

# **ACT Auditor-General's Office**

## **Performance Audit Report**

<p><b>The Water and Sewerage Pricing Process</b></p>
--

**Independent Competition and Regulatory Commission**

**ACTEW Corporation Limited**

**April 2014**



PA13/02

Mrs Vicki Dunne MLA  
The Speaker  
ACT Legislative Assembly  
Civic Square, London Circuit  
CANBERRA ACT 2601

Dear Mrs Dunne

I am pleased to forward to you a Performance Audit Report titled '**The Water and Sewerage Pricing Process**' for tabling in the Legislative Assembly pursuant to Section 17(5) of the *Auditor-General Act 1996*.

Yours sincerely

Dr Maxine Cooper  
Auditor-General  
2 April 2014



# CONTENTS

---

List of abbreviations .....	iii
<b>1. Report summary and conclusions .....</b>	<b>1</b>
Introduction .....	1
Audit objective .....	3
Conclusions .....	4
Key findings .....	6
Recommendations and response to the report .....	15
<b>2. Governance and administrative arrangements for water and sewerage pricing in the ACT.....</b>	<b>23</b>
Summary .....	23
Setting water and sewerage prices in the ACT .....	24
Roles of government entities .....	28
ICRC Chief Executive Officer's role as General Counsel .....	37
<b>3. Legislative requirements for water and sewerage pricing .....</b>	<b>41</b>
Summary .....	41
Key legislative requirements .....	42
Terms of reference .....	43
Conduct of the investigation .....	49
Final Report (June 2013) .....	54
<b>4. The 2013 water and sewerage pricing investigation.....</b>	<b>59</b>
Summary .....	59
Mandate and terms of reference of the ICRC .....	62
The ICRC's technical approach .....	65
The ICRC's administrative approach .....	71
The ICRC's internal procedural guidance for investigations .....	77
<b>5. ICRC assertions about the non-provision of information by ACTEW .....</b>	<b>81</b>
Summary .....	81
ICRC assertion that ACTEW withheld information .....	84
Investigation submission processes .....	86
ICRC assertions on ACTEW's motivations for withholding information .....	123
Options for addressing the ICRC's concerns .....	128
September 2012 Community Consultation Paper .....	130
<b>6. The efficiency and effectiveness of the water and sewerage pricing processes.....</b>	<b>135</b>
Summary .....	135
The effectiveness of water and sewerage pricing processes .....	136
The efficiency of water and sewerage pricing processes .....	138
Implications for future water and sewerage pricing processes .....	139
<b>Appendix A: Audit criteria, approach and method .....</b>	<b>141</b>
Audit objective .....	141
Scope .....	141
Audit approach and method .....	142



## LIST OF ABBREVIATIONS

---

ACTEW	ACTEW Corporation Limited
Audit Office	ACT Auditor-General's Office
ICRC	Independent Competition and Regulatory Commission
ICRC Act	<i>Independent Competition and Regulatory Commission Act 1997</i>
QC	Queen's Counsel



# 1. REPORT SUMMARY AND CONCLUSIONS

---

## INTRODUCTION

- 1.1 This report presents the results of a performance audit that examined the governance and administrative arrangements for the regulatory review of water and sewerage prices in the ACT.

### Supply of water and sewerage services in the ACT

- 1.2 ACTEW Corporation Limited, trading as ACTEW Water (ACTEW), supplies water and sewerage services to the ACT (and Queanbeyan). ACTEW is the sole supplier of water and sewerage services to the ACT.
- 1.3 ACTEW is an unlisted public company with assets and investments in water, sewerage, and energy services and operations. It is owned by the ACT Government and has two voting shareholders: the Chief Minister and Treasurer of the ACT.

### Independent Competition and Regulatory Commission

- 1.4 The Independent Competition and Regulatory Commission (the ICRC) is a statutory body established to regulate prices, access to infrastructure services and other matters in relation to regulated industries, and to investigate competitive neutrality complaints and government-regulated activities.
- 1.5 The ICRC is established under the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act). Subsection 8(1) of the ICRC Act provides that the functions of the ICRC include *inter alia*:
- the provision of price directions;
  - the provision of recommendations about price regulation; and
  - investigation and reporting on matters referred by the Minister and other referring authorities.
- 1.6 As the ACT's economic regulator for utility services, the ICRC's role includes setting the maximum prices that may be charged by ACTEW for the provision of water and sewerage services.

### Process for the pricing of water and sewerage

- 1.7 An investigation is the process by which the ICRC investigates and determines water and sewerage prices for a regulatory period. At the conclusion of an investigation into water and sewerage prices, the ICRC makes a price direction which sets the maximum prices that may be charged by ACTEW for a regulatory period.

- 1.8 On 13 October 2011 the Treasurer provided a reference to the ICRC seeking ‘an investigation into, and the making of a price direction for, regulated water and sewerage services provided by ACTEW Corporation Limited’. The investigation was to determine the prices that ACTEW would be able to charge customers for water and sewerage services for the next regulatory period, commencing on 1 July 2013.

### Assertions that ACTEW withheld information necessary for the ICRC investigation

- 1.9 In a meeting with ACT Auditor-General’s Office (Audit Office) staff on 27 September 2012 in relation to the 2011-12 audit of the ICRC’s financial statements, the Chief Executive Officer of the ICRC asserted that ACTEW was deliberately withholding information necessary for the conduct of the regulatory review of water and sewerage prices and this was associated with the forthcoming 2012 ACT Legislative Assembly election.

- 1.10 The Audit Office staff subsequently conveyed this information to the Auditor-General. The Auditor-General and other staff of the Audit Office met with the Senior Commissioner, Standing Commissioner and Chief Executive Officer of the ICRC on 4 October 2012 and 9 October 2012, where these assertions were again made. On 19 October 2012 the Chief Executive Officer of the ICRC wrote a letter to the Auditor-General on behalf of the ICRC which:

... set out the Commission’s reasons for requesting your office to consider the actions of ACTEW in so far as it relates to the non-provision of information by ACTEW in the current regulatory review of water and sewerage prices.

- 1.11 In the same letter (19 October 2012) the Chief Executive Officer of the ICRC advised that:

For the purpose of exercising its functions under the ICRC Act, the Commission requires information from ACTEW. In not providing the information necessary for the Commission to exercise its functions in ACTEW’s submission and subsequently, under notice, ACTEW is obstructing the Commission in fulfilling its regulatory functions.

ACTEW has not to date provided the Commission with a reasonable excuse required in the absence of ICRC determination why it cannot provide the information.

- 1.12 Also in the same letter (19 October 2012) the Chief Executive Officer of the ICRC advised that:

In E-mails subsequent, a meeting and a letter, ACTEW through its Managing Director, declined to provide the information citing several reasons including that whilst it was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election.

1.13 Also in the same letter (19 October 2012) the Chief Executive Officer of the ICRC advised that:

The Commission has considered the actions and inactions of ACTEW as posing a threat to the public interest. The Commission has come to this view after assessing the information that is in the public domain as published by ACTEW, ACTEW's submission to the Commission, correspondence including meetings with the Commission and a draft report of a review undertaken by independent consultants. The two limbs of the public interest we are concerned may be threatened are:

1. The use of the regulatory process by ACTEW and or its managing director to influence a key pillar of democracy – genuine and periodic elections.
2. The undermining of a core Commission function to set prices for a regulated utility service provider.

1.14 In recognition of the seriousness of the assertions made by the ICRC, the Auditor-General decided to conduct a performance audit in relation to the matters raised.

#### AUDIT OBJECTIVE

1.15 The objective of the audit is to provide an independent opinion to the Legislative Assembly on the efficiency and effectiveness of the processes for the regulatory review of water and sewerage prices in the ACT. To do this, the Audit Office considered:

- roles and responsibilities of key entities involved in the regulatory review of water and sewerage prices in the ACT, specifically the ICRC and ACTEW;
- administrative processes for undertaking the regulatory review of water and sewerage prices in the ACT; and
- communication protocols between key entities involved in the regulatory review of water and sewerage prices in the ACT, specifically the ICRC and ACTEW.

1.16 ACTEW's cooperation in the water and sewerage pricing process was also considered.

#### Scope

1.17 The audit included consideration of:

- the governance arrangements and administrative processes, including communication protocols, within the ICRC and ACTEW, with respect to the regulatory review of water and sewerage prices in the ACT. This included:

- the processes used by the ICRC to identify and request information from agencies to assist the Commission; and
  - the processes used by ACTEW to respond to the ICRC;
  - the legislative basis and support for entities engaged in the regulatory review of water and sewerage prices in the ACT; and
  - the costs associated with the price direction.
- 1.18 The audit also included consideration of the assertions made by the ICRC that ACTEW had withheld information necessary for the Commission to exercise its functions and not fully cooperated with the Commission's requests for information.

### Out of scope

- 1.19 The actual prices that have been set for the supply of water and sewerage within the ACT were not considered in this audit.
- 1.20 The audit is primarily concerned with examining the systems and processes for the setting of water and sewerage prices within the ACT. Adherence to due processes to ensure that appropriate decisions have been, and can be, made were considered.
- 1.21 Appendix A outlines the scope, approach and method used for conducting this audit.

### CONCLUSIONS

Administrative and communication processes associated with the 2013 water and sewerage pricing process have been ineffective and inefficient. In particular, the process has been characterised by poor communication and a poor relationship between the ICRC and ACTEW.

While the ICRC advised that it sought to approach the 2013 process from 'first-principles', this was not supported by effective stakeholder communication. Assertions made by the ICRC about ACTEW reflect the poor relationship between the two organisations. Furthermore, Queen's Counsel, Mr Peter Hanks advises that '...the Price Direction made by the ICRC...is invalid' because the terms of reference issued by the Treasurer was insufficient. The issues identified in this audit indicate that there is a need for the water and sewerage price setting framework in the ACT to be reviewed.

Assertions made by the ICRC that ACTEW deliberately withheld information from the ICRC in the course of the water and sewerage pricing process, including that 'whilst it was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election' are not supported by evidence. Accordingly, the ICRC's view that 'the actions or inactions of ACTEW [posed] a threat to the public interest' is also not supported.

There was a difference in the expectations of the ICRC and ACTEW with respect to the nature of the information to be provided by ACTEW as part of the water and sewerage pricing process. This difference in expectations was never satisfactorily resolved between the ICRC and ACTEW. Assumptions underpinning the different entities' expectations and understanding of the processes, were also never effectively communicated.

The ICRC sought to compel the provision of information from ACTEW through the use of a legal notice under the *Independent Competition and Regulatory Commission Act 1997*. ACTEW did not have the information, as requested by the ICRC in the legal notice. The legal notice issued by the ICRC required that ACTEW provide this information by amending its main submission to the ICRC for the investigation. ACTEW fundamentally disagreed with the ICRC's request that it provide the information by amending its main submission to the investigation. While ACTEW was unwilling to provide the information by amending its main submission, ACTEW consistently advised the ICRC that it was willing to provide the ICRC with other data and information that would assist the ICRC to undertake its investigation. ACTEW's proposed approach was not acceptable to the ICRC.

There are conflicts in the roles of the Treasurer in the setting of water and sewerage prices in the ACT. The Treasurer is a voting shareholder of ACTEW and is also the Minister responsible for water and sewerage price setting policy. As part of the 2013 water and sewerage price setting process, the Treasurer set the terms of reference for the investigation and provided submissions to the ICRC on behalf of the ACT Government. While there are practices that mitigate the risk of adverse effects due to the conflicts in roles, such conflicts remain. Given the importance of the roles it would be prudent to further mitigate (and if possible) eliminate the conflicts in roles.

There is a conflict in the roles undertaken by the ICRC Chief Executive Officer. The ICRC Chief Executive Officer has undertaken the roles of Chief Executive Officer and General Counsel (or Chief General Counsel) for the organisation as part of the 2013 water and sewerage price setting process. Adopting the title of General Counsel (or Chief General Counsel) infers that the advice given is 'independent' of the role of Chief Executive Officer. The Chief Executive Officer does not have sufficient independence to act as the General Counsel (or Chief General Counsel) and should not assume this role.

(Expanded conclusions are at the beginning of each chapter.)

### KEY FINDINGS

1.23 The audit conclusions are supported by the following findings:

#### **Governance and administrative arrangements for water and sewerage pricing in the ACT (Chapter 2)**

##### *Setting water and sewerage prices*

- The maximum water and sewerage prices that ACTEW may charge in the ACT, as determined by the ICRC through its water and sewerage pricing process, will necessarily affect the profitability and potentially the financial viability of ACTEW. All things being equal, higher water and sewerage prices mean larger profits for ACTEW and increased dividends for the Territory. ACTEW's profitability and the dividend paid to the Territory also depend on the efficiency of ACTEW in managing its business operations and its costs.
- The trade-off 'between the community as customers of ACTEW's water and sewerage services and the community as taxpayers and consumers of government services' is recognised by the ICRC in its Final Report (June 2013). The ICRC identified that drought conditions in recent years and a significant increase in water infrastructure investment 'have put considerable pressure on ACTEW's balance sheet, reflected in the rapid growth of ACTEW's debt'. The ICRC has also identified that 'this pressure has been further intensified by the ACT government's policy of requiring ACTEW to pay 100 percent of its after tax profits as dividends to the government as shareholder on behalf of the ACT community'.

##### *Roles of Government entities*

- Government entities involved in the water and sewerage pricing process include ACTEW, the ICRC, the Chief Minister and Treasury Directorate and the Chief Minister and Treasurer as the two voting shareholders of ACTEW. Other ACT Government entities such as the Commerce and Works Directorate and the Environment and Sustainable Development Directorate are also indirectly involved.
- The Chief Minister and the Treasurer are the Ministers responsible for the Chief Minister and Treasury Directorate, which is responsible for 'sustainability policy and coordination' and 'fiscal and economic policy including competition and regulatory reform.' Officers from the Chief Minister and Treasury Directorate were responsible for advising the Treasurer in relation to water and sewerage pricing policy and the provision of submissions and responses to the ICRC for the purpose of the investigation. The Treasurer is the Minister responsible for the ICRC Act, which sets the framework for the water and sewerage pricing process.

### **ICRC Chief Executive's role as General Counsel**

- There was a poor understanding in the ICRC with respect to internal roles and responsibilities for the provision of legal advice. The ICRC Chief Executive Officer has undertaken the role of General Counsel (or Chief General Counsel) for the organisation. Neither this title nor specific responsibilities with respect to the provision of legal advice are part of the Chief Executive Officer's employment documents.
- The Chief Executive Officer advised that approximately 90 percent of the time that they spent on the water and sewerage pricing process was for the purpose of providing legal counsel to the Commissioners.

### **Legislative requirements for water and sewerage pricing (Chapter 3)**

#### **Terms of reference**

- Subsection 20(1) in Part 4 of the ICRC Act provides that when making a price direction at the conclusion of an investigation, 'the commission must decide on the level of prices for services in relation to the period specified in the reference'.
- The Treasurer was provided with a briefing minute by the then Treasury Directorate on the proposed terms of reference on 26 September 2011, with the proposed terms of reference attached. The minute stated that the proposed terms of reference 'have been developed in conjunction with the ICRC and the Environment and Sustainable Development Directorate.'
- The ACT Treasurer provided the terms of reference for the water and sewerage price investigation through *Disallowable Instrument DI 2011-287*, which was issued on 13 October 2011. The terms of reference did not specifically identify a regulatory period. In its Final Report and associated price direction (June 2013), the ICRC 'set' a six-year regulatory period from 2013 to 2019.
- According to advice provided to the Audit Office by Mr Peter Hanks QC, the implication of the Treasurer not specifying a regulatory period in the terms of reference issued on 13 October 2011 is that the price direction is invalid.

#### **Conduct of the investigation**

- The Draft Report and proposed price direction (February 2013) was produced approximately 16 months after the Treasurer issued the terms of reference and approximately two months before the initially planned completion date for the investigation of 1 May 2013. The Draft Report was the first time that the ICRC presented its views and preliminary conclusions on technical and regulatory issues. However, senior ICRC staff advised the Audit Office that the Draft Report was more in the nature of a discussion paper and, when published, did not necessarily represent the ICRC's conclusions with respect to technical and regulatory matters.
- There were significant differences in interpretations and assumptions by participants in the water and sewerage pricing process with respect to the Draft

Report and proposed price direction (February 2013). There was a fundamental difference in the expectations of the ICRC and ACTEW regarding the content of the Draft Report and proposed price direction, and the extent to which it needed to reflect the requirements of Part 4 and Part 4A of the ICRC Act, with respect to the Final Report and price direction.

- In the ICRC there was an expectation that the Draft Report and proposed price direction (February 2013) did not need to meet legislative requirements that applied to a final report and final price direction, including the matters required to be considered as part of an investigation. However, ACTEW expected that the Draft Report and proposed price direction (February 2013) would represent the ICRC's conclusions and demonstrate how legislative requirements under the ICRC Act were met.

### ***Final Report***

- The ICRC's Final Report (June 2013) included a range of additional commentary and findings, specifically on ACTEW and its governance arrangements. This broader commentary did not specifically relate to the setting of water and sewerage prices as part of the price direction. While the ICRC was required to take account of the considerations set out in the 2013 terms of reference, none of the considerations expressly required the ICRC to consider ACTEW's governance arrangements. By making these considerations, the ICRC has stretched the authority conferred on it by the terms of reference.

### **The 2013 water and sewerage pricing investigation (Chapter 4)**

#### ***Terms of reference and mandate of the ICRC***

- The matters to be considered by the ICRC in a water and sewerage pricing investigation are established by section 20 in Part 4 of the ICRC Act and the terms of reference for the investigation. Together, these require a range of economic, environmental and regulatory objectives to be considered. As some of these objectives conflict, trade-offs need to be made by the ICRC. The investigation and price direction process is open to wide differences of opinion, interpretation and emphasis.
- Compounding the challenge of considering the breadth of matters and objectives in the water and sewerage pricing investigation in the ACT, is the lack of documented principles for setting water and sewerage prices, including policy guidance on the relative weight or merit of the objectives.

#### ***The ICRC's technical approach***

- The ICRC's approach to the 2013 water and sewerage pricing investigation was intended to be different to earlier approaches. The ICRC sought to approach the water and sewerage pricing process from 'first-principles' and in doing so it questioned and reconsidered previous expectations and assumptions for the conduct of the water and sewerage pricing investigation. While there were elements of the ICRC's approach that were consistent with earlier price

investigations, other elements of the ICRC's approach were a departure from previous practices in the ACT and those applied by other regulators in Australia.

- Two key features of the 2013 regulatory process that represent a departure from previous practice in the ACT and those applied by other regulators in Australia are:
  - the ICRC's use of a 'firm-specific' approach to calculating ACTEW's weighted average cost of capital for the purpose of calculating a return on capital for ACTEW; and
  - the ICRC's proposal for a six-year regulatory period, with 'biennial recalibrations of the key elements of the pricing model'.
- In its Draft Report and proposed price direction (February 2013) the ICRC proposed an overall 16.8 percent decrease in water prices and a 24 percent decrease in sewerage prices between 2012-13 and 2013-14. In its Final Report and price direction (June 2013) the ICRC determined an overall 5 percent increase in water prices and an 18 percent decrease in sewerage prices. This represents a significant shift in the ICRC's price direction.
- Key reasons for the shift in the ICRC's price direction are:
  - the removal of the 'fair cost recovery scheme', which was initially proposed in the ICRC's Draft Report and proposed price direction (February 2013);
  - changes to the way that the return on capital was calculated in the ICRC's Final Report and price direction (June 2013), compared with the ICRC's Draft Report and proposed price direction (February 2013);
  - the inclusion of additional operating expenditure, which was not included in the Draft Report and proposed price direction (February 2013); and
  - a calculation error in the ICRC's Draft Report and proposed price direction (February 2013), which was recognised and addressed in the Final Report and price direction (June 2013). The error related to the calculation of volumes of water expected to be sold at different tiers of the pricing structure.

#### ***The ICRC's administrative approach***

- The ICRC implemented a different administrative approach for the 2013 water and sewerage pricing investigation, compared with:
  - the 2008 water and sewerage pricing investigation; and
  - the ICRC's planned approach for the 2013 investigation, as identified in its November 2011 Context Paper.

- In the 2013 investigation, there was a greater focus by the ICRC on identifying contextual issues and other broad issues for consideration in the early stages of the investigation process. For example, as part of the November 2011 Context Paper and February 2012 Issues Paper, the ICRC identified issues and posed questions for the purpose of seeking feedback from stakeholders, including the community.
- In the 2008 investigation the ICRC sought to identify contextual issues and other broad issues for consideration, but in doing so also sought to provide information and clarity on the ICRC's analysis and preliminary views earlier in the process. As part of the 2008 review the ICRC produced three technical discussion papers, which were focused and discrete analyses on components of the investigation. The discussion papers included both questions and issues for consideration by stakeholders, including the community, and the ICRC's 'preliminary view' in response to each of these issues.
- In contrast to the 2008 process, in the 2013 investigation the ICRC did not identify any preliminary views or conclusions in any of its public material until the Draft Report and proposed price direction (February 2013), which was released approximately 16 months after the terms of reference were issued and approximately two months before the planned completion date. In pursuing this strategy, the ICRC did not proceed with the Preliminary Conclusions Report or Working Conclusions Reports, which were envisaged in the Context Paper (November 2011).
- Given the ICRC's desire to approach the review from 'first-principles' it would have been prudent for the ICRC to identify and test its potential conclusions at earlier stages of its process. By not doing so, the ICRC missed an opportunity to effectively communicate, at an earlier stage, what the novel features of the price determination might be for the benefit of stakeholders.
- Communication and consultation as part of the 2013 water and sewerage pricing process was also poor. For example:
  - throughout the project there were delays in ICRC deliverables, for example the Issues Paper was delayed by two months and the Draft Report (February 2013) by three months. (It is noted that the ICRC asserts that the delay in the provision of the Draft Report was due to ACTEW. ACTEW disagrees with this assertion);
  - key papers through which the ICRC initially anticipated providing its preliminary views and conclusions, the Preliminary Conclusions Report and Working Conclusions Report, were to occur up to 12 months and 10 months respectively before the release of the Final Report and price determination. The ICRC did not proceed with these papers and the first time that the ICRC presented its preliminary views and conclusions was the Draft Report (February 2013), which was three months later than planned; and

- commensurate with the later than anticipated provision of key reports, there were compressed timeframes for stakeholder consultation at key stages of the process. For example, stakeholder submissions on the Issues Paper were compressed from two months to five weeks and submissions on the Draft Report from three months to six weeks. While the six week consultation period for the Draft Report still met the statutory timeframes of the ICRC Act, this was a compressed period given that the ICRC had adopted some 'novel features' in its Draft Report.

### *The ICRC's procedural guidance for the investigation*

- There is a lack of detailed internal administrative and procedural guidance in the ICRC for its water and sewerage pricing investigations. While the terms of reference and the ICRC Act can be used to guide ICRC processes, specific internal guidance is needed on how the ICRC is to:
  - conduct a water and sewerage pricing investigation;
  - consider information obtained in the course of the investigation; and
  - communicate and consult with key stakeholders.
- There was an absence of detailed project planning documentation associated with the investigation.
- These inadequate processes, combined with the broad terms of reference and mandate for the investigation, and the different administrative and technical approaches of the 2013 investigation, are factors that increase the risks associated with achieving an effective and efficient water and sewerage pricing process.

### *ICRC assertions about the non-provision of information by ACTEW (Chapter 5)*

#### *ICRC's requests for information from ACTEW*

- In August 2012, the ICRC asserted to ACTEW that its main submission to the water and sewerage pricing investigation in July 2012 was lacking information on some issues. The ICRC requested that ACTEW amend its July 2012 main submission and provide the additional information, specifically: ACTEW's proposed treatment of the shortfall in revenue from the 2008 to 2013 regulatory period; estimated water sales forecasts for 2013 to 2018; and ACTEW's proposed tariffs for 2013 to 2018.
- ACTEW fundamentally disagreed with the ICRC's request that the information be provided, as requested by the ICRC. ACTEW's disagreement was based on various grounds, including that it did not wish to amend its main submission. ACTEW's position was that its main submission, provided in July 2012, represented 'the view of ACTEW Corporation (ACTEW) on the matters under review by the [ICRC].'

- The ICRC issued a notice to ACTEW, by virtue of section 41 of the ICRC Act, which sought to compel the provision of the information from ACTEW. The notice sought to compel the provision of:
  - ‘the document or information which amends Table 13.6 on page 218 of its main submission to incorporate the pass-through amount in the proposed water revenue requirement, based on ACTEW’s preferred time profile over which this amount should be recovered, with explanatory comments’;
  - ‘the document or information which amends section 6.1.5 of its main submission to include estimated annual water sales volumes for the 2013-18 regulatory period, with explanatory comments’; and
  - ‘the document or information that amends section 14.1 of its main submission to include a proposed water tariff for 2013-14 and indicative tariffs for the remainder of the regulatory period.’
- ACTEW did not provide the information, as requested by the ICRC, in response to the notice under section 41 of the ICRC Act.
- The Audit Office is satisfied that ACTEW did not have information or documentation ‘that amends...its main submission’ as requested by the ICRC. The Audit Office is satisfied, however, that ACTEW had financial and other information, which it could have used or developed to prepare the information or documentation ‘that amended ACTEW’s main submission’. However, ACTEW fundamentally disagreed with the ICRC’s request that the information be provided by amending its main submission. ACTEW also fundamentally disagreed with the ICRC’s request for five-year water consumption forecasts and proposed tariffs that, in part, reflected these water consumption forecasts. This demonstrates that there was a substantial breakdown in communication between the ICRC and ACTEW.
- ACTEW consistently advised the ICRC that it was willing to provide the ICRC with information that would assist the ICRC undertake its investigation. This included an offer from ACTEW to ‘work up a range of indicative water prices for 2013-14 to 2017-18 based on its proposed cost building blocks and a continuation of Commission decisions currently in force, including water volumes forecasts used by the Commission to set prices for 2011-12 and 2012-13 and include scenarios for the pass-through of foregone revenue with the appropriate caveats.’ These offers of additional assistance and information were not taken up by the ICRC.

### ***ICRC’s assertions about ACTEW’s motivations***

- In support of its assertion that ACTEW did not provide the information to the ICRC as ‘ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election’, the ICRC asserted that statements to this effect were made by the Managing Director of ACTEW at a meeting that occurred on 13 August 2012 between ACTEW (and ActewAGL) and ICRC representatives.

- Meeting attendees' recollections of the meeting and the way in which issues were discussed differed substantially. A key difference related to the way in which the issue of caretaker conventions associated with the forthcoming ACT Legislative Assembly election was raised. While there was agreement amongst attendees at the meeting that the Managing Director of ACTEW raised the issue of the caretaker conventions associated with the forthcoming election, attendees' recollections differed with respect to the manner in which the issue was raised and the purpose for which the issue was raised.
- The ICRC provided a file note in relation to this meeting in support of its assertions. The Audit Office considers that the ICRC file note provides limited support for the assertions made by the ICRC because it was not:
  - a contemporaneous account of the meeting as it was produced approximately one month after the meeting occurred; or
  - shared with ACTEW for verification.
- The ICRC file note also recognises and documents the ACTEW Managing Director's reservations with respect to the forthcoming ACT election and the implications of the caretaker conventions for ACTEW and the provision of the information. These include the need for the Managing Director to consult with the ACTEW Board with respect to amending ACTEW's submission, concern that the ACTEW Board would not adopt a position without consulting with the shareholders (the then Chief Minister and Treasurer) and a recognition that potential shareholders would also need to be consulted.
- There is limited guidance in the ACT Government's *Guidance on Caretaker Conventions* on the type of information covered by caretaker conventions. The document notes it 'is a matter of judgement' and considerations include 'whether the decision is a matter of contention in the election campaign' and whether it is a major policy decision that is 'likely to commit an incoming government.'

#### ***September 2012 Community Consultation paper***

- The ICRC released its Community Consultation Paper the day before caretaker conventions in the ACT formally commenced (14 September 2012) and comments were due, for consideration as part of the Draft Report, on the day before the election was held on 20 October 2012.
- The release of the Community Consultation Paper during the caretaker period, with its focus on price outcomes, and with minimal information or analysis on the technical methodology or assumptions that underpinned this analysis, was construed by ACTEW as a provocative act on the part of the ICRC. This followed ACTEW's communications to the ICRC in August 2012 on its reservations with respect to providing information during the caretaker period.

- The ICRC advised the Audit Office that the selection of dates was not made with a view to seeking a particular outcome or pushing a particular agenda. The ICRC also advised the Audit Office that, at the time, the ICRC was still working towards releasing a Draft Report in November 2012, in accordance with its original proposed timeframe and that the release of the Community Consultation Paper sought to elicit information that would achieve this outcome.
- The Audit Office notes the differing viewpoints of the ICRC and ACTEW with respect to the appropriateness of issuing the Community Consultation Paper as well as the timing of the Community Consultation Paper. The Audit Office notes that this issue highlights the poor relationship that was apparent between the ICRC and ACTEW at the time.

### **The efficiency and effectiveness of the water and sewerage pricing process (Chapter 6)**

#### ***Costs of the water and sewerage pricing process***

- The ICRC has invoiced ACTEW \$2 364 362 (GST inclusive) which represents the ICRC's costs for conducting the process (up to October 2013).
- The ICRC's costs for the 2008 water and sewerage pricing process were \$1 389 086 (GST inc). The current process has therefore cost approximately \$975 276 (70.2 percent) more than the 2008 process. Project budget documentation in the ICRC initially estimated the total cost of the 2013 process to be between \$1 600 134 and \$1 711 134.
- The amount invoiced to ACTEW for the 2013 process (\$2 364 362) consists of:
  - \$843 435 direct staffing expenses;
  - \$471 792 consultancy expenses;
  - \$151 177 administrative expenses; and
  - \$897 958 in overhead expenses incurred by the ICRC.
- These figures represent the ICRC's direct cost for the process and do not represent the other costs associated with the process including:
  - indirect costs incurred by ACTEW in participating in the process, e.g. ACTEW and ActewAGL staff costs; and
  - direct costs incurred by ACTEW in participating in the process, e.g. legal fees incurred by ACTEW with respect to advice on how to respond to ICRC requests and participate in the process.

- ACTEW asserts that a total cost of \$3 965 844 has been incurred by it through participation in the review process (from 2011 to October 2013). This includes:
  - \$2 482 633 (GST exclusive) of indirect staff costs and overheads;
  - \$1 262 261 for contractors and consultants;
  - \$200 109 for legal fees; and
  - \$20 841 in other costs.
- The total cost of the water and sewerage pricing process may therefore be estimated at approximately \$6.3 million, which represents the ICRC's invoiced costs and the direct and indirect costs that ACTEW has asserted it has incurred
- By virtue of subsection 19(1) of the ICRC Act, the ICRC is able to recover the costs of the water and sewerage pricing process from ACTEW. A budget is not set for the water and sewerage pricing process, nor is there a cap on the amount that may be charged by the ICRC for its activities. Having a budget may encourage more effective communication processes.

## RECOMMENDATIONS AND RESPONSE TO THE REPORT

- 1.24 This audit has one overall recommendation and seven other recommendations to address the audit findings detailed in this report.
- 1.25 In accordance with Section 18 of the *Auditor-General Act 1996*, a final Modified Proposed Report was provided to the Chief Minister; Treasurer; Commissioners of the ICRC; Chief Executive Officer of the ICRC; Acting Chief Executive Officer of ACTEW; Chairman of ACTEW Board of Directors; former Managing Director of ACTEW; and the Head of Service and Director-General of the Chief Minister and Treasury Directorate for consideration and comments.
- 1.26 The ACT Government provided specific comments on the recommendations.
- 1.27 The ICRC provided specific comments on the recommendations.
- 1.28 ACTEW provided an overall response and a response of 'Noted' to each of the recommendations.

### ACTEW overall response:

*The audit report highlights the most recent water and sewerage pricing review was extremely challenging, and dealt with a number of unprecedented regulatory issues. In this context, ACTEW notes the recommendations made by the Auditor General.*

*With respect to recommendation (3) and the Auditor General's associated comments in relation to the Price Direction, ACTEW believes, that all standard customer contracts remain valid regardless of whether or not there is a valid Price Direction. ACTEW obtained*

*independent legal opinion from Mr Bret Walker SC and Mr Jonathan Kay Hoyle that supports this view.*

*We welcome the finding that ACTEW and the former Managing Director are exonerated from assertions which “are not supported by evidence”.*

*It is noted, and clearly illustrated in the audit report, that throughout the water and sewerage pricing determination process ACTEW provided information to the ICRC and sought on numerous occasions to discuss and resolve issues. This included four formal submissions, active involvement with the ICRC’s engineering consultant Cardno, and the many offers to meet with the ICRC.*

*ACTEW sought a review of the Price Direction following advice from NERA consulting and regulatory expert Mr Greg Houston. Mr Houston found the ICRC’s technical conclusions left “ACTEW with a highly uncertain basis on which to plan the operation, investment and financing decisions that are necessary to run an efficient, effective water services operation.” We maintain our position in seeking this review.*

1.29 The auditees provided specific responses to each of the recommendations. These responses are shown in italics below each recommendation.

### **Overall Recommendation (Chapter 6)**

The ACT Government should review the water and sewerage price setting framework including legislative, governance and administrative arrangements.

