



Our Ref: #3995525

13 July 2015

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Australian Competition and Consumer Commission  
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To Mr Bye

**Re: Review of the Water Charge Rules**

Thank you for this opportunity to respond to the ACCC's Review of Water Charge Rules Issues Paper released in May and apologies for the late response. As Goulburn-Murray Water (GMW) is a top-tier basin irrigation infrastructure operator subject to the three sets of water charge rules, we appreciate the importance of this comprehensive review and the opportunities it provides for enhancement of the current regulations.

Firstly, I would like to state our strong support for the overarching objective of this review to identify opportunities to reduce the cost of regulation for both governments and industry. The regulatory requirements surrounding our annual pricing and four yearly revenue determinations are not an insignificant cost for our organisation, and opportunities to reduce compliance and regulation costs without compromising on consumer outcomes or the reputation for fair and independent price setting processes are welcome.

We understand that this review will take place over a number of stages, including public forums in July/August and a draft advice in September/October. We look forward to participating in the forthcoming discussions.

At this stage, GMW would like to provide comments on four of the specific matters raised in the issues paper.

**Length of the regulatory period**

The length of the regulatory period has a direct bearing on the cost of the revenue determination processes. Longer regulatory periods increase the efficiency of regulation and reduce regulatory costs for businesses and the regulator. Although there is a trade-off with forecasting risk, as the longer the regulatory period, the more uncertain are the input cost and demand forecasts, this is not a substantial issue for a business such as GMW with predominately fixed costs and operating under a revenue cap.

In many economic regulatory frameworks, including under the Victorian Water Industry Regulatory Order (WIRO), which applied to GMW prior to the establishment of the WCIR,

the regulator has discretion to determine the length of the regulatory period based on the degree of uncertainty or other external factors at the time of the determination. The ESC and the Australian Energy Regulator typically apply five year regulatory periods, as does the UK Water Services Regulation Authority (Ofwat). Some regulators have moved to longer regulatory periods, for example, the Office of Gas and Electricity Markets (Ofgem) has recently moved to eight year regulatory periods for electricity distributors.

Rules 3 and 24 of the Water Charge (Infrastructure) Rules (WCIR) prescribe the length of regulatory periods to apply to Part 6 operators, which includes GMW. The WCIR require that the initial regulatory period for each Part 6 operator under the WCIR is to be three years, after which four year regulatory periods will apply. Rule 24 (1) enables Part 6 operators that also supply urban water services, to apply to the regulator for a different regulatory period.

In its 2013 Rural Water Business Decision, the ESC approved the proposed five year regulatory period for Lower Murray Water, aligning its urban and rural price review processes. As GMW does not also supply urban water services, the ESC does not have the discretion to determine a longer regulatory period, and the three year initial period was determined in accordance with Rule 3 of the WCIR<sup>1</sup>. There does not seem to be any benefit from GMW having a shorter regulatory period than its basin peer, and indeed all of the other regulated water businesses in Victoria. If GMW's regulatory period is out of sync with the rest of the sector, this means that the ESC has to run a dedicated price review process just for one entity, rather than being able to achieve economies of scale through conducting all the price reviews at one time. Although GMW is not privy to the ESC's costs, we envisage the additional costs of running a separate price review are not insignificant.

GMW considers there is an opportunity to reduce regulatory costs by providing for longer regulatory periods through increasing the regulator's discretion or prescribing a longer period. This could be done through changing the WCIR to:

- a) Provide full discretion for the regulator to determine the length of the regulatory period, having regard to the operator's proposal and other factors
- b) Prescribing a longer regulatory period, for example, five years
- c) Determining a minimum length of regulatory period, for example, four years, with discretion for a longer period.

GMW notes that the Water Act Review Panel recommended that the regulator's discretion in this area should be increased, but that a minimum regulatory period equal to the current four year requirements should be retained. GMW supports this recommendation.

### **Variations of determinations**

In most economic regulatory frameworks with ex ante price or revenue setting, provision is made for determinations to be revised during a regulatory period in certain circumstances, to account for material increases and decreases in costs. Pass through events are sometimes defined in a determination, for example, the AER determines pass through events where there is some likelihood of an event occurring but the timing and cost impact is unknown at the time of the determination.

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<sup>1</sup> Essential Services Commission, *Price Review 2013: Rural Water Businesses - Final Decision*, June 2013, p. 55.

Clause 43(5) of the WCIR requires that a regulator must not approve a variation unless it is satisfied that the event which occurred within the regulatory period:

- materially and adversely affects the operator's water service infrastructure or business
- could not have reasonably been foreseen by the operator
- results in an additional cost recovery amount required in the remainder of the regulatory period that exceeds \$15 million or 5% of the value of the RAB at the beginning of the period
- that the total expenditure during the remainder of the regulatory period is likely to exceed the total forecast expenditure for that remaining part of the period
- that the operator has demonstrated it is not able to reduce its expenditure to avoid the material and adverse effects of the event without adversely affecting the reliability and safety of the water service infrastructure or their ability to comply with regulatory or legislative obligations.

The materiality threshold specified (\$15 million or 5% of the starting RAB) is higher than that applied in other regulatory frameworks.

The National Electricity Rules specifies a threshold of 1% of Maximum Allowed Revenue (MAR) for electricity transmission businesses and 1% of the annual revenue requirement for distribution businesses<sup>2</sup>. Both IPART and the ICRC have similarly applied materiality thresholds of 1% of average annual revenues in their revenue variation decisions<sup>3</sup>. The Victorian WIRO provides discretion for the ESC to determine whether to approve a variation, based on the regulatory principles<sup>4</sup>. Although most thresholds are applied with respect to annual revenues, in some cases where discretion is provided in the framework, some regulators have also considered the impact with respect to the size of RAB<sup>5</sup>.

