assets.<sup>72</sup>*

The ACCC pricing principles:

*Charges must also be sufficient to ensure that the required infrastructure services continue to be efficiently delivered. That is, charges must be designed so that businesses earn a sufficient revenue stream in order to meet their regulatory, legal and other obligations.<sup>73</sup>*

...

*For example, charges must promote the economically efficient use of water infrastructure assets. In practice, this can be best achieved where the fixed and variable components of a charge recover the fixed and variable costs of providing services.<sup>74</sup>*

The ACCC's response to State Water's submission on the ACCC pricing principles:

*Volumetric risks and operating leverage can be overcome via the regulated business recovering most of its costs via fixed charges.<sup>75</sup>*

The National Water Initiative provides further guidance on tariff structures and risk allocation:

*Water access entitlement holders are to bear the risks of any reduction or less reliable water allocation, under their water access entitlements, arising from reductions to the consumptive pool as a result of:*

<sup>72</sup> Water infrastructure charge rules: Final advice—June 2009.

<sup>73</sup> ACCC pricing principles 2011.

<sup>74</sup> ACCC pricing principles 2011.

<sup>75</sup> Australian Competition and Consumer Commission response to State Water's issues on pricing principles February 2011.

- (i) *seasonal or long-term changes in climate; and*
- (ii) *periodic natural events such as bushfires and droughts.*<sup>76</sup>

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<sup>76</sup> The Intergovernmental Agreement on a National Water Initiative.