#### **Government Response:**

*Agreed.*

*The Government will introduce improvements to the independent price regulation framework in the ACT. When formulating the improvements, the Government will consider the Territory’s legislative, governance and administrative arrangements.*

#### **ICRC Response:**

*The Commission does not agree. The Commission’s view is that the interpretations and findings presented in the report do not constitute a sound basis for reviewing the ACT’s water and sewerage price setting framework. The findings have not been substantiated and cannot be sustained.*

#### **ACTEW Response:**

*Noted.*

**Recommendation 1 (Chapter 2)**

The ACT Government should review the Treasurer's responsibilities and implement mechanisms to further mitigate (and if possible eliminate) conflicts in roles with respect to the water and sewerage pricing process.

**Government Response:**

*Noted.*

*The Government considers that the different responsibilities of the Treasurer in relation to the water and sewerage pricing process are clearly defined, and as concluded by this report, were carried out in an appropriate manner during the process.*

*A Minister, especially in a smaller jurisdiction, is required to balance multiple interests whilst carrying out his or her various roles. Ministers in other jurisdictions also balance multiple interests in relation to water pricing. Even if the roles in question were separated to other ministers, there would still be the potential for conflict of roles.*

*There are a number of strategies in place to mitigate any potential conflict of roles. As identified in the report, voting shareholders are not involved in the direct management of ACTEW, Government submissions to the ICRC are publicly available and the terms of reference is a Disallowable Instrument hence allowing the Legislative Assembly to have a voice in the process. In addition to the strategies identified in the report, the collective view of Cabinet is sought on any Government submission before provision by the Treasurer, as per normal Government practices. Lastly, it is partly in recognition of the potential for conflict of roles that the pricing process is undertaken independent of Government.*

*The Government is satisfied that current mechanisms in place successfully mitigate any potential for conflict between the different roles of the Treasurer and hence further mitigation is not required.*

**ICRC Response:**

*The Commission does not agree. The Commission's view is that the interpretations and findings presented in the report do not demonstrate a need for a review of the Treasurer's responsibilities.*

**ACTEW Response:**

*Noted.*

**Recommendation 2 (Chapter 2)**

The ICRC Chief Executive Officer should not undertake the role of General Counsel for the ICRC.

**ICRC Response:**

*The Commission does not agree. The Commission's view is that the interpretations and findings presented in the report do not constitute a sound basis for the recommendation and that the recommendation is inconsistent with the operation of an independent statutory body.*

**Government Response:**

*Noted.*

*The Government notes this is a matter for the Independent Competition and Regulatory Commission as the independent regulatory body. The Government will consider this issue within the broader improvement of the water and sewerage pricing framework for the ACT envisaged in the Government's examination of options to improve the system.*

**ACTEW Response:**

*Noted.*

**Recommendation 3 (Chapter 3)**

The ACT Government should address the issues associated with the potential invalidity of the current price direction.

**Government Response:**

*Agreed.*

*It is the view of the Government that the Terms of Reference is effective to ensure the validity of the Price Direction. However, the Government agrees that to remove any doubt, and to particularly remove any uncertainty about the price reductions provided through the price determination, it will introduce appropriate legislation to ensure the validity of the price direction.*

**ICRC Response:**

*The Commission does not agree. The current price determination is valid. The Commission's view is that the interpretation and findings do not identify any issues requiring to be addressed by government.*

**ACTEW Response:**

*Noted.*

**Recommendation 4 (Chapter 3)**

The ACT Government should review and amend the *Independent Competition and Regulatory Commission Act 1997* to clarify the relationship between Part 3 (Investigations) and Part 4 (Price directions) of the Act.

**Government Response:**

*Agreed.*

*The issues that have arisen during the water and sewerage pricing process and consequently highlighted in this report have shown that clarifications to the drafting and structure of the Independent Competition and Regulatory Commission Act 1997, in particular in relation to Parts 3 and Part 4, are required.*

**ICRC Response:**

*The Commission agrees in part. There is clearly a case for removing the doubts about the legislature's intention that have been raised in connection with section 15, and 16 and section 20 of the ICRC Act. However, the Commission does not consider that the interpretations and findings presented in the report provide sound reasons for a broader review and amendment of Parts 3 and 4 of the ICRC Act alone. Although the case is not made in the report, the Commission considers that a thorough review of the whole ICRC Act may be worthwhile.*

**ACTEW Response:**

*Noted.*

### **Recommendation 5 (Chapter 3, Chapter 4 and Chapter 5)**

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- a) a requirement to clearly identify the nature and purpose of stakeholder consultation documents prepared by the ICRC. At a minimum, the principles should require that a draft report and proposed price direction must comply with, and represent, any requirements of a final report and final price direction;
- b) guidance with respect to the prioritisation of objectives that are sought from the water and sewerage pricing investigation;
- c) guidance with respect to administrative processes to be conducted as part of the investigation, in order to facilitate open and timely communication of key issues, findings and conclusions at early stages of the process;
- d) protocols for the provision of information required, including outlining the type and nature of information to be provided by ACTEW as the regulated entity; and
- e) protocols for the resolution of disputes between the regulator and the utility being regulated during a water and sewerage price investigation, specifically with respect to disputes in relation to administrative processes associated with the investigation.

### **Government Response:**

*Agreed.*

*The Government considers that there needs to be increased clarity around the process related to future water and sewerage pricing investigations. The Government will consider the issues identified in this recommendation within the broader improvement of the water and sewerage pricing framework for the ACT envisaged in the Government's examination of options to improve the system. The Government intends that the new system will incorporate the suggestions in this recommendation.*

### **ICRC Response:**

*The Commission does not agree. The Commission's view is that the interpretations and findings presented in the report do not constitute a sound basis for the development of a set of principles for the conduct of water and sewerage pricing investigations nor have the implications of imposing them for the independence of the Commission been properly considered.*

### **ACTEW Response:**

*Noted.*

**Recommendation 6 (Chapter 4)**

The ICRC, for all future water and sewerage pricing review investigations, should develop and implement:

- a) detailed internal procedural guidance. This should include guidance on communication and consultation processes with stakeholders, including ACTEW; and
- b) rigorous project planning, monitoring and reporting procedures.

**ICRC Response:**

*The Commission agrees in part. Following its release of the draft report on water and sewerage services, the Commission reviewed its internal processes for producing that report and instituted changes to improve the management of the production of the final report. Since then the Commission has continued to develop and document its project management procedures for the efficient and effective operation of the Commission. However, the Commission itself will determine the scope and coverage of mechanisms required.*

**Government Response:**

*Noted.*

*While the Government notes this is a matter for the Independent Competition and Regulatory Commission as the independent regulatory body, the Government supports this recommendation.*

**ACTEW Response:**

*Noted.*

**Recommendation 7 (Chapter 5)**

The ACT Government should provide more detailed guidance to ACT Government entities, specifically territory-owned corporations and statutory authorities, on protocols during the caretaker period.

**Government Response:**

*Agreed.*

*The caretaker conventions represent a body of practice that has developed over time in the Westminster system of parliaments that provides guidance to ACT Government*

*Directorates, Territory Owned Corporations and Statutory Authorities on the appropriate actions to be undertaken during the period immediately before and after a general election. They cannot anticipate every circumstance that may arise.*

*As part of the usual process to be conducted before the 2016 election, the Government will consider what changes are required to the Guidance on Caretaker Conventions in relation to the Territory Owned Corporations and Statutory Authorities. It will also consider the benefits that are to be gained from increased opportunities for training or consultation between Territory Owned Corporations and Statutory Authorities and the relevant staff within the Chief Minister and Treasury Directorate that are responsible for the administration of the caretaker provisions.*

**ICRC Response:**

*The Commission has no comment.*

**ACTEW Response:**

*Noted.*

## 2. GOVERNANCE AND ADMINISTRATIVE ARRANGEMENTS FOR WATER AND SEWERAGE PRICING IN THE ACT

---

- 2.1 This chapter discusses the governance and administrative arrangements for water and sewerage pricing in the ACT.

### SUMMARY

#### Conclusions

There are conflicts in the roles of the Treasurer in the setting of water and sewerage prices in the ACT. The Treasurer is a voting shareholder of ACTEW and is also the Minister responsible for water and sewerage price setting policy. As part of the 2013 water and sewerage price setting process, the Treasurer set the terms of reference for the investigation and provided submissions to the ICRC on behalf of the ACT Government. While there are practices that mitigate the risk of adverse effects due to the conflicts in roles such conflicts remain. Given the importance of the roles it would be prudent to further mitigate (and if possible) eliminate the conflicts in roles.

There is a conflict in the roles undertaken by the ICRC Chief Executive Officer. The ICRC Chief Executive Officer has undertaken the roles of Chief Executive Officer and General Counsel (or Chief General Counsel) for the organisation as part of the 2013 water and sewerage price setting process. Adopting the title of General Counsel (or Chief General Counsel) infers that the advice given is 'independent' of the role of Chief Executive Officer. The Chief Executive Officer does not have sufficient independence to act as the General Counsel (or Chief General Counsel) and should not assume this role.

#### Key findings

##### *Setting water and sewerage prices*

- The maximum water and sewerage prices that ACTEW may charge in the ACT, as determined by the ICRC through its water and sewerage pricing process, will necessarily affect the profitability and potentially the financial viability of ACTEW. All things being equal, higher water and sewerage prices mean larger profits for ACTEW and increased dividends for the Territory. ACTEW's profitability and the dividend paid to the Territory also depend on the efficiency of ACTEW in managing its business operations and its costs.
- The trade-off 'between the community as customers of ACTEW's water and sewerage services and the community as taxpayers and consumers of government services' is recognised by the ICRC in its Final Report (June 2013). The ICRC identified that drought conditions in recent years and a significant increase in water infrastructure investment 'have put considerable pressure on ACTEW's balance sheet, reflected in the rapid growth of ACTEW's debt'. The ICRC has also identified that 'this pressure has been further intensified by the

ACT government's policy of requiring ACTEW to pay 100 percent of its after tax profits as dividends to the government as shareholder on behalf of the ACT community'.

### **Roles of Government entities**

- Government entities involved in the water and sewerage pricing process include ACTEW, the ICRC, the Chief Minister and Treasury Directorate and the Chief Minister and Treasurer as the two voting shareholders of ACTEW. Other ACT Government entities such as the Commerce and Works Directorate and the Environment and Sustainable Development Directorate are also indirectly involved.
- The Chief Minister and the Treasurer are the Ministers responsible for the Chief Minister and Treasury Directorate, which is responsible for 'sustainability policy and coordination' and 'fiscal and economic policy including competition and regulatory reform.' Officers from the Chief Minister and Treasury Directorate were responsible for advising the Treasurer in relation to water and sewerage pricing policy and the provision of submissions and responses to the ICRC for the purpose of the investigation. The Treasurer is the Minister responsible for the ICRC Act, which sets the framework for the water and sewerage pricing process.

### **ICRC Chief Executive's role as General Counsel**

- There was a poor understanding in the ICRC with respect to internal roles and responsibilities for the provision of legal advice. The ICRC Chief Executive Officer has undertaken the role of General Counsel (or Chief General Counsel) for the organisation. Neither this title nor specific responsibilities with respect to the provision of legal advice are part of the Chief Executive Officer's employment documents.
- The Chief Executive Officer advised that approximately 90 percent of the time that they spent on the water and sewerage pricing process was for the purpose of providing legal counsel to the Commissioners.

## **SETTING WATER AND SEWERAGE PRICES IN THE ACT**

2.2 The setting of water and sewerage prices is a mechanism by which public policy goals can be achieved. Public policy goals that may be sought through the setting of water and sewerage prices are broad, diverse and, to the extent that they are in conflict, may involve trade-offs. In its August 2011 *Australia's Urban Water Sector Inquiry Report*, the Productivity Commission identified such diverse goals as:

- the efficient allocation of water resources within the community;
- the protection of consumers from abuses of monopoly power;
- principles of ecologically sustainable development; and

- social welfare and equity considerations.
- 2.3 The Productivity Commission also identified that the pursuit of legitimate business interests of a utility provider, for example an appropriate rate of return on investment so that it can remain viable, may also be a legitimate goal of the water and sewerage pricing process.
- 2.4 Reconciling or making trade-offs between the conflicting goals for water and sewerage price setting is a challenge.

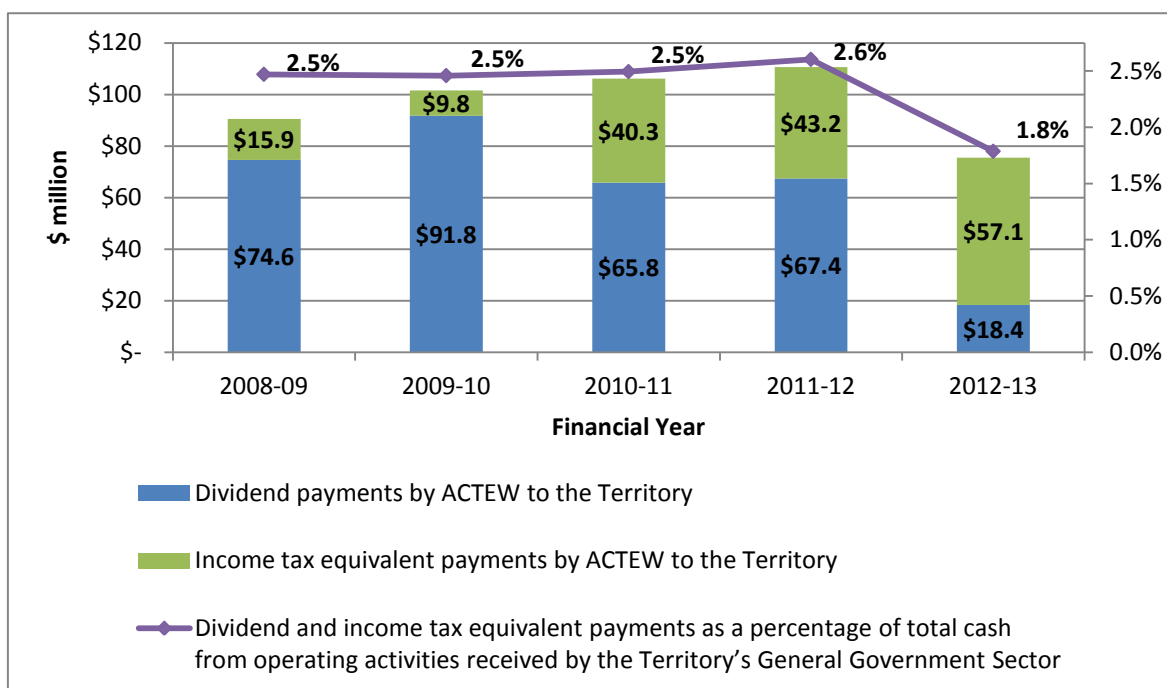
### **The implications of water and sewerage prices on the profitability and financial viability of ACTEW**

- 2.5 ACTEW Corporation (ACTEW) is responsible for providing water and sewerage services to the ACT (and Queanbeyan). The maximum water and sewerage prices that ACTEW may charge in the ACT, as determined by the ICRC through its water and sewerage pricing process, will necessarily affect the profitability and potentially the financial viability of ACTEW. This has direct implications for the Territory's revenue.
- 2.6 All things being equal, higher water and sewerage prices mean larger profits for ACTEW and increased dividends for the Territory. Alternatively, lower water and sewerage prices mean smaller profits for ACTEW and lower dividends for the Territory.
- 2.7 However, the setting of maximum water and sewerage prices that ACTEW may charge is not the only determinant of ACTEW's profitability. ACTEW's profitability and the dividend paid to the Territory also depend on the efficiency of ACTEW in managing its business operations and its costs.
- 2.8 The ICRC's recognition of the need to consider the financial viability of ACTEW as part of the water and sewerage pricing process was demonstrated in its Final Report and price direction (June 2013). There was a significant shift in the prices that ACTEW could charge, from the ICRC's Draft Report and proposed price direction (February 2013) to its Final Report and final price direction (June 2013). In the foreword to its Final Report (June 2013) the ICRC stated that 'the large reductions in water prices proposed in the draft report are simply not feasible, pursuing them would threaten the financial viability of ACTEW.'

### The implications of water and sewerage prices on the Territory's revenue

- 2.9 A potentially competing policy goal is that the supply of water and sewerage services, through ACTEW, is a substantial source of revenue for the Territory. ACTEW receives revenue from different sources, including through the provision of water and sewerage services and through income generated from its interest in ActewAGL, which supplies gas and electricity. The Territory receives two streams of revenue from ACTEW:
- income tax equivalent payments; and
  - annual dividends.
- 2.10 ACTEW is exempt from Commonwealth income tax, but is required to make an income tax equivalent payment to the Territory to meet its obligations under the *Territory-owned Corporations Act 1990*. The annual dividends paid represent ACTEW's 'profits from ordinary activities after income tax expense.'
- 2.11 Figure 2.1 shows income tax equivalent and dividends payments by ACTEW to the Territory. It also shows these payments as a percentage of total cash from operating activities received by the Territory's General Government Sector for the period from 2008-09 to 2012-13.
- 2.12 Figure 2.1 shows that ACTEW's income tax equivalent and dividend payments are an important source of cash for the Territory. In the financial years from 2008-09 to 2012-13, ACTEW paid \$484.3 million to the Territory. This is an average of \$96.9 million per annum and 1.8 to 2.6 percent of the total cash from operating activities received by the Territory's General Government Sector.
- 2.13 The ICRC water and sewerage pricing process results in the setting of maximum water and sewerage prices that ACTEW may charge its customers. The pricing process therefore affects ACTEW's profitability and its capacity to pay dividends. Lower dividend payments reduce the funding available to provide government services.

Figure 2.1: Income tax equivalent and dividend payments by ACTEW to the Territory



Source: ACTEW's audited financial statements and ACT Government Consolidated Annual Financial Statements.

Note 1: The large decrease in dividend payments by ACTEW to the Territory in 2012-13 is due to ACTEW not paying an interim dividend in 2012-13. ACTEW's 2012-13 annual report discloses that 'The interim dividend was not paid in June 2013 (2012 Interim: \$55.6m) due to the Independent Competition and Regulatory Commission (ICRC) final price direction in June 2013 and uncertainty in the water and sewerage infrastructure assets valuation'. (Page 4 of the Director's Report included in the 'ACTEW Corporation Limited Annual Report to the ACT Government 2012-13').

ACTEW's 2012-13 financial statements disclose that ACTEW has recorded a liability to pay a dividend to the ACT Government of \$79.6 million in the 2013-14 financial year. This is significantly higher than the dividend of \$18.4 million paid in 2012-13.

### Trade-offs in the water and sewerage pricing process

2.14 The ICRC in its Final Report (June 2013) stated that:

The prices paid by its customers for...services provide the revenue from which ACTEW derives its profit and hence the return to government. Greater returns to government require greater profits, which, at a given level of operating efficiency and delivery of service, can only come from higher prices. Hence, there is a trade-off between returns to government and returns to community. The government, however, is merely the agent of the community, so the trade-off is really between the community as customers of ACTEW's water and sewerage services and the community as taxpayers and consumers of government services.

2.15 The ICRC also stated in its Final Report (June 2013):

For government it is important to recognise the ultimate source of ACTEW's profits in setting a target rate of return for the business. The regulator must be conscious that regulatory decisions that reduce ACTEW's profits in order to deliver lower prices are simply disadvantaging the community as taxpayers in order to advantage the community as ACTEW customers.

2.16 These trade-offs were specifically highlighted by the ICRC in its Final Report (June 2013), with reference to two key issues that occurred in the 2008 to 2013 regulatory period:

- drought conditions in the ACT, resulting in water restrictions, which lead to lower water sales for ACTEW; and
- a significant increase in water infrastructure investment, including the Enlarged Cotter Dam and the Murrumbidgee to Googong Pipeline.

2.17 The ICRC identified that 'in combination, these two events have put considerable pressure on ACTEW's balance sheet, reflected in the rapid growth of ACTEW's debt.' The ICRC has also identified that 'this pressure has been further intensified by the ACT government's policy of requiring ACTEW to pay 100 percent of its after tax profits as dividends to the government as shareholder on behalf of the ACT community.' In its June 2013 Final Report, the ICRC also suggested that:

...the consequences of the inadequate cash flows to ACTEW fell particularly heavily on its ability to provide returns to its equity holder. Since ACTEW must service its debt or become insolvent, it was forced to use some of the cash flow intended to provide a return on equity to service its debt.

2.18 These issues have been highlighted for the purpose of identifying that there are trade-offs that need to be made in the setting of water and sewerage prices.

## ROLES OF GOVERNMENT ENTITIES

### Clarity of roles

2.19 In its August 2011 report into Australia's urban water sector, the Productivity Commission highlighted the importance of clarity with respect to roles and responsibilities for public sector entities participating in the urban water sector. The Productivity Commission noted:

...much clearer definition of the roles and responsibilities of institutions in the urban water sector is needed to best achieve the overarching objective of maximising net benefits to the community. In particular there is a need for clear delineation between decisions best taken by elected representatives (those regarding 'public interest' considerations), utilities (commercial and operating decisions), regulatory agencies and consumers.

### ***Roles for government elected representatives***

2.20 The Productivity Commission identified that clear roles and responsibilities for government elected representatives should include *inter alia*:

- setting objectives for the development of urban water policy and relevant objectives for each institution;
- developing best practice policy frameworks and principles in relation to public health, the environment and service delivery that are consistent with the objectives;
- appropriately assigning roles and functions to institutions;
- putting in place best practice institutional and governance arrangements for:
  - public health, environmental and economic regulation; and
  - delivery of water and wastewater services.

2.21 In this respect, the Productivity Commission stated:

For those decisions most appropriately made by utilities or regulators, it is important for government to establish service provision and regulatory institutions that are at arm's length from day to day politics (to ensure that decisions made by these bodies are genuinely de-politicised).

### ***Roles for utilities***

2.22 The Productivity Commission identified that clear roles and responsibilities for utilities relate to 'day to day' management considerations, including commercial decisions about operations and investment following government decisions about water security targets.

### ***Roles for independent regulators***

2.23 The Productivity Commission identified that 'the role of independent regulators is to achieve governments' regulatory objectives in a manner unencumbered by political decisions.'

### ***ACT Government – Chief Minister and Treasurer***

2.24 By virtue of the *Territory-owned Corporations Act 1990*, the Chief Minister and Treasurer are the two voting shareholders of ACTEW. In their role as voting shareholders of ACTEW, the Chief Minister and Treasurer are provided with administrative support by the Commerce and Works Directorate.

2.25 The Chief Minister is *inter alia* broadly responsible for ‘sustainability policy and coordination’ and the Treasurer is *inter alia* broadly responsible for ‘taxation and revenue policy’ and ‘fiscal and economic policy, including competition and regulatory reform’.

### The Independent Competition and Regulatory Commission

2.26 The ICRC is a statutory body established to regulate:

- prices;
- access to infrastructure services; and
- other matters in relation to regulated industries.

2.27 It also has responsibility for licensing utility services and ensuring compliance with licence conditions, and has authority to investigate competitive neutrality complaints and government-regulated activities.

2.28 The ICRC is established under the *Independent Competition and Regulatory Commission Act 1997*. Subsection 6(1) in Part 2 of the ICRC Act provides that the ICRC is constituted by ‘1 or more standing commissioners’ and ‘any associated commissioners appointed for particular purposes’.

2.29 Section 7 in Part 2 of the ICRC Act provides that:

The commission has the following objectives in relation to regulated industries, access regimes, competitive neutrality complaints and government-regulated activity:

- a) to promote effective competition in the interests of consumers;
- b) to facilitate an appropriate balance between efficiency and environmental and social considerations;
- c) to ensure non-discriminatory access to monopoly and near monopoly infrastructure.

2.30 Subsection 8(1) in Part 2 of the ICRC Act states the functions of the ICRC, which include *inter alia*:

- the provision of price directions;
- the provision of recommendations about price regulation; and
- investigation and reporting on matters referred by the Minister and other referring authorities.

2.31 The Treasurer is the minister responsible for the ICRC Act.

*ICRC understanding of its role in the water and sewerage price investigation process*

- 2.32 The ICRC provided advice to the Audit Office in relation to its understanding of its role in the water and sewerage price investigation process. The ICRC advised:

It is clear for this review that the pre-eminent objective is to protect the ACT community from the exercise of market power in the provision of water and sewerage services by ACTEW or its shareholders. In order to provide this protection, the ICRC is given the power to set a maximum price for water and sewerage services. This denies ACTEW the opportunity to exercise its market power as the monopoly provider of water and sewerage services in the ACT and avoids any conflicts of interest for the government in being required to set a price for the services of an entity that it owns.

It is noteworthy that the ICRC's predecessor, the Independent Pricing and Regulatory Commission, was created at the time that ACTEW was corporatised in order to have an independent entity set maximum prices in the two markets in which the new entity enjoyed a monopoly, electricity and water sewerage services. The policy of having an independent entity (the ICRC since 2000) setting the maximum price for water and sewerage services has remained in place ever since.

For the ICRC, there can be no doubt that the principal stakeholder in the review is the community of the ACT. This community provides the customers for the service under review and owns, through its government, the entity providing the service. The ICRC must protect the community from the untrammelled exercise of ACTEW's market power by its board and management or by its statutory shareholders. The ICRC must also facilitate the reliable and cost effective delivery of water and sewerage services to the ACT community by ACTEW.

From the perspective of the ICRC as independent regulator, the interests of the government and ACTEW as stakeholders in the review process derive from their roles as agents of the community. For example, the ICRC's concern about the impact of its determination on government revenue derives from the impact that changes in government revenue would have on the welfare of the ACT community. Similar, the ICRC's concern about the impact of its determination on the financial viability of ACTEW derives from a concern about the consequences for the welfare of the ACT community of its provider of water and sewerage services becoming unviable.

**ACTEW**

- 2.33 ACTEW Corporation Limited, trading as ACTEW Water (ACTEW) is an unlisted public company with assets and investments in water, sewerage, and energy services and operations. It supplies water and sewerage services to the ACT (and Queanbeyan). On 1 July 2012 ACTEW took over the direct management, operations and maintenance of the ACT's water and sewerage assets. This was previously undertaken by ActewAGL on behalf of ACTEW.

2.34 ACTEW is fully owned by the Territory and by virtue of the *Territory-owned Corporations Act 1990* has two voting shareholders:

- the Chief Minister; and
- Treasurer.

2.35 ACTEW has a Managing Director and a Board of Directors. The Board comprises seven Directors, one Executive Director and six Non-Executive Directors, who are appointed by the voting shareholders. The voting shareholders determine the terms of appointment and remuneration of Directors.

### Chief Minister and Treasury Directorate

2.36 The Chief Minister and Treasury Directorate is responsible for implementing a range of public sector, economic and financial management responsibilities of the ACT Government.

2.37 The responsibilities of the directorate include *inter alia*:

- providing analysis and advice to the Government and agencies on economic, regulatory and tax reforms; and
- the management of the Government's financial assets and liabilities.

2.38 The ACT Treasury, in the Chief Minister and Treasury Directorate, 'provides strategic financial and economic advice and services to the ACT Government with the aim of improving the Territory's financial position and economic management.'

### Commerce and Works Directorate

2.39 The Shareholder Management Unit in the Commerce and Works Directorate is responsible for supporting the voting shareholders. Prior to the establishment of the Commerce and Works Directorate (and the Chief Minister and Treasury Directorate) in November 2012, the Shareholder Management Unit was in the Treasury Directorate.

2.40 The Shareholder Management Unit is responsible for:

- monitoring and providing strategic advice to the shareholders on the performance and management of Territory-owned corporations;
- facilitating compliance with the statutory requirements of the *Territory-owned Corporations Act 1990*;
- arranging Board appointments for Territory-owned corporations; and

- monitoring major projects as well as managing the structure and governance framework related to selected government business enterprises.

2.41 Practically, the Shareholder Management Unit liaises with Territory-owned corporations such as ACTEW on behalf of the ACT Government.

### **Environment and Sustainable Development Directorate**

2.42 The Environment and Sustainable Development Directorate supports the Minister for the Environment and Sustainable Development with respect to their responsibilities for ‘water policy and water efficiency programs’ (including water security policy) as well as ‘electricity and natural gas, water and sewerage industry technical regulation.’ Technical regulation of the water and sewerage industry relates to environmental regulation, as distinct from price regulation.

### **Summary of ACT Government roles**

2.43 Table 2.1 provides a summary of the different entities and their role in the water and sewerage pricing process. Where relevant, the table also demonstrates the interdependencies between the entities.

**Table 2.1: ACT Government entities involved in the water and sewerage pricing process**

ACTEW	<ul style="list-style-type: none"> <li>• ACTEW is the sole supplier of water and sewerage services in the ACT and the owner of water and sewerage infrastructure in the ACT.</li> <li>• The ACT Government wholly owns ACTEW. There are two voting shareholders – the Chief Minister and Treasurer of the ACT.</li> </ul>
ICRC	<ul style="list-style-type: none"> <li>• The ICRC is the independent statutory regulator for the ACT, including for the price regulation of water and sewerage services.</li> <li>• Through the water and sewerage pricing review process the ICRC sets the maximum price that ACTEW can charge customers for water and sewerage services.</li> <li>• The Minister responsible for the ICRC Act is the Treasurer.</li> </ul>
Chief Minister and Treasury Directorate	<ul style="list-style-type: none"> <li>• The Chief Minister and Treasury Directorate is responsible for <i>inter alia</i> coordinating the development and delivery of economic policy across ACT Government and providing strategic advice to the Chief Minister and Treasurer on the ACT economy. This includes policy matters associated with water and sewerage services and the price determination process.</li> <li>• The Directorate reports to the Chief Minister or Treasurer depending on specific functions and activities.</li> </ul>

<p>Commerce and Works Directorate</p>	<ul style="list-style-type: none"> <li>• The Shareholder Management Unit, in the Commerce and Works Directorate, manages communication with ACTEW and supports the shareholders to meet their responsibilities. This includes: <ul style="list-style-type: none"> <li>• facilitating compliance with legislative requirements such as the <i>Territory-owned Corporations Act 1990</i>;</li> <li>• reviewing material prepared by ACTEW, including for example draft statements of corporate intent; and</li> <li>• facilitating Board appointments.</li> </ul> </li> <li>• The Directorate reports to the Treasurer.</li> </ul>
<p>Environment and Sustainable Development Directorate</p>	<ul style="list-style-type: none"> <li>• The Directorate is responsible for <i>inter alia</i> coordinating the development and delivery of ‘water policy and water efficiency programs’ (including water security policy) across ACT Government.</li> <li>• Directorate reports to the Minister for the Environment and Sustainable Development.</li> </ul>
<p>ACT Government – Chief Minister and Treasurer</p>	<ul style="list-style-type: none"> <li>• The Chief Minister and Treasurer are the two voting shareholders of ACTEW.</li> <li>• The Commerce and Works Directorate supports the Ministers with respect to matters under the <i>Territory-owned Corporations Act 1990</i>.</li> <li>• The Chief Minister is responsible for sustainability policy and coordination and in this regard is advised by the Chief Minister and Treasury Directorate.</li> <li>• The Treasurer is responsible for fiscal and economic policy and in this regard is advised by the Chief Minister and Treasury Directorate.</li> <li>• The Treasurer is also responsible for the ICRC Act.</li> </ul>

Source: Audit Office

### Conflicts in roles

2.44 Key issues with respect to the ACT’s governance and administrative arrangements for the setting of water and sewerages services are that:

- ACTEW is the monopoly water and sewerage service provider in the ACT. ACTEW is a non-listed but publicly owned corporation that pays dividends to the ACT Government and is a substantial source of revenue to the ACT Government. The Chief Minister and Treasurer are the two shareholders of ACTEW;
- the Chief Minister and the Treasurer are the Ministers responsible for the Chief Minister and Treasury Directorate, which is responsible for

‘sustainability policy and coordination’ and ‘fiscal and economic policy including competition and regulatory reform.’ Officers from the Chief Minister and Treasury Directorate were responsible for advising the Treasurer in relation to:

- water and sewerage pricing policy; and
- the provision of submissions and responses to the ICRC for the purpose of the investigation;
- the Treasurer is the Minister responsible for the ICRC Act, which sets the framework for the water and sewerage pricing process.

2.45 There are conflicts in the roles of the Treasurer with respect to the setting of water and sewerage prices in the ACT. The Treasurer is a voting shareholder of ACTEW and is also the Minister responsible for water and sewerage price setting policy. As part of the 2013 water and sewerage price setting process, the Treasurer:

- set the terms of reference for the investigation; and
- provided submissions to the ICRC on behalf of the ACT Government.

2.46 Nevertheless, there were practices that mitigated the risk of adverse effects due to the Treasurer’s conflicting roles. These included:

- the voting shareholders (the Treasurer and Chief Minister) are not involved in the direct management of ACTEW; and
- ACT Government submissions to the ICRC, along with all other submissions, were transparent and made publicly available on the ICRC’s website.

#### *ICRC view on the Treasurer’s role*

2.47 The ICRC has advised that it does not share the Audit Office’s view that there is a conflict in the roles of the Treasurer. The ICRC notes that the ICRC Act provides for the independence of the ICRC and that the ICRC is not subject to direction in the conduct of investigations. The ICRC strongly asserts that it has acted, and will continue to act, independently.

2.48 The Audit Office notes the ICRC’s views and that there is no evidence to suggest that the Treasurer has acted incorrectly during the regulatory review process, or has otherwise sought to influence the ICRC.