The higher materiality threshold under the WCIR results in a greater level of risk being borne by GMW. A recent example is the Victorian Fire Services Levy, which until exemptions were approved by the Minister appeared likely to cost GMW \$12 million. This government-imposed levy was not one that GMW was able to manage or plan for in any way. In practice, it means that while GMW faces a predetermined materiality threshold of \$15 million or 5% of RAB, the ESC is allowed more discretion when assessing variation applications from its peers – an urban business with larger revenue but a smaller cost increase could conceivably receive a pass through when GMW cannot. This situation is exacerbated by GMW's relatively small RAB compared to its book asset value, again meaning it is less likely to qualify for a pass through than its peers.

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<sup>2</sup> NER, Chapter 10, definition of 'materially.'

<sup>3</sup> AER, *Preliminary Positions Matters relevant to distribution determinations for ACT and NSW DNSPs for 2009-2014*, December 2007, p. 48, available: <http://www.aer.gov.au/sites/default/files/Preliminary%20positions%20paper%20-%20guideline%20on%20the%20AER%27s%20approach%20to%20determining%20materiality%20thresholds%20for%20possible%20pass%20through%20events%20-%20December%202007.pdf>

<sup>4</sup> Water Industry Regulatory Order, cl. 12AA, available: [http://www.esc.vic.gov.au/getattachment/Water/Water-Price-Review-2013-18/Wiro-2012-wa-20121018-\(1\).pdf.aspx](http://www.esc.vic.gov.au/getattachment/Water/Water-Price-Review-2013-18/Wiro-2012-wa-20121018-(1).pdf.aspx)

<sup>5</sup> For example, AER, *Decision – Ausgrid - Cost pass through application in relation to the NSW Solar Bonus Scheme*, March 2011, available at: <https://www.aer.gov.au/sites/default/files/Final%20Decision%20-%20Ausgrid%20SBS%20Pass%20Through%20-%2020110307.pdf>. Note that the materiality threshold for electricity distributors was specified in the NER from 2012, prior to which the AER had discretion to determine materiality.

GMW notes that even without a specified materiality threshold, there are administrative costs associated with submitting an application for variation to the regulator, which provide a disincentive for submitting applications for immaterial costs. The WCIR requirements on information to be included in an application are significant enough to ensure that variation applications are limited.

GMW submits that the materiality threshold for variation of determinations should be lowered to 1% of annual revenues, consistent with other regulatory frameworks.

### **Appeal mechanisms**

The issues paper notes that a regulator's decisions made under the WCIR are subject to judicial review under the Administrative Decisions Judicial Review Act 1977. Judicial review allows operators and other stakeholders to seek review by a court of a regulator's decision on the grounds of decision making process matters, such as whether the regulator provided appropriate opportunities for stakeholders to present their views, its interpretation of legislation and the matters taken into account when making a decision.

Other economic regulatory frameworks, such as that set out in the Victorian WIRO, incorporate both judicial and merits review, enabling an operator or stakeholder to challenge the basis and reasoning of the regulator's decision as well as the decision making process. The ESC's determinations under the WIRO can be reviewed by an appeals panel on the basis of the following grounds:

- I. there has been bias; or
- II. the determination is based wholly or partly on an error of fact in a material respect<sup>6</sup>.

The practical effect of the differences between the WCIR and the Victorian WIRO is that, if it is aggrieved by the ESC's Part 6 determination, GMW is restricted to challenging the decision under the judicial review process, while its peers regulated under the WIRO are able to challenge the ESC's determinations on the basis of merit.

GMW strongly supports the introduction of a merits review process for decision made under the WCIR. This would bring it into line with standard regulatory practice and provide the opportunity for manifestly incorrect decisions to be challenged. GMW is aware of arguments that a merits review could bring additional cost and uncertainty into the regulatory process, as it has done in the electricity sector. However the fact that not a single merits review has been sought in the Victorian Water sector since the start of independent economic regulation in the mid-2000s is evidence that this is extremely unlikely.

At the same time GMW considers that the process and context for merits reviews must be proportional to the materiality of the decisions. For example, it may be appropriate for merits reviews only to apply to pricing determinations for Part 6 operators. Where a State Regulator has been accredited under the WCIR, GMW considers that it would be appropriate for the jurisdictional regulatory review processes to apply, in order to keep review costs to a minimum by reducing the need for interstate travel and excessive legal costs.

### **Planning and Management Information Rules**

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<sup>6</sup> *Essential Services Commission Act 2001*, section 55.

The Water Charge (Planning and Management Information) Rules (WCPMR) aim to increase pricing transparency in line with the Basin water charging objectives and principles. Ultimately it would appear they are designed to give impetus to drive a more consistent approach to charging for planning and management activities.

The issues paper highlighted that stakeholders have raised concerns about the effectiveness of the rules in advancing consistency in planning and management cost recovery approaches, and the costs associated with compliance with the WCPMR.

GMW shares the concerns of stakeholders in this regard. Although the costs of complying with these rules are not significant for GMW, it would appear that they have not had the desired effect of increasing transparency.

Should you wish to discuss any of the issues raised in our submission, please do not hesitate to contact Carmine Piantedosi on (03) 5826 3585.

Yours sincerely

A handwritten signature in blue ink, consisting of a stylized, overlapping circular shape with a horizontal line passing through it.

John Calleja  
Managing Director