2.49 While the Audit Office notes the ICRC’s views on this matter, the Audit Office maintains that there is a conflict in the roles of the Treasurer in the overall regulatory review process as the Treasurer is, or has been, responsible for:

- the administration of the ICRC Act;
- ‘fiscal and regulatory policy including competition and regulatory reform’ – in doing so the Treasurer has provided the terms of reference for the ICRC for the 2013 water and sewerage pricing investigation. (The Audit Office also recognises that the terms of reference is a Disallowable Instrument that is tabled in the ACT Legislative Assembly);
- providing submissions to the ICRC as part of the investigation, on behalf of the ACT Government; and
- overseeing the activities of ACTEW as a voting shareholder.

2.50 While there are practices to mitigate the risk of adverse effects due to the conflicting roles, refer to paragraph 2.46, given the importance of these roles it would be prudent to further mitigate (and if possible) eliminate conflicts in these roles.

2.51 The *Review of Institutional Arrangements for ACTEW Corporation Limited*, conducted by Dr Bruce Cohen and reported in December 2013, did not incorporate detailed assessment of the Treasurer’s roles with respect to the ICRC’s regulatory processes, as these processes were subject to contemporaneous review by this audit. The review’s report states in Section 4.2 *ACTEW’s regulatory environment* (p. 133):

... the ICRC’s regulatory processes are currently subject to a review being undertaken by the ACT Auditor-General... [which] ...focuses on the consideration of the roles and responsibilities of the various entities involved in the process for reviewing water and sewerage prices in the ACT, and the efficiency and effectiveness of the administrative processes and communications protocols for undertaking the regulatory review of water and sewerage prices in the ACT. Given the review being undertaken by the Auditor-General, this Review has limited its focus to two issues operating at the interface of pricing regulation and the overarching framework within which ACTEW operates.

2.52 These two issues are addressed in Section 4.3.2 *Clarifying water price regulation processes* (pp. 150–55), which states:

... discussion with respect to price regulation is limited to two issues:

- the general interaction of operational regulation and price regulation; and
- the means by which the regulator may achieve regulatory certainty for the purposes of pricing processes.

2.53 Furthermore, Section 6.3.4 *Regulatory Responsibilities* (pp. 197–9) states that:

...[the review] has not sought to consider issues specifically related to industry regulation, including price determinations involving the ICRC and any

interactions this gives rise to between ACTEW, the ICRC and the ACT Government more generally’.

- 2.54 Inclusion of the extracts in paragraph 2.51 and 2.52 of this report was checked with Dr Cohen.

**Recommendation 1 (Chapter 2)**

The ACT Government should review the Treasurer’s responsibilities and implement mechanisms to further mitigate (and if possible eliminate) conflicts in roles with respect to the water and sewerage pricing process.

**ICRC CHIEF EXECUTIVE OFFICER’S ROLE AS GENERAL COUNSEL**

- 2.55 There was a poor understanding in the ICRC with respect to internal roles and responsibilities for the provision of legal advice. The ICRC Chief Executive Officer has undertaken the role of General Counsel (or Chief General Counsel) for the organisation. Neither this title nor specific responsibilities with respect to the provision of legal advice are part of the Chief Executive Officer’s employment documents. Furthermore, undertaking the role of General Counsel (or Chief General Counsel) creates a conflict because the Chief Executive Officer does not have sufficient independence to act as the General Counsel (or Chief General Counsel).
- 2.56 Subsection 10B(1) Part 2 of the ICRC Act provides for the functions of the Chief Executive Officer of the ICRC.

The chief executive officer has the following functions:

- a) ensuring, as far as practicable, that the commission’s statement of intent is implemented effectively and efficiently;
- b) managing the day-to-day operations of the commission secretariat in accordance with—
  - i. applicable governmental policies (if any) for the commission; and
  - ii. the policies set by the commission (if any); and
  - iii. each legal requirement that applies to the commission;
- c) regularly advising the commission about the commission’s operation and financial performance.

- 2.57 The Audit Office sought advice with respect to executive roles, responsibilities and accountabilities from the Commissioner for Public Administration. The Commissioner for Public Administration advised:

Beyond the statutory provisions of the ICRC Act, the specification of duties in an old form executive contract are set out... by reference to the office to which

the contract applies, and in the performance agreement scheduled to the contract (which for an old form contract was tabled in the Legislative Assembly). It would be by reference to those documents, informed if necessary by the published selection criteria from the relevant recruitment exercise, that one might determine the scope of the specified duties of a particular executive.

### **The Chief Executive Officer's employment documents**

2.58 The Chief Executive Officer was appointed to the role by virtue of a five-year executive contract that commenced on 5 June 2012. The final five-year executive contract was signed by the Chief Executive Officer and the Deputy Director-General of the Chief Minister and Treasury Directorate on 19 February 2013. The 'performance outcomes' component of the executive contract was signed by the Chief Executive Officer and the Senior Commissioner of the ICRC on 12 February 2013 and the Head of Service on 19 February 2013.

2.59 Clause 7.2 of the Executive Contract provides for the duties of the Chief Executive Officer.

The Executive shall:

- a) comply with the Performance Agreement;
- b) carry out all duties as may be directed from time to time by the Employer; and
- c) comply with Section 9 of the [Public Sector Management Act 1994];

provided that any duties or objectives that the Executive shall be required to carry out or achieve shall be consistent with Section 9 of the Act and the other laws of the Territory.

2.60 The 'performance outcomes' component of the executive contract provides for the following:

#### *Statutory Obligations*

CEO to ensure that the [ICRC] is able to discharge its statutory obligations and the [ICRC's] Statement of Intent is implemented effectively and efficiently.

#### *Governance*

The CEO will maintain high standards of corporate governance in the [ICRC], and fulfil their functions outlined as outlined under sections 29 and 30 of the Public Sector Management Act 1994.

The CEO is to ensure that the Strategic Plan of the [ICRC] is developed and implemented.

#### *Reporting*

CEO to ensure that the [ICRC] is provided with relevant, accurately and timely:

- reports on service delivery against agreed standards.
- briefings on issues and risks of strategic, financial and operational significance.

- 2.61 The 'performance outcomes' component of the executive contract is very brief with respect to specific responsibilities and does not specifically provide for the provision of legal advice to the Commissioners.
- 2.62 In addition to the executive contract, the ICRC has also prepared a *Chief Executive Officer Role Description* document. This undated document provides more detail with respect to specific responsibilities of the Chief Executive Officer, including strategic, workplace culture, financial and operational responsibilities. The five page document also states that 'when discharging a statutory function, the Commissioners will wish to be assured that an adequate legal, factual and, as appropriate, analytical basis has been established.' Similar to the executive contract, however, this document does not explicitly provide for the provision of legal advice from the Chief Executive Officer to the Commissioners.

#### The provision of legal advice by the Chief Executive Officer

- 2.63 In evidence provided to the Audit Office under oath or affirmation, pursuant to section 14A of the *Auditor-General Act 1996*, the Senior Commissioner of the ICRC advised:

We had given [the Chief Executive Officer] to understand that at times we would want to draw on [their] legal expertise and have [them] provide legal advice to us and guidance and interpretive commentary of a kind that a lawyer would be expected to be able to provide. And we may have characterised that role as being Chief General Counsel, that aspect of [their] role as being Chief General Counsel. [The Chief Executive Officer] was very concerned to ensure that it was clear when [they] were playing that role, when [they were] wearing that hat amongst the hats that [they] might wear as CEO. And [they] went to the point of actually using that title in the signature block to make sure that it was clear that [they were] functioning in that – in doing whatever it was that they were doing. My understanding is, and I don't have any particular personal expertise in this area, I've been guided by [the Chief Executive Officer], that that's an appropriate way for a lawyer to conduct [themselves] in those circumstances.

- 2.64 The Chief Executive Officer advised that approximately 90 percent of the time that they spent on the water and sewerage pricing process was for the purpose of providing legal counsel to the Commissioners. The Chief Executive Officer also advised that, in the water and sewerage pricing process, external legal advice was sought on only two occasions and this was from Senior Counsel.

2.65 The Chief Executive Officer's role as General Counsel (or Chief General Counsel) was not formally documented, nor was there any amendment to employment documents to reflect this.

2.66 In providing advice to the Audit Office with respect to executive roles, responsibilities and accountabilities, the Commissioner for Public Administration advised:

The ICRC Act contemplates an accountability and reporting line between the CEO and the Commission. I would observe, however, that any variation to the original contract is required to be in writing. A similar expectation applied to performance agreements in the event material changes were necessary, and on their annual renewal. I note it is only the original performance agreement of a multi-year contract that was tabled (or has historically been made available to the Chief Minister and Treasury Directorate).

### Conflict of interest in the provision of legal advice

2.67 Legal advice on the issue of the Chief Executive Officer acting as General Counsel (or Chief General Counsel) was sought from the Australian Government Solicitor. In relation to whether it could be expected that the Chief Executive Officer could be expected to provide independent legal advice to the Commissioners, the Australian Government Solicitor advised:

... it is highly unlikely that any communication between [the Chief Executive Officer] and other parts of the Commission will constitute independent legal advice. [The Chief Executive Officer] is the CEO. [The Chief Executive Officer] is appointed under section 10A of the ICRC Act which requires the director-general to appoint the CEO. The CEO has functions under s 10B of the Act, which include managing the day to day operations of the ICRC and ensuring ICRC complies with legal requirements. Accordingly, [the Chief Executive Officer] is intimately involved in the management of the ICRC. [The Chief Executive Officer] is not in any sense independent.

2.68 The ICRC Chief Executive Officer has undertaken the roles of Chief Executive Office and General Counsel (or Chief General Counsel) for the organisation as part of the 2013 water and sewerage price setting process. Adopting the title of General Counsel (or Chief General Counsel) infers that the advice given is 'independent' of the role of Chief Executive Officer. The Chief Executive Officer does not have sufficient independence to act as the General Counsel (or Chief General Counsel) and should not assume this role.

### Recommendation 2 (Chapter 2)

The ICRC Chief Executive Officer should not undertake the role of General Counsel for the ICRC.

### 3. LEGISLATIVE REQUIREMENTS FOR WATER AND SEWERAGE PRICING

---

3.1 This chapter discusses key legislative requirements for the ICRC's water and sewerage pricing process.

#### SUMMARY

##### Conclusion

Mr Peter Hanks QC has advised the Audit Office that '...the Price Direction made by the ICRC...is invalid' because the terms of reference issued by the Treasurer was insufficient. According to Mr Hanks, the terms of reference was insufficient because it did not specify a regulatory period.

##### Key findings

##### Terms of reference

- Subsection 20(1) in Part 4 of the ICRC Act provides that when making a price direction at the conclusion of an investigation, 'the commission must decide on the level of prices for services in relation to the period specified in the reference'.
- The Treasurer was provided with a briefing minute by the then Treasury Directorate on the proposed terms of reference on 26 September 2011, with the proposed terms of reference attached. The minute stated that the proposed terms of reference 'have been developed in conjunction with the ICRC and the Environment and Sustainable Development Directorate.'
- The ACT Treasurer provided the terms of reference for the water and sewerage price investigation through *Disallowable Instrument DI 2011-287*, which was issued on 13 October 2011. The terms of reference did not specifically identify a regulatory period. In its Final Report and associated price direction (June 2013), the ICRC 'set' a six-year regulatory period from 2013 to 2019.
- According to advice provided to the Audit Office by Mr Peter Hanks QC, the implication of the Treasurer not specifying a regulatory period in the terms of reference issued on 13 October 2011 is that the price direction is invalid.

##### Conduct of the investigation

- The Draft Report and proposed price direction (February 2013) was produced approximately 16 months after the Treasurer issued the terms of reference and approximately two months before the initially planned completion date for the investigation of 1 May 2013. The Draft Report was the first time that the ICRC presented its views and preliminary conclusions on technical and regulatory issues. However, senior ICRC staff advised the Audit Office that the Draft Report was more in the nature of a discussion paper and, when published, did not

necessarily represent the ICRC's conclusions with respect to technical and regulatory matters.

- There were significant differences in interpretations and assumptions by participants in the water and sewerage pricing process with respect to the Draft Report and proposed price direction (February 2013). There was a fundamental difference in the expectations of the ICRC and ACTEW regarding the content of the Draft Report and proposed price direction, and the extent to which it needed to reflect the requirements of Part 4 and Part 4A of the ICRC Act, with respect to the Final Report and price direction.
- In the ICRC there was an expectation that the Draft Report and proposed price direction (February 2013) did not need to meet legislative requirements that applied to a final report and final price direction, including the matters required to be considered as part of an investigation. However, ACTEW expected that the Draft Report and proposed price direction (February 2013) would represent the ICRC's conclusions and demonstrate how legislative requirements under the ICRC Act were met.

### **Final Report**

- The ICRC's Final Report (June 2013) included a range of additional commentary and findings, specifically on ACTEW and its governance arrangements. This broader commentary did not specifically relate to the setting of water and sewerage prices as part of the price direction. While the ICRC was required to take account of the considerations set out in the 2013 terms of reference, none of the considerations expressly required the ICRC to consider ACTEW's governance arrangements. By making these considerations, the ICRC has stretched the authority conferred on it by the terms of reference.

## **KEY LEGISLATIVE REQUIREMENTS**

- 3.2 An investigation is the process by which the ICRC determines prices for a regulatory period. For water and sewerage prices, an investigation is undertaken pursuant to Division 3.1 in Part 3 of the ICRC Act, which deals with industry references to the ICRC. Price directions are issued under section 20 in Part 4 of the ICRC Act.
- 3.3 The following sections of this chapter discuss key legislative requirements of the water and sewerage pricing process:
- the terms of reference;
  - the conduct of the investigation; and
  - the final report and price direction.

## TERMS OF REFERENCE

3.4 Subsection 15(1) in Part 3 of the ICRC Act provides for the provision of an industry reference to the ICRC by a referring authority:

A referring authority may provide an industry reference to the commission in relation to any of the following matters:

- a) prices for regulated services;
- b) competition within a regulated industry;
- c) any other matter in relation to a regulated industry;
- d) any matter in relation to regulated industries in general;
- e) any other matter in relation to an industry, or industries in general; and
- f) any matter provided for by another law of the Territory.

3.5 By virtue of subsection 3A(1) in Part 1 of the ICRC Act the referring authority for an industry reference relating to the setting of water and sewerage prices is the Minister, that is, the Treasurer.

3.6 Subsection 16(1) in Part 3 of the ICRC Act provides that the referring authority may determine terms of reference for an investigation on an industry reference. Subsection 16(2) provides that:

The terms of reference may include 1 or more of the following:

- a) a specification of a period within which a report is required to be submitted to the referring authority;
- b) a requirement that the commission consider specific matters;
- c) except in relation to price regulation, the making of a price direction and any related investigation and report—a requirement that the commission exercise its functions subject to any subsequent written direction of the authority.

3.7 Subsection 20(1) in Part 4 of the ICRC Act provides that when making a price direction at the conclusion of an investigation, 'the commission must decide on the level of prices for services in relation to the period specified in the reference'.

## Regulatory period specification

3.8 The ACT Treasurer provided the terms of reference for the water and sewerage price investigation through *Disallowable Instrument DI 2011-287*, which was issued on 13 October 2011. Under this terms of reference, the ICRC was to provide its Final Report by 1 May 2013. The terms of reference were amended twice as follows:

- *Disallowable Instrument DI2013–35*, released on 18 March 2013, provided that the ICRC was to provide a final report by 12 June 2013; and
- *Disallowable Instrument DI2013–134*, released on 11 June 2013, provided that the ICRC was to provide its final report by 30 June 2013.

3.9 The Treasurer was provided with a briefing minute by the then Treasury Directorate on the proposed terms of reference on 26 September 2011, with the proposed terms of reference attached. The minute stated that the proposed terms of reference ‘have been developed in conjunction with the ICRC and the Environment and Sustainable Development Directorate.’ The minute states:

In the 2008-13 determination, the ICRC forecast average water demand for the entire five year period, rather than considering each year separately and correspondingly making a pricing decision each year. ACTEW has indicated that a key consideration of the next inquiry should be the appropriateness of the five year pricing path.

3.10 The minute also states:

The proposed [terms of reference] require that the Commission consider all possible regulatory pricing models, including the provision of sufficient flexibility in price setting across the regulatory period to minimise the impact of significant price fluctuations.

3.11 The Treasurer approved the briefing minute and the proposed terms of reference without any changes on 13 October 2011. No legal advice was received with respect to the price direction period.

3.12 The breadth of the terms of reference, particularly with respect to the matters to be considered as part of the water and sewerage price investigation, is discussed in further detail in paragraphs 4.8 to 4.11 of this report. There is, however, significant doubt as to whether an effective terms of reference was issued by the ACT Treasurer.

3.13 The terms of reference issued on 13 October 2011, and subsequently amended twice, did not specifically identify a regulatory period. In its Final Report and price direction (June 2013), the ICRC ‘set’ a six-year regulatory period from 2013 to 2019. Advice from the Australian Government Solicitor was sought with respect to the basis on which the ICRC could identify a six-year regulatory period (irrespective of whether it is one six-year period, or three two-year periods) in the absence of any specific period identified by the Minister as the referring authority. The Australian Government Solicitor advised that the ICRC could not specify a regulatory period.

3.14 In support of its conclusion, the Australian Government Solicitor advised that:

The ICRC is a body corporate, and has all the powers granted to it by the ICRC Act. For the ICRC to have the power to determine a regulatory period for a price direction the power must be found within the *ICRC Act* either expressly or impliedly.

3.15 The Australian Government Solicitor further advised that:

[Subsection] 20(1) grants the ICRC the power to ‘decide on the level of prices for services in relation to the period specified **in the reference** and give a price direction accordingly’ [Australian Government Solicitor emphasis]. In our assessment, this legislative structure strongly suggests that the power (and obligation) to make a price direction comes from section 20 in the ICRC Act. However, the only circumstances in which section 20 contemplates the exercise of that power is if the reference given to the ICRC under section 15 specifies a period in relation to which a price direction should be made. Accordingly, the power to choose the period is conferred on the Minister and it is a power to be exercised when making an industry reference under section 15.

3.16 According to the Australian Government Solicitor, the implication of the Treasurer not specifying a regulatory period in the terms of reference issued on 13 October 2011 is that the price direction is invalid. The Australian Government Solicitor advised:

Due to the failure of the terms of reference to set the regulatory period, in our view the ICRC did not have power to make a price direction for any period. **In legal terms it is our view that the ICRC made a jurisdictional error when determining the limits of its powers. Due to faulty terms of reference, the ICRC was never properly seized of a jurisdiction to make a valid price direction for any period** [Audit Office emphasis]. Accordingly, if an application was made to the ACT Supreme Court, in our view it is probable (but by no means certain given the alternative arguments available) that it would declare the 2013-2019 price direction to be invalid.

3.17 The Audit Office sought additional advice on this issue from Queen’s Counsel Mr Peter Hanks. Mr Hanks’ advice is included at paragraphs 3.22 and 3.23 of this report.

### Alternative arguments

3.18 When the potential invalidity of the price direction became apparent during the course of the audit, the Audit Office raised the issue and sought feedback from:

- the ICRC;
- ACTEW; and
- Chief Minister and Treasury Directorate.

3.19 The ACT Government Solicitor also participated in discussions on this issue. An alternative point of view has been put forward by the ACT Government Solicitor. The ACT Government Solicitor argues '[paragraph 16(2)(b) of the ICRC Act] confers on the Minister a discretion to require the ICRC to consider a "specified matter" such as a specific period for a price direction' and that the terms of reference approved by the Minister 'reflect the Minister has not exercised his discretion to require the ICRC to consider a specific period for the price direction in question.' The ACT Government Solicitor further advised:

In circumstances where the Minister has not stipulated in an industry reference that the ICRC consider a specific period for a price direction, the words "in relation to the period specified in the reference" in [subsection 20(1)] of the ICRC Act may be viewed as of ambulatory effect on the capacity of the ICRC to determine the period in which the price direction will operate. That is to say, the ICRC is at liberty, albeit within the bounds of reasonable administrative decision-making, to determine the period during which the price direction will operate.

3.20 The ACT Government Solicitor suggests that this interpretation gives the best effect to section 139 of the *Legislation Act 2001*, which provides for the interpretation that would best achieve the purpose of the ICRC Act.

### Concluding arguments

3.21 In its final advice in relation to this matter, taking into account information received from the ICRC and the ACT Government Solicitor, the Australian Government Solicitor concluded that:

Before s 20 was significantly re-drafted in 2000 by the *Utilities (Consequential Provisions) Act 2000*, the former s 20(4) expressly conferred a discretion on the ICRC to specify a period during which the direction was to apply. However, the Legislative Assembly repealed this provision. The ACT Government Solicitor have suggested that ss 20A, 20B and 20C(1)(b) read together provide the equivalent capacity of the former s 20(4). There is a similar view put forward by the ICRC at page 23 of its 2013 final report, that the 2013 terms of reference, along with various powers relating to price directions in Part 4 of the ICRC Act, confer the necessary power on ICRC to set a regulatory period. There is a further suggestion that s 196 of the *Legislation Act 2001*, which provides that when an entity is given a statutory function, all the powers necessary and convenient to perform that function are also conferred, in combination with section 8 of the ICRC Act, grants the ICRC the power to determine the regulatory period for a price direction.

While these arguments are not lightly dismissed, in our view they involve a certain disregard for the words of the statute, and words which clearly confine the power in section 20.

When 'working out the meaning of an act' s 139 of the *Legislation Act 2001* mandates 'the interpretation that would best achieve the purpose of the Act is to be preferred to any other interpretations'. Justice Besanko remarked in *Casey v Alcock* [2009] ACTCA 1 at [103] that s 139 does not authorise 'a court to rewrite legislation and the construction adopted must be one which is open

having regard to the words of the legislation'. In *Project Blue Sky v ABA* (1998) 194 CLR 355 at 382, the High Court made it clear that all words of a statute must be given some meaning.

In our view, the reading of the ICRC Act as proposed ... above would result in key words in s 20(1) being ignored.

As we consider the text of s 20(1) is meaningful, additional words would need to be read into the ICRC Act to enable the ICRC to determine the regulatory period. Courts are generally reluctant to read words into a statute. In *Thompson v Gold & Co* [1910] AC 409 at 420, Lord Mersey said 'it is a strong thing to read into an Act of Parliament words which are not there, and in the absence of clear necessity it is a wrong thing to do'. Pursuant to *Birmingham v Corrective Services Commission of New South Wales* (1988) 15 NSWLR 292 at 302 a court cannot read words into a law unless the court:

- knows the mischief with which the Act was dealing;
- is satisfied that by inadvertence Parliament has overlooked an eventuality which must be dealt with if the purpose of the Act is to be achieved; and
- must be able to state with certainty what words Parliament would have used to overcome the omission if its attention had been drawn to the defect.

In our assessment, it is doubtful whether any of the preconditions for reading in words are present in this case. In particular, the objects of the Act can be achieved by an appropriately drafted reference. In such circumstances, there is no necessity for the unusual step of reading words into a statute.

Applying the *Legislation Act 2001* and ordinary methods of statutory construction, we have been unable to find persuasive support for the ICRC having express or implied power to set the regulatory period in any of the words in the ICRC Act, nor in the extrinsic aids. **Further, the fact that the 2013 terms of reference failed to specify a regulatory period when such a period is essential for the ICRC to make a price determination, cannot be interpreted as implicitly conferring power on the ICRC to set the regulatory period** [Audit Office emphasis]. In our view it is beyond the Minister's power to confer a discretion on the ICRC to choose the regulatory period. The power to set the regulatory period has been conferred by the Assembly on the Minister (when sections 15 and 20 are read in combination) and until the Minister exercises that power in a reference, the better view is that the ICRC has no power to make a price direction in relation to any period.

3.22 On behalf of the Audit Office the Australian Government Solicitor sought advice from Queen's Counsel Mr Peter Hanks with respect to this issue. Mr Hanks supported the Australian Government Solicitor's opinion on the issue. Mr Hanks advised:

Section 20(1) of the ICRC Act is the source of the ICRC's power to make a price direction in a regulated industry. That subsection requires the ICRC to decide on the level of prices for services "in relation to the period specified in the reference" and to give a price direction accordingly. In my opinion, it is an essential element (because s 20(1) of the ICRC Act makes it essential) in any price direction that the

direction decide on the level of prices for services in relation to the period specified in the reference.

It follows that, although s 15 of the ICRC Act does not expressly require the referring authority to specify the period in relation to which the ICRC is to determine prices for regulated services, a reference that fails to specify such a period will be futile, in the sense that the reference will fail to provide the ICRC with a reference sufficient to support the ICRC's exercise of power under s 20(1).

That is, it is a necessarily implicit requirement, for any industry reference in relation to price for regulated services made by a referring authority under s 15(1) of the ICRC Act, that the reference specify the period in relation to which the ICRC is to decide on the level of prices for services under s 20(1): if the referring authority omits to specify that period when providing an industry reference to the ICRC in relation to prices for regulated services, the reference will be insufficient to allow the ICRC to make a price direction under s 20(1) of the ICRC Act.

**It follows that, because the Treasurer's reference to the ICRC dated 13 October 2011 omitted to specify the period in relation to which the ICRC was to decide on the level of prices for services, the Price Direction made by the ICRC in Report 6 of 2013 is invalid because, without the referring authority having specified that period, the power conferred by s 20(1) of the ICRC Act could not be exercised [Audit Office emphasis].**

3.23 Mr Peter Hanks QC further advised in relation to the alternative view put forward by the ACT Government Solicitor:

In my opinion, the arguments advanced in the ACTGS response are unpersuasive; indeed, those arguments have served to reinforce my conclusion that, unless the referring authority specifies the period in relation to which the ICRC is to decide on the level of prices for services, the ICRC's power under s 20(1) to make a price direction does not arise.

3.24 While it was subject to the terms of reference, and responsible for their implementation during the investigation, the ICRC did not challenge the effectiveness of the terms of reference as prepared by the Treasury Directorate. The ICRC has also advised the Audit Office that '[it has] senior counsel opinion about possible interactions between sections 15 and 20 of the ICRC Act...[and] that the opinion provided supports the position the Commission has taken in regard to this matter.' The Audit Office was not provided with a copy of this opinion.

3.25 In conclusion, the June 2013 price direction may have no legal effect due to ineffective terms of reference for the investigation. The Audit Office notes that a definitive conclusion on this issue may not be achieved until tested through a judicial process. Nevertheless, unless and until that happens, the Audit Office considers that there remains the risk that the 2013 price determination is invalid.

3.26 A key issue for consideration is the lack of clarity between sections 15 and 16 in Part 3 and 20 in Part 4 of the ICRC Act. Sections 15 and 16 of the ICRC Act do not

specify that a terms of reference must have a defined period, while subsection 20(1) of the ICRC Act states that a price direction must be for 'the period specified in the reference.' The legislation needs to be amended to clarify this issue.

- 3.27 ACTEW has also advised the Audit Office of its contention that the price direction is invalid because of the two-year biennial recalibrations proposed by the ICRC. ACTEW asserts that because of the two-year biennial recalibrations proposed by the ICRC, the price direction does not comply with subsection 20(1) of the ICRC Act. The Audit Office did not seek specific legal advice on this issue.

**Recommendation 3 (Chapter 3)**

The ACT Government should address the issues associated with the potential invalidity of the current price direction.

**Recommendation 4 (Chapter 3)**

The ACT Government should review and amend the *Independent Competition and Regulatory Commission Act 1997* to clarify the relationship between Part 3 (Investigations) and Part 4 (Price directions) of the Act.

**CONDUCT OF THE INVESTIGATION**

- 3.28 Section 17 in Part 3 of the ICRC Act provides a range of procedures for the conduct of an industry reference investigation including:

- the investigation must be conducted as authorised by the terms of reference (subsection 17(1));
- specifically in relation to price regulation investigations, the ICRC must invite public submissions and conduct public hearings, although it is not required to hear submissions from all persons (subsection 17(4)); and
- subject to the ICRC Act, the ICRC may conduct an investigation in any way the ICRC considers appropriate (subsection 17(6)).

- 3.29 Subsection 18(1) in Part 3 of the ICRC Act requires the provision of a draft report on an industry reference investigation, prior to the provision of a final report. Subsection 18(1) requires:

- a draft report to be made available to the public for a period of not less than 20 days; and
- written comments are to be invited on the draft report.

- 3.30 Subsection 18(5) of the ICRC Act provides that the draft report should include:
- the proposed price direction;
  - a proposed statement of reasons for the direction; and
  - any proposed report by a commissioner dissenting from proposed majority findings of the ICRC.
- 3.31 Subsection 18(6) provides that any written comments received on the draft report should be taken into consideration in the preparation of the final report.

### Assessment of the 2013 process

- 3.32 The ICRC:
- invited public submissions and conducted public hearings throughout the water and sewerage pricing process; and
  - made a Draft Report publicly available for the required time.
- 3.33 Comments received on the Draft Report (February 2013) were taken into consideration in the preparation of the Final Report (June 2013).
- 3.34 With respect to the subsection 17(1) in Part 3 requirement of the ICRC Act that the ICRC conduct the investigation as authorised by the terms of reference, there is evidence to indicate that the ICRC considered all the matters included in the Minister's October 2011 terms of reference.
- 3.35 The extent to which the ICRC considered all the matters in the terms of reference effectively is subject to differences in opinion and interpretation. In September 2013 ACTEW lodged an application for a review of the price direction by an industry panel pursuant to section 24K in Part 4C of the ICRC Act. Section 24K provides that either the referring authority (the Minister) or the utility (ACTEW) may apply for a review within three months of the price direction by an industry panel. Section 24M and Schedule 3 of the ICRC Act set out the requirements for the industry panel. Some issues associated with the ICRC's conduct of the water and sewerage price investigation, particularly with respect to the ICRC's administrative and procedural approach and communication and consultation processes, are discussed in further detail in Chapter 4 of this report.

### Draft Report (February 2013)

- 3.36 An issue that became apparent during the audit was the significant difference in interpretations and assumptions associated with the Draft Report (February 2013) prepared by the ICRC. Senior ICRC staff advised the Audit Office that the Draft Report was more in the nature of a discussion paper and, when published, did not necessarily represent the ICRC's conclusions with respect to technical and regulatory matters.

3.37 In support of this, ICRC officers advised:

- they believed that they had not been provided with adequate information from ACTEW during the course of the review process (for example, on operating expenditure and capital expenditure); and
- the Draft Report contained some new elements and approaches that the ICRC sought to trial through the Draft Report and so seek reaction and input from stakeholders.

3.38 In the Draft Report (February 2013), the ICRC stated:

The first thing that must be said about these potential price outcomes are that they depend in part on some novel features of the proposed price direction on which the Commission especially welcomes community comment. It is possible, therefore, that the Commission could make adjustments that would somewhat reduce the extent of the proposed price reductions. Because this draft report proposes substantial changes to the way prices are determined, it would be wise to treat its conclusions with more than usual caution. All that said, it is very unlikely that the final report will not see a significant reduction in the prices of water and sewerage services.

3.39 A senior ICRC representative further advised the Audit Office, in testimony under oath or affirmation pursuant to section 14A of the *Auditor-General Act 1996*:

...leading up to the production of that report there was quite a lot – I think there was quite a lot of confusion amongst I know the Secretariat in respect of what the status of the report was. Was it a draft in terms of a draft final report or was it a report that was put out during the process of doing the determination, it was really just like a status update, more of an information paper?

3.40 ACTEW officers, on the other hand, considered that the Draft Report (February 2013) represented the ICRC's conclusions with respect to technical and regulatory matters. In its response to the Draft Report, ACTEW stated:

...ACTEW has identified an underlying failure by the Commission to justify its decision by reference to the requirements of the ICRC Act...ACTEW considers that it is important to highlight the issue as representing a more fundamental shortcoming of the Commission's Draft Report.

3.41 In its response to the Draft Report, ACTEW highlighted that subsection 20(2) in Part 4 of the ICRC Act sets out the matters that the Commission must have regard to when making a price direction, and stated:

ACTEW is concerned that the Draft Report has not clearly discussed and justified its conclusions by reference to the Relevant Considerations.

3.42 Internal documentation in the ICRC, prepared in response to ACTEW's comments on the Draft Report and provided to the Audit Office highlighted that:

- the Draft Report and proposed price direction (February 2013) were prepared under Part 3 of the ICRC Act (dealing with investigations);
- the final price direction (June 2013) was prepared under Part 4 of the ICRC Act (dealing with price directions); and
- the Final Report (June 2013) was prepared under Part 4A of the ICRC Act (dealing with reports of investigations).

3.43 The ICRC's internal documentation presented the view that the Draft Report and proposed price direction (February 2013) (prepared under Part 3 of the ICRC Act) did not need to meet the requirements of Part 4 or Part 4A of the ICRC Act, because they were produced under different parts of the legislation. The ICRC's internal documentation identified that:

...the draft report is provided in accordance with section 18 of Part 3 as part of the investigation; while the final report is provided in accordance with Part 4A and is provided upon concluding the Part 3 investigation. Likewise, the proposed Price Direction is provided in accordance with section 18(5)(a) of Part 3 of the investigation, while the final Price Direction (as with the final report) is set out at the conclusion of the investigation. On a practical level, that means that the draft report and proposed Price Direction are provided roughly three quarters way through the investigation, while the final report and final Price Direction are provided upon concluding an investigation. Importantly...the proposed Price Direction is not set out under Part 4, and nor is the draft report subject to the requirements of Part 4 as ACTEW suggests a number of times.

3.44 It is entirely appropriate that the Draft Report and proposed price direction (February 2013) produced by the ICRC was subject to further change and amendment prior to the Final Report and final price direction, on the basis of stakeholder feedback. Stakeholder feedback was sought on the Draft Report and proposed price direction and any comments received may prove useful in identifying errors or other issues in analysis and conclusions.

3.45 However, there were significant differences in interpretations and assumptions by participants in the water and sewerage pricing process with respect to the Draft Report (February 2013) prepared by the ICRC. There was a fundamental difference in the expectations of the ICRC and ACTEW regarding the content of the Draft Report and proposed price direction, as well as the extent to which it needed to reflect the requirements of Part 4 and Part 4A of the ICRC Act, for the Final Report and price direction.

3.46 Chapter 4 discusses in detail the ICRC's overall communication processes and the way in which it sought stakeholder input and feedback at various points in the water and sewerage pricing investigation. It highlights that overall communication and consultation processes were poor and that some key consultation processes were either removed altogether or subject to compressed timeframes. Chapter 4 also discusses that the Draft Report (February 2013), in the absence of a planned Preliminary Conclusions Report and Working

Conclusions Report, was the first time that the ICRC presented its views and preliminary conclusions on technical and regulatory issues. This occurred approximately 16 months after the Treasurer issued the terms of reference and approximately two months before the initially planned completion date for the investigation of 1 May 2013.

- 3.47 The Audit Office notes the ICRC's contention that the Draft Report and proposed price direction and Final Report and price direction are prepared under different sections of the ICRC Act. The Audit Office also notes the ICRC's contention that the Draft Report and proposed price direction, being prepared under Part 3 of the ICRC Act, are only required to meet the requirements of Part 3 of the ICRC Act.
- 3.48 Notwithstanding the contention of the ICRC, the Audit Office considers that there are deficiencies in process, associated with:
- the ICRC's consideration that the purpose of the Draft Report (February 2013) was to trial and seek reaction on particular aspects of the water and sewerage pricing process. This occurred in the context of overall poor and delayed consultation processes; and
  - the preparation of the Draft Report (February 2013) without addressing or complying with the requirements of Part 4 and Part 4A of the ICRC Act. While the Audit Office recognises the ICRC's contention that this approach does not breach the legislative requirements, the Audit Office considers that a better approach would be to ensure that the Draft Report and proposed price direction addresses all the requirements of Part 4 and Part 4A. The Audit Office considers that this would assist stakeholder consultation, by providing greater clarity on the ICRC's technical and regulatory approach and its alignment with legislative requirements.
- 3.49 There is a lack of principles for guiding the water and sewerage pricing process in the ACT. A set of principles, which is discussed in paragraph 4.38, should assist in providing stronger guidance on the conduct of water and sewerage pricing processes and the requirements of key activities in this process.

### **Recommendation 5 (Chapter 3)**

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- a) a requirement to clearly identify the nature and purpose of stakeholder consultation documents prepared by the ICRC. At a minimum, the principles should require that a draft report and proposed price direction must comply with, and represent, any requirements of a final report and final price direction;

### **FINAL REPORT (JUNE 2013)**

3.50 Subsection 21(1) in Part 4A of the ICRC Act requires the ICRC to provide a Final Report on a price direction to the referring authority which contains:

- particulars of the results of its investigations;
- a copy of the price direction;
- a statement of reasons for the direction;
- a statement of the methodology used in determining the direction;
- the ICRC's findings on any other matter required by the reference;
- any dissenting reports by commissioners; and
- any other matter arising from the investigation that is considered desirable to include in the report.

### **Assessment of 2013 process**

3.51 The requirements mentioned in paragraph 3.50 were met. The ICRC released its Final Report and price direction on 26 June 2013.

3.52 However, as mentioned in paragraph 3.35 in September 2013 ACTEW lodged an application for a review of the price determination by an industry panel pursuant to section 24K in Part 4C of the ICRC Act.

### **Additional commentary and recommendations in the Final Report (June 2013)**

3.53 In the ICRC's Final Report (June 2013), in addition to reasons for and matters relating to the price direction, the ICRC included a range of additional commentary and findings, specifically on ACTEW and its governance arrangements.

3.54 In support of its commentary on the governance and administrative arrangements of ACTEW, the ICRC in its Draft Report stated that:

...it considers it timely to undertake a broad-ranging review of the provision and regulation of water and sewerage services in the ACT. The terms of reference for this inquiry require the Commission to consider and develop a regulatory regime for the supply of water and wastewater services to customers in the ACT. This can only be done by a careful examination of the mechanisms by which water and sewerage services are delivered to the community of the ACT and the impact of various alternative modes of regulation on the performance of those mechanisms.

3.55 The terms of reference issued on 13 October 2011 required the ICRC to among other things:

- undertake an investigation into regulated water and sewerage services provided by ACTEW; and
- make a price direction for regulated water and sewerage services provided by ACTEW.

3.56 Advice from the Australian Government Solicitor was sought on the authority of the ICRC to consider governance arrangements in its Final Report and make recommendations. The Australian Government Solicitor advised:

None of the considerations expressly required the ICRC to inquire into the governance arrangements for water and sewerage in the ACT. By doing so the ICRC stretched significantly the authority conferred on it by the terms of reference.

However, we consider that ICRC's contentions as to its power to investigate and report on the governance arrangements for water and sewerage in the ACT...provide a reasonable basis for the position it took. While its approach is at the outer limits of what could be legitimately included in an investigation of regulated water and sewerage services provided by ACTEW, nothing which was done was beyond the legal power the ICRC possessed. While the ICRC was required to take account of the considerations set out in the 2013 terms of reference, none of the considerations expressly required the ICRC to consider the governance arrangements of ACTEW. By making these considerations, the ICRC has stretched the authority conferred on it by the terms of reference.

3.57 In addition to the review of the governance arrangements, the ICRC made three recommendations in its Final Report (June 2013), directed to the ACT Government. The ICRC made these recommendations as it considered that its review highlighted 'aspects of the governance of ACTEW that the ACT Government might wish to consider altering in order to achieve more effective and efficient provisions of water and sewerage services.'

3.58 These three recommendations form part of the Final Report (June 2013) which, unlike the price direction, is not an enforceable document. The

recommendations are at best ‘particulars of the results of its investigations.’ Due to this, neither the ACT Government nor ACTEW is under any obligation to follow the recommendations.

- 3.59 The ACT Government in its submission to the ICRC in response to the Draft Report (February 2013) outlined that both the ICRC investigation and the associated recommendations did not form part of the terms of reference:

The Government acknowledges the Commission’s draft recommendations in relation to governance of ACTEW and water policy. These matters were not explicitly included in the Terms of Reference and not directly linked to pricing issues. Given the significance of the proposals in their own right, the Government will consider them in due course informed by the outcome of the consultation process and the Commission’s final report.

- 3.60 Chapter 6 of this report discusses the overall cost of the 2013 water and sewerage pricing process and notes that it has been significant. The ICRC’s actions in reviewing the governance and administrative arrangements of ACTEW, and making recommendations in its Final Report, have added to this cost. As noted in paragraph 3.54 of this report, the ICRC asserts that this was a necessary part of the investigation.

### Price Direction

- 3.61 Part 4 of the ICRC Act provides for the provision of price directions by the ICRC. Subsection 20(1) in Part 4 of the ICRC Act provides that:

At the conclusion of an investigation on a reference authorising the commission to make a price direction in a regulated industry, the commission must decide on the level of prices for services in relation to the period specified in the reference and give a price direction accordingly to each person providing regulated services to whom the direction applies.

- 3.62 Subsection 20(2) of the ICRC Act provides that, when making a price direction, the ICRC must have regard to:

- the protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services;
- standards of quality, reliability and safety of the regulated services;
- the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers;
- an appropriate rate of return on any investment in the regulated industry;
- the cost of providing the regulated services;

- the principles of ecologically sustainable development;
- the social impacts of the decision;
- considerations of demand management and least cost planning;
- the borrowing, capital and cash flow requirements of people providing regulated services and the need to renew or increase relevant assets in the regulated industry;
- the effect on general price inflation over the medium term; and
- any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

3.63 In relation to the principles of ecologically sustainable development, subsection 20(5) of the ICRC Act provides that this requires the effective integration of economic and environmental considerations in decision-making processes through the implementation of:

- the precautionary principle – that if there is a threat of serious or irreversible environmental damage, a lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation;
- the inter-generational equity principle – that the present generation should ensure that the health, diversity and productivity of the environment is maintained or enhanced for the benefit of future generations;
- conservation of biological diversity and ecological integrity; and
- improved valuation and pricing of environmental resources.

3.64 Subsection 20(4) of the ICRC Act also provides that, in its price direction, the ICRC must indicate to what extent it has had regard to these matters.

### Assessment of the 2013 process

3.65 The ICRC released its final price direction on 26 June 2013, in conjunction with its Final Report (June 2013).

3.66 In accordance with subsection 20(4) in Part 4 of the ICRC Act the ICRC, in its final price direction, included a table that identified where each of the matters required under subsection 20(2) had been considered in the Final Report (June 2013).

3.67 As noted previously with respect to the terms of reference for the review and the conduct of the actual investigation, the extent to which the ICRC effectively

considered the requirements of subsection 20(2) of the ICRC Act is subject to review. As noted in paragraph 3.35, in September 2013 ACTEW lodged an application for a review of the price direction by an industry panel pursuant to section 24K in Part 4C of the ICRC Act. In its application for review ACTEW highlighted parts of subsection 20(2) that ACTEW asserts were not appropriately considered by the ICRC in its final report and price direction.

- 3.68 Issues associated with the ICRC's conduct of the water and sewerage pricing process are discussed further in Chapter 4 of the report.

## 4. THE 2013 WATER AND SEWERAGE PRICING INVESTIGATION

---

- 4.1 This chapter discusses the conduct of the 2013 water and sewerage pricing investigation. In doing this, the mandate and terms of reference for the ICRC and the ICRC's management and administration of the process are considered.

### SUMMARY

#### Conclusion

The ICRC advised that it sought to approach the 2013 water and sewerage pricing investigation from 'first-principles'. While some aspects of the ICRC's technical and regulatory approach were consistent with earlier price investigations, others were a departure from previous practices in the ACT and those applied by other regulators in Australia. The ICRC's approach to the investigation, including the extent to which it changed its technical and regulatory approach, was not supported by effective consultation and communication processes. Key administrative processes initially envisaged by the ICRC, which would have facilitated communication and consultation, were not performed or were subject to compressed timeframes.

The ICRC Act provides a broad mandate to the ICRC to conduct water and sewerage pricing investigations. In the absence of water and sewerage pricing principles and supporting policy or procedural guidance for the ICRC there is a risk of regulatory inconsistency with different emphases and approaches being used from one review process to another.

#### Key findings

##### *Terms of reference and mandate of the ICRC*

- The matters to be considered by the ICRC in a water and sewerage pricing investigation are established by section 20 in Part 4 of the ICRC Act and the terms of reference for the investigation. Together, these require a range of economic, environmental and regulatory objectives to be considered. As some of these objectives conflict, trade-offs need to be made by the ICRC. The investigation and price direction process is open to wide differences of opinion, interpretation and emphasis.
- Compounding the challenge of considering the breadth of matters and objectives in the water and sewerage pricing investigation in the ACT, is the lack of documented principles for setting water and sewerage prices, including policy guidance on the relative weight or merit of the objectives.

##### *The ICRC's technical approach*

- The ICRC's approach to the 2013 water and sewerage pricing investigation was intended to be different to earlier approaches. The ICRC sought to approach the water and sewerage pricing process from 'first-principles' and in doing so it

questioned and reconsidered previous expectations and assumptions for the conduct of the water and sewerage pricing investigation. While there were elements of the ICRC's approach that were consistent with earlier price investigations, other elements of the ICRC's approach were a departure from previous practices in the ACT and those applied by other regulators in Australia.

- Two key features of the 2013 regulatory process that represent a departure from previous practice in the ACT and those applied by other regulators in Australia are:
  - the ICRC's use of a 'firm-specific' approach to calculating ACTEW's weighted average cost of capital for the purpose of calculating a return on capital for ACTEW; and
  - the ICRC's proposal for a six-year regulatory period, with 'biennial recalibrations of the key elements of the pricing model'.
- In its Draft Report and proposed price direction (February 2013) the ICRC proposed an overall 16.8 percent decrease in water prices and a 24 percent decrease in sewerage prices between 2012-13 and 2013-14. In its Final Report and price direction (June 2013) the ICRC determined an overall 5 percent increase in water prices and an 18 percent decrease in sewerage prices. This represents a significant shift in the ICRC's price direction.
- Key reasons for the shift in the ICRC's price direction are:
  - the removal of the 'fair cost recovery scheme', which was initially proposed in the ICRC's Draft Report and proposed price direction (February 2013);
  - changes to the way that the return on capital was calculated in the ICRC's Final Report and price direction (June 2013), compared with the ICRC's Draft Report and proposed price direction (February 2013);
  - the inclusion of additional operating expenditure, which was not included in the Draft Report and proposed price direction (February 2013); and
  - a calculation error in the ICRC's Draft Report and proposed price direction (February 2013), which was recognised and addressed in the Final Report and price direction (June 2013). The error related to the calculation of volumes of water expected to be sold at different tiers of the pricing structure.

### ***The ICRC's administrative approach***

- The ICRC implemented a different administrative approach for the 2013 water and sewerage pricing investigation, compared with:
  - the 2008 water and sewerage pricing investigation; and

- the ICRC's planned approach for the 2013 investigation, as identified in its November 2011 Context Paper.
- In the 2013 investigation, there was a greater focus by the ICRC on identifying contextual issues and other broad issues for consideration in the early stages of the investigation process. For example, as part of the November 2011 Context Paper and February 2012 Issues Paper, the ICRC identified issues and posed questions for the purpose of seeking feedback from stakeholders, including the community.
- In the 2008 investigation the ICRC sought to identify contextual issues and other broad issues for consideration, but in doing so also sought to provide information and clarity on the ICRC's analysis and preliminary views earlier in the process. As part of the 2008 review the ICRC produced three technical discussion papers, which were focused and discrete analyses on components of the investigation. The discussion papers included both questions and issues for consideration by stakeholders, including the community, and the ICRC's 'preliminary view' in response to each of these issues.
- In contrast to the 2008 process, in the 2013 investigation the ICRC did not identify any preliminary views or conclusions in any of its public material until the Draft Report and proposed price direction (February 2013), which was released approximately 16 months after the terms of reference were issued and approximately two months before the planned completion date. In pursuing this strategy, the ICRC did not proceed with the Preliminary Conclusions Report or Working Conclusions Reports, which were envisaged in the Context Paper (November 2011).
- Given the ICRC's desire to approach the review from 'first-principles' it would have been prudent for the ICRC to identify and test its potential conclusions at earlier stages of its process. By not doing so, the ICRC missed an opportunity to effectively communicate, at an earlier stage, what the novel features of the price determination might be for the benefit of stakeholders.
- Communication and consultation as part of the 2013 water and sewerage pricing process was also poor. For example:
  - throughout the project there were delays in ICRC deliverables, for example the Issues Paper was delayed by two months and the Draft Report (February 2013) by three months. (It is noted that the ICRC asserts that the delay in the provision of the Draft Report was due to ACTEW. ACTEW disagrees with this assertion);
  - key papers through which the ICRC initially anticipated providing its preliminary views and conclusions, the Preliminary Conclusions Report and Working Conclusions Report, were to occur up to 12 months and 10 months respectively before the release of the Final Report and price determination. The ICRC did not proceed with these papers and the first time that the ICRC presented its preliminary views and conclusions was

the Draft Report (February 2013), which was three months later than planned; and

- commensurate with the later than anticipated provision of key reports, there were compressed timeframes for stakeholder consultation at key stages of the process. For example, stakeholder submissions on the Issues Paper were compressed from two months to five weeks and submissions on the Draft Report from three months to six weeks. While the six week consultation period for the Draft Report still met the statutory timeframes of the ICRC Act, this was a compressed period given that the ICRC had adopted some 'novel features' in its Draft Report.

### *The ICRC's procedural guidance for the investigation*

- There is a lack of detailed internal administrative and procedural guidance in the ICRC for its water and sewerage pricing investigations. While the terms of reference and the ICRC Act can be used to guide ICRC processes, specific internal guidance is needed on how the ICRC is to:
  - conduct a water and sewerage pricing investigation;
  - consider information obtained in the course of the investigation; and
  - communicate and consult with key stakeholders.
- There was an absence of detailed project planning documentation associated with the investigation.
- These inadequate processes, combined with the broad terms of reference and mandate for the investigation, and the different administrative and technical approaches of the 2013 investigation, are factors that increase the risks associated with achieving an effective and efficient water and sewerage pricing process.

## **MANDATE AND TERMS OF REFERENCE OF THE ICRC**

4.2 The matters to be considered by the ICRC in a water and sewerage pricing investigation are established by:

- section 20 in Part 4 of the ICRC Act; and
- the terms of reference for the investigation.

### **Section 20 of the ICRC Act**

4.3 Section 20 in Part 4 of the ICRC Act provides for the setting of price directions. Subsection 20(1) of the ICRC Act states:

At the conclusion of an investigation on a reference authorising the commission to make a price direction in a regulated industry, the commission

must decide on the level of prices for services in relation to the period specified in the reference and give a price direction accordingly to each person providing regulated services to whom the direction applies.

4.4 Subsection 20(2) of the ICRC Act states that the ICRC must have regard to:

- the protection of consumers from abuses of monopoly power in terms of prices, pricing policies (including policies relating to the level or structure of prices for services) and standard of regulated services;
- standards of quality, reliability and safety of the regulated services;
- the need for greater efficiency in the provision of regulated services to reduce costs to consumers and taxpayers;
- an appropriate rate of return on any investment in the regulated industry;
- the cost of providing the regulated services;
- the principles of ecologically sustainable development;
- the social impacts of the decision;
- considerations of demand management and least cost planning;
- the borrowing, capital and cash flow requirements of people providing regulated services and the need to renew or increase relevant assets in the regulated industry;
- the effect on general price inflation over the medium term; and
- any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

4.5 The principles of ecologically sustainable development, provided for in subsection 20(2) of the ICRC Act include:

- the precautionary principle – that if there is a threat of serious or irreversible environmental damage, a lack of full scientific certainty should not be used as a reason for postponing measures to prevent environmental degradation;
- the inter-generational equity principle – that the present generation should ensure that the health, diversity and productivity of the environment is maintained or enhanced for the benefit of future generations;
- conservation of biological diversity and ecological integrity; and

- improved valuation and pricing of environmental resources.

### Terms of reference for the investigation

4.6 As stated in paragraph 3.8, the ACT Treasurer provided the terms of reference for the regulatory price investigation through *Disallowable Instrument DI 2011-287*, issued on 13 October 2011. The terms of reference for the investigation provide that the Commission should take into consideration:

- policies of the ACT Government as they relate to water security and the use of water;
- national water initiatives, policies and agreements;
- the impact of a price on carbon on the provision of water and sewerage services in the ACT;
- the ability of the pricing path to match revenue recovery requirements to the consumer benefits accrued from the water security program;
- all potential regulatory models, including consideration of the provision of sufficient flexibility in price setting across the regulatory period to minimise the impact of significant price fluctuations;
- the legislative requirements outlined in section 20 of the ICRC Act; and
- any other matters the Commission considers relevant to the inquiry.

4.7 The terms of reference were amended twice in the course of the review process, but only in relation to the timeframes for reporting (refer to paragraph 3.8).

### Breadth of matters and objectives to be considered as part of the review

4.8 The matters to be considered by the ICRC in a water and sewerage pricing investigation are established by section 20 in Part 4 of the ICRC Act and the terms of reference for the investigation. Together, these require a range of economic, environmental and regulatory objectives to be considered. As some of these objectives conflict, trade-offs need to be made by the ICRC. The investigation and price direction process is therefore open to wide differences of opinion, interpretation and emphasis.

4.9 This was highlighted by the Productivity Commission in its 2011 report into the urban water sector:

Regulators...have to generally deal with a number of conflicting objectives when making determinations. Where regulators are given conflicting objectives, they must implicitly prioritise them.

- 4.10 Compounding the challenge of considering the breadth of matters and objectives in the water and sewerage pricing investigation is the lack of principles for setting water and sewerage prices, including policy guidance on the relative weight or merit of the objectives. In order to address such challenges, in its 2011 report into the urban water sector the Productivity Commission stated:

To ensure decisions about where the 'public interest' lies continue to be made by elected representatives, and not by regulators determining which objectives take priority, governments should avoid having conflicting objectives in regulatory acts. Where conflicting objectives are considered unavoidable, regulators should be given clear guidance by government on how to prioritise objectives.

- 4.11 The implementation of Recommendation 4(b), discussed later in this chapter, will assist in addressing this issue.

### THE ICRC'S TECHNICAL APPROACH

- 4.12 For the purpose of completeness and in order to provide context for the Audit Office's consideration of the ICRC's administrative and communication processes, the Audit Office has briefly outlined the ICRC's technical approach to the 2013 water and sewerage pricing investigation.

- 4.13 In doing so, the Audit Office notes the ICRC's assertions that 'core water pricing principles have...been remarkably stable' over successive price investigations. In this respect, the ICRC advised:

These include that prices should be set to allow ACTEW to recover the prudent and efficient costs of providing water and sewerage services, use of the building block approach to determining these costs, and allowing for a return on and the return of capital, as measured by the regulatory asset base, in these costs.

- 4.14 The Audit Office also notes the ICRC's advice that it sought to approach the 2013 water and sewerage pricing investigation from 'first-principles' and in doing so it questioned and reconsidered previous expectations and assumptions for the conduct of the water and sewerage pricing investigation. The ICRC's Draft Report (February 2013) stated:

The first thing that must be said about these potential price outcomes are that they depend in part on some novel features of the proposed price direction on which the Commission especially welcomes community comment.

### Features of the 2013 water and sewerage pricing investigation

- 4.15 Dr David Cousins of Monash University, a recognised subject matter expert in the field of regulatory economics, provided advice on this audit. In relation to the ICRC's methodology for the regulatory review of water and sewerage prices, Dr Cousins noted that there were both similarities and differences in the ICRC's methodology compared with other jurisdictions. Dr Cousins advised that:

...there are numerous aspects of the methodology which are...quite similar to that adopted by other jurisdictions, for example its general use of a building block approach, broad approach to determining the cost of capital as a weighted average of debt and equity, construction of price structures and escalation of these prices by a CPI [consumer price index] index between re-sets.

4.16 Dr Cousins also advised that:

The ICRC's 2013 proposed methodology is not radical in the sense that it is totally different from what has been done before or that it is contrary to accepted regulatory objectives in relation to monopoly pricing. Its focus is the promotion of efficient prices. It does not appear to offend the high level urban water and sewerage pricing principles of the National Water Initiative. It is not particularly in line with the most recent views on pricing expressed by the Productivity Commission, but it is not alone in this regard.

4.17 With respect to the apparent differences between the ICRC's approach to the 2013 water and sewerage pricing investigation and other jurisdictions' approaches and the ICRC's approach to earlier pricing investigations, Dr Cousins identified two key features:

- the ICRC's use of a 'firm-specific' approach to calculating ACTEW's weighted average cost of capital for the purpose of calculating a return on capital for ACTEW; and
- the ICRC's proposal for a six-year regulatory period, with 'biennial recalibrations of the key elements of the pricing model'.

4.18 The use of a 'firm-specific' approach for calculating ACTEW's weighted average cost of capital formed the basis for how a return on capital for ACTEW was calculated. Allowing for a return on capital, to be provided for in revenues from water and sewerage services, allows ACTEW to service its debts and provides for a return on the equity investment in ACTEW by the ACT community. A 'firm-specific' approach allows for the return on capital to be calculated with specific reference to the cost of capital that ACTEW actually incurs. A 'typical-firm' approach allows for a return on capital to be calculated on the basis of a surrogate, which is determined by reference to a private sector firm engaged in a comparable business.

4.19 In relation to the six-year regulatory period with 'biennial recalibrations of the key elements of the pricing model' and the use of the firm-specific approach to calculating ACTEW's cost of capital, Dr Cousins also advised that:

On a broad continuum of approaches, the ICRC has proposed a move away from incentive regulation more toward cost of service regulation. Its approaches to determining regulatory re-set periods and cost of capital are quite different from those now generally adopted by economic regulators in Australia, but this does not make them wrong. Indeed, it might validly be

suggested that the ICRC has crafted a methodology which is more relevant for the circumstances it confronts, than is the more conventional methodology.

4.20 Incentive regulation broadly refers to using the regulatory process, including the prices allowed to be charged by a utility, to encourage the utility to achieve efficiencies in its operations. Cost of service regulation broadly refers to ensuring that prices to be charged by the utility service provider reflect the actual costs of service delivery.

4.21 In relation to the 2008 and 2013 water and sewerage pricing investigations, Dr Cousins advised:

The 2008 approach followed much more the usual approach adopted by economic regulators in Australia. The new approach builds on the 2008 approach and issues highlighted in the 2008 review. It has had particular regard to experience under this approach, notably the problems encountered in forecasting demand and operational and capital expenditures over a five year period, and seeks to deal with these problems.

#### **Shift in price direction from the Draft Report (February 2013) to the Final Report (June 2013)**

4.22 In its Draft Report and proposed price direction (February 2013) the ICRC proposed an overall 16.8 percent decrease in water prices and a 24 percent decrease in sewerage prices between 2012-13 and 2013-14. In its Final Report and price direction (June 2013) the ICRC determined an overall 5 percent increase in water prices and an 18 percent decrease in sewerage prices. This represents a significant shift in the ICRC's price direction.

4.23 A review of key documentation and material associated with the water and sewerage pricing investigation indicates that the key reasons for the shift in the ICRC's price direction are:

- removal of the 'fair cost recovery scheme', which was initially proposed in the ICRC's Draft Report (February 2013);
- changes to the way that the return on capital was calculated in the ICRC's Final Report (June 2013), compared with the ICRC's Draft Report (February 2013);
- the inclusion of additional operating expenditure, which was not included in the Draft Report (February 2013); and
- a calculation error in the ICRC's Draft Report (February 2013), which was recognised and addressed in the Final Report (June 2013). The error related to the calculation of volumes of water expected to be sold at different tiers of the pricing structure.

4.24 The first three issues are further in the following pages.

### ***Removal of the 'fair cost recovery scheme'***

- 4.25 The 'fair cost recovery scheme' primarily refers to how the costs of recent large-scale capital projects incurred by ACTEW, namely the Enlarged Cotter Dam project and the Murrumbidgee to Googong Pipeline, are to be recovered through prices charged to consumers. The 'fair cost recovery scheme' provides for these costs to be recovered over a longer period, potentially up to 100 years for the Enlarged Cotter Dam project. The ICRC's Final Report noted that, while the costs of these projects were to be recovered by ACTEW through prices charged to consumers over the very long term, ACTEW would be incurring costs on the borrowings it undertook to finance these projects in the short term. The short-term borrowing costs for ACTEW, which were not reflected in revenue achieved through the prices charged for water and sewerage services, would have threatened the financial viability of ACTEW. Hence, the 'fair cost recovery scheme' was not progressed by the ICRC in the Final Report (June 2013).

### ***Changes to the way the return on capital was calculated***

- 4.26 As noted in paragraph 4.18, the ICRC decided to adopt a 'firm-specific' approach to calculate its return on capital, as opposed to the 'typical-firm' approach that had been used in the past. In its Final Report (June 2013), however, the ICRC noted:

...changing one of the elements of the traditional approach without recognising the implication of persisting with the other will further increase the financial pressure on ACTEW, perhaps undermining its financial stability. The Commission has now concluded that adopting the firm specific approach to measuring the cost of capital needs to be coupled with applying that rate of return, uncorrected for inflation, to a [Regulated Asset Base] that has not been indexed for inflation. In this way the cash flows provided to ACTEW, through the water and sewerage services prices resulting from this approach, will match those required to service its debt and provide a return to its equity holder.

### ***Inclusion of additional operating expenditure***

- 4.27 A regulated utility's forecast operating expenditure forms part of the basis on which the prices it may charge in the future are calculated. In its Final Report (June 2013), the ICRC stated:

The Commission stated in its draft report that it was unable to accept ACTEW's proposed operating expenditure for the next regulatory period. The decision was due to ACTEW's main submission, and the supporting step change document, providing insufficient detail to allow the Commission to assess the efficient level of operating expenditure.

- 4.28 The Final Report (June 2013) further stated, with respect to the Draft Report (February 2013):

In response to the incomplete explanation provided by ACTEW for all the step changes in operating expenditure sought in its submission and, therefore, ACTEW's failure to fully justify the proposed expenditure, the Commission proposed a decrease in operating expenditure back to the most recent audited levels in 2010-11.

- 4.29 In its Final Report (June 2013), the ICRC advised that revised information provided by ACTEW in its April 2013 submission provided a stronger basis on which to assess the appropriateness of its proposed expenditure. The ICRC subsequently allowed a greater level of operating expenditure to be incorporated into the prices that could be charged by ACTEW.
- 4.30 These are the key reasons as to why there was such a significant shift in the maximum prices allowed to be charged by ACTEW, from the Draft Report and proposed price direction (February 2013) to the Final Report and price direction (June 2013). There are, however, other reasons that account for smaller variations in the prices.

#### **Contestability of water and sewerage pricing approaches**

- 4.31 Within the broad area of price regulation this audit has sought to demonstrate that there has been both consistency and flexibility in practice in the ACT.
- 4.32 As noted previously the ICRC has advised that 'core water pricing principles have...been remarkably stable' over successive price investigations in the ACT (refer to paragraph 4.13). Advice to the Audit Office from Dr David Cousins has also identified similarities in the ICRC's approach with other jurisdictions (refer to paragraph 4.15). Advice from Dr Cousins has also identified areas of technical and regulatory methodology where the ICRC has departed from previous ACT practice and practices in other jurisdictions (refer to paragraph 4.17).
- 4.33 With respect to differences in approach by the ICRC, the Audit Office notes that the ICRC's treatment of the estimated \$238 million revenue shortfall from the 2008 to 2013 regulatory period exemplifies the flexibility that is open to regulators. The 2008 Final Report and price direction envisaged that any revenue shortfall incurred by ACTEW during the 2008 to 2013 regulatory review period could be considered as a revenue pass-through and would be recovered, by being reflected in water and sewerage prices, in the future regulatory period from 2013 onwards. In its Final Report and price direction (June 2013), however, the ICRC did not include the revenue pass-through and allow this amount to be recovered in the regulatory period from 2013 onwards.
- 4.34 This issue highlights that there is considerable scope for flexibility in price regulation with different technical and regulatory approaches being able to be employed by water and sewerage price regulators.

4.35 In relation to this issue, Dr Cousins advised:

The regulation of monopoly prices cannot be said to be an exact science. Whilst there has been a clear evolution to a relatively common model in Australia, as well as the UK and USA, there is no reason why experimentation with other approaches should not occur. Indeed, it is desirable that such experimentation does occur. Further, different methodological approaches should not be seen as ends in themselves, but rather as means to inform regulators as to the decisions on prices they have to make. Price regulation is, or should be seen as, an art just as much as a science. Regulators need to take many factors into account and these factors need to be balanced by informed and wise judgement.

4.36 In relation to the 2013 water and sewerage pricing process, Dr Cousins noted that:

Much of the focus of the ICRC's review and the key areas of contention relate to the development of the framework developed for assessing prices in the years ahead. The ICRC has chosen to adopt a quite different approach to that which has become the norm for regulators in Australia over the past decade for determining water and sewerage prices. This raises a couple of questions. First, could work on the framework have been separated more from the work of actually determining maximum prices, which requires application of the framework? If this was possible, it might mean that price reviews could be conducted with greater certainty and more speed. Second, should it be left largely in the hands of the regulator to devise the framework which it is to apply in setting prices? **An alternative may be that the framework for setting prices is first largely determined by the Government, albeit after taking advice from the regulator and others** [Audit Office emphasis].

4.37 Dr Cousins also noted that:

Given the lengthy period over which the ICRC's review of water and sewerage prices has been conducted (October 2011–June 2013) and now the further period associated with ACTEW's request for a review of the determination and the uncertainty surrounding basic methodological issues there would seem a strong case for developing a clear set of principles, consistent with the relevant National Water Initiative Pricing Principles that ICRC could then apply in reviewing prices. These will not resolve all issues relating to methodology but they will provide greater certainty for all parties concerned.

4.38 The Audit Office considers that there is merit in developing and documenting water and sewerage price regulation principles for the ACT. At present, the ACT does not have documented water and sewerage price regulation principles, although the Audit Office notes advice from the ICRC that there has been consistency in core elements of its approach across price investigations. The Audit Office considers that documented principles could provide greater certainty for parties involved in water and sewerage price investigations and clarity on issues of possible contention in future price investigations. In accordance with the Productivity Commission's August 2011 *Australia's Urban*

*Water Sector Inquiry Report*, the establishment of a set of principles is likely to be best achieved by the ACT Government as elected representatives of the ACT community, especially as the entities involved in the water and sewerage pricing process are all ACT Government owned or controlled entities.

**Recommendation 5 (Chapter 4)**

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- b) guidance with respect to the prioritisation of objectives that are sought from the water and sewerage pricing investigation;

**THE ICRC'S ADMINISTRATIVE APPROACH**

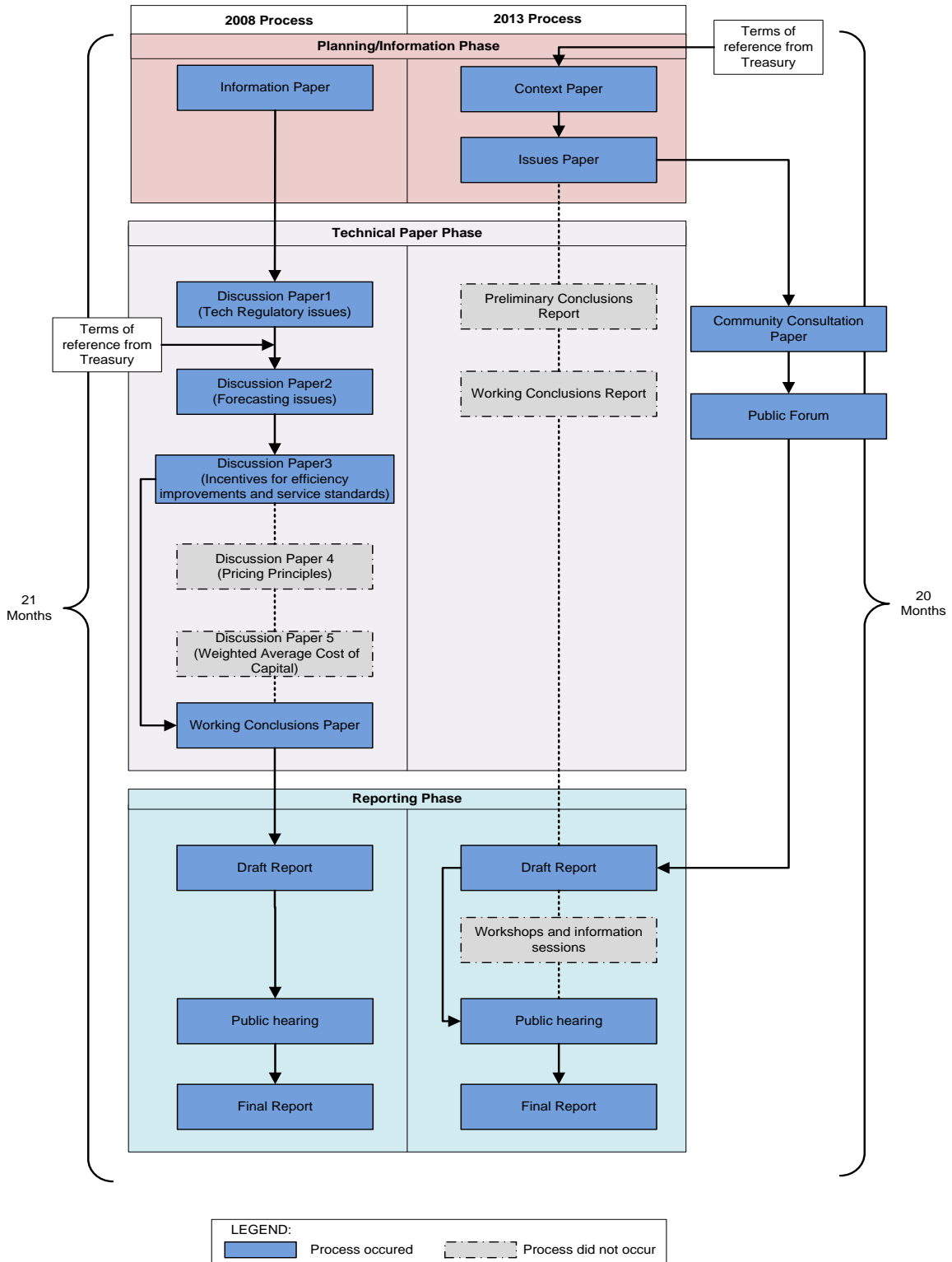
**Administrative steps**

4.39 The ICRC implemented a different administrative approach for the 2013 water and sewerage pricing investigation, compared with:

- the 2008 water and sewerage pricing investigation; and
- the ICRC's planned approach for the 2013 investigation, as identified in its November 2011 Context Paper.

4.40 Figure 4.1 compares these three approaches.

Figure 4.1: Comparison of the planned and actual 2013 processes with the 2008 process



Source: Audit Office, based on information from the ICRC

4.41 Figure 4.1 highlights key differences between the ICRC's actual and planned processes, including:

- the inclusion of a Community Consultation Paper and public forum, which were not initially anticipated; and
- the removal of the Preliminary Conclusions Report, Working Conclusions Report, and workshops and information sessions in the reporting phase.

4.42 Figure 4.1 also highlights key differences between the actual 2013 and 2008 processes, including:

- the release of a Context Paper, Issues Paper and Community Consultation Paper in the 2013 process, compared with the release of a single Information Paper in the 2008 process;
- the release of three technical Discussion Papers in the 2008 process; and
- the release of a Working Conclusions Paper in the 2008 process, prior to the release of the Draft Report.

#### ***Comparison of the 2008 and 2013 water and sewerage pricing investigations***

4.43 An appropriate comparison of the 2008 and 2013 water and sewerage pricing investigations can only be made from a detailed examination of the outputs of the administrative and procedural steps and the purposes that they serve.

4.44 In the 2013 investigation, there was a greater focus by the ICRC on identifying contextual issues and other broad issues for consideration in the early stages of the investigation process. For example, as part of the November 2011 Context Paper and February 2012 Issues Paper the ICRC identified issues and posed questions for the purpose of seeking feedback from stakeholders, including the community. In the February 2012 Issues Paper, the ICRC noted:

The purpose of the issues paper is to provide relevant information to inform submissions from interested parties, including:

- in conjunction with the context paper, relevant background information on the ACT water sector and the Commission's previous ACTEW price direction
- the requirements of the terms of reference
- the key issues to be considered as part of the inquiry and specific issues on which the Commission is seeking comment and information through the submission process.

- 4.45 The purpose of these papers was to generate critical thinking and reaction from stakeholders on potential issues for consideration by the ICRC in the investigation. These papers did not present any views or preliminary analysis by the ICRC.
- 4.46 In the 2008 investigation the ICRC sought to identify contextual issues and other broad issues for consideration, but in doing so, also sought to provide information and clarity on the ICRC's analysis. As part of the 2008 review the ICRC produced three technical discussion papers, which were focused and discrete analyses on components of the investigation. The discussion papers included both:
- questions and issues for consideration by stakeholders, including the community; and
  - the ICRC's 'preliminary view' in response to each of these issues.
- 4.47 Furthermore, in 2008 the ICRC built on the 'preliminary views' it identified in the three technical discussion papers by releasing a Working Conclusions Paper. This provided further detail on the ICRC's analysis and proposed treatment of the issues under consideration, prior to the release of the Draft Report. In 2008 the Discussion Papers and Working Conclusions Paper were also made publicly available and comment was invited by stakeholders, including the community. These papers were followed by the Draft Report and proposed price direction.
- 4.48 In contrast, in the 2013 investigation the ICRC did not identify any preliminary views or conclusions in any of its public material until the Draft Report (February 2013), which was released approximately 16 months after the terms of reference were issued and approximately two months before the planned completion date. In pursuing this strategy, the ICRC did not proceed with the Preliminary Conclusions Report or Working Conclusions Reports, which were envisaged in the Context Paper (November 2011).
- 4.49 In summary, the key differences between the 2008 and 2013 processes were:
- in the 2013 investigation there was a greater focus on the identification of 'first-principles' issues for consideration by stakeholders, including the community, at the earliest stages of the process; and
  - in the 2008 investigation there was a greater focus on the identification of preliminary views and conclusions at earlier stages of the process.
- 4.50 As mentioned in paragraph 4.14 the ICRC sought to approach the 2013 investigation from 'first-principles' and in its Draft Report (February 2013) identified that the potential price outcomes 'depend in part on some novel features of the proposed price direction.' Given the ICRC's desire to approach the review from 'first-principles' it would have been prudent for the ICRC to identify and test its potential conclusions at earlier stages of its process. By not

doing so, the ICRC missed an opportunity to effectively communicate, at an earlier stage, what the novel features of the price determination might be for the benefit of stakeholders.

4.51 The Draft Report (February 2013) raised expectations amongst stakeholders, including the community, for water price reductions, which were ultimately not met in the Final Report (June 2013). As discussed in paragraph 4.23, the ICRC decided not to proceed with particular features of the Draft Report and proposed price direction (February 2013). This resulted in a substantial shift in the water prices identified in the Final Report and price direction (June 2013).

**Comparison of the 2013 investigation against its planned processes**

4.52 The following table shows the planned and actual dates for the 2013 investigation, as identified in the ICRC’s Context Paper (November 2011).

**Table 4.1: Planned and actual activities for the 2013 water and sewerage pricing investigation**

Task / Activity	Planned date	Actual date	Achievement against plan
Receive terms of reference	October 2011	13 October 2011	✓
Release of context paper	23 November 2011	23 November 2011	✓
Release of issues paper	December 2011	21 February 2012	2 months late
Submissions on issues paper close	February 2012	30 March 2012	1 month late
Release of preliminary conclusions report	May 2012	Did not occur	✗
Submissions on preliminary conclusions report close	June 2012	Did not occur	✗
Release of working conclusions report	July 2012	Did not occur	✗
Submissions on working conclusions report close	August 2012	Did not occur	✗
Release of community consultation paper	Not planned	13 September 2012	New

Task / Activity	Planned date	Actual date	Achievement against plan
Public forum	Not planned	27 September 2012	New
Release of draft report	November 2012	26 February 2013	3 months late
Workshops and information sessions (if required)	December 2012	26 March 2013	3 months late
Submissions on draft report close	February 2013	12 April 2013	2 months late
Public hearing	February 2013	23 April 2013	2 months late
Final report	1 May 2013	26 June 2013	2 months late <sup>1</sup>

Source: Audit Office, based on ICRC documentation

Note 1: The ICRC sought and received an extension of time for the Final Report and price direction from the Treasurer, to 30 June 2013.

4.53 Table 4.1 shows:

- throughout the project there were delays in ICRC deliverables, for example the Issues Paper was delayed by two months and the Draft Report (February 2013) by three months;
- key papers through which the ICRC initially anticipated providing its preliminary views and conclusions, the Preliminary Conclusions Report and Working Conclusions Report, were to occur up to 12 months and 10 months respectively before the release of the Final Report and price determination. The ICRC did not proceed with these papers and the first time that the ICRC presented its preliminary conclusions was the Draft Report (February 2013), which was three months later than planned; and
- commensurate with the later than anticipated provision of key reports, there were compressed timeframes for stakeholder consultation at key stages of the process. For example, stakeholder submissions on the Issues Paper were compressed from two months to five weeks and submissions on the Draft Report from three months to six weeks. While the six week consultation period for the Draft Report still met the statutory timeframes of the ICRC Act, this was a compressed period given that the ICRC had adopted some 'novel features' in its Draft Report.

### Consideration of ICRC's consultation on its technical approach

- 4.54 A key conclusion that may be drawn from the 2013 investigation is that there were minimal opportunities during the process for external peer review and evaluation of the technical approach that underpinned the price direction. In this respect, the ICRC did not engage, or seek assistance from, an external body or expert with respect to its proposed technical approach. The ICRC advised the Audit Office that external peer review is not a requirement of the ICRC Act.
- 4.55 There may have been an expectation, however, that the stakeholder consultation processes employed throughout the investigation would assist in providing feedback on the technical approach taken by the ICRC. However, as noted in the previous section of this report, while the ICRC sought comment from the public and other stakeholders (including ACTEW and the ACT Government) at various stages of the review process, including the Issues Paper, the Community Consultation Paper and the Draft Report:
- the Issues Paper and the Community Consultation Paper did not provide any information on the ICRC's technical approach; and
  - the Draft Report was produced 16 months after the issue of the terms of reference and approximately two months before the planned completion date for the review of May 2013. Therefore stakeholders were only provided with six weeks to comment on the Draft Report.
- 4.56 A review of submissions received by the ICRC in the 2013 water and sewerage pricing process showed that some submissions commented on technical issues. However, the majority were not focused on these issues.

#### **Recommendation 5 (Chapter 4)**

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- c) guidance with respect to administrative processes to be conducted as part of the investigation, in order to facilitate open and timely communication of key issues, findings and conclusions at early stages of the process;

### THE ICRC'S INTERNAL PROCEDURAL GUIDANCE FOR INVESTIGATIONS

- 4.57 Previous sections of this report have highlighted:
- the breadth of the ICRC's mandate for the conduct of the 2013 water and sewerage pricing investigation, as determined by its legislative mandate and the terms of reference;

- the different administrative and technical approaches of the 2013 water and sewerage pricing investigation compared to previous investigations; and
  - the different administrative approach that the ICRC undertook, from what it had originally planned.
- 4.58 The Audit Office considers that these factors increase the risks associated with achieving an effective and efficient water and sewerage pricing process.
- 4.59 These risks are exacerbated by a lack of detailed internal procedural guidance in the ICRC for its water and sewerage pricing review investigations. While the terms of reference and the ICRC Act can be used to guide ICRC processes specific internal guidance is needed on:
- how the ICRC is to conduct administrative and procedural aspects of its water and sewerage pricing investigations;
  - how the ICRC is to consider information obtained in the course of the investigation; and
  - how the ICRC is to communicate and consult with key stakeholders.
- 4.60 As mentioned in paragraph 4.48, and discussed in further detail in Chapter 5, there were inadequacies in the ICRC's communication and consultation processes with ACTEW. There is a need for the ICRC to develop administrative and procedural guidance to support more effective communication and consultation processes in the future.
- 4.61 There was also an absence of detailed project planning documentation associated with the investigation. A high-level draft project plan was prepared in October 2011, prior to the release of the terms of reference. The draft project plan included:
- a broad list of key deliverables such as 'issues paper', 'draft report' and 'final report';
  - a timeline with milestones, including the deliverables listed above, with start and end dates for delivery. The start and end dates for the commencement and completion of deliverables were not specific, only listing months of the year as guidance; and
  - a 'communications strategy', which identified different administrative processes for the provision of information from different stages of the process to stakeholders. For example, the 'communication strategy' identified what documents were to be placed on the ICRC's website, which documents were to be accompanied by a media statement and procedural requirements for the conduct of the public forums.

4.62 The draft project plan was not finalised and did not contain sufficient detail or guidance to support effective administrative practices for the water and sewerage pricing investigation. Furthermore, the project plan did not include information such as:

- roles and resourcing requirements of all members of the ICRC. The project plan identified a project team comprising three members of the ICRC Secretariat, but did not identify the roles of the Commissioners and the Chief Executive Officer; and
- a risk assessment, including key risks and potential mitigation measures.

4.63 The draft project plan identified that weekly project meetings would take place within the project team and a monthly update on progress would be provided to the Commissioners. These were not well-documented and it is unclear as to whether they occurred as planned.

**Recommendation 6 (Chapter 4)**

The ICRC, for all future water and sewerage pricing review investigations, should develop and implement:

- a) detailed internal procedural guidance. This should include guidance on communication and consultation processes with stakeholders, including ACTEW; and
- b) rigorous project planning, monitoring and reporting procedures.



## 5. ICRC ASSERTIONS ABOUT THE NON-PROVISION OF INFORMATION BY ACTEW

---

- 5.1 This chapter discusses assertions made by the ICRC that ACTEW deliberately withheld information from the ICRC during the conduct of the water and sewerage pricing process.

### SUMMARY

#### Conclusions

Assertions made by the ICRC that ACTEW deliberately withheld information from the ICRC in the course of the water and sewerage pricing process, including that ‘whilst it was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election’, are not supported by evidence. Accordingly, the ICRC’s view that ‘the actions or inactions of ACTEW [posed] a threat to the public interest’ is also not supported.

There was a difference in the expectations of the ICRC and ACTEW with respect to the nature of the information to be provided by ACTEW as part of the water and sewerage pricing process. This difference in expectations was never satisfactorily resolved between the ICRC and ACTEW. Assumptions underpinning the different entities’ expectations and understanding of the processes, were also never effectively communicated.

The ICRC sought to compel the provision of information from ACTEW through the use of a legal notice under the *Independent Competition and Regulatory Commission Act 1997*. ACTEW did not have the information, as requested by the ICRC in the legal notice. The legal notice issued by the ICRC required that ACTEW provide this information by amending its main submission to the ICRC for the investigation. ACTEW fundamentally disagreed with the ICRC’s request that it provide the information by amending its main submission to the investigation. While ACTEW was unwilling to provide the information by amending its main submission, ACTEW consistently advised the ICRC that it was willing to provide the ICRC with other data and information that would assist the ICRC to undertake its investigation. ACTEW’s proposed approach was not acceptable to the ICRC.

#### Key findings

##### *ICRC’s requests for information from ACTEW*

- In August 2012, the ICRC asserted to ACTEW that its main submission to the water and sewerage pricing investigation in July 2012 was lacking information on some issues. The ICRC requested that ACTEW amend its July 2012 main submission and provide the additional information, specifically: ACTEW’s proposed treatment of the shortfall in revenue from the 2008 to 2013 regulatory period; estimated water sales forecasts for 2013 to 2018; and ACTEW’s proposed tariffs for 2013 to 2018.
- ACTEW fundamentally disagreed with the ICRC’s request that the information be provided, as requested by the ICRC. ACTEW’s disagreement was based on

various grounds, including that it did not wish to amend its main submission. ACTEW's position was that its main submission, provided in July 2012, represented 'the view of ACTEW Corporation (ACTEW) on the matters under review by the [ICRC].'

- The ICRC issued a notice to ACTEW, by virtue of section 41 of the ICRC Act, which sought to compel the provision of the information from ACTEW. The notice sought to compel the provision of:
  - 'the document or information which amends Table 13.6 on page 218 of its main submission to incorporate the pass-through amount in the proposed water revenue requirement, based on ACTEW's preferred time profile over which this amount should be recovered, with explanatory comments';
  - 'the document or information which amends section 6.1.5 of its main submission to include estimated annual water sales volumes for the 2013-18 regulatory period, with explanatory comments'; and
  - 'the document or information that amends section 14.1 of its main submission to include a proposed water tariff for 2013-14 and indicative tariffs for the remainder of the regulatory period.'
- ACTEW did not provide the information, as requested by the ICRC, in response to the notice under section 41 of the ICRC Act.
- The Audit Office is satisfied that ACTEW did not have information or documentation 'that amends...its main submission' as requested by the ICRC. The Audit Office is satisfied, however, that ACTEW had financial and other information, which it could have used or developed to prepare the information or documentation 'that amended ACTEW's main submission'. However, ACTEW fundamentally disagreed with the ICRC's request that the information be provided by amending its main submission. ACTEW also fundamentally disagreed with the ICRC's request for five-year water consumption forecasts and proposed tariffs that, in part, reflected these water consumption forecasts. This demonstrates that there was a substantial breakdown in communication between the ICRC and ACTEW.
- ACTEW consistently advised the ICRC that it was willing to provide the ICRC with information that would assist the ICRC undertake its investigation. This included an offer from ACTEW to 'work up a range of indicative water prices for 2013-14 to 2017-18 based on its proposed cost building blocks and a continuation of Commission decisions currently in force, including water volumes forecasts used by the Commission to set prices for 2011-12 and 2012-13 and include scenarios for the pass-through of foregone revenue with the appropriate caveats.' These offers of additional assistance and information were not taken up by the ICRC.

### ***ICRC's assertions about ACTEW's motivations***

- In support of its assertion that ACTEW did not provide the information to the

ICRC as 'ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election', the ICRC asserted that statements to this effect were made by the Managing Director of ACTEW at a meeting that occurred on 13 August 2012 between ACTEW (and ActewAGL) and ICRC representatives.

- Meeting attendees' recollections of the meeting and the way in which issues were discussed differed substantially. A key difference related to the way in which the issue of caretaker conventions associated with the forthcoming ACT Legislative Assembly election was raised. While there was agreement amongst attendees at the meeting that the Managing Director of ACTEW raised the issue of the caretaker conventions associated with the forthcoming election, attendees' recollections differed with respect to the manner in which the issue was raised and the purpose for which the issue was raised.
- The ICRC provided a file note in relation to this meeting in support of its assertions. The Audit Office considers that the ICRC file note provides limited support for the assertions made by the ICRC because it was not:
  - a contemporaneous account of the meeting as it was produced approximately one month after the meeting occurred; or
  - shared with ACTEW for verification.
- The ICRC file note also recognises and documents the ACTEW Managing Director's reservations with respect to the forthcoming ACT election and the implications of the caretaker conventions for ACTEW and the provision of the information. These include the need for the Managing Director to consult with the ACTEW Board with respect to amending ACTEW's submission, concern that the ACTEW Board would not adopt a position without consulting with the shareholders (the then Chief Minister and Treasurer) and a recognition that potential shareholders would also need to be consulted.
- There is limited guidance in the ACT Government's *Guidance on Caretaker Conventions* on the type of information covered by caretaker conventions. The document notes it 'is a matter of judgement' and considerations include 'whether the decision is a matter of contention in the election campaign' and whether it is a major policy decision that is 'likely to commit an incoming government.'

#### **September 2012 Community Consultation paper**

- The ICRC released its Community Consultation Paper the day before caretaker conventions in the ACT formally commenced (14 September 2012) and comments were due, for consideration as part of the Draft Report, on the day before the election was held on 20 October 2012.
- The release of the Community Consultation Paper during the caretaker period, with its focus on price outcomes, and with minimal information or analysis on the technical methodology or assumptions that underpinned this analysis, was

construed by ACTEW as a provocative act on the part of the ICRC. This followed ACTEW's communications to the ICRC in August 2012 on its reservations with respect to providing information during the caretaker period.

- The ICRC advised the Audit Office that the selection of dates was not made with a view to seeking a particular outcome or pushing a particular agenda. The ICRC also advised the Audit Office that, at the time, the ICRC was still working towards releasing a Draft Report in November 2012, in accordance with its original proposed timeframe and that the release of the Community Consultation Paper sought to elicit information that would achieve this outcome.
- The Audit Office notes the differing viewpoints of the ICRC and ACTEW with respect to the appropriateness of issuing the Community Consultation Paper as well as the timing of the Community Consultation Paper. The Audit Office notes that this issue highlights the poor relationship that was apparent between the ICRC and ACTEW at the time.

### ICRC ASSERTION THAT ACTEW WITHHELD INFORMATION

- 5.2 In a meeting with ACT Auditor-General's Office (Audit Office) staff on 27 September 2012 in relation to the 2011-12 audit of the ICRC's financial statements, the Chief Executive Officer of the ICRC asserted that ACTEW was deliberately withholding information necessary for the conduct of the regulatory review of water and sewerage prices and this was associated with the forthcoming 2012 ACT Legislative Assembly election.
- 5.3 The Audit Office staff subsequently conveyed this information to the Auditor-General. The Auditor-General and other staff of the Audit Office met with the Senior Commissioner, Standing Commissioner and Chief Executive Officer of the ICRC on 4 October 2012 and 9 October 2012, where these assertions were again made. These assertions were specifically made against the Managing Director of ACTEW.
- 5.4 The information that the ICRC asserted was not forthcoming from ACTEW related to:
- how ACTEW wanted to address the then estimated \$238 million shortfall in ACTEW's revenues arising from the 2008 to 2013 price direction in prices for the 2013 to 2018 period. The ICRC was seeking 'ACTEW's preferred time profile over which this amount should be recovered, with explanatory comments';
  - forecast water sales volumes for 2013 to 2018. The ICRC was seeking 'annual water sales volumes for the 2013-18 regulatory period, with explanatory comments'; and
  - the tariffs ACTEW proposes for 2013 to 2018. The ICRC was seeking information from ACTEW on its 'indicative annual water tariffs for the 2013-18 regulatory period.'

5.5 During the meeting the ICRC also advised that it had, in its view, mitigated the issue by ensuring that information was in the public domain relating to the information sought from ACTEW. At the conclusion of these meetings, the Auditor-General requested that the ICRC provide any information that would support these assertions.

5.6 On 19 October 2012 the Chief Executive Officer wrote a letter to the Auditor-General on behalf of the ICRC which:

... set out the Commission's reasons for requesting your office to consider the actions of ACTEW in so far as it relates to the non-provision of information by ACTEW in the current regulatory review of water and sewerage prices.

5.7 In the same letter to the Auditor-General (19 October 2012) the Chief Executive Officer of the ICRC advised that:

For the purpose of exercising its functions under the ICRC Act, the Commission requires information from ACTEW. In not providing the information necessary for the Commission to exercise its functions in ACTEW's submission and subsequently, under notice, ACTEW is obstructing the Commission in fulfilling its regulatory functions.

ACTEW has not to date provided the Commission with a reasonable excuse required in the absence of ICRC determination why it cannot provide the information.

5.8 Also in the same letter (19 October 2012) the Chief Executive Officer of the ICRC advised that:

In E-mails subsequent, a meeting and a letter, ACTEW through its Managing Director, declined to provide the information citing several reasons including that whilst it was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election.

5.9 Also in the same letter (19 October 2012) the Chief Executive Officer of the ICRC advised that:

The Commission has considered the actions and inactions of ACTEW as posing a threat to the public interest. The Commission has come to this view after assessing the information that is in the public domain as published by ACTEW, ACTEW's submission to the Commission, correspondence including meetings with the Commission and a draft report of a review undertaken by independent consultants. The two limbs of the public interest we are concerned may be threatened are:

1. The use of the regulatory process by ACTEW and or its managing director to influence a key pillar of democracy – genuine and periodic elections.

2. The undermining of a core Commission function to set prices for a regulated utility service provider.

## INVESTIGATION SUBMISSION PROCESSES

5.10 Subsection 17(2) in Part 3 of the ICRC Act provides that, for the purpose of conducting an investigation, the ICRC may:

- request submissions from the public or any specified person or body; or
- conduct hearings.

5.11 Subsection 17(6) of the ICRC Act also provides that the ICRC may conduct an investigation in any way that the ICRC considers appropriate.

## Expectations for information to be provided by ACTEW

5.12 The ICRC's February 2012 Issues Paper states:

The Commission will provide ACTEW with a detailed information request early in 2012 seeking, among other things, details of actual expenditures in the current period against the 2008 projections as well as planned expenditures for the 2013-18 period.

5.13 The ICRC achieved this by providing an Excel spreadsheet to ACTEW, which was to be populated by ACTEW with financial and other operational data.

5.14 The ICRC's February 2012 Issues Paper also states:

... ACTEW will also provide the Commission with a detailed public submission setting out its proposed treatment of various technical regulatory matters and its forecast customer and volume figures and proposed pricing structures and outcomes.

## Section 7.1 requirement of the 2008 Price Direction

5.15 The 2008 price direction is included as an appendix to a document titled *Final Report and Price Determination*. Section 7.1 of the 2008 price direction provides:

Where the net present value of actual water revenue earned by ACTEW over the period 2008-09 to 2012-13...differs by more than 3% from the forecast net present value of revenue set out in the Commission's price determination, then **ACTEW must, when submitting proposed tariffs to the Commission as part of the Commission's price determination for the period commencing on 1 July 2013, incorporate in tariffs a revenue pass-through amount** [Audit Office emphasis]. The pass-through will be determined as the difference between the net present value of revenue earned over the period 1 July 2008 to 30 June and net present value of revenue allowed in the final report plus or minus 3% depending on whether there has been an overcollection or an undercollection of revenue. Forecast revenue will be used for those quarters of the financial year 2012-2013 for which actual revenue data is unavailable.

5.16 Section 7.1 appears to envisage that under-recovered or over-recovered revenue, greater than 3 percent of that provided for, from the 2008 to 2013

period was to be considered in the development of tariffs for the 2013 price direction. As shown in paragraph 5.24, Section 7.1 of the 2008 price direction was cited by the ICRC as the basis on which it sought the information from ACTEW.

- 5.17 In its Draft Report and proposed price direction (February 2013) and Final Report and price direction (June 2013) the ICRC decided not to include the under-recovered revenue in prices for the regulatory period commencing on 1 July 2013.

#### Information provided by ACTEW

- 5.18 Throughout the course of the water and sewerage pricing investigation ACTEW provided a range of information and documentation to the ICRC. Information was provided through formal submissions and informally, in response to requests for information from the ICRC. ACTEW submissions to the ICRC included:

- submission in response to the Issues Paper – 30 March 2012;
- submission in response to the Community Consultation Paper – 19 October 2012; and
- submission in response to the Draft Report – 12 April 2013.

- 5.19 ACTEW also provided a separate and lengthy submission to the ICRC in July 2012, referred to as ACTEW's main submission. This was approved by its Board and included:

- a confidential submission;
- a public version of the confidential submission. The public version of its confidential submission contained all matters in its confidential submission, except for commercial-in-confidence material. The omitted parts of the confidential submission are clearly marked in the public version; and
- an Excel spreadsheet, which primarily contained expenditure data for ACTEW for the current regulatory period and forecast expenditure data for the forthcoming regulatory period.

- 5.20 In the foreword to its July 2012 submission to the investigation ACTEW stated:

This submission provides the view of ACTEW Corporation (ACTEW) on the matters under review by the Independent Competition and Regulatory Commission (ICRC or the Commission) in its current investigation of prices for regulated water and sewerage services in the ACT for the period from 1 July 2013. The submission addresses the matters raised in the Government's terms of reference for the investigation and expands on views expressed in ACTEW's

response to the Commission's February 2012 Issues Paper. The Commission requested that ACTEW provides a further major submission at this time, ahead of any response by the Commission to matters arising from the ICRC's Issues Paper process.

5.21 The assertions made by the ICRC to the Audit Office in relation to the withholding of information by ACTEW relate to the information provided by ACTEW in its July 2012 main submission to the investigation.

### ICRC communication to ACTEW for further information

5.22 On 8 August 2012 the ICRC Senior Commissioner sent a letter to the Managing Director of ACTEW advising that 'having reviewed ACTEW's Excel information return and main submission, the Commission notes that ACTEW has not addressed three key information requirements.' The letter from the ICRC Senior Commissioner identified that ACTEW's submission did not address:

- how ACTEW wanted to address the then estimated \$238 million shortfall in ACTEW's revenues arising from the 2008 to 2013 price determination in prices for the 2013 to 2018 period;
- ACTEW's forecast water sales volumes for 2013 to 2018; and
- the tariffs ACTEW propose for 2013 to 2018.

5.23 Paragraphs 5.24 to 5.38 include correspondence between the ICRC and ACTEW which relate to the further information sought by the ICRC. This correspondence is in chronological order and provides the context for the discussion in paragraphs 5.39 to 5.56.

5.24 The 8 August 2012 ICRC Senior Commissioner's letter stated:

**Revision of ACTEW's Main Submission to the Price Direction for the Supply of Water and Sewerage Services for the period 1 July 2013 to 30 June 2018**

The Commission set out its information requirements from ACTEW for the current review of prices for ACTEW water and sewerage services in the Commission's February 2012 issues paper and Excel information request. In particular, ACTEW is required 'to provide the Commission with a detailed public submission setting out its proposed treatment of various technical regulatory matters and its forecast customer and volume figures and proposed pricing structures and outcomes.'

The Commission received ACTEW's Excel information return on 12 July 2012. The Commission received ACTEW's main written submission to the review on 30 July 2012.

Having reviewed ACTEW's Excel information return and main submission, the Commission notes that ACTEW has not addressed three key

information requirements, which are identified below.

Water revenue requirement

The exclusion of the water revenue pass-through for 2008-13 from ACTEW's water revenue requirement for 2013-18 means that the submission does not provide a complete revenue requirement proposal.

It also means that the submission does not comply with Section 7.1 of the Commission's final price direction for the 2008-13 regulatory period which requires ACTEW to incorporate any pass-through amount in proposed tariffs for the 2013-18 period.

The Commission requests that ACTEW amend Table 13.6 on page 218 of its main submission to incorporate the pass-through amount in the proposed water revenue requirement, based on ACTEW's preferred time profile over which this amount should be recovered, with explanatory comments.

Forecast water sales volumes

Neither ACTEW's main submission nor Excel information return provides forecast water sales volumes for the 2013-18 regulatory period.

The Commission requests that ACTEW amend section 6.1.5 of its main submission to include forecast annual water sales volumes for the 2013-18 regulatory period, with explanatory comments.

Indicative water tariffs

Neither ACTEW's main submission nor Excel information return provides indicative annual water tariffs for the 2013-18 regulatory period. The Commission notes that ACTEW has provided indicative tariffs for sewerage services over the regulatory period.

The Commission requests that ACTEW amend section 14.1 of its main submission to include indicative annual water tariffs for the 2013-18 regulatory period.

The Commission requests that ACTEW provide a copy of its revised main submission, amended to reflect the requirements noted above, to the Commission by close of business on Friday 17 August 2012. This will provide the Commission with the necessary information to make a draft decision on water and sewerage charges by November 2012. In the interests of maintaining transparency in the review process, the Commission intends to place this letter on its website. ACTEW's revised main submission will also be placed on the Commission's website in accordance with normal practice.

In order to assess ACTEW's proposal to reduce the current price step threshold from 200 to 120kL per annum, the Commission would find it helpful to have the most up to data [sic] available on the profile of ACTEW

water customers. The Commission will separately provide ACTEW with an Excel information request specifying the exact nature of the customer profile data required.

If you have any questions or require any clarification regarding this letter, please feel free to contact me directly.

5.25 A key issue to note is that the ICRC requested ACTEW to amend or revise its main submission to provide the information. The ICRC's letter of 8 August 2012 was explicit with respect to the sections of ACTEW's main submission that the ICRC wished ACTEW to amend.

5.26 On 8 August 2012, the Managing Director of ACTEW sent an email to ICRC representatives, including the Senior Commissioner, which stated:

Thanks for this letter. It raises very critical questions which the Commission has offered little guidance on how we respond. I think there would be some value in organising a discussion with the Commissioners prior to us developing a written response. If they are agreeable to this I will ask...to liaise with you on the timing of a meeting.

5.27 At 9:39 am on 9 August 2012, the Senior Commissioner of the ICRC sent an email in response, which stated:

I'm not sure why you would be having difficulty with our requests but, if a meeting would help, we're happy to meet.

5.28 At 10:03 am on 9 August 2012 the Managing Director of ACTEW sent an email to the Senior Commissioner of the ICRC, with respect to a forthcoming meeting on 13 August 2012. This meeting is discussed in detail in paragraphs 5.91 to 5.96. The email states:

A meeting would be good. Difficulties is a broad word but covers it.

As a thought starter on lost water revenue the guidance we have in the current determination that we "must" seek to recover the revenue but no further guidance on how. The issues paper suggests options from recover nil to recover it quickly. My owners have indicated that they believe it should be smoothed. Depending on election outcomes a potential owner has said it "would be unfair to recover" but I do not think it is Liberal policy. The election occurs prior to the draft determination. The ACTEW Board are interested in developing a position in accord with its shareholders. We have a number of options but not yet a preferred one.

On projected water volumes our submission does offer some estimates of volume. Again we are keen to push for an acceptable model to all parties. That model should run as close to the final determination as possible and at least after summer. We could run the model now but for forecast

consumption in 2013-14 we would hold reduced confidence in outcome.

Developing a tariff table at this point would require these two issues to be resolved.

As you know on sewerage we are able to progress with greater forecasting certainty and have no lost revenue. We have been able to develop a tariff table and have submitted them.

I hope a discussion can give us some guidance on a way forward.

Thanks for the note and I will arrange a meeting.

5.29 At 11:49 on 9 August 2012, the Senior Commissioner of the ICRC sent an email to the Managing Director of ACTEW, which stated:

I think it would be useful to separate the formal requirements Actew is obliged to meet from any other advice or views it might wish to provide the Commission at its discretion. The requests in my letter were concerned with the former, the latter are entirely a matter for Actew.

As noted in my letter, the Commission's interpretation of section 7 of the current price determination is that Actew must include the pass-through amount in the revenue requirement on which the tariff schedule is based.

In regard to water volumes, the Commission has no wish to engage in a fruitless "battle of forecasting models". Reflecting on recent experience, including the analysis of it provided by Actew's ANU consultants that was the subject of a very useful discussion with the Commission arranged by Actew, the Commission considers it very unlikely that complex statistical analysis will shed much light on future water demand or required abstractions. For the same reasons, I think it is unlikely that a few more months data will alter that. The Commission would expect that, faced with the time constraints of this process which bind us all, Actew would provide its best estimate based on currently available information. There will, of course, be an opportunity to update that estimate in Actew's response to the Commission's draft report.

With those two elements in place the methodology of previous years would be to set an X factor for the CPI+X adjustment to apply year by year which then enables the a tariff schedule to be determined.

It is then up to the Commission to decide whether the result of this exercise constitutes the best regulatory outcome. If Actew wished to offer any views on that now the Commission would be pleased to consider them. Alternatively, including for the reasons you have noted, Actew might wish to provide such views in response to the Commission's draft report. It is also worth noting that your shareholders may make submissions to the Commission directly and did so in response to the issues paper.

As I mentioned in my letter, the Commission has noted that Actew has provided a tariff table for sewerage services.

While I'd be happy to continue this discussion face to face, time is pressing and, if we are to meet, it needs to be sooner rather than later.

- 5.30 On 13 August 2012 a meeting was held between the ICRC and ACTEW. This is discussed in detail in paragraphs 5.91 to 5.96 of this report.

### ACTEW response to information requests

- 5.31 In response to the ICRC's request, on 17 August 2012 the ACTEW Managing Director sent a letter to the ICRC which stated:

Thank you for the discussion on the 13<sup>th</sup> of August in relation to your letter on the 8<sup>th</sup> of August and in particular the openness of the discussion.

The letter highlighted a number of difficult issues that have been raised in the ICRC Issues Paper and ACTEW's main submission. These include remedying the current form of regulation, developing and agreeing on a water volumes model and the method to recover the \$238 million forgone revenue eligible for pass-through. These issues directly relate to the way our expenditure should be recovered from the community and not the level of return or expenditure which has been provided in detail. The matters are extremely complex and we agree an open and transparent process is required to get them right.

The letter has requested ACTEW to provide detailed positions on these matters by 17 August 2012 and, in so doing, also provide indicative annual water tariffs for the 2013-18 period.

As I noted at our meeting, our current position was set out in the main submission with the intention for further detailed consultation with your officials and the community to ensure the best outcome for all and to use the best available information before we could arrive at a final position.

I set this current position out below, along with our further thoughts on how we believe we can assist the Commission in resolution of these matters.

#### **Water Consumption Forecasts**

The considerable uncertainty inherent in forecasting water consumption beyond a 12-month horizon severely limits the usefulness of any attempt to calculate indicative water prices at this time. It is for this reason we advised in our submission on July 2012 that we intended to provide a consumption forecast for 2013-14 in February 2013. In relation to our water consumption forecasting capability, I would also like to say that I don't share pessimistic views on the usefulness of the Breusch/Ward water consumption forecasting model. This modelling work will provide the

rigour and integrity the community require. We described the model in our July 2012 submission as being an excellent tool for annual demand forecasting and we stand by that, but we also indicated the model can only deliver real value once we have sufficient input data on consumption for the upcoming 2012-13 summer months. This is why any consumption forecasts now would be premature and would be seen to lack validity.

The timing of this process is consistent with the Commission's process as applied during 2007, ahead of the 2008 determination. ACTEW was not in a position to publicly advise indicative water prices at the time of its major submission in September 2007. This was due to ongoing work on the appropriate water forecasting model in consultation with the Commission and heavy dependence, as the Commission subsequently noted, on assumptions about future weather. The end result of this assessment process was that the Commission elected to use its consultant's (MMA) consumption forecasts in preference to applying the ACTEW forecasting model.

#### **Revenue Pass Through**

ACTEW has provided its current best estimate of the revenue shortfall likely to be accrued by the end of the current regulatory period, with \$238m included in the revenue building blocks in its submission to be consistent with the revenue pass through provision in the Commission's 2008 final decision.

ACTEW indicated in its submission that it intended to provide an updated forecast in February 2013. ACTEW further noted the Government's submission to the inquiry and the need to explore options that would minimise social impact and price pressure of any revenue pass through.

It is our view that there remains options for managing price impacts to the potential benefit of customers that must be explored first. This process needs to be progressed and sufficiently concluded before it is possible for ACTEW to be in a position to derive a revenue outcome on which to set indicative water prices for 2013-14, notwithstanding the need to also resolve the issue with water consumption volume forecasts as discussed above.

#### **Consultation and Assessment**

We would be pleased to be a part of a discussion and consultation process with the Commission on these and other important matters for the inquiry. To this end, the Commission specifically noted in its February 2012 Issues paper that it may elect to release papers and analysis on specific issues ahead of the release of the draft report in November 2012.

Such a process would also be consistent with past reviews. During 2007-08, ACTEW engaged fully with the Commission's consultation process that allowed for specific points of public involvement and stakeholder engagement over an 18-month period. This process included an information paper, three technical papers, a water pricing roundtable with

customer representation, a demand forecasting model workshop and a working conclusions paper, all ahead of the Commission's draft determination in December 2007. The Commission specifically noted then that community involvement was a crucial part of the regulatory process.

ACTEW is very willing to support and assist the Commission's consultation process and notes that the revenue pass through and consumption forecasting issues could both benefit from this approach. To this end, ACTEW suggests that it could work up a range of indicative water prices for 2013-14 to 2017-18 based on its proposed cost building blocks and a continuation of Commission decisions currently in force, including water volumes forecasts used by the Commission to set prices for 2011-12 and 2012-13 and include scenarios for the pass-through of forgone revenue with the appropriate caveats.

ACTEW would be keen to meet with the Commission in the first instance to discuss ideas and mechanisms to manage price impacts arising from pass through of forgone revenue to the potential benefit of customers from 1 July 2013.

### Notice from the ICRC to ACTEW under section 41 of the ICRC Act

5.32 In response to ACTEW's letter of 17 August 2013, on 23 August 2012 the ICRC Senior Commissioner sent a letter to ACTEW which contained a notice pursuant to section 41 in Part 7 of the ICRC Act. Subsection 41(1) of the ICRC Act provides:

If the commission has reason to believe that a person has information or a document that may assist it in exercising its functions, it may, by written notice, require the person to give it the information or a copy of the document

5.33 The letter accompanying the notice stated:

Enclosed is a notice issued pursuant to section 41 of the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) which formally requires you to produce documents and/or information to the Commission.

If you have any questions regarding the notice or what you are required to do to comply with the notice you should contact ... as soon as possible.

Penalties can apply if you do not comply with all of the requirements of the notice. These penalties are set out with the notice.

You cannot refuse to comply with this notice on the basis of self-incrimination. However, section 41 of the ICRC Act does not override legal professional privilege.

The document/s as required in the attached notice is for the purpose of applying the *Independent Competition and Regulatory Commission Act 1997* (ICRC Act) in relation to Independent Competition and Regulatory Commission (Regulated Water and Sewerage Services) Terms of Reference

Determination 2011 for the regulatory period 2013-2018.

- 5.34 The schedule to the notice issued by the ICRC under section 41 of the ICRC Act stated:

**NOTICE PURSUANT TO SECTION 41 OF THE *INDEPENDENT COMPETITION AND REGULATORY COMMISSION ACT 1997***

1. ACTEW is required to produce the document or information which amends Table 13.6 on page 218 of its main submission to incorporate the pass-through amount in the proposed water revenue requirement, based on ACTEW's preferred time profile over which this amount should be recovered, with explanatory comments.
2. ACTEW is required to produce the document or information which amends section 6.1.5 of its main submission to include estimated annual water sales volumes for the 2013-18 regulatory period, with explanatory comments.
3. ACTEW is required to produce the document or information that amends section 14.1 of its main submission to include a proposed water tariff for 2013-14 and indicative tariffs for the remainder of the regulatory period.

- 5.35 Penalties for non-compliance with the notice are provided for in subsection 41(4) of the ICRC Act. The maximum penalty for non-compliance is '100 penalty units, imprisonment for 1 year or both'.

- 5.36 In response to the notice, on 28 August 2012 the Managing Director of ACTEW sent a letter to the Senior Commissioner of the ICRC which stated:

I refer to your letter dated 23 August 2012 enclosing a Section 41 Notice requiring ACTEW to produce documents and or information to the Commission.

Due to the short time frame in which you are requiring ACTEW to comply with the Notice, I advise that ACTEW is unable to respond by 29 August 2012. I consider this matter to be of such significance and importance that I have appraised the ACTEW Board and the Shareholders of the Notice. This matter is listed for urgent discussion at the Board Meeting tomorrow afternoon.

As such ACTEW requests an extension of time to respond to your letter and Notice to close of business Friday 31 August 2012.

I confirm that ACTEW is committed to working with the Commission.

5.37 On 29 August 2012 the Senior Commissioner of the ICRC sent a letter to ACTEW which stated:

I refer to your letter dated 28 August 2012 and your request for an extension for the return of documents or information named in the schedule of the section 41 notice issued to ACTEW Corporation on 23 August 2012.

The Commission grants ACTEW Corporation an extension for the production of documents or information pursuant to the section 41 notice. The Commission grants the extension on the ground noted in your letter of 28 August 2012, namely to notify and discuss with your Board and shareholders receipt of the section 41 notice.

ACTEW must comply with the notice by producing the documents and information by close of business Friday 31 August 2012 to the Commission. Penalties can apply if you do not comply with all of the requirements of the notice. These penalties are set out with the notice.

5.38 In response to the ICRC's request, on 31 August 2012 the ACTEW Managing Director sent a letter to the ICRC which stated:

I refer to your letter of 23 August 2012 enclosing a Section 41 Notice under the ICRC Act to produce documents and information described in the Schedule which are in the custody or control of ACTEW Corporation.

**Response to Notice**

I formally advise that, having made due enquiry, ACTEW has no document or information in our custody or under our control which amends table 13.6, section 6.1.5 or section 14.1 of our main submission dated July 2012 as described in the Schedule of Notice.

In particular I note that:

- Item 1 – Preferred time profile – ACTEW does not currently have a preferred time profile for the pass through of forgone revenue. As previously advised to the Commission, ACTEW agrees with the position of the ACT Government regarding the pass through of forgone revenue to the consumer and would welcome the Commission's views on how best to deal with this matter given the Commission's previous determination and observations on this point.
- Item 2 – Estimated annual water sales – ACTEW does not currently have estimated annual water sales volumes for the 2013-18 regulatory period.

As you know we have already provided a forecast of volumes to be released from storage over that period for the purposes of cost

forecasting. We have also provided a forecasting model developed by Professor Trevor Breusch and Professor Michael Ward as part of a study commissioned by ACTEW to directly address the volumes forecasting challenges faced as part of this price review process. Further, and as noted below, ACTEW would be willing to provide internal, preliminary/hypothetical scenarios of water volume use.

- Item 3 – Proposed water tariff – ACTEW does not currently have any proposed water tariffs for the period 2013 to 2018 due to the absence of the information referred to in Item 1 and Item 2 above.

#### **Assistance going forward**

ACTEW has some concerns that, through the section 41 notice process, the Commission appears to be trying to force ACTEW to amend its position, as set out in its main submission. We also would like to understand why the Commission has sought by the Notice an estimate of annual water sales volumes (when ACTEW has on a number of occasions indicated that it will not have accurate modelling for 2013-14 volumes until after the summer of 2012-13), which seeks the creation of material which would be inaccurate, and if used, likely result in a poor decision for the people of Canberra. In this regard, it is important to understand that you are asking us to propose a position that is contrary to that adopted in our submission, which was that tariffs be set on a year-by-year basis, given the degree of variability in consumption experienced over the previous period.

While ACTEW does not have documents or information to give in response to the Notice, I can confirm that ACTEW wishes to continue to work with the Commission in good faith in relation to the current inquiry and provide assistance where it can.

As advised in our letter of 17 August 2012, our intention was for further detailed consultation with your officials and the community, and to use the best available information before arriving at a final position.

Furthermore, ACTEW also suggest in its letter that it could work up a range of indicative water volumes and prices for 2013-14 to 2017-18 to progress analysis of the issue. We suggest basing a scenario on our proposed cost building blocks and a continuation of the Commission's decisions currently in force, including water volumes forecasts used by the Commission to set prices for 2011-12 and 2012-13, and including scenarios for the pass-through of forgone revenue with the appropriate caveats. We remain willing to create this information for your consideration.

In the interests of continuing this dialogue with the Commission, and taking into account the types of information sought by the Notice, ACTEW management has further considered the matter raised and has developed some further positions for considerations by the Commission, nothing though that the stated positions have not been approved by wither the ACTEW Board or ACTEW's Shareholders.

**Item 1 – Preferred time profile**

While ACTEW has reached no formal position on the time profile for the revenue pass-through, ACTEW management further understands that the Board’s initial view on recovery of the revenue pass-through is that restraint should be shown in its recovery.

I can also offer a management developed view on a scenario that we believe warrants consideration.

We believe there may be merit in excluding the revenue pass-through from the revenue requirement in the first two years of the price path and to monitor outcomes over these two years given climate and consumption uncertainty. After the expiration of this 2 year period, the matter of the revenue pass-through could be re-examined. This would provide a means to establish the degree and extent to which revenue pass-through would need to be pursued. While the details of such a review need further development, we are confident there is necessary flexibility in the regulatory process for the adoption of such an innovative solution, for the potential benefit of customers.

However, the application and scope of such a review mechanism and ACTEW’s position would need to be finalised in the context of the overall decisions on our revenue claim.

**Item 2 – Estimated annual water sales**

ACTEW has already provided its proposed model for forecasting billed consumption and has indicated that it is “keen to continue working with the Commission to arrive at a model that is agreeable to both parties.”

As you know, ACTEW has a strong view that this model should be used to forecast volumes over a horizon of around one year after incorporating spring/summer consumption. However, we offer three options for being able to run scenarios with a view to meeting the Commission’s desire for information over the extended period:

- ACTEW to work with the Commission to further developed the ACTEW model – using the Commission’s assumptions that the currently estimated relationships between consumption, weather, time of year, and restrictions can hold over the course of the next regulatory period, though as stated above and in our submission we don’t believe that this is a valid assumption.
- Use a forecast to be developed independently by the Commission; or
- Use the Commission existing model used at the 2011 mid-term review for the current regulatory period.

**Item 3 – Proposed water tariff**

ACTEW has previously committed to providing indicative tariffs for 2013-14 in February 2013, after the summer consumption volumes are better known.

In the meantime, ACTEW would work on developing a number of possible scenarios for water prices for the period 2013 to 2018, based on our proposed cost building blocks and a continuation of the Commission decisions and forecasts currently in force.

We do however have some concerns about the Commission's request for the provision of proposed (as distinct from indicative) water tariffs for 2013-14 at this stage of the process, when the Commission is yet to consult and decide on which of the forms of regulation available to the Commission under Section 20A of the Act will be applied in the next regulatory period.

The ACTEW Board recognised fully its final price recommendation will involve the careful balance of the revenue building blocks, community and shareholder value. It further understands that this may require price restraint in the final position. Considering this, plus on insistence of the Commission, ACTEW management notes that in the ACTEW submission a side constraint was proposed to manage bill impacts on the consumer and believes that any 2013-14 tariff proposal could take this constraint into consideration – effectively restraining any possible water and sewerage price increase. Please note that this is a management position and has not been formally approved by the ACTEW Board. To formalise the position will require a significant piece of work with further detailed analysis.

ACTEW remains committed to working with the Commission to ensure the best outcomes for the regulatory process. In this context, if you wish ACTEW to develop a range of indicative water prices and scenarios (including the pass through of forgone revenue), please do not hesitate to contact me as I will instruct my staff to develop that information for you as quickly as possible.

it is important that we maintain a good relationship between our organisations, and I sincerely hope that we can work out a way forward as quickly as possible.

In the meantime, please rest assured that I will be briefing both the ACTEW Board as well as its shareholders on this matter so that once an appropriate way forward has been agreed with the Commission we will be in a position to action that resolution as soon as possible.

Finally, this letter should be treated confidential, give the management views expressed and noting Sections 44 and 45 in the Act.

*The ICRC's request for information from ACTEW*

5.39 Subsection 17(2) in Part 3 of the ICRC Act provides that, for the purpose of conducting an investigation, the ICRC may request submissions from the public or any specified person or body. As noted in paragraphs 5.12 to 5.14, through its February 2012 Issues Paper the ICRC established that it expected ACTEW to provide information for the purpose of the investigation. Furthermore, by virtue of section 7.1 of the 2008 price direction:

Where the net present value of actual water revenue earned by ACTEW over the period 2008-09 to 2012-13...differs by more than 3% from the forecast net present value of revenue set out in the Commission's price determination, then **ACTEW must, when submitting proposed tariffs to the Commission as part of the Commission's price determination for the period commencing on 1 July 2013, incorporate in tariffs a revenue pass-through amount.** [Audit Office emphasis]

5.40 The Audit Office sought to understand whether subsection 17(2) of the ICRC Act or section 7.1 of the 2008 price direction compelled ACTEW to provide the requested information to the ICRC. (Section 41 of the ICRC Act, which allows the ICRC to compel the provision of information or a document if it reasonably believes a person has information or a document that may assist it in its functions, is discussed in paragraphs 5.52 to 5.56 of this report.)

5.41 The Audit Office sought legal advice from the Australian Government Solicitor on this issue. The Australian Government Solicitor advised:

On its face section 7.1 imposes a very limited obligation on ACTEW. The obligation imposed is not an obligation to submit tariffs. What section 7.1 requires is that *when* ACTEW is submitting proposed tariffs it must include a revenue pass through amount. Accordingly it is only at that point that any mandatory obligation could be triggered.

5.42 The Australian Government Solicitor noted:

ACTEW made two submissions to the ICRC in 2012. On 30 March 2012 ACTEW responded to an ICRC issues paper and on 30 July 2012 it lodged a major submission with the ICRC. Both of these documents canvassed information about its revenue shortfall over the 2008-2013 regulatory period. Neither of these documents proposed water tariffs.

5.43 The Australian Government Solicitor further advised that 'at that point there was no breach of section 7.1 by ACTEW.' The Australian Government Solicitor noted, however, that there appeared to be a technical breach of section 7.1 of the 2008 price direction by ACTEW in relation to its April 2013 submission in response to the ICRC's Draft Report (February 2013). The Australian Government Solicitor advised:

ACTEW then responded to the 2013 draft report on 15 April 2013. In that response it complained about the ICRC's decision to not allow revenue pass-

through but also proposed a water tariff that appears to have not included a revenue pass through amount in accordance with section 7.1 of the 2008 price direction.

Strictly speaking this represents non-compliance with the terms of section 7.1. However, given the ICRC's clear position in the 2013 draft report that it was not going to determine prices in accordance with the principles set out in section 7.1, it is understandable that ACTEW elected not to submit tariffs based on a principle it understood that the ICRC was not going to apply.

5.44 Furthermore, the Australian Government Solicitor advised:

...when the proposed tariffs submitted by ACTEW were not calculated on the basis required by section 7.1, it was, strictly speaking open to the ICRC to enforce the requirement.

Section 7.1 was part of a price direction which was in force at the time. Accordingly it was open to the ICRC to serve on ACTEW an order under section 53 of the ICRC Act to require ACTEW to comply with the terms of the price direction.

***ACTEW's Statements of Corporate Intent***

5.45 The ICRC identified to the Audit Office information in ACTEW's Statement of Corporate Intent as a rationale for its view that ACTEW had 'information or a document' on forecast water sales volumes, i.e. the second item of its request for information.

5.46 At the time of the request for information ACTEW's *Statement of Corporate Intent 2012-13 to 2015-16* included information on financial performance targets for the years to 2015-16. This included projected revenues from ACTEW's 'Water Business'. The note to the table identified 'water and sewerage revenue is based on the ICRC final decision adjusted for water consumption levels.'

5.47 These figures can legitimately lead to an expectation that ACTEW had 'information or a document' with respect to forecast water sales volumes at least up to 2015-16 (but not necessarily up to 2017-18).

5.48 ACTEW advised that the revenue figures in the Statement of Corporate Intent from 2013-14 were not calculated on the basis of a price and water sales volume formula, because no prices had been determined for the next regulatory period, commencing from 2013. Revenues beyond 2013-14 were, instead, calculated on the basis of an assumption of full cost recovery of revenues sought from the water and sewerage pricing process.

5.49 The table in ACTEW's Statement of Corporate Intent was, therefore, misleading with respect to the information conveyed, because it stated that the figure is 'adjusted for consumption levels.' This misleading information led to an expectation on the part of the ICRC that ACTEW had 'information or a document' with respect to projected water sales figures at least to 2015-16. While this is an

inadequacy in the public information provided by ACTEW, the ICRC's contention that ACTEW's Statement of Corporate Intent was a basis for it to believe ACTEW had the relevant information was never explicitly discussed or resolved between senior representatives of the ICRC and ACTEW. This appeared to be first raised by the ICRC as a rationale for its expectations in a letter to ACTEW on 16 October 2012.

- 5.50 The assumptions underpinning each agency's point of view on this issue were never effectively communicated between the ICRC and ACTEW. This demonstrates the poor communication and consultation processes between the ICRC and ACTEW in the course of the water and sewerage pricing investigation.
- 5.51 Paragraphs 5.60 to 5.78 of this report presents the correspondence between the ICRC and ACTEW on this issue.

### *ACTEW's compliance with the ICRC's notice under section 41 of the ICRC Act*

- 5.52 As evident in paragraph 5.32, on 23 August 2012 the ICRC Senior Commissioner issued a notice to ACTEW pursuant to section 41 of the ICRC Act, the schedule of which stated:

1. ACTEW is required to produce the document or information which amends Table 13.6 on page 218 of its main submission to incorporate the pass-through amount in the proposed water revenue requirement, based on ACTEW's preferred time profile over which this amount should be recovered, with explanatory comments.

2. ACTEW is required to produce the document or information which amends section 6.1.5 of its main submission to include estimated annual water sales volumes for the 2013-18 regulatory period, with explanatory comments.

3. ACTEW is required to produce the document or information that amends section 14.1 of its main submission to include a proposed water tariff for 2013-14 and indicative tariffs for the remainder of the regulatory period.

- 5.53 ACTEW consistently responded to the ICRC by advising that it did not have any document or information as described by the ICRC in its notice. For example, in a letter to the ICRC on 31 August 2012 the ACTEW Managing Director advised:

I formally advise that, having made due enquiry, ACTEW has no document or information in our custody or under our control which amends table 13.6, section 6.1.5 or section 14.1 of our main submission dated July 2012 as described in the Schedule of Notice.

- 5.54 To ascertain whether ACTEW had the information or documentation 'that **amended** [Audit Office emphasis] ACTEW's main submission' as requested by the ICRC the Audit Office undertook the following:

- interviews with ACTEW (and ActewAGL) representatives under oath or affirmation pursuant to section 14A of the *Auditor-General Act 1996*;

- a review of the process by which ACTEW satisfied itself that it did not have the information or documentation; and
- an examination of ACTEW information systems.

5.55 The Audit Office is satisfied that ACTEW did not have information or documentation 'that amends...its main submission' as requested by the ICRC.

5.56 However, ACTEW had financial and other information, which it could have used or developed to prepare the information or documentation 'that amended ACTEW's main submission'. While ACTEW did not have the 'information or document' 'that amended ACTEW's main submission' as requested by the ICRC, it could have developed the 'information or document' and provided it to the ICRC. However, it is clear that ACTEW fundamentally disagreed with the ICRC's request that the information be provided. ACTEW's disagreement was based on various grounds, including that it did not wish to amend its main submission.

#### ***Escalation of issues and continuing impasse***

5.57 Following the issuing of the notice pursuant to section 41 of the ICRC Act by the ICRC on 23 August 2012 (refer to paragraph 5.32) and ACTEW's response on 31 August 2012 (refer to paragraph 5.38), a series of communications occurred between the ICRC and ACTEW throughout the latter half of 2012 in relation to this issue.

5.58 Key correspondence on the escalation of issues and the continuing impasse between the ICRC and ACTEW is presented in paragraphs 5.60 to 5.78. This correspondence is in chronological order and provides the context for the discussion in paragraphs 5.79 to 5.85

5.59 A key part of communication on this issue was a meeting that occurred between ACTEW representatives and ICRC representatives on 13 August 2012. This meeting is discussed in further detail in paragraphs 5.91 to 5.96 of this report.

#### **Letter from the ICRC to ACTEW, including the issue of a 'final notice' under section 41 of the ICRC Act (7 September 2012)**

5.60 On 7 September 2012 the Senior Commissioner of the ICRC sent a letter to ACTEW, which included a 'final notice' for the provision of the information, issued under section 41 of the ICRC Act. The letter stated:

**Re: FINAL NOTICE pursuant to Section 41 of the *Independent Competition and Regulatory Commission Act 1997***

This final notice requests again, and for the final time, the information outlined in that notice. We note that your response of 31 August 2012 failed to provide the required information, and appeared to fail to provide any reasonable excuse as to why you cannot comply with the notice.

There have been no material changes from schedule 1 of the notice of 23 August 2012 to schedule 1 of this final notice. We have sought to clarify the items in the schedule to the notice in light of your 31 August response to the notice.

In relation to item 1 in the schedule of the final notice, the Commission is requiring you to set out the information in table 13.6 to incorporate the pass-through amount in the proposed water revenue requirement. This may be done in an addendum. Secondly, this information is to be based on ACTEW Water's preferred time profile and appear with explanatory comments. With reference to your letter of 31 August 2012, we are not asking you to assess whether you may or may not provide the information based on whether a formal position has or has not been reached on the preferred time profile.

We also draw your attention to the requirements as set out in clause 7.1 of the Water and Wastewater Price Review - Final Report and Price Determination, Report 1 of 2008. To avoid all doubt, this item requires you - as well as item 1 of this notice - to provide the document or information in the form of table 13.6. Table 13.6 does not provide all the required information as it stands.

With reference to item 2 of the schedule to the notice and your letter of 31 August 2012, we are not requiring you to assess whether you may or may not provide the information on the basis of whether your modelling is accurate in the future.

With reference to item 3 of the schedule to the notice and your letter of 31 August 2012, we are not requiring you to assess whether you may or may not provide the information on the basis of whether your indicative tariffs are more accurately assessed at some other time.

The Commission will not accept any request for an extension, unless accompanied by a reasonable excuse.

We reiterate that the information required in the notice is for the purpose of assisting the Commission in exercising its functions under the Act in relation to the Independent Competition and Regulatory Commission (Regulated Water and Sewerage Services) Terms of Reference Determination 2011 for the regulatory period 2013-2018

- 5.61 The schedule to the 'final notice' that accompanied the letter was essentially the same as that which was initially provided on 23 August 2012 (refer to paragraph 5.34 of this report).

Letter to the ICRC from ACTEW's legal representatives (12 September 2012)

5.62 On 12 September 2012 ACTEW's legal representatives sent a letter to the ICRC. The letter stated:

**ACTEW Corporation - Response to final notice under section 41**

We act for ACTEW Corporation (**ACTEW**) and refer to:

- a) your letter of 7 September 2012 enclosing a notice purportedly issued under section 41 of the *Independent Competition and Regulatory Commission Act 1997 (ICRC Act) (Final Notice)*;
- b) your letter of 23 August 2012 enclosing an earlier notice under section 41 (**First Notice**); and
- c) ACTEW's letter of 31 August 2012 in response to the First Notice.

We note that there is no substantive difference between the First Notice and the Final Notice.

Consistently with ACTEW's letter of 31 August 2012, we are instructed that:

- a) ACTEW has no documents in its custody or control to give which fall within the description of the documents referred to in paragraphs 1 - 3 of the Schedule to the Final Notice.
- b) ACTEW has no information in its custody or control to give which falls within the description of the information referred to in paragraphs 1 - 3 of the Schedule to the Final Notice.

Therefore, the Commission's issue of the Final Notice is concerning insofar as it is either a misapprehension that section 41 of the ICRC [sic] can require ACTEW to create documents or information not presently in existence, or an unfounded allegation that ACTEW has failed to comply with obligations under the First Notice by not producing documents or information which it presently has.

In respect of the former, section 41 of the ICRC Act does not give the Commission power to require a person to create information or documents which are not yet in existence and instead provides for the giving of documents or information that a person "has" at the time of the issue of a notice.

Otherwise, section 41 only gives the Commission the power to issue a notice "*if the commission has reason to believe that a person has information or a document that may assist it in exercising its functions*" (emphasis added). By reason of ACTEW's letter dated 31 August 2012, the

Commission has been informed that ACTEW has no information or document answering the descriptions set out in the Schedule to Final Notice. Absent any basis upon which the Commission could reasonably otherwise form a belief that ACTEW has such information or documents (which it has previously withheld), the jurisdictional fact for the issue of the Final Notice is absent and the Commission ought not to have purported to issue the Final Notice.

Accordingly, please confirm by 2pm tomorrow, Thursday 13 September 2012 that the Commission withdraws the Final Notice.

Otherwise, we are instructed that ACTEW will separately correspond later this week in order to, in whatever way it can, assist the Commission with formulating the information it appears to desire.

Letter to ACTEW's legal representatives from the ICRC (13 September 2012)

- 5.63 On 13 September 2012, the Senior Commissioner of the ICRC sent a letter to ACTEW's legal representatives. The letter stated:

We refer to your letter dated 12 September 2012 re ACTEW Corporation - Response to final notice under section 41.

The Independent Competition and Regulatory Commission does not confirm item 6 of your letter. That is, the Independent Competition and Regulatory Commission is not withdrawing the section 41 notice. The Final Notice issued under section 41 of the Independent Competition and Regulatory Commission Act, stands.

Letter to the ICRC from ACTEW (14 September 2012)

- 5.64 On 14 September 2012 the Managing Director of ACTEW sent a letter to the ICRC. The letter stated:

I refer to our recent correspondence concerning two notices issued under Section 41 of under the ICRC Act.

As indicated in [legal representatives'] letter of 12 September, ACTEW has no document or information which meets the descriptions given in the two notices. ACTEW is, however, willing to assist the Commission in formulating the information it is seeking.

To that end, please find attached a preliminary analysis of the maximum bill impact in 2013-14, from a range of hypothetical tariff scenarios. Please note that none of these scenarios should be considered a proposal by ACTEW, and they do not reflect any preferred position of ACTEW. I again stress that ACTEW's proposal is that water tariffs be set on an annual basis, which is also consistent with our view in the 2008 review. These scenarios have been put together by ACTEW for the purposes of facilitating discussions between our organisations.

**Item 1 - Time profile for revenue pass-through**

As you know, ACTEW has no preferred time profile for the recovery of the pass-through. However, to assist the ICRC in its consideration of the issues, ACTEW makes the following general comments regarding the attached five scenarios for the recovery of the revenue pass-through in 2013-14, assuming alternatively:

- recovery over five years
- recovery over ten years
- recovery over a long period by treating the pass-through amount in the Regulated Asset Base “RAB”
- recovery over 30 years; and
- no recovery in 2013-14.

As stated in our main submission, ACTEW supports the option to limit the impact of the shortfall on customers. The bill impacts that would arise from recovery of the revenue pass-through over a five year period range from 21 to 33 per cent - a significant impact on customers and a position ACTEW does not support. The bill impacts that would arise from recovery of the revenue pass-through over a ten year period, although lower in magnitude, are also a significant impact to customers. The bill impacts under the other three options, which seek recovery over a longer period, are more consistent with ACTEW’s principle to limit the impact of the shortfall on customers.

ACTEW believes that recovery of the pass through over a longer period requires further consideration. In this regard, and following the preliminary advice in my letter of 31 August 2012, ACTEW proposes that the revenue pass-through be excluded from prices for the first two years of the regulatory period and that outcomes be monitored over those two years given climate and consumption uncertainty. A mid-term re-examination could be undertaken by the Commission with recovery over a long period if natural balancing has not resulted. This would provide a means to establish the degree and extent to which revenue pass-through would need to be pursued. While the details of such a review require further development, and we appreciate it does not provide any particular time profile for the recovery of the pass through, we are confident there is the necessary flexibility in the regulatory process for the adoption of such a solution, which may be of real benefit to customers. Necessarily, the application and scope of such a review mechanism, and ACTEW’s position on pass-through, would need to be developed and finalised with the ICRC in the context of the overall decision on our revenue claim.

**Clause 7.1 of the 2008 Price Direction**

In relation to the requirement for ACTEW to provide pass through information in accordance with clause 7.1 of the Final Determination 2008

(which was referred to in the Commission's letter of 7 September 2012), ACTEW will of course comply with its obligations under that determination.

However, ACTEW notes the following:

- a) The obligation to provide information on the revenue pass-through amount arises with the submission of tariffs. There is no established process in relation to the provision of proposed tariffs by ACTEW as part of ICRC investigations. As part of the Commission's 2008 investigation, ACTEW's main submission provided only an *indicative* tariff for the first year of the regulatory period. The appropriate timing of tariff *proposals*, if they are required at all, would depend on the form of regulation. Under some of the forms of regulation available to the Commission under Section 20A of the ICRC Act, tariffs would not be proposed until after the final determination. The Commission has not yet consulted or advised on any position or working conclusion on form of regulation. As detailed in ACTEW's main submission indicative tariffs for 2013-14 are to be provided in the response to the Commission's draft decision, consistent with the previous submission.
- b) In any event, the Commission's 2008 Final Report indicates that the Commission will determine the revenue pass-through amount 2012-13 and by implication the total amount. This determination has not yet taken place.

#### **Item 2 - Estimated annual water sales**

The Commission is aware that ACTEW does not currently have estimated annual water sales volumes for the 2013-18 regulatory period and that it will not have a proper forecast for 2013-14 volumes until after the summer of 2012.

Nonetheless, attached are three scenarios for water sales volumes (please note that these are not ACTEW's estimates - they are simply hypothetically assumed volume figures which are used for further calculations) based on the forecast used by the Commission to set prices for 2011-12 and 2012-13 of around 48 GL per annum, a forecast of 46 GL per annum and a forecast of 50 GL per annum.

Otherwise, as stated in previous correspondence and consistent with our main submission, the inclusion of five year water volumes at this time would be premature and provide an inaccurate result to our customers. We continue to support the annual pricing review with consumption forecasts developed in February once we have sufficient data from summer months. The water forecasting model developed by Professor Trevor Breusch and Professor Michael Ward would be used at this time.

**Item 3 - Proposed and indicative water tariffs**

ACTEW does not currently have any proposed water tariff for the period 2013 to 2018 and has committed to providing tariffs for 2013-14 in February 2013.

The scenarios attached to this letter include six tariff structure options - price step thresholds at 30, 40 and 50 kl per quarter, each with a water supply charge of either \$130 per annum or \$105.32 per annum (a CPI+3% increase) - please note that these have only been provided for the purposes of discussions with the ICRC and are not able to be taken as a proposal by ACTEW of any particular tariff.

ACTEW’s main submission balanced the recommendation from the Productivity Commission of a single tier price structure and the direct impact on customers. This was proposed through a reduced first tier step to 30 kl per quarter. The transition to this tariff structure would need to be managed to limit bill impacts in any one year. An approach that warrants consideration is a staged reduction in the price step threshold, initially to around 40 kilolitres per quarter in 2013-14. The impact of the increase in the supply charge to \$130 is modest relative to other factors and ACTEW considers that this change could take place in 2013-14.

ACTEW does not currently have any proposed water tariff for the period 2013 to 2018 and has committed to providing indicative tariffs for 2013-14 in February 2013. However, an indicative water tariff for 2013-14 is provided in the following table (again, this is not a proposal by ACTEW of a water tariff), based on the approach set out above (including no revenue pass-through in 2013-14). This scenario represents early management thinking and requires a considerable amount of analysis, with the potential that alternative options might also be developed with the ICRC.

**Indicative Water Tariff 2013-14**

<i>Tariff component</i>	<i>Price</i>
Supply charge	\$130 per annum
Tier 1 price for use up to 40kL per quarter	\$2.41 per kL
Tier 2 price for use thereafter	\$4.81 per kL

Further assumptions underlying this indicative tariff include an x-factor on all prices from 2014-15 of 3 per cent, a ratio of 2 between the tiered volumetric prices, and a nominal WACC of 9.14 per cent (which is reduced relative to the 2008 determination).

When combined with an indicative sewerage supply charge of \$658.03 for 2013-14, this tariff would result in a maximum bill impact of 10 percent and an average bill impact of around 3 per cent in real terms.

**Steps forward**

I wish to reiterate that the ACTEW Board recognises fully that its final price recommendation will involve the careful balancing of the revenue building blocks, community and shareholder value. It further understands that this may require price restraint and will be provided in the position in February.

We note the release of your Community Consultation Paper: Possible Price Outcomes on Thursday the 13<sup>th</sup> of September. We have concerns around some of the assumptions used and inaccuracies recorded within the paper. We will provide a response to these concerns and a submission will be provided to the paper.

ACTEW wishes to stress the importance it places upon the maintenance of a good relationship between our organisations and that it remains committed to ensuring the best outcome for the regulatory process. Accordingly, rather than further exchanges of legal correspondence, ACTEW proposes a meeting between its staff and the Commission's staff to discuss the matters above and progress in a timely and cost effective manner the creation of further information the Commission regards essential to the proper discharge of its functions. Equally, ACTEW is content to discuss what raw data it is able to provide as input to any modelling to be undertaken by the Commission.

Please do not hesitate to contact me if you wish to progress these discussions.

Letter to ACTEW from the ICRC (19 September 2012)

5.65 On 19 September 2012, the Senior Commissioner of the ICRC sent a letter to ACTEW. The letter stated:

The Independent Competition and Regulatory Commission (the Commission) acknowledges receipt of your letter dated 14 September 2012.

The Commission notes that ACTEW Corporation has not provided the information required under the Final Notice dated the 7th day of September issued under section 41 of the Independent Competition and Regulatory Commission Act and has not provided the Commission with a reasonable excuse for not furnishing the information required thereunder.

Letter to the ICRC from ACTEW's legal representatives (5 October 2012)

5.66 On 5 October 2012, ACTEW's legal representatives sent a letter to the ICRC. The letter stated:

**ACTEW Corporation ("ACTEW") - Notices under s 41 of the Independent Competition and Regulatory Commission Act ("Notices")**

We refer to your letter to ACTEW of 19 September 2012 concerning the Notices.

As requested in our email to...of 13 September 2012, kindly direct correspondence in respect of the Notices to our firm.

Your letter [of 19 September 2012] asserts that ACTEW "has not provided the information required under the Final Notice dated the 7<sup>th</sup> day of September issued under section 41 of the Independent Competition and Regulatory Commission Act and has not provided the Commission with a reasonable excuse for not furnishing the information required thereunder".

You have provided no explanation for this assertion.

However, as ACTEW has repeatedly indicated:

- a) it has no documents in its custody or control to give which fall within the description of the documents referred to in paragraphs 1 - 3 of the Schedule to the Notices; and
- b) it has no information in its custody or control to give which falls within the description of the information referred to in paragraphs 1 - 3 of the Schedule to the Notices.

Given the above, our client does not understand there to be any basis for the assertions contained in your letter. This is even more concerning given that ACTEW has, at all times, made its position clear as to what information it does possess, and has repeatedly offered to assist the Commission in otherwise formulating the information it seeks; offers which have, to date, not been addressed or acknowledged by the Commission.

As a result of your letter, ACTEW considered it appropriate to obtain written advice from Senior Counsel as to its compliance with the Notices. The advice of...is enclosed.

In light of the foregoing, our client requests that the Commission formally withdraw the assertions contained in your letter of 19 September. ACTEW reserves its rights should the Commission fail to do so.

In this regard, if the Commission has referred questions concerning ACTEW's compliance with the Notices to any other authority, kindly

ensure that this letter and its enclosures are provided to that authority.

Notwithstanding the above, our client again offers to meet with the Commission to determine what information it can provide to assist in the current inquiry.

5.67 The Senior Counsel advice referred to in the above legal representatives' letter stated: 'in our view...ACTEW has validly complied with the First Notice and Second Notice'. In providing the advice, the Senior Counsel noted that it was based on a series of assumptions. The Senior Counsel advice stated:

For the purpose of this opinion, we have been asked to make, and do make, the following assumptions:

- a) ACTEW has no document which amends its main submission in the ways requested by the Notices;
- b) ACTEW has no information which amends its main submission in the ways requested by the Notices; and
- c) as regards to the Schedule to each Notice:
  - i. in relation to item 1, ACTEW has no preferred time profile within which to incorporate the pass through amount. ACTEW maintains that (A) the time scale over which to incorporate the pass through amount and (B) the amount of revenue to pass through which should be allowed, are matters that should be decided by the Commission after deliberation and consultation with the ACT Government, ACTEW and the community;
  - ii. in relation to item 2, ACTEW has not adopted any estimated annual water sales volumes for the 2013-18 period. The model that ACTEW has developed will only provide an accurate estimate of water consumption for the period 2013-2014 after the summer of 2012-2013 (that is, when further consumer usage data is known). If ACTEW used its model now to create any estimate of annual water volumes that estimate would be inaccurate and would provide a flawed basis for setting tariffs for the next regulatory period; and
  - iii. in relation to item 3, ACTEW has no proposed water tariff for the period 2013-2014, and no indicative water tariffs for the rest of the regulatory period, due to the lack of information on pass through and estimated annual water sales, as set out in paragraphs (i) and (ii) above. However, ACTEW has provided draft scenarios and water tariffs to the Commission for consideration.

Letter to ACTEW from the ICRC (16 October 2012)

- 5.68 On 16 October 2012 the Chief Executive Officer of the ICRC sent a letter to ACTEW's legal representatives. The letter stated:

We refer to your letter dated 5 October 2012. In that letter you refer to [the ICRC Senior Commissioner's] letter to [the ACTEW Managing Director] dated 19 September 2012. This letter was a response to [the ACTEW Managing Director's] letter to [the ICRC Senior Commissioner] dated 14 September. We request that you kindly direct any correspondence on this matter to the Chief Executive of the Commission...

Your letter provided an opinion from counsel on whether ACTEW has validly complied with the section 41 notices that the Commission has issued to it. You point out that counsel concludes that ACTEW has validly complied with the notices issued to it. We note, that this conclusion rests on a number of assumptions that counsel was asked to make. In summary, these assumptions amount to the proposition that ACTEW has no document or information conforming to the requirements of the notice.

We note that assertions in substantially similar terms have been made in earlier correspondence from ACTEW on this matter. The difficulty for the Commission, however, is that statements made by Mr Sullivan and ACTEW Corporation in meetings, letters and publicly available documents, such as its statement of corporate intent, could readily be taken to indicate that the information required to be provided under the notice is in the possession of ACTEW.

If the Commission is to reconsider its position on the basis of the opinion of counsel that you have provided, the Commission needs to be confident that the assumptions on which that opinion rests accurately represent the facts upon which that opinion was provided. The Commission would accept statutory declarations from the chairman of the board and chief executive of ACTEW couched in the same terms as paragraph 6 of counsel's opinions as resolving this doubt. This would go towards removing an obstacle to the Commission reconsidering its position in the light of counsel's advice. The sooner such declarations are received, the sooner the Commission can reconsider its position.

Email to the ICRC Senior Commissioner from ACTEW Managing Director (16 October 2012)

- 5.69 On 16 October 2012 the Managing Director of ACTEW sent an email to the Senior Commissioner of the ICRC. The email stated:

I am sure that people are putting to you a similar message to what others are putting to me. We are wondering what game each of our organisations are up to.

I do want to assure you that ACTEW (nor I) are playing games and I believe that you would not be acting in anyway but what you think is appropriate for the Commission.

In the end the impasse that has developed needs to be solved by you and I. I am committed to attempting to do this. It may be that we need assistance from an independent third party. I have been thinking about the sort of person who could be useful and one name that I have thought of is... [They are] pragmatic with a good legal mind. I do not know how you would react to such a proposition or whether you have other ideas about how we could proceed or other possible assistance. (I have of course not approached...)

I have not consulted lawyers or my colleagues in sending this email. If you are not keen on pursuing a less formal resolution I would understand and ask that you regard this as private and confidential communication.

5.70 The Senior Commissioner of the ICRC did not respond to this email.

Letter to the ICRC from ACTEW's legal representatives (30 October 2012)

5.71 On 30 October 2012, ACTEW's legal representatives sent a letter to the ICRC. The letter stated:

**ACTEW Corporation - Response to final notice under section 41**

We refer to our letter dated 5 October 2012, enclosing ACTEW's legal opinion from Counsel ("**Counsel's Advice**") and to the Commission's letter in response dated 16 October 2012.

We confirm that the assumptions provided to Counsel were:

- a) consistent with statements that have been made by ACTEW to the Commission in response to the Notices, some 5 times (in correspondence of 17 August 2012, 31 August 2012, 12 September 2012, 14 September 2012 and most recently in our letter of 5 October 2012);
- b) also consistent with statements ACTEW has made in its initial confidential submission to the Commission (dated July 2012).

Our client is greatly concerned at the suggestion in your 16 October 2012 letter that the Commission "*needs to be confident*" that these statements by ACTEW "*accurately represent the facts*". This is the first time that the Commission has plainly indicated that the basis for its previous assertions that ACTEW has failed to comply with the Notices did not proceed from a difference as to the proper construction of the *Independent Competition and Regulatory Commission Act 1997* ("**ICRC Act**") (which has now been addressed by Counsel's Advice), but were instead predicated upon a concern that ACTEW is wilfully failing to provide information to, and otherwise seeking to mislead, the Commission. In this regard, ACTEW's

Board and Management have always understood the need for these statements to the Commission to be correct, given both ACTEW's responsibilities under the ICRC Act and their own statutory and general law obligations. It was for that reason that ACTEW's Board and Management ensured that there were thorough enquiries within the business before the statements were made.

Accordingly, given the gravity of the allegations now advanced by the Commission and notwithstanding that the Chairman and Managing Director of ACTEW have no in principle objection to providing statutory declarations, ACTEW requires that the Commission identify, with particularity, those "*statements made by Mr Sullivan and ACTEW Corporation in meetings, letters and publicly available documents*" that "*could readily be taken to indicate that the information required to be produced under the notice is in the possession of ACTEW*", and on which the Commission has (acting reasonably and in good faith) relied upon in both forming the belief and advancing allegations that ACTEW has not complied with its obligations under s 41 of the ICRC Act, notwithstanding ACTEW's statements in its July Submissions, and correspondence of 17 August 2012, 31 August 2012, 12 September 2012, 14 September 2012 and 5 October 2012.

Once the information identified in paragraph 4 above has been provided, ACTEW will consider the appropriateness of the provision of any statutory declarations by its Chairman and Managing Director and what further steps ACTEW may take in respect of this matter.

Letter to ACTEW's legal representatives from the ICRC (2 November 2012)

5.72 On 2 November 2012 the Chief Executive Officer of the ICRC sent a letter to ACTEW's legal representatives. The letter stated:

We refer to your letter dated 30 October 2012 where you refer to our letter of 16 October 2012.

The commission, we note, is under no obligation under s.41 of the Independent Competition and Regulatory Commission Act to provide the basis for the issuance of the notice. We also note that comments made in paragraph 3, lines 4 and 5 of your letter which appear to state your client's interpretation of the basis of the issuance of the s.41 notices. It was your client who sought legal advice on the validity of the notices issued under s.41. We would appreciate you amending your records accordingly.

We would also appreciate you amending your records to correct the statement in lines 6, 7 and 8 of paragraph 3 to reflect that the commission has not in any public statements, meetings or correspondence stated, implied or referred to your client wilfully failing to provide information to, and otherwise seeking to mislead, the commission.

We have not made allegations in our letter of 16 October 2012, in any

correspondence or meetings with your client, ACTEW Water or in any other forum.

The information referred to your paragraph 4, is information that is within your client's possession or experience (that is meetings requested and attended by Mr Mark Sullivan), indeed the information referred to was created by your client.

We also note that the Chairman and Managing Director of ACTEW have no objection in principle to providing a statutory declaration to the effect noted in our letter of 16 October 2012. We therefore look forward to receiving such declarations.

We take this opportunity to note the delay this has caused to the 2013-2018 regulatory price determination.

Letter to the ICRC from ACTEW's legal representatives (26 November 2012)

5.73 On 26 November 2012 ACTEW's legal representatives sent a letter to the ICRC. The letter contained extensive commentary which sought to 'detail the background and correspondence between ACTEW and the Commission, insofar as these support the confirmations and assurance that ACTEW seeks below.' This commentary has not been replicated in this report, however, the latter part of the letter stated:

**Letter of 2 November 2012**

*Obligations to provide basis*

In the 2 November Letter, the Commission states that it "*is under no obligation under s.41 of the Independent Competition and Regulatory Commission Act to provide the basis for the issuance of the notice.*" ACTEW accepts that the ICRC Act does not contain any express obligation on the Commission to provide reasons for the issue of any notice pursuant to section 41 of the Act. Nonetheless, the power to issue a notice pursuant to section 41 only arises if "*[t]he commission has reason to believe that a person has information or a document that may assist it in exercising its functions*".

As set out above, the Commission has been consistently informed that ACTEW does not have information or documents in its possession as requested by the Notices. Responses to this effect were provided to the Commission on each of 17 August 2012, 31 August 2012, 12 September 2012, 5 October 2012 and 30 November 2012. Despite this, the Commission has maintained its position that the Final Notice was properly issued (and refused to withdraw it). In these circumstances, ACTEW is entitled to inquire as to the basis of the Commission's reasonable belief in this regard, and does not understand why the Commission refuses to provide this. The request is reasonable, and the Commission's basis for the issue of the Notices is directly relevant to questions of whether the Notices are validly issued pursuant to section 41 of the ICRC Act and to

the further matters set out in section 3 below.

*Our client's interpretation of the issue of the notices*

The 2 November Letter states *"the comments made in paragraph 3, lines 4 and 5 of your letter which appear to state your client's interpretation of the issuance of the s.41 notices."*

In the [legal representatives'] letter of 12 September 2012, the two bases upon which ACTEW assumed that the Commission had issued the Final Notice were plainly stated. Either the Commission believed that it had the power to compel the production of documents or information not presently in existence, or it believed that ACTEW possessed the documents or information, but had failed to produce them pursuant to the Notices (notwithstanding representations by ACTEW to the contrary). The Commission did not address these statements and ACTEW proceeded to obtain, and subsequently divulge, legal advice from Counsel as to its compliance with section 41 of the ICRC Act. This would not have been necessary if the Commission had indicated, in its correspondence of 13 September 2012 or 19 September 2012, the basis upon which the Final Notice was issued. It is ACTEW's understanding, based on the Commission's correspondence of 16 October 2012 and 2 November 2012, that the basis for the issue of the Final Notice was the Commission's belief that ACTEW did in fact possess the information and documents sought and had not disclosed these. The only basis the Commission has identified for such a belief is the suggestion that the, as yet unidentified, allegedly inconsistent public statements are (when viewed reasonably and in good faith) such as to permit the Commission to reject repeated representations by ACTEW as to the non-existence of the information required by the Final Notice. Please let us know by return if, and how, this understanding is incorrect.

*Implications that ACTEW has wilfully failed to provide information*

The Commission's letter of 2 November 2012 states that *"the commission has not in any public statements, meetings or correspondence stated, implied or referred to your client wilfully failing to provide information to, and otherwise seeking to mislead, the commission."*

This is incorrect. As set out above, ACTEW has on numerous occasions made representations to the Commission as to the fact that it is not in possession of the documents or information sought. If the Commission accepted the truthfulness of these representations, then there could be no basis for the Commission to issue the Final Notice, nor to state, as it has in its letters of 19 September 2012 and 16 October 2012, that ACTEW has not complied with that Notice. The issue of the Final Notice, the Commission's letters of 19 September 2012 and 16 October 2012 and the highly unusual request for statutory declarations from ACTEW's Chairman and Managing Director plainly indicate that the Commission does not accept that the representations made by ACTEW as to its possession of the information requested are true.

*Information in the possession of our client*

The 2 November Letter also states that the information sought from the Commission in the [legal representatives'] letter of 30 October 2012 is "information that is within your client's possession or experience". This is misconceived. ACTEW has attempted, in good faith, to understand the Commission's concerns with a view to assessing their merits and addressing them. The Commission has suggested that the allegedly inconsistent statements "could readily be taken to indicate that the information required to be provided under the notice is in the possession of ACTEW". ACTEW has assumed that the Commission is able to identify the specific statements and documents that, viewed reasonably and in good faith, could support this statement. If the Commission cannot, then it is difficult to understand the proper basis upon which the Commission has issued the Final Notice, made subsequent statements as to ACTEW's alleged non-compliance with that notice and requested the statutory declarations.

*Requested Statutory Declarations*

In the 2 November Letter, the Commission has re-iterated its request that ACTEW's Chairman and Managing Director provide statutory declarations. As noted in the [legal representatives'] letter of 30 October 2012, ACTEW will not permit its Chairman and Managing Director to provide such voluntary statutory declarations unless the Commission identifies, with particularity, the basis for its belief that ACTEW has not complied with its obligations under s41 of the ICRC Act - namely the allegedly inconsistent statements.

*Delay*

The Commission's letter of 2 November 2012 states "[w]e take this opportunity to note the delay this has caused to the 2013-2018 regulatory price determination."

Respectfully, none of the actions of ACTEW or its management has any way delayed the activities of the ICRC or the consideration of the 2013-2018 regulatory price determination. Indeed, the provision of statutory declarations (as requested) could not be a relevant consideration as to the 2013-2018 regulatory price determination, and the failure to provide such declarations should not properly be a cause for any delay to this decision.

**Issues of Concern**

We note that the powers afforded the Commission pursuant to the ICRC Act are powers that may only be used in the exercise of the Commission's functions under that Act - specifically in relation to the Determination. In making the Determination or exercising these powers, the Commission must not act for an improper purpose, nor must it take into account irrelevant considerations. The Commission must also abide by principles of natural justice. The Commission does not have any power to

investigate or enforce compliance with section 41 of the ICRC Act and such activity would not be in proper discharge of its statutory function.

In light of the matters identified in sections 1, 2 and 3.1 of this letter, ACTEW presently has no alternative but to conclude that:

- a) the Commission is presently engaged in the making of Determination;
- b) the Commission has issued First and Final Notices in the course of making the Determination;
- c) the Commission considers that ACTEW has in its possession information of the type described in the First and Final Notices, notwithstanding the repeated statements to the contrary made by ACTEW and its legal advisors;
- d) the Commission presently considers that ACTEW or its officers have knowingly:
  - i. withheld that information from the Commission;
  - ii. refused to comply with s 41 of the ICRC Act;
  - iii. made untrue statements to the Commission as to the non-existence of the information;
- e) the Commission considers that the non-production by ACTEW of statutory declarations from its Chairman and Managing Director has delayed the preparation of the Determination;
- f) in making the Determination, the Commission proposes to:
  - i. have regard to the matters in sub-paras (c) - (e) above; and/or
  - ii. rely upon those matters;
- g) prior to making the Determination, the Commission is unwilling to identify the allegedly inconsistent statements to ACTEW.

If the above conclusions are correct, the making of the Determination will be infected by reviewable error (including for taking into account irrelevant considerations and breaching the rules of natural justice).

**Next steps**

As the Commission is aware, ACTEW is an unlisted public company owned by the ACT Government, whose voting shareholders are the Chief Minister and Deputy Chief Minister of the ACT. If possible, ACTEW believes that it would be preferable to avoid any proceedings that would result in the expenditure of what is, essentially, public money. In the circumstances, ACTEW requests that the Commission provide the following confirmations

and assurances:

- a) that, in making the Determination, the Commission will not take into account the matters identified in paragraph 3.2 (c) - (e) above;
- b) that, in performing its functions, the Commission will, absent credible evidence to the contrary, regard representations made by ACTEW as being made honestly and in good faith; and
- c) that the Commission withdraws any contention that ACTEW has not complied with either the First or Final Notice, or, alternatively, the Commission confirms that such compliance is not properly a matter to which the Commission should have regard in the exercise of its functions under the ICRC Act with respect to Determination.

Our client requires the above confirmations and assurances in order to provide it with sufficient comfort that the Determination will not be based on a consideration of irrelevant matters and will otherwise be carried out properly and according to law.

We look forward to your response.

Email from the Managing Director of ACTEW to the ICRC (28 November 2012)

5.74 On 28 November 2012 the Managing Director of ACTEW sent an email to the Senior Commissioner of the ICRC. An ActewAGL staff member involved in the water and sewerage pricing investigation was copied in to the email. The email included a forwarding of the previous email of 16 October 2012, sent by the Managing Director of ACTEW to the Senior Commissioner of the ICRC, and a new message as follows:

I am hoping that you will agree to a meeting to discuss the progress of the determination process and any other issues. I would propose that [ActewAGL staff member] would accompany me. If you agree I will make the necessary arrangements.

5.75 The Senior Commissioner of the ICRC did not respond to this email.

Letter to ACTEW from the ICRC (24 December 2012)

5.76 On 24 December 2012 the Chief Executive Officer of the ICRC sent a letter to ACTEW's legal representatives. The letter stated:

I refer to your letter of 26 November 2012.

With reference to your paragraph 4.1(a), the Commission notes that the allegations made in paragraph 3.2(f), namely that the Commission proposes to have regard to the matters in paragraph 3.2(c) - (e) and/or

rely upon those matters, are made with no foundation. The commission recognises that the making of a price determination and compliance with and enforcement of a section 41 notice are two quite separate and distinct matters. The Commission has not conflated the two issues and has no intention of conflating the two issues.

I refer to your paragraph 4.1(b) where you request assurances from the Commission that absent credible evidence, the Commission will regard representations by ACTEW as being made honestly and in good faith. The Commission approaches material presented to it objectively, assessing it on its merits. The Commission reserves the right subject to any information presented to it to whatever level of scrutiny and analysis it deems necessary to carry out its statutory functions.

With regard to your paragraph 4.1(c), requesting that the Commission withdraw any contention that ACTEW has not complied either with the first or final notice or that such compliance is not properly a matter to which the Commission should have regard in the exercise of its functions under the Act with respect to the determination, I assure you that the Commission is and will properly discharge its responsibilities, including those arising under statute in responding to the reference provided to the Commission by the Treasurer on 13 October 2011.

Meeting between the ICRC and ACTEW (22 February 2013)

- 5.77 ACTEW advised the Audit Office that a meeting occurred between representatives of the ICRC and ACTEW on 22 February 2013. At the meeting, the ICRC 'provided ACTEW with an embargoed draft decision and foreshadowed that it would withdraw the section 41 notice.'

Letter from the ICRC to ACTEW, including the withdrawal of the notice issued under section 41 of the ICRC Act (26 February 2013)

- 5.78 On 26 February 2013 the Chief Executive Officer of the ICRC provided a notice to ACTEW which stated:

**NOTICE OF WITHDRAWAL WITHOUT PREJUDICE OF NOTICE PURSUANT TO SECTION 41 OF THE INDEPENDENT COMPETITION AND REGULATORY COMMISSION ACT, 1997**

PLEASE TAKE NOTICE that the Independent Competition and Regulatory Commission (Commission), hereby withdraws the Notice Pursuant to Section 41 of the Independent Competition and Regulatory Commission Act 1997, issued to ACTEW Corporation dated 23 August 2012. For completeness, the Final Notice Pursuant to Section 41 of the Independent Competition and Regulatory Commission Act 1997, issued to ACTEW Corporation dated 07 September 2012 is also withdrawn. The Commission released its draft Report into Water and Wastewater Services and Draft Price Determination on 26 February 2013. The information required to be produced under the notices is therefore no longer

required.

The Commission withdraws the Notices without prejudice.

### Audit Office conclusions

- 5.79 There was a difference in the expectations of the ICRC and ACTEW with respect to the nature of the information to be provided by ACTEW as part of the water and sewerage pricing process. It is apparent that the ICRC sought information from ACTEW and that, for various reasons, ACTEW did not wish to provide this information to the ICRC. This difference in expectations was never satisfactorily resolved between the ICRC and ACTEW. Other issues, including assumptions underpinning the different entities' expectations and understanding of the process, were never effectively communicated.
- 5.80 The Audit Office notes that the ICRC Act does not, with the exception of section 41 in Part 7, provide the ICRC with authority to compel the provision of information as part of a price investigation process. That is, the ICRC Act does not allow the ICRC to compel a party (including ACTEW) to provide a submission, nor does it allow the ICRC to identify the nature and type of information to be provided in the submission. Section 41 of the ICRC Act does provide the ICRC with authority to compel the provision of information, but only 'if the commission has reason to believe that a person has information or a document that may assist it in exercising its functions.' Section 41 does not provide the ICRC with the authority to compel an entity (including ACTEW) to bring into existence any document or information.
- 5.81 Notwithstanding the provisions of the ICRC Act, the ICRC expected ACTEW to provide at least some of the information, i.e. the information relating to the pass-through amount and proposed tariffs, by virtue of Section 7.1 of the 2008 price direction. In this respect, however, section 7.1 of the 2008 price direction did not impose an obligation on ACTEW to provide the information that the ICRC was seeking. According to Australian Government Solicitor's advice to the Audit Office 'the obligation imposed is not an obligation to submit tariffs. What section 7.1 requires is that when ACTEW is submitting proposed tariffs it must include a revenue pass through amount. Accordingly it is only at that point that any mandatory obligation could be triggered.' Accordingly, the Audit Office considers that there was no obligation on ACTEW to provide the information that the ICRC was seeking.
- 5.82 The ICRC sought to compel the provision of the information through the issue of notices under section 41 of the ICRC Act. In doing so, the notices that were issued by the ICRC sought to compel ACTEW to amend its main submission. The notices issued by the ICRC required ACTEW to provide 'the document or information which amends...its main submission.' The Audit Office is satisfied that ACTEW did not have 'the document or information which amends...its main submission.'

5.83 Notwithstanding the conclusion that ACTEW did not have 'the document or information which amends...its main submission' ACTEW consistently advised that it was willing to provide the ICRC with information that would assist the ICRC undertake its investigation. In communication with the ICRC throughout the latter part of 2012, ACTEW provided similar advice to that which was provided in a letter of 31 August 2012:

ACTEW is very willing to support and assist the Commission's consultation process and notes that the revenue pass through and consumption forecasting issues could both benefit from this approach. To this end, ACTEW suggests that it could work up a range of indicative water prices for 2013-14 to 2017-18 based on its proposed cost building blocks and a continuation of Commission decisions currently in force, including water volumes forecasts used by the Commission to set prices for 2011-12 and 2012-13 and include scenarios for the pass-through of foregone revenue with the appropriate caveats.

5.84 ACTEW's proposed approach was not acceptable to the ICRC.

5.85 In order to resolve this apparent difference in expectations, there is merit in the ACT Government, in consultation with the ICRC and ACTEW, developing principles, policy and procedural guidance for the conduct of water and sewerage pricing investigations. This would provide a framework for future water and sewerage pricing investigations, and would assist in outlining the information that is expected to be provided by stakeholders, including ACTEW.

#### **Recommendation 5 (Chapter 5)**

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- d) protocols for the provision of information required, including outlining the type and nature of information to be provided by ACTEW as the regulated entity;

#### **ICRC ASSERTIONS ON ACTEW'S MOTIVATIONS FOR WITHHOLDING INFORMATION**

5.86 Notwithstanding that the Audit Office is satisfied that ACTEW did not have information or documentation 'that amends...its main submission' as requested by the ICRC, for completeness the Audit Office has also considered the assertions made by the ICRC with respect to ACTEW's motivations.

#### ***Evidence in support of the ICRC's assertions***

5.87 In October 2012 the ICRC provided a series of documents to the Audit Office in support of its assertions that ACTEW was not cooperating in the water and sewerage pricing process. The documents provided to the Audit Office included:

- correspondence to and from ACTEW and the ICRC; and

- a file note, produced by ICRC representatives, on a meeting that occurred on 13 August 2012.
- 5.88 While the documentation provided by the ICRC refers to, and provides support for, the fact that there was ongoing disagreement between ACTEW and the ICRC on the provision of the information, the only documents provided by the ICRC that refer to the forthcoming ACT Legislative Assembly election are:
- an email from the Managing Director of ACTEW to the ICRC on 9 August 2012 (refer to paragraph 5.28); and
  - an ICRC file note in relation to a meeting that occurred on 13 August 2012, which directly refers to the forthcoming ACT Legislative Assembly election.
- 5.89 None of the other documents provided by the ICRC, with the exception of the covering letter for the information provided, directly refers to the forthcoming ACT Legislative Assembly election or provides documentary evidence for its assertions.
- 5.90 In the course of the audit, no other documentary evidence was provided by the ICRC in support of its assertions with respect to the forthcoming ACT Legislative Assembly election as a potential motivation for ACTEW's actions in response to the ICRC's requests for information.

### Meeting of 13 August 2012

- 5.91 A meeting occurred on 13 August 2012 between ACTEW representatives and ICRC representatives. While individual participants' recollection of attendees at the meeting sometimes differed, there was general consensus, and other evidence, to support that there were four attendees at the meeting from the ICRC and three attendees at the meeting from ACTEW (and ActewAGL). The Audit Office interviewed all participants at the meeting under oath or affirmation, pursuant to section 14A of the *Auditor-General Act 1996*.
- 5.92 According to attendees, only the Managing Director of ACTEW and the Senior Commissioner of the ICRC spoke at the meeting. Attendees' recollections of the meeting differed on the key issue of whether ACTEW, and the Managing Director of ACTEW, was not providing the information, as requested, because 'ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election.' While all attendees recalled that the issue of the forthcoming election was raised by the Managing Director of ACTEW during the meeting, recollections differed with respect to the manner in which the issue was raised and the purpose for which the issue was raised. Attendees at the meeting variously recalled that:

- the Managing Director raised the issue of the forthcoming ACT Legislative Assembly election as a reason for not providing the information to the ICRC; or
- the Managing Director identified the caretaker conventions, associated with the forthcoming election, as placing constraints on the extent to which ACTEW could provide information as part of the water and sewerage pricing process.

**ICRC file note in relation to the meeting**

5.93 A file note in relation to this meeting was produced by the ICRC attendees. The file note was produced by an ICRC staff member on 12 September 2012 and amended by the ICRC Chief Executive Officer on 15 September 2012. The month delay in producing the file note is a mitigating factor with respect to its accuracy.

5.94 There is, nevertheless, a close correlation with the *issues* documented in the ICRC file note and the *issues* documented in the ICRC staff member's handwritten notes of the meeting. A notation on the ICRC file note states 'these notes reflect words to the effect of rather than an exact word for word record.'

5.95 ACTEW representatives at the meeting advised that a record of the meeting was not made by ACTEW. The Audit Office did obtain the hand-written notes of two ACTEW or ActewAGL meeting attendees. The hand-written notes of the ACTEW / ActewAGL representatives document many of the issues discussed during the meeting and do not provide support for the assertions made by the ICRC.

5.96 The Audit Office considers that the ICRC file note provides limited support for the assertions made by the ICRC. The ICRC file note:

- recognises and documents the arguments consistently put forward by ACTEW in correspondence for not providing the information. These include:
  - reservations with respect to long-term forecasts and a preference for providing a forecast in early 2013, after the summer; and
  - complaints with respect to the previous 2008 price determination (and the perceived problems it had caused for the current process), specifically with respect to the \$238 million revenue shortfall and that the ICRC was expecting ACTEW to provide its view on how to address this issue;
- recognises and documents the ACTEW Managing Director's reservations that ACTEW was being asked to provide information that goes beyond the information provided in ACTEW's July 2012 submission, which was approved and endorsed by the ACTEW Board; and

- recognises and documents the ACTEW Managing Director's reservations with respect to the forthcoming ACT election and the implications of the caretaker conventions for ACTEW and the provision of the information. These include the need for the Managing Director to consult with the ACTEW Board with respect to amending ACTEW's submission, concern that the Board would not adopt a position without consulting with the shareholders (the then Chief Minister and Treasurer) and a recognition that potential shareholders would also need to be consulted.

### *Caretaker Conventions in the ACT*

5.97 According to the ACT Government's *Guidance on Caretaker Conventions* (updated in September 2012) 'it is the accepted practice of State, Territory and Commonwealth Governments in Australia that special operating arrangements apply in the caretaker period immediately before and after an election.' According to the *Guidance on Caretaker Conventions* 'successive Australian Capital Territory Governments have followed a series of accepted practices, known as "caretaker conventions", which aim to ensure that their actions do not bind an incoming government and limit its freedom of action'. Caretaker conventions primarily ensure that the government avoids making major policy decisions that are likely to commit an incoming government.

5.98 Paragraph 3(a) of the ACT Government's *Guidance on Caretaker Conventions* provides:

The Government should avoid taking major policy decisions likely to commit an incoming government. What constitutes a major decision is a matter of judgement, but relevant considerations include not only the significance of the decision in terms of policy and resources, but also whether the decision is a matter of contention in the election campaign.

5.99 Paragraph 3(a) further provides:

If circumstances require the Government to make a major policy decision during the caretaker period that would potentially commit an incoming government, this should be done in consultation with the relevant opposition and cross bench spokesperson.

5.100 Caretaker conventions for the 2012 ACT Legislative Assembly election formally commenced on 14 September 2012.

5.101 There is limited guidance in the *Guidance on Caretaker Conventions* on the type of information covered by caretaker conventions. The document notes it 'is a matter of judgement' and considerations include 'whether the decision is a matter of contention in the election campaign' and whether it is a major policy decision that is 'likely to commit an incoming government.'

- 5.102 There is a need for further and more detailed guidance to be provided on the type of information covered by caretaker conventions, including for information to be provided through processes such as the water and sewerage price investigation.

**Recommendation 7 (Chapter 5)**

The ACT Government should provide more detailed guidance to ACT Government entities, specifically territory-owned corporations and statutory authorities, on protocols during the caretaker period.

**Audit Office conclusions**

- 5.103 Assertions made by the ICRC that ACTEW deliberately withheld information from the ICRC in the course of the water and sewerage pricing process, including that ‘whilst it was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election’ is not supported by evidence. Accordingly, the ICRC’s view that ‘the actions or inactions of ACTEW [posed] a threat to the public interest’ is also not supported.
- 5.104 In support of this conclusion the Audit Office notes:
- while there was agreement amongst attendees at a meeting on 13 August 2012 that the Managing Director of ACTEW raised the issue of the caretaker conventions associated with the forthcoming election, attendees’ recollections differed on the manner in which the issue was raised and the purpose for which the issue was raised; and
  - the ICRC file note that was produced in relation to the meeting is problematic because it was not:
    - a contemporaneous account of the meeting as it was produced approximately one month after the meeting occurred; or
    - shared with ACTEW for verification.
- 5.105 The file note also documents a range of different reasons put forward by ACTEW for not providing the information, as requested, to the ICRC, which is consistent with other correspondence from ACTEW to the ICRC.
- 5.106 It is apparent that there was consistent information and reasoning put forward by ACTEW for not providing the information as requested by the ICRC. These reasons were put forward in correspondence to the ICRC from ACTEW and were also documented by the ICRC in its file note for the meeting on 13 August 2013.
- 5.107 The Audit Office also recognises testimony, under oath or affirmation pursuant to section 14A of the *Auditor-General Act 1996*, from the Senior Commissioner of

the ICRC who stated that he believed that the comments made by the ACTEW Managing Director during the meeting of 13 August 2012 in relation to the forthcoming election were off the cuff comments and that the Senior Commissioner did not place any specific emphasis on the comments at the time of the meeting. The Senior Commissioner of the ICRC advised the Audit Office:

[The Managing Director of ACTEW] had made several different attempts to explain why he couldn't do what we were asking him to do, and this was simply one in a string.

- 5.108 The Senior Commissioner of the ICRC further advised that it was not clear, at the conclusion of the meeting, as to whether ACTEW was going to provide the information or not. Accordingly it was only later, when ACTEW made it clear through correspondence to the ICRC that it would not provide the information, as requested by the ICRC, that the ICRC placed emphasis on the comments made by the Managing Director of ACTEW in the meeting:

... bear in mind that at the time of the meeting, we didn't know that ACTEW were going to refuse to provide the information... The conclusion of the meeting was that I think as is recorded on the file note, that ACTEW would respond to our request that was given to them in the form of a letter within the timelines that that letter specified. You could have left the meeting...thinking the information was going to be provided, although that was not explicitly said. We didn't know whether the information would be provided or not, until the letter was received. When the letter was received, it was clear the information we sought hadn't been provided. Which obviously puts the comments that were made in the meeting in a somewhat different perspective.

### OPTIONS FOR ADDRESSING THE ICRC'S CONCERNS

- 5.109 The ICRC has made serious assertions about the actions of the Managing Director of ACTEW.
- 5.110 The Audit Office considers that the way in which the ICRC's initial concerns about the actions of the ACTEW Managing Director were raised was inappropriate. As noted in paragraph 5.2, concerns were indirectly raised with Audit Office staff members in the course of a meeting on 27 September 2012 on an un-related matter (the 2011-12 financial statements audit process). While the comments made in the course of this meeting may have been interpreted as off the cuff comments on the part of ICRC Chief Executive Officer, they were immediately followed up by the Auditor-General and senior Audit Office staff members in a series of meetings on 4 October 2012 and 9 October 2012. The assertions were reiterated during these meetings and the ICRC provided documentary information in support of its assertions and a letter of request to consider the actions of ACTEW on 19 October 2012.
- 5.111 While it is appropriate for matters such as this to be raised with the Auditor-General or senior Audit Office staff members, the matter should have been

raised in a more considered way, rather than indirectly in the course of a meeting on an unrelated issue.

- 5.112 Furthermore, the ICRC's concerns with respect to the actions of the ACTEW Managing Director, which primarily derived from comments made in the course of a meeting on 13 August 2012, were raised with the Audit Office over six weeks after that meeting. As noted in paragraph 5.107 and 5.108 of this report, however, the Senior Commissioner of the ICRC did not place any specific emphasis on the comments at the time of the meeting.
- 5.113 Options for consideration and resolution of such issues can be through various channels, including:
- the Chairman of the ACTEW Board of Directors;
  - the Head of Service;
  - the Commissioner for Public Administration; and
  - Ministers.
- 5.114 As noted in paragraph 5.111, raising the issue directly with the Auditor-General or senior Audit Office staff in a more considered way is an appropriate option.
- 5.115 The ICRC's concerns and assertions were never raised directly with the Managing Director of ACTEW. The ICRC's concerns were first communicated to the Managing Director of ACTEW by the Audit Office in January 2013. Given that the ICRC's assertions are not supported by the evidence, and that considerable time and effort has been expended to investigate the issue, it would have been more prudent to seek to resolve issues through direct and ongoing communication with ACTEW at the time, perhaps through an independent mediator. If the ICRC was uncomfortable in doing so, given the seriousness of the assertions, it could have sought the assistance of any of the other entities in paragraph 5.113 or the Auditor-General.

### Dispute resolution options

- 5.116 Notwithstanding the ICRC's assertions with respect to the Managing Director of ACTEW, it is apparent that there was a breakdown in the relationship between ACTEW and the ICRC during the water and sewerage pricing process. Correspondence between ACTEW and the ICRC and other documented evidence indicates that there were fundamental differences in expectations and assumptions of the agencies, as well as fundamental disagreement on the obligations of ACTEW in the water and sewerage pricing process.
- 5.117 There is merit in putting in place a process for mediation or dispute resolution in water and sewerage pricing processes. This is likely to assist in resolving differences early and removing the risk of an inefficient and ineffective process, which has occurred in this instance (refer to Chapter 6).

### Recommendation 5 (Chapter 5)

The ACT Government, in consultation with key stakeholders, should develop a set of principles for the conduct of water and sewerage pricing investigations in the ACT. The principles should include:

- e) protocols for the resolution of disputes between the regulator and the utility being regulated during a water and sewerage price investigation, specifically with respect to disputes in relation to administrative processes associated with the investigation.

### SEPTEMBER 2012 COMMUNITY CONSULTATION PAPER

5.118 On 13 September 2012 the ICRC issued a Community Consultation Paper as part of its investigation processes. In the foreword to the Community Consultation Paper, the ICRC stated:

This paper was not in our original schedule. Having completed an initial analysis of the likely price increases flowing from some of the propositions now before us, we have decided that it would be highly desirable to place these preliminary results, tentative though they are, before the ACT community and seek their reaction to the issues raised.

Our analysis of the propositions that have been put before us is only in its initial stages and I am not able to give you much guidance about the likely content of our draft report. I can, however, assure you that the Commission is seriously concerned about the impact on the community of some of the prospective price increases coming out of our initial analysis. Your input will assist us in dealing with the important issues that are identified in this paper as giving rise to these prospective increases.

The principal purpose of this paper is to reach as wide an audience as possible. In order to do this we have traded off technical precision and its associated complexity for clear communication of the essential messages that we judge it vital for the community to hear.

5.119 The ICRC sought submissions on the Community Consultation Paper. The ICRC advised that:

Submissions received by the Commission before **5 pm, Friday 19 October** will be considered in the Commission's draft report. Submissions received after that date will be considered in the Commission's final report.

5.120 The Community Consultation Paper was released the day before caretaker conventions in the ACT formally commenced (14 September 2012) and comments were due, for consideration as part of the Draft Report, on the day before the election was held on 20 October 2012. The Audit Office notes that ACTEW had communicated to the ICRC in August 2012 its reservations about providing information during the caretaker period. ACTEW advised the Audit

Office that it considered the actions of the ICRC, in releasing the Community Consultation Paper to coincide with the caretaker period, as improper.

5.121 The ICRC advised the Audit Office that the selection of dates was not made with a view to seeking a particular outcome or pushing a particular agenda. The ICRC also advised the Audit Office that, at the time, the ICRC was still working towards releasing a Draft Report in November 2012, in accordance with its original proposed timeframe and that the release of the Community Consultation Paper sought to elicit information that would achieve this outcome.

5.122 With respect to the purpose of the Community Consultation Paper, the ICRC stated:

ACTEW Water provided its main submission to the price review on 30 July 2012. While deficient in some respects, as noted below, the material in the submission allowed the Commission to make preliminary estimates of the impact of various factors on the water prices that may confront ACT water consumers in coming years. It is apparent from these preliminary estimates that the effect of some of these factors is substantial. The water price increases emerging from this preliminary analysis are well beyond those experienced in recent years. While there has been some speculation in the media and elsewhere that significant water price increases may be in the offing, the ACT community has not been given any clear idea of the principal choices that need to be made in determining water prices for the next regulatory period. The purpose of this community consultation paper is to fill that gap and invite the community to comment on the issues the paper raises.

The Commission believes that these issues are of such importance that the community should be given the opportunity to comment before it produces its draft report, scheduled for late November 2012. In reading this paper, please keep in mind that these are preliminary estimates. We have not yet completed our review of ACTEW Water's proposed operating cost and capital expenditure budgets. These and other elements that enter into the determination of prices may undergo significant refinement between now and May 2013, when we issues our final price direction. We believe, nevertheless, that the factors contributing to these preliminary estimates are of sufficient importance that public consideration is essential.

5.123 The Community Consultation Paper contained details on potential price outcomes for a range of different scenarios. A series of tables were presented that identified the potential prices to be charged at different levels of usage, for the following scenarios:

Case 1 - the starting point, which incorporates ACTEW Water's proposed operating and capital expenditure

Case 2 - recovering a revenue shortfall of \$238 million over the next five years

Case 3 - recovering a revenue shortfall of \$238 million over a longer period

Case 4 - increasing the rate of return as proposed by ACTEW Water

Case 5 - adopting the alternative water price structure as proposed by ACTEW

Case 6 - removing the enlarged Cotter Dam cost overrun.

- 5.124 The Audit Office considers that the Community Consultation Paper contained minimal information or analysis with respect to the methodology or assumptions that underpinned the potential prices to be charged. The Audit Office notes, however, that this was traded-off by the ICRC in its effort to reach as 'wide an audience as possible.' As noted previously, in paragraph 5.118, in the foreword to the Community Consultation Paper, the ICRC stated:

The principal purpose of this paper is to reach as wide an audience as possible. In order to do this we have traded off technical precision and its associated complexity for clear communication of the essential messages that we judge it vital for the community to hear.

- 5.125 The release of the Community Consultation Paper during the caretaker period, with its focus on price outcomes, and with minimal information or analysis on the technical methodology or assumptions that underpinned this analysis, was construed by ACTEW as a provocative act on the part of the ICRC.

- 5.126 Information on this issue was sought from the Commissioner for Public Administration. In a letter to the Auditor-General, the Commissioner for Public Administration advised:

...the issuing of a consultation paper can reasonably be seen as part of the ongoing ordinary business of the ICRC. Given the focus during the 2012 election campaign on costs of living, one might have been inclined to question whether consultation might better be delayed to avoid bringing the public sector into an arena of contested political debate, but I would not go so far as to say that the release of a consultation paper constitutes a breach of the guidelines.

Similarly, I am advised ACTEW expressed some reticence about providing a public submission to the ICRC in light of the caretaker conventions. In this context I would note that the pre- and post- election period during which the caretaker conventions apply is defined in the guidelines. Outside that window, while consideration can be given to the (largely political) implications of being seen to game on the caretaker conventions (e.g. by making a significant appointment shortly before the caretaker period proper commences), in the ACT the cut over point at which the guidelines come into force is clearly delineated.

I would not consider it inappropriate for a public sector organisation asked to provide information that might become public in the context of political debate during an election campaign to consider whether or not it should be provided in light of the caretaker guidelines and the desirability of public sector organisations being seen to be politicised during that election campaign.

For completeness, I note the ICRC and ACTEW did not seek my advice, or the advice of the Head of Service, in relation to this matter.

- 5.127 The Audit Office notes the differing viewpoints of the ICRC and ACTEW with respect to the appropriateness of issuing the Community Consultation Paper as well as the timing of the Community Consultation Paper. The Audit Office notes that this issue highlights the poor relationship that was apparent between the ICRC and ACTEW at the time.
- 5.128 Chapter 4 of this report provides detail on the ICRC's administrative processes for the conduct of the investigation and the lack of timely and appropriate information from the ICRC in the form of technical papers, discussion papers or working conclusions papers.



## 6. THE EFFICIENCY AND EFFECTIVENESS OF THE WATER AND SEWERAGE PRICING PROCESSES

---

- 6.1 This chapter draws conclusions on the effectiveness and efficiency of the 2013 water and sewerage pricing investigation processes in relation to administrative and communication matters.

### SUMMARY

#### Conclusion

Administrative and communication processes associated with the 2013 water and sewerage pricing process have been ineffective and inefficient. In particular, the process has been characterised by poor communication and a poor relationship between the ICRC and ACTEW.

While the ICRC advised that it sought to approach the 2013 process from 'first-principles', this was not supported by effective stakeholder communication. Assertions made by the ICRC about ACTEW reflect the poor relationship between the two organisations. Furthermore, Queen's Counsel, Mr Peter Hanks advises that '... the Price Direction made by the ICRC...is invalid' because the terms of reference issued by the Treasurer was insufficient. The issues identified in this audit indicate that there is a need for the water and sewerage price setting framework in the ACT to be reviewed.

#### Key findings

##### *Costs of the water and sewerage pricing process*

- The ICRC has invoiced ACTEW \$2 364 362 (GST inclusive) which represents the ICRC's costs for conducting the process (up to October 2013).
- The ICRC's costs for the 2008 water and sewerage pricing process were \$1 389 086 (GST inc). The current process has therefore cost approximately \$975 276 (70.2 percent) more than the 2008 process. Project budget documentation in the ICRC initially estimated the total cost of the 2013 process to be between \$1 600 134 and \$1 711 134.
- The amount invoiced to ACTEW for the 2013 process (\$2 364 362) consists of:
  - \$843 435 direct staffing expenses;
  - \$471 792 consultancy expenses;
  - \$151 177 administrative expenses; and
  - \$897 958 in overhead expenses incurred by the ICRC.
- These figures represent the ICRC's direct cost for the process and do not represent the other costs associated with the process including:

- indirect costs incurred by ACTEW in participating in the process, e.g. ACTEW and ActewAGL staff costs; and
- direct costs incurred by ACTEW in participating in the process, e.g. legal fees incurred by ACTEW with respect to advice on how to respond to ICRC requests and participate in the process.
- ACTEW asserts that a total cost of \$3 965 844 has been incurred by it through participation in the review process (from 2011 to October 2013). This includes:
  - \$2 482 633 (GST exclusive) of indirect staff costs and overheads;
  - \$1 262 261 for contractors and consultants;
  - \$200 109 for legal fees; and
  - \$20 841 in other costs.
- The total cost of the water and sewerage pricing process may therefore be estimated at approximately \$6.3 million, which represents the ICRC's invoiced costs and the direct and indirect costs that ACTEW has asserted it has incurred
- By virtue of subsection 19(1) of the ICRC Act, the ICRC is able to recover the costs of the water and sewerage pricing process from ACTEW. A budget is not set for the water and sewerage pricing process, nor is there a cap on the amount that may be charged by the ICRC for its activities. Having a budget may encourage more effective communication processes.

### THE EFFECTIVENESS OF WATER AND SEWERAGE PRICING PROCESSES

6.2 Overall, administrative and communication processes for the 2013 water and sewerage pricing process have not been effective. This conclusion is supported by the material presented in this report:

- the Draft Report (February 2013) and proposed price direction, which was provided approximately 16 months after the issue of the terms of reference and approximately two months before the initially planned completion date of May 2013 (refer to Chapter 4), was the first opportunity for stakeholders to provide feedback to the ICRC on key technical and regulatory issues associated with the water and sewerage pricing investigation. Some of the technical and regulatory features of the Draft Report (February 2013) and proposed price direction, e.g. the removal of the 'fair cost recovery scheme' and changes to the way the return on capital was calculated, were not included in the Final Report and price direction (June 2013) and resulted in a significant shift in the price direction;
- there has been poor stakeholder communication in the 2013 water and sewerage pricing process. While the ICRC advised that it sought to

approach the 2013 process from ‘first-principles’, this was not supported by effective stakeholder communication. In particular:

- planned stages of the water and sewerage pricing process, as identified in the ICRC’s November 2011 Context Paper, did not eventuate (refer to Chapter 4). A planned Preliminary Conclusions Report and Working Conclusion Report were not produced;
  - there were delays in key processes associated with the water and sewerage pricing process, including the release of the Issues Paper and the Draft Report and proposed price direction (refer to Chapter 4). The delays in the release of these documents led to engagement on key issues at a later stage in the process than initially envisaged; and
  - key stages of the water and sewerage pricing process were compressed, which constrained the ability of stakeholders to effectively engage. For example, the Draft Report and proposed price direction (February 2013), which was the first time that the ICRC presented its preliminary findings and conclusions on technical and regulatory issues, had a consultation period of six weeks and not the planned three months.
- the 2013 regulatory process has been characterised by a poor relationship between the ICRC and ACTEW (refer to Chapter 5). This is exemplified by:
    - significant differences between the two organisation with respect to their perception and understanding of the Community Consultation Paper. The ICRC issued the Community Consultation Paper the day before the 2012 ACT Legislative Assembly election caretaker period began, with comments due on the day before the election was held. The ICRC is of the view that it was important to issue the Community Consultation Paper, while ACTEW has construed its release at this time as a deliberately provocative act from the ICRC;
    - assertions made by ICRC senior executives to the Auditor-General that ACTEW deliberately withheld information and that ‘whilst [ACTEW] was in possession of the information, ACTEW did not want to release the information and be responsible for influencing the outcome of the upcoming election’. As discussed in Chapter 5 of this report these assertions are not supported by evidence;
    - organisational and personal conflicts between the agencies not being resolved in a timely manner during the process (refer to Chapter 5); and

- Queen's Counsel, Mr Peter Hanks advises that '... the Price Direction made by the ICRC...is invalid' because the terms of reference issued by the Treasurer was insufficient (refer to Chapter 3).

6.3 Findings, conclusions and recommendations have been made throughout the report with respect to these issues.

### THE EFFICIENCY OF WATER AND SEWERAGE PRICING PROCESSES

6.4 Overall, the 2013 water and sewerage pricing process has not been efficient. This conclusion is supported by the material presented in this report, which highlights a range of issues associated with the regulatory review process primarily associated with communication inadequacies and organisational and personal conflicts of view between the agencies not being resolved in a timely manner.

6.5 The ICRC has invoiced ACTEW \$2 364 362 (GST inclusive) which represents the ICRC's costs for conducting the process (up to October 2013).

6.6 The ICRC's costs for the 2008 water and sewerage pricing process were \$1 389 086 (GST inc). The current process has therefore cost approximately \$975 276 (70.2 percent) more than the 2008 process. Project budget documentation in the ICRC initially estimated the total cost of the 2013 process to be between \$1 600 134 and \$1 711 134.

6.7 The amount invoiced to ACTEW for the 2013 process (\$2 364 362) consists of:

- \$843 435 direct staffing expenses;
- \$471 792 consultancy expenses;
- \$151 177 administrative expenses; and
- \$897 958 in overhead expenses incurred by the ICRC.

6.8 These figures represent the ICRC's direct cost for the process and do not represent the other costs associated with the process including:

- indirect costs incurred by ACTEW in participating in the process, e.g. ACTEW and ActewAGL staff costs; and
- direct costs incurred by ACTEW in participating in the process, e.g. legal fees incurred by ACTEW with respect to advice on how to respond to ICRC requests and participate in the process.

6.9 ACTEW asserts that a total cost of \$3 965 844 has been incurred by it through participation in the review process (from 2011 to October 2013). This includes:

- \$2 482 633 (GST exclusive) of indirect staff costs and overheads;
  - \$1 262 261 for contractors and consultants;
  - \$200 109 for legal fees; and
  - \$20 841 in other costs.
- 6.10 The total cost of the water and sewerage pricing process may therefore be estimated at approximately \$6.3 million, which represents the ICRC's invoiced costs and the direct and indirect costs that ACTEW has asserted it has incurred.
- 6.11 While it is not possible to determine with certainty the dollar impact of the inefficiencies and issues identified throughout this report on the total cost of the process, it is possible to conclude that as a whole, these have contributed to the high costs of the 2013 process.
- 6.12 In September 2013 ACTEW sought a review of the ICRC's price direction, by virtue of section 24K of the ICRC Act. Subsection 24K(1) of the ICRC Act allows for an application for review to be lodged by the referring authority or the utility providing the services. Sections 24L to 24W of the ICRC Act provide a range of legislative requirements for the conduct of the review. If the industry panel review of the water and sewerage investigation and price direction occurs, it will result in a higher total cost for the water and sewerage pricing process.
- 6.13 By virtue of subsection 19(1) of the ICRC Act, the ICRC is able to recover the costs of the water and sewerage pricing process from ACTEW. A budget is not set for the water and sewerage pricing process, nor is there a cap on the amount that may be charged by the ICRC for its activities. Having a budget may encourage more effective communication processes.

### IMPLICATIONS FOR FUTURE WATER AND SEWERAGE PRICING PROCESSES

- 6.14 In summary, the Audit Office considers that administrative and communication processes associated with the 2013 water and sewerage pricing process have been ineffective and inefficient.
- 6.15 While recommendations have been made throughout this report in relation to specific processes and activities which, if implemented, are likely to improve future water and sewerage pricing processes, there is a need for the ACT Government to fundamentally reconsider the water and sewerage price setting framework in the ACT.

6.16 In accordance with the Productivity Commission's suggested roles and responsibilities for the water and sewerage pricing process (refer to paragraphs 2.20 to 2.21), this is something that the ACT Government is best-placed to undertake.

**Overall Recommendation (Chapter 6)**

The ACT Government should review the water and sewerage price setting framework, including legislative, governance and administrative arrangements.

## **APPENDIX A: AUDIT CRITERIA, APPROACH AND METHOD**

---

### **AUDIT OBJECTIVE**

The objective of the audit is to provide an independent opinion to the Legislative Assembly on the efficiency and effectiveness of the processes for the regulatory review of water and sewerage prices in the ACT. To do this, the Audit Office considered:

- roles and responsibilities of key entities involved in the regulatory review of water and sewerage prices in the ACT, specifically the ICRC and ACTEW;
- administrative processes for undertaking the regulatory review of water and sewerage prices in the ACT; and
- communication protocols between key entities involved in the regulatory review of water and sewerage prices in the ACT, specifically the ICRC and ACTEW.

ACTEW's cooperation in the water and sewerage pricing process was also considered.

### **SCOPE**

The audit included consideration of:

- the governance arrangements and administrative processes, including communication protocols, within the ICRC and ACTEW, with respect to the regulatory review of water and sewerage prices in the ACT. This included:
  - the processes used by the ICRC to identify and request information from agencies to assist the Commission; and
  - the processes used by ACTEW to respond to the ICRC;
- the legislative basis and support for entities engaged in the regulatory review of water and sewerage prices in the ACT; and
- the costs associated with the price direction.

The audit also included consideration of the assertions made by the ICRC that ACTEW had withheld information necessary for the Commission to exercise its functions and not fully cooperated with the Commission's requests for information.

### **Out of scope**

The actual prices that have been set for the supply of water and sewerage within the ACT were not considered in this audit.

The audit is primarily concerned with examining the systems and processes for the setting of water and sewerage prices within the ACT. Adherence to due processes to ensure that appropriate decisions have been, and can be, made were considered.

### AUDIT APPROACH AND METHOD

The performance audit was conducted under the authority of the *Auditor-General Act 1996*, and in accordance with the principles, procedures, and guidance contained in Australian Auditing Standards relevant to performance auditing. These standards prescribe the minimum standards of professional audit work expected of performance auditors. Of particular relevance is the professional standard on assurance engagements - *ASAE 3500 Performance Engagements*.

The audit approach and method consisted of:

- discussions with key representatives from the ICRC, ACTEW and other ACT Government entities;
- discussions with the Chief Minister and Treasurer, as shareholders of ACTEW and ministers responsible for the Chief Minister and Treasury Directorate and the ICRC;
- interviews with key representatives of the ICRC, ACTEW (and ActewAGL) under oath or affirmation, pursuant to section 14A of the *Auditor-General Act 1996*;
- a review of key documentation for the 2013 water and sewerage pricing process, including publicly available reports and other documents for the process, as well as internal documentation maintained within the ICRC and ACTEW (and ActewAGL); and
- a review of relevant literature and work undertaken on water and sewerage price regulation by other jurisdictions with the intention of finding better practices;
- the engagement of Dr David Cousins of Monash University, a subject matter expert in the field of regulatory economics, who provided advice and assistance during the audit;
- requests for legal advice and assistance from the Australian Government Solicitor and Mr Peter Hanks QC;
- an external quality assurance review of the draft report by Crowe Horwath; and
- a review by Mr Des Pearson, a former Auditor-General of Victoria and Western Australia, of the Audit Office's consideration and acquittal of auditee responses to draft and proposed reports.

## AUDIT REPORTS

### Reports Published in 2013-14

Report No. 2 / 2014	The Water and Sewerage Pricing Process
Report No. 1 / 2014	Speed Cameras in the ACT
Report No. 7 / 2013	Management of Funding for Community Services
Report No. 6 / 2013	ACT Auditor-General's Office Annual Report 2012-13
Report No. 5 / 2013	Bushfire Preparedness

### Reports Published in 2012-13

Report No. 4 / 2013	National Partnership Agreement on Homelessness
Report No. 3 / 2013	ACT Government Parking Operations
Report No. 2 / 2013	Executive Remuneration Disclosed in ACTEW Corporation Limited's (ACTEW) 2010-11 Financial Statements and Annual Report 2011
Report No. 1 / 2013	Care and Protection System
Report No. 10 / 2012	2011-12 Financial Audits
Report No. 9 / 2012	Grants of Legal Assistance
Report No. 8 / 2012	Australian Capital Territory Public Service Recruitment Practices
Report No. 7 / 2012	ACT Auditor-General's Annual Report 2011-12
Report No. 6 / 2012	Emergency Department Performance Information

### Reports Published in 2011-12

Report No. 5 / 2012	Management of Recycling Estates and E-waste
Report No. 4 / 2012	Development Application and Approval System for High Density Residential and Commercial Developments
Report No. 3 / 2012	Early Childhood Schooling
Report No. 2 / 2012	Whole-of-Government Information and ICT Security Management and Services
Report No. 1 / 2012	Monitoring and Minimising Harm Caused by Problem Gambling in the ACT
Report No. 06 / 2011	Management of Food Safety in the Australian Capital Territory
Report No. 05 / 2011	2010-11 Financial Audits
Report No. 04 / 2011	Annual Report 2010-11

### Reports Published in 2010-11

Report No. 03 / 2011	The North Weston Pond Project
Report No. 02 / 2011	Residential Land Supply and Development
Report No. 01 / 2011	Waiting Lists for Elective Surgery and Medical Treatment
Report No. 10 / 2010	2009-10 Financial Audits
Report No. 09 / 2010	Follow-up audit – Courts Administration
Report No. 08 / 2010	Delivery of Mental Health Services to Older Persons
Report No. 07 / 2010	Management of Feedback and Complaints
Report No. 06 / 2010	Annual Report 2009-10
Report No. 05 / 2010	Delivery of ACTION Bus Services

Details of reports published prior to 2010-11 can be obtained from the ACT Auditor-General's Office or the ACT Auditor-General's homepage: <http://www.audit.act.gov.au>.



## AVAILABILITY OF REPORTS

Copies of reports issued by the ACT Auditor-General's Office are available from:

ACT Auditor-General's Office  
Level 4, 11 Moore Street  
Canberra City ACT 2601

or

PO Box 275  
CIVIC SQUARE ACT 2608

Phone (02) 62070833 / Fax (02) 62070826

Copies of reports are also available from the  
ACT Auditor-General's Office Homepage: <http://www.audit.act.gov.au>